SECURITIES ARBITRATION COMMENTATOR

PUBLISHING SINCE 1988 (MAY '13) ISSN: 1041-3057

DEFINING WHO IS A CUSTOMER IN FINRA ARBITRATION: TIME TO CLEAR THINGS UP!

*By George H. Friedman**

Investors also should have the unencumbered right to seek redress in all available forums.... Section 921(a) of the Dodd-Frank Act authorizes the Commission to prohibit or restrict mandatory pre-dispute arbitration provisions in customer agreements, if such rules are in the public interest and protect investors. The authority covers broker-dealers and investment advisers. I believe the Commission needs to be proactive in this important area. We need to support investor choice.

--- SEC Commissioner Luis A. Aguilar[1]

Introduction

With this statement, Commissioner Aguilar fired the opening salvo in what will undoubtedly be a highly charged debate over whether brokerage firms will be permitted to continue using predispute arbitration agreements ("PDAAs") in customer agreements. While it's a long road from one SEC commissioner's expression of views to promulgation and approval of a rule banning PDAAs, we must now at least entertain the possibility that PDAAs in brokerage and investment adviser [2] accounts will be banned. And if that happens, then defining clearly the term "customer" will quickly become of key importance.

Why? Because if PDAAs are banned[3] then customers will have two roads to arbitration: 1) a post-dispute agreement to arbitrate entered into by all parties – an unlikely occurrence given that one party typically has a strategic or tactical reason not to agree once a dispute has arisen;[4] or 2) through FINRA'S Rule 12200, which requires brokers to arbitrate upon the demand of a customer.[5] So, in a world where PDAAs are banned in customer-broker agreements, the most likely way a customer will have access to FINRA arbitration is via Rule 12200, which FINRA states will not go away even if the SEC bans PDAAs.[6] And Commissioner Aguilar's emphasis on investor choice presages support for FINRA's position. But, the meaning of the term "customer" for purposes of access to the FINRA arbitration forum under Rule 12200 remains somewhat unclear.

This article covers recent regulatory and legal developments on the question of how the term "customer" has come to be defined and interpreted for access to FINRA arbitration via Rule 12200. It updates a June 2012 article appearing in this publication, *"Know Your Customer!? Who is your 'Customer'?,"* (2011 SAC;No. 2), and

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concludes that, given the possibility that PDAAs may be banned by the SEC, and the continued inconsistency in how courts are interpreting Rule 12200, it behooves FINRA to clarify its rules defining the term "customer" as it pertains to access to its arbitration forum. The article closes by proposing a new definition based on what the courts are telling us.

FINRA's Rules

Let's start with Rule 12200, which appears in the Code of Arbitration Procedure for Customer Disputes ("Customer Code"). The rule states in its entirety:

12200. Arbitration under an Arbitration Agreement or the Rules of FINRA

Parties must arbitrate a dispute under the Code if:

• Arbitration under the Code is either:

(1) Required by a written agreement, or

(2) *Requested by the customer;*

• The dispute is between a *customer* and a member or associated person of a member; *and*

• The dispute arises in connection with the *business activities* of the member or the associated person, except disputes involving the insurance business activities of a member that is also an insurance company [emphasis added].

So, absent a PDAA and assuming the dispute arises out of the broker's "business activities," this rule allows a "customer" to require the broker to arbitrate. Simple enough. How then is that term defined? One might logically turn to FINRA's rules governing its members to see if they define "customer" and indeed they do. For example, FINRA Rule 0160, appearing in the "general standards" section establishes the definition of "customer:"

0160. Definitions

(a) The terms used in the Rules, if defined in the FINRA By-Laws, shall have the meaning as defined in the FINRA By-Laws, unless a term is defined differently in a Rule, or unless the context of the term within a Rule requires a different meaning.

(b) When used in the Rules, unless the context otherwise requires...

(4) "Customer"

The term "customer" shall not include a broker or dealer.

This is rather broad, and defines the term by saying what a customer is not. Let's continue our search for meaning.

FINRA Rule 1250(b)(1) covering the "firm element" (continuing training requirements) provides:

(b) Firm Element

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SUBSCRIPTION INFORMATION:

The Securities Arbitration Commentator is published 8 times per year and sells by annual subscription. Regular Subscription: $290; Preferred Subscription (with weekly e-mail Alerts): $590. Back issues of SAC are archived at www.sacarbitration.com > SBI-SAC (Search Back Issues-SAC). At SBI-SAC, subscribers may search and download PDF copies of past issues for free. Non-subscribers may search this database for $25 per download.

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(1) Persons Subject to the Firm Element

The requirements of this subparagraph shall apply to any person registered with a member who has direct contact with customers in the conduct of the member's securities sales, trading and investment banking activities, any person registered as an operations professional ... and to the immediate supervisors of such persons (collectively, "covered registered persons"). *"Customer" shall mean any natural person and any organization, other than another broker or dealer, executing securities transactions with or through or receiving investment banking services from a member* [emphasis added].

So, at least for determining who is covered by the firm element, we have added a transactional aspect to the definition.

And then there's Regulatory Notice 12-55, issued last December, which provides guidance on FINRA's suitability rule. It, too, defines customer:

Q6(a). What constitutes a "customer" for purposes of the suitability rule?

A6(a). The suitability rule applies to a broker-dealer's or registered representative's recommendation of a security or investment strategy involving a security to a "customer." *FINRA's definition of a customer in FINRA Rule 0160 excludes a "broker or dealer." In general, for purposes of the suitability rule, the term customer includes a person who is not a broker or dealer who opens a brokerage account at a broker-dealer or purchases a security for which the broker-dealer receives or will receive, directly or indirectly, compensation even though the security is held at an issuer, the issuer's affiliate or a custodial agent (e.g., "direct application" business ,"investment program" securities, or private placements), or using another similar arrangement* [emphasis added and footnotes omitted].

Another transactional aspect. If one stopped the search for meaning here, one might conclude that FINRA's rules actually do define "customer" rather clearly. But alas that's not the case insofar as arbitration is concerned. Rule 1250(b)(1) and Regulatory Notice 12-55 are *contextual* – they define "customer" in context. Rule 1250(b)(1) defines customer for firm element purposes. Regulatory Notice 12-55 defines customer for suitability purposes. But doesn't Rule 0160 above define customer for arbitration purposes? Not really. The rule has an important caveat that's worth repeating:

> The terms used in the Rules, if defined in the FINRA By-Laws, shall have the meaning as defined in the FINRA By-Laws, *unless a term is defined differently in a Rule, or unless the context of the term within a Rule requires a different meaning* [emphasis added].

One can find more definitions of "customer" in the FINRA rules, but in each instance the term is defined in context:

- See, for example, FINRA Rule 2261(c), which sets forth a customer's right to inspect certain financial records of a FINRA member: "As used in paragraph (a) of this Rule, the term 'customer' means any person who, in the regular course of such member's business, has cash or securities in the possession of such member."
- Or Rule 4210(a)(3) with respect to margin: "The term 'customer' means any person for whom securities are purchased or sold or to whom securities are purchased or sold whether on a regular way, when issued, delayed or future delivery basis. It will also include any person for whom securities are held or carried and to or for whom a member extends, arranges or maintains any credit. The term will not include the following: (A) a broker or dealer from whom a security has been purchased or to whom a security has been sold for the account of the member or its customers..."
- Or Rule 4530, n. 08 regarding reporting requirements and customer complaints: "for purposes of paragraph (a)(1)(B) of this Rule, a 'customer' includes any person, other than a broker or dealer, with whom the member has engaged, or has sought to engage, in securities activities."

Is there a FINRA rule specifically defining customer for *arbitration* purposes? Indeed there is. For that we turn to Customer Code Rule 12200(i) which since April 2007 has defined "customer" for arbitration purposes thusly:

12100. Definitions

Unless otherwise defined in the Code, terms used in the Rules and interpretive material, if defined in the FINRA By-Laws, shall have the meaning as defined in the FINRA By-Laws...

(i) Customer

A customer shall not include a broker or dealer.

This of course is a very broad definition. At one point a glossary on the arbitration part of the FINRA web site defined "customer," but the definition is no longer there.[7] Also, thirty years ago the NASD's National Arbitration Committee – the predecessor to the FINRA's National Arbitration and Mediation Committee – issued an interpretive statement[8] that "[a]n issuer of securities should be considered a public customer of a member firm where a dispute arises out of a proposed underwriting," but it's anyone's guess whether that statement is still operative.

Summing up, while FINRA's rules do in places define the term "customer" these definitions are trumped by the specific arbitration rule that very broadly defines customer. This definition has given rise to litigation over its meaning.

The Courts Weigh In

This publication's prior article on the "who is a customer" issue described several cases that were in progress or subject to appeal. In the ensuing year and a half there has been lots of activity, with the Second and Fourth Circuits

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taking the lead. These cases have some common scenarios and fact patterns, which can be distilled as follows:

- The involved claimant/"customer" does not have a customer account with the broker dealer;
- The broker has some sort of business relationship with the customer: for example, the broker provided underwriting or advisory services to the institutional customer, or issued a product like bond funds that the customer purchased somewhere else, or recommended a financial adviser to the customer;
- A dispute arises and the customer files an arbitration under Rule 12200 (there being no underlying agreement containing a PDAA);
- Broker moves in court to enjoin[9] the arbitration contending that: 1) there is no agreement to arbitrate; and 2) Rule 12200 cannot be invoked because the claimant is not a "customer" as defined by the Customer Code.
- A court rules on whether the claimant is a "customer" whose "dispute arises in connection with the *business activities* of the member" who can invoke Rule 12200.

Let's take a look at the recent decisions, which have tended to focus on both core requirements of Rule 12200, that is: 1) was the party seeking arbitration a customer? and 2) does the dispute arise out of the broker's business activities?

Not a Customer:
The Morgan Keegan Cases

As a law professor, I like to boil holdings down to simple, easily remembered statements. A series of cases involving Morgan Keegan & Company ("MK") can be described succinctly: *"Just because they issued the fund doesn't make you their customer—unless MK signed a submission agreement and you argued this issue."* These cases have similar fact patterns:

- MK distributes and underwrites a bond fund.
- Investor buys the fund from another broker not affiliated with MK.
- Fund performs poorly.
- Investor suffers significant losses.
- Alleging fraud/misstatements/omissions, investor files an arbitration against MK, invoking Rule 12200.
- Contending the investor is not its customer MK resists, either by seeking a stay or attacking an adverse arbitration award.

This was the basic fact pattern in two cases decided in 2011 and 2012 where the challenge came as a motion to vacate an award. In *Zarecor v. Morgan Keegan,* 2011 WL 5592861 (E.D. Ark. 2011), *rev. den.,* 2011 WL 5508860 (E.D. Ark. 2011), the challenge came in the form of a motion to vacate an adverse award. The court found that the investor was not a customer as defined by Rule 12200. The investor sought reconsideration under Rule 59(e) of the Federal Rules of Civil Procedure, contending that the court overlooked a material fact: that MK had signed a submission agreement after the case was filed with FINRA.[10] The court denied the motion, because this argument had not been made earlier, and amounted to an attempt to introduce new evidence, something not permitted under Rule 59(e). It seems that, if the "MK signed a submission agreement" argument had been made originally (when the initial motion to vacate had been made), it might have succeeded.

This is precisely what happened in *Morgan Keegan & Company, Inc. v Garrett*, No. 11-20736 (5th Cir. 2012). There, the submission agreement issue was raised in the original motion to vacate and on appeal. While the district court held that the investor was not a customer of MK and vacated the award on this and other grounds – holding that the arbitrators had exceeded their powers under the Federal Arbitration Act (9 U.S.C sec. 10(a)(4)) by determining that the investors were customers – the Fifth Circuit reversed, relying in part on the submission argument. In other words, the Rule 12200 "is this a customer?" issue was mooted because MK had agreed to submit to arbitration after the dispute arose. However, the court also disposed of the "customer" issue by holding that MK had not met the very high bar set by the Federal Arbitration Act for vacating an award based on the arbitrators exceeding their powers. This case can be distinguished from those discussed below because it dealt with a motion to vacate the arbitration award, which is extraordinarily difficult to win and in which courts give great deference to the arbitrators.

So, assuming MK did not sign a submission agreement and instead contested jurisdiction from the beginning by seeking to enjoin the arbitration, what do the cases tell us? It seems then that the investor is decidedly *not* a customer under Rule 12200. In two district court cases in 2011, *Morgan Keegan & Co., Inc. v. Ras,* No. 5:11-CV-352-KKC (E.D. Ky. 2011) and *Morgan Keegan & Co. v. Shadburn*, 829 F.Supp.2d 1141 (M.D. Ala. 2011), the district courts ruled that in the absence of a customer agreement, or a customer account, or evidence that the funds were purchased directly from MK, or other evidence of a business relationship between the investor and MK, the investor was not a customer of MK who could require arbitration under Rule 12200. This was the case even though the investor's broker may have had conversations with MK.

The result does not vary at the Circuit Court level. Earlier this year the Fourth Circuit reached the same conclusion in *Morgan Keegan & Co., Inc. v. Silverman,* --- F.3d ---, 2013 WL 425556 (2013).

A Question of Balance

While it seems clear what *won't* qualify a claimant as a customer under Rule 12200, what factors are enough to successfully attain "customer" status under this rule? A pattern has emerged from recent federal circuit court decisions. The reviewing court will balance the strong federal policy in favor of liberally construing arbitration agreements articulated many times by the Supreme Court[11] versus whether there actually is an agreement to arbitrate by virtue of Rule 12200. Where there is clear evidence of a direct customer relationship with the broker

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and the dispute clearly arises out of the broker's securities business activities, arbitration will be ordered. Where the relationship is tenuous or does not arise clearly out of the broker's securities business, arbitration will not be ordered. Or, to sum it up for my law students: *"To be considered a customer, you need clear evidence of a direct, significant securities business relationship."*

Not Enough: Innovex *and* Cary

The seminal case, and one that is referred to in the more recent decisions, is *Fleet Boston v. Innovex,* 264 F.3d 770 (8th Cir. 2001), which sets the outer limit on defining Rule 12200.[12] There the broker provided "banking and financial advice" to the putative customer concerning its planned merger. The agreement between the parties specifically did not call for Fleet Boston to act as a broker for the "customer." Applying the balancing test, the court said there was not enough of a relationship present to establish customer status:

> We do not believe that the NASD [now FINRA] Rules were meant to apply to every sort of financial service an NASD member might provide, regardless of how remote that service might be from the investing or brokerage activities, which the NASD oversees.... Although not entirely clear, or consistent, other NASD Rules support a general definition of "customer" as one who receives investment and brokerage services or otherwise deals more directly with securities than what occurred here.

The Fourth Circuit very recently came to the same conclusion in *Raymond James Financial Services v. Cary,* 709 F.3d 382 (4th Cir. Mar. 18, 2013). The facts are a bit convoluted, but they come down to this: the investors bought unregistered promissory notes from Innofin, which most decidedly was not a FINRA member. The wife of a registered rep, Keough (who ultimately worked at Raymond James), received referral fees from Innofin. She shared these fees with Affeldt, described by the court as "Keough's friend, brokerage customer, and tax attorney." Innofin eventually declared bankruptcy and was accused of operating a Ponzi scheme. The investors then commenced an arbitration under Rule 12200 against Raymond James, which succeeded in having the district court enjoin the arbitration. On appeal, the Fourth Circuit affirmed, finding too tenuous the connection between the investors and Raymond James' securities business:

> Although FINRA itself provides no precise definition of "customer" as used in Rule 12200, our recent decisions ...have defined that term to mean "an entity that is 'not a broker or dealer, who purchases commodities or services from a FINRA member in the course of the member's business activities,' namely, 'the activities of investment banking and the securities business.'" ... Applying that definition to the facts of this case, we conclude that appellants are not RJFS customers because they did not purchase any "commodities or services" from RJFS or Keough in the course of the firm's business activities. Any connection appellants did have to RJFS by virtue of their dealings with Affeldt is far too remote to make them customers of RJFS.

There was no customer agreement, no account, and of key importance no assertion that the investors ever believed they were dealing with Raymond James. Applying the balancing test, the Court found no arbitration agreement created by Rule 12200 for it to liberally construe under the Federal Arbitration Act.

Enough: West Virginia Hospitals *and* Carilion Clinic

What, then, is enough to create a "customer" under Rule 12200? Two recent circuit court decisions are shaping an answer to this question. In the first case, *UBS Financial Services, Inc. v. West Virginia University Hospitals, Inc.,* 660 F.3d 643 (2d Cir. 2011), FINRA member UBS provided underwriting and brokerage services for a fee to the hospital, in connection with its issuance of auction rate securities ("ARS") to finance the renovation and expansion of the hospital and to restructure debt. After the ARS market collapsed in 2008, the hospital had to pay much higher interest rates on its ARS. Eventually, the hospital started an arbitration under Rule 12200, and UBS sought declaratory relief that the hospital was not a customer. The district court held that "FINRA intended for an issuer to be a customer of an underwriter."[13] On appeal, the Second Circuit affirmed.

The Court found that the hospital clearly was UBS' customer ("[the hospital] was UBS' customer because [it] purchased a service, specifically auction services, from UBS") and that the dispute arose in connection with UBS' business activities.

> Under any conceivable interpretation of Rule 12200's nexus requirement that the dispute "arises in connection with the business activities of the member," the allegations here satisfy the requirement for purposes of defeating a motion for preliminary injunction and link the grievance [the hospital] asserts in arbitration to the transaction that established its customer status.

Applying the balancing test here, the Court found enough present for it to liberally construe the arbitration agreement created by Rule 12200.

Saving the best for last, let's examine *UBS Financial Services, Inc. v. Carilion Clinic,* No. 12-2066 (4th Cir. Jan. 23, 2013). This was another ARS case involving an underwriter and an issuer, with a fact pattern very similar to *West Virginia*, including a district court ruling that the issuer was a customer under Rule 12200. The Fourth Circuit affirmed, distinguishing the facts here from *Innovex* ("the court [there] was faced with a purported customer who had merely received financial advice..."). It embraced a plain English definition of customer, citing *Merriam-Webster's Collegiate Dictionary* ("one that purchases a commodity or service"), and adopted the definition articulated by the Second Circuit in *West Virginia:*

> In short, we conclude that "customer," as that term is used in the FINRA Rules, refers to one, not a broker or

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> a dealer, who purchases commodities or services from a FINRA member in the course of the member's business activities insofar as those activities are regulated by FINRA—namely investment banking and securities business activities.

The Fourth Circuit two weeks later affirmed this definition in *Silverman* and a month after that in *Cary* (both discussed above). Applying the balancing test here led the court to liberally construe the arbitration agreement created by Rule 12200, and to allow the arbitration filed by the putative customer to proceed..

Time to Clear Up the Confusion: a Proposal

In some respects this reminds me of the time following passage of the Americans with Disabilities Act. The term "reasonable accommodation" was very broadly defined by Congress. This gave rise to years of litigation and uncertainty over what that term meant.[14] I suggest that FINRA start the process now to give clarity to the arbitration customer definition. Yes, the courts are slowly resolving the issue, but the process can take a long time and can be fraught with uncertainty.[15] And with the possibility that PDAAs will be banned and Rule 12200 will become the only realistic path to FINRA arbitration for customers, the time to act is now.

I propose that FINRA consider adopting the arbitration customer definition articulated by the Fourth Circuit in Carilion, Silverman and Cary. With minor editing by the author, the definition becomes:

> "Customer" as that term is used in the FINRA Code of Arbitration Procedure for Customer Disputes refers to one, not a broker or a dealer, who purchases commodities or services from a FINRA member in the course of the member's business activities insofar as those activities are regulated by FINRA—namely investment banking and securities business activities.

This is a nice, simple, clear definition. Enhancing investor protection – FINRA's core mission – and, for that matter, clearing up the ambiguity for the broker-dealers that FINRA regulates, dictate that the lack of clarity be addressed.

ENDNOTES

[1] Addressing the North American Securities Administrators Association on Apr. 16, 2013. See http://www.sec.gov/news/speech/2013/spch041613laa.htm <visited Apr. 21, 2013>. The reference to Commissioner Aguilar's statement is a premise that supports the author's proposition. Using it does not mean that the author necessarily agrees with Mr. Aguilar's position. While the author believes action will be critical if PDAAs are banned, he also believes that FINRA, the industry, and the investing public would be best served by a more precise definition, irrespective of whether the SEC bans the PDAA, directs modifications and restrictions on its use, or decides ultimately that the public interest is well-served by maintaining the status quo.

[2] Dodd-Frank section 921(b) gives SEC similar authority to address PDAAs in investment adviser agreements with customers.

[3] Beyond the scope of this article and for another day is addressing such sticky issues as retroactivity.

[4] *See,* Gross, J., *The End of Mandatory Arbitration?* 30:5 PACE L. REV. 1174, 1189-93 (2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1669816 <visited May 5, 2013>.

[5] FINRA Rule 12200, available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4106 <visited May 5, 2013>.

[6] See this statement appearing on the FINRA web site: "If the SEC decides to prohibit or limit mandatory arbitration, FINRA believes that it is vital for investor protection that FINRA's rules continue to permit investors to require arbitration with firms and associated persons. Specifically, FINRA believes that, whatever position the SEC takes on mandatory arbitration, it is critical that FINRA's Customer Code Rule 12200, which empowers investors to require arbitration with their broker, be maintained." http://www.finra.org/web/groups/industry/@ip/@edu/@mat/documents/education/p123609.pdf <visited May 5, 2013>.

[7] See http://www.finra.org/arbitrationandmediation/finradisputeresolution/additionalresources/glossary/ <visited May 5, 2013>.

[8] *See, UBS Fin. Svcs. Inc. v, West Virginia Univ. Hosps., Inc.,* 660 F.3d 643, 653 (2d Cir. 2011),

[9] Waiting until an award is issued, and fashioning the challenge as a motion to vacate the award based on the arbitrator exceeding authority, can lead to disappointment for the challenger. *See, Morgan Keegan & Co., Inc. v, Garrett,* No. 11-20736 (5th Cir. 2012), discussed above. There, the firm challenged the award, contending among other bases that the arbitrators had erroneously concluded that investors who bought Morgan Keegan bond funds from a third-party broker in the secondary market were "customers." This was successful at the district court level, but failed at the 5th Circuit Court of Appeals. An old proverb says "It is much easier to seek a stay of arbitration than it is an award vactur."

[10] This is standard operating procedure under the Customer Code.

[11] Citing, for example, *Moses H. Cone Mem'l. Hosp. v. Mercury Constr. Corp.,* 460 U.S. 1, 24-25 (1983), *Volt Info. Sciences, Inc. v. Stanford,* 489 U.S. 468, 478 (1989); *CompuCredit Corp. v. Greenwood,* 132 S.Ct. 665, 669 (2012), and *AT&T Mobility LLC v. Concepcion,* 131 S. Ct. 1740, 1745 (2011).

[12] The case actually dealt with the predecessor NASD Rule.

[13] 760 F.Supp.2d at 378 (S.D.N.Y. 2010).

[14] See, for example, the exhaustive list in U.S. E.E.O.C., *Enforcement Guidance: Reasonable Accommodation: and Undue Hardship under the ADA,* available at http://www.eeoc.gov/policy/docs/accommodation.html <visited Apr. 20, 2013>.

[15] Meanwhile, the court challenges keep coming. The Southern District is now dealing with whether a hedge fund that purchased mortgage-backed securities via its broker may arbitrate under Rule 12200 against the issuer. *See, SunTrust Banks, Inc. v. Turnberry Capital Management LP,* No. 13-879 (S.D.N.Y. Feb. 5, 2013). In the District Court of Maryland, a new Complaint has been filed by Credit Suisse, challenging the "customer" status of a group of more than 30 investors who invested in an ETN (TVIX) product issued by the brokerage firm. *Credit Suisse Securities (USA) LLC v. VLS Securities LLC,* No. 13-1187 (D. Md. 4/22/13). Finally, as we headed to press, a NY federal court completed a 9-day trial to decide whether a Saudi investor, who entered into complex investinvestment transactions with Ctiigroup, was a "customer" under Rule 12200 and could maintain is case in FINRA arbitration. In a 14-page Opinion, the Court granted Citigroup injunctive relief staying FINRA arbitration. *CGMI v. Abbar,* No. 11-06993 (SDNY 5/2/13), citing with favor the "customer" definitions articulated in *West Virginia, Silverman* and *Carilion.*

IN BRIEF

(ed: This Section of the newsletter draws upon material previously published in the Securities Arbitration Alert, a supplemental e-mail service that is supplied to SAC Preferred subscribers weekly. A number of items in the Arb Alert do not appear here and those that do are often edited to bring them current to the date the newsletter goes to press.)

FINRA, YEAR IN REVIEW, 2012:

A FINRA News Release, dated January 8, 2013, summarizes the events and accomplishments that marked 2012 at FINRA. As a result of its regulatory activities, FINRA assessed some $112 million in fines and restitution. **Market Surveillance:** FINRA credits its cross-market surveillance programs with more effectively detecting manipulative electronic trading. Market surveillance has also led to some 692 referrals (usually to the SEC) this year concerning insider trading and suspected fraud.

Disciplinary Actions: FINRA itself brought 1,541 disciplinary actions, including three it highlights for special mention (WR Rice; Hudson Valley; TWS Financial). Among the **sales practice** problems FINRA addressed were unsuitable sales of Non-Traded REITs (David Lerner Assocs.); improper sales of ETFs (Citigroup Global, Morgan Stanley, UBS Financial and Wells Fargo); and concentration in structured products (Merrill Lynch). Under the subject of **conflicts, disclosures and mispricing** cases, FINRA fined Goldman Sachs for research analyst conflicts, sanctioned five big houses for MSRB rule violations; and ordered restitution by Pruco (see below) for mutual fund pricing errors. Finally, disciplinary actions against firms on **market integrity issues** resulted in sanctions against Hold Bros, Genesis and Title Securities for allowing foreign traders improper direct market access to conduct suspicious trading; GFI Securities and personnel for pricing violations in Credit Default Swaps; Deutsche Bank Securities and Jefferies Securities for inflated advertised trade volume; and an expulsion for Biremis Securities related to market manipulation.

Investor Protection: FINRA's new **suitability rule**, which launched on July 9, now imposes reasonable basis and reasonable diligence duties on brokers. A new **private placement** rule requires broker-dealers to file offering documents with FINRA. **Recruitment compensation** for transferring brokers has been recognized as a potential conflict requiring disclosure and FINRA is developing a proposed rule on that topic. **BrokerCheck** enhancements this year include a zip code search function and a combined search mechanism for advisers with information on the SE's Investment Adviser Public Disclosure (IAPD) Database. FINRA is also marketing BrokerCheck by linking with broker-dealer WebSites and with Internet search engines that receive broker-dealer and broker queries. Leading arbitration developments include the **All-Public Panel option**, a program that FINRA has been monitoring; win-rate statistics announced in November indicate that All-Public Panels are granting monetary awards in 51% of the decided cases and mixed or Majority Public Panels are delivering a 32% win rate. **FINRA's Investor Education Foundation** has a host of accomplishments, all designed to reach investors with educational information about investments and the economy. The Foundation has focused on the jobless, military families, underserved communities and the unwary investor in its outreach efforts and has also distributed grants to other organizations – 25 in 2012 totaling $2.68 million – to promote investor education.

Market Integrity Initiatives: To bolster its market surveillance capabilities, FINRA implemented a comprehensive **cross-market surveillance** program that covers NASDAQ, NYSE, and the OTC market and switched to an enhanced thematic and cause examination structure for doing more **risk-based exams**. It is working with the national exchanges to develop a plan to implement a **consolidated audit trail** (CAT) to identify problematic trading across various markets. FINRA also strives to bring greater transparency to the fixed income markets and, in particular, has worked to expand **price transparency** in the ABS markets in 2012 by requiring enhanced dissemination in specified MBS sectors. A proposed rule change on dissemination has been approved by the SEC and will be implemented on July 22, 2013.

Crowdfunding: Get to know this word. Crowdfunding is a phenomenon of the Internet and was a key focus in the recently enacted JOBS Act. SEC and FINRA are developing rulemaking to catch up with fundraising developments through this new vehicle and will soon issue rules requiring registration of funding portals. As part of its efforts to research and learn, the Authority has developed an information form for prospective funding portals to complete that will provide information FINRA seeks about this new method of raising investor capital. (SAC Ref. No. 2013-03-01)

FINRA RULE CHANGES APPROVED IN 2012:

We have begun to expect regular changes to the Arbitration (and Mediation) Codes by FINRA Dispute Resolution. The pace slowed in 2012, but, still, four new changes were proposed and approved and one proposal from 2011 was approved in 2012. First to receive approval and implementation was the 2011 proposal to amend Rule 13204 to preclude collection action claims from being arbitrated at **FINRA (#2011-075)**. The four 2012- proposals followed: **No. 2012-011** amended FINRA Rule 14107 to provide the Director of Mediation with discretion to determine whether parties to a FINRA mediation may select a mediator who is not on FINRA's mediator roster. **No. 2012-012** amended FINRA's Customer and Industry Codes to raise the limit for simplified arbitration from $25,000 to $50,000. **No. 2012-040** initiated a By-Law change that will permit mediators to serve on the National Arbitration and Mediation Committee as Public Members. The change clarifies that services provided by mediators *qua* mediators will not cause them to be classified as Industry Members under the By-Laws. Finally, **No. 2012-041** amended FINRA

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Rules 12512, 12513, 13512 and 13513 relating to arbitrator subpoenas and to a FINRA arbitrator's authority to direct appearances of associated person witnesses and production of documents without subpoenas.

*(ed: *We did not count in this tally, No. 2012-027, which made a technical change to Rule 13204, Class & Collective Action Claims, that was implemented in July 2012. **One arbitration rule proposal, No. 2010-036, carries over to 2013 in pending status. There exists a stalemate, with the Commission evidently declining to approve the ill-advised proposal and FINRA resolved to leave it in place, instead of withdrawing it. The proposal would permit FINRA arbitrators to make disciplinary referrals during an arbitration proceeding, rather than after it concludes.)*

2012 CUSTOMER RECOVERY SURVEY. ***We took a look at how much customer claimants recovered as a group and at the top 10 damage awards for the year in particular. Our findings indicate that panels are, for one reason or another, no longer as eager to award top dollar.*** On the other hand, we noticed that the proportion of "win" Awards that result in payouts of $1 million or more has gradually increased over time and reached its apex (at least since that cycle began) last year. In 2012, arbitrators awarded a total of $112,701,800 in damages of all kinds in a total of 252 customer-initiated Awards (an average of $447,300 per Award), including 28 (11%) with total damages of $1 million or more. 2012's aggregate total represented a precipitate drop from the aggregates of the preceding three years ($331,173,200 in 2011, $285,718,200 in 2010 and $526,336,000 in 2009). The average recoveries among winning customers were also greater in those years, ranging from $1,731,400 in 2009 to $693,500 in 2010. Part of the reason for the reductions in 2012 was the failure of any panel to award $10 million or more; by contrast, each of the three preceding years saw awards of $10 million or greater, totaling 12 in all. Nevertheless, in both 2010 and 2011, awards of $1 million or more constituted only 10% of all "wins" and, in 2009, they were only 6%. 2012 did beat 2008, which had an aggregate total of only $54,005,800 in awards, an average recovery of $263,400, only 7% in the $1 million or more range, and none that reached $10 million.

Top 10 Monetary Awards. The largest Award was *ADKO Investors, LLC v. CapWest Securities, Inc.*, FINRA ID #09-06972 (Dallas, 9/5/12), which assessed a total of $9,120,500 in a case arising out of investments in Provident Royalities, LLC. Dallas was evidently a favorable situs for investors in Provident Royalties, especially one named Milo H. Segner, Jr., who received two awards in the top 10: *Segner v. Meadowbrook Securities, LLC*, FINRA ID # 11-03635 (issued 9/5/12; $6,959,500 in damages awarded, ranking second) and *Segner v. Harrison Douglas, Inc.*, FINRA ID # 11-03650 (11-03650 (9/27/12; $3,157,000, ranking seventh). The panel in *Meadowbrook* bolstered Mr. Segner's win with a punitive damage award of $4,490,000, almost half of all punitive damages awarded during the entire year! Rounding out the top 10, in order of award size, were:

Sophin Investments, S.A. v Merrill Lynch Capital Services, Inc., FINRA ID # 08-02290 (NYC, 9/11/12) - $6,119,500;
Davi v. Oppenheimer & Co., Inc., FINRA ID # 10-03067 (NYC, 1/5/12) - $6,109,100;
Jones v. Bronstein, FINRA ID # 10-04410 (Newark, NJ, 4/11/12) - $4,140,200;
O'Grady v. Woodbury Financial Services, Inc., FINRA ID # 10-04965 (Houston, 10/4/12) - $3,988,200;
Wagner v. Dolhare, FINRA ID # 10-03743 (Los Angeles, 5/8/12) - $2,231,000;
Lighfoot v. Pacific West Financial Gp., FINRA ID # 11-00230 (Seattle, 5/8/12) - $2,063,200; and
Feathergill v. Morgan Keegan & Co., Inc., FINRA ID # 10-01746 (Birmingham, AL, 2/17/12) - $1,950,000.

FINRA INVESTOR NEWSLETTER: ***The January 2013 edition of FINRA's online newsletter for investors features a restitution program relating to Pruco Securities, finance tips, videos on investment topics, and news on mediation options.***

Restitution Program: The January issue of "Investor Newsletter," leads with an announcement concerning Pruco Securities, LLC. Evidently, approximately 37,000 customers who placed their mutual fund orders via mail or fax from late 2003 to June 2011 may have received an inferior price for their shares. Under a restitution program that will offer customers some $10.7 million, plus interest, Pruco will notify eligible parties of their right to receive payments that will be ready on or about July 29, 2013. This Restitution Program emerged from a settlement of disciplinary charges that FINRA announced on December 26, 2012, in which Pruco (which self-reported the pricing errors) was also fined $550,000. FINRA's News Release on the Program indicates that the program does not foreclose an aggrieved investor from pursuing arbitration or mediation.

Finance Tips: A Newsletter article on "Five Tips to Keep Your Finances from Going Off a Cliff" offers advice from the FINRA Investor Education Foundation designed to "help Americans successfully navigate changing conditions and avoid a personal financial cliff." They are briefly: Lower taxes by saving the maximum amount in a 401(k); establish a "rainy day fund" for financial security; consider refinancing your mortgage through HARP, a Treasury and HUD project; avoid credit card debt (track your spending at saveandinvest.org); and, last but not least, check your broker annually on BrokerCheck (only 14% of investors report checking at all).

Three Videos for Investors: In one of the videos, "The Investment Con's Playbook," FINRA features con artists who explain their schemes and scams. "Trick$ of the Trade: Outsmarting Investment Fraud," is an excerpt from an hour-long video documenting stories from victims and cons on investment fraud and how to avoid it. A third video is designed for teens who want to understand finance and perhaps start their own business – called "Teens & Money: Understanding the Break-Even Point."

Other Announcements: FINRA Dispute Resolution has launched a new low-cost mediation program for small claims disputes (see below). The FINRA WebSite now offers a 401(k) calculator advising workers how much to save each pay period in order

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to reach the maximum $22,000 contribution. Crowdfunding exchanges are coming and SEC and FINRA are preparing rules to govern their operation. A new form invites crowdfunders to sign up and share information with FINRA for its use in developing rulemaking. FINRA has published a summary of its report on 2012 (see below). (SAC Ref. No. 2013-03-02)

FINRA LISTENS ... AND SPEAKS, 2/4: ***Every year for the past fourteen years, the New York Regional Director or other FINRA-DR representative makes an appearance before a group of lawyers, neutrals and others at the New York County Lawyers Association and addresses the past year's events and accomplishments and faces questions from the audience.*** Moderator Martin Feinberg, a FINRA Arbitrator and Claimant's attorney, acts as moderator at these evening forums, which are customarily held on the first Monday of February, and fields the questions from the assembled group. On hand this year was Katherine Bayer, Northeast Regional Director, FINRA-DR, since 2008 and a career administrator of FINRA arbitrations. Ms. Bayer began with forum statistics for 2012 and then moved on to more substantive matters, mentioning in turn new technological improvements at the Dispute Resolution facility, 2012 Rule changes, new pilots, pending rule changes, the OAPP results to date, and other developments. Among the highlights of Ms. Bayer's presentation were the following items:

FINRA Statistics: Most of the statistics Ms. Bayer reported can be viewed online at the FINRA WebSite (www.finra.org; SAA 2013-03), but she did drill down in some areas that are not generally covered in the monthly disclosures from FINRA. She indicated, for instance, that customer case filings generally fluctuate widely and account for most of the swings we see in new submissions from year to year. In 2012, 2,586 of the 4,299 cases were customer-related; that was down 16% from 2011, while the caseload was down only 9% overall in 2011. Industry cases, therefore, account for a higher proportion of the overall caseload in leaner years and 2012 was no different. Industry matters accounted for 40% of the overall caseload in 2012, whereas in 2011, its slice of the overall pie was only 35%. *(ed: Ms. Bayer indicated that the Simplified Arbitrations experienced an 11% increase in processing time and attributed that delay, in part, to the new threshold of $50,000 for such claims (up from $25,000; see SAA 2012-24). True to a degree, we think, but that comment may be better held until 2013, since the rule change took effect in July 2012 and the cases first arising from that change were only just being decided at the end of 2012.)*

Party Portals: The first stage of the Arbitrator Portals has already been launched and more than 200 neutrals have registered and are utilizing the Portal to manage their cases. Ms. Bayer presented a detailed explanation of the Arbitrator Portal, when she appeared at the NYS Bar Association's full-day program on securities arbitration last November (2012 SAC, No. 2); at this program, she explained its use and spoke of a coming announcement from FINRA about the launch of a Party Portal sometime in 2013. When the Party Portal is fully operational, parties will be able to, among other things, accept service, submit Statements of Answer and other filings, perform arbitrator rankings, participate in scheduling, and much more. *(ed: It sounds from this that Simplified Arbitrations may be able to be performed entirely online at some point in the not too distant future.)*

Large Case Pilot: The idea for this pilot FINRA-DR (see SAA 2012-33) evolved from party inquiries about managing their own cases, especially in the area of arbitrator selection. The pilot, which permits parties to pay a $1,000 administrative fee to FINRA and to sit down and negotiate the ways in which their case will be handled, in essence, outside the box, is voluntary and available to all in theory. Practically speaking, FINRA developed the program for parties involved in disputes of $10 million or more, where they want to choose their own arbitrators and want to explore alternative methods of panel selection. Ms. Bayer stated that FINRA is able to respond to party requests for specific qualifications (except if the parties want non-FINRA arbitrators to serve), including, for instance, providing all attorneys for consideration, providing arbitrators by times served, or naming only retired judges as Chairperson. The Pilot is still getting underway, but, in the past two weeks, three inquiries have been received by her office.

Replacement Arbitrators–Short List Option: This pilot, again a voluntary program, was introduced in 2012 (SAA 2012-05) and has proved popular with parties. It brings list selection to the triage area of arbitrator replacement and is designed to cut down on the incidence of extended arbitrator (aka "cram-down" arbitrator) appointments by the staff. Through periodic innovations, the staff has reduced the incidence of extended arbitrator appointment in the initial selection of arbitrators to about 3%, according to Ms. Bayer, and this program, which is being used in 58% of the replacement occasions, serves to reduce extended use even further. Where parties are not using the option, she indicated, they are generally concerned about the requirement that, within five days of hearing, a postponement agreement must accompany a request for the three-Arbitrator "short list option." That means potential additional fees and certain delay.

Non-Member RIAs @ FINRA-DR: This policy change occurred mid-year 2012 and was directed at permitting RIAs to arbitrate at FINRA, even if their dispute does not involve a member or member affiliate. The primary stipulation for allowing such non-member cases to use the forum requires that all parties mutually agree and agree post-dispute to arbitration under the Authority's auspices. Ms. Bayer covered the other restrictions that apply and indicated that three such cases are currently pending at FINRA.

Subpoena Rule Changes: A rule change to these pre-hearing procedures requires arbitrators to turn when possible to the use of orders of production and orders of appearances, instead of issuing arbitrator subpoenas to non-party industry entities and persons (see RN 13-04; SAA 2013-04). Moderator Feinberg, on this point, added that FRCP 45 is under revision and will, when finally approved, more easily allow nationwide service of subpoenas. (ed: see, for further detail, an online article circulated by the ABA and authored by Katherine S. Kayatta, Robinson & Cole, Boston: go to ABA WebSite: http://apps.americanbar.org/litigation/committees/realestate/Email/fall2012/fall2012-1212-frcp-45-proposed-amendments-changing-subpoena-procedures.html.

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Expungement Relief, In Re Proposal: FINRA has been searching for ways to formalize procedures under which unnamed brokers can obtain expungement relief. In 2012, it sought comment on some proposals (SAA 2012-13) that it then modified and presented again to the FINRA Board of Directors in December (SAA 2012-45). The specific modifications have not been aired publicly, but will likely be disclosed in rulemaking in the near future. Ms. Bayer described the ways in which, under the new proposal, unnamed brokers will have access to expungement relief: (1) in the course of the proceeding by requesting a party to present the case for relief -- happens frequently, when the house and the broker are on good terms; (2) by intervening in the merits case – not a frequent occurrence; or (3) by requesting, during the merits proceeding, an expedited expungement proceeding that will follow at the end of the case and will essentially be embedded in the merits proceeding, in that the same panel will rule and make its determination, without the introduction of new evidence, "based on the record as compiled."

OAPP Program: In place since February 2011, this All-Public Panel Option permits customers to ensure, if they are so inclined, that a Non-Public Arbitrator will not be appointed to their three-person panel (APP). Over the course of the OAPP's operation, eligible customer cases have opted to join the program 76% of the time. The 24% who did not opt in received default Majority Public Panels (MPP). The opt-in cases that proceeded to arbitrator selection then ranked a Non-Public Arbitrator 33% of the time (essentially opting for a MPP), indicating, as Mr. Feinberg quickly calculated, that customers are choosing APP in about 50% of the cases. With respect to the significant gap in "win" rates for customers that has been appearing in the early results between APP and MPP empanelments (a gap that did appear at all in the predecessor PAPP pilot), one "theory" posited is that the 24% default users are quite frequently represented by inexperienced attorneys, whereas experienced counsel are choosing to opt in.

Promissory Note Cases: Ms. Bayer offered some statistics on promissory note cases, which have been far more prevalent at the forum in recent years. These BD-Claimant cases, processed under FINRA's Industry Arbitration Code, were most numerous in 2010. Still, in 2011, 751 of the 4,729 cases filed were promissory note cases (down 29% from 2010) and, in 2012, the total was up 3% to 777, while the overall total of 4,299 cases, was down 9%.

Arbitrator Expense Reimbursement: Previously, arbitrators who have submitted expense reimbursement requests have been asked to supply supporting documentation on any expense exceeding $10. Effective February 1, that threshold has been lifted to $25.

FINRA STATS, 3/13: ***With 918 new submissions in the first quarter of 2013, FINRA has slowed to a pace of about 300 new cases filed each month.*** While still anemic compared to almost any other year in this Millennium, the March tally of 330 new filings actually beats the monthly results of the first two months of 2013: January, 321; February, 267. As compared to immediately prior years, the first quarter's new case inflow lags 22% behind 2012 (1,183) and 28% behind 2011 (1,276). The number of cases concluded through March 2013 by the FINRA Dispute Resolution forum stands at 1,130, 18% behind 2012's 1,375 close-outs and 31% behind 2011's 1,634 close-outs. We anticipate that close-outs will slow even further as case inventory dries up; the 375 matters concluded in March, compared to the 384 concluded in January and 371 in February, does not yet reflect that expectation – but we believe it soon will. Just to illustrate, the slowest year for new filings in the past seven (2006-2012) occurred in 2007, when 3,238 case submissions were recorded, and the briskest year was 2009, just after the 2007-2008 price collapse. The slowest close-out year during that same period was 2008 (3,757) -- the year before the 2009 case surge and the year after the slowest year for filings (2007). All told, in the past seven years, FINRA has closed 38,102 cases and only opened 34,679; the bulk of that decrease in case inventory has occurred in the past three years, as case filings have dwindled. On another subject, *we caution that there are a few apparent errors or anomalies in this month's report.* For instance, we are unsure how to read the mediation statistics. They indicate a 25% decline from 2011 in cases entering agreement through March (132 vs. 176) and a 37% decline in closed cases (130 vs. 207). The settlement percentage is reported as 76%, suggesting that 99 cases have settled in the past quarter. However, FINRA reports only 71 cases settled by mediation on the case disposition chart. That chart also reports only 1,111 cases closed and we know that 1,130 were closed; the 71 figure is also out of line with past years' mediation settlement tallies. Finally, we were drawn to focus on the "win" rates for customers in this month's FINRA report, where some surprising results are reported. Only 15% of customer claims resulted in a decision by the arbitrators, versus 22% for cases as a whole. The "win" rate for those 104 cases is a dismal 38% (39/104), whereas in 2012 the customer "win" rate reached 45% overall. FINRA separately reports "win" rates for customers offered the OAPP program, i.e., those with claims exceeding $100,000. In that smaller group of cases, FINRA reports that 42 cases have been decided through March (about 40% of the 104 decided cases). Among those selecting an All-Public Panel (APP), the "win" rate among the decided cases is 44% (11/25). Among those selecting (or defaulting to) a Majority Public Panel (MPP: includes one Non-Public Arbitrator), the "win" rate is 53%! Those are the results for 2013 cases. For all such OAPP Awards from 2011 through March 2013, the "win" rate for APPs stands at 49% (67/137) versus 34% (49/145) for the MPP Awards. The 2013 results, if they are accurate, suggest that a wide gap may not exist after all between these two Panel types. (SAC Ref. No. 2013-14-02)

APPROVED, NEW ARBITRATOR CLASSIFICATIONS: In SAA 2013-01, we reported the details of FINRA-DR's filing of a rule proposal (SR-FINRA-2013-003) to amend the "Public Arbitrator" classification under both the Customer and Industry Arbitration Codes. FINRA has amended these classifications many times; this latest proposal attaches a two-year "cooling-off" period to certain disqualification criteria and adds to the list of

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disqualified persons those individuals who are associated with a mutual fund of hedge fund. Thus, under the new provisions, such an individual could not qualify as a Public Arbitrator for two calendar years after the hedge/mutual fund affiliation ceased. The two-year restriction also extends to other subparagraphs and individuals. Subparagraphs 5-7 will now be covered by the two-year restriction, which provisions cover professionals whose firm derives 10 percent or more of its revenues from the industry; professionals whose firm derives $50,000 or more in annual revenue for services to the industry that relate to customer disputes; employees (including directors and officers), spouses and immediate family of employees of entities and affiliates of entities engaged in "the securities business."By using the phrase "calendar," FINRA seems to intend that, in measuring the "cooling-off" period, during which the taint of prior association will be presumed to fade, one would begin the two-year countdown at the end of the calendar year in which the association terminated. The SEC published the proposal for comment in Release No. 34-68632 (dtd. 1/11/13), which appeared in the Federal Register on January 17 (78 Fed. Reg. 3925). The comment period ended on February 7, 2013. Forty-five comment letters were submitted, not one of which argued that the proposal went too far, while 37 generally supported the proposal and many of those suggested ways that FINRA might disqualify more people or lengthen the cooling off period. In approving the proposal as submitted (SEC Rel. 34-69297, dtd. 4/4/13), the Commission expressed its belief that the revisions would "improv[e] investor confidence in the neutrality of FINRA's public arbitrator roster." This belief was bolstered by FINRA's undertaking to "conduct a comprehensive review" of its arbitrator classifications "with a view towards further clarifying the definitions...." *(ed: The Approval Release was published in the Federal Register on April 10, 2013, 78 Fed. Reg. 21449.*) (SAC Ref. Nos. 2013-01-01, 02-02 & 13-05)

RN 13-02, RECRUITMENT COMPENSATION: ***One of FINRA's regulatory focuses in 2013 has been on conflicts of interest in the recommendation and sale of securities products to customers and a new proposal from FINRA on payments to transferring brokers moves boldly on this front.*** The competition for client assets and sales talent among the remaining houses of size has sharpened and led to compensation packages that contractually tie the broker in for years and set production goals that are ambitious. The pressure to produce and to retain accounts when transferring to a new employer presents challenges to the customer-broker relationship that are intense and continuing in nature. Yet, brokers do not generally share that information with their existing clientele. Now, FINRA is proposing that they do, in a Regulatory Notice, issued in January, that seeks comment from the industry and others on a rule requiring disclosure "of the recruitment incentives provided to a registered representative in conjunction with a move to a new firm." Thus, when a broker moves from one firm to another, transferring customers would, upon initial contact, receive detailed information about the "enhanced compensation" paid to the recruited broker. If there is no contact, before the client moves to transfer his/her account, the recruiting firm must give written disclosures "with respect to the timing, amount and nature of the enhanced compensation arrangement." Disclosure requirements would continue for one year. The key phrase, "enhanced compensation arrangement" is defined in the Regulatory Notice, as other-than-normal compensation, including the signing bonuses, upfront or back-end bonuses commonly paid in these arrangements, loans, accelerated payouts, transition assistance and similar incentives. FINRA makes specific requests for comment on eight items, generally asking whether the Authority has gone far enough in its disclosure requirements and then offering an alternative approach that would not require disclosure unless requested by the customer. FINRA also sets forth seven questions designed to prompt comment on the economic impact and likely consequences of the proposal, should it be adopted. *(ed: FINRA deserves praise for using a disclosure approach in this sensitive area and not trying to set standards or specific restrictions on compensation arrangements. Just what impact will this have on recruiting?– very little impact, we believe. On the other hand, the enhanced disclosure may strengthen Respondents' arbitration defenses, vis a vis claims of hidden motivations and compensation-driven recommendations.)* (SAC Ref. No. 2013-01-02)

JOINTLY REQUESTED EXPLAINED DECISIONS. ***The third anniversary recently passed of the first Award issued under FINRA's "Explained Decisions" Rule (Customer Code Rule 12904(g) and Industry Code Rule 13904(g)) and, while only 11 such Awards have issued so far, we thought it was an opportune time to survey how this option has functioned. The exercise revealed a few surprises.*** The foregoing set of rules defines an "explained decision" as "a fact-based award stating the general reason(s) for the arbitrators' decision." To take advantage of the rule, all parties must jointly request the explained decision "no later than the time for the prehearing exchange of documents and witness lists." The duty (to explain) is assigned to the Chair, who receives an additional $400 honorarium as compensation. However, the option is not available in simplified arbitrations or default cases. Given the tiny number of Awards so far, one should not read too much into these results. That said, here are the highlights of what we found:

Characteristics of Explained Decision Cases. The explained decisions were more likely to issue in intra-industry cases: Employee-Member cases accounted for four of the 11 (36%) and Member-Employee cases for three others (27%). Only three such decisions issued in Customer-Member cases (27%) and one in a Small Claims case. That is markedly at variance with the general pattern for the same three-year period: Customer-Member cases account for 47% of all Awards issued in 2010-12 (2203/4655), Member-Employee cases for 25% (1163) and Employee-Member cases for only 12% (546). Not surprisingly, given the rule's exclusion of decisions on papers and by default, all of the explained decision cases had from two to 19 hearing sessions, with a median of eight (precisely twice the median number of sessions in all cases with at least one hearing that resulted in an Award in 2010-12). By the same token, the explained decision cases had turnaround times (TAT) ranging

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from 10.5 to 30 months, with a median of 16 (while the median TAT was 11 months for all Awards in the same period and 14 months for those eligible for explained decisions).

Customer-Member Win Rates and Recovery Rates. Jointly requested explained decisions as a whole reflected modestly higher win rates than the overall rate for 2010-12 Awards (64% vs. 59%), as did the median recovery rate (defined as the median total damage award divided by the median compensatory damage claim in "win" Awards) - 73% vs. 64%). This difference was due entirely to the extraordinarily greater success that claimants in Customer-Member cases enjoyed when they received jointly requested explained decisions than they did in general during the same three-year period: win rates of 100% vs. 49% and median recovery rates of 71% vs. 41%.

The Explanations. Finally, we took a look at how extensively the Arbitrators explained their decisions, when formally asked by the parties. These explanations ranged in length from one paragraph to 40 pages. Only two (both intra-industry) were less than one page, five were one to four pages long and the remaining three were seven or more pages long (the median length was three and a half pages). In contrast, only a quarter of the more than two hundred explained Awards SAC identified in 2010-12 had a page or more of explanation. Customer-Member Awards included the two longest explanations and even the shortest of them ran over two pages of text. In contrast, no explanation in a Member-Employee Award was more than two pages, while Employee-Member cases tended to fall in the middle range. The longest explanation, in *Malm v. Charles Schwab*, FINRA ID # 10-04653 (Chicago, 9/2/11), determining the allocation of a decedent's IRA account among his heirs, in addition to a detailed discussion of the facts, analyzed the applicable law at length and painstakingly calculated the damage figures (even though Rule 12904(g) does not require the inclusion of any legal authority or damage calculations in an explained decision). *(ed: * We summarized* Malm *in our sister publication, the* Securities Awards *Monthly, Vol. 2011, Issue 9. We have, in fact, published summaries of almost every jointly requested explained decision in one issue or another of that newsletter. **We do not know how to explain the high Customer-Member win rates. An analysis of Customer-Member Awards in which panels refused to grant requests for explained decisions (either because only one party invoked the rule or because the request was untimely) did not reveal any such pattern. We did note that claimants and respondents were almost equally likely to make the request. It may be possible that both sides have particular reasons to request explained decisions when a customer is likely to win – perhaps, for instance, the claimant because he wants to keep the arbitrator "honest" and the respondent because it hopes to find a basis for challenging the Award. More likely, it is a statistical fluke that will evaporate as more explained decisions come in.)*

ARBITRATION DECISIONS, WASHINGTON SUPREME COURT: ***The Washington Supreme Court is on a tear, on the subject of arbitration, having issued three significant decisions regarding arbitration issues since the beginning of the year.*** Through the first dozen years we have been covering court decisions affecting broker-dealers in the *Securities Litigation Commentator,* we have had occasion to summarize only one decision by this Court, *Broom v. Morgan Stanley,* SLA 2010-32. *Broom* held that claims in arbitration, which relied upon Washington law, were not "actions" within the meaning of Washington's statutory limitations provisions and could not, therefore, be enforced by arbitrators.

That was 2000-2012. In the opening weeks of 2013, the Washington Supreme Court decided *State of Washington DOT v. James River Ins. Co.*, SLA 2013-03, upholding the enforceability of an anti-arbitration state statute dealing with the sale of insurance, because the McCarran-Ferguson Act's protections trumped the proscriptions of the Federal Arbitration Act (SLA 2013-03). The two decisions, summarized below, followed. Together, they recognize the considerable reach of the Federal Arbitration Act and acknowledge the work of the U.S. Supreme Court in interpreting that Act. They also interpret the Act's reach and explore its impact on state prerogatives. Both decisions were rendered by the Court's presiding Justices *en banc.*

Saleemi v. Doctor's Associates, Inc., No. 87062-4, *en banc* (Wash., 1/17/13). Messrs. Saleemi and Sharyar operated three Subway sandwich franchises in Washington State, until the Doctor's Associates (DAI) Legal Department applied contractual sanctions that forced the franchisees to seek a purchaser. Claiming breach of restrictive covenants in the franchise agreement, DAI demanded arbitration. Notice of that demand scared off the purchaser Saleemi and Sharyar had found and that led them to commence the underlying lawsuit for damages. Plaintiffs also sought to invalidate the agreement's requirement that the pair arbitrate their dispute with DAI in Connecticut, that they arbitrate under Connecticut law, and that they accept a damage limitation of $100,000. The state trial court found the forum selection clause unconscionable and ordered arbitration in Washington, under Washington law, and with no limitations on remedies or damages. The case went to arbitration before the AAA, as the agreement dictated, and the Arbitrator ruled for Plaintiffs on all counts. As damages, the Arbitrator granted Plaintiffs' compensatory claims to the extent of $230,000 and then awarded attorney fees of $161,536 and costs of $32,837.96. DAI sought to vacate. Returning to the original trial court, it argued that the court erred in its original ruling and that the contract should have, under the recent U.S. Supreme Court ruling, in *AT&T Mobility v. Concepcion,* 131 S.Ct. 1740 (2011), been enforced according to its terms. The courts involved never reached the arbitrability issue, each deciding in turn to reject a collateral challenge on procedural grounds. Washington law permits an immediate, albeit discretionary, review of a trial court's order compelling arbitration, yet DAI opted for arbitration first. In that instance, this Court rules, a showing of prejudice must accompany the challenge. No prejudice to DAI either occurred or was shown. The dispute was arbitrated, as the DAI contract required, and it made no substantial difference that Washington law and a Washington situs were used. As for the damage limitations, there were three franchises and the ceiling of $100,000, on a per contract basis, was, therefore, observed. The Court leaves open whether *Concepcion* has any application beyond class

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arbitration procedures. Before these issues can be reached in this case, DAI is required to show prejudice caused by the trial court's orders and it failed to do that.

(ed: This prejudice requirement is new to us, as the FAA does not generally allow appeals of orders compelling arbitration. The Court cites an "emerging consensus of courts" in support of its judgment. Overturning an Award because the trial court erred, when the challenger could have appealed earlier, represents a great loss of wasted time and expense. It makes sense to us that, in such instances, there should be some higher obstacles to hurdle as the price of making that election.) (SAC Ref. No. 2013-06-01A)

Gandee v. LDL Freedom Enterprises, Inc., No. 87674-6 *en banc* (Wash., 2/7/13). Plaintiff-Respondent Patty Gandee initiated a putative class action against LPL Freedom, dba Financial Crossroads, in connection with a debt adjustment contract she signed. She claimed excessive fees that violated the State consumer protection statute (CPA) and the debt adjusting act, Ch. 18.28 RCW. Freedom sought arbitration pursuant to a clause in the original contract that required AAA arbitration based in Orange County, CA and assessed the attorney fees of the "prevailing party" and the costs of arbitration against the loser. Ms. Gandee opposed the motion on grounds of timeliness and unconscionability. In this appeal, the Court's scrutiny falls upon three provisions in the arbitration agreement: the burden-shifting provision, which would impose prohibitive costs in this case; the "loser pays" provision, which was "one-sided and overly harsh;" and a 30-day contractual time limitation in the PDAA, finding that it effectively "shortens the statute of limitations from the four-years provided by the CPA to 30 days." With respect to the preemptive effect of the FAA, the Court observes that the invalidated clause in *Concepcion* actually contained provisions that could be deemed favorable to the claimant and rendered her "better off" under the arbitration agreement. Thus, the *Discover Bank* Rule, if obeyed, would have disallowed a clause that was "fairly and evenly drafted;" that left the PDAA in *Concepcion* unequally protected, relative to other contractual provisions, and the Rule standing as an "obstacle to the accomplishment of the FAA's objectives." The Court's ruling on unconscionability in this case is based upon specific facts and numerous unconscionable provisions. "*Concepcion* provides no basis for preempting our relevant case law nor does it require the enforcement of Freedom's arbitration clause."

(ed: SAC thanks to George H. Friedman, SAC Board Member and former FINRA Director of Arbitration, who alerted us to both of these Washington Supreme Court decisions.) (SAC Ref. No. 2013-06-01B)

SHORT BRIEFS:

FINRA PILOT, SMALL CLAIMS MEDIATION: In a Press Release, dated January 16, 2013, FINRA Dispute Resolution announced that it had commenced a pilot program on January 15, offering parties engaged in simplified arbitrations the opportunity to participate in telephonic mediation of their dispute. The program is voluntary and open to cases involving $50,000 in claims or less. The mediators who will conduct the telephonic sessions will either serve *pro bono* or at a reduced fee, depending upon the dollar size of the case. The reduced-fee sessions ($50 per hour) are available in connection with claims ranging from $25,001 to $50,000. The *pro bono* mediations relate to claims of $25,000 and under. FINRA states in the Release that it will not charge any administrative fee for processing cases entering the Program. FINRA will be notifying eligible parties of the Program's availability. Uncertain from the January 16 Press Release that announced the new Pilot, we asked FINRA who would be serving as mediators – would it be limited to one or more individuals with an exclusive arrangement or open to all qualified mediators? The answer appears to be the latter, i.e., FINRA will be using its mediator roster and inviting all mediators and anyone who is interested to participate. Interested parties may obtain information and a link to a Small Claims Mediation Submission Form at www.finra.org/arbitrationmediation/smallclaims. (SAC Ref. No. 2013-03-03)

LMS, FINRA ARB TRAINING AID: FINRA Arbitrators have been notified by the Dispute Resolution staff of a new Learning Management System to which FINRA neutrals can log in. The new LMS permits FINRA neutrals to access more easily and manage better the arbitrator training materials and online learning courses FINRA has created for its arbitrators and mediators. FINRA also provides a user guide to assist in navigating LMS. Using LMS, arbitrators can easily see what courses they need to take (Learning Plan) and what courses they have taken in the past (Learning History). The LMS User Guide provides information about accessing FINRA-DR Courses, purchasing a Course or Library, surveying Current Learning, which shows what courses have been purchased, started and completed, and reviewing Learning History. Questions about the new system may be addressed to education@finra.org. (SAC Ref. No. 2013-01-05)

RN 13-04, SUBPOENA RULES: When FINRA-DR first solicited comment on its still-pending "*in re* expungement" proposals (SAA 2012-20), it received a number of comments about the time and expense of requesting and serving subpoenas. There is also the administrative chores involved in procuring an arbitrator subpoena (the only kind available in FINRA arbitration since 2007 – see SAA 2007-02). At last year's "FINRA Listens..." seminar, the moderator (Martin Feinberg) noted that Section 7 of the FAA requires the signatures of a majority of the Panel on a valid subpoena. FINRA initiated a rule proposal (SR-FINRA-2012-041) in mid-2012 (SAA 2012-32). Comments were generally favorable and the SEC approved the proposal in December 2012 (SAA 2012-47). FINRA released a Regulatory Notice in January, setting an effective date for implementation of the rule changes of February 18, 2013. The biggest change is to make orders of appearance/production the default instrument for industry parties who require testimony or documents from non-party industry firms or persons. (SAC Ref. No. 2013-04-03)

FINRA FORMS ONLINE: FINRA-DR's monthly e-mail update highlighted this item that we have not previously covered: **Updated Hearing Scripts and Forms.** According to the e-mail,

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the following forms are now available online for arbitrators to complete and submit electronically: (1) Order on Request for Permanent Injunction; (2) Attendance List; (3) List of Claimant's Exhibits; (4) List of Respondent's Exhibits; (4) Award Information Sheet; (5) Simplified Case Checklist; (6) Promissory Note Case Checklist; and (7) Disciplinary Referral Form. In addition, the e-mail notes, the Initial Pre-Hearing Conference Script and IPC Order have been changed to include headings by topic and page numbers and to provide additional guidance for *pro se* parties. (SAC Ref. No. 2013-05-02)

NOTES ON PARTY PORTAL: FINRA-DR has been talking for a long time about an online facility similar to the U.S. PACER project for securities arbitration and it now looks as if the project is moving forward from design to realization. Just who was in on the design we have not heard, nor have we heard assurances from FINRA officials that the contemplated Party Portal will be secure in ways that will satisfy all parties. PACER records online all filings by parties, including briefs, exhibits, and other submissions, but the courts are meant to be an open book. Filings in arbitration are meant to be confidential, but, with attorneys, expert witnesses, parties, neutrals and others all potentially requiring or being given access by FINRA or by others with passcodes, the security of sensitive information could be easily compromised -- even without hacking. If an authorized party gives access to an otherwise unauthorized party, will that be known by, or need to be approved by, one's adversary – or the arbitrators? Will material that is necessarily available during the proceedings be immediately blocked from access upon settlement, end of hearings, issuance of Award? Will this stuff be stored on the "Cloud," FINRA's mainframe, and for how long? The Arbitrator Portals are one thing – essentially an internal accommodation to the neutrals – but getting the parties online presents a variety of new considerations, things we think would be best aired for comments by users before they build it, rather than after.

NJ PRACTICE RULE RELAXED: With the endorsement of the New Jersey State Bar Association, the New Jersey Supreme Court has modified the requirements of the State's *bona fide* office rule, eliminating its more onerous requirements. On January 15, 2013, the Court adopted amendments to Professional Responsibility Rule 1:21:1, which drops an onerous and inflexible description of a practicing attorney's office for a more flexible provision that requires the attorney to assure accessibility and communication, plus a "fixed physical location" for client and business file control. Previously, out-of-state attorneys were permitted to practice in the State, pursuant to RPC 5.5(b), but they too had to comply with the *bona fide* office requirement and, if that office was out-of-state, they had to designate the Clerk of the Supreme Court as agent for service of process. Those requirements appear to remain, unless the lawyer maintains a "fixed physical location" within the State. These changes do not appear to affect the State's UPL provisions, but relaxing the *bona fide* office requirement for in-state lawyers should enable more solo and part-time practitioners. The new Rule took effect February 1, 2013. (SAC Ref. No. 2013-03-04)

WHO's YOUR CUSTOMER I? We dedicated an edition of the *Securities Arbitration Commentator* print newsletter to this issue last June (*Know Your Customer!? Who Is Your Customer),* in which we canvassed the growing body of case law regarding broker-dealers seeking to avoid FINRA arbitration and its requirement (FINRA Rule 12200) permitting "customers" of brokerage firms to demand unilaterally the right to arbitrate their disputes. The phenomenon of institutional investors launching multi-million dollar claims in FINRA arbitration has been one source of such legal battles and, in that area, the battles continue. Citigroup Global Markets is pursuing such a challenge involving two wealthy Arab investors in New York federal court, who claim losses of $350 million. In its 2012 Year in Review on Litigation and Arbitration, the Milbank law firm reported that, in *CGMI v. Abbar,* it would soon be engaging before Southern District Judge Louis L. Stanton in a two-week bench trial on the arbitrability issue. That trial was most recently scheduled for April 22, 2013 (Dkt. No. 11-06993). (SAC Ref. No. 2013-06-02)

WHO's YOUR CUSTOMER II? In a case just decided by the Fourth Circuit, *UBS Finl. & CGMI v. Carilion Clinic,* No. 12-00424 (SLA 2013-05), two brokerage giants challenged whether they should be required as members of FINRA to arbitrate disputes arising out of services provided to defendant in connection with its multi-million dollar bond issues. A similar case ended with a decision in favor of arbitration in the Second Circuit, *UBS Finl. v. WVU Hospitals* (SLA 2011-37), and the Fourth Circuit follows suit here. However, in its Opinion, the Fourth Circuit appears to articulate a more expansive definition than the Second Circuit, plus the *WVU Hospitals* precedent was somewhat hobbled by a dissent. The term, "customer," it decides, is broader than simply one who receives investment and brokerage services. It extends to all of the member's "business activities," insofar as those activities are regulated by FINRA – namely, investment banking and securities business activities. Here, part of the underwriters' discount constituted a management fee for assistance in structuring and managing the transaction and annual broker-dealer fees of 25 basis points in exchange for managing the ARS bond auctions. (SAC Ref. No. 2013-06-03)

WHO's YOUR CUSTOMER III? Another institutional investor's attempt at invoking arbitration under FINRA's Rule 12200 has led to a court fight that is now getting underway. SunTrust Banks, Inc. has just (2/6/13) commenced a federal action challenging a Connecticut hedge fund reach for "customer" status in a dispute over an offering of mortgage-backed securities (MBS), because it actually bought the securities from Raymond James (S.D. N.Y., No. 13 Civ 879). SunTrust owns Robinson Humphrey (STRH) and admits that STRH underwrote the MBS offering, but it denies providing any investment advice or holding any investment account for Turnberry Capital Management LP. Turnberry reportedly claims reliance upon SunTrust offering documents and its reputation for prudently evaluating MBS products. Turnberry

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also alleges that it sought help from STRH when prices nosedived, was denied access to loan files, and ultimately lost $13 million (SAC Ref. No. 2013-06-04; see Law360 article, 2/7/13, "SunTrust Sues to Block FINRA Arbitration In MBS Row").

PIABA OFFICERS, 2012-2013: In a November 10, 2012 Press Release, issuing from its headquarters in Norman, OK, the Public Investors Arbitration Bar Association announced a new roster of officers and directors to lead the organization. The newcomers were elected at the Association's October annual meeting in Austin, TX, with **Scott Ilgenfritz** leading the slate as the 2013 President. Mr. Ilgenfritz is a partner in the Tampa, FL firm of Johnson Pope; he has been a PIABA member since 1997 and has served on the PIABA Board of Directors since 2008. EVP **Jason Doss** of Atlanta, GA will serve as President-Elect and **Glenn Gitomer** (Radnor, PA) and **William Jacobson** (Ithaca, NY) were installed as Secretary and Treasurer, respectively. Re-elected Directors include Mr. Doss, Mr. Jacobson, and **Richard Lewins** (Dallas, TX) and new additions to the Board are **Lisa A. Catalano** (New York, NY) and **Marnie Lambert**, Columbus, OH. (SAC Ref. No. 2013-01-07)

PIABA *AMICUS, LaWARRE v. FIFTH THIRD:* To what lengths run a broker-dealer's duty to warn customers of foreseeable harm from a broker's risky trading strategy? Only until they become former customers, according to the decision on appeal in this case to the Ohio Supreme Court. The Public Investor Arbitration Bar Association has stepped in to see if it can get Ohio's Top Court to adopt a less restrictive approach to broker-dealer liability; it has urged the Court to exercise jurisdiction over this discretionary appeal and to alter the judgment. We recently summarized the Ohio Court of Appeals decision under review in SLA 2013-01 (No. 110302, 9/6/12); it contains a dissent that is longer than the majority Opinion and should also encourage the requested review. The case concerns a broker, who, while at Fifth Third, made money for his clients utilizing an options trading strategy that stimulated considerable supervisory oversight. The broker departed Fifth Third, taking his customers and continuing the trading strategy at his new firm, but this time the clients lost millions. While the lower Appellate Court drew the line at the departure point, PIABA argues, in support of Appellants, that Fifth Third had an affirmative duty to notify the departing customers of the risk of financial harm, "even if the harm is realized after the termination of the" customer-broker relationship. (SAC Ref. No. 2013-01-06)

ARTICLES

As a regular feature, SAC summarizes articles and case decisions of interest in the field of securities/commodities arbitration law. If you find one we missed or are involved in a case that produces an interesting decision, please write and send us a copy. ***As it is our objective to cover all relevant decisions, we will sometimes include decisions in the current "Articles & Case Law" section that issued a year or more ago. We also summarize unpublished decisions and orders. For these reasons, readers are cautioned to cite-check cases to assure they have not been overruled and may be cited in accordance with local court rules.*** **We thank our readers who have contributed court opinions and who, by their efforts, help us all to keep informed. Credit is given to contributors at the end of the relevant case summaries.**

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Advisers Garnering More Trust: For clients, financial crisis proves worth of expert financial guidance, by Jason Kephart, INVESTMENTNEWS, (April 7, 2013) available at www.investmentnews.com (Although the financial crisis has left many investors' portfolios in disarray, investors are strengthening their relationships with their financial advisors. According to a recent survey, a third of investors reached out to an adviser during the financial crisis and a quarter said that they rely more on their financial advisor than in previous years. Financial advisers are becoming more trusted by investors than banks, insurance companies and investment firms as increasing numbers of investors are looking for help managing their long-term financial future.)

Advocates Urge SEC to Propose Crowd-Funding Rules, by Mark Schoeff Jr., INVESTMENTNEWS, (February 25, 2013) p. 20 (One provision of President Obama's Jumpstart Our Business Startups Act, that is receiving much attention of late is crowd funding. In recent months, nearly a dozen crowd-funding and venture capital representatives and small-business advocates have urged SEC Chairman Elisse Walter to propose rules for crowd funding. Although supporters of crowd funding contend that it would help spur economic growth and create jobs by providing capital to small businesses, skeptics (including state regulators) warn that diluting registration requirements could harm investors.)

Fees Net More Revenue: A weak year for the IBD channel accentuated the value of steady income, by Bruce Kelly, INVESTMENTNEWS, (April 21, 2013) available at www.investmentnews.com (2012 proved to be a weak year for the independent broker-dealer channel as they saw declines in their revenue after two years of strong revenue growth. Despite a rising stock market that saw a 16% gain in the S&P 500, the largest of the 25 independent broker-dealers managed to only squeeze out a mere 3.8% year-over-year increase in revenue, which saw numbers of 16.9% in 2010 and 12.3% in 2011. One contributing factor in this decline is the independent broker-dealer's heavy reliance on revenue generated from commissions as opposed to generating revenue from fees charged against clients' assets.)

Fidelity Doubles Down on Free ETFs: Will offer twice as many commission-free programs with iShares, by Jason Kephart, INVESTMENTNEWS, (March 13, 2013) available at www.investmentnews.com (In a recent move, Fidelity Investments has expanded the number of commission-free exchange-traded funds on its platform. The core of this expanded platform is the popular iShares ETFs, which were launched last fall, as well as a broader range of fixed-income and commodities ETFs. Under this expanded platform, financial advisers can now trade 65 iShares ETFs without paying a commission, which is up from 30 iShares. The move comes after increasing interest and demand by investors and advisers in the popular iShares market, as well as Fidelity's efforts to keep pace with their competitors who also offer commission-free exchange traded funds.)

Supremes May Decide FINRA-Schwab Scuffle: Appeal of panel ruling sets it on path to high court, by Dan Jamieson, INVESTMENTNEWS, (March 4, 2013) p. 1 (FINRA has decided to appeal a decision issued by an arbitration panel that ruled in favor of Charles Schwab over its use of class action waivers in arbitration agreements. The ruling comes after an arbitration panel found that the Federal Arbitration Act prevented FINRA from enforcing rules that ban the controversial waivers (a tactic used by businesses increasingly to force all claims into arbitration) where class actions often are banned or difficult to prosecute. The appeal now sits before FINRA's National Adjudicatory Council. However, if the appeal is unsuccessful, the case could be heard before the SEC, then a U.S. Circuit Court of Appeals and, finally, the Supreme Court. Just the first step in what could be a long journey for the

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unconscionable, by Daniel B. Mitchell, JOURNAL OF DISPUTE RESOLUTION. Vol. 2012, No. 1, pp. 303-316.

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CASES

(ed: The court decisions summarized below are arranged by major subject heading first and digested in a single sentence. This enables readers to quickly refer to the courts or topics that are of key interest. The decisions are then arranged in alphabetical order by Plaintiff and summarized more fully. The single summary sentences are repeated and bold-type headnotes are added to facilitate quick scanning for topics of interest or for sorting decisions by major issues. Generally speaking, these case synopses were prepared for SAC's other newsletter service, the Securities Litigation Commentator/ Alert (SLC) *and have been previously published in that organ's weekly e-mail alert service* ("Lit Alert"). *Where the synopsis has been written by one of* SLC's *Contributing Editors, the author's first initial and last name appear at the end of the summary. We thank the* SLC *Contributing Editors for their assistance in creating these case summaries.)*

SUMMARY OF DECISIONS

ARBITRATION AGREEMENT: *By agreeing to arbitrate before FINRA and pursuant to the FINRA Code, the parties incorporated FINRA's procedural rules into their agreement.* **Domnarski v. UBS Financial Services, Inc.** (D. Mass., 1/23/13)

ARBITRATION AGREEMENT: *A court is not empowered under federal or Iowa law to compel arbitration at FINRA, when the exclusive forum cited in the agreement to arbitrate is NASD.* **Keller v. ING Financial Partners, Inc.** (S.C. App., 1/9/13)

ARBITRATION AGREEMENT: *An agreement to submit to arbitration an existing controversy shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.* **Peyser v. Kirshbaum** (S.D. N.Y., 12/11/12)

ARBITRATION AGREEMENT: *A party seeking to compel arbitration must introduce a copy of the arbitration agreement signed by the party he seeks to compel, in the absence of competent evidence that the actual agreements are unavailable and were not lost or destroyed in bad faith.* **Taylor v. Community Bankers Securities, LLC** (S.D. Tex., 12/19/12)

ARBITRATOR MISCONDUCT: *Sleeping on the part of an arbitrator may be grounds for vacatur, but to establish prejudicial misconduct, the proof of "habitual" sleeping must be clear and convincing and rise to a level of fundamental unfairness.* **Baker v. Merrill Lynch, Pierce, Fenner & Smith, Inc.** (N.Y. Sup., NY Cty., 3/9/12)

AWARD CHALLENGE: *In a vacatur proceeding decided under New York law, an Award is not wholly irrational and has a colorable basis where it is supported by contractual language.* **Longfield v. Financial Technology Partners L.P.** (N.Y. Sup. Ct., N.Y Cty., 12/6/12)

CONTRACT ENFORCEABILITY: *An investment management agreement is found not to be an adhesion contract and thus not subject to the requirement that its arbitration clause be conspicuous.* **Fry v. Phillips & Company Securities, Inc.** (Wis. App., 3Dist., 11/14/12)

DISCOVERY ISSUES: *For a New York court to order expedited discovery before a submission to arbitration, extraordinary circumstances must be demonstrated.* **AXA Equitable Life Ins. Co. v. Kalina** (N.Y.App., 4Dept., 12/21/12)

FAA: *The party seeking to vacate an arbitration Award bears the burden to show that one of the limited grounds for setting aside the award as set forth in the FAA § 10 is met, which is a heavy burden.* **Fisher v. Wells Fargo Advisors, LLC** (D. Kan., 12/17/12)

FEDERAL STATUTES INTERPRETED: *McCarran-Ferguson protects an anti-arbitration state statute from FAA preemption, because its prohibition of arbitration clauses in insurance policies constitutes the regulation of the "business of insurance."* **State of Washington DOT v. James River Insurance Co.** (Wash. Sup. Ct. (*en banc*), 1/17/13)

JURISDICTION ISSUES: *A merely tenuous connection with New York is not sufficient to subject non-residents to the jurisdiction of New York courts.* **Morgan Keegan v. Rote** (N.Y. Sup., N.Y. Cty., 11/30/12)

REMEDIES: *Awards containing an assessment of punitive damages must, under Florida law, observe certain procedural requirements.* **Tarrant v. Kovack Securities, Inc.** (S.D. Fla., 3/23/12)

SRO RULES: *A securities issuer for whom a FINRA member serves as an underwriter is a "customer" within the meaning of FINRA Rule 12200.* **J.P. Morgan Securities, Inc. v. Louisiana Citizens Prop. Ins. Corp.** (S.D. N.Y., 5/3/10)

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SRO RULES: *An arbitration claim that essentially argues that a prior arbitration decision was procured by fraud does not fall within the agreement to arbitrate between industry parties under FINRA Rule 13200.* **Morgan Stanley & Co., Inc. v. Druz** (N.J. App., 1/8/13)

STANDARD OF REVIEW: *A court does not abuse its discretion in refusing to stay litigation of non-arbitrable claims after ordering other claims in the same action to arbitration, where the non-arbitrable claims are independent of the arbitrable claims.* **Branch v. Ottinger** (11th Cir., 7/1/12)

STATUTORY DEFINITIONS: *The Fourth Circuit concludes that "customer," as used in FINRA Rules, refers to one, not a broker or dealer, who purchases products or services from a FINRA member in the course of the member's investment banking and securities business activities.* **UBS Financial Services & Citigroup Global Markets v. Carilion Clinic** (4th Cir., 1/23/13)

Cases

AXA Equitable Life Ins. Co. v. Kalina, No. 1295 CA 12-00938 (N.Y. App., 4Dept., 12/21/12). **Stay of Arbitration * Employment Dispute * Raiding/ Recruiting Issues (Protective Order) * Discovery Issues ("Disclosure In Aid of Arbitration") * State Statutes Interpreted (NY CPLR §3102, 3217, 5515 & 5520) * Statutory Definitions ("Extraordinary Circumstances") * Appealability (Leave to Reargue) * Timeliness Issues (Filing Appeal).** *For a New York court to order expedited discovery before a submission to arbitration, extraordinary circumstances must be demonstrated.*

AXA Advisors (AXA) is a registered broker-dealer and member of FINRA, but the other two AXA-affiliated entities who joined AXA in this lawsuit against six former financial advisors and their new firm, Diversified Wealth Strategies, LLC, were not. Thus, when Defendants sought to compel arbitration, Plaintiffs responded by moving to remove AXA from the case or, in the alternative, to obtain expedited discovery prior to arbitration. Neither side was happy with all elements of the trial court's decision, which was to compel arbitration as to AXA, but also to order expedited discovery, and both launched appeals. The Appellate Court agrees with defendants that expedited discovery should not have been ordered. Disclosure "in aid of arbitration" is permitted under New York law in "extraordinary circumstance;" however, the need must be evident and, here, there appears no showing that discovery as permitted under FINRA arbitration rules would not suffice for justice to be done. Interestingly, the Court does not deal with Plaintiffs' objection to the timeliness of part of Defendants' appeal, relating to the trial court's stay of arbitration pending discovery, until it has decided the substantive issues. At that point, the Court agrees that the appeal of the stay was untimely, but, in light of the decision reversing the order of expedited discovery, a stay of arbitration would be unwarranted. The Court, therefore, vacates the stay of arbitration. (SLC Ref. No. 2013-04-03)

Baker v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 108492/2011 (N.Y. Sup., NY Cty., 3/9/12). **Award Challenge * Arbitrator Misconduct * FAA (§10 "Pertinent & Material") * Confirmation of Award * Damages Calculations * Expert Testimony/ Opinions (Expert Exclusion) * Sanctions (Baseless Challenge) * Arbitra-**

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tion Record * Evidentiary Issues/ Standards (Admissibility). *Sleeping on the part of an arbitrator may be grounds for vacatur, but to establish prejudicial misconduct, the proof of "habitual" sleeping must be clear and convincing and rise to a level of fundamental unfairness.*

John Baker, Natalie Baker and John Baker, as personal representative of the Estate of Harriet Baker, won an award of $880,000 in FINRA Arbitration (ID #09-06762), but when they moved to confirm, they were met with a motion to vacate by Merrill Lynch. The Court explains that Petitioners' claims in the underlying arbitration "relate to respondent's management of petitioners' investments in the Merrill Lynch Phil Scott Team Income Portfolio." After a sharp decline in value starting in 2007, the Bakers were advised to stay the course, but they liquidated their share in the Portfolio in March 2009. Respondents demonstrated that staying the course would have led to a profit for the Bakers of $1.25 million. Petitioners' real claim, though, was that the Portfolio was unsuitable for them, as it was concentrated in equities, and their entire liquid net worth was involved. The case took 18 hearing sessions, but Merrill Lynch's objections aver that the evidence adduced was restricted unfairly by the Panel and that documents and testimony relating to the Bakers' subsequent investment profile, expert opinion on the hold recommendation, and the Portfolio's later performance should have been admitted. Merrill also tests the proposition that "habitual sleeping" on the part of one of the Panel's Arbitrators constituted misconduct. Case law, the Court begins, holds that panel rulings on evidentiary matters are "largely unreviewable." The burden of proving prejudicial misconduct rests with the movant and "a barely colorable justification" supporting the exclusion ruling will frustrate vacatur. Arbitrators have the authority to refuse to hear evidence that is deemed to be of little relevance, so any exclusion of evidence must be shown to be fundamentally unfair. The evidence here does not leave the Court persuaded in any way that Merrill was deprived of a fair hearing. Moreover, sleeping does not rise to a vacatable offense, at least when the proof is not clear and convincing of habitual disregard and no objections were voiced. While Petitioners' proofs fail, the Court does not find the allegations so meritless as to warrant sanctions.

(ed: In the course of eighteen months, we have seen three Awards dealing with the Phil Scott Team and each has resulted in a big-dollar award with a total take of about $4 million. See also, Mirabelli v. MLPFS *(FINRA ID #10-3400) and* Courturier v. MLPFS *(FINRA ID #11-00867). Common to all three Awards was Claimants' representation by, among others, Barry R. Lax, Lax & Neville, New York, NY.)* (SLC Ref. No. 2013-06-01)

Branch v. Ottinger, No. 11-14807, 477 Fed. Appx. 718 (11th Cir., 7/1/12). **Arbitrability * Agreement to Arbitrate * FAA * Contract Formation (Non-Signatories) * Contract Enforceability (Equitable Estoppel) * Appealability (Preservation of Issues) * Stay of Litigation * Standard of Review (*De Novo*; Abuse of Discretion).** *A court does not abuse its discretion in refusing to stay litigation of non-arbitrable claims after ordering other claims in the same action to arbitration, where the non-arbitrable claims are independent of the arbitrable claims.*

This decision considers whether a court may compel arbitration against a non-party to an arbitration agreement or, in the alternative, stay proceedings of non-arbitrable claims pending litigation of arbitrable claims. Plaintiffs K. Craig and his children filed suit in the Northern District of Georgia against several parties, including John Ottinger, asserting claims under federal and state securities laws and state tort law in

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connection with a series of purported fraudulent securities transactions. The district court dismissed the claims against the other defendants pursuant to a valid arbitration agreement. Thereafter, Plaintiffs filed a motion to compel arbitration of claims against Ottinger or, alternatively, stay proceedings against him pending completion of the arbitration against other defendants who had been compelled to arbitrate. Plaintiffs argued that, while Ottinger was not a signatory to the arbitration agreement with the other defendants, he should be compelled to arbitrate claims nonetheless since the issues were "virtually indistinguishable" from his co-defendants. The Plaintiffs also claimed that equitable state law principles required such a determination. The district court rejected Plaintiffs' arguments, concluding that the non-arbitrable claims against Ottinger were independent of the arbitrable claims and that the outcome of Plaintiffs' non-arbitrable claims against Ottinger were not contingent on the arbitrator's decision in the proceeding against the latter's co-defendants. Citing to *Klay v. All Defendants*, 389 F.3d 1191 (11th Cir. 2004), the Eleventh Circuit reaffirms that, as a matter of basic policy, "where the parties have not agreed to arbitrate, a court cannot compel them to arbitration." *Klay*, 389 F.3d at 1200. In addition, the Court observes, the district court properly acted within its discretion in refusing to stay proceedings of non-arbitrable claims, given that the claims against Ottinger are independent of the arbitrable claims against co-defendants. Accordingly, the Eleventh Circuit affirms.

(B. Wiand) (EIC: We summarized three decisions in this case by the district court in SLA 2012-28.) (SLC Ref. No. 2013-03-01)

Domnarski v. UBS Financial Services, Inc., No. 12-30139 (D. Mass., 1/23/13). **Award Challenge * Employment Dispute (Promissory Note) * Timeliness Issues (Statutes of Limitations) * Confirmation of Award * FAA (§ 10 "Procured by Fraud" & 12) * Notice Requirements * Representation Issues * Arbitration Agreement (Incorporation by Reference) * SRO Rules (FINRA Code 13300) * Tolling Principles (Equitable Tolling) * Statutory Definitions ("Undue Means").** *By agreeing to arbitrate before FINRA and pursuant to the FINRA Code, the parties incorporated FINRA's procedural rules into their agreement.*

Broker Nicole Domnarski began employment with Defendant UBS in November 2008 and terminated in August 2011. During her employment, she received two Employee Transition Program loans and UBS sought to recover a portion of those loans, in the amount of 126,422.58, when she left. Through her attorney, Plaintiff objected to any repayment obligation, but agreed to arbitration. The attorney further instructed that future communications should be directed to her, not Plaintiff. That was in September 2011. UBS served the underlying FINRA Statement of Claim on Plaintiff in January 2012. Despite several notices from FINRA seeking an Answer, Ms. Domnarski did not respond and her attorney did not make an appearance. Two weeks after FINRA notified Plaintiff of the Arbitrator's selection, the Award issued, granting UBS' prayer for relief in the amount requested, plus $300 in costs (FINRA ID No. 12-00096 (On Papers, 4/24/12). FINRA sent the Award by express mail on April 27 and her attorney received it on May 1. Plaintiff's motion to vacate was filed on July 31. In her petition, she claims that Defendant's failure to notify FINRA that she was represented by counsel was fundamentally unfair and constituted "corruption, fraud, or undue means" under Section 10(a)(1) of the Federal Arbitration Act. Defendant opposes the motion, cross-moving to confirm, and further objects on timeliness grounds. FINRA Rules are incorporated into the arbitration agreement at bar by reference to FINRA in the agreement. FINRA Rule 13300 provides that the Award is served on the date of mailing, which was April 27. Section 12 of the FAA provides that a motion to vacate be served within three months of the date the Award is "filed or delivered." Thus, the Court calculates, Plaintiff's petition was filed at least four days late. Finding no precedent – or any offering from Plaintiff – that would excuse any lateness in filing. Plaintiff does ask that the limitations period be tolled, but the Court finds inadequate justification for tolling. "Plaintiff (and her attorney) had more than adequate time to file the instant motion but failed to do so," the Court concludes. Timeliness aside, Defendant did not procure the Award by fraud, as charged. UBS complied with the FINRA Code by sending its Statement of Claim to FINRA and not to opposing counsel. FINRA sent multiple reminders when Plaintiff-Claimant did not respond. Due diligence would anticipate that Plaintiff would have timely forwarded the arbitration materials and communications to counsel; Plaintiffs' reasons for not acting do not in any way equate to fraud or undue means. The motion to vacate is denied and, pursuant to Section 9 of the FAA, the Award is confirmed.

(ed: SLC thanks to Jim Komie, a member of our SLC Board of Contributing Legal Editors and Partner of Schuyler, Roche & Crisham, PC, Chicago, for alerting us to this decision. Mr. Komie's Partner, Dave Sullivan, represented UBS in the underlying arbitration and in the post-Award proceedings.) (SLC Ref. No. 2013-04-01)

Fisher v. Wells Fargo Advisors, LLC, No. 12-1413-CM (D. Kan., 12/17/12). **Award Challenge (Arbitrator Misconduct) * FAA (§§ 9, 10) * Motion Practice Issues * Discovery Issues * Sanctions (Vexatious Conduct) * Federal Statutes Interpreted (28 U.S.C. § 1927).** *The party seeking to vacate an arbitration Award bears the burden to show that one of the limited grounds for setting aside the award as set forth in the FAA § 10 is met, which is a heavy burden.*

This decision following removal concerns defendant's motions to confirm an arbitration Award and for entry of judgment. The arbitration Panel entered an award in favor of defendant and against plaintiff in the amount of $48,172, plus 10% interest per annum, attorneys' fees and costs, offsetting an award for plaintiff ($739.3k) by an award for defendant ($691.1k) (FINRA ID #11-01681 (Wichita, 8/27/12). Plaintiff

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initially filed the case in the District Court of Finney County, Kansas, urging vacatur due to the Panel's prejudicial misconduct before and during the hearing of the case. He does not discuss actual misconduct by the Panel, but rather discovery decisions that plaintiff believes were erroneous. Defendant filed an answer to plaintiff's application and requested confirmation. Plaintiff failed to timely respond to the motion for confirmation and failed to respond to the Court's order to show cause why the motion should not be granted as unopposed. The Court could consider defendant's motion uncontested pursuant to D. Kan. Rule 7.4(b); however, in the interest of justice, the Court considers the content of plaintiff 's motion to vacate when evaluating the merits of defendant 's motion for confirmation. Under the FAA, which governs this dispute, a request for confirmation of an arbitration Award under 9 U.S.C. § 9 is intended to be summary: courts may only deny confirmation if an award has been corrected, vacated or modified in accordance with FAA § 9. FAA § 10 permits vacatur in only four circumstances: where the award was procured by corruption, fraud or undue means; where there was evident partiality or corruption in the arbitrators; where the panel was guilty of misconduct in refusing to postpone the hearing or in refusing to hear pertinent evidence; or where the arbitrators exceeded their powers. A handful of judicially created reasons also justify vacatur, including public policy violations, manifest disregard of the law and denial of a fundamentally fair hearing. The Tenth Circuit has emphasized this limited review standard, affording arbitration panels maximum deference. In his application, plaintiff asks the Court to vacate the Award, because the Arbitrators exceeded their powers under FINRA Rules and conducted the hearing so as to substantially prejudice the plaintiff's rights. Many of plaintiff's complaints center on defendant's conduct, not that of the Panel. Even if the Court assumes that the Panel erred in allowing defendant to present certain documents, such error did not deprive plaintiff of a fundamentally fair hearing (though he claims that certain documents were not produced during discovery). Defendant asks the Court to sanction plaintiff's counsel for seeking vacatur. When an attorney unjustly multiplies proceedings by seeking to vacate an Award on a "completely meritless" basis, he may be subject to sanctions; 28 U.S.C. § 1927 provides that an attorney who multiplies the proceedings unreasonably and vexatiously may be required to satisfy personally the excess costs, expenses and attorneys' fees reasonably incurred due to such conduct. Subjective bad faith is not a necessary showing for the application of § 1927 sanctions. The Court finds that plaintiff's counsel has not relentlessly pursued this case and has all but abandoned the cause. An absence of merit does not automatically equate to intentional or reckless disregard of the attorney's duties to the Court. The Court declines to impose sanctions.
(S. Anderson) (SLC Ref. No. 2013-02-02)

Fry v. Phillips & Company Securities, Inc., No. 2012 AP61 (Wis. App., 3 Dist., 11/14/12). **Agreement to Arbitrate * Contract Enforceability (Conspicuous Disclosure; Unconscionability/ Contract of Adhesion) * Forum Costs/Exorbitant Fees.** *An investment management agreement is found not to be an adhesion contract and thus not subject to the requirement that its arbitration clause be conspicuous.*
Plaintiff, a Wisconsin resident, filed suit against defendant Phillips & Company

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Securities, Inc. after suffering investment losses. Plaintiff also sought to void the arbitration clause in the investment management agreement he signed with Defendant. Defendant cross-moved for an order compelling arbitration, which the trial court granted. On appeal, the trial court's ruling is affirmed. Under Wisconsin law, certain provisions in a contract of adhesion must be printed so that they are conspicuous. While the arbitration clause – which was in a separately numbered paragraph – was most likely sufficiently conspicuous, the Court does not reach that issue because the investment management agreement is not a contact of adhesion. It was not forced upon plaintiff, nor was he in a position where he had little choice but to accept its terms. To the contrary, he willingly decided to do business with defendant, a firm based in Oregon, rather than use a local investment firm, and the investment management agreement reserved substantial authority to him, including the ability to terminate it. Neither were the investment management agreement or its arbitration clause procedurally unconscionable; Plaintiff was not forced to enter into the agreement and he was in a position, both by reason of education and economic status, to make an informed and free decision. Nor does the arbitration clause meet the high standards for a finding of substantive unconscionability, merely because it specifies that the arbitration take place in Oregon and authorizes an award of fees to the prevailing party. The trial court's order compelling arbitration is affirmed. *(J. Komie)* (SLC Ref. No. 2013-03-02)

J.P. Morgan Securities, Inc. v. Louisiana Citizens Prop. Ins. Corp., No. 10-2517, 712 F. Supp.2d 70 (S.D. N.Y., 5/3/10). **Statutory Definitions ("Customer"; "Business Activities") * Underwriting Issues (Issuer Litigation) * Liability Issues (Issuer-Underwriter) * Product/Sales Practice Issues (ARS: Auction Rate Securities) * Injunctive Relief (Arbitration Stay) * Venue Issues (Hearing Location) * Arbitrator Authority, Scope of (Situs) * SRO Rules (FINRA Rule 12200 & 12213) * Staff Interpretations, Effects of * FAA (§4).** **A securities issuer for whom a FINRA member serves as an underwriter is a "customer" within the meaning of FINRA Rule 12200. **Where FINRA has decided to arbitrate a claim in a particular situs, a motion to compel arbitration must be brought in the district in which the situs is located.*

Both Bear Stearns and J.P. Morgan Securities (JPMS) were named in a FINRA Arbitration by Louisiana Citizens Property Insurance Corp. in its capacity as an issuer of auction rate securities. In 2006, Citizens issued $1 billion in bonds that were sold by Plaintiffs acting as co-lead underwriters. The bonds were issued as municipal securities and $300 million of the bonds were sold as auction rate securities (ARS) and the rest as fixed-rate bonds. The arbitration concerned the ARS component, as the interest rate LCPIC was required to pay on these bonds soared to 14%, when the rate-setting auctions failed in 2008. Citizens was partially covered by derivatives transactions put into place in 2006 with Chase and Bear Stearns, but that hedge protection was insufficient to protect Citizens entirely from the surge. Citizens reacted by refinancing the bonds in April 2009 as fixed-rate securities, but it suffered excess interest payments in the interim. In the FINRA arbitration, it also seeks its refinancing costs, the extra interest it will have to pay on the new bonds, versus what Plaintiffs promised, and return of the commissions and fees it paid Plaintiffs in connection with the issuance of, and the auctions for, the ARS bonds. The arbitration proceeding, FINRA ID #09-07085, was filed in December 2009 and FINRA has set the hearing location as New Orleans. Nevertheless, the Court assumes jurisdiction over this injunctive action, when Plaintiffs move to stay the arbitration. They claim that Citizens, as an issuer with whom they contracted as underwriters, is not a "customer" of JPMS or Bear Stearns and that there is, therefore, no agreement obliging them to arbitrate. The Court examines Third Circuit precedent holding that an issuer may be considered a "customer." That decision, *Patten Securities v. Diamond Greyhound,* dealt with NASD Rules and

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the language of the applicable provision has since changed, but the Court still deems it "the most compelling evidence" of whether issuers are viewed as "customers" under FINRA Rule 12200. It also views the rule allowing customers to demand arbitration unilaterally as one of "inclusion, not exclusion" and, following Second Circuit instructions to resolve any ambiguity about the scope of the "customer" definition in favor of inclusion, the Court holds that "an issuer is a customer of an underwriter." The "nub" of Citizen's claim is that Plaintiffs failed to warn it that the auction process would fail without the supporting "blanket bids" placed by Plaintiffs until the auction freeze in 2008. That theory of liability "relates directly" to Plaintiffs' role as co-underwriters and are, thus, part of the "business activities" of the two broker-dealers. Thus, an agreement to arbitrate exists, in the Court's view, which is sufficient to deny injunctive relief. The Court, however, declines to compel arbitration under Section 4 of the Federal Arbitration Act, as FAA §4 requires arbitration to proceed in the district (New York) in which the petition to compel is granted. Issuing an order compelling arbitration would contravene FINRA's determination to arbitrate in New Orleans. If arbitration must be compelled, Citizens will have to petition for an order in Louisiana federal court. *(ed: Brokerage firms have made it a habit recently to challenge institutions that seek arbitration as "customers" of the firm, presumably from a conviction that they will be better off in court. That assumption was clearly wrong in this case. Here, the dispute ultimately did proceed to an Award, which issued in September 2011, and Citizen's claims for $3.6 million in damages were dismissed in their entirety.)* (SLC Ref. No. 2013-01-01)

Keller v. ING Financial Partners, Inc., No. 2011-193026 (S.C. App., 1/9/13). **Arbitration Agreement (NASD v. FINRA) * Contract Enforceability (Impossibility) * Forum Selection Issues (Non-Availability) * Choice of Law (Iowa vs. SC) * FAA (§5) * Choice of Forum.** *A court is not empowered under federal or Iowa law to compel arbitration at FINRA, when the exclusive forum cited in the agreement to arbitrate is NASD.*

The parties to this dispute contracted for arbitration, but selected as the exclusive forum, NASD. As NASD no longer existed at the time Plaintiffs brought this action, ING was unable to persuade the lower court to compel arbitration at the successor forum, FINRA. Without explaining why (presumably because Iowa was the governing law choice in the container agreement), the Appellate Court interprets the law of Iowa on arbitration. It acknowledges that FINRA is the successor to NASD. It acknowledges as well that the Federal Arbitration Act, Section 5, provides a procedure for selecting an alternative forum when the chosen forum fails. Still, the agreement said NASD, NASD rules required arbitration before NASD itself if NASD were named in the agreement, and courts have generally conformed to that construction of the rules. In the Court's view, it "cannot rewrite the parties' agreement to substitute FINRA for NASD. Neither Iowa state nor the Eighth Circuit Court of Appeals have [sic] decided whether a court may substitute an arbitral forum when a designated forum has become unavailable to arbitrate." It reads Second Circuit precedent as construing Section 5 restrictively and holding that it does not apply when a specifically designated arbitrator becomes "unavailable" to arbitrate. The provision is more mechanical than that, designed for those situations where parties are dilatory in naming an arbitrator or filling a vacancy and judicial assistance is needed. No such "mechanical breakdown" has occurred here; the selected forum simply does not exist. "Regardless of any similarities between NASD's and FINRA's procedural rules, therefore, we cannot impose upon the parties the power of an arbitral forum that they did not agree to submit to." The Court affirms the denial of arbitration by the trial court. *(ed: *Happily, the Court labels this decision "not precedential," but one can still reasonably project that agreements appointing NASD only are no longer enforceable in SC (Iowa will presumably not adhere to this ruling). **The decision certainly suggests, tactically, that firms must revise their agreements to*

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acknowledge the change in forum name; it also suggests that an alternate forum should generally be included in account agreements to ensure enforceability.) (SLC Ref. No. 2013-05-02)

Longfield v. Financial Technology Partners L.P., No. 103204/12, 2012 NY Slip Op 32885 (N.Y. Sup. Ct., N.Y Cty., 12/6/12). **Award Challenge (Irrationality/Rational Basis) * Confirmation of Award * FAA * Employment Disputes * Manifest Disregard of Law * State Statutes Interpreted (NY CPLR §7511(b)) * Sanction Powers (Judicial) * Termination Issues * Compensation Issues * Collection/Debtor Issues.** *In a vacatur proceeding decided under New York law, an Award is not wholly irrational and has a colorable basis where it is supported by contractual language.*

In January 2008, Respondent Financial Technology Partners, LP,, an investment bank, hired Petitioner Tina M. Longfield as a Managing Partner. An employment agreement executed by the parties provided that Longfield's employment was at-will; that she was to receive an annual base salary and a "Minimum Bonus" to be paid out incrementally over the course of 2008; and that, in the event that Longfield resigned from the firm for an "Acceptable Reason" or that the firm terminated her for any reason other than for Cause, she would receive her 2008 Minimum Bonus prorated for that portion of the year during which Longfield had been an employee of the firm; additionally, under the terms of the agreement, the firm had the right to prior notice of Longfield's voluntary resignation as well as the right to try to cure whatever "Acceptable Reason" was causing Longfield to want to resign. The Employment Agreement also provided that, if Longfield were terminated for "Cause," she would be obligated to reimburse the firm for any of the Minimum Bonus payments received thus far. Finally, the agreement set forth definitions of "Cause" and of an "Acceptable Reason" for resignation. In September 2008 a senior executive at the firm contacted Longfield while she was on a vacation, directing her to return immediately to the office due to business affairs. Rather than return, however, Longfield forwarded the executive what the court describes as a "rather long and rambling e-mail," expressing her extreme dissatisfaction with the firm. While her e-mail did not expressly convey her resignation, Longfield did relate certain points implying her resignation. The e-mail made no reference to the firm's opportunity to cure any of Longfield's concerns. Subsequently, FTP terminated Longfield for "Cause," citing her insubordination in refusing management's directive to return to work, and, concluding that she did not resign for an "Acceptable Reason," demanded repayment of the bonus payments she already received for that year. The Arbitrator concluded that Longfield resigned her position when she submitted her September 2008 e-mail, but failed to allow the firm its contractually mandated opportunity to cure. The Arbitrator also found that the firm had cause to terminate Longfield for Cause, due to her insubordination, and ordered her to repay the firm $233,750 (the bonus payments received during 2008). Longfield seeks the vacatur of that portion of the Award granting payment to the firm, arguing that the Arbitrator made a specific finding that she had resigned; therefore, she maintains it was "manifest disregard of the law" for the Arbitrator to conclude that she had been terminated for Cause. The Court disagrees, finding that the Award was not "totally irrational" and had a "colorable" basis in the language of the Employment Agreement. In sum, the Court maintains, the Arbitrator appropriately found that Longfield could not avoid the effect of her insubordination and keep her bonus payments.

(N. Sorkin) (EIC: The decision mentions FINRA, but does not specifically state that FINRA sponsored the arbitration; in any case, FINRA has not published an Award in the names of these parties.) (SLC Ref. No. 2013-03-03)

Morgan Keegan v. Rote, No. 650505/2012 (N.Y. Sup., N.Y. Cty., 11/30/12). **Award Challenge * State Statutes Interpreted (NY CPLR §§302, 3211 & 7501) * Venue Issues * Jurisdiction Issues (Case/Controversy; Personal; Extraterritorial; Minimum Contacts) * Constitutional Issues (Due Process) * Arbitration Agreement (SRO Requirement) * Contract Formation (Acquiescence).** *A merely tenuous connection with New York is not sufficient to subject non-residents to the jurisdiction of New York courts.*

In 2002, the Rotes, residents of Memphis, Tennessee, began investing in RMK Funds through broker-dealer Morgan Keegan, located in the same city. The account opening documents contain a choice of law provision, requiring Tennessee and federal law to apply to any disputes and an arbitration agreement requiring arbitration before FINRA, the NYSE or other securities exchange. In 2009, the Rotes filed a FINRA arbitration against Morgan Keegan, seeking damages for the loss in value of their holdings in the RMK Funds. FINRA scheduled the hearing in Memphis, but, at the end of the first week, the Arbitrators, who were all from the New York area, proposed moving the hearing location to New York and all parties agreed. After additional sessions in the new situs, the Panel awarded damages of $400,000, listing the hearing site as Memphis (FINRA ID #09-03437, issued 2/17/12). Morgan Keegan moved to vacate the Award in New York County court, asserting personal jurisdiction over the Rotes under CPLR 302(a), New York's long-arm statute, and CPLR 7501, because the Rotes agreed to participate in the hearings there, and the latter moved to dismiss on the ground that their consent to the Arbitrators' request did not alter the official site of the arbitration and did not constitute sufficient contacts to give the state jurisdiction. The Court finds no agreement to arbitrate in New York and CPLR 7501, accordingly, unavailing. FINRA designated Memphis as the official hearing site and the parties agreed to arbitrate there. The fact that several days of arbitration took place in New York did not alter the parties' agreement or change the official hearing location. Under CPLR 302(a)(1), a court may exercise personal jurisdiction over a non-domiciliary defendant if its New York activities were purposeful and there

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is a substantial relationship between the transaction in the state and the claim asserted; but not all purposeful activity constitutes a "transaction of business" within the meaning of CPLR 302(a)(1). Due process standards require the non-domiciliary to have minimum contacts with the forum state "such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice." Physical presence alone is not enough; the Rotes' presence in New York was incidental to the Tennessee arbitration and was merely for the convenience of the Arbitrators. Ruling this tenuous relationship to New York insufficient to give it personal jurisdiction over them, the Court grants the motion to dismiss and denies the motion to vacate as moot.

*(S. Anderson) (EIC: *These RMK disputes are playing out now, but there were hundreds of such claims. We recall a story about one Memphis Arbitrator sitting on nine RMK cases in the course of a year. To deal with the situation, FINRA had to call in arbitrator recruits from other jurisdictions. ** We saw no mention in the Award (FINRA ID #09-03437, dtd. 2/17/12) of hearings being moved to NYC. ***Query whether Morgan Keegan's brief time to file a vacatur proceeding in Tennessee will be tolled, in consideration of the time spent pursuing this action in New York.)*

Morgan Stanley & Co., Inc. v. Druz, No. A-0076-10T1 & A-2256-10T1 (N.J. App., 1/8/13). **Re-Litigation Issues * Award Challenge * Confirmation of Award * Arbitrability (Non-Arbitrable Dispute) * Scope of Agreement (Malicious Prosecution; Abuse of Process) * Injunctive Relief * Res Judicata/Collateral Estoppel (Entire Controversy) * Arbitration Record (Transcript) * Privileges/Immunities (Work Product) * Waiver (Privilege) * Arbitrator Misconduct (Material & Pertinent Evidence) * SRO Rules (Rule 13200).** *An arbitration claim that essentially argues that a prior arbitration decision was procured by fraud does not fall within the agreement to arbitrate between industry parties under FINRA Rule 13200.*

From employment with Dean Witter, a Morgan Stanley predecessor, that lasted for six years and ended in 1987, a series of litigations – ranging from arbitrations to regulatory actions to criminal indictments and civil lawsuits – have plagued the participants in this affair for more than two and a half decades. During that time, Mr. Druz has been disciplined by the NYSE and criminally indicted, while Morgan Stanley and its predecessor have been the subject of monetary awards to their former employee exceeding a half million dollars. That amount probably dwarfs the legal fees expended, as there have been, along the way, at least three arbitration proceedings, a NYSE investigation, a State grand jury indictment, arbitration stay proceedings in both state and federal court, Award challenges in state court, and numerous appeals, including this one. The current appeal, initiated by Mr. Druz, consolidates two state court actions that alternately rejected an Award challenge to the arbitration that Mr. Druz lost and that enjoined him from pursuing a third arbitration against members of the Morgan Stanley legal department. The Law Division or lower court decided that the third arbitration (Druz III) was an attempt to challenge as fraudulently procured the dismissal in the second arbitration (Druz II) and, as it no longer related to Druz's employment, it fell outside the scope of the arbitration agreement between the parties. The lower court also rejected Mr. Druz's theory that Druz II was procured by fraud and it rejected a discovery challenge that had denied Mr. Druz a copy of the transcript of proceedings. Based on these findings, the Law Division imposed injunctive relief that stayed Druz III and prevented any further actions by Mr. Druz seeking to vacate or "re-arbitrate" Druz II. The Appellate Division, Superior Court, affirms on all counts, praising the reasoning of the lower court and relying in good part upon its conclusions. Morgan Stanley paid for the stenographic record during Druz II and used it for preparing the next day's defense. Thus, the lower court was correct in deeming the transcript work product and not permitting access by Mr. Druz. That counsel for Morgan Stanley cited portions of that transcript to the Panel did not constitute waiver of the privilege. Finally, Mr. Druz had a recorded transcript of proceedings – the official record – and could not demonstrate hardship or prejudice. On the evidentiary decisions made by the Druz II Panel, the Court agrees on one point after the other with the trial court and concludes, as it did, "We are unconvinced that the arbitration panel refused to consider evidence material to the controversy so as to substantially compromise appellant's rights" or that it ignored "overwhelming evidence of the claims of fraud" and false testimony by Respondents and its witnesses. The Appellate Court then turns to Druz III and the trial court's finding that it was a non-arbitrable dispute whose purpose was to challenge a prior final arbitration Award as procured by fraud. "We find the court's reasoning sound," the Court signals in agreement. FINRA Rule 13200 requires arbitration of disputes arising out of the business activities of members or associated persons. Appellant argues that his claims, because they are similar to those made in Druz II, must be arbitrable; Respondents in Druz II agreed to arbitrate without objection. In Druz III, the parties are different, so *res judicata* cannot apply. Respondents' argument, which the Court accepts, does not rely so much on *res judicata*, as it does on the idea that Druz III does not relate to the employment relationship, but to a challenge of Druz II. To permit that would allow arbitrating parties to re-argue their claims in following arbitrations and end-run the vacatur process. That would frustrate finality, a chief attribute of arbitration. Consequently, the grant of injunctive relief was warranted and appropriate.

*(ed: *Mr. Druz is a lawyer, so ethical investigations were also among his travails – they ended successfully, according to a Third Circuit decision we covered in SLA 2004-41. Two other of the many prior decisions in this matter were issued by the Third Circuit and we summarized them at SLAs 2003-11 and -40. Among the arbitration proceedings were two Awards, FINRA ID #99-00155 & NYSE ID 2005-016092. The latter,*

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which issued in April 2007, awarded Mr. Druz $551,450 in compensatory damages.) (SLC Ref. No. 2013-02-03)

Peyser v. Kirshbaum, No. 12 Civ. 2857 (KBF) (S.D. N.Y., 12/11/12). **FAA (§§ 2-4) * Arbitrability * Agreement to Arbitrate * Arbitration Agreement (SRO Requirement) * SRO Rules (FINRA Rule 12200) * Supervisory Duties * Statutory Definitions ("Customer") * Product/ Sales Practice Issues (Ponzi Scheme).** ** An agreement to submit to arbitration an existing controversy shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. **A broker-dealer who permits its agent to service an account thereby agrees to arbitrate a claim regarding the agent's conduct in handling the account.*

Petitioner Robert Peyser ("Peyser") sought to compel respondents Lawrence Kirshbaum ("Kirshbaum") and Prestige Financial Center, Inc. ("PFCI") (collectively "Respondents") to participate in a FINRA arbitration. Peyser alleged that Respondents were responsible for their failure to properly supervise and control their former broker, Michael Ligouri ("Ligouri"), who serviced and marketed a Tax-Advantage Stock Loan ("TASL") in which Peyser participated, thereby failing to discover that some of those investments involved a Ponzi scheme. Peyser initiated an arbitration before FINRA, naming Respondents and a long list of broker/dealers and other intermediaries who allegedly failed in their fiduciary obligations to discover the Ponzi scheme. When Respondents did not submit to the FINRA arbitration, Peyser filed an action to compel Respondents to arbitrate. Respondents did not appear in the district court matter. The Court grants the motion. The Federal Arbitration Act ("FAA") applies where a "written provision in . . . a contract evidencing a transaction involving commerce" states that the parties will "settle by arbitration." 9 U.S.C. § 2. There is a strong federal policy in favor of arbitration under the FAA. On a motion to compel arbitration, once the threshold of applicability of the FAA is satisfied, the moving party must show that: 1) there is a valid agreement between the parties to arbitrate disputes; and 2) the dispute falls within the scope of the arbitration agreement. Peyser submitted sufficient evidence of a valid arbitration agreement. In the absence of a written agreement, Rule 12200 of FINRA's Code of Arbitration Procedure ("Code") provides that an arbitration "agreement" exists and is valid if the dispute is between 1) a FINRA "customer" and 2) a FINRA "member" or "associated person," and 3) "arises in connection with the business activities of the member or the associated person." There was no dispute that PFCI was a FINRA member during the relevant time period and that Kirshbaum was an associated person. Although Peyser did not allege a contractual relationship with PFCI, he did allege that he was a customer of PFCI for purposes of the Code on account of his dealings with PFCI's agent, Ligouri. The Court agrees that a person may be considered a customer of a FINRA registrant where that person is involved in a business relationship with the registrant's agent. *Oppenheimer & Co., Inc. v. Neidhardt,* 56 F.3d 352, 357 (2d Cir. 1995) (noting that acts of agent were imputed to member). Therefore, Respondents are parties to a valid agreement to arbitrate. In addition, the Court is satisfied that the dispute falls within the scope of the FINRA arbitration agreement. By permitting Ligouri to service Peyser's TASL, Respondents agreed to the arbitration of claims against them regarding Ligouri's conduct in the course of his employment. As a result, Peyser's claims are within the scope of the FINRA arbitration agreement – namely a "dispute . . . between a customer and a member or associated person of a member; [that] . . . arises in connection with the business activities of the member or associated person." FINRA Arb. R. 12200. The Court grants Peyser's motion to compel arbitration.

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(P.Michaels)(EIC: Claimants generally rely upon the Arbitrators to find jurisdiction over named Respondents, so we are wondering what prompted the decision to secure the court order. In the right circumstances, this could prove a prudent move, even an inspired one, as having the order in hand places Claimant in a far better tactical position with Defendant-Respondents, the Arbitrators, and with the courts in a post-Award setting.) (SLC Ref. No. 2013-01-02)

State of Washington DOT v. James River Insurance Co., No. 87644-4 (Wash. Sup. Ct. (*en banc*), 1/17/13). **Insurance Issues * Arbitrability * Federal Statutes Interpreted (McCarren-Ferguson Act) * FAA (§2) * State Statutes Interpreted (RCW 48.18.200 & 48.15.150) * Forum Selection Clause * Preemption, Federal.** *McCarran-Ferguson protects an anti-arbitration state statute from FAA preemption, because its prohibition of arbitration clauses in insurance policies constitutes the regulation of the "business of insurance."*

In this decision, the Washington Supreme Court, sitting *en banc*, considers the question of whether insurance companies may include pre-dispute arbitration clauses in their agreements with policyholders and the surprising answer is that they may not. The Plaintiff in this case is a state agency, the Washington Department of Transportation (WSDOT), but its standing to claim, which depends upon a bond undertaken by a construction contractor that failed to perform, does not implicate WSDOT's status as a governmental entity. Rather, the Court's position relies upon state law, which prohibits any agreement in insurance contracts that deprives the state courts of jurisdiction. James River argues that the law should not be interpreted to preclude arbitration clauses, as it does not specifically mention arbitration clauses. WSDOT also argues that the federal insurance statute, McCarran-Ferguson, trumps the FAA in protecting state regulation of insurance from federal preemption. Arbitration clauses prevent Washington policyholders from bringing original court actions against insurance companies that utilize them. James River's notion is that the Legislature intended to ban forum selection clauses that might designate foreign states and effectively displace Washington courts. The Court interprets the statute as WSDOT urges, finding that RCW 48.18.200's purpose is to assure the "protection of Washington law to Washington residents." Thus, the statute voids the pre-arbitration clauses in James River's insurance contracts. The remaining question is whether the FAA preempts this prohibition. It would, of course, if McCarran-Ferguson provides no shield, but if the statute were enacted "for the purpose of regulating the business of insurance, then the specific nature of that insurance statute will "reverse preempt" the FAA and "shield the statute from invalidation." U.S. Supreme Court precedent has described other Washington statutes as protected by McCarran-Ferguson, when "'aimed at protecting or regulating' the performance of an insurance contract." RCW 48.18.200 regulates the insurer-insured relationship directly by assuring the protection of Washington courts. Other jurisdictions have concluded that similar state insurance statutes prohibiting binding arbitration clauses in the insurance context "regulate the 'business of insurance,'" the Court observes. Thus, the Court concludes, RCW 48.18.200 is "shielded from preemption by the FAA under the McCarran-Ferguson Act." The motion to compel arbitration by James River was correctly denied by the trial court. *(ed: No similar statutory provision as McCarran-Ferguson exists in the securities world, so we see no real omnibus threat to brokerage PDAAs. However, we can see the possibility of some spill-over in an investor dispute that involves both securities and insurance products. A court might, in such an instance, refuse enforcement of the entire agreement as barred by McCarran-Ferguson and thereby deny arbitration of the securities side of the dispute, as well as the insurance side.)* (SLC Ref. No. 2013-03-04)

Tarrant v. Kovack Securities, Inc., No. 0:12-cv-60272-JIC (S.D. Fla., 3/23/12). **Award Challenge * Remedies (Punitive Damages) * State Law, Applicability of * Vacatur of Award.** *Awards containing an assessment of punitive damages must, under Florida law, observe certain procedural requirements.*

Behind the Award PDF that downloads when one enters "10-03532" in the "Docket Number Search" page on the ARBchek Homepage, www.arbchek.com, is a copy of this Court's vacatur Order. Despite the arbitration hearing situs being located in another state (Atlanta, GA), the law applied by

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the Panel in awarding $100,000 in compensatory damages and $200,000 in punitive damages was Florida state securities and common law. According to the allegations, as reported in the Award, Claimant was solicited by his Kovack broker to invest in a real estate project and, for that purpose, securities in his account, including an annuity, were sold to "fund a loan made to Claimant's broker." Pursuant to a joint motion of the parties, the Court vacates the FINRA Award and dismisses all of the claims in the case with prejudice. In its vacatur motion, Kovack alleged that the award was a product of evident partiality, that the Panel exceeded its authority under both state and federal law, and that procedures required by Florida law for the issuance of awards of punitive damages were not observed by the Panel. The parties agree, the Court relates, that grounds for vacatur "exist in the form of the Award" and, based upon this, the parties have agreed to the Court's issuing the instant Order.

*(ed: *The underlying Award contained an explanation by the Arbitrators and was highlighted in a recent edition of SAC's "Securities Awards Monthly" newsletter, 2012 SAM, #2. **SAC also takes note of vacaturs in our reporting of Awards – any pre-hearing or post-Award litigation of which we are aware will be noted with "PHL" and "PAL" designations in the relevant Award record and displayed prominently through the "Remarks" field on ARBchek; in addition, a copy of our SLC summary of the court decision is made available to users through ARBchek's "Awards-Plus" section. ***The Tampa law firm of Wiand, Guerra & King represented Kovack Securities in the vacatur proceeding (not in the arbitration). Burt Wiand of WGK is a member of SLC's Board of Contributing Legal Editors.)* (SLC Ref. No. 2013-02-01)

Taylor v. Community Bankers Securities, LLC, No H-12-2088 (S.D. Tex., 12/19/12). **Arbitration Agreement * Breadth of Agreement (Third-Party Distributor) * Evidentiary Issues/Standards * FRCP (Rule 12(b)(6) "Claim for Relief") * Choice of Law (TX vs. VA) * Evidentiary Issues/Standards * F.R. Evid. (Rule 1004) * Receivership/ Trust/Estate.** *A party seeking to compel arbitration must introduce a copy of the arbitration agreement signed by the party he seeks to compel, in the absence of competent evidence that the actual agreements are unavailable and were not lost or destroyed in bad faith.*

Plaintiff Taylor was appointed receiver for Evolution Capital Advisors, LLC, ("Evolution"), a company which the SEC showed had perpetrated a Ponzi scheme through two offers and sales of secured notes (the "Notes") to members of the investing public (the "Noteholders"). Evolution sold the Notes using Defendant Community Bankers Securities, LLC ("Community") as its primary placement agent. Community then subcontracted with other brokers to offer the Notes to prospective investors, earning commissions and due diligence payments totaling $750,000.00. Taylor demanded disgorgement of the fees as fraudulent proceeds of a Ponzi scheme, but Community refused to comply. Taylor then brought an action against Community on behalf of the Noteholders to recover the Note Proceeds. Community moved to compel arbitration, arguing that the Noteholders had all signed arbitration agreements with their respective brokerage firms. However, the only evidence of this fact was an affidavit with one attached example of an arbitration agreement, presented by Community with the claim that all the Noteholders had signed similar agreements. The Court holds that this testimony is inadmissible under Federal Rule of Evidence 1004, because there was no showing that the actual agreements were unavailable, and were not lost or destroyed in bad faith. Because there is no competent evidence that the Noteholders were party to arbitration agreements, the motion to compel arbitration is denied. Community also moved to dismiss the receiver's claims, arguing that Virginia law should apply to those claims. However, Community failed to apply Texas's choice of law rules in a meaningful manner to the facts of the case. Similarly, in response, Taylor did not properly analyze the choice of law issue. The Court finds that the choice of law questions are complex and declines to rule on the issue without the benefit of proper briefing by the parties. The motion to dismiss is denied without prejudice. *(J. Ballard)* (SLC Ref. No. 2013-04-02)

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UBS Financial Services & Citigroup Global Markets v. Carilion Clinic, No. 12-2066 (4th Cir., 1/23/13). **Arbitrability * Agreement to Arbitrate * Arbitration Agreement (SRO Requirements) * FAA (§4) * SRO Rules (FINRA Rule 12200) * Statutory Definitions ("Customer") * Contractual Issues (Forum Selection Clause) * Competing Agreements * Scope of Agreement * Capital Formation Issues (Underwriting) * Product Issues (Auction Rate Securities) * Waiver (Arbitration).** *The Fourth Circuit concludes that "customer," as used in FINRA Rules, refers to one, not a broker or dealer, who purchases products or services from a FINRA member in the course of the member's investment banking and securities business activities.*

This case presents the question whether plaintiffs are required as members of FINRA to arbitrate disputes arising out of services provided to defendant in connection with its multi-million dollar bond issues. Plaintiffs recommended that defendant issue a large percentage of its bonds as auction rate securities (ARS) and purchase interest rate swaps to hedge against interest rate fluctuations on the bonds. ARS are long-term variable-rate instruments for which the interest rates are reset periodically through an auction process. The bonds are sold at the lowest interest rate at which they can be sold at par. If there are insufficient orders to purchase all the bonds, the auction fails and the interest rate jumps to a contractual maximum rate until the next auction. Defendant claims that plaintiffs served as underwriters and lead broker-dealers for the bonds, sold defendant interest rate swaps, acted as its agents in dealing with the rating agencies, conducted discussions with the bonds' insurers and provided monitoring and advisory services on the bonds and swaps. After the collapse of the ARS market in February 2008 forced it to refinance, defendant brought an arbitration before FINRA, claiming that plaintiffs misled it as to the true nature of the ARS bond market by failing to disclose that they had a practice of placing support bids to prevent failure of the auctions. Plaintiffs commenced this action to enjoin the arbitration, contending that defendant was not a "customer" within the meaning of FINRA Rule 12200, because its claims did not relate to a brokerage account or investor relationship, and that defendant waived any right to arbitration by agreeing to the forum selection clause in written agreements with plaintiffs. The district court rejected these arguments and plaintiffs appealed. This Court affirms. Plaintiffs are FINRA members and, under Rule 12200, must arbitrate disputes with customers on their request if the dispute arises in connection with the business activities of the member. FINRA Rules do not define the term "customer," but it retains its generally accepted meaning – "one that purchases a commodity or service" and is broader than simply one receiving investment and brokerage services. The Court concludes that "customer," as used in FINRA Rules, refers to one, not a broker or dealer, who purchases commodities or services from a FINRA member in the course of the member's business activities insofar as those activities are regulated by FINRA – namely, investment banking and securities business activities. Plaintiffs earned an underwriter's discount, part of which constituted a management fee for their assistance in structuring and managing the transaction and annual broker-dealer fees of 25 basis points in exchange for managing the ARS bond auctions. Plaintiffs contend that the forum selection clause in the broker-dealer agreements require litigation, but the Court finds a more natural reading of the clause to require that any litigation be brought in federal court in New York County, without a jury, not that the signatory is waiving arbitration.

*(S. Anderson) (EIC: *We summarized the district court opinion in SLA 2012-31. **This seems like a broader definition of "customer" than the Second Circuit adopted in the* WVU Hospitals *case, SLA 2011-37. There, a strong dissent insisted that an underwriter could not be a "customer" and the majority pinned their vote for arbitration on the non-underwriter services performed by UBS. ***It appears, from the decisions we have seen on the issue, that positing a forum selection clause as an implicit waiver of arbitration is a loser.)* (SLC Ref. No. 2013-05-01)

SAC's BULLETIN BOARD

Editor: The announcements below first appeared on SAC's online "Bulletin Board." They are e-published there upon receipt as a public service to the securities arbitration community. For more up-to-date information, we encourage readers to visit the online Bulletin Board in SAC's Research Center at www.sacarbitration.com for news about people and events relating to securities arbitration.

PEOPLE

Arbitration Resolution Services Inc., a cloud-based dispute resolution company, is pleased to announce the addition of **George Friedman, Esq.** to its Board of Directors. Mr. Friedman, an expert in arbitration in the United States, brings extensive industry experience to ARS. He has worked for the **American Arbitration Association** from 1976 to 1998, the last four years of which as the Senior Vice President. From 1998 through Januray 2013, Mr. Friedman worked for **FINRA** as its Executive Vice President and Director of Dispute Resolution. Mr. Friedman has also lectured extensively on the subject of alternative dispute resolution. He is the adjunct Professor of Law at the **Fordham Law School** in New York for which he has taught a course on commercial arbitration since 1996. He also published articles in the **New York Law Journal**, the **Rutgers Law Review**, and the **National Law Journal.**

Shustak Frost & Partners is pleased to announce that associate **Robert L. Hill** has been named partner of the firm, based in the **San Diego, CA** office. Mr. Hill's practice focuses on business and securities litigation and arbitration. He is also experienced with appellate matters, arguing before the California Court of Appeals on multiple occasions. To learn more about Mr. Hill and his various achievements, please visit **Shustak Frost & Partners'** website: www.shufirm.com.

ANNOUNCEMENTS

In August 2012, **Ethan A. Brecher** formed the **Law Office of Ethan A. Brecher LLC.** Mr. Brecher has been practicing law for 21 years. His law practice is devoted primarily to three principal areas: representing indidviduals who have employment-related claims of all types against their employers; representing individuals who have been defrauded by their securities brokers; and representing companies and hedge funds in commercial litigation disputes. Mr. Brecher also negotiates employment and severance agreements between employees and employers. Mr. Brecher was named a New York Super Lawyer in 2009, 2010 and 2011. He was appointed to the United States Court of Appeals for the Second Circuit Pro Bono Panel for a three-year term ending August 27, 2015 and was elected on 1/18/13 as a member of The American Law Institute (ALI). Mr. Brecher is also a member of the New York and Connecticut Bars. To contact Mr. Brecher, please write to: **Law Offices of Ethan A. Brecher**, 600 Third Ave., 2nd floor, New York, NY. 10016. Phone: 646-571-2440. Fax: 888-821-0246. Website: www.ethanbrecherlaw.com.

Shustak Frost partner **Erwin Shustak** was named the 2012 Attorney of the Month by **the Attorney Journal, San Diego Edition** and featured on the cover of the October 2012 issue. According to the article, Mr. Shustak's inimitable perspective and perception have protected clients to the tune of hundreds of millions recovered for victims of financial abuse and fraud. To learn more about Mr. Shustak, please visit **Shustak Frost & Partners'** website: www.shufirm.com.

SCHEDULE OF COMING EVENTS

MAY 30	"Corporate Compliance and Ethics Institute 2013," sponsored by the Practising Law Institute, will be held in **New York, NY** at the PLI New York Center. Those who attend will learn: how to design and conduct compliance risk assessments to obtain the most valuable information; the evolving role of the Board - more active oversight and greater expectations; how to investigate and manage allegations of wrongdoing; the tools to help your program connect to employees of all ages - including those who spend their lives on social media sites; and the best practices in compliance communications and training. For further information and to register for this event, call 800-260-4PLI or visit www.pli.edu Regis Fee: $1,795.00.
MAY 31	"Municipal Securities Activity by Broker-Dealers and Advisers 2013," sponsored by the Practising Law Institute, will be held in **New York, NY** at the PLI New York Center. Those who attend will: learn how the MSRB, SEC and FINRA interact regarding municipal securities regulation; get an overview of the regulatory framework; learn FINRA guidance regarding broker-dealer sales of municipal securities; and learn the SEC's Municipal Advisor Rule. For further information and to register for this event, call 800-260-4PLI or visit www.pli.edu Regis Fee: $895.00.
JUNE 4	"Securities Arbitration & Mediation: Hot Topics 2013," sponsored by the City Bar, will be held at the Association's Home of Law, **New York, NY**. Mediator-Arbitrator **Roger M. Deitz** will, as moderator, lead an expanded faculty of speakers, including FINRA-DR President **Linda D. Fienberg,** in a discussion of rule changes, the OAPP, the importance of experts, customers and Rule 12200, expungement, complex products, the new suitability rule, protecting senior investors, and reg-arb interactivity. A key hallmark of the "Hot Topics" program is interactive audience participation and this year's agenda contributes extra time towards generating an audience-panel dialogue. Other scheduled speakers are: **Darya Geetter, Sandra D. Grannum, Scott C. Ilgenfritz, Theodore Krebsbach, Joseph Peiffer, Michael Schwartzberg, and James Wrona.** (The half-day program will be followed by a networking luncheon -- which the speakers actually attend). Regis. Fee: $255/$365, with a steep discount for FINRA neutrals and NFA Members. For more information, please visit the City Bar WebSite, www.nycbar.org. (SAC Ref. No. 2013-15-04)
JUNE 5	"Global Capital Markets & the U.S. Securities Laws 2013: Raising Capital in an Evolving Regulatory Environment," sponsored by the Practising Law Institute, will be held in **New York, NY** at the PLI New York Center. Those who attend will learn: the latest developments in global regulatory efforts; the current developments with private and public offering practices; the changes to the global regulation of alternative investment vehicles and derivatives; and securities enforcement in an increasingly global regulatory environment. For further information and to register for this event, call 800-260-4PLI or visit www.pli.edu Regis Fee: $1,595.00.
JUNE 10	"International Arbitration 2013," sponsored by the Practising Law Institute, will be held in **New York, NY** at the PLI New York Center. Those who attend will learn: the recent developments in international arbitration; emerging ventures in arbitration; practical tips for winning your cases; the international arbitrator's point of view; and in-house counsel's perspective on how to achieve a successful arbitration. For further information and to register for this event, call 800-260-4PLI or visit www.pli.edu Regis Fee: $1,595.00.
JUNE 11	"Business As Unusual 2013: Business Development in the 'New Normal'," sponsored by the Practising Law Institute, will be held in **New York, NY** at the PLI New York Center. Those who attend will learn: how to sustain current business and proof it from competitive threats; how to create new business by better serving existing clients, who will offer you critical referrals/recommendations; whether improved firm business models and internal supports can help lawyers generate new business - making superior service measurable; and how to define a value proposition that distinguishes you, your practice and your firm. For further information and to register for this event, call 800-260-4PLI or visit www.pli.edu Regis Fee: $895.
JUNE 14	"Current Hot Topics in IPOs 2013," sponsored by the Practising Law Institute, will be held in **San Francisco, CA** at the PLI California Center. Those who attend will learn: the areas of special focus for drafters of today's IPO registration statements; special topics in due diligence; the challenges of corporate governance, equity planning and executive compensation planning for companies contemplating their IPO; and the latest hot topics in technology company IPOs, including dual-class common stock. For further information and to register for this event, call 800-260-4PLI or visit www.pli.edu Regis Fee: $1,595.