Expungement of Customer Complaint CRD Information Following Settlement of a FINRA Arbitration

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ABSTRACT

The Financial Industry Regulatory Association (“FINRA”) maintains a database of customer complaints about individuals licensed by FINRA as registered representatives. The data can be accessed and used by both securities regulators and the investing public to find out about past complaints made by customers of the registered representatives. But records of customer complaints can be expunged from the database through an arbitration process created by FINRA.

This Article traces the history of that arbitration process, focusing on how it is employed in cases where the investor was paid money to settle a claim. The Article studies FINRA arbitrations in such cases, and reveals that, post-settlement, customer complaints are being expunged at the rate of 94%, often in perfunctory ex-parte proceedings where the complainant has agreed not to oppose the application. The Article concludes with a proposal for major changes to the process of expungement that are necessary if the FINRA database is to maintain its integrity.

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INTRODUCTION

The Financial Industry Regulatory Authority (“FINRA”) maintains a database (“CRD”) of information about individuals registered as representatives of securities brokerage firms. The CRD profile on a registered representative contains information about, inter alia, un-adjudicated complaints and pending arbitrations brought by investor-customers. That information is available to the public through an on-line system called “BrokerCheck.”

The reporting and public availability of un-adjudicated customer complaints causes concern among industry participants because of its potential effect on the reputation of registered representatives. Industry participants decry the fact that information about un-adjudicated complaints is publicly available but FINRA has shown no inclination to eliminate such reporting. FINRA does, however, offer a process by which a broker may apply to have such information expunged from the database. Any broker’s whose CRD is affected by a customer complaint can ask a FINRA arbitration panel to grant that relief. This arbitration process creates few difficulties when, after a merits hearing in which both the complainant and the broker appear, the investor’s claim is dismissed. In those cases, the arbitrators who heard the evidence are in a good position to decide whether the record should be expunged, e.g., by concluding the claim was unfounded.

But the process for expungement creates problems – and there is a controversy – in cases that settle before an arbitration hearing is held. In such situations, expungements may have been “purchased,” i.e. a complaining investor may have been paid a substantial sum of money in exchange for a “Stipulated Award” of expungement, or an agreement not to oppose a request for expungement made by the registered representative. Information about complaints that might be valuable to regulators, prospective employers of the individual whose conduct was the subject of the arbitration or the investing public can thereby be erased from the public record.

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3 Id.


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


7 Id.

8 See infra Part VII.

9 See Antilla, A Rise in Requests From Brokers to Wipe the Slate Clean, THE NEW YORK TIMES, at p.D1 (June 10, 2013).
Since 1999, FINRA has tried to define standards and impose safeguards to prevent unwarranted or inappropriate expungements. In addition to trying to impose standards and develop procedures at the arbitration level, FINRA requires that a registered representative seeking expungement obtain a court’s confirmation of any expungement award, and that the representative give FINRA notice of that proceeding in order to permit FINRA (or a state securities regulator) to oppose it.

This Article demonstrates that the safeguards and procedures created by FINRA are not working the way they were intended. Expungements, which FINRA describes repeatedly in Notices and SEC Rule-filings as an “extraordinary remedy,” are being granted in settled cases at a rate of 94%. This Article analyzes why that is so. It also shows that the supposed safeguards of notice to regulators and judicial confirmation of expungement awards are ill-conceived failures.

Part I introduces the CRD system and the background of the expungement controversy. It then traces FINRA’s first attempts to address the issues raised by expungement from a 1999 moratorium on arbitrator-initiated expungements of customer complaints, through a series of Notices issued by FINRA, to FINRA’s adoption in 2003 of Rule 2080 empowering arbitrators to grant expungement. That Rule was supposed to limit the circumstances in which arbitrators could grant the expungement remedy. Instead, the Rule appears to be doing little more than enabling a rubber-stamp process.

By the end of 2007, it was clear that the definitions and safeguards FINRA created in 2003 were not working. A series of cases showed that some state regulators were concerned that many arbitrators were indeed rubber-stamping expungement requests. The decisions in those cases also showed that once arbitrators entered an award of expungement, the regulators had little, if any, power to stop the expungement of CRD information.

As a result, in 2008, FINRA adopted Rule 12805, again purportedly designed to limit agreed-to expungements and preserve the regulatory and informational value of CRD. Part III(a) describes Rule 12805 and its implementation. Under the Rule, arbitrators are required to hold hearings (by telephone or in person) on expungement. The amount of the settlement must be considered. And the arbitrators have to make a finding that the complaint was either erroneous or false, or that the representative was not involved in a sales practice violation, they must provide a “brief written explanation” of the reasons for such finding.

In order to see whether the 2008 changes make any difference, Part IV of this Article studies and analyzes all the post-settlement arbitration awards rendered in the first half of 2013. The study shows that, even with the Rules and their supposed safeguards, arbitrators still grant

10 See generally infra Part II.
11 Id.
12 See infra Part IV.
13 See infra Part I.
14 The Rule was NASD 2130 when adopted; it was re-numbered FINRA Rule 2080 in 2009. See FINRA, Regulatory Notice 09-33, SEC Approval and Effective Date for New Consolidated FINRA Rules; Effective Date: August 17, 2009, available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p118967.pdf (effective August 17, 2009)(hereinafter “Rule 2080”).
15 See infra Part I.
16 See infra Part II.
expungement in virtually every settled case in which expungement is requested. There was no opposition to the expungement application in all but three of these cases, each of those three cases resulted in a denial of expungement. In all the other cases, the arbitrators heard only the registered representative protest his innocence, and saw only the evidence the representative wanted the arbitrators to see. Almost 2/3 of the hearings leading to these awards were conducted on the telephone. The study also shows that only 12 of these 205 “hearings” took no more than 3 1/2 hours.

Parts V(a) analyzes all the problems associated with the current expungement process, demonstrating how and why the system fails to achieve its goals. Part V(b) proposes a better system, one that, if adopted will provide for appropriate notice and regulatory review of expungement applications, and put an end to the ex-parte arbitration hearings that are not effectively safeguarding the CRD system.

I. CRD BASICS AND THE EXPUNGEMENT CONTROVERSY

(a) CRD BASICS

Securities broker-dealers and their sales representatives are subject to a multitude regulation at both the federal and state levels. The federal responsibility is delegated by the Securities and Exchange Commission to the Financial Industry Regulatory Authority (“FINRA”), a so-called Self-Regulatory Organization. In its role as a regulator, FINRA sets licensing requirements, administers licensing examinations, establishes and enforces regulations concerning the conduct of licensed entities and persons, and maintains an Enforcement Division to discipline violators and carry out these functions.

State regulatory jurisdiction overlaps that of FINRA. Each state has its own licensing requirements, investigatory and enforcement divisions and adjudicatory mechanisms. The state regulators coordinate their policies and activities through the North American Securities Administrators Association (“NASAA”).

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17 This study is annexed hereto as “Expungement Awards Settlement Analysis, First Half of 2013”
18 Id.
19 Id.
20 Id.
In 1981, FINRA, then known as the National Association of Securities Dealers, Inc. (“NASD”), together with the states, created an electronic database known at the Central Registration Depository (“CRD”). CRD contains a host of information about both brokerage firms (“firms”) and their registered representative (“brokers”). Each firm, and each broker, has a unique identifier (called a “CRD number”), and information concerning each is catalogued separately. That information can then be accessed and used by FINRA, state regulators and the SEC as part of their regulatory functions. The information can also be viewed and used by prospective employers of brokers as part of their pre-hiring due diligence. Investors can access CRD information about brokers through FINRA’s searchable on-line database, called “BrokerCheck.” While FINRA and NASAA share ownership of CRD and BrokerCheck, under an agreement with NASAA, FINRA administers both CRD and BrokerCheck. But both sets of regulators, along with the public, clearly have an interest in the integrity of CRD information.

The record of customer complaints on a broker’s CRD is called “customer dispute information.” Customer dispute information includes (a) written complaints, (b) arbitrations that


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

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

30 The NASD renamed the “Public Disclosure Program” BrokerCheck” in 2003. See NASD Notice to Members 03-76, NASD Seeks Comment on Enhanced Access to NASD BrokerCheck (Formerly Known as NASD’s Public Disclosure Program) (Dec. 2003), available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003055.pdf (last visited Jan. 25, 2013). Public investors do not have access to the CRD system; however, the information in the system is available to investors via BrokerCheck.


32 See Rule 2080(a). See also NASD, Notice to Members 04-16, NASD Adopts Rule 2130 Regarding Expungement of Customer Dispute Information From The Central Registration Depository; Effective Date: April 12, 2004 available at http://www.finra.org/Industry/Regulation/Notices/2004/p003233 (last visited June 16, 2013)
name the broker as a party, (c) litigation that names the broker as a party, (d) arbitration awards and civil judgments. In addition, since 2009, arbitrations and litigations in which the broker is not named as a party must be reported on CRD if the pleading alleges that the broker was involved in a sales practice violation.  

Brokers often argue that even a single publicly-available record of a complaint can damage their business prospects. Brokers are particularly concerned about the presence on their CRD records of information about un-adjudicated complaints, but FINRA continues to include that information in CRD and makes it available to the public through BrokerCheck. As a result, brokers want a method for seeking expungement of customer dispute information from CRD. At the same time, however, FINRA, the state regulators and the investing public have an interest in assuring that information on the CRD system is complete, and these groups have fought to make expungement harder. The stakes are high – when information on CRD is erased or expunged, it disappears from the view of all, including regulators, potential employers and investors.

FINRA’s solution to these competing interests is to use its arbitrators to decide requests for expungement. From 1981 to 1998, FINRA’s policy was to erase customer dispute information from CRD.

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33 See Expungement, available at http://www.finra.org/arbitrationandmediation/arbitration/specialprocedures/expungement/ (last visited Mar. 31, 2013) (Brokerage firms must submit a disclosure report about a broker even if the broker is not a named party to the arbitration or lawsuit. A report is required merely when a broker is the “subject of” sales practice violation allegations in arbitration claims or civil lawsuits).

34 See The 2009 change in reporting is discussed in Part IIIB of this Article. n 5, supra.

35 See supra note 29 and accompanying text.


37 While adopting Rule 2080 regarding expungement, the NASD outlined the need for balancing three competing interests: (1) the interests of regulators and states in retaining access to customer dispute information for the purpose of meeting regulatory requirements and investor protection needs; (2) the interests of the brokerage community; and (3) the interests of investors in having access to complete and accurate information about financial professional with whom they conduct, or may conduct, business. See Notice to Members Mar. 2004, available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003235.pdf (last visited Jan. 25, 2013).

38 By seeking “expungement” a brokers seeks to have a reference to allegations or to involvement in an arbitration removed from their CRD System records entirely. See Expungement, FINRA, available at http://www.finra.org/ArbitrationAndMediation/Arbitration/SpecialProcedures/Expungement/ (last visited Jan. 25, 2013).

39 FINRA’s arbitration division’s principal function is to administer and conduct arbitrations of disputes between customers and securities industry members, among securities industry members (i.e. firms) and disputes between firms and their employees (including brokers). Since the 1987 U.S. Supreme Court decision in Shearson v. McMahon, when agreements to arbitrate broker-customer disputes were declared binding, nearly all disputes between brokerage firms and their customers have been resolved in arbitration. See Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220 (1987) (holding that arbitration is a just and efficient method of resolving securities claims under the Securities Exchange Act of 1934). See About the Financial Industry Regulatory Authority, FINRA, available at http://www.finra.org/AboutFINRA/ (last visited Jan. 25, 2013).
information from CRD if there was either a judgment or an arbitration award directing expungement. There were no standards in place, no requirements that arbitrators had to follow before ordering expungement and there was no regulatory or judicial review of expungement orders from arbitrators.

(b) THE EXPUNGEMENT MORATORIUM AND FINRA’S ADOPTION OF RULE 2080

Problems were first exposed in August 1998. The Securities Commissioner from Florida wrote a letter to FINRA questioning the legality of arbitrator-directed expungements. In January 1999, NASAA supported the Florida regulator. It told FINRA that, under laws of certain states, information filed with the CRD system is a “state record” and that CRD is subject to all of the regulations and protocols that apply to state records, including provisions on expungement. NASAA informed FINRA that, in NASAA’s opinion, the laws of some states do not recognize the authority of an arbitrator to expunge state records, and they asked FINRA to cease honoring arbitrator-directed expungements.

The agreement between NASAA and FINRA creating the CRD system expressly authorized FINRA to honor judicially-directed expungements, but the agreement was silent as to arbitrator-directed expungements. In February 1999, as a result of NASAA’s views, FINRA acceded and announced a moratorium on arbitrator-awarded expungement of customer dispute information. After announcing the moratorium, in July 1999, FINRA issued a Notice seeking comments as to how proceed. FINRA Notice to Members (or “NTM”) 99-54 explained that, in FINRA’s view, expungement of information from the CRD system that is directed by an arbitrator and contained in an arbitration award should be afforded the same treatment as a court-ordered expungement. The Notice explained that FINRA was looking for a way to implement that policy “while at the same time complying with any applicable state record-keeping laws and maintaining the integrity of the CRD system.”

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41 See id., The link to the Florida letter referred to in footnote 1 of the Notice is dead.
43 Id.
44 Id
45 Id
47 See id., at 352.
In the Notice, FINRA acknowledged that expungement has “important investor protection implications,” and that the information in the system should be “complete and accurate.”48 The Notice declared that customer dispute information “should not be expunged without good reason,”49 but the Notice conceded that despite CRD having been in existence for 18 years, FINRA had never developed a clear policy about how its arbitrators should decide expungement applications.

Through the Notice, FINRA sought comments on how to handle expungement awards by arbitrators. A main concern expressed by FINRA in NTM 99-54 was whether “consent awards,” i.e. awards memorializing a settlement of the investor’s complaint and containing an expungement directive, should be treated differently from awards rendered after a contested proceeding.50 NTM 99-54 recognized that in cases of consent awards (soon to be referred to by FINRA as “Stipulated Awards”),51 arbitrators were issuing expungement awards simply at the parties’ (joint) request.52 FINRA said it was concerned that significant amounts of money were being paid to complainants in settlements that included an agreed expungement.53

The Notice stated that one of FINRA’s objectives was “to ensure that investor protection is not compromised” by paid-for expungements.54 But FINRA also said that it wanted to ensure that expungements were not being granted in questionable circumstances, and that it wanted to set appropriately high standards. High standards, FINRA explained, “would enhance the integrity of the CRD system” [while] still providing a mechanism to remove misleading, inaccurate, or erroneous information from CRD.55 Examples FINRA offered where expungement would be warranted were cases where a customer’s complaint was frivolous or groundless (i.e., it had no basis in fact) or brought for an improper purpose (e.g., to damage the reputation of the named person/firm).56

48 Id.
49 Id.
50 Id.
52 See supra note 29, at 352.
53 FINRA offered several approaches to the problem of settled cases. One approach was to retain the complaint information on the CRD system, but delete it from BrokerCheck. See supra note 29, at 353. Another approach was to maintain the information in both places but to add a legend that the complaint had been ordered expunged by an arbitrator or a panel of arbitrators. Id. A third approach was to establish standards for arbitrator-ordered expungements resulting from consent awards. Id. A fourth approach, similar to the first, was to delete the information from CRD and Broker-Check after first sending a record to each state through an alternative medium, such as hard-copy or microfilm. See id.
54 See NASD Notice to Members 99-54 at 352.
55 Id.
56 See id. at 354.
In 2001, FINRA issued yet another Notice about expungements. The 2001 Notice, NTM 01-65, described the comments received on NTM 99-54 as mixed. Industry-affiliated commenters were generally in favor of allowing arbitrator-ordered expungements, while most public commenters opposed allowing arbitrator-decreed expungements. In NTM 01-65, FINRA, for the first time, included concern for damaged reputations as a factor in formulating expungement policy, and it was again clear that FINRA wanted to promote an arbitrator-expungement process. The main purpose of the 2001 Notice was to vet FINRA’s new ideas about how to balance a broker’s reputational concerns against the regulatory and public interests identified in the 1999 Notices.

The creation of high standards was again said to be part of the solution. FINRA described expungement as an “extraordinary” remedy. NTM 01-65 explained that FINRA would permit expungement in any case where a fact finder – an arbitration panel or a court – had conducted an adversarial hearing and concluded that the case fell into one of the three enumerated categories:

(a) factual impossibility or clear error;
(b) the claim was without legal merit; or
(c) the information on CRD was defamatory.

NTM 01-65 specifically sought comments as to whether these three categories were the appropriate ones.

The FINRA Notice then turned to the problem of Stipulated Awards. FINRA again characterized expungement relief as extraordinary. As it did in 1999, FINRA said it was concerned that a firm may agree to pay to settle a claim filed by a customer only on condition that

58 See id. at 564; see also Letter Comment of Stuart J. Kaswell, Senior Vice President and General Counsel of Securities Industry Association (July 20, 1999), available at www.sifma.org/workarea/downloadasset.aspx?id=1365 last visited Mar. 31, 2013)(commenting that SIA believes there is no basis to change the pre-moratorium system).
60 Id. at 563.
61 FINRA proposed and sought comment on three categories of cases it felt merited expungement: (1) the claim is factually impossibility or the product of clear error, (2) the claim is without legal merit; or (3) the information on the CRD system is defamatory in nature. See NASD Notice to Members 01-65 at 565.
62 FINRA offers, as an example of cases that fall into this category, where the person named in the complaint was “named in error.” See id.
63 FINRA stated that the fact that the party seeking expungement had prevailed was not itself conclusive, because expungement was extraordinary relief. FINRA also said that expungement should never be granted when the award was adverse to the party seeking expungement of the issue. Id.
64 Id. at 563.
the customer agrees to the inclusion of a directive to expunge all information about the claim from the broker’s CRD. Indeed, FINRA observed that it was aware of “allegations that firms have pressed customer/claimants into accepting expungement as a condition of settlement of arbitration proceedings.” FINRA conceded that despite the fact that arbitrators are not required to sign awards with which they disagree, many arbitrators were executing Stipulated Awards without inquiry. FINRA acknowledged that settling parties do not share the interests of regulators and the investing public about the accuracy and completeness of CRD.

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

FINRA also explained in NTM 01-65 that it would still require (a) judicial confirmation of all arbitration awards granting expungement, and (b) that FINRA receive notice of all applications for judicial orders of expungement. FINRA promised it would review all such applications, to ensure that the cases meet the criteria described in the Notice, and advise the court of its conclusion. FINRA also promised to notify state regulators every time it received notice of an application for a judicial order of expungement, so that “one or more states may ... intervene in the ... proceeding.” The Notice said nothing about the standards that FINRA would apply in the

65 See id. at 567.
66 See id. at 570.
67 See id. at 565.
68 These categories, according to FINRA exemplified by situations such as where the person named in a complaint did not work at the firm at the time of the complaint. “[S]uch persons,” FINRA reasoned, “should be able to avail themselves of the settlement opportunity,” and then request expungement. See id. at 567.
69 Id.
70 The requirement would include both applications to confirm awards of expungement and applications settlements of cases outside of the arbitration process that are then submitted for court approval.
71 In NTM 01-65, FINRA knew it was wading into a deep thicket. The Notice contained a form, with boxes to check, indicating the commenter’s answer to specific questions. See NASD Notice to Members 01-65, NASD Seeks Comment on Proposed Rules and Policies Relating to Expungement of Information From The Central Registration Depository (Nov. 2001), available at http://www.finra.org/Industry/Regulation/Notices/2001/p003744 (last visited Jan. 25, 2013). FINRA received 579 responses to NTM 01-65. See Proposed Rule 2130 Governing Expungement of Customer Dispute Information From the Central Registration Depository (CRD System), available at http://www.finra.org/web/groups/industry/@ipl/@reg/@rulefil/documents/rulefilings/p001015.pdf (last visited Jan. 25, 2013). Of the 579 responses, 539 were responses on the check-the-boxes form. Id. at 10. The vast majority of these were sent from brokers (mostly from one firm), all indicating that expungements – whether after a hearing or as a result of settlement – should be unregulated and recognized without condition. Id. The forty written comments were predictably mixed – industry participants were opposed to any regulation, or were reluctantly amenable, so long as the bases were adjusted and expanded. Id. at 1-15. The Investor advocates who wrote were mostly opposed to all arbitrator-directed expungements, indeed to any expungement. The investor advocates questioned whether FINRA arbitrators could be relied upon to make appropriate findings, and whether FINRA enforcement would truly serve the public interest at the confirmation stage. They noted that arbitration award confirmation rarely involved meaningful judicial scrutiny, especially when the requested relief was unopposed. Id.
promised review, nor did it say what FINRA would or could do in the event the review showed that the expungement was not justified.

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

FINRA gave no explanation why the available bases for waiving the requirement to name FINRA as a party in post-settlement awards was expanded. The concerns about purchased expungements had apparently disappeared from FINRA’s view. In the Rule filing, FINRA simply explained that its purpose was to validate arbitrator expungements. Still, FINRA continued to tell the SEC that expungement should only be granted in circumstances that were extraordinary, but by declining to limit expungement to the “clearly erroneous or factually impossible” category, FINRA opened the door to a much-easier expungement scheme.

NASD Rule 2130 (now FINRA Rule 2080) was approved by the SEC on December 16, 2003. In its approval order, the SEC determined it was “designed to promote just and equitable

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74 The three bases, however, had been reworked from the 2001 Notice. See supra, notes 66-72, and accompanying text. The first - the “factually impossible / clear error” category was changed to “without factual basis”; the second, “without legal merit,” was changed to “the complaint fails to state a claim upon which relief can be granted or is frivolous”; the third category, that the information on the CRD system was “defamatory in nature” was unchanged from the 2001 NTM. Compare NASD Notice to Members 01-65, NASD Seeks Comment on Proposed Rules and Policies Relating to Expungement of Information From The Central Registration Depository (Nov. 2001), available at http://www.finra.org/Industry/Regulation/Notices/2001/p003744 (last visited Jan. 25, 2013) with 68 Fed. Reg. 74667. In September 2003, FINRA proposed yet more modifications to its enumeration of the three bases. See Amendment No. 2 to Proposed NASD Rule 2130 Governing Expungement of Customer Dispute Information From the Central Registration Depository (CRD System), available at http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p001019.pdf (last visited Jan. 25, 2013). The “without factual basis” category was changed back to “factually impossible / clearly erroneous.” The “without legal merit” category, which in the 2002 rule proposal had been changed to “fails to state a claim or is frivolous,” was changed to “the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds”; and the “defamatory in nature” category was changed to “false.” Id. The change to the first category is inconsequential because FINRA has repeatedly used the terms interchangeably. The change to the second category would prove to be important after 2008, when a whole series of opaque investment products failed. See infra Part IV. The change to the third category – from “defamatory in nature” to “false” – would eventually open the door to wholesale expungements. See infra Part VI.
76 See id.
77 Id.
principles of trade, and, in general, to protect investors and [the] public interest.” The SEC wrote that “the potential involvement of [FINRA] at the court confirmation level will provide greater safeguards ...” of those interests. As demonstrated in Section IIIA of this Article, both FINRA and the SEC were wrong in their belief that the court confirmation process provided “additional safeguards.”

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

If the parties settle the arbitration, they may jointly ask the arbitration panel for a stipulated award and request that the panel make affirmative findings and order expungement based on one or more of the standards in Rule 2130. The arbitrators would determine whether to grant expungement relief and, if so, state in the award the basis on which the expungement relief was granted. The arbitrators may require the submission of documents or a brief evidentiary hearing to gather the information necessary to make such findings.

After a five-year moratorium, expungement was back on the arbitrators’ docket. But the tenor of FINRA’s message had changed. Granting expungement relief was cast in the Notice as a routine process in which the arbitrators’ job was to “gather documents” that would enable them to make the needed findings. The message in the Notice was that the arbitrators’ role was to execute the request for expungement, rather than conduct an independent, skeptical, review.

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78 Id..
79 Id.
81 Id.
82 The word appeared four times in NTM 01-65. FINRA’s Rule Filing for Rule 2130 stated clearly that they and other regulators participating in the CRD system agree that expungement is extraordinary relief,...http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p001015.pdf at p.8; see also id. at23. In support of its second proposed amendment to Rule Filing, FINRA wrote that they “recognize[] that expungement of a CRD record under any condition is an extraordinary remedy and should only be used when the expunged information has no meaningful regulatory value.” See Amendment No. 2 to Proposed NASD Rule 2130 Governing Expungement of Customer Dispute Information From the Central Registration Depository (CRD System), available at http://www.finra.org/web/groups/industry/@ip/@reg/@rulfil/documents/rulefilings/p001019.pdf (last visited Jan. 25, 2013.), at p.8
83 Id. at p.214.
84 To this day, FINRA’s template for arbitration awards of expungement makes reference to NTM 04-016 and no other FINRA document.
II. EXPUNGEMENT AWARDS ARE CHALLENGED IN TWO STATES

(a) THE STATE OF MARYLAND INTERVENES IN A KARSNER CASE

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

After receiving an award recommending expungement, Mr. Karsner petitioned the United States District Court for confirmation of the award. He named as Respondents the investor and FINRA; neither appeared in the court to oppose the application. The court was prepared to grant Mr. Karsner’s application, when the Maryland Securities Commissioner filed a motion seeking permission to intervene. Karsner opposed the Commissioner’s motion, and the District Court denied the Commissioner’s request to intervene. The U.S. Court of Appeals reversed, however, holding that, as a regulator, the State was interested in the outcome of the court proceeding and was thus entitled to intervene, and the case was remanded to the District Court.

The Court of Appeals’ decision is important not just because it recognizes the regulatory interest of the states in the CRD system. In dicta, the court stated that the District Court lacked the authority under the Federal Arbitration Act to grant confirmation because of the form of the award. Written on a template FINRA provided to the arbitrators, the award stated that “[t]he Panel recommends the expungement of all reference to the above-captioned arbitration from Respondent Karsner’s registration record maintained by the NASD Central Registration Depository (‘CRD’).”

The D.C. Circuit’s opinion said:

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

85 See Karsner v. Lothian, No. 07cv334 (D.D.C. Apr. 9, 2007) (minute order).
86 Id.
87 The Maryland Securities Commissioner appealed the district court’s denial of her motion to intervene as of right in an arbitration confirmation proceeding. See Karsner v. Lothian, No. 07 cv334 (D.D.C. Apr. 9, 2007) (minute order). Karsner named Lothian and the NASD as parties to the confirmation proceedings. The NASD notified NASAA, and NASAA notified Melanie Lubin, the Maryland Securities Commissioner. Lubin saw that the Lothian request was not an isolated incident, and decided to try to stop it by intervening in the case before the District Court. See
88 Neither Lothian nor FINRA appeared in the court proceedings.
89 Karsner v. Lothian, No. 07 cv334 (D.D.C. Apr. 9, 2007) (minute order)
90 Karsner v. Lothian, 532 F.3d 876 (D.C. Cir. 2008) (holding that the Commissioner’s motion was timely, as required for intervention as of right and that the District Court lacked authority to “confirm” arbitrator’s expungement recommendation).
91 Id. At 886.
92 Karsner v. Lothian, 532 F.3d 876, 886. [footnotes omitted] This theme, that FINRA lacks the authority to empower courts to elevate a “recommendation” to a “direction” is inconsistent with the decision in Kay v. Abrams, discussed infra Part IIIb. that Courts lack the power to review expungement awards to ensure the awards fall into one of the three categories. Although the rationale (a limited judicial role) is adopted in both cases, the conclusion of the Kay court is the opposite of that of the Karsner court. In Kay, the limited judicial role led to the court’s ruling that it
FINRA arbitration awards to this day, however, continue to use the same template and language as was used in Karsner – that the awards are “recommendations” of expungement and not directives. But no other court has yet adopted the D.C. Circuit’s restrictive view of the confirmability of FINRA expungement awards. Yet FINRA cannot simply change its form award to change the word “recommends” to “directs.” Such language would violate the state laws that prevent arbitrators from altering state records – the laws that led to the original moratorium. The decision of the influential DC Circuit thus casts doubt on the viability of FINRA’s entire method of allowing brokers to seek expungement because it declared the whole system – whose lynchpin is court confirmation of the award – ultra vires. The D.C. Circuit’s decision remains a latent problem which may eventually demolish FINRA’s entire process.

The Karsner litigation ended there. The Maryland Securities Commissioner and Mr. Karsner entered into a settlement within months of the court’s decision. Mr. Karsner consented to findings that he made unsuitable recommendations to his unsophisticated clients, that he had falsified New Account Forms and engaged in improper “switching” of mutual funds in his clients’ accounts. He consented to Conclusions of Law that he violated the anti-fraud provision of Maryland’s securities laws, and engaged in dishonest and unethical practices. In the Consent Order, Mr. Karsner agreed to withdraw his application in Karsner v. Lothian, to seek no further expungements, to cooperate with the State of Maryland to vacate the expungements he already obtained, pay a $50,000 and agree to not renew his registration for 10 years.

(b) NEW YORK - THE SEVEN CASES

At about the same time that Maryland was protesting the Karsner expungement, FINRA’s expungement procedures also drew the attention of the newly-elected New York Attorney General, Andrew Cuomo. The New York Attorney General made motions to intervene in seven cases where brokers were seeking to confirm expungement awards in New York State courts. The Attorney-General made a variety of arguments, including concern that Rule 2080 findings in awards were mere recitals, that expungements were being paid for and that expungement violated public policy.94

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94 The Attorney General also argued (in at least one of the cases) that expungement should be denied because CRD records are state records subject to retention requirements, and that arbitrators lacked the authority to order their expungement. That argument was rejected in BNY v. Bacchus, on the ground, inter alia, that the Attorney General had not identified any such requirements. That same court also rejected the argument that the expungement was just a “recommendation,” not an award that could be confirmed. BNY Investment Center Inc. v. Bacchus, Index No. 109678/07 (N.Y. Sup. Ct. 2008)
As was the case in Maryland, the New York Attorney General’s request to intervene in the seven cases in 2007 was based on that office’s role as a securities regulator and its regulatory interest in preserving state records. The request to intervene was granted in all but one of the cases. The courts that granted intervention all found that New York State had a strong interest in maintaining the accuracy and integrity of the CRD records for the protection of New York’s investing public, just as had the DC Circuit in Karsner v. Lothian.

The New York courts, however, all viewed their role in the expungement controversy as highly limited, rejecting the policy arguments made by the Attorney General. Arbitration law, and a prior decision of an intermediate appellate court, proved to be insurmountable obstacles.

Goldstein v. Preisler was a 2005 case that pre-dated the Attorney General’s efforts and attention to the expungement issue. The Appellate Division ruled that judicial review of such awards was limited to the usual grounds for vacatur of arbitration awards – fraud, arbitral misconduct, arbitrator partiality, irrationality and manifest disregard of the law. The Appellate Division’s decision in Goldstein rejected any argument that the public’s interest in preserving the CRD records was grounds to refuse confirmation. Indeed, the Appellate Division stated that when the lower court denied the broker’s application to confirm the expungement award on policy grounds, i.e. exceeded its judicial role by “engag[ing] in an impermissible modification of the award that affected the substantive rights of the parties.”

The Attorney General was confronted by Goldstein in each of the seven cases. In 2007 in two of the cases where the Attorney General intervened, the courts initially declined to confirm awards of expungement on the ground that the awards were not in accord with the requirements of FINRA Rule 2080. These courts objected to confirmation because the awards in those cases only stated that the cases fell into the “false” category of Rule 2080; the awards gave no explanation, and made no findings to support their decision that the claims were false. These two cases thus remanded to the arbitrators, who then modified the awards to provide brief explanations, and those awards were confirmed.

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95 In Kay v. Abrams, the court denied the motion to intervene on the ground that it was “moot” because the court determined it lacked the power under the Federal Arbitration Act and New York arbitration law to conduct the kind of judicial review for which the Attorney General advocated. See Kay v. Abrams, 853 N.Y.S.2d 862 (N.Y. Sup. Ct. 2008).

96 See, e.g. In re UBS Financial Services, Inc., 13 Misc 3d 1131(A) (N.Y. Sup. Ct. 2007). That case attracted the attention of NASAA and the Securities Industry Financial Markets Association (“SIFMA”), both of which filed briefs as amicus. After granting Attorney General’s motion orally, the court entered a formal written decision. In it, the court noted that “the Attorney General clearly has an interest which may be affected by the court’s judgment, and which not been adequately represented by any other party, since respondent Gibson, the complainant in the arbitration proceeding, has failed to appear and has not opposed expungement in this case.” That decision covered both the (separate) Kurasch (UBS) and Johnson (Summit Equities) applications, which had been consolidated by the court. Intervention was also granted in BNY Investment Center Inc. v. Bacchus,; Zaferiou v. Holgado, Index No. 102996/07 (N.Y. Sup. Ct. 2007); Sage, Rutty & Co. v. Salzberg, Index No. 2007-01942 (N.Y. Sup. Ct. 2007); Walker v. Connelly.


98 Id.

99 See id.

100 Goldstein, N.Y.S.2d at 649. The Goldstein court also stated that because they awards came in the form of stipulations, they were especially insulated, because stipulations can only be set aside in cases of fraud or duress. Id.
In re Johnson (Summit Equities, Inc.) was the first New York court preliminarily to decline confirmation. Justice Marcy Kahn (who consolidated the two cases assigned to her), refused to confirm those two of the awards of expungement. One was a Stipulated Award, the other an award of expungement after a full adversarial hearing. Justice Kahn rejected both because each award merely recited the Rule 2080 grounds in boilerplate fashion, without any arbitrator “findings,” elaboration or explanation. Rule 2080, she held, imposed “exact[ing] standards for expungement” and required that the arbitrators make “affirmative findings of specific facts” supporting their conclusion that the case falls into one of the three expungement categories. The bald recitation by the arbitrators of the Rule 2080 grounds was, in her view, insufficient even where a full hearing had been held and the investor’s complaint dismissed.

Justice Kahn distinguished the Goldstein case, explaining that the award in Goldstein predated Rule 2080, and thus was neither subject to, nor reviewed for, issues associated with the “findings” requirement of Rule 2080. In Justice Kahn’s view, a higher degree of judicial review was appropriate because the Rule was based upon “policy considerations and [the] attendant roles and responsibilities [of] FINRA, state regulators and reviewing courts” in expungement situations. The combined requirements in the Rule of “affirmative findings” and judicial confirmation convinced her that FINRA anticipated and intended greater judicial review, and she was prepared to conduct it. Justice Kahn felt that such review could not occur because the arbitrators had failed to make the required findings. Justice Kahn remanded the matters to the arbitrators for further action in accordance with Rule 2080. One of the two brokers pursued the matter further before the arbitrators; the other did not. After the arbitrators in the pursued cases entered a modified award with the explanation Justice Kahn sought, she confirmed the award.

Sage, Rutty v. Salzberg was the other case where, after granting the Attorney General permission to intervene, a New York court criticized the award for failing to make the affirmative

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See In re Johnson, 864 N.Y.S.2d at 668.

Id. at 659.

Id. at 655: “Nothing in either award demonstrates the “findings” of any facts specific to the case. The Summit award states neither the conduct in which petitioners were not engaged, nor any facts supporting a conclusion that petitioners were not the parties involved. In UBS, nothing indicates which aspects of the customer complaint were impossible or erroneous. Moreover, the language of the findings in each case are couched in the disjunctive as alternative conclusions, sounding more like general denials characteristic of a pleading, rather than specific findings after a hearing or upon the parties' stipulated agreement in the particular case.”

Id. at 655 - 656 (finding that only statements which contain evidentiary facts and demonstrate that the circumstances of Rule 2130(b)(1) exist in a particular case constitute factual findings that support the conclusions represented by the Rule's standards). The decision further highlights that the qualifier “affirmative” was added to proposed Rule 2130 in order to meet concerns that members seeking expungement relief would arrange for “findings” consisting of merely pro forma recitals that matched the wording of one of the required standards. See id at 656-57.; see also SEC Approval Statement, 68 Fed. Reg. 74667 (proposed Dec. 24, 2003), at 74670.

Id. at 653.

The arbitrators in the UBS portion of the case subsequently issued a modified award making “findings,” and Justice Kahn confirmed the modified award (with no opposition). FINRA’s award database does not show any record of further proceedings in Johnson, and there were no further court proceedings before Justice Kahn.
findings required by Rule 2080. In that case, the award showed that the arbitrators never held any evidentiary hearings whatsoever to support their conclusion that the Rule 2080 grounds had been met. The *Sage Rutty* court held that *Goldstein* applied, and that there was no room in the law for greater judicial review of expungement award than exists for other types of arbitration awards. But, the court also held that the arbitrators’ mere recitation of grounds – without having ever held a hearing – was “irrational,” and irrationality is recognized basis for declining confirmation under New York arbitration law. Thus, as did Justice Kahn in *Johnson*, the court *Sage Rutty* court remanded the case for further proceedings before the arbitrators. Following that remand, a hearing before the arbitrators, and a new award with “findings,” the Court confirmed the award.

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

The other New York cases all resulted in easy confirmation. For example, *Kay v. Abrams*, Justice Edward Lehner adhered strictly to *Goldstein*. He ruled that courts did not have any authority whatsoever to question the conclusions reached by arbitrators that Rule 2080’s requirements had or had not been satisfied. In his view, it was irrelevant whether the arbitrators conducted any hearings on expungement grounds or made any “affirmative findings.” All the types of judicial inquiry the Attorney General sought were precluded by federal and state arbitration law. According to Justice Lehner, New York law was clear – neither the FINRA

110 Id.
111 Id.
112 Cf. *Walker v. Connelly*, 873 N.Y.S.2d 516 (N.Y. Sup. Ct. 2008). In *Walker*, the court observed that even though the award in the case contained only a bare recitation of the Rule 2130 grounds and no “affirmative findings,” the arbitrators held a telephone conference call with counsel for the parties, and received an affidavit from the brokers seeking expungement and “Stipulated Factual Particulars” signed by counsel for both the investor and the brokers. The Stipulation, the court wrote, was “essentially [a] recant[ation] of the allegations in his Statement of Claim,” and the broker’s affidavit was a total denial.

113 *Sage, Rutty* is unusual because it was the only case in which the investor appeared along with the Attorney General to oppose the expungement. When the matter was remanded to the arbitrators, she appeared there as well. In both proceedings, the investor was *pro se*. The investor tried to explain her earlier consent to expungement by stating that she felt pressured by her lawyer to accept a settlement, and that, despite having agreed, she still believed her allegations were not false. But as both the court and the arbitrators observed, her agreement to expunge was made one full month after she had accepted the monetary settlement. After hearing her testimony, the arbitrators modified their prior award to add that finding. The arbitrators then wrote that her complaint was “clearly erroneous” and lacked merit, and recommended expungement. The court then confirmed the award. *BNY v. Bacchus*, supra, presented a similar settlement scenario. In that case, the court observed that agreement to expunge was entered into two years after the settlement, and thus could not have been “paid-for.”

115 *See* e.g. *Bacchus*, discussed at n. 96, supra, *cf. Dailey v. Legg Mason Wood Walker, Inc.*, 2009 WL 4782151 (W.D.Pa.)(confirming a FINRA award recommending expungement and citing *Karsner v. Lothian*, but not addressing at all the dicta about whether recommendations create confirmable awards).

Rule 116 nor the Attorney General’s arguments about protecting the public interest 117 changed the “very limited review” allowed of arbitration awards under state law and the Federal Arbitration Act. 118 FINRA could not pass rules that effectively amended the Federal Arbitration Act to elevate the level of review of its arbitration awards. 119

At the end of his decision in Kay, however, Justice Lehner expressed discomfort with expunging information where “the arbitrator gave no explanation for his factual finding.” It did not matter in the case before him, because the law was clear, and the grounds for vacatur limited. But Justice Lehner offered a note of optimism. He observed that improvement was coming, because three days before oral argument in the case, FINRA announced that it was seeking a change in its Rules to require that arbitrators hold a recorded hearing on expungement. Justice Lehner also observed that FINRA intended to impose other safeguards, although he still doubted whether these new safeguards would in fact make expungements “extraordinary.”

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

III. FINRA AMENDS ITS RULES AGAIN IN 2008

(a) FINRA ADDS RULE 12805

FINRA’s response to the criticisms and the cases 120 was to augment Rule 2080 by trying to add more safeguards to the process. In its March 2008 Rule filing, FINRA admitted that its system was not working as anticipated:

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

117 The judge in Zaferiou v. Holgado, goes even further, stating that “Goldstein demonstrates that there is no public policy against expungement.” Zaferiou v. Holgado, Index No. 102996/07 (N.Y. Sup. Ct. 2007)

118 Indeed, Justice Lehner seems to reject the notion that Rule 2130 empowered the Attorney General to oppose confirmation of arbitral findings on policy grounds. “[A] regulation of NASD, even if approved by the SEC, cannot modify the FAA which was adopted through an act of Congress.” See also Zaferiou v. Holgado, Index No. 102996/07 (N.Y. Sup. Ct. 2007); BNY Investment Center Inc. v. Bacchus, Index No. 109678/07 (N.Y. Sup. Ct. 2008); Walker v. Connelly, 873 N.Y.S.2d 516 (N.Y. Sup. Ct. 2008). To these courts, even the FINRA Rule 2130 requirement that the arbitrators make [findings] cannot be enforced by courts because arbitration law provides that arbitrators need not give reasons for their awards.

119 In this regard, Justice Lehner’s decision foreshadowed the U.S. Supreme Court’s decision in Hall St. Associates, L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008), holding that parties, in their arbitration agreements, cannot empower or authorize courts to conduct any greater level of review of arbitration awards than is provided in the F.A.A.

120 Rule 12805 was proposed before the DC Circuit’s decision in Karsner v. Lothian, supra, wherein the court all-but-declared FINRA’s expungement process – with awards that “recommend” expungement followed by court confirmation unworkable. See supra Part IV. It thus did not address that issue, which continues to lurk to this day. Id.
Sometimes, arbitrators will order expungement at the conclusion of an evidentiary hearing on the merits of the case. More often, however, arbitrators will order expungement at the request of a party to facilitate settlement of the dispute. For example, customers may receive monetary compensation as part of a settlement, the terms of which require the customer to consent to (or not oppose) the entry of a stipulated award containing an order of expungement. In such cases, FINRA expected that arbitrators would examine the amount paid to any party and any other terms and conditions of the settlement that might raise concerns about the associated person’s behavior before awarding expungement. Contrary to this expectation, however, arbitrators often did not inquire into the terms of settlement agreements.

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

FINRA’s Rule filing stated that the added requirement that the arbitrators hold a recorded hearing assures that the arbitrators “perform the critical fact finding necessary before granting expungement.” FINRA anticipated that it would be criticized on the basis that the hearing it envisioned was likely to be ex-parte and that the results were likely to be skewed by the fact that only the broker and the broker’s lawyer are presenting evidence and making arguments. First, FINRA stated that the customers could participate in such hearings. But FINRA knew that almost never happened, and conceded that was often the case. Settling respondents often bargained for an agreement not to oppose expungement, and even when no such bargain is struck, investors who settle cases do not want to expend time and monies (including paying a lawyer) to appear in a case that had already settled. Such investors were not showing up to contest expungements before 2008; FINRA had no basis to believe they would do so after 2008.

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\(^{122}\) Id.

\(^{123}\) Id.


\(^{125}\) Id. (requiring the “hold[ing] [of] a recorded hearing session (by telephone or in person) regarding the appropriateness of expungement”).

\(^{126}\) See NASD Notice to Members 01-65, NASD Seeks Comment on Proposed Rules and Policies Relating to Expungement of Information From The Central Registration Depository (Nov. 2001), available at http://www.finra.org/Industry/Regulation/Notices/2001/p003744 (last visited Mar. 31, 2013). In addition, as FINRA observed in the quotation above from the Rule filing, such parties might have agreed not to oppose expungement as a condition of settlement. Of all the arbitrations studied for this Article, and all the cases cited, there was only case of
FINRA’s second argument for perpetuating its system of arbitrator expunge ments was that its arbitrators are “trained to conduct ex-parte proceedings.” But, as will be seen, no amount of arbitrator training can cure the inherent problem – that non-adversarial, one-sided hearing inherently lacks the adversarial mechanism needed for “fact finding.”

Despite these obvious flaws, the proposed Rule was approved by the SEC on October 30, 2008. Henceforth, FINRA arbitrators would be required to hold a “hearing” – formal or informal, in person or telephonic – before granting an expungement request. They would at least have to consider the amount of the settlement. And the arbitrators would have to write something about the grounds for granting expungement. But there would still be no prosecutor or complainant challenging the broker’s version of events, and only exculpatory evidence would be presented. There would still be advance no notice to either FINRA’s Enforcement Division or any state regulator, and no opportunity for them to intervene or object before it was too late. And expungement awards would still be framed as “recommendations” and not directions, leaving the Karsner decision lurking in the background.

(b) FINRA EXPANDS REPORTING OF CUSTOMER ARBITRATIONS

While the attention was focused on the expungement process, a hole in CRD and BrokerCheck was growing. The problem was that customer dispute information on CRD and BrokerCheck gets into CRD only when brokerage firms report. The forms FINRA uses – the U-4 opposition – the investor in Sage, Rutty, supra. That investor, notably was pro se. Hardly a fair fight when the respondent is represented by experienced arbitration counsel.

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


In order to grant expungement of customer dispute information under Rule 2080, the panel must:
(a) Hold a recorded hearing session (by telephone or in person) regarding the appropriateness of expungement. This paragraph will apply to cases administered under Rule 12800 even if a customer did not request a hearing on the merits.
(b) In cases involving settlements, review settlement documents and consider the amount of payments made to any party and any other terms and conditions of a settlement.
(c) Indicate in the arbitration award which of the Rule 2080 grounds for expungement serve(s) as the basis for its expungement order and provide a brief written explanation of the reason(s) for its finding that one or more Rule 2080 grounds for expungement applies to the facts of the case.
(d) Assess all forum fees for hearing sessions in which the sole topic is the determination of the appropriateness of expungement against the parties requesting expungement relief.

FINRA Rule 12805(b)(requiring review settlement the amount of payments made to any party). Id.

FINRA Rule 12805(c)( requiring arbitrators to draft a brief written explanation of the reason(s) for its finding that one or more Rule 2080 grounds for expungement applies to the facts of the case). Id.
and the U-5,132 did not require reporting in cases where a customer filed a lawsuit or arbitration against the firm without also naming the broker as a defendant or a respondent.133 And investors’ attorneys usually do not name the broker as a respondent in arbitrations because of respondeat superior and the firms’ deeper pockets.134 As a result, many arbitration filings that involved the conduct of “unnamed” brokers went unreported on CRD and BrokerCheck.135

In 2009, FINRA decided to plug the hole. Beginning May 18, 2009, arbitration filings (and law suits) would have to be reported as customer dispute information on a broker’s CRD so long as it is reasonably clear from the body of the pleadings that the broker was involved in an alleged sales practice violation.136 This change greatly increased the incidence of reporting. That increased incidence or reporting, in turn, created an increase in the volume of expungement requests, including the volume of requests in settled cases. The incidence of expungement requests was about to explode.

IV. EXPUNGEMENT AWARDS IN SETTLED CASES IN 2013 STUDIED

In the wake of all these changes, the author conducted a study of arbitration awards in settled cases.137 The period of time studied was the first six months of 2013. Using the FINRA database of arbitration awards, an electronic search was conducted for all arbitration awards in these periods that contain the word “expungement.” These awards were reviewed to identify those which began as customer-initiated arbitrations or complaints, and which were settled for money prior to the arbitrators holding any adversarial hearings and where the broker or his attorney (named or unnamed) then appeared before an arbitration requesting expungement.138

Two hundred five such awards were found. Only thirteen resulted in a denial of the request for expungement; 192 cases resulted in recommendations of expungement.139 The expungement rate was 93.66%

Out of the 205 cases, in only three cases did the investor object to expungement. In each of those cases, the request for expungement was denied.140 There were no cases where an investor

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133 That is true even if, reading the body of the pleadings, the broker’s conduct is the obvious subject of the complaint.
134 For example FINRA requires its members to adopt and enforce certain supervisory procedures. See NASD Rule 3010, available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3717 (last visited June 16, 2013). As a result a breach by the broker generally ties in the firm’s supervisory system or lack thereof.
136 See Form U-4, available at http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015112.pdf (last visited June 16, 2013) at 13 (requiring the filing party to disclose whether they have been involved in one or more sales practice violations which settled a “customer complaint/arbitration” prior to May 18, 2009 for an amount of $10,000 or after May 18, 2009, for an amount of $15,000 or more).
137 This study is annexed hereto as “Expungement Awards Settlement Analysis, 2011 and 2012.”
138 FINRA does not report the total number of cases that settle in a given quarter.
139 45 of the awards involved multiple requests for expungement.
objected and expungement was granted. Indeed, in nine of the cases, the investor was not even named as a party, and thus received no notice. In these cases, the broker named only his firm as a party.

The awards indicate that 150 of the hearings were done by telephone, and that thirty-eight were in-person hearings. Seventeen of the awards do not state whether the hearing was in person or on the phone. 193 of the awards were the result of a 1/2-day hearing session (3½ hours or less, including breaks); ten involved two sessions, and only two took three or four sessions. None took more.

The study also shows that the incidence of expungement is rising. In the 4th quarter of 2010, for example, there were sixty-one post-settlement awards involving expungement; in the 4th quarter of 2012, there were eighty-nine. This increase in volume is undoubtedly attributable to the 2009 reporting change detailed in Part V. Arbitration cases typically take a little over a year from filing to completion. But some of the increase may also be the product of increased broker awareness of the impact of BrokerCheck or the apparent ease of obtaining expungement.

V. SOLVING THE EXPUNGEMENT MESS

(a) THE TROUBLE WITH EXPUNGEMENTS

The combination of SEC oversight, FINRA regulation, state licensure and public disclosure of unadjudicated customer complaints is unique to the securities field. The public disclosure of information about unadjudicated customer complaints by FINRA may seem unfair to brokers, but it must also be kept in mind that all of securities law and regulation is grounded in principles of full disclosure. In addition, because brokerage firms insert arbitration agreements in their all agreements with their customers, but for the existence of CRD and the FINRA reporting rules, the public would have no access whatsoever to information about the existence of legal proceedings brought by customers. Unlike the filing of claims in a court, FINRA arbitrations are not public. The fact that CRD provides public access to information about arbitrations filed by customers of brokerage firms thus fills a significant gap in the public record.

This Article focused on one aspect of CRD expungement – the process that FINRA uses to allow brokers to apply for expungement following settlement of an arbitration. That process is important, and it is fatally flawed. FINRA’s repeated and continued attempts to adapt their arbitration system to the problem of expungement in settled cases have failed in every respect.

The issues associated with CRD expungement began in 1998 with concern that arbitrators lack the power to erase state records. That objection exposed many other problems – a lack of substantive standards, an absence of any procedures and a near-collusive environment in which arbitrators were granting expungement without making any inquiry whatsoever. Money was being paid to aggrieved investors, who in turn were agreeing to expungement of any record of their complaint. Information that was potentially valuable to regulators, prospective employers of brokers and the investing public was disappearing from CRD.

After the moratorium was imposed in early 1999, FINRA spent over three years studying the issues. After three Notices and several different proposals, NASD Rule 2130 (now FINRA Rule 2080) was enacted. Substantive standards were supposedly articulated, but these standards were broad, vague and over-lapping. Almost any case could be fit into one or more of these categories. There was no requirement of a hearing, and no provision for regulatory review.

When FINRA proposed Rule 2130, it told the SEC that that Rule would insure that expungement – relief that was sometimes justified – would be granted only in extraordinary situations. But that was not to be the case. Indeed, by 2007, it was apparent that the supposed articulation of the substantive standards changed nothing. The eighteen expungements granted by arbitrators to Mr. Karsner were particularly problematic. Then the prospect of regulatory review and an opportunity for regulators to oppose expungement disappeared with the New York cases.

Ignoring these facts and failures, FINRA again proposed a fix to its expungement procedures. In Rule 12805, FINRA - required that prior to recommending expungement, the arbitrators would have to hold a hearing and provide a “brief explanation of [their] reasons.” The Rule also provided that arbitrators had to consider the amount of the settlement before granting expungement. These additional safeguards were supposed to solve the problems.

But FINRA was fooling itself. The requirement that arbitrators hold a hearing, review the amount of the settlement, and make more specific findings was purely cosmetic. Despite statements that complainants could object to expungement by appearing before the arbitrators, FINRA was aware that these hearings would be informal, ex-parte, one-sided presentations of evidence.

The hearing requirement adds nothing but cover. The investor, having settled and bought peace, does not appear. Arbitrators hear only the broker’s testimony and see only the documents the broker wants them to see. With no complainant and no prosecutor, and no rule prohibiting a settling firm or broker from extracting an agreement that the investor not oppose the expungement, testimony and documents which might prove the truth of the customer’s allegations remain buried in closed files.

The analysis of arbitration awards of expungement post-settlement that is attached to the Article proves that expungement is not extraordinary and that Rule 12805 produced no change in the incidence of expungement. None of the supposed safeguards – from the alternated definition of standards to the requirement of a hearing to the requirement of judicial confirmation – is working as originally intended.

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141 Now FINRA proposes to create yet more expungement procedures for ex parte expungements. A rule filing is anticipated in late August 2013 [note to editor – details regarding this filing are unknown at this time; they can be filled in during the editing process.]

142 The attorney or law firm that represented the investor was paid all it will ever be paid on that case, and it too makes no appearance (even when the broker is asking the arbitrators to find that investor and lawyer filed a claim that was “false.”) In the 150 cases studied, only three times did the settling party appear to contest the request for expungement.

143 In some cases, the broker did not even testify and the “hearing” consisted of a lawyer’s presentation of evidence. See e.g., Weiss v. Nationwide Planning Associates, Inc., No. 11-01164 (12/21/11) (one of the arbitrators dissented from the grant of expungement on that basis).
FINRA’s informal, ex-parte expungement hearings have proven to be meaningless exercises.\textsuperscript{144} No meaningful cross-examination, the basis of our truth-divining system, take place in the vacuum of an ex-parte proceeding. At least 73\% of the studied cases involved hearings that were merely telephonic – hardly a good setting for a legal proceeding. No matter how dedicated to the public interest an arbitrator may be, no matter how hard an arbitrator may try to evaluate the validity of a complaint, an ex-parte arbitration hearing is never going to be anything more than a short, stylized affair.

The requirement that the arbitrators make findings that the case fits within one of the three broad categories established by FINRA adds no meaningful safeguard. Arbitrators just recite the denials the broker offers during the ex-parte expungement hearing. Indeed, in many cases, the arbitrators’ expungement award contains an explanation that was drafted by the broker’s attorney, or that was the product of a Stipulation that accompanied the settlement.

An especially good example of what is wrong with FINRA’s expungement process is \textit{Barker v. Securities America, Inc.}\textsuperscript{145} In that case, expungement relief was sought collectively by twenty-two different brokers who were employed by Securities America. In the expungement request, these brokers named only their employer as the Respondent; the investors who made the complaints were not named. All twenty-two expungements were granted after a single hearing session (\textit{i.e.} in less than 3 ½ hours). The award does not indicate whether any testimony was taken from any of these twenty-two brokers, and it seems impossible that all twenty-one brokers gave sworn testimony before the arbitrator. The award recites that “the parties submitted a Proposed Award for the arbitrator’s review.” The award that was entered appears likely to be the one the “parties” proposed.\textsuperscript{146}

In \textit{Wayman v. Securities America, Inc.},\textsuperscript{147} by contrast, an arbitration Panel awarded $1.2 million (including punitive damages) against Securities America in a case involving that same investment. Curiously, the law firm that represented the brokers in \textit{Barker} represented Securities American in \textit{Wayman}.

The requirement that requires arbitrators consider the amount of the settlement also fails to act as a meaningful safeguard. First, many arbitrations involve modest amounts of damages, often not much greater than the cost of an expensive legal defense. Many such (meritorious) complaints are undoubtedly being expunged despite the requirement that the amount of the settlement be taken into account because the settlements can be justified by the potential cost of defense. Even in larger cases, FINRA provides arbitrators with no guidance other than that they should take the amount of the settlement into account. In one arbitration, a $160,000 settlement

\textsuperscript{144} See \textit{e.g.}, \textit{York v. Morgan Stanley Smith Barney}, No. 11-03966 (10/2/12), the arbitrators attached to their award a stipulation, signed by the parties, reciting the grounds and basis for expungement. The award incorporates that stipulation word-for-word.

\textsuperscript{145} FINRA No. 12-01305 \textit{See also Hyman v. Securities American}, No. 12-01701 (5/22/13) in which expungement was granted en masse for six other Securities Americas brokers; \textit{Stief v. Advanced Equities}, No. 11-03116 (4/27/12) (granting expungement for nine brokers); \textit{Glubiaki v. Securities America, Inc.} (No. 12-01156 (1/23/13) (granting expungement of four complaints in a single half-day hearing).

\textsuperscript{146} One of the brokers who received expungement in \textit{Barker} was recently fined by the State of Utah for failure to supervise in a different case. Eight of the brokers already had CRDs that showed customer complaints. Two of these had more than one such complaint. The award does not indicate whether the panel that granted these twenty-two expungements was told any of these facts.

\textsuperscript{147} FINRA No. 10-00012 (12/31/10) (CITE NEEDED).
– which a dissenting arbitrator said approximated the damages incurred by the Claimant – nevertheless resulted in an award of expungement.\textsuperscript{148} In another case, where $96,000 was paid in settlement, the arbitrators explained away the amount of the settlement by writing that the payment to the investor was the least it would cost the broker to defend the allegations had a full-blown adversarial hearing been held. By contrast, the entire expungement hearing – in which the Respondent ostensibly proved that the claim was false – consumed only a single FINRA arbitration session, \textit{i.e.} it lasted no more than 3 ½ hours.\textsuperscript{149} It was, after all, ex parte.

No amount of arbitrator training can fix these flaws. Arbitrators can only make decisions based on the evidence they hear. Indeed, FINRA’s own training materials for arbitrators explain that an arbitrator’s function is to “determine the facts of the case, … evaluate the testimony and weigh to credibility of witnesses ….”\textsuperscript{150} The absence of contradictory evidence in post-settlement expungement cases surely explains the 94% expungement rate.\textsuperscript{151}

Nor has FINRA fixed the problem that looms because of the New York cases or the \textit{Karsner} dicta. The supposed purpose of confirmation was to provide an additional safeguard for regulatory and public interests. The New York cases, however, show that no such safeguard exists because the expungement award is not subject to judicial review. The \textit{Karsner} decision, with its suggestion that awards styled as “recommendations” to expunge are not confirmable, looms as an issue that FINRA has ignored.

There is yet another problem with the current system – one that has not yet appeared in the records, but that is beginning to appear in law offices around the country. When an investor brings an arbitration, as we have seen, the broker’s CRD is amended to reflect the complaint. The arbitration claim itself is not a public document, and Broker-Check does not identify the

\textsuperscript{148} See \textit{Lee v Centaurus Financial, Inc.}, No. 11-03229 (April 8, 2013), an arbitration panel granted expungement on the ground that the broker was not involved in a sales practice violation. The settlement agreement provided for a cash payment of $160,000.00 and a “covenant whereby the Claimant was affirmatively obligated to assist the Respondent in having the customer dispute information expunged....” \textit{Id.} But one arbitrator dissented, writing that the amount of the settlement “approximated the amount of the Respondent’s actual damages.” This combination of facts shows that the problem with expungement was not solved by either the 2008 amendment or by FINRA’s training program.

\textsuperscript{149} See \textit{Wexco Industries v. UBS Financial Services, Inc.}, No. 11-01063, (February 11, 2013), following a settlement of a case that involved a net payment to an investor $96,000, a FINRA arbitration panel granted expungement, ruling that the claims made by the investor were “false.” The arbitration award states that the panel held heard testimony from the broker, reviewed twenty-five and received Respondent counsel’s explanation that the $96,000 settlement was the least it would cost to defend the allegations had the case not settled. One can only wonder what evidence the Respondent expected the Claimant to adduce that would have converted a 3½-hour ex parte hearing proving that the claim was “false” into a $96,000 legal bill needed to defend an adversarial arbitration hearing.

\textsuperscript{150} See FINRA Basic Arbitration Training, May 2013, at p 110, http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@arbtors/documents/arbmed/p125416.pdf. Indeed, these training materials, at p. 99, state (in the context of contested proceedings) that “Affidavits are infrequently submitted in an evidentiary hearing for anything other than ministerial matters, like authenticating third-party records. If the panel, however, decides to admit an affidavit, the chairperson may state that its weight as evidence may be diminished, because the opposing party will not have a chance to challenge the truth of the statements it contains.” The same can be said of everything that occurs at an expungement hearing.

\textsuperscript{151} In \textit{Fabrizio v. Wells Fargo}, No. 11-02293, an arbitrator dissented from an award recommending expungement, writing “the Statement of Claim contained numerous specific allegations of unsuitable investments .... [The] dissent [does not] imply that any of the allegations in the Statement o Claim are true. Since the Panel was deprived of the opportunity to hear all of the facts through a full evidentiary hearing, there is no way to reach an informed conclusion on the truth or falsity of the allegations asserted.”
complainant. But an investor who then settles that claim may not realize that, if expungement is sought and granted, that anonymous complaint on Broker-Check will be erased – with an award in FINRA award database. That award will have the investor’s name in the caption, and it is likely to contain a “finding” that the complaint was false and erroneous. The name of the lawyer who represented that investor will also appear in that award.152

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

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In sum, no one should be surprised that expungements-post-settlement are being granted at a rate of 94%. The conditions for such results are ripe, and the results have been consistent over a long period of time. Regulators, prospective employers of brokers, the investing public (and their lawyers) ought, however, to be very concerned about this high expungement rate and the ease with which expungement is obtained. The relief that is supposed to be “extraordinary” is virtually automatic. FINRA’s reforms and supposed safeguards do not work. FINRA’s arbitration-based approach to post-settlement expungement should thus be abandoned because it cannot function properly. A different system is desperately needed. In the next section, such a system is proposed.

(b) A BETTER APPROACH

The system put in place by FINRA in 2004 is a 10-year failure. The safeguards FINRA tried to create in order to balance the interests of the regulators, the public and the brokers are not working. It is time to consider a different method of determining expungement.

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

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

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152 FINRA’s procedures are already creating difficulty for investor and lawyers. Even though FINRA stated in NTM 04-16 that it considers the practice a violation of its rules, settlement offers are already being made conditional on a Stipulated Award including expungement, or at least an agreement not to oppose expungement. Lawyers are having to make difficult decisions about what to tell clients. Both lawyers and clients should be concerned about either Stipulating that the complaint was false, agreeing not to oppose the entry of such a finding, or, even in the absence of agreement, an arbitral finding that investor and lawyers filed a false complaint. The process FINRA created may, in the end, discourage settlement of cases.
expungement. In addition, the regulators can, if they wish, use their broad subpoena powers to obtain information from the brokerage firm or the broker.

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

Third, there is no good reason for arbitrators to be the decision-makers in post-settlement expungement situations. Not only are arbitrators unable to play the role of prosecutors and adjudicators, they are not equipped to serve as guardians of the public interest. An arbitrator’s role is to be the resolver of private disputes about money. An administrative law judge or other adjudicatory body created under the aegis of a regulator is better-suited to the task of evaluating the importance to the public interest in expungement than is an arbitration panel. Both FINRA and the States already have units that can address and adjudicate expungement issues properly, and that can take into account the actual regulatory interest in preserving or expunging a complaint.

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

A recent case from California demonstrates how such a system would work. In Lickiss v. FINRA, broker Edwin Lickiss sought expungement of seventeen customer complaints from the 1990s. Instead of proceeding in arbitration, Mr. Lickiss skipped arbitration and applied directly to a court for expungement. Lickiss asserted that the claims on his CRD were more

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153 While FINRA’s Rules require notice to the investor (or rather, the investor’s attorney), a notice from a state regulator that the state is interested in the issue is more likely to result in a response than a notice from FINRA in a case that the investor already considers fully and finally settled.

154 See description, at https://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/industry/p006757.pdf. Efficiency nevertheless dictates that in cases that don't settle, arbitrators should remain empowered to decide expungement based on findings, e.g. that the claim was false.

155 See discussion of Karsner, at Part IIIB, supra.

156 FINRA’s rules provide a right to appeal an adverse decision of one of its Hearing Panels, and a firm or individual can appeal FINRA’s action to the SEC and then to a federal court. See FINRA webpage titled “Adjudication,” at http://www.finra.org/Industry/Enforcement/Adjudication/ (last checked 7/16/13). See also 5 U.S.C. 706(2)(E).


158 Id.
than 20 years old, that his regulatory since then has been clean, and that each of the complaints arose from a single investment for which Mr. Lickiss was paid an “ordinary commission.”

Lickiss’ action, which named FINRA as a defendant, sought to invoke the court’s general equitable powers to grant expungement. FINRA opposed the application on the ground that expungement could only be obtained if the one of the three Rule 2080 grounds was pled and established. The lower court vacillated, but an appellate court eventually ruled that the FINRA Rule 2080 categories did not apply to the court because they were intended to be procedural rather than substantive. Instead, the court relied on its inherent equitable powers, and the case was remanded to the trial court for a hearing on whether expungement is justified.

The court’s decision did not define the standard to apply, but it did cite the SEC’s 2003 pronouncement that expungement was justified when the information “lacks regulatory value.”

The court’s decision in Lickiss is correct. The categories now used by FINRA (“clearly erroneous,” “not involved” or false) are artificial and amorphous. Instead, the standard for expungement post-settlement should be the one that FINRA Rule 2080 already applies in cases where there is no judicial or arbitral finding that the case falls within one of the three categories. Rule 2080 (b)(2) provides that “under extraordinary circumstances, [FINRA] may waive the obligation to name FINRA as a party if it determines that (A) the expungement relief and accompanying findings on which it is based are meritorious; and (B) the expungement would have no material adverse effect on investor protection, the integrity of the CRD system or regulatory requirements.”

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

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

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159 Id. at 1131.
160 Id. at 1128.
161 Id. at 1134.
162 The court observed that Rule 2080 simply states the conditions under which FINRA will waive notice and the requirement that it be named a party in an application to confirm an expungement award, and that the Rule does not expressly limit expungement to the three categories.
163 The case is sub judice.
164 Id. at 1129.
165 FINRA Rule 2080(b)(2). Cf. Obrien, “Fact Finder to European Court Backs Google in a Spanish Privacy Battle,” NYT.com, 6/25/13. (Citing a policy of Spanish Data Protection Agency to seek deletion deletions of information on the internet pursuant to the 1995 EU data protection law in cases where “the information was ‘obsolete, lacked any relevance or public interest, and where widespread dissemination would lead to the harm of the applicant....’” The article reports that a recommendation has been made to the European Court of Justice that rejects Spain’s policy. According to the article, the recommendation states that “the 1995 law ‘does not entitle a person to restrict or terminate dissemination of personal data that he considers to be harmful or contrary to his interests,’” and that the recommendation concluded that “wishing to eliminate embarrassing information is not reason enough to redact public records via Google.”)
CONCLUSION

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

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