

SECURITIES LAW ALERT

DECEMBER 2011

FINRA Board of Governors Approves Moving Forward with Arbitration and Expungement Rulemaking Changes

On December 9, 2011, FINRA announced that its Board of Governors had approved proceeding with rulemaking proposals and amendments related to expungement applications, third-party subpoena procedures, and simplified arbitration limits. In connection with these proposals, the Board of Governors has authorized FINRA staff to set forth the proposals in forthcoming Regulatory Notices and to solicit comment on these proposals from member firms.

Proposed Changes to Rules Related to Expungement for Persons Not Named as Parties in Arbitration Claims

According to the December 9th announcement, FINRA will promulgate a Regulatory Notice requesting comment on a rule proposal to amend the Arbitration Code “to adopt new rules that would permit persons who are the ‘subject of’ allegations of sales practice violations made in arbitration claims, but who are not named as parties to the arbitration, to seek expungement relief by initiating *In re* expungement proceedings.” According to FINRA, “The proposed *In re* proceeding would eliminate the practice of naming public customers or brokerage firms as respondents in claims seeking expungement. However, unnamed persons would retain the ability to have their firm or former firm seek expungement in the underlying customer arbitration.”

Currently, registered persons not named as respondents in an arbitration, but against whom there are allegations that they were involved in a sales practice violation are required to report those matters under Question 14I(4) or (5) of Form U4 or Question 7E(4) or (5) of Form U5. For many registered representatives, the fact that they are not parties to the arbitration is a substantial procedural barrier to seeking expungement relief. In order for a Panel to grant expungement relief, a Panel must, as required by Rule 12805, hold a hearing in order to determine if one of the three grounds for expungement under Rule 2080 is present (i.e., (i) the claim or allegation is false, (ii) the registered representative was not involved in the alleged sales practice violation, or (iii) the claim is clearly erroneous or factually impossible).

In many cases, persons not named as parties, but against whom reportable allegations are made, are not involved in the arbitration proceeding itself. Nor are their interests necessarily represented by counsel for the respondent parties at the hearing. Since the May 2009 changes to Forms U4 and U5 requiring reporting in cases where the representative is not named, but is alleged to be “involved” in a sales practice violation, affected persons seeking expungement have faced considerable procedural hurdles in bringing their applications to a hearing panel. First among those challenges is the question of whom should be named as the “respondent” in such actions where there are no damages or other

SECURITIES LAW ALERT

relief sought against any party. In many cases, impacted registered persons have filed claims against the initial claimant, sometimes seeking nominal damages to avoid the higher filing fees associated with applications for declaratory relief. In other cases, registered representatives have filed actions naming the reporting firm as a nominal defendant, resulting in the firm incurring arbitration member firm surcharges in matters where no damages or other relief is sought specifically against them.

In these cases, FINRA's proposed "*In re*" application procedure would allow impacted registered persons to initiate claims for expungement without naming "nominal" defendants such as the original claimant or the reporting firm.

According to FINRA, the forthcoming proposal will also "clarify] that if an associated person is named as a respondent in a customer-initiated arbitration proceeding, that person may seek expungement of customer dispute information only during that customer case, and not later under the *In re* expungement rule."

FINRA anticipates creating a "Notice of Intent to File an *In re* Expungement Claim", and a "Submission Agreement for *In re* Expungement Claims" to facilitate the process.

FINRA did not provide a timetable for the release of the Regulatory Notice on this proposal, but did indicate that it would be seeking comments on the proposal prior to finalizing any changes to the Arbitration Code.

Subpoenas and Orders of Production in Arbitrations

FINRA also announced that it also plans to propose amending Rules 12512, 12513, 13512 and 13513 to "standardize FINRA practices relating to arbitrator orders or subpoenas to non-party brokerage firms." FINRA's proposed amendments would provide that "a brokerage firm party requesting the appearance of a witness or production of documents, either by subpoena or arbitrator order, would pay the reasonable costs of the appearance and/or production." FINRA also stated that the proposed amendments "would codify FINRA's current practice of allowing the non-party to raise objections to subpoenas or orders issued by arbitrators."

Threshold for Simplified Arbitration

Finally, FINRA announced that it had authorized proposed amendments to FINRA Rules 12800 and 13800 to increase the threshold for simplified arbitration from \$25,000 to \$50,000.

For more information about any of the topics covered in this issue of the Securities Law Alert, please contact:

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