SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Arbitration Between	
	INDEX NO. 104034/07
ELIZABETH JOHNSON, individually and as Trustee for the Casaburi Family Trust and as POA for Betty Casaburi.	
And	
SUMMIT EQUITIES, INC. and PETER O'NEILL,	
NASD, INC. as Relief Defendant,	
And	
THE ATTORNEY GENERAL OF THE STATE OF NEW YORK	
Third Party Intervenor.	

AMICUS CURIAE BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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IDENTITY OF THE AMICUS CURIAE

The North American Securities Administrators Association, Inc. ("NASAA") is the nonprofit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 67 members, including the state securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, it is the oldest international organization whose members are devoted to protecting investors from fraud and abuse in the offer and sale of securities.

The members of NASAA are the state securities agencies, including the Office of the New York Attorney General ("Attorney General"), that are responsible for regulating securities transactions and securities professionals under state law. These state securities agencies are charged with the fundamental mission of protecting investors, and their jurisdiction extends to a wide variety of investment products and financial services. Their principal activities include registering certain types of securities: licensing the firms and agents who offer and sell securities or provide investment advice; investigating violations of state law; and initiating enforcement actions where appropriate. By licensing the companies and individuals who interact with the investing public, and by continuously tracking the enforcement actions and arbitration claims filed against those professionals, state securities regulators protect investors from those who are unfit to serve in the industry.

NASAA supports the work of its members in many ways: coordinating multi-state enforcement actions, conducting training programs, publishing investor education materials, and representing the membership's position, as amicus curiae, in significant

cases involving financial services regulation. In its amicus briefs, NASAA addresses a wide variety of issues pertaining to securities regulation and investor protection.[1] Protecting the accuracy and integrity of broker licensing records through the proper application of Rule 2130 has assumed special significance for NASAA in expungement litigation. Recently, for example, NASAA filed an amicus brief in the matter of the *Application of Mary Ellen Kay against Loretta D. Abrams and the National Association of Securities Dealers*, Index No. 100235/07 (Hon. Edward H. Lehner), arguing, as in this case, that the court should deny a petition for confirmation of an expungement award where the procedural and substantive safeguards set forth in Rule 2130 have not been applied.

NASAA also plays a vital role in supporting the states' licensing and registration function for stockbrokers and their firms. To that end, NASAA and the National Association of Securities Dealers ("NASD")[2] developed a centralized system used by states and other regulators to process applications for securities industry licenses. This system, which is jointly administered by NASAA and NASD, is known as the Central Registration Depository ("CRD").

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[1] *See* NASAA's website to view this and other NASAA amicus curiae briefs, *available at* http://www.nasaa.org/issues___answers/enforcement___legal_activity/968.cfm.

[2] On July 27, 2007, the Securities and Exchange Commission approved certain changes to the by-laws of NASD facilitating the merger of NASD with the regulatory arm of the New York Stock Exchange. The merged entity has adopted the new name Financial Industry Regulatory Authority or "FINRA." However, in this brief, NASAA will continue to refer to the "NASD" for purposes of clarity, since the pleadings filed to date with the Court have all used "NASD."

As discussed in more detail below, the CRD system serves two vitally important functions. It provides state and federal regulators with a centralized mechanism through which licensing applications can be filed and processed electronically. The CRD system also enables members of the public to track the disciplinary history of industry participants after they obtain their licenses. For example, the information contained in the CRD enables potential investors to review the disciplinary history (including arbitration claims) and the licensing status of stockbrokers via the web or through contact with state securities regulators. The CRD thus helps investors protect themselves from members of the industry who may be unscrupulous.

INTEREST OF THE AMICUS CURIAE

NASAA and its members have a stake in the outcome of this case because the Court's disposition of the issues will have a significant impact on the ability of the Attorney General and other state securities regulators to carry out their statutory licensing responsibilities. At issue in this matter is when and under what circumstances customer complaint information can or cannot be expunged from the CRD. State regulators rely on the information in the CRD as they carry out their statutory duty to review license applications to determine if applicants meet the fitness requirements under state statutes. In addition, regulators and members of the investing public rely on information in the CRD regarding disciplinary proceedings and arbitration claims to ensure that only those who comply with the law may continue to do business with the public.

Allowing information on the CRD system to become incomplete and inaccurate through expungement, as threatened in this case, will undermine the ability of regulators

to protect the public in the licensing and registration process. Removing information from the system will also hinder the ability of the public to protect itself when selecting a broker.

The Court will benefit from NASAA's input because of the association's intimate knowledge of the CRD licensing system and the expungement process. NASAA played a significant role in developing the CRD system and it continues to administer the system in conjunction with NASD. Furthermore, NASAA was actively involved in the deliberations that gave rise to NASD Rule 2130 ("Rule 2130"), the rule that sets forth the standard for granting and confirming requests for expungement of customer complaint information.

Additionally, NASAA has significant experience in the application of the rule. As part of the implementation of Rule 2130, NASAA and the NASD have established a procedure for notifying state regulators when a stockbroker seeks to expunge customer complaint information from his or her CRD record. Whenever NASD receives notice of an expungement request under the rule, it notifies NASAA and NASAA in turn forwards the materials to the states in which the stockbroker is registered. In its formal order approving Rule 2130, the SEC expressly acknowledged the value of notifying states and affording them an opportunity to intervene in expungement confirmation cases, to help ensure that "investor protection or regulatory issues" can be adequately addressed. *See* 68 Fed. Reg. 74,667, at 74,671 fn. 30. Since implementation of this notification process in 2004, NASAA has received and reviewed approximately 450 expungement matters.

NASAA's participation as amicus will assist the Court by providing the history of the rule and an insight into its underlying remedial purpose. That history makes clear that Rule 2130 was intended as a safeguard against abuses in the expungement process, including the type of abuse threatened in this case: the lure of a monetary settlement to procure an unwarranted expungement and to conceal from the public and regulators the filing of a customer complaint.

SUMMARY OF NASAA'S ARGUMENT

Rule 2130 was drafted and adopted with the intent of narrowing the circumstances under which expungements could be awarded and to ensure that reportable customer complaints were not bargained away through the settlement process. Arbitration panels may recommend expungement relief only when the procedural requirements and substantive standards of Rule 2130 have been satisfied and not simply when a stockbroker prevails or when a complainant acquiesces in the expungement due to a settlement agreement. Further, courts should conduct a meaningful review of such recommendations to ensure that the arbitrators have complied with both the letter and the intent of the rule. This robust approach is consistent with the purposes of the rule and sound public policy for the protection of investors. With respect to the merits in this matter, the petition seeks confirmation of an award that does not comply with Rule 2130 on procedural or substantive grounds. Accordingly, the award is irrational and contrary to public policy, and in issuing such an award the arbitration panel exceeded its powers. Accordingly, the Court should deny confirmation and should vacate the award as provided in N.Y. C.P.L.R. § 7511.

SUMMARY OF THE UNDERLYING ARBITRATION

On June 8, 2004, Elizabeth Johnson ("Johnson") initiated an arbitration proceeding against Peter O'Neill ("O'Neill") and Summit Equities ("Summit") by filing a Statement of Claim ("Claim") with the National Association of Securities Dealers Dispute Resolution office ("NASD DR"). In her Claim, Johnson alleged that O'Neill, the stockbroker responsible for managing Johnson's accounts, engaged in misconduct that resulted in a loss of $200,000. Johnson contended that as a result of a series of unsuitable investments, including junk bonds and high-risk mutual fund shares, numerous unauthorized trades, and the improper use of margin trading, O'Neill and Summit committed common law fraud, breach of fiduciary duty, negligence, failure to supervise, and suitability violations.

O'Neill and Summit denied the allegations against them but the claims were never arbitrated. Rather, in September and October of 2005, Johnson reached a settlement with O'Neill and Summit, and she withdrew her claims.[3] In or around May of 2006, the Arbitration Panel formalized its resolution of the case in two separate and somewhat contradictory documents: a Stipulated Award, and a memorandum describing a "Telephonic Expungement Hearing." The Stipulated Award recited an "affirmative finding" that "[t]he registered person was not involved in the alleged investment-related sales practice violation[s]," and it recommended expungement. *See* Stipulated Award,

[3] The Stipulated Award indicates that the claims against O'Neill were withdrawn on September 12, 2005 and a settlement agreement between Summit and Johnson was finalized on or about October 10, 2005. *See* Stipulated Award, Case No. 04-04272, Brady Aff. Ex. 1 at 2.

Case No. 04-04272, Brady Aff. Ex.1 at 2, 3. The Stipulated Award also made clear, however, that it was prepared and presented to the Panel by the parties in accordance with their settlement agreement and further that it was entered "in lieu of a hearing and upon motion of both parties." *See* Stipulated Award, Case No. 04-04272, Brady Aff. Ex. 1 at 2.

Also in May 2006 or shortly thereafter, the Panel issued a separate memorandum reflecting the substance of a telephone call regarding O'Neill's expungement request.[4] In that memorandum, the Panel revealed that only attorneys and none of the parties participated in the call, and that the only "available evidence" in the proceeding was a written affidavit provided by *O'Neill*, the broker seeking expungement.[5] *See* Supplemental Filing, Brady Aff. Ex. 2 at 5. In addition, in the memorandum, the Panel retreated from the "affirmative finding" contained in the Stipulated Award, and instead offered the more guarded pronouncement that the Panel was granting expungement "based upon" the provision set forth in 2130(b)(1)B. *Id.* at 2.

O'Neill subsequently filed his petition to confirm the Panel's recommendation in this court. O'Neill named the NASD as a respondent pursuant to Rule 2130, and in accordance with an agreement reached with the NASD and NASAA, the NASD notified NASAA of service of the petition. Since O'Neill is registered in New York, and since

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[4] This memorandum is attached to a document filed with the Court by William A. Despo, counsel for O'Neill, entitled, "Supplemental Affidavit of William A. Despo in Support of Petition to Confirm Arbitration Award and in Opposition to Motion of Attorney General to Intervene" ("Supplemental Filing").

[5] To NASAA's knowledge, O'Neill's affidavit has not been served on any parties or filed with this Court.

the Attorney General is New York's representative to NASAA, NASAA notified the Attorney General's office of O'Neill's filing pursuant to the notification process discussed above.

ARGUMENT[6]

I. RULE 2130 CONSTITUTES A SET OF PROCEDURAL AND SUBSTANTIVE STANDARDS THAT ARBITRATORS MUST FOLLOW WHEN CONSIDERING EXPUNGEMENT REQUESTS, AND COURTS SHOULD VACATE AN EXPUNGEMENT AWARD WHERE AN ARBITRATION PANEL HAS FAILED TO PROPERLY APPLY THE RULE.

Rule 2130 was promulgated to allow NASD and state regulators to challenge expungement awards that might impair the integrity of the CRD, and to ensure the maintenance of essential information on CRD for use by regulators and investors. *See* NASD Rule Filing SR-NASD-2002-168, Nov. 18, 2002, Brady Aff. Ex. 3 at 7. And, it was drafted to address the SEC's serious concern that valuable information about customer complaints was being bargained away through negotiated settlements. 68 Fed. Reg. 74,667, 74,672 (Dec. 24, 2003). Whenever an arbitrator has failed to apply the procedural and substantive standards in Rule 2130 correctly, that arbitrator has exceeded his or her authority. On that basis, the resulting award can and should be vacated under

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[6] The Securities Industry and Financial Markets Association ('SIFMA"), in a brief submitted to this Court in the action styled *In the Matter of the Arbitration of Certain Controversies Between UBS Financial Services, Inc. and Karen A. Karrasch and Marshal D. Gibson and NASD Dispute Resolution*, raised the issue of preemption by arguing that some of the Attorney General's arguments conflict with Rule 2130. NASAA has not addressed these issues because it believes that the matter before the Court can be resolved without resort to the constitutional doctrine of preemption. However, NASAA's silence on the preemption issue is not intended to signify agreement with the position advanced by SIFMA or other parties.

N.Y. C.P.L.R. § 7511.

A. The History of Rule 2130 Reveals that it Was Intended to Bind Arbitrators to Certain Procedural and Substantive Standards in the Expungement Process.

The issue of removing information from the CRD has been a matter of concern to state securities regulators for many years. Rule 2130 represents at least a partial solution to those concerns. Rule 2130 was approved by the SEC and formally became a part of the NASD rule book in April 2004. *See* NASD Notice to Members 04-16 (March 2004) ("NTM 04-16"), Brady Aff. Ex. 4 at 211. NASAA was involved in discussions with NASD as the rule was being drafted, as were other parties such as the Securities Industry Association.[7] Ultimately, NASD was the principal drafter of this rule and it was adopted as a conduct rule applicable to NASD members. To understand what the rule was intended to accomplish, and its role in serving the interest of regulators, investors, and stockbrokers, a review of the history of the rule is helpful.

From the inception of the CRD, NASD routinely expunged customer dispute information based on awards issued by arbitration panels without judicial confirmation. NASAA, however, objected to the expungement of customer dispute information based solely on an award from an arbitration panel. NASAA's concerns were grounded in large part on the fact that arbitration panels do not and should not have the authority to enter awards that result in the destruction of state records. NASAA was also concerned that expungements were being used improperly to conceal broker misconduct. In response to

[7] The Securities Industry Association merged with the Bond Market Association in 2006 to form SIFMA, the Securities Industry and Financial Markets Association.

these concerns, NASD and NASAA agreed in 1999 on a moratorium on all arbitrator-ordered expungements issued in disputes between public customers and stockbrokers. NASD, however, continued to effectuate court-ordered expungements.

In July 1999, NASD, as part of its rulemaking process, published Notice to Members 99-54 ("NTM 99-54"). In NTM 99-54, NASD solicited comments on four proposals that would allow the expungement of some information from the CRD while at the same time complying with applicable state record laws. The four proposals were as follows: (1) information ordered expunged would remain on CRD but would not be disclosed through NASD's public disclosure program; (2) NASD would stamp a legend on the information that had been ordered expunged noting it as such; (3) NASD would provide copies of the expunged information to state regulators in an alternative media format; or, (4) NASD would establish standards that would have to be satisfied before NASD would execute an award of expungement. *See* NTM 99-54 (July 1999), Brady Aff. Ex. 5, at 353.

After reviewing the comments on the various proposals in NTM 99-54, NASD issued Notice to Members 01-65 ("NTM 01-65") announcing that it would pursue the fourth approach: establishing certain criteria that must be met and procedures that must be followed before NASD would expunge information from the CRD. *See* NTM 01-65 (Oct. 2001), Brady Aff. Ex. 6. NASD acknowledged that in crafting this approach it was attempting to balance the interests of regulators in retaining customer dispute information, the interests of stockbrokers in protecting their reputations, and the interests of investors in having access to information about brokers with whom they do business.

NASD affirmed that expungement is extraordinary relief that should only be granted in limited circumstances and then only after a determination that the matter satisfied at least one of three specific criteria. *See* NTM 01-65 (Oct. 2001), Brady Aff. Ex. 6 at 566. Regarding stipulated awards where cases had been resolved through settlement, NASD proposed that it would be appropriate to include expungement relief in stipulated awards *only* in cases involving factual impossibility, such as when a person was mistakenly named. *Id.* at 567.

NASAA submitted a comment letter to NASD in response to NTM 01-65. *See* NASAA Comment Letter to the NASD, Brady Aff. Ex. 7. While generally supportive of the proposal, NASAA's comment letter was unequivocal in its view that expungement should be available through a court order and only under very limited circumstances.[8]

Following the issuance of NTM 01-65, NASD filed a rule proposal with the SEC seeking to formally adopt a rule governing expungement. The proposal was published by the SEC for comment and NASAA again offered its views. In its comment letter to the SEC, NASAA suggested that the rule could have been drafted more clearly in order to accomplish the purpose of the rule as described in NTM 01-65, but generally endorsed the effort to improve the expungement process. *See* NASAA Comment Letter to the SEC, Brady Aff. Ex. 8.

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[8] In NASAA's comment letter to NASD on this issue, NASAA wrote that "Both sound public policy and the delegation doctrine demand that alteration of state public records requires an order by a court of competent jurisdiction based on law, not a non-judicial NASD arbitration panel's declaration." *See* NASAA Comment Letter to the NASD, Brady Aff. Ex. 7, at 4. NASAA has been consistent in its position that arbitration panels lack the authority to issue a directive expunging state records.

Following the comment period, the SEC approved proposed Rule 2130 in Release No. 34-48933, 68 Fed. Reg. 74,667 (Dec. 24, 2003). In approving the rule, the SEC found that it was "a clear improvement over the [then] current system for the expungement of information from the CRD system" and that it should "ensure that investors and regulators have access to more accurate information through the CRD system." *Id.* The SEC further observed that the rule addressed "serious concern[s] that valuable information is being expunged from the CRD system *through arbitration settlements that include negotiated expungement instructions*." *Id.* at 74,671 – 672 (emphasis added). The SEC concluded that the rule would accomplish this by ensuring that "only information that is not valuable to regulators and investors is expunged from the CRD System." *Id.* at 74,672.

The SEC noted that states would be able to petition the courts in expungement matters should any state be concerned that NASD had not adequately considered relevant regulatory or investor protection issues. *Id.* at 74,671. According to the SEC, an improper expungement would adversely affect "the integrity of the CRD system, and regulatory requirements." *Id.* In order for CRD to be an effective regulatory tool, the SEC noted, it is important that "regulators be able to examine the entirety of a registered person's record, *with the limited exceptions as proposed*." *Id.* at 74,670 (emphasis added). The SEC found that Rule 2130 is consistent with the Exchange Act's goal "to protect investors and the public interest." *Id.* at 74,671. The SEC also responded specifically to concerns raised during the comment period that stockbrokers were misusing expungement in the context of settled cases by "buying" clean CRD records.

On this issue, the SEC observed that the NASD had amended the proposed rule by requiring an "*affirmative* finding" – not merely a "finding" – that at least one of the expungement criteria were present. *Id.* (emphasis added). In the SEC's view, this toughening of the rule would greatly reduce the "ability of members and associated persons to 'buy clean records.'" *Id.*

After the SEC approved the rule, NASD issued NTM 04-16, mentioned above, which explained the process by which stockbrokers were to proceed on expungement requests and further explained NASD's intent to notify the states of such requests. *See* NTM 04-16 (March 2004), Brady, Aff. Ex. 4 at 214. The notice cautioned that even if arbitrators dismissed a customer's claim, the panel still should consider whether or not to grant relief on one or more of the grounds in the rule. This is consistent with earlier pronouncements by NASD that dismissal of a claim is not in and of itself a reason to order expungement of the claim. *See* Rule Filing SR-NASD-2002-168, Amendment No. 2, Sept. 11, 2003, Brady Aff. Ex. 9 at 2. Even if the parties settle their dispute, counsels the notice, the arbitrators must still make an affirmative finding and may require the submission of documents or an evidentiary hearing. *See* NASD NTM 04-16 (March 2004), Brady Aff. Ex. 4 at 214.

Thus, while formulating the rule, NASD considered several approaches, but ultimately settled on a framework that established strict procedures and standards for arbitrators to follow in recommending expungement. Such an approach reflects the fact that removing information from a system designed to provide regulators and the public with a complete picture of a broker's complaint history is an extraordinary remedy. In

the words of the NASD, "[e]xpungement relief is extraordinary relief that should be granted in limited circumstances only after a determination by an independent adjudicator that the matter in question meets at least one of the criteria established for expungement." *See* NTM 01-65, (Oct. 2001), Brady Aff. Ex. 6 at 566.

This theme of establishing standards for expungement is constant throughout the rule filings and proposing releases. As noted by the NASD in its original filing with the SEC, specific information should be removed from the CRD but only after "certain criteria have been met and certain protocols are followed." *See* NASD Rule Filing SR-NASD-2002-168, Nov. 18, 2002, Brady Aff. Ex. 3. at 9. Throughout the expungement debate and the rule-making process, the NASD has adhered to the view that there should be "parameters for arbitrator-ordered expungements to ensure that investor protection is not compromised and to give some indication of the arbitrators' reasons for granting such relief." *See* NASD NTM 99-54 (July 1999), Brady Aff. Ex. 5 at 353.

B. The Proper Application of Rule 2130 Requires a Factual Record and an Affirmative Finding, Supported by the Record, That at Least One of Three Grounds for Expungement Is Present.

Rule 2130 requires that before expungement may be recommended or confirmed, the arbitration award must contain an affirmative finding of the presence of one or more of the three standards listed in the rule. It is axiomatic that an affirmative finding must be based on something more than the pleadings or one-sided arguments and that there must be a sufficient factual record in the arbitration proceeding to support the finding. In other words, arbitrators are constrained not only by the standards established in the rule but also by the nature of the remedy itself to grant expungement relief only after fully

considering all evidence and arguments both in favor of and in opposition to the expungement, and only after articulating an affirmative finding that allows for meaningful review.

At least one New York Court has squarely agreed with this approach. Justice Devlin of the Erie County Supreme Court was asked to confirm an arbitration award, obtained as the result of a settlement, recommending that the customer dispute be expunged from the CRD. *Sage, Rutty & Co., Inc. v. Salzberg et al.*, 2007-01942 (N.Y. Sup. Ct. May 30, 2007). In refusing to confirm the award and in remanding the matter back to the arbitration panel, Justice Devlin wrote that there were "no facts before the Court necessary to make a reasonable determination that one of the standards for expungement in Rule 2130 was met." Without this, the court could not fulfill its responsibility under Rule 2130. *Id.* at 5.

Even when a hearing has been conducted and an affirmative finding has been made, courts must also ensure that the finding is supported by the facts of the case. This substantive standard complements the procedural requirements of Rule 2130 and helps to ensure that expungement is only granted when it is warranted under the rule.

C. An Arbitrator Who Fails to Properly Apply Rule 2130 Has Exceeded His or Her Power Within the Meaning of N.Y. C.P.L.R. Section 7511, and Any Resulting Award Can and Should Be Vacated.

Under N.Y. C.P.L.R. § 7511(b)(1)(iii), an arbitration award "shall be vacated" if the arbitrator "exceeded his power." Under the case law, arbitrators may be deemed to have exceeded their powers in a variety of circumstances. Included among them are: (1) the arbitrator has exceeded a specifically enumerated limitation on his authority; (2) the

decision is irrational; or (3) the award is violative of a strong public policy. *Matter of Silverman (Benmor Coats)*, 61 N.Y.2d 299, 308 (N.Y. 1984). The arbitrator will be deemed to have "exceeded his power" within the meaning of N.Y. C.P.L.R. 7511(b)(1)(iii) when one of these three circumstances is shown. *Cf. Rochester City School Dist. v. Rochester Teachers' Ass'n.*, 362 N.E.2d 977, 981 (N.Y. 1977) (if arbitrator's award is completely irrational, "it may be said that he exceeded his power").

When applying these tests, the court's function is not "simply to rubber-stamp the award." *Carty v. Nationwide Ins. Co.*, 149 A.D. 2d 328, 329 (N.Y. App. Div. 1989); *Unger v. Unger*, 547 N.Y.S.2d 529, 531 (N.Y. App. Div. 1989) (observing that while a court may appear to have limited discretion in denying or confirming an arbitration award, it is not utterly powerless); *Stalinsky v. Pyramid Electrical Co.*, 160 N.E.2d 78 (N.Y. 1959) (on a motion to confirm an award, the court does not sit as an administrative rubber stamp over an arbitrator's determination, but rather as a court of equity applying equitable principles and enjoys a certain latitude of discretion). In general, the power of the arbitrator to fashion a remedy is not without limits. *Rochester City School Dist. v. Rochester Teachers' Ass'n.*, 41 N.Y.2d 578, 582 (N.Y. 1977). And in this case, Rule 2130 has expressly circumscribed the authority of an arbitrator to grant expungement relief by imposing rigorous standards and by requiring a court order to confirm any expungement award. Therefore, in order to insure that expungement relief is appropriate and granted only in extraordinary circumstances, courts should conduct a meaningful review of the recommendations from arbitrators before confirming expungement.

II. THE COURT SHOULD DENY O'NEILL'S PETITION TO CONFIRM THE PANEL'S RECOMMENDATION OF EXPUNGEMENT BECAUSE THE RECOMMENDATION WAS NOT MADE IN COMPLIANCE WITH THE PROCEDURAL AND SUBSTANTIVE REQUIREMENTS IN RULE 2130.

The arbitrators' expungement recommendation in this case was entirely improper under the standards set forth in Rule 2130. The Panel failed to conduct a proper hearing, failed to make the requisite affirmative finding, and invoked a basis for expungement that was not supported by the facts in the case. Furthermore, this case does not warrant the exceptional remedy of expungement. Deleting this arbitration claim from O'Neill's CRD record will violate the important policies favoring regulatory disclosure and investor protection that underlie the CRD system. Far from being confirmed, the award should be vacated.

A. The Arbitration Panel Failed to Conduct an Adequate Hearing and Develop an Adequate Record on the Expungement Request.

The Panel in this case failed to conduct a proper hearing or compile an adequate evidentiary record. The necessity of a hearing follows implicitly from the structure of Rule 2130 and from its legislative history. Neither the NASD (which must evaluate each expungement request under the rule), nor any court asked to confirm an expungement award, nor any state seeking to contest an expungement matter, can adequately assess the merits of an expungement request unless the panel gathers and reviews evidence on the alleged grounds for expungement. NASD's NTM 04-16 which announced the adoption of Rule 2130 reinforces this conclusion. Specifically, NTM 04-16 explains that even in settled arbitrations, arbitrators must make affirmative findings with respect to the standards for expungement and must "state in the award the basis on which the

expungement relief was granted." *See* NASD NTM 04-16 (March 2004), Brady Aff. Ex. 4 at 214. The NTM goes on to say – again with respect to settled claims – that "arbitrators may require the submission of documents or a brief evidentiary hearing to gather the information necessary to make such findings." *Id.* In both contested and settled arbitrations, then, panels must conduct a hearing or otherwise compile a fair evidentiary record on the claimed grounds for expungement.

The Panel in this case failed to discharge that obligation. In the Stipulated Award, the arbitrators dispensed with the hearing requirement altogether: the Award plainly states that it is being entered "in lieu of a hearing" and "upon motion of both parties." *See* Stipulated Award, Case No. 04-04272, Brady Aff. Ex 1 at 2. The Stipulated Award thus purports to make a finding based on no hearing or evidence whatsoever.

At oral argument, the Court was provided with the Supplemental Filing which indicates that the arbitration Panel convened a conference call on O'Neill's request for expungement. However, according to the Panel's memorandum summarizing the call (attached to the Supplemental Filing), the hearing consisted of a telephone call in which none of the parties actually testified or participated. Further, the only evidence considered was an affidavit tendered by O'Neill. As stated by the Panel in its memorandum reflecting the substance of the telephone call, "Peter O'Neill's affidavit contains all of the available evidence in this proceeding." *See* Supplemental Filing, Brady Aff. Ex. 2 at ¶ 4. Based on O'Neill's uncontested and presumably self-serving affidavit, coupled with the complainant's acquiescence pursuant to the settlement, the Panel "grant[ed] expungement." *Id.* at ¶ 6.

Both the Stipulated Award and the supplemental filing thus demonstrate that the Panel failed to complete an essential procedural step: conducting a meaningful hearing to ensure that the extraordinary remedy of expungement was justified under the facts and circumstances. This handling of O'Neill's expungement request represents an abdication of the responsibilities imposed by Rule 2130. For this reason alone, the Court is justified in vacating the award.

B. Conclusory Findings Such as Those in This Matter Do Not Satisfy the Substantive Requirements of Rule 2130 and the Law of This State.

The Panel's "findings" were also inadequate under Rule 2130. The drafters of Rule 2130, as well as the SEC, recognized that arbitration settlements pose a particularly grave threat of abuse. The SEC was clear in its order approving the rule that requiring arbitrators to make an "affirmative finding" that one of the standards was met would provide the necessary protection against "buying clean records." 68 Fed. Reg. 74.671. The rule itself certainly draws no distinction between settled and contested cases for purposes of the findings necessary for expungement. In short, in all cases involving expungement requests, whether contested or settled, arbitrators have a duty to hold hearings, consider evidence both for and against expungement, and make affirmative findings that are supported by the record.

In this case, the Panel's findings were deficient. In the Stipulated Award, the Panel incanted the phrase "affirmative finding," but the gesture was meaningless because the Panel was simply adopting the terms of the parties' settlement, without the benefit of a hearing. In its memorandum of the telephonic "hearing," the Panel conspicuously

stopped short of making any findings at all. The panel simply wrote that it was granting expungement to O'Neill "based solely upon 2130(b)(1)B." *See* Supplemental Filing, Brady Aff. Ex. 2 at 6. This hardly constitutes an affirmative finding that O'Neill was "not involved" in the alleged misconduct based upon an appropriate factual record.

The Panel's half-hearted and conclusory decision to grant relief is contrary to Rule 2130 and deprives the Court of the ability to conduct a meaningful review of the award. In the words of Justice Devlin, "There is nothing in the award which the Court can rely upon in order to fulfill its responsibility under Rule 2130." *Sage, Rutty & Co., Inc. v. Salzberg, et al.*, No. 2007-01942 (N.Y. Sup. Ct. May 30, 2007); *see also Shereff v. Tax Commission of the City of New York*, 42 A.D.2d 593 (N.Y. App. Div. 1973) (affirmative finding of fact must be made in order to assure that there can be a meaningful appellate review). For this reason as well, the Panel's recommendation should be vacated.

C. The Panel's Decision That O'Neill Was Not Involved in the Alleged Sales Practice Violation Is Irrational.

In this case, the pleadings and motions alone are sufficient to invalidate the Panel's decision to grant expungement under the "not involved" standard set forth in Rule 2130(b). Rule 2130 provides three specific standards for expungement:

> (A) the claim, allegation or information is factually impossible or clearly erroneous;
> (B) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or
> (C) the claim, allegation, or information is false.[9]

[9] In addition, there is a fourth standard that applies in extraordinary circumstances, but it certainly would not apply in this case. It requires that the award and the findings on

The arbitrators in the instant matter invoked the second standard. *See* Stipulated Award, Case No. 04-04272, Brady Aff. Ex. 1 at 3. However, even the limited record available to NASAA and the Court reveals that the arbitrators' reliance upon this standard was erroneous. The "not involved" test requires evidence showing that the broker did not handle the complainant's account, did not deal with the complainant during the relevant time period, or was otherwise not involved in the events comprising the factual predicate of the claim. It does not permit expungement simply because the panel may have found that the actions alleged do not give rise to *legal* liability. In the words of the NASD, "merely prevailing in an arbitration case" is not an appropriate ground for expunging information from the CRD. *See* NASD Rule Filing SR-NASD-2002-168, Amendment No. 2, Sept. 11, 2003, Brady Aff. Ex. 9 at 2.

O'Neill's own defenses to Johnson's claims flatly contradict the arbitrators notion that he was "not involved" in the conduct at issue. O'Neill was unequivocal in his assertion that he "certainly knew his customer . . . as he took detailed notes and chartered a comprehensive plan of strategy for the subject account." *See* Motion for Summary Judgment, Motion to Dismiss, Motion for More Definite Statement and Answer, Case No. 04-04272, Brady Aff., Ex. 10 at 2. In fact, throughout O'Neill's responsive pleading, he contended that his handling of the accounts was appropriate beginning on the first day he met with the complainant and opened the accounts until the day the accounts were

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which it is based be "meritorious" and that the expungement have "no material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements." 2130(b)(2). O'Neill does not contend that this standard applies, nor could he under the facts of this case.

closed. This degree of involvement in the underlying facts of the case – regardless of whether or not O'Neill was ever found *legally* culpable – flatly contradicts the Panel's suggestion that he was "not involved." Thus, even the scant record in this case shows that the Panel's award of expungement relief was not only procedurally defective, but also wrong in substance and should be vacated. [10]

D. This Case Exemplifies the Type of Abuse in the Expungement Process That Rule 2130 Was Intended to Address, and Denial of the Petition Therefore Serves the Policies Underlying the Rule.

As discussed throughout this brief, Rule 2130 was drafted and adopted with the goal of preventing valuable information from being expunged from the CRD, all for the benefit of regulators engaged in licensing activity and investors in search of honest brokers. *See* 68 Fed. Reg. 74,667. Further, the rule was specifically intended to address the serious concern that valuable information was being purged from the CRD through stipulated awards. *Id.*

Both of these concerns are present in this case. First, expunging this matter from O'Neill's record will compromise the accuracy and integrity of the CRD system. Sanitizing a broker's record is a grave disservice to regulators and investors alike. Second, this case typifies one of the particular abuses that Rule 2130 was designed to address – the "rubber stamping" of stipulated awards and the buying of clean records by stockbrokers. Confirming an expungement award under these circumstances would

[10] Although unlikely considering O'Neill's own assertions and defenses in his handling of the Johnson accounts, it is conceivable that the affidavit O'Neill submitted for purposes of the telephone call with the arbitrators sheds further light on whether the "not involved" test in Rule 2130(b)(1)(B) applies. As noted above, however, to NASAA's knowledge, that affidavit has not been filed or served in this confirmation proceeding.

nullify Rule 2130 and would undermine the important investor protection goals the rule was designed to serve.

CONCLUSION

In conclusion, NASAA urges this Court to deny O'Neill's petition and vacate the Panel's award as irrational and beyond the Panel's authority.

Dated: Washington, DC
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CERTIFICATE OF SERVICE

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