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

Application of MARY ELLEN KAY,	:	
Petitioner,	:	Index No. 100235/07
For an Order Pursuant to Article 75 of the CPLR Confirming an Arbitration Award	:	The Hon. Edward H. Lehner IAS Part 19
-against-	:	
LORETTA D. ABRAMS AND THE NATIONAL ASSOCIAITON OF SECURITIES DEALERS (NASD),	:	
Respondents.	:	
And	:	
THE ATTORNEY GENERAL OF THE STATE OF NEW YORK,	:	
Proposed Third-Party Intervenor.	:	

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

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IDENTITY OF THE AMICUS CURIAE

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.[1] NASAA also plays a vital role in supporting the states' licensing and registration function for stockbrokers and their firms. 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").

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.

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[1] *See* NASAA's website to view all of NASAA's 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."

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 inaccurate through the expungement process, as threatened in this case, will undermine the ability of regulators to protect the public in the licensing and registration process. It will also undermine 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. 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 the very type of expungement at issue in this case: the lure of a monetary settlement to procure an unwarranted expungement and to conceal from the public and regulators a pattern of customer complaints.

SUMMARY OF NASAA'S ARGUMENT

The Court should grant the Attorney General's motion to intervene and should deny Kay's petition to confirm the expungement. The Attorney General has satisfied all of the requirements necessary for intervention under New York's arbitration law, under the state's general rules of procedure governing intervention, and under Rule 2130 itself. With respect to the merits, the petition seeks confirmation of an award that simply does not comply with Rule 2130. By issuing such an award, the arbitrator exceeded his powers. The award is also irrational and it violates public policy. Accordingly, the Court should deny confirmation and should vacate the award under N.Y. C.P.L.R. § 7511.

SUMMARY OF THE UNDERLYING ARBITRATION

Loretta Abrams ("Abrams") initiated an arbitration proceeding against Mary Ellen Kay ("Kay") and Prudential Securities, Incorporated, ("Prudential") by filing a Statement of Claim ("Claim") with the National Association of Securities Dealers Dispute Resolution office ("NASD DR") on April 22, 2004.[3] In her Claim, Abrams alleged that Kay, the stockbroker responsible for managing her accounts, engaged in misconduct

[3] According to its website, NASD operates the largest dispute resolution forum in the securities industry. *See* http://www.finra.org/ArbitrationMediation/index.htm.

resulting in losses in her various accounts in excess of $450,000. Abrams alleged that Kay and Prudential had committed common law fraud for false statements to the effect that the accounts would be managed in a manner appropriate to her age and financial circumstances; common law breach of contract for failing to act in Abrams' best interest and in accord with industry standards; negligence and recklessness for failure to detect and prevent the mismanagement of the accounts; and breach of fiduciary duty for failure to act in a fair, honest, and equitable manner. *See* Abrams' Statement of Claim, Brady Aff. Ex. 3.

Prudential and Kay retained separate counsel and they each denied the allegations against them. Kay acknowledged that she had handled Abrams account for years, and that she had been in constant contact with Abrams, discussing the various trades and the reasons for those trades. Kay also responded that she had thoroughly explained to Abrams the mechanics of a margin account and the risks involved with such an account. In short, Kay contended that she was in regular contact with Abrams and that Abrams, being fully advised by Kay, approved all trades and the manner in which the account was handled. *See* Prudential Answer and Kay Answer, Brady Aff. Exs. 4 and 5.

Abrams' claims against Kay and Prudential were never arbitrated. Rather, Abrams reached a settlement with Prudential and Kay wherein Prudential paid Abrams $155,000, which was approximately one-third of her alleged compensatory damages. In exchange, Abrams released Prudential and Kay from any and all claims. Abrams further agreed to keep the settlement confidential and consented to the submission of a proposed expungement award to the arbitration panel. Apparently, however, the proposed award

was never submitted to the panel. The proceeding was closed by NASD DR and the arbitration panel was dissolved.

Over eighteen months after the matter was settled, Kay and Prudential filed a Statement of Claim against Abrams. Kay's one page Claim briefly described the events of the prior arbitration between Kay and Abrams. The Claim then asked that an award be entered similar to the one contemplated by the parties in the earlier arbitration, that Abrams' claims from the *prior* arbitration be dismissed with prejudice, and that the panel recommend the expungement of the Abrams complaint from Kay's CRD record. *See* Kay's Statement of Claim, Brady Aff. Ex. 6.

Shortly after Kay filed her Statement of Claim, a single arbitrator was appointed to hear her request that the Abrams complaint be removed from her CRD record. Without conducting a hearing of any kind, the arbitrator issued an award recommending expungement. In the award, the arbitrator made the affirmative finding of fact that Kay was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds. *See* Stipulated Award for Case No. 05-05072, Brady Aff. Ex. 7, at 1.

Kay then filed her petition to confirm the arbitrator's recommendation in this Court. Kay named NASD as a respondent pursuant to Rule 2130 and in accordance with an agreement reached between NASD and NASAA, NASD notified NASAA of service of the petition. Since Kay is registered in New York, and since the Attorney General is New York's representative in NASAA, NASAA notified the Attorney General's office of Kay's filing.

ARGUMENT[4]

I. THE ATTORNEY GENERAL IS ENTITLED TO INTERVENE.[5]

The Attorney General has a right to intervene in this proceeding under all of the standards that govern intervention. The drafters of Rule 2130 certainly intended states to exercise that right whenever, as in this case, an expungement petition raises regulatory or investor protection concerns. In addition, the Attorney General has the requisite interest in this case to satisfy the requirements for intervention under New York's arbitration code as well as its general statute governing civil procedure.

A. As Explained by NASD and the SEC in the Promulgation of Rule 2130, Intervention by State Securities Regulators in Proceedings to Confirm Awards was Specifically Recognized.

As a threshold matter, the drafters of Rule 2130 intended that states would have a right to intervene in judicial proceedings to confirm arbitration awards. Specifically, the Securities and Exchange Commission ("SEC") wrote in its order approving the rule that "As a further means to ensure that the court is made aware of the investor protection and

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[4] Both Kay and the Securities Industry and Financial Markets Association ('SIFMA") have 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 Kay.

[5] The Attorney General has moved to intervene in this matter and while the amicus brief submitted by SIFMA does not address this issue, Kay's counsel has raised strong arguments in opposition to the Attorney General's motion. Because the issue of intervention by the Attorney General is central not only in this matter but in all expungement proceedings where states may seek to oppose expungement of records, NASAA believes it is important to address the Attorney General's right to intervene.

regulatory implications of an expungement, NASD noted that states will be able to intervene if they have concerns regarding whether investor protection or regulatory issues have been fairly considered." 68 Fed. Reg. 74,667, at 74,671 (Dec. 24, 2003).

At least one New York court has readily granted the Attorney General leave to intervene where a stockbroker was seeking to confirm a recommendation of expungement under Rule 2130. Recently, in *Sage, Rutty & Co., Inc. v. Salzberg et al.*, 2007-01942 (N.Y. Sup. Ct. May 30, 2007), Justice Devlin summarily granted the Attorney General's motion to intervene in a matter that is procedurally identical to this case. *See* Decision, Brady Aff. Ex. 8, at 3.

As discussed in the introductory sections of this brief, Kay's request for expungement raises both regulatory and investor protection concerns. It threatens to compromise the integrity of the CRD system that the Attorney General and other state regulators rely upon in making licensing decisions. If granted, it also will deprive public investors of accurate information about complaints against Kay. Thus, as the drafters of Rule 2130 intended, the Attorney General should be permitted to intervene.

B. The Attorney General Is Also Entitled to Intervene Under New York's Arbitration Statute.

Pursuant to N.Y. C.P.L.R. § 7511(b)(2), a party who did not participate in an arbitration may nevertheless petition to have the award vacated. Subdivision (b)(2) applies if the aggrieved party did not participate in the arbitration and was not served with a notice of intention to arbitrate. *See Interboro Mut. Indem. Ins. Co. v. Legros*, 614 N.Y.S.2d 278. (N.Y. App. Div. 1994) (relief under N.Y. C.P.L.R. § 7511(b)(2) is

available to a party who neither participated in the arbitration nor was served with notice of intention to arbitrate). Any person satisfying this test may have the award vacated if "the rights of that party were prejudiced" by any one of several enumerated causes. Among those causes are situations where "an arbitrator . . . exceeded his power." N.Y. C.P.L.R. § 7511(b)(1)(iii).

The Attorney General satisfies all of these criteria and therefore should be permitted to intervene and to have the award vacated. The Attorney General did not participate in either of the relevant arbitrations, nor did the Attorney General receive notice of the intention to arbitrate. Moreover, as argued below, the arbitrator issued the expungement award without complying with Rule 2130, so he clearly "exceeded his power."

Finally, the arbitrator's award prejudices the rights of the Attorney General in several ways. It prejudices the Attorney General's licensing function as well as the Attorney General's ongoing effort to ensure that all citizens have access to accurate information about brokers. The award also prejudices the Attorney General in a more fundamental sense by depriving New York of its property rights in CRD records. All state securities authorities have an ownership interest in CRD information as well as a regulatory interest in it.[6] As pointed out in the Attorney General's Affirmation in Reply

[6] The development of the CRD system and its subsequent enhancements have been negotiated between NASAA and NASD, with NASAA representing the interests of all state securities regulators. The CRD contract between NASAA and NASD is explicit on this point. The preamble to the original CRD contract states in part that, "WHEREAS, the parties hereto understand that NASAA is entering into this Agreement to provide for the coordination of the central registration depository for the benefit of its members."

to Petitioner's Opposition to the Attorney General's Motion to Intervene, those agreements make clear that the statutorily required information contained in the forms is jointly owned by the states in which the person is registered and by NASD. For instance, the most recent iteration of the relevant provision of the contract between NASAA and NASD governing the CRD reads as follows:

> The data on CRD Uniform Forms [including the U4 and U5[7]] filed with the CRD shall be deemed to have been filed with each CRD State in which the applicant seeks to be licensed and with the NASD and shall be the joint property of the applicant, NASD, and those CRD States (and, in the case of Forms BD and BDW, the Securities and Exchange Commission). The compilation constituting the CRD database as a whole shall be the property of NASD.[8]

See Attorney General's Affirmation in Reply to Petitioner's Opposition to the Attorney General's Motion to Intervene, Ex. 2.

Furthermore, prior to the development of the CRD, individuals and firms completed paper registration forms and delivered those forms to each of the states in which the individual or firm wished to register. Those paper forms were undoubtedly the property of the states in which they were filed. The CRD was established to eliminate the

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See Attorney General's Affirmation in Reply to Petitioner's Opposition to the Attorney General's Motion to Intervene, Ex. 2. The NASAA members, including the New York Attorney General, are intended third party beneficiaries pursuant to the express language of the contract.

[7] The Form U4 (for registration) and the Form U5 (for termination of a registration) are used by firms to register and terminate the registration of stockbrokers with the states and other regulators. The Form U4 is also used by stockbrokers to disclose customer complaints and arbitration claims.

[8] NASD's ownership of the entire compilation on CRD does not dilute the interest that each state has in its CRD information. That compilation includes technology, hardware, and software that make up the CRD.

multiple filing of paper copies with numerous jurisdictions however this innovation was not intended to dilute the property interest that each state enjoyed in its official records.

CRD records are not only co-owned by the states, they also constitute "original" records of the states. NASAA and NASD have worked continuously to improve the CRD system to ensure that it meets both the regulatory and enforcement needs of the states. Modifications to the contract governing the CRD make clear that CRD records need to be authenticated for use in enforcement proceedings, and that "[E]ach jurisdiction relies upon the system as its original record." *See* Electronic Filing Exhibit, Brady Aff. Ex. 9, at 1.

Thus, it is abundantly clear that the information filed with the states through the CRD and maintained thereon constitutes state records and the states have both an ownership and a regulatory interest in those records. This proceeding threatens to prejudice the Attorney General's interest in those records, and intervention under N.Y. C.P.L.R. § 7511(b)(2) is accordingly appropriate.[9]

[9] Representations that NASAA "abandoned" its argument that the records in CRD are state records are inaccurate. NASAA did no such thing. NASAA raised that issue to NASD in its comment letter and included a copy of that comment letter with its comment letter to the SEC. Further, the order approving the rule acknowledges that one of the issues raised was CRD information as state "books and records" and attributes that issue to NASAA. *See* 68 Fed. Reg. 74,667, 74,669.

C. The Attorney General Should Be Granted Leave to Intervene Because He Has Also Satisfied the Requirements for Intervention as a Matter of Right Under N.Y. C.P.L.R. Section 1012 and by Permission Under N.Y. C.P.L.R. Section 1013.

Under New York law, a party may seek to intervene either as a matter of right pursuant to N.Y. C.P.L.R. § 1012 or by permission as provided in N.Y. C.P.L.R. § 1013. The Attorney General has met the requirements for intervention under both standards.

"Provision for intervention is made in N.Y. C.P.L.R. 1012 and 1013 which respectively provide for intervention as a matter of right or as a matter of discretion of the court. Those provisions should be liberally construed." *Bay State Hearing and Air Conditioning Co. v. Am. Ins. Co.*, 78 A.D. 2d 147, 149 (N.Y. App. Div. 1980). N.Y. C.P.L.R. Section 1012(a)(2) requires that the proposed intervenors show that their interests will not be adequately represented by the parties and that they will be bound by the court's judgment. Both of these requirements are satisfied. As it stands now, there is no party before the Court that will represent the Attorney General's interest in this matter much less "adequately" represent that interest. Kay opposes intervention, and neither Abrams nor NASD objects to the expungement. As to the second element for intervention in N.Y. C.P.L.R. § 1012(a)(2), if the Court grants Kay the relief she is seeking, the Attorney General will be left with no venue in which to challenge the destruction of the record. The record will disappear from CRD and neither the Attorney General nor the public investors in New York or in any other state will have access to this

record through the CRD.[10] The Attorney General will thus be bound by the Court's ruling.

The alternate ground for intervention, N.Y. C.P.L.R. § 1013, only requires that the proposed intervenor's claim or defense and the main action share a common question of law or fact. The Attorney General has clearly spelled out common issues of law and fact in this case. *See* Attorney General's Affirmation in Reply to Petitioner's Opposition to the Attorney General's Motion to Intervene. Further, when deciding whether to grant a request to intervene pursuant to N.Y. C.P.L.R. § 1013.

> The factors to consider in determining whether to grant permission to intervene are grounded in general concepts of judicial efficiency and fairness to the original litigants [and] are more likely to be outweighed. and intervention therefore warranted, when the intervenor has a direct and substantial interest in the outcome of the proceeding.

Burlingame v. State, 2007 WL 1953893, at *1 (citations omitted).

That the New York Attorney General has a direct and substantial interest in the outcome of this proceeding is without question. The Attorney General's intervention is necessary in order to ensure that his ability to enforce the laws of New York for the protection of New York investors and others is not compromised by the expungement of records that the Attorney General requires, relies upon, and co-owns with NASD. This interest far outweighs any prejudice that might result to Kay in having a record of her

[10] SIFMA has suggested in its amicus brief that the states can preserve broker records that are subject to expungement by simply printing off the subject record and "dropping it into a paper file." *See* SIFMA Brief at 17. Apart from questions about feasibility, cost, and investor access. this argument suggests that the states be forced to return to a paper filing system independent of the CRD and frustrates the very purpose of establishing the CRD.

dispute with Abrams available to regulators and the public.[11]

II. RULE 2130 CONSTITUTES A SET OF STANDARDS THAT ARBITRATORS MUST FOLLOW WHEN CONSIDERING EXPUNGEMENT REQUESTS, AND COURTS SHOULD VACATE AN EXPUNGEMENT AWARD WHERE AN ARBITRATOR HAS FAILED TO PROPERLY APPLY RULE 2130.

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, at 7, Brady Aff. Ex. 10. 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, 74,72 (Dec. 24, 2003). Whenever an arbitrator has failed to apply the 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 N.Y. C.P.L.R. § 7511.

A. The History of Rule 2130 Reveals that it Was Intended to Bind Arbitrators to Certain 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. NASAA was involved in discussions with NASD as the rule was being drafted, as were other parties such as the Securities Industry

[11] The disclosure will fairly reflect the outcome of the arbitration via settlement and without findings against Kay.

Association, which has filed an amicus brief with the court.[12] 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, not just courts. 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.[13] In response to 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.

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

[13] SIFMA in its amicus filing with this court wrote that "NASAA, which represented the interest of state securities administrators in the process leading to the adoption of Rule 2130, never asserted that arbitrators lacked the power to include expungement relief in their awards." *See* SIFMA Brief at 24. SIFMA has mischaracterized NASAA's position on arbitrator awarded expungement. In NASAA's comment letter to NASD, 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. 11, at 4. NASAA has been consistent in its position that arbitration panels lack the authority to issue a directive expunging state records.

In July 1999, NASD, as part of its rulemaking process, published Notice to Members 99-54 ("NTM 99-54"). It solicited comments on 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. 14, 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. 15. 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. But 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. 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.

NASAA submitted a comment letter to NASD in response to NTM 01-65. *See* NASAA Comment Letter to the NASD, Brady Aff. Ex. 11. While generally supportive of the proposal, NASAA's comment letter was unequivocal in its view that expungement could only be accomplished through a court order and only in very limited circumstances.[14]

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 a comment letter to the SEC. In its comment letter, NASAA suggested that the rule could have been drafted more clearly, but generally approved its thrust. *See* NASAA Comment Letter to the SEC, Brady Aff. Ex. 13. Following the comment period, the SEC approved proposed Rule 2130 in Release No. 34-48933, 68 Fed. Reg. 74,667 (Dec. 24, 2003). 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." 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*

[14] In an amendment to the proposal filed with the SEC, NASD made the following observation: "NASD and NASAA agree that CRD information should be expunged only on the basis of specific, limited criteria." *See* NASD Rule Proposal SR-NASD-2002-168, Amendment 2, Sept. 11, 2003, Brady Aff. Ex. 12, at 7.

negotiated expungement instructions." *Id.* at 74.671 – 672 (emphasis added). The SEC concluded that the rule would accomplish this goal 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. In response to concerns raised during the comment period that stockbrokers were misusing expungement in the context of settled cases to buy clean CRD records. the SEC observed that the requirement of an affirmative determination of one of the criteria by judges or arbitrators in issuing an expungement order would greatly reduce the "ability of members and associated person to 'buy clean records.'" *Id.*

After the SEC approved the rule, NASD issued another regulatory notice on expungement to its members. In summary, Notice to Members 04-16, ("NTM 04-16") explained the process by which stockbrokers were to proceed on expungement requests. Specifically. brokers were advised that in arbitration matters involving customer disputes

they should ask the panel for expungement relief in their prayer for relief. The notice went on to point out that even if the arbitrators dismissed the 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. *See* NASD NTM 04-16 (March 2004). Brady Aff. Ex. 16. 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. *Id.*

Thus, while formulating the rule, NASD considered several approaches, but ultimately settled on a scheme that contemplated the establishment of strict standards for arbitrators to consider in ordering expungement. In taking this approach, NASD noted that its objective was to "provide some 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. at 17. This theme of establishing standards for expungement is a 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. 10, at 9.

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). As noted earlier, the Attorney General was granted leave to intervene and objected to the petition. In remanding the matter back to the arbitration panel for further findings, 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.

B. An Arbitrator Who Fails to Apply Rule 2130 Properly 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, an arbitration award "shall be vacated" if the arbitrator "exceeded his power." [15] 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 totally irrational; or (3) the award is violative of a strong public policy. *Matter of Silverman (Benmor Coats)*, 473 N.Y.S. 2d 774 (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").

[15] SIFMA argues in its amicus brief that this matter should be resolved under the Federal Arbitration Act. 9 U.S.C. § 10. However, that Kay brought her Petition to Confirm Arbitration Award pursuant to New York state law and, therefore, this matter is properly resolved pursuant to those state law provisions.

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 Assn.*, 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, the Court should not be reluctant to conduct a meaningful review of the recommendation from the arbitrator.

III. THE COURT SHOULD DENY KAY'S PETITION TO CONFIRM THE ARBITRATOR'S RECOMMENDATION OF EXPUNGEMENT BECAUSE THE RECOMMENDATION WAS NOT MADE IN COMPLIANCE WITH RULE 2130.

The arbitrator's expungement award in this case was entirely improper under the standards set forth in Rule 2130. A review of Kay's Statement of Claim reveals that she failed to allege, let alone establish, any facts that would support the requisite findings under Rule 2130. *See* Kay Statement of Claim, Brady Aff. Ex. 5. Based on that defect alone, she is not entitled to have the recommendation confirmed. As to the procedural

aspects of Rule 2130, the failure of the arbitrator in this instance to conduct a hearing of any kind or to review any evidence beyond the allegations in the pleadings is an abdication of the responsibilities imposed by the rule. Expunging this arbitration claim from Kay's CRD record will violate the important policies favoring regulatory disclosure and investor protection that underlie the CRD system. All of these factors demonstrate that the arbitrator exceeded his powers, issued an irrational award, and violated a "strong public policy." Far from being confirmed, the award should be vacated.

A. Kay Made No Allegations in Her Statement of Claim That Would Entitle Her to Expungement Relief.

Kay's Statement of Claim contains a prayer for relief that does not address any of the findings required by Rule 2130. As explained above. Kay initiated this arbitration proceeding over a year after resolution of the underlying arbitration claim. In her Statement of Claim. Kay briefly discussed the settlement of the arbitration filed by Abrams and the fact that the panel was dissolved prior to the execution of the award. Abrams then asked for a "recommendation of expungement of any reference" to the Abrams arbitration. *See* Kay Statement of Claim, Brady Aff. Ex. 5. Nowhere in her Statement of Claim does Kay allege any facts that would entitle her to expungement relief under Rule 2130.

As discussed above, 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.[16]

Kay makes no allegations of any kind in her Claim that she is entitled to expungement of the customer complaint information under any of these standards. Rather, her sole basis for arguing that the matter should be expunged is that the first panel failed to enter such an order. Even taking the allegations as pleaded in her complaint as true, they do not form a sufficient basis upon which expungement relief can be granted. Kay's *Claim* on its face is insufficient to support her claim for expungement relief.

B. The Arbitrator Failed to Comply With Rule 2130 Because He Did Not Conduct a Hearing on the Propriety of Expungement and His Findings Were Patently False.

Yet another fatal flaw in the expungement award was the arbitrator's failure to hold a hearing and consider evidence on the propriety of expungement.[17] This is especially troublesome in light of the fact that this matter involved a settlement. [18] The

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[16] 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 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). Kay does not contend that this standard applies, nor could she under the facts of this case.

[17] While the award does not specify what documents the arbitrator considered in reaching his decision, counsel for Kay informed the Court during argument held on April 27, 2007, that the arbitrator had before him the pleadings from the prior arbitration proceedings. *See* Hearing Transcript, Brady Aff. Ex. 1, at 23.

[18] This issue was apparently troubling to the Court as well as seen from the following exchange that occurred between the Court and Kay's counsel on April 27, 2007:

Mr. Kalmus: But this award before your Honor, in the award, it contains an affirmative factual finding.

The Court: How did that finding come about?

Mr. Kalmus: It doesn't matter to you.

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 of fact" 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 fact, NASD Notice to Members 04-16 expressly states that in settled cases the arbitrators may convene hearings or request documents in order to gather the information necessary to make the required findings. *See* NASD Notice To Members 04-16, Brady Aff. Ex. 16, at 214. This Court also recognized the importance of conducting a hearing when considering an expungement request. Upon learning that no such hearing was held in this matter, the Court described the process as a "fraud" and pointed out that "if [the arbitrator] never had a hearing, the arbitrator doesn't know whether any of those claims really – any of the exceptions, any of the requirements for expungements really existed." *See* Hearing Transcript, Brady Aff. Ex. 1, at 14. In short, in all cases involving expungement requests, whether contested or settled, arbitrators have a duty to hold hearings and make findings

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The Court: It doesn't matter. Counsel, if it came about merely based on the stipulation between Prudential and the claimant, if that's how it came about, there's a stipulation we're doing to pay you x number of [sic], but as far as we also want an expungement and Prudential said, yes, and the claimant says, what do I care? I'll sign it too.

The arbitrator gets that settlement, doesn't hold a hearing, comes to me, and I don't hold a hearing, and there's an expungement, and nobody has ever looked into whether the fact, whether the claims made by Ms. Abrams have any validity to it, and we maybe had a broker who committed a lot of bad stuff, that nobody knows about. *See* Hearing Transcript, Brady Aff. Ex. 1, at 16.

that are supported by the record.

In the instant matter, it is plain that the arbitrator did not conduct a hearing to inquire into the appropriateness of Kay's expungement request and did not consider any documents beyond the pleadings from the arbitrations. 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).

Even the meager record that the arbitrator did consider reveals that his finding was patently false. Kay's own defenses in the first arbitration flatly contradict the arbitrators supposed finding. The arbitrator granted expungement based on the notion that Kay was "not involved" in the alleged misconduct. *See* Stipulated Award, Brady Aff. Ex. 7, at 1. However, Kay was unequivocal in her defense of the way she handled the Abrams' accounts, contending that she regularly conferred with Abrams and fully informed Abrams as to all the transactions that occurred in the account, including those that gave rise to the claim for damages. *See* Kay Statement of Claim, Brady Aff., Ex. 5. This degree of involvement in the underlying facts of the case – regardless of whether or not Kay was ever found *legally* culpable – flatly contradicts the arbitrator's finding.

C. 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 Kay's record will compromise the accuracy and integrity of the CRD system. Especially where a broker has developed a history of customer complaints, as Kay has,[19] sanitizing that 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. This matter was brought before a single arbitrator who declined to conduct a hearing or consider any evidence, who plucked a finding from thin air, and who signed an award at the behest of the parties. Confirming an expungement award under these circumstances would nullify Rule 2130 and would undermine the important investor protection goals the rule was designed to serve.

[19] The Attorney General has supplied the Court with Kay's CRD record. *See* Attorney General's Affirmation of R. Verle Johnson in Opposition to the Application for an Order Confirming an Arbitration Award, Ex. 2. According to the Attorney General, Kay's CRD record reflects that numerous customer complaints have been filed against her.

CONCLUSION

In conclusion, NASAA urges this Court to deny Kay's petition and vacate the arbitrator's award.

Dated: New York, New York
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