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

Application of Mary Ellen Kay,	:	
	:	
Petitioner,	:	Index No. 100235/07
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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 ASSOCIATION OF SECURITIES DEALERS (NASD),	:	
	:	
Respondents.	:	

AMICUS CURIAE BRIEF OF SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

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I. INTEREST OF AMICUS CURIAE

The Court was correct when it observed at the hearing on April 27, 2007 that the New York Attorney General (the "Attorney General") was arguing in favor of a rule that would reverse a New York policy that has existed for many years[1] and that the Attorney General's position was in direct conflict with a rule of national application adopted by the National Association of Securities Dealers ("NASD").

The Attorney General does not just oppose confirmation of the arbitrator's award in this particular case based on its specific facts. Rather, he challenges both the power of an arbitration panel to include in its award expungement relief with respect to customer dispute information contained in NASD's Central Registration Depository (the "CRD") and the power of this court or any New York court to confirm such an award notwithstanding the provisions of NASD Rule 2130.[2] Mr. Johnson, on behalf of the Attorney General at the April 27, 2007 hearing, asserted that New York's records laws prohibit expungement no matter what the facts are in a particular case. Hearing Transcript at 35 (DeBonis Aff., Exhibit 1). This argument, if upheld, would nullify NASD Rule 2130 in New York.

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[1] Hearing Transcript at 38. *See* DeBonis Aff., Exhibit 1.

[2] The Court: What your [sic] coming down to saying is: There's no power to enforce -- an arbitrator does not have the power to do what the NASD Rule authorizes them to do . . . hence, there is no power for a court to confirm. Is that right?

Mr. Johnson: Yes, your honor.

Hearing Transcript at 37.

The Attorney General, in his briefs, asserts a slightly different position. He contends that information in the CRD cannot be expunged "if the Attorney General believes that such information is pertinent." *See* Affirmation of R. Verle Johnson In Opposition To The Application For An Order Confirming An Arbitration Award ("Johnson Opposition Aff.") at 11. This position is equally inimical to NASD Rule 2130. Under the Rule, courts make the final decision with respect to expungement. If the Attorney General's argument were upheld, it would make him, not the court, the final decision maker in expungement cases.

NASD, which promulgated Rule 2130, is a quasi-governmental organization. It has authority delegated by Congress to implement and enforce federal securities laws through its own rules. NASD's rules must be approved by the United States Securities and Exchange Commission (the "SEC"). The SEC approved Rule 2130 in 2003. *See* Exchange Act Release No. 34-48933, 68 Fed. Reg. 74,667 (Dec. 24, 2003). The Rule permits expungement in three narrow circumstances described in subsection (b)(1)(A)-(C) of the Rule, provided that a court of competent jurisdiction orders it or confirms an arbitration award containing expungement relief.[3] *See* DeBonis Aff., Exhibit 2. These are:

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[3] The relevant part of NASD Rule 2130 states:

(a) Members or associated persons seeking to expunge information from the CRD system arising from disputes with customers must obtain an order from a court of competent jurisdiction directing such expungement or confirming an arbitration award containing expungement relief.

(b) Members or associated persons petitioning a court for expungement relief or seeking judicial confirmation of an arbitration award containing expungement relief must name NASD as an additional party and serve NASD with all appropriate documents unless this requirement is waived pursuant to subparagraph (1) or (2) below.

(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.

Contrary to the repeated suggestions of the Attorney General, Rule 2130 does not permit expungement based solely on a decision or directive by an arbitration panel. The Rule requires a court order in every case.

The SEC approved NASD Rule 2130 after public notice and review of comments submitted by numerous parties. These parties included the North American Securities Administrators Association, Inc. ("NASAA"). NASAA, which represents the interests of state securities regulators, including New York's, supported the Rule. NASAA acknowledged the power of arbitrators to issue awards containing expungement relief relating to customer dispute

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(1) Upon request, NASD may waive the obligation to name NASD as a party if NASD determines that the expungement relief is based on affirmative judicial or arbitral findings that:

(A) the claim, the 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.

(2) If the expungement relief is based on judicial or arbitral findings other than those described above, NASD, in its sole discretion and under extraordinary circumstances, also may waive the obligation to name NASD as a party if it determines that:

(A) the expungement relief and accompanying findings on which it is based are meritorious; and

(B) the expungement would have no material adverse effect on investor protection, the integrity of the CRD system, or regulatory requirements.

information in the CRD and the power of courts to order the expungement relief notwithstanding state records laws.

The right to obtain expungement relief in the circumstances in Rule 2130 is of vital importance to the securities industry and to its associated persons (often called brokers). When a customer files a claim against a broker, the claim must be reported to the CRD regardless of its merit.[4] Absent expungement, the claim remains on the broker's record permanently, no matter how frivolous it might be. The public has access to this information over the Internet and may take it into account in deciding when to enter into a customer relationship with a particular firm or a particular broker.

Some customer claims have no merit whatsoever. They satisfy one or more of the criteria in Rule 2130(b)(1)(A)-(C). Fairness requires that the record of such claims be expunged from the CRD, provided that a court either has ordered expungement or confirmed an arbitration award containing expungement relief. Expungement in these circumstances also is in the public interest. Maintaining a record of spurious claims in the CRD is more likely to confuse than enlighten investors. Thus, the SEC, in approving Rule 2130, stated that expungement of inaccurate information (i.e., records of claims that have been determined to meet the criteria of the Rule) from the CRD is "crucial to the system's value."

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[4] Question 14I(l) of the Uniform Application for Securities Industry Registration and Transfer ("Form U-4") requires that registered representatives report any arbitration matter in which he or she is named as a respondent if the claim alleges a sales practice violation. It also requires reporting of all customer complaints, with narrow exceptions, that allege sales practice misconduct. *See* NASD Form U-4 and Form U-5 Interpretive Questions (DeBonis Aff., Exhibit 13).

Amicus Curiae Securities Industry and Financial Markets Association ("SIFMA") is the principal trade association of the securities industry. It is the product of the November 1, 2006 merger of the Securities Industry Association and the Bond Market Association. SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers.

SIFMA's securities firm members include broker-dealers that employ brokers who may be subject to customer claims so meritless that they should be expunged. They have an interest in the continuing vitality of Rule 2130 which permits expungement when approved by both an arbitration panel and a court of competent jurisdiction.

SIFMA's members have knowledge and experience that will assist the court in resolving the legal issues presented in this case.[5] The Securities Industry Association (which became part of SIFMA in 2006) participated in the process leading to the adoption of Rule 2130. SIFMA's members and their associated persons have been involved in expungement matters involving the CRD since at least as early as 1981.

II. SUMMARY OF ARGUMENTS

The Attorney General's arguments should be rejected, and the arbitrator's award confirmed, for each of the following reasons.

A. The Attorney General's Claims Are Preempted By NASD Rule 2130. The Attorney General's central claims -- that arbitration panels may not issue awards containing

[5] This brief is limited to these legal issues. SIFMA is not taking a position on whether the court should confirm the arbitrator's award based on the facts specific to this case or on whether the Attorney General has established an appropriate basis for intervening in it.

expungement relief and courts lack the authority to confirm such awards -- directly conflict with NASD Rule 2130. Rule 2130 contemplates that arbitration awards may include expungement relief and it permits expungement when that relief is ordered or approved by a court of competent jurisdiction.

When there is a conflict between an NASD rule and inconsistent State claims or laws, the NASD rule must be given preemptive effect. Courts treat NASD rules approved by the SEC as equivalent to SEC rules for purposes of preemption.

While there is a direct conflict between the Attorney General's claims and NASD Rule 2130, there is no such conflict between New York's records laws and Rule 2130. Expungement does not "destroy" a state record as the Attorney General argues. New York law provides that the State may maintain its own registry of information that is in the CRD. Information to be expunged from the CRD could be preserved indefinitely in a New York database. New York already has systems in place that could be adapted for this purpose.

B. **The State Failed to Exhaust Statutory Remedies**. Rule 2130 was approved by the SEC pursuant to Section 19(b) of the Securities Exchange Act, 15 U.S.C. § 78s (1997). The Attorney General and the State of New York had the opportunity to challenge the Rule before the SEC and then the opportunity to seek judicial review of the Rule within sixty days after the Commission's approval by filing a petition in an appropriate federal court of appeals. *See* Securities Exchange Act Section 25(b), 15 U.S.C. § 78y(b) (1997). However, they did not avail themselves of these opportunities. They failed to exhaust their statutory remedies. This precludes them from collaterally attacking the Rule in this case.

C. **Expungement Is Permitted Under Well-Established Principles Of Federal and New York Law Governing The Roles Of Arbitrators And The Courts**. Both New York State courts and federal courts have held that arbitrators have broad discretion to grant remedies that they consider appropriate under the circumstances. Consistent with this principle, New York courts have upheld expungement as a permissible remedy that arbitrators may include in their awards and that courts may confirm. NASD Rule 2130's provision with respect to judicial review also operates in a manner consistent with federal and New York law. Courts have the power to confirm awards containing expungement relief whether the awards are reviewed under the Federal Arbitration Act or under State standards.

III. NASD RULE 2130

NASD Rule 2130 is at the heart of this case. It is important to understand that this Rule, which has nationwide application, was promulgated by NASD and approved by the SEC after a four-year process that included several rounds of public comment. NASAA, the association that represents the interests of state regulators, including New York's, not only actively participated in the process but worked closely with NASD to develop the Rule. The rule-making process involved the reconciliation of various competing interests. These included the interests involving state records now advanced by the Attorney General.

A. NASD's Role As Regulator And As Operator Of The CRD System

The Attorney General describes NASD as a membership organization that is a "private not-for-profit corporation." Johnson Opposition Aff. at 12, Johnson Reply Aff. at 13. This description ignores NASD's major role in enforcing the securities laws for the protection of the public.

NASD is a quasi-governmental organization with authority delegated by Congress to implement and enforce compliance with securities laws through its own rules and regulations, subject to oversight by the SEC. It is the primary regulator of the broker-dealer industry. *Rosenberg v. MetLife*, 8 N.Y.3d 359, 366 (2007).[6] NASD promulgates rules that are designed to protect the investing public. *Id.* It is required by the federal securities laws to enforce its own rules. *See* Section 19(g) of the Securities Exchange Act, 15 U.S.C. § 78s(g).

NASD also maintains and operates the CRD system pursuant to an agreement between it and NASAA. The CRD system has been in use since about 1981. It is an electronic registration and licensing system that contains information used by the SEC, NASD, other self-regulating organizations ("SROs") and state securities regulators to make registration and licensing decisions. *See* NASD Notice To Members ("NTM") 99-09 (February 1999) (DeBonis Aff., Exhibit 3). The information on the CRD system includes, among other things, information relating to customer disputes. Firms that are NASD members must file a Form U-4 (relating to the broker) and U-6 (relating to the firm) reporting, with some limited exceptions, any customer dispute (including arbitrations) involving claims against their "associated persons" or brokers.

B. Prior NASD Practice Regarding Expungement And The 1999 Moratorium

NASD has expunged information concerning customer disputes from the CRD in appropriate circumstances since the system became operational in 1981. *See* Exchange Act

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[6] *See also Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1128 (9th Cir. 2005). (The Securities Exchange Act "delegated government power" to SROs, including NASD "to enforce . . . compliance by members of the industry with both the legal requirements laid down in the Exchange Act and ethical standards going beyond those requirements." 400 F.3d 1119, 1128, quoting S. Rep. No. 94-75, at 23 (1975).

Release No. 34-48933 (Dec. 16, 2003), 68 Fed. Reg. 74,667, 74,669 n. 29 (Dec. 24, 2003) (DeBonis Aff., Exhibit 9). Prior to January 19, 1999, NASD would expunge information relating to customer claims from the CRD when it was ordered to do so by a court of competent jurisdiction or when expungement relief was granted by an arbitration panel. *See* NTM 99-09 (February, 1999) (DeBonis Aff., Exhibit 3).

At the time, NASAA, representing the interests of state securities regulators, objected to expungement insofar as it was based solely on an arbitration award. It cited grounds similar to those the Attorney General relies upon here: that information filed in the CRD is deemed to be filed with the individual states and therefore it is a state record subject to all applicable state regulations that apply to state records. NASAA asserted that state law did not recognize the authority of an arbitrator or arbitration panel to expunge a state record. *See* NTM 99-09 (February 1999) (DeBonis Aff., Exhibit 3).

Because of NASAA's concerns, in 1999, NASD imposed a moratorium on expungements if they were based solely on a directive of an arbitration panel. However, NASD continued to expunge customer dispute information from the CRD if a court either ordered expungement or confirmed an arbitration award containing expungement relief. *See* NASD NTM 99-54 (July 1999) (DeBonis Aff., Exhibit 4).

C. Adoption Of Rule 2130 By NASD After Notice And Comment

In July 1999, NASD published NTM 99-54 seeking comments as to possible approaches that might reconcile the interests of parties seeking expungement, the need to maintain the integrity of the CRD system, and the provisions of applicable state records laws. *See* NTM 99-54 (DeBonis Aff., Exhibit 4). In October 2001, NASD requested comments on a new approach

to handling expungements. *See* NTM 01-65 (October 2001) (DeBonis Aff., Exhibit 5). This approach specifically contemplated the expungement of customer complaint information from the CRD only when ordered by a court or when a court approved an arbitration award containing expungement relief. To protect against potential abuses, the rule also contemplated that NASD would appear in court and oppose expungement unless the arbitrators made one of three specific findings that would merit expungement of a meritless claim. *Id.*

NASAA submitted a December 31, 2001 comment letter in response to NTM 01-65. NASAA proposed some "clarifications" to the approach NASD proposed but supported its adoption, noting that it had participated in the development of the rule.[7] NASAA, which from the outset sought to protect state records from expungement by arbitrators, acknowledged that courts had the authority to approve expungement even if the information involved was a "state record" and subject to state record retention laws. *See* Letter from Joseph Borg, NASAA President, to Barbara Sweeney, Secretary, NASD Regulation, Inc. (December 31, 2001) ("NASAA Comment Letter to NASD") at 3, 4. (DeBonis Aff., Exhibit 6).

After reviewing the comments it received, on November 19, 2002, NASD submitted proposed Rule 2130 to the SEC for approval, as required under Section 19(b)(1) of the Exchange Act.

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[7] NASAA stated in its Comment Letter: "As joint managers of the CRD, NASAA and the states it represents are interested parties to this rule. We acknowledge that NASAA worked closely with the NASD over many months to produce this NTM." Comment Letter To NASD at 1. It further stated: "The current NTM is a product of years of discussion among many entities representing different interests with often-divergent goals. . . . We have worked very hard to try to strike a balance between treating stockbrokers fairly and providing and preserving relevant information about stockbrokers for regulators and investors." *Id.* (DeBonis Aff., Exhibit 6). New York was one of the states NASAA represented.

D. The SEC's Approval Of Rule 2130

Substantive NASD Rules must be approved by the SEC before they can become effective. Section 19 of the Exchange Act, 15 U.S.C. § 78s (1997), describes the process by which self-regulatory organizations, including NASD, are required to submit proposed rules to the SEC for approval. *See* DeBonis Aff., Exhibit 10.

The SEC published notice of the proposed rule in the Federal Register on March 10, 2003 and solicited comments. *See* 68 Fed. Reg. 11,435 (Mar. 10, 2003) (DeBonis Aff., Exhibit 8). The proposed rule permitted arbitration panels to issue awards containing expungement relief but provided that actual expungement from the CRD would occur only if a court ordered it or confirmed an award containing it. The proposed rule required parties seeking a court's approval to name NASD as a party unless NASD waived this requirement. The proposed rule said that NASD could waive this requirement if the expungement relief was based on one of three affirmative findings.

The SEC received and considered 28 different comment letters, including one from NASAA dated June 4, 2003. *See* Letter from Deborah Bortner, NASAA CRD Steering Committee Co-Chair, to Margaret H. McFarland, SEC Deputy Secretary (June 4, 2003) ("NASAA Comment Letter To SEC"); *see* DeBonis Aff., Exhibit 7. NASAA criticized the proposed rule largely because it did not specifically require the arbitration panel to make one of the three findings. However, NASAA did not question the power of an arbitration panel to issue an award containing expungement relief or object to actual expungement if a court confirmed the

panel's award.[8] To the contrary, NASAA described a court order as "an essential requirement under state record law." NASAA Comment Letter To SEC at 2 (DeBonis Aff., Exhibit 7). In other words, NASAA acknowledged that a court order (or court confirmation of an award containing expungement relief) did not violate state records laws.

The SEC subsequently approved the Rule on December 16, 2003. It found the Rule to be protective of investor interests and in the public interest because it allowed "fact finders and NASD to consider all competing interests before directing or granting expungement of customer dispute information from the CRD." 68 Fed. Reg. 74,667, 74,671 (DeBonis Aff., Exhibit 9). The SEC also stated: "[T]he Commission believes that the NASD has . . . struck a fair and reasonable balance between the burden that the proposed change will impose upon member firms and associated persons and the benefit that the proposed rule change will bestow on investors, generally." *Id.* The SEC also observed that "expungement of inaccurate information from the CRD system is crucial to the system's value." *Id.* at 74,672.

The SEC specifically concluded that customer dispute information could be expunged in appropriate cases notwithstanding the state "public record" status of data in the CRD system. *Id.* The SEC said with respect to the states' books and records rules, that, "[t]o the extent this is a valid concern of the states, the Commission would have expected NASAA to have raised this

[8] As the SEC observed when it later approved the Rule, NASAA did not raise any concern regarding the Rule's potential conflict with states' books and records rules. 68 Fed. Reg. 74,667, 74,672.

point." *Id.*[9] It noted, "[i]ndeed, a process for the expungement of data from the CRD system has been in place since the establishment of the CRD system." *Id.*

The SEC also rejected an argument like the one the Attorney General makes here: that the Rule permits brokerage firms or their associated persons to "buy clean records" through stipulated expungement relief. The SEC concluded that the Rule provided sufficient safeguards to protect against that risk. *Id.* at 74670.

IV. ARGUMENTS

A. The Attorney General's Position In This Case, Which Conflicts Directly With NASD Rule 2130, Is Preempted By The Rule

As the Court noted and the Attorney General's counsel confirmed on the record, there is a direct conflict between NASD Rule 2130 and the Attorney General's position in this case. Hearing Transcript at 37. *See* DeBonis Aff., Exhibit 1. The Rule contemplates that arbitration panels have the power to issue awards containing expungement relief and that courts may confirm such awards. The Attorney General contends that arbitrators do not have power to provide for expungement relief and that courts may not confirm an award containing expungement relief over its objection.

The Attorney General's arguments are based on the premise that expungement involves the destruction of state records and the loss of information in which the State has an ownership interest. As discussed below at pp. 16-18, this premise is false. However, to the extent it is true, New York's laws and the Attorney General's arguments must yield to NASD Rule 2130.

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[9] As described above, NASAA did not raise the point because it correctly understood that courts had the power to expunge notwithstanding state records laws.

Federal law preempts conflicting state laws and claims pursuant to the Supremacy Clause. U.S. Const., art. VI, cl. 2. Similarly, federal regulations issued by an agency generally will preempt inconsistent state laws if the regulations are issued pursuant to authority delegated by Congress. *See City of New York v. FCC*, 486 U.S. 57, 63-64 (1988).

Rules adopted by self-regulating organizations ("SROs") like NASD also may have preemptive effect. They operate like federal regulations.[10] The Securities Exchange Act, as amended, "establishes a scheme of regulation of the securities marketplace that combines self regulation by the securities exchanges with oversight and direct regulation by the SEC." *Bantum v. Am. Stock Exch., LLC,* 777 N.Y.S.2d 137, 140, 7 A.D.3d 551, 553 (2004). The Securities Exchange Act delegated to SROs "government power," as well as the duty to enforce compliance by members of the securities industry with the requirements of the Securities Exchange Act. *See Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1128 (9th Cir. 2005) ("*CSFB*"). *See also Feins v. Am. Stock Exch.*, 81 F.3d 1215, 1218 (2d Cir. 1996).

SROs enforce compliance through rules like NASD Rule 2130 that regulate the securities marketplace. These rules must be approved by the SEC. "The ultimate approval of a proposed SRO rule reflects the Commission's determination that the proposed rule is consistent with the purposes of the Exchange Act. 15 U.S.C. § 78s(b)(2)." *CSFB*, 400 F.3d at 1130. The Court of Appeals for the Ninth Circuit held in *CSFB*:

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[10] This Court recognized this point in *F.N. Wolf v. Bowles*, 610 N.Y.S.2d 757 (1994), where it deferred to NASD's interpretation of its own rules as it said it would defer to a federal agency's interpretation of its own regulations.

> "SRO rules that have been approved by the Commission pursuant to 15 U.S.C. § 78s(b)(2) preempt state law when the two are in conflict, either directly or because the state law stands as an obstacle to the accomplishment of the objectives of Congress.[11]
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> *Id.* at 1132.

The SEC approved NASD Rule 2130 pursuant to 15 U.S.C. § 78s(b)(2) (1997). (DeBonis Aff., Exhibit 10). *See* 68 Fed. Reg. 74,667 *et. seq.* It specifically found that "the proposed rule change, as amended, is consistent with the Act." 68 Fed. Reg. at 74,667, 74,671. Rule 2130 has national application. It applies with uniformity in all other states. The Attorney General's position in this case and its interpretation of New York's records laws directly conflict with the NASD rule. They also stand as obstacles to Congress' objective of having SROs like NASD regulate their members' activities in a national marketplace to assure compliance with the federal securities laws. The Court in *CSFB* said that permitting each state to regulate NASD arbitrations "would create a patchwork of laws that would interfere with Congress's chosen approach of delegating nationwide, cooperative regulating authority to the Commission and the NASD." *See CSFB* at 1135. This point applies with equal force here. NASD Rule 2130 preempts the Attorney General's position in this case.

The Ninth Circuit's decision in *CSFB* ruling that an NASD rule has preemptive effect vis-à-vis inconsistent state rules is in accord with New York state court precedents. In *Guice v. Charles Schwab & Co.*, 89 N.Y.2d 31, the New York Court of Appeals made clear that a cause of action based on New York law was preempted by SEC rules when the two conflicted. It said

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[11] The *CSFB* case arose out of the adoption by California of an ethics standard for NASD-appointed neutral arbitrators. This standard established heightened disclosure and disqualification requirements. They conflicted with NASD's own standards, which had been approved by the SEC.

the Securities Exchange Act, as amended, was intended to permit the SEC to develop a "coherent and rational regulatory structure" to police the national market system, *Id.*, and a state rule that adversely affected the power to regulate comprehensively and with uniformity may be preempted. *Id.*

In *Bantum v. American Stock Exchange, LLC,* 777 N.Y.S.2d 137, 7 A.D.3d 551 (2004), the Appellate Division for the Second Department, citing *Guice*, held that a rule of an SRO (the American Stock Exchange) preempted a claim based on the New York City Human Rights law seeking the recovery of damages for sexual harassment. The theory of the plaintiff's case was that the Stock Exchange had failed to conduct a proper investigation of the plaintiff's claims. The Stock Exchange had its own rules that governed disciplining members suspected of violating federal laws or internal rules. The Court concluded that to allow claims against The Stock Exchange arising out of its disciplinary functions would stand as an obstacle to Congress' objective of encouraging self regulation of the securities industry. *Id.*, at 140,.

These cases and the principles on which they rely dictate that the Attorney General's claims in this case are preempted by NASD Rule 2130.

As noted above, the premise of the Attorney General's arguments that neither arbitrators nor courts have the power to expunge information in the CRD is that expungement involves the destruction of state records and the loss of information in which the State has an ownership interest. This premise serves as the basis for the Attorney General's argument that he and the State are prejudiced by expungement of information in the CRD. *See* Johnson Opposition Aff. at 8.

In fact, information earmarked for expungement is not "destroyed" in the sense the Attorney General uses the word. The State has the ability to preserve expunged information if it wishes to do so. The CRD is an electronic database, not a paper file, and information in the CRD can be stored, downloaded or printed by the State. Further, as the Attorney General notes in his Reply brief, the State is notified whenever there is an arbitration award recommending expungement of a broker that is registered or seeks to be registered in New York. *See* Affirmation of R. Verle Johnson In Reply To Petitioner's Opposition To The Attorney General's Motion To Intervene ("Johnson Reply Aff.") at 3. Therefore, the State could easily preserve a broker's CRD as it exists prior to an expungement hearing by means as simple as printing the broker's record and dropping it into a paper file.

Indeed, New York law allows the State to participate in the CRD as an "alternative method of record maintenance." N.Y. Gen. Bus. Law § 359e-13 (2005). The State already has its own system of maintaining the records of brokers employed by NASD member firms. *See* Johnson Opposition Aff., Exhibit 3 ("registrations, supplements, amendments and receipts" of persons "covered by the NASD system" shall be maintained by the State). The State maintains those records for one year. The State also has a system that parallels the CRD and maintains the records of brokers who are employees of non-NASD member firms. *See* Johnson Opposition Aff. at 13. Records relating to those brokers are never put into the CRD because the CRD only stores information concerning NASD member firm employees. They go into the parallel system instead. Thus, the State already has systems in place to maintain any broker information that is to be expunged or the ability to create such a system.

If NASD's expungement rule, Rule 2130, does not involve the destruction of State records and the loss of information in which the State has an ownership interest, there is no

reason to sustain the Attorney General's argument that arbitration panels are without power to issue awards containing expungement relief and courts are without power to confirm such awards.

B. The Attorney General's Position In This Case Must Be Rejected Because Neither He Nor The State Of New York Pursued Their Statutory Remedies At The Time Rule 2130 Was Approved By The SEC.

As described above, the Attorney General's arguments that arbitration panels may not issue awards containing expungement relief and that courts lack the authority to confirm any such award directly conflict with NASD Rule 2130. Rule 2130 plainly allows both actions.

One striking aspect of the Attorney General's position is that neither he nor the State advanced it -- at least publicly -- during the time NASD Rule 2130 was under consideration by NASD and the SEC. Indeed, NASAA, which was representing the interests of the State regulators in the process[12],, and which specifically focused on the integrity of the state records laws, did not question the power of arbitration panels to include expungement relief in their awards or the power of the court to confirm such awards. Rather, NASAA's goal, as described above, was to deny arbitration panels the power to effectuate expungement without a court order and to tighten the standards for granting expungement relief. *See* pp. 9-12 above.

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[12] In its December 31, 2001 comment letter to NASD relating to expungement policy, NASAA described itself as "the voice of securities agencies responsible for grass-roots protection and efficient capital formation" in its December 31, 2001 comment letter to the NASD relating to expungement policy. *See* Letter from Borg, NASAA President to Sweeney, NASD Regulation, Inc. Secretary, of Dec. 31, 2001 ("Comment Letter To NASD"). (DeBonis Aff., Exhibit 6).

The fact that New York and its Attorney General acquiesced in the SEC's approval of NASD Rule 2130 has legal consequences now. The law requires parties that disagree with a rule approved by the SEC to take action during or immediately after the approval process. They may not remain silent and then collaterally attack the rule as the Attorney General does here.

NASD Rule 2130 was approved by the SEC pursuant to Section 19(b) of the Securities Exchange Act, 15 U.S.C. § 78s. (*See* DeBonis Aff., Exhibit 10). The Securities Exchange Act provides for a "comprehensive system of review" of NASD rules approved by the SEC. *See Standard Inv. Chartered, Inc. v. Nat'l Ass'n of Secs. Dealers, Inc.*, 2007 WL 1296712, *4 (S.D.N.Y. May 2, 2007). Once an NASD rule is approved, the Securities Exchange Act provides for review by petition to the SEC and by filing a petition for review in a United States Court of Appeals within sixty days of the rule's approval. 15 U.S.C. § 78y. *See Standard Inv. Chartered, Inc.*, 2007 WL 1296712 (S.D.N.Y.) at *4, *citing Am. Benefits Group v. Nat'l Ass'n of Secs. Dealers*, 1999 WL 605246 (S.D.N.Y. Aug. 10, 1999), at *5-*8. Limiting judicial review of the rulemaking process protects the integrity of the administrative process in this manner and recognizes the expertise of the SEC in regulating the securities industry and the actors within it. *See Standard Inv. Chartered*, 2007 WL 1296712 (S.D.N.Y.) at *6.

The limitation on judicial review is codified in Section 25 of the Securities Exchange Act. This provides that any person adversely affected by an order or rule of the SEC may obtain review in a *federal court of appeals* within *sixty days* after the entry of the order approving the rule. *See* 15 U.S.C. §§ 78y(a)(1) and (b)(1) (DeBonis Aff., Exhibit 11). In addition, Section 25 states that "[n]o objection to an order or rule of the Commission . . . may be considered by the court unless it was urged before the Commission." 15 U.S.C. § 78y(c)(1). Section 25 of the Securities Exchange Act applies to the NASD rule-making process. *See, e.g., Desiderio v. Nat'l*

Ass'n of Secs. Dealers, 2 F.Supp.2d 516 (S.D.N.Y. 1998); *Standard Inv. Chartered,* 2007 WL 1296712 (S.D.N.Y. May 2, 2007).

It does not appear on the record that the Attorney General ever petitioned the SEC for review of Rule 2130. It is well-settled that plaintiffs "must exhaust their administrative remedies before the SEC prior to attempting to obtain judicial review." *Standard Inv. Chartered*, 2007 WL 1296712 (S.D.N.Y.) at *2 (internal quotations omitted), *citing Touche Ross & Co. v. Sec. & Exch. Comm'n,* 609 F.2d 570, 582 (2d Cir. 1979). *See* 15 U.S.C. § 78y. The Attorney General cannot challenge Rule 2130 when he has not yet brought his objection before the SEC and has not sought review in a federal court of appeals.

New York federal courts have dismissed previous challenges to NASD rules when plaintiffs failed to exhaust their statutory remedies. In *Desiderio v. National Ass'n of Securities Dealers,* the plaintiff challenged an NASD rule requiring brokers to submit employment disputes to arbitration as a condition of their employment. The court observed that the SEC had approved the NASD rule three years prior to the filing of the complaint, and that the plaintiff had neither filed a petition within sixty days of the approval of the rule nor filed her complaint in a federal court of appeals, as prescribed by Section 25 of the Securities Exchange Act. *Id.* at 522. The court held that plaintiff had not complied with Section 25 of the Securities Exchange Act and had not exhausted her statutory remedies and dismissed the complaint accordingly. *Id.*

In *Standard Investment Chartered*, plaintiff filed a class action complaint challenging the pending consolidation of NASD and the New York Stock Exchange. NASD submitted proposed amendments to its by-laws to the SEC for approval, in anticipation of the consolidation. Plaintiff sought an injunction against the consolidation and the amendments to the NASD by-laws. In

dismissing the complaint, the court found that "plaintiffs must initially challenge SRO rulemaking in front of the agency that administers the Exchange Act and in accordance with that agency's administrative scheme." *Standard Investment Chartered,* 2007 WL 1296712 (S.D.N.Y. May 2, 2007) at *6.

In *American Benefits Group,* the court dismissed the complaint because plaintiff had failed to challenge or even object to the NASD rules at issue until it filed its complaint with the court. 1999 WL 605246 (S.D.N.Y.) at *5. The court noted that the proposed NASD rules had been published in the Federal Register and related information had been published in two quarterly updates issued by the OTC Bulletin Board, a subsidiary of NASD.

There are four recognized exceptions to the exhaustion doctrine: (1) available remedies will provide no genuine opportunity for adequate relief, (2) irreparable injury may occur without immediate judicial relief, (3) an administrative appeal would be futile, and (4) plaintiff has raised a "substantial constitutional question." *Am. Benefits Group* at *7. None of them apply in this case.

Here, the Attorney General could have challenged the Rule by petitioning the SEC and timely seeking judicial review in a federal court of appeals. This was a genuine opportunity for adequate relief. The Attorney General cannot show irreparable injury because, as discussed *supra*, more detail in the next section, expungement of information from the CRD system does not prevent the State from retaining the expunged information in another database. If the harm here truly was irreparable, the Attorney General would have opposed the Rule when it was approved. The Attorney General cannot argue that an administrative appeal would have been

futile, especially given the fact that he has never provided the SEC with an opportunity to consider his arguments. The Attorney General has not raised any constitutional question.

Finally, the Attorney General's argument that state record retention laws conflict with Rule 2130 is irrelevant here. In the context of a failure to exhaust administrative remedies, conflicting state laws are simply not relevant. *See Standard Investment Chartered*, 2007 WL 1296712 (S.D.N.Y.) at *8-*9.

C. NASD Rule 2130 Is Consistent With Well-Established Principles Of Federal And New York Law Governing The Powers Of Arbitrators And The Courts

The Attorney General's arguments that arbitrators lack the power to issue awards containing expungement relief and courts lack the power to confirm such awards are flatly inconsistent with well-established principles of New York and federal law. In reality, NASD Rule 2130, which ascribed these powers to arbitrators and courts, meshes seamlessly with these principles.

1. The Power Of Arbitrators

Arbitrators have broad discretion to fashion remedies that are appropriate under the circumstances.[13] This would be so even if NASD Rule 2130 did not exist. *See Baravati v. Josepthal, Lyon & Ross, Inc.*, 28 F.3d 704, 710 (7th Cir. 1994) ("It is commonplace to leave the

[13] Arbitration awards in securities cases containing expungement relief have been commonplace since the establishment of the CRD system in about 1980. Exchange Act Release No. 34-48933, 68 Fed. Reg. at 74,672 (Dec. 24, 2003). The NASD's Code of Arbitration Procedure, which was approved by the SEC, *see* Exchange Act Release No. 34-55158 (Jan. 24, 2007), 72 Fed. Reg. 4,574 (Jan. 31, 2007), grants plenary power to arbitrators to adjudicate all liability issues in a particular case and "award any relief that would be available in a court of law." NASD Rule 10214.

arbitrators pretty much at large in the formulation of remedies" and "[c]lose questions concerning the interpretation of the scope of the powers authorized to the arbitrator are resolved in favor of those powers.") Under N.Y. C.P.L.R. Article 75 (2003), an arbitrator has broad discretion to resolve disputes and fix remedies, and any limitation on that discretion must be contained in the arbitration argument. *In re New York State Governor's Office of Employee Relations*, 661 N.Y.S.2d 861, 862 (1997).[14] In *In re Arbitration Of Lubin & Schlesinger, Inc.*, 641 N.Y.S.2d 509, 511, *rev'd on other grounds*, 651 N.Y.S.2d 502 (N.Y.A.D. 1 Dept 1966), this Court wrote that an arbitrator "may do justice as he sees it, applying his own sense of law and equity to the facts as he finds them to be . . . ."

There is no reported case holding that an arbitrator lacks the power to include expungement relief in an award in appropriate circumstances. There are, however, New York cases where courts affirmatively have ruled that an arbitrator may include expungement relief in an award. In *Rosenberg v. MetLife*, 8 N.Y.3d 359, 368 (2007), the New York Court of Appeals ruled that registered employees who are defamed on a Form U-5 may commence an arbitration proceeding or a court action to expunge defamatory language. This constitutes clear support for the proposition that arbitrators have the power to issue awards containing expungement relief.

Similarly, *In re Gregory E. Goldstein*, 805 N.Y.S.2d 647 (2005), the Appellate Division reversed an order of the Supreme Court where the Court refused to confirm the part of a

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[14] *See also Bowmer v. Bowmer*, 50 N.Y.2d 288, 296 (Ct. App. 1980) (stating that once a controversy is properly before an arbitrator he has wide discretion in his choice of remedies); *Bd. of Ed. of Norwood-Norfolk Cent. School Dist. v. Hess*, 49 N.Y.2d 145 (Ct. App. 1979), (stating that "to achieve what the arbitration tribunal believes to be a just result, it may shape its remedies with a flexibility at least as unrestrained as that employed by a chancellor in equity") (citations omitted).

stipulated arbitration award that recommended expungement. It is clear from the Appellate Division's opinion that it had concluded that the arbitration panel had the power to include expungement relief in its award.

NASAA, which represented the interests 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. Its position was that actual expungement could not occur unless a court confirmed such awards.

2. The Role Of The Court

NASD Rule 2130(a) provides that persons seeking expungement from the CRD based on an arbitration award must obtain an order from a court of competent jurisdiction confirming the award. Both the Federal Arbitration Act, 9 U.S.C. § 1 et seq. (the "FAA"), and N.Y. C.P.L.R. § 7511 give courts of competent jurisdiction the authority to confirm arbitration awards. There is no basis to exclude awards containing expungement relief from this authority, as the Attorney General seeks to do in this case.

Rule 2130 does not prescribe its own standard of judicial review. Rather, it contemplates that courts asked to confirm awards containing expungement relief will apply traditional standards of review. In this case, the Attorney General cites the standards in N.Y. C.P.L.R. § 7511 which permits a non-party to move to vacate in certain circumstances. However, it is the FAA that generally applies to the review of arbitration awards in securities cases.[15] *See* this

[15] The FAA does not contain a provision like the one in N.Y. C.P.L.R. § 7511 that permits persons like the Attorney General who were not parties to the arbitration to seek to vacate an award.

Court's decision in *In re Arbitration Of Lubin & Schlesinger*, 641 N.Y.S.2d at 511, *rev'd on other grounds*, 651 N.Y.S.2d 502 (N.Y.A.D. 1 Dept. Dec. 24, 1996) ("Disputes among parties involved in the securities industry have been repeatedly held to be governed by the FAA").[16] Recent cases where the FAA was applied to NASD arbitrations involving customer disputes include *Lessin v. Merrill Lynch*, 481 F.3d 813 (D.C. Cir. 2007), *Festus & Helen Stacy Found., Inc. v. Merrill Lynch*, 432 F.Supp.2d 1375 (N.D. Ga. 2006), and *Kruse v. Sands Bros. & Co. LTD*, 226 F.Supp.2d 484 (S.D.N.Y. 2002).

Under the FAA, a court must grant an arbitration panel's decision "great deference" and a party seeking *vacatur* bears "the heavy burden of showing that the award falls within a very narrow set of circumstances delineated by statute and case law." *Duferco Int'l Steel Trading v. Klaveness Shipping*, 333 F.3d 383, 388 (2d Cir. 2003).[17] "Arbitration awards are subject to very limited review in order to avoid undermining the twin goals of arbitration, namely, settling disputes efficiently and avoiding long and expensive litigation." *Folkways Music Publishers, Inc. v. Weiss*, 989 F.2d 108, 111 (2d Cir. 1993). In *Wien & Malkin LLP v. Helmsley-Spear, Inc.*, 6 N.Y.3d. 471, 813 N.Y.S.2d 691 (2006), the New York Court of Appeals, considering a case governed by the FAA, said: "Indeed, we have said time and again that an arbitrator's award should not be vacated for errors of law or fact committed by the arbitrator and courts should not assume the role of overseers to mold the award to conform to their sense of justice." *Id.* at 479-

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[16] *See also, Merrill Lynch v. Sorvino et al.*, 2007 U.S. Dist. LEXIS 23126 (S.D.N.Y. 2007) e.g., *Austin Mun. Secs., Inc. v. Nat'l Ass'n of Secs Dealers, Inc.*, 757 F.2d 676, 697 (5th Cir. 1985); *Corey v. New York Stock Exch.*, 691 F.2d 1205, 1210 (6th Cir. 1982).

[17] New York law accords similar deference to arbitrator awards. It discourages judicial interference with both the arbitration process and with arbitration awards. *See Matter of New York City Transit Auth. v. Transp. Workers Union of Am.*, 99 N.Y.S.2d 1, 6 (2002).

480. The party seeking to vacate an award bears the burden of showing that one of the grounds for *vacatur* listed in 9 U.S.C. § 10 exists in the case. *Wall Street Assocs., L.P. v. Becker Paribus, Inc.*, 27 F.2d 845 (2d Cir. 1999). *See* DeBonis Aff., Exhibit 12.

Section 10 of the FAA, 9 U.S.C. § 10, permits *vacatur* where the award was procured by corruption, fraud, or undue means; where there was evident partiality or corruption in the arbitrators; where there was misbehavior or misconduct in refusing to postpone a hearing or to hear evidence; and where the arbitrators exceeded their powers. (*See* DeBonis Aff., Exhibit 12). The Attorney General argues here that the arbitrator exceeded his power by approving expungement. Johnson Opposition Aff., p. 8. He objects particularly to the fact that the arbitrator did so based on a stipulated award rather than a record of a hearing on the merits of the underlying claims.

As an initial matter, there is nothing suspect or improper in the fact that the parties stipulated to an award containing expungement relief. Indeed, the Appellate Division has ruled that stipulated awards, including ones containing expungement relief, are entitled to great deference and "will not be set aside on facts less than needed to avoid a contract, e.g., fraud, overreaching, mistake, duress or some other similar ground." *See In re Gregory E. Goldstein*, 805 N.Y.S.2d at 649, 24 A.D.3d at 442 (2005).

The fact that the award in a case is the result of a stipulation does not expand the scope of judicial review. The FAA provisions still govern and an award may not be vacated unless it contravenes one of the FAA's standards. The most a court presented with an application to vacate an award containing expungement relief should do is determine whether the arbitrator made one of the findings specified in Rule 2130. If the arbitrator did so, that is the end of the

court's inquiry. Arbitrators are not required to state the reasons for their awards. *See, e.g., Wall Street Assocs., supra* at 849; *Reichman v. Creative Real Estate Consultants, Inc.*, 476 F.Supp. 1276, 1282 (S.D.N.Y. 1979). There is a sound and long-standing public policy basis for this principle. In *Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211, 1215 (2d Cir. 1972), the court said that it would "be destructive" of the arbitral process to require a statement of reasons because it would diminish the efficiency of the process. Thus, the FAA does not permit "the luxury of a remand to the arbitrator for a statement of reasons." *Reichman, supra* at 1282.[18]

V. CONCLUSION

Arbitrators have the power to issue awards containing expungement relief and courts have the power to confirm such awards. The court should not vacate the award in this case based on the Attorney General's erroneous legal arguments. To the contrary, it should rule that NASD arbitrations in New York continue to be governed by Rule 2130 as they are elsewhere in the country.

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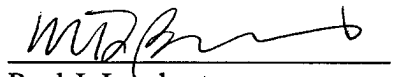
[18] In a May 30, 2007 decision, the Honorable Diane Y. Devlin of the New York Supreme Court for Erie County ordered a rehearing by an arbitration panel of an award containing expungement relief. *See Sage, Rutty & Co., Inc. v. Salzberg, et al.*, No. 2007-01942 (N.Y. Sup. Ct. May 30, 2007), attached hereto. The panel had made one of the affirmative findings contemplated by Rule 2130. However, the award did not contain the evidentiary basis for the finding. The court stated that arbitrators exceed their power under C.P.L.R. § 7511 if their awards are "totally irrational" and that an award is irrational if the evidentiary basis for it is lacking. *Id.* at 4. SIFMA respectfully asserts that the court erred in this case. The award should have been reviewed under the FAA which does not provide a "totally irrational" standard of review. In addition, for the reasons stated in the text, courts may not remand to arbitrators for a statement of reasons supporting their awards.

Respectfully submitted,



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