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Summer 2020

## Adversarial Failure

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### Recommended Citation

Benjamin P. Edwards, *Adversarial Failure*, 77 Wash. & Lee L. Rev. 1053 (2020).

Available at: <https://scholarlycommons.law.wlu.edu/wlulr/vol77/iss3/4>

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# Adversarial Failure

Benjamin P. Edwards\*

## *Abstract*

*Investors, industry firms, and regulators all rely on vital public records to assess risk and evaluate securities industry personnel. Despite the information's importance, an arbitration-facilitated expungement process now regularly deletes these public records. Often, these arbitrations recommend that public information be deleted without any true adversary ever providing any critical scrutiny to the requests. In essence, poorly informed arbitrators facilitate removing public information out of public databases. Interventions aimed at surfacing information may yield better informed decisions. Although similar problems have emerged in other contexts when adversarial systems break down, the expungement process to purge information about financial professionals provides a unique case study.*

*Multiple interventions may combine to more effectively surface information and generate better informed decisions. In quasi-ex parte proceedings, traditional attorney ethics rules must yield to a higher duty of candor. Yet adjudicators should not rely on duty alone. Adversarial scrutiny may emerge by designating an advocate to independently and critically engage in circumstances where no party has any real incentive to oppose an outcome. Ultimately, addressing adversarial failures may*

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*require a shift away from adversarial adjudication to a more regulatory framework.*

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### I. Introduction

Customer complaints about stockbrokers (brokers), misconduct findings, and other information have long been public record. The public disclosures for Gregory Brian VanWinkle, a broker affiliated with Essex Securities, reveal a history of problems detailed in seven different disclosures.<sup>1</sup> In 2013, Securities America discharged him for violating the firm's policy related to client signatures.<sup>2</sup> Arising from this incident, the Financial Industry Regulatory Authority (FINRA) also brought a disciplinary action against him which culminated in a fine of \$5,000 and a twenty-day suspension.<sup>3</sup> The public record

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1. See *Gregory Brian VanWinkle*, BROKERCHECK, <https://perma.cc/KXP7-U53R> (providing the employment history and public disclosure record of VanWinkle).

2. See *id.* (detailing that VanWinkle was discharged due to an allegation that he “violated firm policy relating to client signatures”).

3. See Letter of Acceptance, Waiver, and Consent No. 2013038209301 from Gregory Van Winkle to Fin. Indus. Reg. Auth. 2 (June 29, 2015), <https://>

includes three customer disputes, two of which resulted in settlements.<sup>4</sup> But these public disclosures only tell part of the story.

VanWinkle erased another twenty-four customer disputes and some now unknowable number of settlements from the public record with one weird trick. In 2017, he filed an arbitration claim against a former employer, IFS Securities.<sup>5</sup> IFS never responded to the action and did not file any answer.<sup>6</sup> Importantly, VanWinkle did not seek any damages from IFS Securities.<sup>7</sup> He filed the action to secure an arbitration award declaring that the twenty-four customer complaints should not be on his record because they were either false or that he had nothing to do with the alleged misconduct.<sup>8</sup> He succeeded and obtained the arbitration award after a single fact-finding hearing lasting four hours or less.<sup>9</sup>

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[perma.cc/XA38-UTDV](https://perma.cc/XA38-UTDV) (detailing that VanWinkle agreed to “[a twenty] business-day suspension from association with any FINRA firm in any capacity and a \$5,000 fine”).

4. See *Gregory Brian VanWinkle*, *supra* note 1 (reporting that one customer dispute was denied and two other customer disputes were settled).

5. See *VanWinkle v. IFS Sec., Inc.*, No. 17-02465, 2018 WL 4051277, at \*1 (Aug. 13, 2018) (Ver Beek, Arb.) (memorializing VanWinkle’s arbitration claim).

6. See *infra* Part II.C.1.d and accompanying text (explaining why brokerages do not oppose these requests); see also *VanWinkle*, 2018 WL 4051277, at \*1 (noting that IFS “did not file with FINRA Office of Dispute Resolution a properly executed [s]ubmission [a]greement” and that IFS “did not participate in the expungement hearing”).

7. See *VanWinkle*, 2018 WL 4051277, at \*1 (stating that VanWinkle’s requested relief was only for “expungement of the [u]nderlying [c]laims from his registration records maintained by the [Central Registration Depository]”).

8. See FIN. INDUS. REG. AUTH., RULE 2080 (2009) (setting out the requirements for expungement awards); see also *VanWinkle*, 2018 WL 4051277, at \*2 (supporting VanWinkle’s expungement claim on the basis that the underlying issues in the customer’s complaints were not VanWinkle’s fault but rather the fault of the issuer of the security).

9. See *VanWinkle*, 2018 WL 4051277, at \*2 (reporting that the arbitrator found in favor of VanWinkle’s expungement argument). Within the FINRA forum, a hearing session lasts for four hours or less. See *Summary of Arbitration Fees*, FIN. INDUS. REG. AUTH., <https://perma.cc/9L8N-APY6> (“A hearing session is any meeting between the parties and arbitrator(s) of four hours or less, including a hearing or a prehearing conference.”).

A traditional, adversarial fact-finding process may have yielded a substantially different result. With no opposing voice in the room, VanWinkle successfully shifted the blame to a third party who played no role in the arbitration—an insurance company who accurately described its offering in its prospectus.<sup>10</sup> In granting VanWinkle’s request, the arbitrator found that VanWinkle “sold a particular annuity product to many customers” and that he “was familiar with this product from sales meetings and prior sales to several customers.”<sup>11</sup> Implicitly acknowledging that VanWinkle did not understand the product he sold, the arbitrator found that “[a]pparently the issuer changed the [d]eath [b]enefit with nothing calling attention to the change except language in a very long prospectus.”<sup>12</sup> Ultimately, the arbitrator found that the customer claims were false and that VanWinkle had not been involved with the misconduct because the “fault lies with the issuer, not [VanWinkle], and none of the allegations raised involved actions by [VanWinkle].”<sup>13</sup> The award seemingly acknowledges that VanWinkle either did not understand the product he sold or that he sold it to customers while misrepresenting its true nature. At best, the reasoning might support a finding that VanWinkle repeated the same innocent mistake at least twenty-four times. It does not establish that the customer complaints about him were false.

The arbitrator’s ruling appears particularly puzzling because customers work with brokers to help them find financial products that are suitable for their situation.<sup>14</sup> This requires that brokers like VanWinkle understand the products that they sell to customers and not simply push whatever

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10. See *VanWinkle*, 2018 WL 4051277, at \*1 (noting that the parties involved in the arbitration included VanWinkle and IFS Securities, a broker-dealer, but did not include the insurance company who issued the underlying annuity that was at issue in the case).

11. *Id.* at \*2.

12. *Id.*

13. *Id.*

14. See FIN. INDUS. REG. AUTH., RULE 2111 (2014) (obligating a broker to “have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer”).

product pays the highest commission.<sup>15</sup> The rules governing brokers make clear that a broker must have “an understanding of the potential risks and rewards associated with the recommended security or strategy” and that a broker who lacks “such an understanding when recommending a security or strategy violates the suitability rule.”<sup>16</sup> The arbitrator’s factual finding about VanWinkle shows that he lacked that understanding.

Many different stakeholders have an interest in these disputes and could have pointed out obvious problems with a broker selling dozens of customers the same variable annuity without understanding its terms. State regulators rely on public records to target their oversight and enforcement efforts. FINRA, which oversees brokers, would likely want to know this information when its staff examines a brokerage. Future investors would likely want to know about these complaints when deciding whether to hire him as a broker. And, presumably, the annuity’s issuer might want to point out that the broker and brokerage firm must understand the product it sells. But none of these stakeholders participated in the arbitration hearing.<sup>17</sup>

The required final step of judicial confirmation of arbitration awards provides no real check on the process.<sup>18</sup> Even when regulators have attempted to intervene at this stage, they have not generally succeeded at stopping confirmation. Courts routinely confirm these arbitration awards without any inquiry into whether the arbitrator made a reasonable decision.<sup>19</sup> A

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15. Cf. Ann Lipton, *I Do Not Think It Means What You Think It Means*, BUS. L. PROF BLOG (May 7, 2016), <https://perma.cc/N9NV-7USX> (describing variable annuities as “a product that might be suitable if you’re trying to shelter your assets from a lawsuit, but otherwise one whose chief virtue lies in its capacity to serve as a litmus test for the honesty of your broker”).

16. FIN. INDUS. REG. AUTH., RULE 2111 Supplementary Material .05(a) (2014).

17. See *VanWinkle v. IFS Sec., Inc.*, No. 17-02465, 2018 WL 4051277, at \*1 (Aug. 13, 2018) (Ver Beek, Arb.) (listing participating parties).

18. See *id.* at \*2 (noting that before arbitration awards may be enforced, they must be confirmed by courts of competent jurisdiction).

19. See Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703, 711 (1999)

confirmed award allowed VanWinkle to have all this information deleted from public records.

For decades, brokers and financial services industry firms have used private arbitration decisions to strip information from the public record.<sup>20</sup> In theory, this expungement process provides an extraordinary remedy to protect financial professionals from having malicious, false, or entirely baseless complaints taint their records and harm their careers.<sup>21</sup> In reality, significant evidence indicates that the expungement process actually suppresses important public information and tends to increase financial misconduct.<sup>22</sup> This may happen either by allowing bad actors to remain or by emboldening others to take advantage of clients.<sup>23</sup>

Brokers win expungements quite frequently. By one calculation, brokers have requested to expunge around 12 percent of the allegations of misconduct made by customers and firms in recent years.<sup>24</sup> Brokers making these requests generally succeed at suppressing information and win over 80 percent of their requests.<sup>25</sup> Notably, brokers who successfully

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(“Courts do not closely review arbitration awards to ensure that arbitrators apply the law. And even if a court discovers that an arbitration award does not apply the law, the court will likely confirm the award.”(citation omitted)).

20. See Jill E. Fisch, *Top Cop or Regulatory Flop? The SEC at 75*, 95 VA. L. REV. 785, 800 (2009) (noting that existing arbitration rules “facilitate the concealment of allegations of misconduct”).

21. See Colleen Honigsberg, *The Case for Individual Audit Partner Accountability*, 72 VAND. L. REV. 1871, 1914 (2019) (explaining that FINRA’s “BrokerCheck . . . database includes unverified customer complaints, prompting concerns that certain brokers are unfairly targeted”).

22. See Colleen Honigsberg & Matthew Jacob, *Deleting Misconduct: The Expungement of BrokerCheck Records*, J. FIN. ECON. (forthcoming 2020) (manuscript at 1) (on file with the Washington and Lee Law Review) [hereinafter Honigsberg & Jacob] (reporting that brokers with past history of successful expungements are more likely than brokers without past expungements to engage in future misconduct).

23. See *id.* at 5 (“Our analysis provides evidence that successful expungements increase recidivism.”).

24. See *id.* at 3 (explaining that evidence “suggests that brokers request to expunge 12% of the allegations of misconduct made by customers and firms” (citation omitted)).

25. See *id.* at 15 (“[O]ver 80% of expungements decided on the merits are successful in each year from 2007 to 2016 . . .”).



expunge complaints from their record “are 3.3 times as likely to engage in new misconduct as the average broker.”<sup>26</sup>

The finding that brokers who have secured expungements pose significantly more risk than the average broker raises real concerns about the legitimacy of the expungement process itself. Private arbitration proceedings may be particularly poorly suited to resolve questions of great public importance.<sup>27</sup> If the expungement process reliably functioned to remove only false information, a broker who obtains an expungement award would not pose any special danger.<sup>28</sup> Instead, the statistics emerging from the current expungement process reveal that the system likely purges truthful information, or at least information with significant predictive power.

Many stakeholders have strong interests in knowing about a broker’s disclosures. The broker’s current and future investor clients have an interest in knowing about past customer disputes, as well as bankruptcies and convictions.<sup>29</sup> Similarly, regulators have an interest in the information to effectively police their markets. Future employers also have an interest because a record of past disputes may help a firm decide whether a new hire will generate new liabilities. Yet the current expungement process only requires the participation of a broker and a brokerage firm.<sup>30</sup> Regulators are able to participate at the confirmation stage, but rarely do. Customers whose disputes

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26. *Id.* at 4.

27. *Cf.* Jean R. Sternlight, *Mandatory Binding Arbitration Clauses Prevent Consumers from Presenting Procedurally Difficult Claims*, 42 SW. L. REV. 87, 127 (2012) (“[O]ur system often relies heavily and explicitly upon enforcement by private parties to achieve public regulatory objectives.”).

28. Theoretically, it might be possible that the brokers most likely to harm the public were also the most likely to draw false allegations. This seems highly unlikely.

29. *See* Benjamin P. Edwards, *The Professional Prospectus: A Call for Effective Professional Disclosure*, 74 WASH. & LEE L. REV. 1457, 1485 (2017) (“For market forces to function effectively, reputation must play a significant role. Yet reputation only plays a weak role in the current markets for professional services because public consumers both struggle to recognize and broadcast information about low quality professionals.”).

30. *See infra* Part II.

may have settled years ago may receive notice but have little incentive to participate.<sup>31</sup>

The current broker expungement process exemplifies “adversarial failure.” In using the phrase, I mean more than that the system simply does not work well. As Malcom Feeley has noted, adversarial systems can fail in ways analogous to market failures.<sup>32</sup> Although writing in the criminal law context, he explains that although we “have theories and well-recognized institutions to prevent or correct for market failure—public finance theory, public utilities, regulatory agencies, and the like—we have no equivalent safeguards for adversarial failure.”<sup>33</sup>

Adversarial failure may occur when parties to a dispute have either aligned interests or no real incentive to contest. Accustomed to adjudicating genuinely contested disputes, arbitrators and courts mistakenly expect that the lawyers and parties appearing before them will raise all relevant facts as well as applicable law and rules. They may also expect that, collectively, participating parties have some incentive to bring reasonably pertinent information to the adjudicator’s attention. Yet in many securities, shareholder, and mass tort disputes, the named parties have little incentive to generate a complete record.<sup>34</sup> Sometimes, no party to an action has any real interest

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31. For a description of the limited notice customers receive in many instances, see *infra* Part II.C.3 and accompanying text.

32. See Malcolm M. Feeley, *How to Think About Criminal Court Reform*, 98 B.U. L. REV. 673, 704 (2018) (“Just as there is market failure at times, so too there can be adversarial system failure.”).

33. See *id.* (describing the criminal law system as using “some crude stop-gap measures, such as chronically underfunded public defender systems” to address the problem).

34. See ELIZABETH CHAMBLEE BURCH, *MASS TORT DEALS: BACKROOM BARGAINING IN MULTIDISTRICT LITIGATION* 107-09 (2019) (discussing how settlement deals may emerge without significant information ever reaching a court); see also Elizabeth Chamblee Burch, *Publicly Funded Objectors*, 19 THEORETICAL INQUIRIES L. 47, 48-49 (2018) (“On paper, things run like clockwork. But practice suggests the need for tune-ups: some judges still approve settlements rife with red flags, and professional objectors may be more concerned with shaking down class counsel than with improving class members’ outcomes.” (citation omitted)).

in focusing a court's attention on a significant issue.<sup>35</sup> Seeing only what parties with aligned interests place before them, adversarial systems chug along—blind to the real picture.

This Article connects with scholarly discussion in the shareholder derivative and securities class action settlement context. For the most part, scholars have highlighted problems in the context of class action settlement approvals.<sup>36</sup> Principal-agent problems often occur when lawyers representing named parties generally have interests which align in favor of settlement approval, often to the detriment of other key stakeholders and class members.<sup>37</sup> Normal adversarial processes break down at this point because all of the parties actually involved desire the same result—approval of the settlement agreement.<sup>38</sup> After agreeing to pay a set price to resolve all liability, defendants have no reason to pay lawyers to point out any defects in the settlement agreement or plan of distribution to the court. With significant fees on the table,

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35. See Cathy Hwang & Benjamin P. Edwards, *The Value of Uncertainty*, 110 NW. U. L. REV. 283, 284–85 (2015) (explaining that “despite the fact that some security holders may benefit from raising [a] jurisdictional issue and possibly having the case dismissed, courts and parties have generally not raised it” (citation omitted)).

36. See, e.g., Susan P. Koniak, *Feasting While the Widow Weeps: Georgine v. Amchem Products, Inc.*, 80 CORNELL L. REV. 1045, 1126 (1995) (explaining that in settlement approval hearings, “settling parties are aligned, and there may be no objector represented at the fairness hearing. These proceedings are thus analogous to ex parte proceedings, where a lawyer’s duty of candor to the court is much greater than in an ordinary adversarial proceeding”); Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051, 1057–68 (1996) (describing class counsel taking advantage of absent class members in class action settlements).

37. See Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs’ Attorney’s Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 46 (1991) [hereinafter Macey & Miller] (“[S]ettlement hearings are typically pep rallies jointly orchestrated by plaintiffs’ counsel and defense counsel. Because both parties desire that the settlement be approved, they have every incentive to present it as entirely fair.”).

38. See *In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884, 893 (Del. Ch. 2016) (“Once an agreement-in-principle is struck to settle for supplemental disclosures, the litigation takes on an entirely different, non-adversarial character. Both sides of the caption then share the same interest in obtaining the Court’s approval of the settlement.”); see also *supra* note 37 and accompanying text.

plaintiffs' lawyers have little incentive to encourage a court to reduce their fees or carefully scrutinize how the agreement will affect all unrepresented and absent class members. In many instances, significant conflicts and flaws with a settlement deal may never be brought to a court's attention.<sup>39</sup> Yet little work connects these threads to similar problems within the financial regulatory system.

This Article explores how an adversarial system breaks down and fails to produce informed decisions in a way that hurts the public. It focuses on the process stockbrokers use to delete public information. It begins in Part II by developing a detailed case study about how brokers now leverage a private arbitration process to enlist courts in suppressing public access to information. Courts reviewing these arbitration awards actually exercise little oversight. The Federal Arbitration Act limits judicial review of arbitration awards, and only permits a court to vacate an arbitration award in rare circumstances.<sup>40</sup> In essence, poorly informed arbitration decisions now drain important information from society without any real judicial or adversarial check.<sup>41</sup> As with the problems in securities class actions, skewed incentives, underrepresentation, and conflicts amplify these recurring problems within the process for expunging customer dispute information about stockbrokers.

Channeling disputes through arbitration proceedings only serves to amplify these problems—leaving courts as an ineffective check on arbitration outcomes.<sup>42</sup> In contrast,

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39. See Benjamin P. Edwards & Anthony Rickey, *Uncovering the Hidden Conflicts in Securities Class Action Litigation: Lessons from the State Street Case*, 75 BUS. LAW 1551, 1552–53 (2020) (“[A]dversarial review of settlements is rare, and no settling party has a reason to bring uncomfortable facts to the attention of a reviewing court.” (citation omitted)).

40. See 9 U.S.C. § 10 (2018) (setting out circumstances in which a court may vacate an arbitration award).

41. See Jean R. Sternlight, *Hurrah for the Consumer Financial Protection Bureau: Consumer Arbitration as a Poster Child for Regulation*, 48 ST. MARY'S L.J. 343, 345 (2016) (explaining that “regulation is desirable . . . when market forces are not sufficient to protect individual or public interests”).

42. Cf. Jean R. Sternlight, *Mandatory Arbitration Stymies Progress Towards Justice in Employment Law: Where to, #MeToo?*, 54 HARV. C.R.-C.L. L. REV. 155, 159 (2019) (“If companies can continue to use mandatory

ordinary judicial dispute resolution systems create some restraint on adversarial failures. Public courts owe duties to the public to correctly state the law and consider how the precedent created will shape future cases.<sup>43</sup> In contrast, private arbitrators often look no further than the materials submitted to them by the parties.<sup>44</sup>

To its credit, FINRA has periodically responded to problems and imposed additional requirements.<sup>45</sup> In 2017 it considered additional incremental reforms, including establishing a dedicated arbitrator pool for expungements, requiring unanimous approval from three arbitrators, imposing a one-year time period for seeking expungements, and other changes.<sup>46</sup> In 2019, FINRA's Board of Governors "approved . . . amendments to the Codes of Arbitration Procedure to create, among other things, a roster of arbitrators . . . to decide" expungement requests.<sup>47</sup> Although these proposals have not yet been released, they will not solve the core problems which flow from bad incentives and conducting fact-finding through an arbitration process. At best, they may mitigate the ongoing harm to a degree.

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arbitration to eradicate access to court, where judges are potentially influenced by social movements, social movements will no longer be able to assist the overall progressive trend of our jurisprudence.”).

43. See Benjamin P. Edwards, *Arbitration's Dark Shadow*, 18 NEV. L.J. 427, 432 (2018) (“Arbitrators and judges adjudicate disputes in different ways. Precedent-creating judges owe a duty to the public to correctly state the law because court judgments are public acts by public officials. This means that judges will not simply regurgitate incorrect statements of law provided by the parties.” (citation omitted)).

44. FINRA's training materials for arbitrators instruct that “[a]rbitrators should not make independent factual investigations of a case.” FIN. INDUS. REG. AUTH., FINRA DISPUTE RESOLUTION SERVICES ARBITRATOR'S GUIDE 60 (May 2020), <https://perma.cc/5W3F-NKXU> (PDF).

45. For a discussion of past problems with the process, see *infra* Part II.D and accompanying text.

46. See Fin. Indus. Reg. Auth., Reg. Notice 17-42, Expungement of Customer Dispute Information 5 (Dec. 6, 2017), <https://perma.cc/K8U4-Q2WU> (PDF) (detailing updates to FINRA expungement rules and related arbitration proceedings).

47. Robert W. Cook, *Update: FINRA Board of Governors Meeting*, FIN. INDUS. REG. AUTH. (Oct. 3, 2019), <https://perma.cc/3H3M-UUE8>.

These failures reveal the need for a range of interventions to produce better informed decisions. Part III considers some possibilities. It proposes shifting resolution of these issues to a non-adversarial and more regulatory process. Adjudicators might also mitigate adversarial failures by adopting a more skeptical approach or recruiting assistance when parties lack incentives to develop and present important information. If an adversarial system must be used, it also explores necessary changes to the dominant ethical framework for lawyers presenting information to decision makers. The American Bar Association's Model Rules of Professional Conduct provides the framework and operative text for most state professional ethics rules.<sup>48</sup> Although Model Rule 3.3 generally calls for lawyers to be candid with tribunals, the rules grant lawyers substantial leeway to shape the factual scenarios adjudicators actually see.<sup>49</sup> Changes to attorney ethics rules might cause lawyers to present more balanced pictures.

## II. *Expungement and Adversarial Failure*

For decades, brokers have been able to leverage arbitration proceedings to remove customer complaints from readily accessible public records.<sup>50</sup> Brokers have long supported the process because it gives them a path to challenge unverified customer complaints. Yet the process does not sufficiently protect the public's interest in information. One arbitrator generally criticized the way most expungements occur, pointing out that many arbitration awards recommending expungement "are not much more than conclusory reiterations of the findings and not careful discussions and analyses of the evidence."<sup>51</sup> Ultimately, the arbitrator recognized that many "decisions suggest that the panel did little more than have a mini ex-parte

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48. See generally MODEL RULES OF PROF'L CONDUCT (AM. BAR ASS'N 2020).

49. See MODEL RULES OF PROF'L CONDUCT r. 3.3 (AM. BAR ASS'N 2020) (allowing lawyers to present information they suspect may be false or incomplete).

50. For an explanation of FINRA's role, see *infra* Part II.D.

51. Gilliam v. Sagepoint Fin., Inc., No. 12-03717, 2013 WL 3963949, at \*3 (July 22, 2013) (Meyer, Arb.).

trial on the merits,” resulting in expungements.<sup>52</sup> State regulators have also panned this expungement process as “a failed system.”<sup>53</sup> This case study details the broad context and history surrounding the expungement process before examining the many reasons why this adversarial expungement process fails to generate informed or reliable decisions. At root, much of the harm flows from the reality that this arbitration-facilitated expungement system most substantively resembles an ex parte proceeding cloaked in the form of an ordinary, adversarial arbitration. In the end, the system now functions so poorly that brokers receiving expungements pose over three times as much danger to the public on a statistical basis than the average broker.<sup>54</sup>

Importantly, arbitration-facilitated expungements only partially erase and blur history. Those in the know may find expungement awards buried in FINRA’s database of publicly available arbitration awards.<sup>55</sup> Although it is not possible to reconstruct all expunged information, informed observers can identify brokers who have had customer dispute information deleted. Some informed observers may still take the fact of prior expungements into account. Yet most ordinary regulatory, arbitral, and judicial processes will not. After all, a court does confirm an award before the customer dispute information is actually deleted.<sup>56</sup>

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52. *Id.*

53. Letter from Christopher Gerold, N. Am. Sec. Admins. Ass’n President, to Vanessa Countryman, Sec’y, U.S. Sec. & Exch. Comm’n 3 (Mar. 18, 2020) (on file with the Washington and Lee Law Review).

54. See Honigsberg & Jacob, *supra* note 22, at 4 (finding that brokers with expungements pose significantly greater risks than the average broker).

55. See Nicole G. Iannarone, *Finding Light in Arbitration’s Dark Shadow*, 4 NEV. L.J.F. 1, 7 (2020) (“In the process of removing all information concerning the customer’s dispute from her CRD, the broker asserts a claim for expungement in the FINRA arbitration forum, the result of which is then recorded as an award and publicly available . . .” (citation omitted)).

56. See *supra* note 10 and accompanying text.

*A. The Broad Context*

When Americans need help allocating funds and saving for retirement, they often turn to financial advisors for assistance.<sup>57</sup> These advisors operate within a variety of regulatory structures and may owe different duties depending on the particular capacity in which they operate at any time.<sup>58</sup> And many brokers operate in a dual capacity, sometimes acting as a fiduciary investment adviser and a salesperson with the same customer. The actual standards for investment advice continue to evolve, and many financial advisors provide advice subject to significant conflicts which often skew their advice toward more expensive and underperforming options.<sup>59</sup> A financial advisor's prospective clients need accurate information to screen advisors to protect themselves from conflicts of interest. Existing clients need this information to determine whether to stay with a broker or whether to investigate products the broker may have previously sold them. This case study focuses on brokers—commission-compensated salespeople affiliated with brokerage firms. Although many of these brokers wear multiple

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57. See Benjamin P. Edwards, *Conflicts & Capital Allocation*, 78 OHIO ST. L.J. 181, 213 (2017) (explaining that different “types of financial advisors now play a major role in dispensing personalized investment advice and influencing retail capital allocation”).

58. See Christine Lazaro & Benjamin P. Edwards, *The Fragmented Regulation of Investment Advice: A Call for Harmonization*, 4 MICH. BUS. & ENTREPRENEURIAL L. REV. 47 (2014), and Benjamin P. Edwards, *Fiduciary Duty and Investment Advice: Will a Uniform Fiduciary Duty Make a Material Difference?*, 14 J. BUS. & SEC. L. 105 (2014), for discussions of the divergent standards governing financial advisors. Some have begun to turn to automated investment advice platforms known as “roboadvisers” for assistance. See Benjamin P. Edwards, *The Rise of Automated Investment Advice: Can Robo-Advisers Rescue the Retail Market?*, 93 CHI.-KENT L. REV. 97, 98 (2018) (“Consumer interest in automated investment advice continues to grow.”).

59. One well-known bias is toward recommending higher-fee, actively managed mutual funds. See Jacob Hale Russell, *The Separation of Intelligence and Control: Retirement Savings and the Limits of Soft Paternalism*, 6 WM. & MARY BUS. L. REV. 35, 59 n.102 (2015) (likening the debate over active versus passive investing to the debate over climate change because the debate persists even though the relative underperformance of active management has been conclusively established for decades).



hats and also operate within other capacities, this case study focuses on them as brokers.

Clients often struggle to monitor their broker's performance because of life cycle, behavioral, and innumeracy-related reasons. Many Americans turn to financial advisers for assistance at a time when they may be less capable of protecting their own interests than ever before. Most ordinary savers accumulate retirement savings within some defined-contribution pension, such as a 401(k). Many savers also have individual retirement accounts or taxable brokerage accounts. As a saver approaches and enters retirement, she faces an ever-increasing risk of cognitive decline.<sup>60</sup> In this context, retiring savers stand to suffer enormous losses if they entrust their assets to an unfaithful or inept manager. Detecting mismanagement or exploitation may be especially challenging for many Americans because Americans, as a whole, exhibit low levels of basic financial literacy.<sup>61</sup> Despite this, America's securities law regime assumes that Americans will be able to make sense of our disclosure-based regime for financial products.<sup>62</sup> In reality, Americans generally struggle to understand financial products and the obligations financial services professionals actually owe to them.<sup>63</sup>

The regulatory framework also aims to protect Americans through significant oversight of industry actors. The federal Securities and Exchange Commission (SEC) possesses broad

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60. See ALZHEIMER'S ASS'N, 2020 REPORT, ALZHEIMER'S DISEASE FACTS AND FIGURES REPORT 18 (2020), <https://perma.cc/DM6M-MQDZ> (PDF) (explaining that 10 percent of persons over 65, and 32 percent of persons over 85, suffer from dementia).

61. See U.S. SEC. & EXCH. COMM'N, STUDY REGARDING FINANCIAL LITERACY AMONG INVESTORS iii (2012), <https://perma.cc/C6WZ-3SYQ> (PDF) [hereinafter SEC FINANCIAL LITERACY STUDY] (documenting extensively widespread financial illiteracy).

62. See Lisa M. Fairfax, *The Securities Law Implications of Financial Illiteracy*, 104 VA. L. REV. 1065, 1069 (2018) (“[T]he federal securities law regime is inextricably linked to financial literacy because the regime presumes investors have the capacity to sufficiently understand the information being disclosed to them and thus the capacity to make suitable investment choices for themselves.”).

63. See Edwards, *supra* note 29, at 1462 (discussing “information asymmetry between professional service providers and the public”).

jurisdiction over the securities markets.<sup>64</sup> It also delegates authority to FINRA, which “oversee[s] more than 634,000 brokers across the country,” and focuses on “protecting investors and safeguarding market integrity in a manner that facilitates vibrant capital markets.”<sup>65</sup>

FINRA plays a unique role and bridges the gap between business and government. As a financial self-regulatory organization, FINRA operates with significant oversight from the SEC.<sup>66</sup> It funds its own operations, primarily from member dues.<sup>67</sup> Its members consist of broker-dealer firms—the same entities it regulates.<sup>68</sup>

FINRA also maintains a dispute resolution forum which captures nearly all brokerage industry disputes. When disputes between investors and brokers arise, mandatory pre-dispute arbitration agreements channel nearly all of those disputes into FINRA’s dispute resolution forum.<sup>69</sup> FINRA remains responsive to stakeholder concerns and has changed the rules governing its arbitration process to address many of those concerns.<sup>70</sup>

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64. See *FINRA*, FIN. INDUS. REG. AUTH., <https://perma.cc/2QAA-8Q8E> (explaining that FINRA “work[s] under the supervision of the SEC”).

65. FINRA was formerly known as the National Association of Securities Dealers. FINRA describes itself as a “government-authorized not-for-profit organization that oversees U.S. broker-dealers.” *About FINRA*, FIN. INDUS. REG. AUTH., <https://perma.cc/V2M2-BW47>.

66. See 15 U.S.C. § 78o-3 (2018) (prescribing the regulations for “registered securities associations”).

67. See William A. Birdthistle & M. Todd Henderson, *Becoming A Fifth Branch*, 99 CORNELL L. REV. 1, 20 n.101 (2013) (describing FINRA’s funding).

68. See Andrew Stoltmann & Benjamin P. Edwards, *FINRA Governance Review: Public Governors Should Protect the Public Interest*, 24 PIABA B.J. 369, 370 (2017) (describing FINRA’s governance structure).

69. See Jill Gross, *The Historical Basis of Securities Arbitration as an Investor Protection Mechanism*, 2016 J. DISP. RESOL. 171, 171–72 (2016) (“Today, in fact, most disputes between customers of broker-dealer firms and the firms and their associated persons must be arbitrated through FINRA Dispute Resolution . . .”).

70. One 2008 study found investors were mostly dissatisfied with their experience in the FINRA arbitration forum. See Jill I. Gross & Barbara Black, *When Perception Changes Reality: An Empirical Study of Investors’ Views of the Fairness of Securities Arbitration*, 2008 J. DISP. RESOL. 349, 386 (2008) (“An overwhelming 71% of customers disagreed with the positive statement that ‘I am satisfied with the outcome,’ and only 22% of customers agreed with

### B. *BrokerCheck and the Underlying CRD Database*

Investors and regulators may learn about complaints other investors have lodged against brokers by reviewing information about a broker on BrokerCheck, a website operated by FINRA.<sup>71</sup> BrokerCheck explains that it “is a free tool to research the background and experience of financial brokers, advisers and firms.”<sup>72</sup>

Yet this tool has real limits.<sup>73</sup> Information available on BrokerCheck comes from the Central Registration Depository (CRD) and the Investment Adviser Registration Depository (IARD), databases operated by FINRA and jointly owned by the states.<sup>74</sup> The North American Securities Administrators Association (NASAA) and FINRA developed the CRD to consolidate regulatory processes.<sup>75</sup> It “contains the licensing and disciplinary histories on more than 630,000 securities professionals.”<sup>76</sup> Much of this information enters the database when brokers file their licensing forms. NASAA has long held that CRD records are state records because state regulations direct brokerages to file forms with the CRD to register their

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that statement.”); *see also* Teresa J. Verges, *Evolution of the Arbitration Forum as a Response to Mandatory Arbitration*, 18 NEV. L.J. 437, 439 (2018) (“FINRA has made significant changes to its arbitration rules governing customer disputes to better serve investors.”).

71. *See BrokerCheck by FINRA*, FIN. INDUS. REG. AUTH., <https://perma.cc/KRN3-245G> (noting that BrokerCheck is operated and controlled by FINRA).

72. *Id.*

73. *See* Susan Antilla, *The Unbelievable Story of One Broker and Her Firm Fighting to Clean Her Tarnished Record*, THE STREET (June 21, 2016, 11:14 AM), <https://perma.cc/W7DH-8DB4> (“[A]nyone who does business with a securities firm would be insane to assume that the stuff they read on Finra’s online BrokerCheck tells the whole story.”).

74. *See CRD & IARD Resources*, N. AM. SECS. ADMIN. ASS’N, <https://perma.cc/2HCM-DN4G> (providing informational resources regarding the CRD and IARD).

75. *See CRD at a Glance*, N. AM. SECS. ADMIN. ASS’N, <https://perma.cc/TG43-LTQD> (“Developed by NASAA and NASD (now FINRA) and implemented in 1981, CRD consolidated a multiple paper-based state licensing and regulatory process into a single, nationwide computer system.”).

76. *Id.*

associated persons.<sup>77</sup> Courts also recognize that the CRD data is “the joint property of the applicant, [FINRA], and those CRD [s]tates.”<sup>78</sup> State public records laws generally apply to information contained in the CRD database.<sup>79</sup>

The Exchange Act requires that some information from the CRD database be freely available to the public and grants FINRA discretion to decide the “type, scope, and presentation of information to be provided” to the public.<sup>80</sup> FINRA exercises discretion to curate BrokerCheck disclosures down to reveal only a portion of the information contained in the full CRD. This sanitization has drawn some criticism for obscuring too much information.<sup>81</sup>

Investors need access to information about brokers to protect themselves.<sup>82</sup> FINRA recognizes that customer complaint disclosures are useful in predicting future

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77. See Letter from Joseph Borg, N. Am. Secs. Admins. Ass’n President, to Barbara Sweeney, Sec’y Nat. Ass’n Secs. Dealers Regulation, Inc. (Dec. 31, 2001) (on file with the Washington and Lee Law Review).

78. *E.g.*, *Karsner v. Lothian*, 532 F.3d 876, 885 n.9 (D.C. Cir. 2008) (quoting CRD Agreement Amendment) (emphasis in original removed) (alteration in original).

79. See Advisory Legal Opinion from Robert A. Butterworth, Attorney Gen. of Fla. to Robert F. Milligan, Comptroller of Fla. (Aug. 28, 1998) (“[A]pplication and disciplinary reports maintained by the National Association of Securities Dealers Central Registration Depository that are used by the Department of Banking and Finance in licensing and regulating securities dealers doing business in this state do constitute public records . . .”).

80. 15 U.S.C. § 78o-3(i)(1)(C) (2018).

81. The Public Investors Advocate Bar Association (PIABA), criticized FINRA in 2014 and in 2016 for providing limited information. See JASON R. DOSS, CHRISTINE LAZARO, & BENJAMIN P. EDWARDS, *THE INEQUALITY OF INVESTOR ACCESS TO INFORMATION* (Mar. 6, 2014), <https://perma.cc/VSQ4-9L4T> (PDF); see also HUGH D. BERKSON & MARNIE C. LAMBERT, *BROKERCHECK—THE INEQUALITY OF INVESTOR ACCESS TO INFORMATION REMAINS UNABATED—AN UPDATE TO PIABA’S MARCH 2014 REPORT 26* (2016), <https://perma.cc/BC3H-K4CP> (PDF).

82. See Order Granting Accelerated Approval to Filing Related to Changes to Forms U4, U5, and FINRA Rule 8312 No. 34–59916, 74 Fed. Reg. 23,750, 23,754 (May 20, 2009) (explaining that investors entrust brokers “with their savings and should have sufficient pertinent information available to enable them to select a registered representative with whose background they are comfortable”).

misconduct.<sup>83</sup> One study by FINRA staff found “that BrokerCheck information, including disciplinary records, financial disclosures, and employment history of brokers has significant power to predict investor harm.”<sup>84</sup> Since investors cannot get complete information from BrokerCheck, the SEC also encourages investors to seek information from state regulators.<sup>85</sup>

Expungement processes—discussed in greater detail in the next subpart—remove information from the CRD database and, consequently, it also disappears from the more broadly known and accessible BrokerCheck website.<sup>86</sup> Importantly, this record suppression likely harms even those public investors who would have never personally conducted due diligence. Industry firms may hire brokers without knowledge of past problems. Even if they do become aware of past expungements, they have no way to know the true merits of any past expunged complaint. In the same way, deletion also inhibits regulators’ ability to protect the public.<sup>87</sup>

Ultimately, a well-functioning expungement process must balance appropriate, competing interests. Although brokers will generally prefer to minimize unflattering information about themselves, they have a legitimate interest in removing provably false and defamatory claims. But this interest must be

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83. See Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend FINRA Rule 8312 to Allow the Dissemination of IAPD Information Through BrokerCheck No. 34-62468, 85 Fed. Reg. 26,502, 26,505 (May 4, 2020) (explaining that an inclusion of customer complaints in the CRD system can help “increas[e] the ability of users to understand the potential risk of misconduct” on the part of their brokers).

84. HAMDAD QURESHI & JONATHAN SOKOBIN, DO INVESTORS HAVE VALUABLE INFORMATION ABOUT BROKERS? 1 (2015), <https://perma.cc/S8QA-VEHC> (PDF).

85. See Order Approving a Proposed Rule Change to Amend FINRA Rule 8312 (FINRA BrokerCheck Disclosure), 75 Fed. Reg. 41,254, 41,258 (July 15, 2010) (“The Commission urges the public to utilize all sources of information, particularly the databases of the state regulators . . .”).

86. See *infra* Part II.C.

87. See Fin. Indus. Reg. Auth., Reg. Notice 14-31 Expungement of Customer Dispute Information 2 (July 30, 2014) <https://perma.cc/49B7-UGZ2> (PDF) (“Once information is expunged from the CRD system, it is permanently deleted and, therefore, no longer available to the investing public or regulators.”).

balanced against the need for regulators to have access to past complaints and for diligent investors to be able to gather information before turning their life savings over to a broker. The current process has drawn criticism for improperly balancing these interests and broadly facilitating the removal of information.<sup>88</sup>

### C. *Expungement Incentives and Process*

Expungement processes have evolved substantially over the years. After the CRD's creation in 1981, FINRA would delete information from the database after either an arbitration award or a court decision called for it.<sup>89</sup> FINRA instituted a moratorium on arbitrator-ordered expungements in 1999 after state regulators expressed concern about the removal of information from the CRD database that regulators contended were state records without any court order directing removal.<sup>90</sup>

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88. A study by the PIABA Foundation found that FINRA's "current expungement process fails to properly balance the interests of investors, regulators, and the public in the CRD maintaining complete and accurate information about brokers against the interest of brokers in protecting their reputations from false customer complaints." JASON R. DOSS & LISA BRAGANÇA, 2019 STUDY ON FINRA EXPUNGEMENTS: A SERIOUSLY FLAWED PROCESS THAT SHOULD BE STOPPED IMMEDIATELY TO PROTECT THE INTEGRITY OF THE PUBLIC RECORD 7 (2019), <https://perma.cc/9FSY-GJ6F> (PDF).

89. See Nat. Ass'n Secs. Dealers, Notice to Members 01-65 Request for Comment on Proposed Rules Relating to Expungement from the CRD 563 (Oct. 2001), <https://perma.cc/CK26-BFZB> (PDF) (requesting comment on changing procedures).

90. See Nat. Ass'n Secs. Dealers, Notice to Members 99-09 Moratorium on Arbitrator-Ordered Expungements from the CRD 47 (Feb. 1999), <https://perma.cc/7FDZ-8569> (PDF)

NASD Regulation has taken the position that expungement of information from the CRD system that is ordered by an arbitrator and contained in an award should be afforded the same treatment as a court-ordered expungement. NASAA disagrees with this position and has informed NASD Regulation that it does not believe that arbitrator-ordered expungements should be afforded the same treatment as court-ordered expungements.

To resolve the issue, FINRA created a new process, now codified under Rule 2080.<sup>91</sup> Under Rule 2080, brokers can pursue relief two different ways, either by going directly to court or by having a court confirm an arbitration award which recommends expungement.<sup>92</sup> Rule 2080 requires brokers seeking judicial assistance with an expungement to “name FINRA as an additional party and serve FINRA with all appropriate documents unless this requirement is waived.”<sup>93</sup> FINRA may waive the requirement to name it as a party if the underlying customer claim is: (i) “factually impossible or clearly erroneous;” (ii) the broker had no involvement in the conduct; or (iii) the “claim, allegation or information is false.”<sup>94</sup> FINRA also reserves the right to waive the requirement to name it as a party under “extraordinary circumstances.”<sup>95</sup>

When the SEC approved Rule 2080, it also contained the requirement to name FINRA as a party to the court action unless FINRA opted to waive the requirement.<sup>96</sup> The SEC approved the framework because it believed “that the potential involvement of [FINRA] at the court confirmation level will provide greater safeguards than simple application of the rule to members.”<sup>97</sup> As conceived, the system aimed “to shift final authority on expungement away from arbitrators, and to courts of law.”<sup>98</sup>

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91. See Seth E. Lipner, *The Expungement of Customer Complaint CRD Information Following the Settlement of a FINRA Arbitration*, 19 FORDHAM J. CORP. & FIN. L. 57, 68–76 (2013) (tracing the early history of FINRA Rule 2080).

92. See FIN. INDUS. REG. AUTH., RULE 2080 (2009) (“Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD) System.”).

93. *Id.*

94. *Id.*

95. *Id.*

96. The SEC first approved a nearly identical, earlier iteration of Rule 2080 issued by the National Association of Securities Dealers (NASD).

97. Order Granting Accelerated Approval of Proposed Rule Change Relating to Proposed NASD Rule 2130 Concerning the Expungement of Customer Dispute Information from the Central Registration Depository System No. 34–48933, 68 Fed. Reg. 74,667, 74,671 (Dec. 24, 2003).

98. *Reinking v. Fin. Indus. Reg. Auth.*, No. A-11-CA-813-SS, 2011 WL 13113323, at \*3 (W.D. Tex. Dec. 1, 2011).

Yet courts of law are not well-situated to constrain expungements. A court may only vacate an arbitration award in rare circumstances.<sup>99</sup> Both federal statutory law and precedent leave courts unable to conduct any significant review of an arbitrator's decision absent rare circumstances.<sup>100</sup> Absent some indication that the arbitrator was biased or otherwise refused to listen to evidence, it remains extraordinarily difficult to prevent an arbitration award from being confirmed in a court hearing. Courts simply do not get into the weeds when reviewing arbitration awards. Absent extraordinary circumstances, they simply confirm them.<sup>101</sup>

Now, most expungement hearings proceed under a mix of official FINRA rules, guidance, and arbitrator training materials. Because the critical fact-centric expungement hearings occur within an arbitration forum, the public has little or no access to information about the hearings.<sup>102</sup> Only in the rarest circumstances will a court review the evidence considered by an arbitrator before confirming an arbitration award.

Although most brokers pursue expungements through the FINRA arbitration process before having a court confirm the award, a few still attempt to go directly to court proceedings.<sup>103</sup> Courts divide over whether and how to consider these direct-to-court filings. Some courts evaluating these requests

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99. See 9 U.S.C. § 10 (2018) (setting out circumstances where a court may vacate an arbitration award).

100. See *Hall St. Assocs. v. Mattel, Inc.*, 552 U.S. 576, 584 (2008) (“We now hold that §§ 10 and 11 respectively provide the FAA’s exclusive grounds for expedited vacatur and modification.”).

101. See, e.g., *Walker v. Connelly*, No. 100681/08, 2008 WL 4754138, at \*7 (N.Y. Sup. Ct. Oct. 16, 2008) (confirming arbitration award over opposition).

102. Notably, FINRA itself is not subject to the Freedom of Information Act because it is not a government agency. A quirk in the law also exempts information about the SEC’s oversight of FINRA from disclosure. See *Pub. Invs. Arbitration Bar Ass’n v. U.S. Sec. Exch. Comm’n*, 930 F. Supp. 2d 55, 72–73 (D.D.C. 2013), *aff’d*, 771 F.3d 1 (D.C. Cir. 2014) (“[A]ll records relating to the SEC’s examination reports—including reports relating to the administrative functions of FINRA—are exempt from disclosure under the FOIA.”).

103. See *In re Lickiss*, No. C-11-1986 EMC, 2011 WL 2471022, at \*2 (N.D. Cal. June 22, 2011) (“[A]s FINRA conceded at the oral argument herein, its rules do not require a member or associated person to first present a request to expunge to FINRA before going to court under Rule 2080(a).”).



have sought to weigh the equities, balancing the public's rights against the broker's interest to reach a decision.<sup>104</sup> Others have declined jurisdiction on the theory that the broker already has a remedy through the FINRA arbitration process.<sup>105</sup>

### 1. *Incentives*

Understanding how the arbitration-facilitated expungement process operates requires a sense about how different incentives influence actors who participate within the arbitration forum. These fundamental incentive problems bias the expungement process toward facilitating the removal of information from public records.

#### *a. Customers Have No Real Incentive to Participate*

At the outset, it has long been clear that customers have little incentive to oppose a broker's request to expunge information from public records.<sup>106</sup> Harmed customers have no need to ensure that public information about the broker is accurate once they have settled or otherwise resolved their dispute. These customers already know to avoid the broker who

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104. See *Lickiss v. Fin. Indus. Reg. Auth.*, 146 Cal. Rptr. 3d 173, 180 (2012) (instructing lower court to consider the equities in evaluating an expungement request); see also *Reinking*, 2011 WL 13113323, at \*2 (“[T]he Court finds (1) it has the power to expunge a CRD record, and (2) the correct guiding standard should be whether the disputed record has any regulatory value . . .”).

105. See *Aiguier v. Fin. Indus. Reg. Auth.*, No. SUCV201602491BLS1, 2017 WL 1336579, at \*6–7 (Mass. Super. Ct. Mar. 11, 2017) (declining equity jurisdiction over FINRA because it would “circumvent the arbitration provisions that govern the resolution of claims that the plaintiff asserts against NYLife. Accordingly, this court holds that it does not have jurisdiction in equity to consider the plaintiff's claim for expungement.”).

106. See Letter from Karen Tyler, N. Am. Secs. Adms. Ass'n President and N.D. Sec. Comm'r, to Nancy M. Morris, Sec'y, Sec. Exch. Comm'n (Apr. 24, 2008) (on file with the Washington and Lee Law Review) (“[T]he claimant and their counsel have no incentive to participate in the expungement hearing. Quite the opposite is true. Claimants would incur additional costs, in the way of attorney's fees and time, in order to participate and would gain no benefit through their participation.”).

swindled them. Unsurprisingly, customers rarely appear to contest a broker's request for expungement.<sup>107</sup>

At best, harmed customers may feel they have some civic duty to protect the information if they understand the broader systemic ramifications of a broker's attempt to expunge information. Yet aside from the dry pleasure of protecting the integrity of public information, customers receive no real benefits by opposing a broker's expungement request.

Consider a customer's financial interests. One court recognized that "customers have no financial interest in the outcome of [expungement] claims the plaintiff asserts in the [c]omplaint and may well be disinterested in whether BrokerCheck reports their complaints against him or not."<sup>108</sup> Customers do not receive any additional compensation if they successfully oppose a broker's expungement request. In most instances, customers will need the assistance of a lawyer to mount any reasonable opposition to an expungement request—and they should not be compelled to defend an action.<sup>109</sup> Few lawyers will assist customers and oppose expungements on a pro bono basis. Even if the customer could find pro bono assistance, many would likely prefer to spend their time doing other things than participating in arbitration hearings where they will likely be called a liar.

Customers face little downside from spending their time on more enjoyable activities. While customers may theoretically face reputational risk if arbitrators deem their complaint "false" and recommend that it be expunged, this will likely have no real-world effect on them. When the customers are not parties

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107. One study of over one thousand expungement awards found that customers appeared only 13 percent of the time. *See* DOSS & BRAGANÇA, *supra* note 88, at 4.

108. *Aiguier v. Fin. Indus. Reg. Auth., Inc.*, No. 16-02491, 2017 WL 1311986, at \*4 (Mass. Super. Ct. Mar. 10, 2017).

109. *See id.*

[T]he court has grave concerns about naming a person as a defendant in a case in which no claim is asserted against him/her, thereby putting that person to the potential expense of retaining counsel to explain the nature of the proceeding and what if anything he/she must do in response to being served with a summons and complaint.

to the arbitration, the expungement awards do not ordinarily even identify them by name.<sup>110</sup>

*b. Weak Claimant Attorney Incentives*

While the customer receives notice of the expungement hearing, the attorney who represented that customer can only learn of the expungement proceeding if the customer tells her. Even when the attorney learns about a hearing, the attorneys who regularly represent claimants in FINRA arbitration also have little incentive to convince clients to aggressively oppose expungement attempts. Most claimant attorneys take cases on a contingency basis. Representing a client at an expungement hearing usually requires a substantial amount of time and preparation. After expending this effort, the claimant's attorney will not recover any funds if she successfully opposes an expungement. Very few customers are willing to pay an attorney fees to oppose an expungement request.

Still, claimants' attorneys may have some incentive to oppose expungements because they operate as repeat players in FINRA arbitrations. A string of expungement awards finding that they file "false" claims may hurt their reputations. They may also have an interest in preserving information about past claims to assist future clients. A claimant's attorney may desire to ask a broker about past complaints or use the information in the CRD database to identify possible additional witnesses who could testify about a broker's behavior.

Ultimately, claimant attorneys who learn of an expungement proceeding may hesitate to devote significant resources to opposing the expungement request. Although preserving information may benefit future clients, the claimants' bar is not monolithic. A lawyer who expends resources to protect information from expungement may never be positioned to use the information in a later arbitration hearing because some other lawyer may represent future clients who were harmed by the particular broker. In contrast, the

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110. See, e.g. *Loris v. Sec. Am., Inc.*, No. 19-02661, 2020 WL 2494752, at \*1 (May 7, 2020) (Thompson, Arb.) (“[C]ustomer in Occurrence Number 1933223 (the ‘Customer’) was served with the [s]tatement of [c]laim.”).

broker or brokerage firm will almost certainly benefit from removing the information from the public record.

Securities arbitration clinics affiliated with law schools may contain the only claimant attorneys with a real incentive to oppose broker requests for expungement.<sup>111</sup> An expungement hearing may provide an opportunity for a law student to both protect the public and gain practical experience. Regrettably, only about a dozen securities clinics exist and they rarely appear in expungement hearings because the hearings may happen on relatively short notice, making it difficult for clients to find the pro bono clinics and for students to prepare.

*c. Brokers Have Strong Incentives to Seek Expungement*

In contrast, brokers have strong incentives to seek expungements. We know that brokers place substantial value on expunging unflattering information because they regularly pay lawyers to secure expungements. Public customer complaints likely inhibit a broker's ability to drum up new business and continue to make money. Customers who do review a broker's record may pause if they see that other investors have raised complaints.

Brokers may also seek expungement to reduce regulatory pressure and scrutiny. FINRA's enforcement process now prioritizes "high risk" brokers and imposes its harshest penalties on repeat offenders.<sup>112</sup> In particular, FINRA now focuses special oversight on "high-risk brokers."<sup>113</sup> Although it does not disclose the precise method it uses to identify high-risk brokers, FINRA has disclosed that its criteria include settlements, customer complaints, disclosures, and proximity to

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111. See Jill Gross, *The Improbable Birth and Conceivable Death of the Securities Arbitration Clinic*, 15 CARDOZO J. CONFLICT RESOL. 597, 600 (2014) (describing securities arbitration clinics).

112. See Honigsberg & Jacob, *supra* note 22, at 4 (explaining that the FINRA disciplinary regime "imposes increasingly severe sanctions on repeat offenders").

113. See Melanie Waddell, *Here's How FINRA Defines a 'High-Risk' Broker*, THINK ADVISOR (May 23, 2018, 2:02 PM), <https://perma.cc/L8G8-BKQF> (describing FINRA's assessment mechanisms to determine if a broker is high-risk).

other high-risk brokers.<sup>114</sup> The expungement process offers a method to purge many of the identifying factors from a broker's record and possibly allow her to sink beneath the radar.<sup>115</sup> If higher-risk brokers use the expungement process to avoid scrutiny, it would explain one finding that brokers who have received "expungements are 3.3 times as likely to engage in new misconduct as the average broker."<sup>116</sup>

Negative information in a broker's CRD creates real risk for a broker facing a FINRA enforcement action. FINRA's guidance for sanctions instructs adjudicators to look for a pattern when reviewing a broker's record.<sup>117</sup> FINRA's guidance explains that adjudicators considering arbitration awards or settlements "should rely on the CRD description of the amount of the award or settlement."<sup>118</sup> Within the disciplinary proceeding at least, "parties are precluded from challenging the arbitration award or contesting the CRD description of arbitration settlements."<sup>119</sup> Expunging information from the CRD may reduce the broker's exposure to recidivism-related enhancements in disciplinary sanctions.<sup>120</sup>

Brokers may also pursue expungements because a clean record may help a broker remain at higher-tier industry firms. Remaining affiliated with a marquee firm grants status and often greater access to more profitable high net-worth

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114. *See id.* (stating that FINRA looks at a broker's "settlements, complaints, disclosures, employment history/termination history, exam attempts, geography . . . [and] individuals who associate with high-risk brokers").

115. Although it has not disclosed that it does so, FINRA might keep a log of brokers with expungements for use in identifying higher risk brokers.

116. Honigsberg & Jacob, *supra* note 22, at 4.

117. *See* FIN. INDUS. REG. AUTH., FINRA SANCTION GUIDELINES 3 (Mar. 2019), <https://perma.cc/8K49-LYZY> (PDF) ("Adjudicators should draw on their experience and judgment when evaluating if a respondent's [d]isciplinary and [a]rbitration [h]istory establishes a pattern.").

118. *Id.*

119. *Id.*

120. *See* Honigsberg & Jacob, *supra* note 22, at 4 ("[I]f brokers are abusing the expungement process, . . . removing misconduct from BrokerCheck will . . . hamper the effectiveness of FINRA's disciplinary regime, which imposes increasingly severe sanctions on repeat offenders.").

investors.<sup>121</sup> One recent economics paper found that brokers with records of misconduct tend to migrate from higher-tier to lower-tier industry firms.<sup>122</sup> Higher-tier brokerage firms seemingly care more about their reputations and keep discipline by deciding not to employ brokers with misconduct records.<sup>123</sup> In essence, a broker may be able to enhance her chances of staying at or migrating to a higher-tier firm by securing an expungement.

*d. Brokerage Firms Have Little Incentive to Oppose*

In expungement-only cases, brokers seeking expungements often name their current or former employers as respondents.<sup>124</sup> Importantly, brokerage firms have little incentive to oppose a broker's expungement request and may actually benefit if the broker secures an expungement.<sup>125</sup> One recent study of over a thousand arbitration awards involving expungements found that brokerage firms "did not object or otherwise oppose the individual broker's expungement request . . . over 98% of the time."<sup>126</sup>

Brokerage firms typically benefit when their current and former brokers secure expungements because it lowers their

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121. See Mark Egan, Gregor Matvos & Amit Seru, *The Market for Financial Adviser Misconduct*, 127 J. POL. ECON. 233, 275 (2019) ("[D]efrauding large investors may be more profitable, since they have more wealth.").

122. See *id.* at 237 (explaining that the firms that hire brokers with misconduct records "are less desirable and offer lower compensation").

123. See *id.* at 236 ("Firms, wanting to protect their reputation for honest dealing, would fire advisers who engage in misconduct. Other firms would have the same reputation concerns and would not hire such advisers.").

124. See *Notice to Arbitrators and Parties on Expanded Expungement Guidance*, FIN. INDUS. REG. AUTH., <https://perma.cc/VC8L-5YEV> (last updated Sept. 2017) ("In some instances, an associated person will file an arbitration claim against a member firm solely for the purpose of seeking expungement, without naming the customer in the underlying dispute as a respondent.").

125. See Lisa Bragança & Jason Doss, *How Expungement-Only Cases Are "Gamed, Exploited and Abused" by Brokers*, FIN. PLAN. (Oct. 29, 2019, 11:48 AM), <https://perma.cc/RH4T-EH58> ("Since brokers and their brokerage firms both have an interest in erasing customer complaints from the brokers' records, they are rarely in opposition to each other.").

126. *Id.*

regulatory profile and reduces their reputation and litigation risks.<sup>127</sup> FINRA imposes additional obligations on firms employing brokers with “a recent history of customer complaints, disciplinary actions involving sales practice abuse or other customer harm, or adverse arbitration decisions.”<sup>128</sup> Implementing heightened supervisory procedures for brokers with checkered pasts costs firms money and may expose them to additional liability if the broker harms another customer or if the firm fails to set up adequate enhanced supervision.<sup>129</sup> FINRA tells its firms that they should consider, among other things, “a pattern of unadjudicated matters, such as unadjudicated customer complaints” in determining whether to implement heightened supervision for a particular broker.<sup>130</sup> Successful expungements may cause a “pattern” to disappear from the regulatory record, removing the need for heightened supervision.

One rare unsuccessful expungement attempt showcases how a brokerage firm’s interest generally aligns with a broker’s interest. In 2019, Paul Douglas Larson named brokerage firm Larson Financial Securities, LLC as a respondent in an arbitration where he sought an expungement.<sup>131</sup> BrokerCheck reveals that the managing member of Larson Financial Securities, LLC is Larson Financial Holdings, LLC.<sup>132</sup> A disclosure form for an affiliated entity reveals that Paul Douglas

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127. See Honigsberg & Jacob, *supra* note 22, at 6 (recognizing that brokerage firms care more about public, rather than private, misconduct).

128. See Fin. Indus. Reg. Auth., Reg. Notice 18-15 Guidance on Implementing Effective Heightened Supervisory Procedures 2 (Apr. 30, 2018), <https://perma.cc/UB23-PYRE> (PDF) (discussing heightened supervision requirements).

129. See *id.* at 3 (“The failure to assess the adequacy of its supervisory procedures in light of an associated person’s history of industry or regulatory-related incidents would be closely evaluated in determining whether the firm itself should be subject to disciplinary action for a failure to supervise.”).

130. *Id.*

131. Larson v. Larson Fin. Secs., LLC, No. 19-02660, 2020 WL 2494751, at \*1 (May 5, 2020) (Matek, Arb.).

132. Larson Financial Securities, LLC, BROKERCHECK, <https://perma.cc/R4DX-FWZZ>.

Larson is a control person for Larson Financial Holdings.<sup>133</sup> In essence, Paul Douglas Larson filed an arbitration against an entity he controls, and somehow managed to defy the odds and lose.<sup>134</sup> The loss might be attributable to unnamed customers who “filed submissions in opposition to the request for expungement.”<sup>135</sup> Notably, one customer actually “appeared at the expungement hearing” and counsel for the customers “appeared at all of the hearings on expungement and opposed” the request.<sup>136</sup>

*e. Arbitrator Selection Pressure*

Arbitrators within FINRA’s forum also face incentives to facilitate expungement requests. FINRA’s arbitrators serve as independent contractors and are paid by the number of hearing sessions they conduct.<sup>137</sup> Although an arbitrator might request additional information and conduct additional, lengthy hearing sessions for expungement requests, the arbitrator would likely only get to do this once.<sup>138</sup> Critically, repeat business for arbitrators depends on being selected to conduct arbitrations and only the named parties have any say in the arbitrator selection process.<sup>139</sup> An arbitrator who denies expungement requests will likely stop receiving expungement cases.

When a broker seeking an expungement files a FINRA arbitration against an employer, both the broker and the employer will participate in FINRA’s arbitrator selection

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133. LARSON FIN. GRP., LLC, FORM ADV, CRD NUMBER: 140599 28–29 (2020), <https://perma.cc/79EA-RFGN> (PDF).

134. *Larson*, 2020 WL 2494751, at \*1.

135. *Id.*

136. *Id.*

137. FIN. INDUS. REG. AUTH., RULE 13214 (2019).

138. See Kate Webber Nuñez, *Toxic Cultures Require a Stronger Cure: The Lessons of Fox News for Reforming Sexual Harassment Law*, 122 PENN ST. L. REV. 463, 507–08 (2018) (“Arbitrators also have financial incentives to favor employers who, unlike employees, are in a position to hire the arbitrator again in the future.”).

139. Cf. Bradley A. Areheart, *Organizational Justice and Antidiscrimination*, 104 MINN. L. REV. 1921, 1945 (2020) (“[E]mployers, as ‘repeat players,’ can choose arbitrators that have been known to rule in favor of other employers.”).



process.<sup>140</sup> To reduce costs and trigger a proceeding with a single arbitrator, brokers have been filing these actions with a claim for \$1.00 in nominal damages, a practice FINRA recently moved to constrain.<sup>141</sup> To select the single arbitrator who will hear the case, FINRA first provides a list of ten names to the claimant and the respondent.<sup>142</sup> Both the claimant and the respondent may each strike up to four arbitrators from the list and rank the remaining arbitrators.<sup>143</sup> If both the claimant and the respondent favor arbitrators who routinely grant expungements, an arbitrator who occasionally rejects an expungement request may be less likely to be selected.<sup>144</sup>

Some evidence suggests that parties in expungement-only cases prefer arbitrators who routinely grant expungements. A recent study by the PIABA Foundation found that the three arbitrators most frequently selected for expungement-only cases “granted expungement requests over 95% of the time.”<sup>145</sup>

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140. FIN. INDUS. REG. AUTH., FINRA’S DISPUTE RESOLUTION PROCESS 3 (2012), <https://perma.cc/93BS-29ZT> (PDF) (“Both sides are allowed to remove or strike some of the arbitrators on the list of consideration and to rank the remaining names in order of their preference.”).

141. See Notice of Filing of Proposed Rule Change to Amend the FINRA Code of Arbitration Procedure for Customer Disputes and the FINRA Code of Arbitration Procedure for Industry Disputes to Apply Minimum Fees to Requests for Expungement of Customer Dispute Information, 85 Fed. Reg. 11,165, 11,167 (Feb. 26, 2020) (“FINRA is aware that associated persons who file a straight-in request often add a small monetary claim (typically, one dollar) to the expungement request to reduce the fees assessed against the associated person and qualify for an arbitration heard by a single arbitrator.”).

142. See *Arbitrator Selection*, FIN. INDUS. REG. AUTH., <https://perma.cc/MF44-TY7M> (“For claims of up to \$100,000, the parties receive one list of 10 chair-qualified non-public arbitrators . . . For claims of more than \$100,000 for unspecified or non-monetary claims, the parties receive two lists (one including 10 non-public chair-qualified arbitrators, and one including 20 non-public arbitrators).”).

143. *Id.*

144. See David A. Hoffman & Erik Lampmann, *Hushing Contracts*, 97 WASH. U. L. REV. 165, 217 (2019) (“[A]rbitrators face incentive structures to not depart from the parties’ settled expectations, and are not rewarded, reputationally or otherwise, for issuing public-facing rulings.”).

145. DOSS & BRAGANÇA, *supra* note 88, at 4.

*f. Weak Institutional Oversight Incentives*

FINRA also faces institutional constraints limiting its ability to vigorously protect information contained in the CRD.<sup>146</sup> Critically, reviewing and challenging arbitration awards in court would consume substantial time and resources. My search revealed 935 different arbitration awards involving expungement in 2019 alone. Effective review and oversight would likely require substantial independent investigation, something FINRA never committed to do when it agreed to create and manage the CRD database. Although FINRA has responded to criticisms of its expungement process and made significant reforms over the years, it has not generally led efforts to protect information contained in the CRD.<sup>147</sup> Its members may also not push FINRA to lead efforts to preserve the public availability of unflattering information about brokers.<sup>148</sup>

*2. Arbitrator Fact-Finding in Expungement Hearings*

There are two different routes to an expungement hearing within FINRA's arbitration forum, either at the conclusion of a customer arbitration or in a separate arbitration without naming the complaining customer as a party. Brokers named as parties to a customer arbitration "may request expungement during that arbitration, but [are] not required to do so."<sup>149</sup> In practice, many brokers have waited "years after FINRA closed

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146. See Benjamin P. Edwards, *The Dark Side of Self-Regulation*, 85 U. CIN. L. REV. 573, 608 (2017) ("[S]elf-regulatory bodies may be particularly lethargic protectors in situations where actions in the public's interest would undercut private profits.").

147. See Mason Braswell & Jed Horowitz, *Top Merrill Broker Patrick Dwyer Leaves Amid Accusations*, ADVISORHUB (Aug. 22, 2019), <https://perma.cc/7YKF-5GGM> (describing FINRA's move to block confirmation of an arbitration award directing expungement as a "rare step").

148. See, e.g., Honigsberg & Jacob, *supra* note 22, at 7 (describing a human resources office's decision to ignore allegations of an employee's misconduct until that misconduct became public).

149. Fin. Indus. Reg. Auth., Reg. Notice 17-42 Expungement of Customer Dispute Information 5 (Dec. 6, 2017), <https://perma.cc/HB2Z-YAV3> (PDF).

the Underlying Customer Case” to request expungement.<sup>150</sup> Troublingly, these delays often mean that important evidence and witnesses have been lost to the passage of time.<sup>151</sup>

Adversarial failure explains many stale expungements. Under the arbitration forum’s rules, brokers should face at least some challenge pursuing an expungement through FINRA arbitration after more than six years from the time the information appeared in the CRD database.<sup>152</sup> FINRA’s rules explain that its arbitration forum may only be used within six years of the occurrence or event giving rise to the claim.<sup>153</sup> Despite this, arbitrators regularly expunge information dating back 20 years or more.<sup>154</sup> Arbitrators may not apply—or even consider—the eligibility rule because no party to the arbitration points out that the dispute may no longer be eligible to be heard in the FINRA forum.<sup>155</sup> Of course, arbitrators may interpret the rule in some way allowing access to the forum, but it appears odd that arbitrators do not regularly even consider the issue when presented with stale expungement requests.

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150. *Id.*

151. *See id.* (“Given the length of time between case closure and filing of the request, in many of these instances, the customers cannot be located and any documentation that could explain what happened in the case is not available or cannot be located.”).

152. *See* FIN. INDUS. REG. AUTH., RULE 13206 (2011) (explaining that in industry disputes “[n]o claim shall be eligible for submission to arbitration under the Code where six years have elapsed from the occurrence or event giving rise to the claim”).

153. *See* FIN. INDUS. REG. AUTH., RULE 12206 (2011) (directing that in customer disputes “[n]o claim shall be eligible for submission to arbitration under the Code where six years have elapsed from the occurrence or event giving rise to the claim”).

154. *See* *Rosenberg v. A. G. Edwards & Sons*, No. 19-02801, 2020 WL 2494754, at \*2 (May 8, 2020) (Mintzer, Arb.) (recommending expungement where the underlying information “was received by Respondent on July 17, 2000 and solely alleged ‘breach of fiduciary duty’ concerning an ‘Equity Listed (Common & Preferred Stock)’”).

155. *See* FIN. INDUS. REG. AUTH., RULE 12206 (2011) (placing responsibility for determining eligibility on the party who submits the claim, not the arbitrator).

Notably, the current rules do not require brokers to make the complaining customer a party.<sup>156</sup> Brokers will frequently file their action against a current or former employer and provide notice to a customer shortly before the final evidentiary hearing.<sup>157</sup> Brokers name their employers on the theory that the employers were the ones who actually reported the information to the CRD.<sup>158</sup> These expungement-only arbitrations have dramatically increased in recent years. The PIABA Foundation found that expungement-only cases increased “924% from 2015 to 2018.”<sup>159</sup>

The trend has continued since that time. Consider one recent arbitration award recommending expungement.<sup>160</sup> Steven Phillip Margulin sued his current employer, Centaurus Financial, Inc., “seeking expungement of a customer complaint” and relying on evidence from 2003—seventeen years ago.<sup>161</sup> In responding to Margulin’s complaint, “Centaurus stated that it does not oppose” the “expungement request.”<sup>162</sup> Margulin provided notice to the estate of the deceased customer on February 21, 2020, and a telephonic hearing was held thirty-three days later on March 25, 2020.<sup>163</sup> The arbitrator granted the request and recommended that the customer dispute information be expunged from the CRD database,

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156. FINRA’s training materials for its arbitrators note that brokers may “file an arbitration claim against a member firm solely for the purpose of seeking expungement, without naming the customer in the underlying dispute as a respondent.” FIN. INDUS. REG. AUTH., FINRA OFFICE OF DISPUTE RESOLUTION EXPUNGEMENT TRAINING 14 (2016), <https://perma.cc/NLE2-6657> (PDF) [hereinafter EXPUNGEMENT TRAINING].

157. *See id.* (“[A]rbitrators should order the associated persons to provide a copy of their Statement of Claim to the customer(s) involved in the underlying arbitration.”).

158. *See* FIN. INDUS. REG. AUTH., RULE 4530 (2015) (requiring the firm to report broker misconduct).

159. DOSS & BRAGANÇA, *supra* note 88, at 3.

160. *See* Margulin v. Centaurus Fin., Inc., No. 19-01639, 2020 WL 1943589, at \*3 (Apr. 17, 2020) (Tindall, Arb.) (recommending “the expungement of all references to the Underlying Complaint”).

161. *Id.*

162. *Id.*

163. *Id.*

finding that the information was “false.”<sup>164</sup> Once Margulin confirms the award in court, the information will be deleted from the CRD database. Yet, if asked, an arbitrator might have found this expungement request ineligible for arbitration under FINRA’s Rules because the dispute was over six years old.<sup>165</sup>

With limited information and briefing, arbitrators regularly make critical factual findings bearing on whether past customer complaints should be expunged from the public record. Today, arbitrators must at least hold hearings before granting expungement requests.<sup>166</sup> FINRA explains that arbitrators should only recommend expungement of customer dispute information from the public record “when the expunged information has no meaningful regulatory or investor protection value.”<sup>167</sup>

The process has evolved over time as FINRA has implemented change after change to address known problems. When past guidance directing arbitrators to make findings did not generate consistent affirmative findings by arbitrators, FINRA amended its code.<sup>168</sup> Both FINRA Rule 12805 (customer disputes) and Rule 13805 (industry disputes) now “establish specific procedures that arbitrators must follow before ordering expungement of customer dispute information from the CRD system.”<sup>169</sup>

Arbitration awards recommending expungement must contain specific findings.<sup>170</sup> Although arbitrators do not

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164. *Id.*

165. *See* FIN. INDUS. REG. AUTH., RULE 13206 (2011) (“No claim shall be eligible for submission to arbitration under the Code where six years have elapsed from the occurrence or event giving rise to the claim.”).

166. FIN. INDUS. REG. AUTH., RULE 12805 (2009); *id.* RULE 13805.

167. *Frequently Asked Questions about FINRA Rule 2080 (Expungement)*, FIN. INDUS. REG. AUTH., <https://perma.cc/D7WW-APB2> [hereinafter *FAQ About FINRA Rule 2080*].

168. *See* Fin. Indus. Reg. Auth., Reg. Notice 08-79 Expungement 1 (Dec. 2008), <https://perma.cc/ZTX7-3QPZ> (PDF) (describing changes to FINRA’s procedural codes for both customer and industry disputes).

169. *Id.* at 2.

170. *See FAQ About FINRA Rule 2080, supra* note 167 (“Arbitrators considering expungement relief are required to complete training provided by FINRA Dispute Resolution regarding . . . the requirement to make specific findings if they decide that expungement is appropriate.”).

ordinarily have to explain any basis for their decisions, FINRA Rule 12805 and 13805 require the arbitrator to “indicate in the arbitration award which of the Rule 2080 grounds for expungement serves as the basis for its expungement order.”<sup>171</sup> For example, an arbitrator might find that a broker had no involvement in a customer complaint or that it was false because the broker did not even work at the firm at the time of the alleged misconduct.<sup>172</sup> It also requires arbitrators to “provide a brief written explanation of the reason(s) for its finding that one or more Rule 2080 grounds for expungement applies to the facts of the case.”<sup>173</sup> In approving the rule change, the SEC found that “additional procedures, such as the required review of settlement documents, and the written explanation of the regulatory basis and reason for granting expungement, in the proposed rule are designed to help assure that the expungement process is not abused.”<sup>174</sup> The SEC also encouraged FINRA to “use its authority to review expungement requests to ensure that expungement is an extraordinary remedy.”<sup>175</sup>

FINRA’s training materials instruct the arbitrators crafting these findings. They explain that the “written explanation should provide regulators and other interested parties with additional insight into why the arbitrators recommended expungement and any facts and circumstances they found in support of the recommendation.”<sup>176</sup> While the goal of the rule change was to ensure that arbitrators were recommending expungement selectively as an “extraordinary remedy,” that appears not to have happened.<sup>177</sup> Arbitration

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171. FIN. INDUS. REG. AUTH., RULE 12805(c) (2009); *id.* RULE 13805(c).

172. *See id.* RULE 2080 (“Upon request, FINRA may waive the obligation to name FINRA as a party if FINRA determines that . . . the registered person was not involved in the alleged investment-related sale practice violation.”).

173. *Id.* RULE 12805.

174. Order Approving a Proposed Rule Change Amending the Codes of Arbitration Procedure to Establish Procedures for Arbitrators to Follow When Considering Requests for Expungement Relief, 73 Fed. Reg. 66,086, 66,089 (Nov. 6, 2008).

175. *Id.* at 15.

176. EXPUNGEMENT TRAINING, *supra* note 156, at 16.

177. *Id.* at 8.

awards recommending expungement are more prevalent than before and generally do not show evidence of having considered any evidence against expungement.<sup>178</sup>

### 3. *Customers Receive Inconsistent and Limited Notice*

No FINRA Rule now requires a broker to provide notice to a former customer about an expungement hearing.<sup>179</sup> The rules also do not require any notice to the securities regulators in states where the broker holds a license. The “requirement” to provide notice appears in the arbitrator training materials, which explain that an arbitrator must “order the associated persons to provide a copy of their Statement of Claim to the customer(s).”<sup>180</sup> FINRA emphasizes that “without this directive from the arbitrators, the customer(s) may not even be aware that an expungement claim is pending regarding their prior dispute.”<sup>181</sup>

#### a. *Arbitrators Do Not Always Require Notice*

Despite guidance instructing them to require notice be given to former customers, arbitrators do not always actually require that customers receive notice. In some instances, customers receive no notice before arbitrators hold hearings to

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178. See DOSS & BRAGANÇA, *supra* note 125 (“But today, the floodgates are wide open and the number of expungement cases filed by brokers against their brokerage firms has risen nearly 1,000% in the last four years.”).

179. Although FINRA’s Board of Governors approved codifying its expanded expungement guidance in 2018, it has not yet codified the guidance. See *Update: FINRA Board of Governors Meeting*, FIN. INDUS. REG. AUTH. (Dec. 21, 2018), <https://perma.cc/9CUE-FVVL> (“The Board approved proposed amendments to the Codes of Arbitration Procedure for Customer and Industry Disputes to codify the Notice to Arbitrators and Parties on Expanded Expungement Guidance and modify the fees for small claim expungement.”).

180. EXPUNGEMENT TRAINING, *supra* note 156, at 14.

181. See *id.* (elaborating that “notice provides the customer(s) with the opportunity to advise the arbitrators and parties of their position on the expungement request, which may assist arbitrators in making the appropriate finding under Rule 2080”).

determine whether to recommend expungement.<sup>182</sup> This may occur when counsel for a party argues for some idiosyncratic interpretation of FINRA's guidance. For example, in one arbitration, the attorney argued that he did not need to provide notice to three different customers because "it was his position that the notification requirements of an expungement request applies to customers who have filed for arbitration."<sup>183</sup> The arbitration panel agreed.<sup>184</sup>

*b. Short Notice Windows*

Determining actual notice times remains difficult. Arbitration awards do not always reveal the date on which a broker seeking expungement notifies a former customer that a hearing will be held. For example, Mark Kravietz procured an arbitration award recommending that customer information be expunged from public records on May 1, 2020.<sup>185</sup> Although the award does not reveal the date on which notice was sent to the customer, Kravietz provided FINRA with an Affirmation of Service on or about April 9, 2020, before a telephonic hearing was held on April 28, 2020, just nineteen days later.<sup>186</sup> Unsurprisingly, the award found that the "underlying customer did not participate in the expungement hearing and did not oppose the request for expungement."<sup>187</sup>

Although arbitrators do not seem to aggressively police notice periods, they may balk at egregiously short periods. In one instance, an arbitrator postponed an expungement hearing on account of inadequate notice.<sup>188</sup> The broker had transmitted

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182. See, e.g., *Dwyer v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 16-02781, 2017 WL 3189311, at \*1 (July 20, 2017) (Ainbinder, Thorpe, & Santillo, Arbs.) (recommending expungement of six customer complaints even though the broker made no attempt to notify three of the customers).

183. *Id.*

184. *Id.*

185. *Kravietz v. U.S. Fin. Servs., Inc.*, No. 20-00601, 2020 WL 2235746, at \*1 (May 1, 2020) (Lascar, Arb.).

186. *Id.*

187. *Id.*

188. See *Papadopoulos v. Lasalle Fin. Servs., Inc.*, No. 17-01201, 2018 WL 1452616, at \*2 (Mar. 16, 2018) (Murphy, Arb.) ("The Arbitrator postponed the expungement hearing due to inadequate notice.").



notice of the hearing “via priority express mail notice” just three days before the hearing.<sup>189</sup>

FINRA’s expungement training materials do not specify that notice must go out any particular number of days before a hearing may be held.<sup>190</sup> While there are FINRA Rules specifying dates for motions and responses in its forum, the time period for a customer to receive notice remains undefined.<sup>191</sup> This also contrasts with the law for class action settlement approvals which require notice to be sent to important stakeholders both within ten days after any proposed settlement is filed and at least ninety days before a court can grant approval.<sup>192</sup> Notice norms in expungement cases fall far short of the usual sixty-day period under the federal rules for a defendant to respond to a complaint after waiving service or for a defendant to respond to a statement of claim within the FINRA arbitration forum.<sup>193</sup>

*c. Vague and Discouraging Notice Language*

Neither FINRA’s expungement guidance nor its arbitrator training materials require the notice to be provided in any particular form, leaving self-interested parties free to craft notice language in ways seemingly calculated to suppress customer participation. For example, consider the notice language used in one letter sent to notify a customer of about an expungement hearing.<sup>194</sup> The letter opens with legalese, stating that “[p]ursuant to FINRA’s Published Guidance, ‘Notice to Arbitrators and Parties on Expanded Expungement Guidance,’ we are notifying you that a request for customer dispute

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189. *Id.*

190. EXPUNGEMENT TRAINING, *supra* note 156, at 14.

191. *See, e.g.*, FIN. INDUS. REG. AUTH., RULE 13503(a)(3) (2017) (“Written motions must be served at least 20 days before a scheduled hearing, unless the panel decides otherwise.”).

192. 28 U.S.C. § 1715(b), (d) (2018).

193. *See* FED. R. CIV. P. 4(d)(3) (“A defendant who, before being served with process, timely returns a waiver need not serve an answer to the complaint until 60 days after the request was sent—or until 90 days after it was sent to the defendant outside any judicial district of the United States.”).

194. Letter from Dochter D. Kennedy, President & Founder, Advisor Law, LLC to Dan Tennent (Dec. 31, 2018) (on file with the Washington and Lee Law Review).

expungement relief has been filed in the aforementioned case.”<sup>195</sup> The letter seems calculated to discourage, stating that “[y]ou are not a party to this case and are under no duty or obligation to answer, respond, participate or engage in any manner.”<sup>196</sup> Although the letter does reveal the date and time of the hearing, it does not tell the recipient where it is or how to actually participate in these primarily telephonic hearings.<sup>197</sup> A motivated, proactive customer would have to take additional steps to gather more information in order to participate.

Importantly, customer participation provides extraordinary value to an arbitration panel considering an expungement request. When a customer does not participate, an arbitration panel will often receive no evidence to contradict a broker’s testimony.<sup>198</sup> A notice seemingly calculated to discourage their participation increases the likelihood that an arbitrator will later render a poorly informed decision.<sup>199</sup>

#### 4. *Unclear Standards of Proof*

Identifying how these grounds should be interpreted or what standard of proof an arbitrator should apply in reviewing an expungement request remains difficult. Arbitrator training materials do not contain any reference to common standards of proof such as by a “preponderance” of the evidence, by “clear and convincing” evidence, or “beyond a reasonable doubt.”<sup>200</sup> One arbitrator concluded that the standard surely must be higher than a preponderance of the evidence because FINRA does not remove a customer complaint if the customer does not prevail in arbitration under an ordinary preponderance standard of civil

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195. *Id.*

196. *Id.*

197. *Id.*

198. *See, e.g.,* Royal All. Assocs. v. Liebhaber, 206 Cal. Rptr. 3d 805, 813 (Cal. Ct. App. 2016) (“[N]o evidence was presented or information not disputed [*sic*] because the arbitrators did not allow Ms. Liebhaber to present any evidence at the hearing despite her appearance and multiple requests to do so.”).

199. *See id.* (describing how the arbitrators prevented the client from presenting evidence at the hearing).

200. EXPUNGEMENT TRAINING, *supra* note 156.

proof.<sup>201</sup> The arbitrator recognized that if an “allegation is supported by some reasonable proof, even short of ‘preponderance,’ it cannot be said to be ‘false.’ Unfortunately, too many decisions improperly label ‘false’ claims simply because they were not supported by a preponderance of the evidence.”<sup>202</sup>

Despite this reasoning, most arbitrators seemingly apply a preponderance standard to recommend expunging significant information after a quick, one-sided hearing where only the broker seeking expungement presents any evidence.<sup>203</sup> Consider a recent arbitration award recommending the expungement of twelve different items from the CRD for two brokers.<sup>204</sup> The two brokers brought an arbitration against Geneos Wealth Management, Inc., which “did not appear at the expungement hearing and did not contest the expungement requests.”<sup>205</sup> The arbitrator found that “the Customers were served with the Statement of Claim and received notice of the expungement hearing” at some unspecified date before the hearing.<sup>206</sup> At a hearing where only the brokers appeared, the arbitrator found that “preponderance of the evidence adduced at the expungement hearing” supported a series of factual findings.<sup>207</sup> Altogether, the brokers successfully erased “five FINRA arbitration cases, [one] civil court case and two customer complaints” from the CRD.<sup>208</sup> The arbitrator reached this

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201. See Gilliam v. Sagepoint Fin., Inc., No. 12-03717, 2013 WL 3963949, at \*2 (July 22, 2013) (Meyer, Arb.) (“[The customer] failed to prove his/her case by a preponderance of the evidence . . . the allegations nevertheless appear on the respondents’ CRD records . . . From this it may be inferred that to expunge . . . something more than a preponderance of the evidence is required.”).

202. *Id.* at \*3.

203. See, e.g., *Royal All. Assocs.*, 206 Cal. Rptr. 3d at 813 (discussing the one-sided evidence presented at the hearing).

204. Arford v. Geneos Wealth Mgmt., Inc., No. 19-00739, 2019 WL 5681728, at \*1 (Oct. 24, 2019) (Cutler, Arb.).

205. *Id.* at \*2.

206. *Id.*

207. *Id.*

208. *Id.*

conclusion after just a single hearing session on the expungement requests which lasted four hours or less.<sup>209</sup>

Importantly, the arbitration systems seem unlikely to ever definitively resolve this standard of proof issue or meaningfully engage with arbitration decisions which do address the issue. Arbitrations do not create any binding precedent and a thoughtful resolution of the standard of proof issue by one arbitrator will not bind another.<sup>210</sup> Parties to arbitrations do not even need to inform the arbitration panel about arbitration decisions interpreting the grounds because they are not legal authority.<sup>211</sup> Although arbitration remains an “equitable” forum, the arbitrators may only seek to do equity between the named or appearing parties and not to the silent stakeholders who do not appear in the proceeding.<sup>212</sup>

##### 5. *Limited Rights for Customers to Participate*

FINRA Rules do not contain any provisions explicitly providing for a right for customers to participate in expungement hearings before information about their disputes are erased from the public record. Instead, FINRA provides guidance to arbitrators and instructs them to allow customers to participate in expungement hearings. In guidance, FINRA notifies arbitrators that it is “important to allow customers and their counsel to participate in the expungement hearing in

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209. *Id.* at \*7. Within FINRA’s arbitration system, a “hearing session is any meeting between the parties and arbitrator(s) of four hours or less.” *Summary of Arbitration Fees*, FIN. INDUS. REG. AUTH., <https://perma.cc/7DA4-7EMY>.

210. *See* Edwards, *supra* note 43, at 434 (pointing out that arbitration “cannot ‘answer’ these questions in any meaningful way because their decisions do not create precedent”).

211. *See* MODEL RULES OF PROF’L CONDUCT r. 3.3 (AM. BAR ASS’N 2020) (requiring a lawyer to inform a tribunal about controlling legal authority).

212. *Cf.* Barbara Black & Jill I. Gross, *Making It Up As They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 1029–30 (2002) (“Arbitrators are expected to achieve an equitable resolution of the dispute before them but they may not ignore the law. However, without ample training or legal briefing by the parties on each relevant issue, how can the arbitrators know what the law is or how to apply it?”).

settled cases if they wish to.”<sup>213</sup> The guidance instructs arbitrators that they should allow customers to appear with counsel, testify, introduce documents and evidence, cross-examine witnesses, and “present opening and closing arguments if the panel allows any party to present such arguments.”<sup>214</sup>

FINRA issued the guidance after arbitrators in its forum declined to allow a customer’s counsel to cross-examine a broker who testified in favor of her own expungement request.<sup>215</sup> In this case, the customer claimant had already settled in part because the arbitration panel would not require the brokerage firm to provide discovery or allow her to present any oral argument on motions.<sup>216</sup> In this instance, the customer had clear notice because the expungement hearing occurred within the customer-initiated arbitration and the customer remained a named party to the arbitration.<sup>217</sup> The broker, Kathleen J. Tarr, gave an unsworn monologue that the allegations were “highly offensive and without basis in any fact” and that she was “the daughter and granddaughter of ministers.”<sup>218</sup> When counsel for the customer sought to introduce the customer’s contrary testimony and to question Tarr, the arbitration panel’s chairperson stated that he did not “see that any testimony such as this is necessary.”<sup>219</sup> When another arbitrator suggested hearing the customer out to generate a complete record, the chair responded “how can we make sure we’re not going to be here for another two hours? That’s the problem.”<sup>220</sup> Ultimately,

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213. *Notice to Arbitrators and Parties on Expanded Expungement Guidance*, FIN. INDUS. REG. AUTH. (Sept. 2017), <https://perma.cc/542Y-UNSN>.

214. *Id.*

215. See Robert S. Banks, Jr., *Muzzling the Claimant Due Process Denied in FINRA Expungement Hearing*, 21 PIABA B.J. 397, 397 (2014) (describing a FINRA expungement hearing where a customer and counsel were not permitted to fully participate).

216. *Id.* at 397 (describing a client who settled an action after an arbitration panel chair “refused to allow oral argument on any of our motions and refused to refer our motions to the full panel”).

217. Notably, brokers do not have to seek an expungement in the same action. Many wait to name their employers in a subsequent action.

218. Banks, *supra* note 215, at 398.

219. *Id.*

220. *Id.*

the three-arbitrator panel declined to allow the customer or counsel to fully participate and unanimously recommended expungement anyway.<sup>221</sup> Surprisingly, despite the protests of the customer's counsel, not one of the arbitrators dissented from the decision.<sup>222</sup>

With the assistance of pro bono counsel, the customer sought to vacate the arbitration award.<sup>223</sup> In *Royal Alliance Associates, Inc. v. Liebhaber*,<sup>224</sup> the customer explained that she had a real interest in the expungement proceeding “because the award deemed her complaints against Tarr false and therefore found her ‘essentially to have been a liar without anyone hearing from her or giving her a right to cross-examine’” Tarr.<sup>225</sup> With FINRA also opposing confirmation, the award was ultimately vacated because the arbitrators refused to hear evidence from a party to the arbitration.<sup>226</sup>

FINRA's current guidance and training materials seem designed to address the specific problems that arose in the *Royal Alliance* arbitration.<sup>227</sup> It instructs arbitrators to permit customers to do the specific things the customer was not allowed to do in *Royal Alliance*, including appearing, presenting testimony, and cross-examining any witnesses.

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221. See *Liebhaber v. Royal All. Assocs.*, No. 13-01522, 2014 WL 4647001, at \*2 (Sept. 10, 2014) (Stall, Jr., McLaughlin, & Aragon, Arbs.) (“Panel recommends the expungement of all references to the above-captioned arbitration from non-party Kathleen Tarr’s (CRD #4215307) registration records maintained by the CRD.”).

222. As discussed below, arbitrators may decline to oppose expungement requests because they fear they will not be selected for future panels if they do. See *supra* Part II.C.1.e.

223. See *Banks*, *supra* note 215, at 400 (explaining that the customer “filed an opposition to the confirmation petition and a request that the Award be vacated, with generous assistance from . . . pro bono counsel”).

224. 206 Cal. Rptr. 3d 805 (Cal. Ct. App. 2016).

225. *Id.* at 814.

226. *Id.* at 1110 (“[A]rbitrators gave Royal Alliance an unfettered opportunity to bolster the written record but denied Liebhaber even a limited chance to do the same.”).

227. See *Notice to Arbitrators and Parties on Expanded Expungement Guidance*, FIN. INDUS. REG. AUTH., <https://perma.cc/PR8L-BDAN> (last updated Sept. 2017) (“It is important to allow customers and their counsel to participate in the expungement hearing in settled cases if they wish to.”).

The guidance fails to address the many instances where a broker brings a separate expungement action to which the customer is not a party. The guidance does not facilitate full participation. Although FINRA's guidance calls for arbitrators to require brokers to provide notice and a copy of their statement of claim when seeking an expungement, it does not generally call for customers to have copies of everything that has been submitted to the arbitrators.<sup>228</sup> As a result, customers cannot see any answer that has been filed, participate in arbitrator selection, readily view all other documents which have been submitted, or even know what the arbitration panel has been told about them in earlier hearings in the matter. This puts the customers who do participate at a substantial disadvantage in the matter.

Thus, even an unusually savvy customer who opted to participate in expungement hearings where she was not a party will struggle to oppose confirmation of any arbitration award. Even after expending the time and effort necessary to oppose an arbitration award, a customer will not receive notice of any award when FINRA delivers it to the parties.<sup>229</sup> The customer must search FINRA's arbitration database to find out the result.<sup>230</sup>

The customer also receives no notice of the next step—confirmation of the arbitration award in court. As the customer was not a party to the arbitration, the customer will not receive notice when a party seeks to confirm the arbitration award.<sup>231</sup> This makes it practically impossible for customers to block confirmation.

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228. See EXPUNGEMENT TRAINING, *supra* note 156, at 14 (“[N]otice provides the customer(s) with the opportunity to advise the arbitrators and parties of their position on the expungement request, which may assist arbitrators in making the appropriate finding.”).

229. See *Decision & Award*, FIN. INDUS. REG. AUTH., <https://perma.cc/QEP4-LDAR> (“Once the award is signed by a majority of the arbitrators, FINRA will send copies of the award to each party or representative of the party.”).

230. See *id.* (“FINRA makes all arbitration awards publicly available for free by posting them on Arbitration Awards Online.”).

231. See *id.* (explaining the confirmation process).

### 6. *No Independent Investigation in Arbitration*

Facilitating expungements through arbitrations also largely prevents any independent fact-finding into the underlying disputes. FINRA's training materials for arbitrators instruct that arbitrators "should not make independent factual investigations of a case."<sup>232</sup> Although FINRA encourages arbitrators to ask questions of the parties and for the parties to provide any briefing requested by the arbitrator, its guidance makes clear that arbitrators "generally should review only those materials presented by the parties."<sup>233</sup>

A rule against any independent investigation makes the most sense when purely private parties with equal resources have contracted for an arbitrator to decide a dispute. It makes less sense when it puts public information at risk and forces arbitrators to refrain from conducting even the most rudimentary of independent investigations.

#### D. *Past Problems*

The incentives and processes detailed above have left FINRA continually struggling to manage the arbitration-facilitated expungement process. As explained below, FINRA has moved to address some past problems, yet resolving these concerns has not substantially improved the process.

##### 1. *Stipulated Expungements after Settlements*

For years, brokers secured expungements through stipulated awards agreed to as part of a settlement process.<sup>234</sup> In explaining the operation of NASD Rule 2130, an earlier

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232. FIN. INDUS. REG. AUTH., FINRA DISPUTE RESOLUTION SERVICES ARBITRATOR'S GUIDE 60 (2020), <https://perma.cc/9DR9-49CC> (PDF).

233. *Id.*

234. See Christine Lazaro, *Has Expungement Broken Brokercheck?*, 14 J. BUS. & SEC. L. 125, 136 (2014) ("[P]arties would place a stipulated award before the arbitrators containing an expungement directive, which the arbitrators would then sign. The broker would then confirm the award in a court of competent jurisdiction either with the consent of the customer or by default if the customer did not appear.").



version of FINRA Rule 2080, FINRA explained how brokers could procure a stipulated award containing the findings necessary to have information about the dispute expunged from public records.<sup>235</sup> The process was straightforward. Settling parties simply asked the arbitration panel “for a stipulated award and request[ed] that the panel make affirmative findings and order expungement based on one or more of the standards in Rule 2130.”<sup>236</sup> After Rule 2130 came into effect, FINRA noted that arbitrators would still state in the award the basis on which the expungement relief was granted.<sup>237</sup>

Stipulated awards sat in tension with the rule’s requirement that an expungement recommendation be “based on affirmative judicial or arbitral findings.”<sup>238</sup> FINRA’s guidance on stipulated expungement awards did not direct arbitrators to make any searching inquiry to protect the public’s interest in the accuracy and reliability of CRD information. After all, an arbitrator ordinarily sits to resolve a private dispute, not to play some public enforcement role. One scholar explained that the “message in the Notice is that the arbitrators’ role is to execute the request for expungement rather than conduct an independent, skeptical review.”<sup>239</sup> Notably, the SEC never directly addressed stipulated awards in its order approving NASD Rule 2130.<sup>240</sup>

But concerns about stipulated awards and the risk that brokers would force customers to agree to expungement as a settlement condition had been raised. One prescient commenter

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235. Nat. Ass’n Secs. Dealers, Notice to Members 04-16 Expungement of Customer Dispute Information from the CRD 214 (March 2004), <https://perma.cc/E7HJ-5NHW> (PDF). FINRA was known as the National Association of Securities Dealers (NASD) until 2007, when it became FINRA.

236. *Id.*

237. *Id.*

238. *Id.*

239. Lipner, *supra* note 91, at 76.

240. See Order Granting Approval and Notice of Filing and Order Granting Accelerated Approval Relating to Proposed NASD Rule 2130 Concerning the Expungement of Customer Dispute Information from the Central Registration Depository System No. 34-48933, 68 Fed. Reg. 74,667, 74,667 (Dec. 24, 2003) (discussing requirements for obtaining an order of expungement of customer dispute information from the central registration depository).

argued that a “broker should not be allowed to purchase a clean CRD from a destitute customer. This is especially true when the broker is the reason the customer is destitute.”<sup>241</sup> The commenter also panned judicial confirmation as a “phony safeguard” because customers were not likely to appear at confirmation hearings and they would be granted “without independent review unless the NASD objects.”<sup>242</sup>

Over time, stipulated awards facilitating the expungement of information likely did real harm to the public by enabling fraud and misconduct to go undetected. Consider the aftermath of one stipulated expungement. Carl Martellaro served as a principal for First Associated Securities Group, a firm FINRA expelled from the securities industry in the year 2000.<sup>243</sup> Years before FINRA discovered wrongdoing and expelled the firm, two investors alleged that Martellaro had run a fraudulent scheme causing them to lose \$1.75 million.<sup>244</sup> Martellaro settled the dispute on the condition that the investors would not oppose his subsequent request to expunge information about their complaint from public records.<sup>245</sup> He succeeded and later went on to run a Ponzi scheme causing other investors to suffer \$125 million in losses.<sup>246</sup> The attorney who represented the first two investors explained that although his clients “cut a deal, . . . the public got cut out.”<sup>247</sup>

These deals left only a faint trace behind. A search of arbitration awards reveals that Martellaro successfully expunged at least two disputes from his record before his Ponzi scheme ultimately collapsed. In 1999, an arbitration award directed that a dispute alleging \$1.25 million in damages be

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241. Letter from Barry D. Estell to Sec. & Exch. Comm’n (Mar. 28, 2003) (arguing that an “agreement to expunge an arbitration claim is inherently corrupt and contrary to the purpose of the CRD”) (on file with the Washington and Lee Law Review).

242. *Id.*

243. *First Associated Securities Group, Inc.*, BROKERCHECK, <https://perma.cc/5KYC-Y6F6>.

244. Michael Freedman, *The X-ed Out Files*, FORBES (Dec. 25, 2000, 12:00 AM), <https://perma.cc/23HN-9D3F>.

245. *Id.*

246. *Id.*

247. *Id.*

expunged.<sup>248</sup> In the same year, arbitrators also directed that another claim alleging \$500,000 in damages be expunged.<sup>249</sup> On both occasions, the parties secured a stipulated award calling for the information to be expunged.<sup>250</sup>

In Martellaro's case, the expungement of dispute information likely facilitated his ongoing fraud. Investors doing ordinary diligence would not see complaint information on his record. Regulators surveying the CRD records for red flags involving brokers operating within their territory would also not have seen the information.

State regulators eventually intervened to oppose the confirmation of some stipulated awards with mixed success.<sup>251</sup> In 2007, Maryland sought to block the confirmation of a stipulated expungement award, arguing that the Maryland Securities Commissioner "has a substantial interest in ensuring the integrity of her records."<sup>252</sup> The customer had collected a \$47,000 settlement on the condition that she stipulate to the expungement of all reference to the dispute.<sup>253</sup> After the district court initially rejected Maryland's request to intervene, the D.C. Circuit found that the state regulator should be allowed to intervene as of right because Maryland had an interest in protecting its records and neither the broker nor the customer

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248. Drake v. First Associated Sec. Grp., No. 95-03869, 1999 WL 1253565, at \*2 (Jan. 15, 1999) (Bardack, Krotinger, & Mainardi, Arbs.).

249. See Bann v. First Associated Sec. Grp., No. 96-04601, 1999 WL 1253604, at \*3 (Jan. 15, 1999) (Gault, Goldberg, & McClaskey, Arbs.) ("The NASD shall expunge from its Central Registration Depository (CRD) records maintained for stipulating Respondents Carl Martellaro, Larry Miller, Jay Dugan and First Securities USA, all references to this claim.").

250. In 2014, FINRA prohibited member firms from conditioning any settlement offer on a customer agreeing not to oppose the expungement of complaint information. Fin. Indus. Reg. Auth., Notice to Members 14-31 Expungement of Customer Dispute Information 4 (July 2014), <https://perma.cc/3R5A-B2N9> (PDF).

251. See Lazaro, *supra* note 234, at 139–46 (describing state efforts to intervene to stop courts from confirming awards recommending expungement).

252. Karsner v. Lothian, 532 F.3d 876, 879 (D.C. Cir. 2008).

253. *Id.* at 881.

“represents the Commissioner's interest in protecting the integrity of the CRD.”<sup>254</sup>

States still struggled to block the confirmation of stipulated awards. Some courts confirmed expungement awards over state opposition.<sup>255</sup> For example, New York unsuccessfully sought to intervene and oppose an expungement arising out of a stipulated award in *Kay v. Abrams*.<sup>256</sup> There, the broker had paid \$155,000 to secure a stipulated award providing “for confidentiality and expungement of the matter from CRD records.”<sup>257</sup> The court confirmed the award because it felt bound by precedent that it lacked authority to set aside the award because a New York appellate court had reversed a prior trial court for refusing to confirm an expungement.<sup>258</sup> Generally, New York’s attempts to intervene were unsuccessful because the New York courts generally “viewed their role in the expungement controversy as highly limited, rejecting the policy arguments made by the Attorney General.”<sup>259</sup>

Still, the efforts brought attention to significant concerns with how arbitration rules facilitated expungement. One court highlighted real issues with the stipulated award process by focusing on the award before her.<sup>260</sup> The court explained that

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254. *Id.* at 885–86.

255. *See, e.g.,* Walker v. Connelly, 21 Misc. 3d 1123(A), at \*2 (N.Y. Sup. Ct. Oct. 16, 2008) (“The Attorney General opposes confirmation of the stipulated award pursuant to CPLR 7511(b) on the grounds that the panel ‘exceeded its authority.’”).

256. *See Kay v. Abrams*, 853 N.Y.S.2d 862, 867 (Sup. Ct. 2008) (“[S]ince no basis has been alleged to deny confirmation, other than the legal arguments of the Attorney General referred to above, petitioner’s motion to confirm the Award is granted. In light of the foregoing, the application of the Attorney General to intervene is denied.”).

257. *Id.* at 863.

258. *Id.* at 866–67 (citing Goldstein v. Preisler, 805 N.Y.S.2d 647 (App. Div. 2005)) (“Although the then Attorney General did not seek to intervene in that case, since it is on ‘all fours’ with the case at bar and there is no contrary First Department decision, the court feels bound by the determination therein.”).

259. Lipner, *supra* note 91, at 80.

260. *See In re Sage, Rutty, & Co. v. Salzberg*, No. 2007-01942, slip op. at 4–5 (N.Y. Sup. Ct. June 1, 2007) (order granting partial rehearing) (“A hearing was never conducted, no written settlement agreement was ever drafted, and

“there are aspects of the [s]tipulated [a]ward which trouble the [c]ourt. The arbitrators found that (certain) claims were factually impossible or clearly erroneous, but there is not a single fact or circumstance described upon which the arbitrators base this conclusion.”<sup>261</sup>

Concerns about an arbitration-facilitated expungement process grew. One review of 200 stipulated or settled arbitration awards in 2006 found arbitrators regularly granted expungement without conducting any affirmative fact finding.<sup>262</sup> On the whole, arbitrators granted expungement requests after settlements 98 percent of the time.<sup>263</sup> The arbitrators conducted no fact-based hearings 71 percent of the time.<sup>264</sup> The troubling statistics revealed that decisions to expunge information from public records were being made without fully informed arbitrators. As one law professor noted, arbitrators were not considering “the larger policy implications and considerations associated with an effective CRD system.”<sup>265</sup> In many cases, arbitrators were simply ordering “expungement at the request of a party to facilitate settlement of a dispute.”<sup>266</sup>

After some negative publicity, FINRA moved in 2008 to make changes to its code. It added Rules 12805 and 13805 to require arbitrators to hold at least one hearing session and

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no other documents were submitted. In that sense, the arbitrators’ decision on expungement is irrational because it was made without any evidentiary support.”).

261. *Id.* at 4.

262. See PUB. INV’RS ARB. BAR ASS’N, STUDY OF STIPULATED OR SETTLED NASD CUSTOMER AWARDS, ISSUED IN CALENDAR YEAR 2006, FOR WHICH STATEMENTS OF CLAIM WERE FILED ON, OR SUBSEQUENT TO, APRIL 12, 2004, 14 (2007), <https://perma.cc/A7A3-NZNN> (PDF) (reviewing these awards).

263. *Id.*

264. *Id.*

265. Letter from Barbara Black, Charles Hartsock Professor of Law, Dir. of Corp. Law Ctr., Univ. of Cincinnati, to Nancy M. Morris, Sec’y, Sec. & Exch. Comm’n 2 (Apr. 24, 2008) (on file with the Washington and Lee Law Review).

266. Order Approving a Proposed Rule Change Amending the Codes of Arbitration Procedure to Establish Procedures for Arbitrators to Follow When Considering Requests for Expungement Relief, 73 Fed. Reg. 66,086, 66,087 (Nov. 6, 2008).

explain the basis for their expungement recommendations.<sup>267</sup> These new rules effectively ended stipulated awards but left the underlying incentives unchanged.

## 2. *Purchasing Perjury & Silence*

Brokers had also found other ways to ensure that arbitration panels would approve requests for expungements. Brokers ensured one-sided expungement hearings and evidence by conditioning settlement offers on a customer either agreeing to support an expungement with a sworn affidavit saying the underlying complaint was false, or at least an agreement not to oppose a broker's request.<sup>268</sup> FINRA took repeated steps to address the issue. In 2004, FINRA warned industry members that "affidavits, attested to in connection with settlements that often are incorporated into stipulated awards, appear to be inconsistent on their face with the initial claim and terms of the settlement."<sup>269</sup> FINRA explained that members may face discipline if they submitted "affidavits in which the content is the product of a bargained-for consideration as opposed to the truth."<sup>270</sup> Obtaining expungements with bargained-for evidence undercuts the requirement that arbitrators have some

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267. See Notice of Filing of Proposed Rule Change Relating to Amendments to the Codes of Arbitration Procedure to Establish New Procedures for Arbitrators to Follow When Considering Requests for Expungement Relief, Fed. Reg. 18,308, 18,308 (Apr. 3, 2008) ("The procedures are designed to: (1) make sure that arbitrators have the opportunity to consider the facts that support or weigh against a decision to grant expungement; and (2) ensure that expungement occurs only when the arbitrators find and document one of the narrow grounds specified in Rule 2130.").

268. See Melanie S. Cherdack, *Drafting A Securities Arbitration Claim: The Pen Is (Still) Mightier Than the Market*, 18 PIABA B.J. 333, 342 (2011) (explaining that for claimant's counsel "[n]aming the individual broker may have benefits, too . . . . If, for instance, the broker is a big producer and important to the firm, the firm may have some incentive to settle the action and seek your client's cooperation . . . .").

269. See Nat. Ass'n Secs. Dealers, Notice to Members 04-43 Members' Use of Affidavits in Connection with Stipulated Awards and Settlements to Obtain Expungement of Customer Dispute Information 554 (June 2004), <https://perma.cc/2H7C-F7M6> (PDF) (warning against procuring false affidavits).

270. *Id.*

affirmative basis for recommending an expungement.<sup>271</sup> In effect, the practice of requiring customers to swear to affidavits attesting that their initial claim was “false” may have amounted to purchasing perjury.

Despite the warning, brokers continued to negotiate for customers to assist with, or at least not oppose, their expungement requests as a settlement condition until 2014 when FINRA updated its rules to prohibit the practice.<sup>272</sup> In adopting the rule, FINRA explained that it believed the new rule would “ensure that information is expunged from the CRD system only when there is an independent judicial or arbitral decision that expungement is appropriate”<sup>273</sup>

As often happens, new problems arise after regulators address old ones.<sup>274</sup> The NASD prohibited the use of affidavits in 2004, ended stipulated awards in 2008, and explicitly prohibited negotiations over nonparticipation in expungements in 2014.<sup>275</sup> In response to these changes, many brokers began to seek expungements in separate arbitrations naming their current or former employers as respondents. A report from the PIABA Foundation found that there has been an “explosive

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271. See Scott Ilgenfritz, *Expungement Study of the Public Investors Arbitration Bar Association*, 20 PIABA B.J. 339, 349 (2013) (“Bargaining for such an affidavit from a customer claimant could clearly result in the ‘buying of a clean record’ and would make a mockery of any ‘affirmative determination’ of one of the three grounds in Rule 2130 by a panel of arbitrators.”).

272. See FIN. INDUS. REG. AUTH., RULE 2081 (2014) (prohibiting brokers and firms from conditioning “settlement of a dispute with a customer on, or to otherwise compensate the customer for, the customer’s agreement to consent to, or not to oppose, the member’s or associated person’s request to expunge such customer dispute information from the CRD system”).

273. Fin. Indus. Reg. Auth., Reg. Notice 14–31 Expungement of Customer Dispute Information 2 (July 2014), <https://perma.cc/Q4MN-2S2Q> (PDF).

274. See Jeffrey N. Gordon, *The Empty Call for Benefit-Cost Analysis in Financial Regulation*, 43 J. LEGAL STUD. S351, S351 (2014) (explaining that in the “financial sector, however, the system that generates costs and benefits is constructed by financial regulation itself and the subsequent processes of adaptation and regulatory arbitrage. An important new rule will change the system beyond our calculative powers”).

275. See FIN. INDUS. REG. AUTH., RULE 2081 (2014) (“Rule 2081 removes the ability of parties to a customer arbitration to bargain for expungement relief as part of a settlement negotiation.”).

increase” in these “expungement-only” arbitrations, rising 924 percent from 2015 to 2018.<sup>276</sup>

### *E. Uninformed Decisions*

Ultimately, the current system for arbitration-facilitated expungements reveals that arbitrations now regularly occur where no party has any real incentive to bring pertinent, material information to the attention of arbitrators if that information would diminish the odds that an arbitrator will grant an expungement request. Courts asked to confirm these arbitration awards should not have any confidence that the arbitrators made a well-informed decision. Although the arbitrators may hear all the evidence presented to them, they usually hear no more than what the broker seeking an expungement wants them to hear.

Consider an arbitration award directing expungement obtained by Patrick James Dwyer, a broker who once managed billions of dollars in assets.<sup>277</sup> Dwyer secured an arbitration award recommending the expungement of six different customer complaints in two hearing sessions conducted on the same day.<sup>278</sup> His employer, Merrill Lynch, did not oppose the expungement request and indicated that it “agreed that a finding should be entered by the Panel in favor of” the expungement request.<sup>279</sup> Of the six complaining customers, only three of them received any form of notice.<sup>280</sup> Dwyer’s counsel took the position “that the notification requirements of an expungement request applies to customers who have filed for

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276. DOSS & BRAGANÇA, *supra* note 88, at 3.

277. *See* Braswell & Horowitz, *supra* note 147 (reporting that Dwyer “led a 12-person team that managed some \$3.7 billion and generated over \$10 million of annual revenue, left this week while under review”).

278. *See In re Dwyer v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, No. 16-02781, 2017 WL 3189311, at \*6 (July 20, 2017) (Ainbinder, Arb.) (noting that Plaintiff’s requested relief was the expungement of all records of these occurrences).

279. *Id.* at \*1.

280. *See id.* (“Claimant provided notice of this proceeding to the only customer who filed for arbitration . . . . Claimant also provided notice to two other customers and they or their counsel gave written authority to not oppose nor support Claimant’s request for expungement . . . .”).



arbitration.”<sup>281</sup> Because some of the complaining customers had never filed an arbitration complaint against Dwyer, he did not notify them of the expungement hearing at all.<sup>282</sup> Hearing no objections from customers, some of whom had not even been told about the hearing, the arbitration panel agreed.<sup>283</sup> The panel noted as significant the fact that his employer supported the request.<sup>284</sup> The panel trusted Merrill Lynch to faithfully defend the integrity of the CRD because Merrill Lynch, as Dwyer’s employer, also had “a duty to protect the investing public and the firm’s customers from improper, fraudulent or otherwise culpable conduct.”<sup>285</sup>

But the arbitration panel did not hear the complete story. FINRA sought to vacate the award in a Florida state court, contending that Dwyer had fraudulently concealed information from the arbitration panel and exhibited an “extreme lack of candor” in the arbitration proceeding.<sup>286</sup> Dwyer, a Miami-based broker, had previously filed an action against FINRA in a California court seeking to force FINRA to expunge information from the CRD.<sup>287</sup> Although his name eventually emerged as the broker behind the request, Dwyer had filed his California suit under a pseudonym. He may have sought relief in court first under the pseudonym to avoid the publicity that would follow

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281. *See id.* (“Claimant’s counsel advised the Panel that it was his position that the notification requirements of an expungement request applies to customers who have filed for arbitration. The Panel agrees with Claimant’s counsel’s position.”).

282. *See id.* (noting that despite the fact that only one customer had filed an arbitration, Dwyer’s counsel represented that he had secured some written statement of some kind from two other complaining customers that they would not oppose the expungement request).

283. *See id.* at \*2 (recommending expungement).

284. *See id.* (“Critical facts regarding the Focus 20 Fund were not contradicted by Respondent’s representative.”).

285. *Id.*

286. Petition to Vacate Arbitration Award at ¶¶ 9–10, Fin. Indus. Reg. Auth., Inc. v. Dwyer, No. 2017-023398-CA-01 (Fla. Cir. Ct. 2017), Dkt. No. 3.

287. *See id.* at Exhibit B (filing under the pseudonym John Doe).

when a broker with his multibillion-dollar book of business won an expungement.<sup>288</sup>

Yet once Dwyer named FINRA as a defendant in a court action, FINRA contested the case and won, securing a post-trial decision denying Dwyer's request to have information expunged from the CRD database.<sup>289</sup> After adversarial litigation, the California court found that Dwyer "presented no evidence to show that any of these complaints are false, inaccurate, meritless or frivolous" and that the "disclosure of accurate customer dispute information is most definitely in the public interest."<sup>290</sup> The California court concluded that the "equities weigh heavily against expungement of Plaintiff Dwyer's record."<sup>291</sup> The California court was presented with evidence and information that Dwyer, Dwyer's counsel, and Merrill Lynch declined to provide to the arbitration panel.

Ultimately, the Florida court considering vacating the arbitration award recommending expungement never ruled on the propriety of Dwyer's behavior. On November 15, 2018, the parties presented the court with a joint stipulation of dismissal.<sup>292</sup> It stipulated that Dwyer's Petition to Confirm the Arbitration Award was "dismissed with prejudice."<sup>293</sup> Thus, FINRA succeeded at keeping the customer dispute information on the CRD system.

Dwyer may have failed in his expungement attempt because he went to court first and faced FINRA as an actual adversary. If he had proceeded through arbitration first against his employer, FINRA likely would not have sought to block the confirmation of Dwyer's award—or had a clear ground to do so.

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288. See, e.g., *Star Merrill PBIG Broker Sweeps His Record Nearly Clean*, ADVISORHUB (July 21, 2017), <https://perma.cc/HN22-L722> (reporting on Dwyer's expungement award).

289. See *Petition to Vacate Arbitration Award*, *supra* note 286, at 28, Ex. B ("This is not a close case. The equities weigh heavily against expungement of Plaintiff Dwyer's record.").

290. *Id.* at 27–28.

291. *Id.* at 28.

292. See *Stipulation to Dismissal with Prejudice*, Fin. Indus. Reg. Auth., Inc. v. Dwyer, No. 2017-023398-CA-01 (Fla. Cir. Ct. 2017), Dkt. No. 56 (stipulating to a dismissal with prejudice of Dwyer's petition to confirm the arbitration award).

293. *Id.*

Under Rule 2080, FINRA must be named as a defendant in court actions unless FINRA waives the requirements under Rule 2080.<sup>294</sup> If Dwyer had obtained affirmative arbitral findings first, FINRA might have waived the requirement to name it as a party or chosen not to contest the expungement because no strong rationale for opposing the individual arbitration award seems readily apparent. The process effectively leaves it up to the parties and the rare customer to present arbitrators with pertinent, material facts.

### *III. Interventions*

Some interventions may address, or at least mitigate adversarial failure. The best solution, discussed in the next subpart, would be to simply remove expungement and other matters with a high degree of adversarial failure from adversarial systems entirely. Absent that, process-oriented changes and ethics-focused interventions might address the issue to some degree.

Ultimately, adversarial failure occurs whenever the parties to an action have no real incentive to present information to an adjudicator. In these situations, courts, regulators, and legislators should not assume that an adjudicator made an informed decision because no party had any real incentive to present the adjudicator with complete information. Adversarial failure may often be a matter of degree. In some instances, a disparity of resources or advocate skill and diligence may generate the same results.

#### *A. Moving Away from Adversarial Adjudication*

In most instances, it may be better to simply abandon adversarial adjudication in favor of some alternative approach. Barbara Black suggested this type of shift in 2008, explaining that “the integrity of the CRD is such an important and integral part of an effective investor education and protection system that only the regulators whose responsibilities include, first and

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294. See FIN. INDUS. REG. AUTH., RULE 2080 (2009) (“Members or associated persons petitioning a court for expungement relief . . . must name FINRA as an additional party . . . unless this requirement is waived.”).

foremost, protection of the investing public should make decisions about removing information from the record.”<sup>295</sup> Black also recognized that arbitration may be particularly ill-suited to this task because the “arbitrators’ mission . . . does not include consideration of the larger policy implications and considerations associated with an effective CRD system.”<sup>296</sup>

For expungement processes, the interests of all stakeholders may be better balanced by removing the entire process from an adversarial system. When the parties to an action do not have real incentives to fully inform an adjudicator, society should not resolve issues by routing them through a phony adversarial process and then roping courts in to confirm the results.

Gaming regulation may provide a rough, workable model for effectively policing the CRD system’s integrity. Consider how Nevada approaches gaming licenses. Lawyers and enrolled agents who practice before the Nevada gaming regulators operate within a demanding regulatory framework. When a lawyer appears on a client’s behalf before the Nevada Gaming and Control Board, “the person represented [is] deemed to have waived all privileges with respect to any information in the possession of such attorney.”<sup>297</sup> The gaming regulators also require attorneys practicing before them to be expansively candid, explaining that they “shall not be intentionally untruthful to the board or commission, nor withhold from the board or commission any information which the board or commission is entitled to receive.”<sup>298</sup> These obligations also include a duty to investigate before appearing and instruct that attorneys appearing before gaming regulators “shall exercise due diligence in preparing or assisting in the preparation of documents for submission to the board or commission.”<sup>299</sup> The regulations place continuing obligations on attorneys appearing

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295. Black, *supra* note 265, at 2.

296. *Id.*

297. NEV. GAMING REG. § 10.080 (2017).

298. *Id.* § 10.090(1).

299. *Id.* § 10.090(2).

before the board to update any information that is “no longer accurate and complete in any material respect.”<sup>300</sup>

Gaming regulators make the lawyers appearing before them function as gatekeepers.<sup>301</sup> A lawyer may be banned from practicing before the gaming regulators if she “willfully failed to exercise diligence in the preparation or presentation” materials or “knowingly misrepresented any material fact to the board or commission.”<sup>302</sup> In effect, an attorney may lose her right to practice before the regulator if she fails to discover readily available information. Bad faith behavior or simple ineptitude may also result in exclusion.<sup>303</sup>

But the attorneys do not serve as the only gatekeepers. Importantly, gaming regulators do not rely entirely upon these expansive disclosure requirements or expect attorneys and applicants to surface all information on their own. They independently investigate persons who apply for a gaming license and may even bill applicants for the costs incurred in conducting an investigation.<sup>304</sup>

An appropriate gatekeeper model may greatly improve the process. Securities regulators already have substantial familiarity with gatekeeping.<sup>305</sup> The securities laws impose gatekeeping liability on underwriters in an effort to improve the quality of information investors receive.<sup>306</sup> Underwriters put

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300. *Id.* § 10.090(3).

301. Professor Coffee defines “gatekeeper” as “a reputational intermediary who provides verification or certification services to investors.” John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 309 (2004).

302. NEV. GAMING REG. § 10.065(2)(b) (2017).

303. *Id.* § 10.025(2)(d) (allowing exclusion if a person lacks “requisite qualifications or expertise to represent others before the board or commission, lacks character or integrity, or has engaged in unethical or improper conduct”).

304. *See id.* § 4.070 (“[T]he Board may require an applicant to pay such supplementary investigative fees and costs as may be determined by the Board.”).

305. *See* Frank Partnoy, *Strict Liability for Gatekeepers: A Reply to Professor Coffee*, 84 B.U. L. REV. 365, 367 (2004) (“Professor Coffee and I both support a strict liability regime for gatekeepers, not a negligence regime.”).

306. *See* John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1297 (2003) (“The underwriter in an initial

their capital and reputations on the line when selling securities. In contrast, arbitrators are not well-situated to serve as key gatekeepers here. They face no liability for any failure, and they lack real incentives and tools to gather information necessary to make an informed decision. If anything, a reputation for close scrutiny may reduce the likelihood that an arbitrator will even be selected. Fundamentally, arbitrators should not serve as the key gatekeepers in this context.

A regulatory model for resolving these types of disputes would likely yield better informed decisions. As an independent, self-regulatory organization, FINRA could transition its involvement in the expungement process from passively operating an arbitration forum to a more significant gatekeeping role. Some regulatory process akin to the method Nevada uses to vet applicants for gaming licenses might serve as a rough model for a process through which FINRA could better balance the key interests at stake here, allowing brokers to contest and remove provably false information while protecting the integrity of information within the CRD.

A well-constituted committee could manage this process. A committee could incorporate relevant stakeholders including state securities regulators, investor advocates, and brokerage firms. Channeling all expungement requests through a single committee instead of a rotating cast of arbitrators would allow for a more regularized process to develop. Importantly, the committee would accumulate experience resolving these issues much more rapidly than a broadly dispersed pool of arbitrators. A committee could also hire counsel, investigators, and others to help surface information relevant to the committee's decision. This would allow the committee to avoid total dependence on a requesting party's willingness to provide information.

### *B. Changes to Attorney Ethics Rules*

Professional ethics rules shape how attorneys present information to adjudicators when advocating for their clients. In most states, the ethical rules governing law practice generally

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public offering also performs a gatekeeping function, in the sense that its reputation is implicitly pledged and it is expected to perform due diligence services.”).

track the ethics rules and policies promulgated by the American Bar Association (ABA).<sup>307</sup> As the lawyers elected to the ABA House of Delegates have obligations to their own clients, the lawyers collaborating to generate these rules “likely have direct financial interest in the rules that they draft.”<sup>308</sup>

Our adversarial system of justice implicitly assumes tribunals will reach informed decisions because each side will investigate the matter and bring forward facts relevant to the dispute.<sup>309</sup> In theory, clashing parties will hold each other accountable and point out any errors, allowing adjudicators to reach informed decisions.<sup>310</sup> This idyllic vision does not match reality.<sup>311</sup> As explained below, the current ethics rules grant lawyers broad flexibility to frame factual scenarios in their clients’ interest without cluing courts or arbitrators in to all relevant information.

### 1. Existing Rules Treat Law and Fact Differently

The ABA Model Rules of Professional Conduct treat legal arguments and factual presentations differently, often allowing lawyers to withhold adverse relevant facts from a tribunal as long as they disclose governing law.<sup>312</sup> ABA Model Rule 3.3, which speaks to a lawyer’s duty of candor, treats a failure to

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307. See Renee Newman Knake, *The Legal Monopoly*, 93 WASH. L. REV. 1293, 1298 (2018) (“Most states draw from model ethics rules and policies promulgated by lawyers elected by their peers to the American Bar Association (‘ABA’) House of Delegates.”).

308. *Id.*

309. I use the word “tribunal” here to track the ethics rules and because it also encompasses disputes resolved by an arbitrator.

310. See MODEL RULES OF PROF’L CONDUCT PREAMBLE ¶ 8 (AM. BAR ASS’N 2020) (“When an opposing party is well represented, a lawyer can be a zealous advocate on behalf of a client and at the same time assume that justice is being done.”).

311. See Daniel Markovits, *Adversary Advocacy and the Authority of Adjudication*, 75 FORDHAM L. REV. 1367, 1369 (2006) (explaining that the general assumption that the adversarial system will on balance generate the best results has “been shown to be not just mistaken but simply implausible. To begin with, its factual predicates do not generally obtain.”).

312. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 111 cmt. c. (AM. LAW. INST. 2000) (pointing out that that “it is sometimes argued that the rule . . . it draws a dubious distinction between legal authority and facts”).

disclose pertinent, adverse legal authority differently from a failure to disclose pertinent, adverse facts.<sup>313</sup>

*a. Governing Law*

ABA Model Rule 3.3(a)(2) prohibits lawyers from knowingly failing to disclose “legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel.”<sup>314</sup> The official comment to the rule explains that “[t]he underlying concept is that legal argument is a discussion seeking to determine the legal premises properly applicable to the case.”<sup>315</sup> In essence, the ethics rule sometimes requires a lawyer to carry the discussion into legal territory she might prefer to avoid—even if the lawyer on the other side of the case does not raise the precedent.<sup>316</sup>

The expectation that lawyers will not knowingly withhold information about relevant past precedents has long been part of the American legal system.<sup>317</sup> Alabama included requirements to not knowingly cite “as authority an overruled case” or not “knowingly misquoting the language of a decision” in the Alabama Code of Ethics of 1887.<sup>318</sup> The Restatement also embraces this view and makes clear that a lawyer “may not knowingly . . . fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly

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313. See MODEL RULES OF PROF'L CONDUCT r. 3.3 (2020) (distinguishing between the two).

314. *Id.* at (a)(2).

315. *Id.* at cmt. 4.

316. See Am. Bar Ass'n Comm. on Prof'l Ethics & Grievances, Formal Op. 146 (1935) (explaining that a precedent-disclosing lawyer “may, of course, after doing so, challenge the soundness of the decisions or present reasons which he believes would warrant the court in not following them in the pending case”).

317. See Andrea Pin & Francesca M. Genova, *The Duty to Disclose Adverse Precedents: The Spirit of the Common Law and Its Enemies*, 44 YALE J. INT'L L. 239, 256 (2019) (tracing the origin on the rule).

318. CODE OF ETHICS OF THE ALA. STATE BAR ASS'N r. 5 (1887), reprinted in ALA. STATE BAR ASS'N, PROCEEDINGS OF THE FORTY-FIRST ANNUAL MEETING OF THE ALA. STATE BAR ASS'N 336 (1918).



adverse to the position asserted by the client and not disclosed by opposing counsel.”<sup>319</sup>

Courts have reacted harshly to lawyers who fail to present relevant, adverse legal authority when arguing for their clients. Most famously, Judge Posner published an opinion directing a stinging rebuke at one lawyer for failing to cite relevant authority.<sup>320</sup> After the lawyer repeatedly failed to address a particular case, the opinion compared the lawyer to an ostrich, explaining that the “ostrich is a noble animal, but not a proper model for an appellate advocate.”<sup>321</sup> Capturing additional attention, the opinion includes two photographs, one with an ostrich burying its head in the sand and another with a figure clad in a tan business suit in a similar posture.<sup>322</sup>

### *b. Factual Presentations*

In contrast, the Model Rules and ethical norms do not usually require lawyers to disclose adverse factual information. Instead, the model rule instructs that a lawyer “shall not knowingly . . . make a false statement of fact or law to the tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer.”<sup>323</sup> The Restatement also follows this approach and prohibits lawyers from offering testimony the lawyers knows to be false.<sup>324</sup>

319. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 111(2) (AM. LAW. INST. 2000).

320. See *Gonzalez-Servin v. Ford Motor Co.*, 662 F.3d 931, 934 (7th Cir. 2011) (“When there is apparently dispositive precedent, an appellant may urge its overruling or distinguishing or reserve a challenge to it for a petition for certiorari but may not simply ignore it.”).

321. *Id.*

322. *Id.* at 935. Notably, the rebuke itself may have been an ethical breach for Judge Posner. See Joseph P. Mastrosimone, *Benchslaps*, 2017 UTAH L. REV. 331, 352 (2017) (criticizing so-called benchslaps because “[i]nstead of meeting the attorney’s unprofessional or unethical conduct with dispassionate and professional counseling or sanctions, the judges in these benchslaps . . . use[d] their authority to shame and belittle the lawyers”).

323. MODEL RULES OF PROF’L CONDUCT r. 3.3 (AM. BAR ASS’N 2020).

324. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 120 (AM. LAW. INST. 2000) (prohibiting lawyers from offering false facts or testimony to the tribunal).

*c. The Knowledge Qualifier*

A lawyer's ethical obligations within this framework shift once the lawyer has *knowledge* that some evidence or factual information is false. The knowledge qualifier grants substantial flexibility and even allows lawyers to present information they believe to be false. The Model Rules define "knowledge" as "actual knowledge of the fact in question," with the addition that "[a] person's knowledge may be inferred from circumstances."<sup>325</sup>

In discussing the ABA's Model Rule, the official comment explains that the "prohibition against offering false evidence only applies if the lawyer knows that the evidence is false. Even a lawyer's reasonable belief that evidence is false does not preclude its presentation to the trier of fact."<sup>326</sup>

Substantial justification undergirds this rule. Lawyers practice with limited information and may not be able to actually know whether a client's account actually transpired or was simply fabricated. If lawyers could not present a client's version of events simply because the lawyer harbored some doubts, it would substantially interfere with a client's ability to obtain assistance.

Doubting lawyers do not always need to investigate dubious factual claims. A comment to the Model Rule instructs lawyers to "resolve doubts about the veracity of testimony or other evidence in favor of the client."<sup>327</sup> The ethics rules do not explicitly require lawyers to make any attempt to put their doubts to rest before offering evidence they believe may be false.<sup>328</sup> Although the comment to the Model Rule indicates that a lawyer may not "ignore an obvious falsehood," in most practice situations, lawyers have no clear ethical obligation to investigate their client's factual claims or search for evidence which would show that a client has given a false factual

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325. MODEL RULES OF PROF'L CONDUCT r. 1(f) (2020).

326. *Id.* r. 3.3 cmt. 8 (2020).

327. *Id.*

328. See George M. Cohen, *The State of Lawyer Knowledge Under the Model Rules of Professional Conduct*, 3 AM. U. BUS. L. REV. 115, 117 (2014) ("The actual knowledge standard aims to exclude a duty to inquire.").

account.<sup>329</sup> George Cohen characterized the “knowledge” qualifier as a “key marker in a contentious struggle over the scope of a lawyer’s duty to investigate.”<sup>330</sup> The ethics rules only create clear liability for lawyers issuing reckless statements about “the qualifications or integrity of a judge, adjudicatory officer or public legal officer, or of a candidate for election or appointment to judicial or legal office.”<sup>331</sup>

In some instances, lawyers may decide that they would rather not investigate and know the truth because knowing the truth might impair their ability to advocate for a client.<sup>332</sup> George Cohen explains that “a lawyer faced with a suspicious fact” might reason that “investigating would be a bad idea because that would put the lawyer at risk of violating the knowledge-based rule.”<sup>333</sup> Of course, for lawyers practicing in federal court, Federal Rules of Civil Procedure (FRCP) provide a limited check. FRCP Rule 11 forces lawyers submitting papers to a court to certify that a lawyer conducted “an inquiry reasonable under the circumstances.”<sup>334</sup> The requirement does not force a lawyer to certify that she believes a contention to be true, so much as “the factual contentions have evidentiary support.”<sup>335</sup> In some instances, this evidentiary support may simply be a client’s doubtful claims.

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329. *See id.* at 125 (“Thus, a lawyer faced with a suspicious fact that is not sufficient along with other circumstances to impart actual knowledge need not do anything further.”).

330. *Id.* at 124.

331. MODEL RULES OF PROF’L CONDUCT r. 8.2(a) (2020).

332. Duties of inquiry do exist in some practice areas. In transactional securities practice, lawyers and other professionals have long faced a duty to inquire. *See Cohen, supra* note 328, at 118 (“Transactional lawyers in particular are familiar with the recklessness standard because it plays an important role in securities fraud and other business crimes and torts.”). Lawyers must also make inquiries when preparing opinion letters. *See, e.g., Excalibur Oil, Inc. v. Sullivan*, 616 F. Supp. 458, 463 (N.D. Ill. 1985) (“Necessarily implicit in any [opinion letter] contract is the lawyer’s duty to investigate the title with reasonable diligence and to report his findings accurately.”).

333. Cohen, *supra* note 328, at 125.

334. FED. R. CIV. P. 11.

335. *Id.* (b)(3).

*d. A Limited Duty to Correct*

Under the ethics rules, lawyers owe only a limited obligation to inform a tribunal when they know that false evidence has been presented to it. The ABA's Model Rules only explicitly require lawyers to take "remedial measures, including, if necessary, disclosure to the tribunal" when a lawyer learns that she, her client, or a witness she called offered material evidence she later came to know was false.<sup>336</sup> The Restatement takes the view that lawyers have "no responsibility to correct false testimony or other evidence offered by an opposing party or witness."<sup>337</sup>

Lawyers do owe an obligation to the tribunal to correct false information when they have had some hand in presenting the information to the tribunal. The Restatement explains that even if it would hurt a client's interests, a lawyer must correct false information she had some role in presenting because "preservation of the integrity of the forum is a superior interest."<sup>338</sup>

*e. Undisclosed Vital Factual Evidence*

In most situations, ethics rules do not obligate lawyers to provide tribunals or opposing counsel with all, significant, material information in their possession.<sup>339</sup> The ethics rules do not generally require lawyers to volunteer accurate information vital to developing an informed understanding of a dispute.<sup>340</sup>

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336. MODEL RULES OF PROF'L CONDUCT r. 3.3(a)(3) (AM. BAR ASS'N 2020).

337. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 120 cmt. d. (2000) ("[A] plaintiff's lawyer, aware that an adverse witness being examined by the defendant's lawyer is giving false evidence favorable to the plaintiff, is not required to correct it . . .").

338. *Id.* cmt. b.

339. See Nathan M. Crystal, *Limitations on Zealous Representation in an Adversarial System*, 32 WAKE FOREST L. REV. 671, 715 (1997) ("It is a well-established doctrine that lawyers have no obligation to disclose voluntarily . . . to opposing parties or to the tribunal evidence that is material to the case, even if nondisclosure would produce a result that is inconsistent with the truth.").

340. See John A. Humbach, *Shifting Paradigms of Lawyer Honesty*, 76 TENN. L. REV. 993, 1013 (2009) ("[I]t is a professional truism of current American legal practice that a lawyer has no general duty to volunteer.").

The ABA has even issued a formal ethics opinion that lawyers may violate the ethics rules if they inform opposing counsel that the statute of limitations has run on a claim because it would violate their duties to their client.<sup>341</sup> At the most, the comment to the ABA ethics rule recognizes that some circumstances exist “where failure to make a disclosure is the equivalent of an affirmative misrepresentation.”<sup>342</sup>

Some courts have found “failure to make disclosure of a material fact to a tribunal is the equivalent of affirmative misrepresentation.”<sup>343</sup> New Jersey goes further than most states and requires lawyers to disclose unprivileged or otherwise unprotected material facts if a court would otherwise be misled by nondisclosure.<sup>344</sup> These limited requirements leave substantial room for error.

Yet tribunals often fail to receive information vital to developing a well-informed understanding of a dispute—even when the information is known to one or all of the parties to a dispute.<sup>345</sup> Importantly, procedural, ethical, and economic constraints all shape the information tribunals actually receive.<sup>346</sup>

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341. See ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 94-387 (1994) (“[W]e conclude that a lawyer has no ethical duty to inform an opposing party that her client’s claim is time-barred; to the contrary, it may well be unethical to disclose such information without the client’s consent.”).

342. MODEL RULES OF PROF'L CONDUCT r. 3.3 cmt. 3 (AM. BAR ASS'N 2020).

343. *AIG Haw. Ins. v. Bateman*, 923 P.2d 395, 402 (Haw. 1996), *amended on reconsideration in part*, 925 P.2d 373 (Haw. 1996); see, e.g., *In re Fee*, 898 P.2d 975, 979 (Ariz. 1995) (“The system cannot function as intended if attorneys, sworn officers of the court, can . . . mislead judges in the guise of serving their clients.”).

344. See N.J. RULES OF PROF'L CONDUCT r. 3.3(a)(5) (2003) (prohibiting failure “to disclose to the tribunal a material fact knowing that the omission is reasonably certain to mislead the tribunal, except that it shall not be a breach of this rule if the disclosure is protected by a recognized privilege or is otherwise prohibited by law”).

345. See *supra* Part II.E.

346. See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 120 cmt. b. (2000) (“[An] advocate who knows of the evidence, and who has complied with applicable rules concerning pretrial discovery and other applicable disclosure requirements . . . has no legal obligation to reveal the evidence, even though the proceeding thereby may fail to ascertain the facts as the lawyer knows them.”).

In some instances, all parties to the litigation might prefer to avoid presenting courts with particular factual information or arguments. Lawyers after all tend to operate in the interests of their clients and not in the interest of helping a tribunal develop the most accurate understanding.<sup>347</sup> This means that tribunals will proceed without important material information when it is not in any party's interest to provide the information and the law does not compel disclosure. Adding to the problem, even when the ethics rules compel disclosure, attorneys will only rarely face any repercussion for failing to disclose.<sup>348</sup>

*f. Ex Parte Proceedings*

The ethics rules impose an expanded duty of candor on advocates in *ex parte* proceedings. The ABA's Model Rules instruct that in an *ex parte* proceeding "a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, *whether or not the facts are adverse*."<sup>349</sup>

The comment to the Model Rule explains why disclosure is required in *ex parte* proceedings. In an ordinary situation, "an advocate has the limited responsibility of presenting one side of the matters that a tribunal should consider in reaching a decision."<sup>350</sup> In our adversarial system, "the conflicting position is expected to be presented by the opposing party."<sup>351</sup> Yet in *ex parte* situations, such as a request for "a temporary restraining order, there is no balance of presentation by opposing advocates."<sup>352</sup> Despite this, the comment instructs that the

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347. See Humbach, *supra* note 340, at 995 ("Lawyers do not generally view it as part of their professional role to be personally responsible for getting at the truth of the matter but, rather, to persuade others to believe or accept whatever interpretation of the raw evidence is most beneficial to the interests of their own clients.").

348. See Edwards, *supra* note 29, at 1491 ("In many instances, state bars do not allocate substantial resources to their enforcement staff to investigate complaints.").

349. MODEL RULES OF PROF'L CONDUCT r. 3.3(d) (AM. BAR ASS'N 2020) (emphasis added).

350. *Id.* cmt. 14.

351. *Id.*

352. *Id.*

object of the proceeding “is nevertheless to yield a substantially just result.”<sup>353</sup> To accomplish this goal, it requires a lawyer for the represented party “to make disclosures of material facts known to the lawyer and that the lawyer reasonably believes are necessary to an informed decision.”<sup>354</sup>

In describing a lawyer’s ethical obligations in *ex parte* proceedings, the Restatement goes further and also prohibits lawyers from presenting “evidence the lawyer reasonably believes is false” and instructs lawyers to also comply with “any other applicable special requirements of candor imposed by law.”<sup>355</sup> The comment recognizes that the “potential for abuse is inherent in applying to a tribunal in absence of an adversary.”<sup>356</sup>

Identifying the situations where a lawyer must operate under an expanded duty of candor remains challenging because the ABA’s Model Rules do not define *ex parte* proceedings.<sup>357</sup> Although technical definition would exclude all cases where some other party appears in the action, this would overly limit the rule’s impact. One Idaho court read Idaho’s rule as applying when one of the parties, after having received notice, failed to appear in a proceeding.<sup>358</sup> It read the comment as suggesting “that the application of the rule is not meant to hinge on a technical definition of the term *ex parte*, but is instead intended to ensure that the tribunal is informed of facts necessary to render a just decision.”<sup>359</sup> It found that the underlying rationale applied when “there is no balance of representation by opposing advocates” applied when one of the parties was simply absent from a proceeding.<sup>360</sup>

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353. *Id.*

354. *Id.*

355. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 112 (2000).

356. *Id.* cmt. b.

357. MODEL RULES OF PROF’L CONDUCT r. 1.0 (2020) (failing to define *ex parte*).

358. *See In re Malmin v. Oths*, 895 P.2d 1217, 1220 (Idaho 1995) (“The judge has an affirmative responsibility to accord the absent party just consideration.”).

359. *Id.*

360. *Id.* (quoting MODEL RULES OF PROF’L CONDUCT r. 3.3 cmt. 14 (AM. BAR ASS’N 2020)).

Policy rationales support extending the requirement beyond purely technical situations. The Restatement recognizes that in some special proceedings, “public policy requires unusual candor from an advocate.”<sup>361</sup> It identifies child custody proceedings, involuntary commitment proceedings, and class action settlement proceedings.<sup>362</sup>

Massachusetts also treats class action settlement proceedings as quasi-ex parte proceedings requiring lawyers to be fully candid with the court. The comment to its ethics rule explains that when:

[A]dversaries present a joint petition to a tribunal, such as a joint petition to approve the settlement of a class action suit or the settlement of a suit involving a minor, the proceeding loses its adversarial character and in some respects takes on the form of an ex parte proceeding.<sup>363</sup>

The Massachusetts rule recently played a significant role in extended litigation arising out of a class action settlement before a Massachusetts federal court.<sup>364</sup> After the court approved a large class action settlement deal, it emerged that “\$4,100,000 of the \$75,000,000 fee award had been paid to Damon Chargois, a lawyer in Texas who had done no work on the case, and whose name was not disclosed to [the named plaintiff], the class, or the court.”<sup>365</sup> Other problems emerged as well. Over 9,000 attorney hours had been double counted.<sup>366</sup> It also appeared that attorneys were billed at rates in excess of what hourly clients ever paid.<sup>367</sup> Troubled by the revelation, the court ultimately reduced class counsel’s fee award and explained the need for

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361. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 112 cmt. c (2000).

362. *Id.*

363. MASS. RULES OF PROF’L CONDUCT r. 3.3. cmt. 14A (2015).

364. For a more thorough discussion of the case, see Edwards & Rickey, *supra* note 39.

365. Ark. Teacher Ret. Sys. v. State St. Bank & Tr., 404 F. Supp. 3d 486, 492 (D. Mass. 2018).

366. *See id.* at 499 (“[D]ouble-counting resulted in inflating the number of hours worked by more than 9,300.”).

367. *See id.* (“[S]taff attorneys involved in this case were typically paid \$25–\$40 an hour . . . [T]he regular hourly billing rates for the staff attorneys were much higher—for example, \$425.”).



complete candor in class action settlement hearings because “the adversary process does not operate and have the potential to expose misrepresentations.”<sup>368</sup>

## 2. *Expanded Duties*

The professional ethics rules governing attorney conduct assume that the attorney plays a defined role within a functioning adversarial system. Yet incentives sometimes align in ways that undercut this assumption within dispute resolution systems. Ethics authorities might address the gap by providing enhanced guidance for attorneys operating in these types of proceedings. A practical expansion may be accomplished by amendments to the ABA’s Model Rules or by individualized efforts by states to address the issue. State bar ethics opinions may also operate with some force to shift behavior.

In circumstances where adversarial failure regularly occurs, professional ethics rules should clearly and unambiguously expand an attorney’s duties in ways designed to increase the likelihood that a tribunal will render a well-informed decision. An expanded disclosure duty may serve to increase the likelihood that a tribunal will render a reasonably informed decision. Practically, the duty must include two distinct parts, an expanded duty of candor accompanied by an affirmative obligation to investigate.

### *a. An Expanded Duty of Candor*

Ethics authorities could respond to adversarial failure by requiring that attorneys operate under an expanded duty of candor in situations that resemble *ex parte* proceedings in substance, if not form. Massachusetts, at least, already embraces this premise with its official comment recognizing that when “adversaries present a joint petition to a tribunal, such as a joint petition to approve the settlement of a class action suit or the settlement of a suit involving a minor, the

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368. Ark. Teacher Ret. Sys. v. State St. Bank & Tr., No. 11-10230, 2020 WL 949885, at \*47 (D. Mass. Feb. 27, 2020).

proceeding loses its adversarial character and in some respects takes on the form of an ex parte proceeding.”<sup>369</sup>

The same dynamic may apply whenever an adversary simply opts not to contest an application for relief. Consider the dynamic in expungement-only arbitrations brokers now file against their employers. From an adjudicator’s perspective, there may be little difference between a joint application and an uncontested one. In each case, the adjudicator hears no opposition and only views evidence from one party pushing it toward a single outcome.

*b. An Expanded Duty to Investigate*

Yet an expanded duty of candor alone will not suffice. To avoid speaking any evil, attorneys may simply opt to hear and see little other than what their client tells them. Tribunals should not be deprived of reasonably accessible information simply because a lawyer opts to shut her eyes to obvious lines of inquiry.

A clear duty to conduct a reasonable investigation under the circumstances may address this issue. In instances where attorneys fail to disclose readily obtainable information to a tribunal, protestations that the attorney was not aware of the information should not remove all ethical liability.<sup>370</sup> This obligation might reduce the incentive to seek expungements in cases where readily available public information undercuts a broker’s claims.

*c. Disclosure’s Limits*

Changes to attorney ethics rules may do some real good, but they certainly will not entirely solve the problems that flow from attempting to resolve these issues through processes designed for adversarial parties to resolve private disputes. Disclosure-oriented reforms have not always shifted actual

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369. MASS. RULES OF PROF’L CONDUCT r. 3.3. cmt. 14A (2015).

370. Cf. Cohen, *supra* note 328, at 148 (suggesting that the ABA “add a comment to the definition of knowledge stating that the knowledge requirement does not negate or limit any duty to investigate or communicate that otherwise exists, and that the deliberate breach of these duties can be evidence of willful blindness and therefore knowledge”).

conduct in adversarial proceeding.<sup>371</sup> Even substantive disclosure requirements in securities class action litigation, requiring repeat plaintiffs to disclose prior litigation have not always generated expected disclosures.<sup>372</sup> Expanded ethical guidance must be accompanied by some real enforcement pressure to be effective.

Arbitration forums also present real challenges because the reach of attorney ethics rules may depend on the state. New York's federal courts have found that representing a party in arbitration does not qualify as the practice of law.<sup>373</sup> In contrast, California treats arbitration as part of the practice of law.<sup>374</sup>

As an alternative to state-by-state ethics changes, FINRA could make rules applicable to all representative advocates appearing in expungement hearings. It could enforce these rules by suspending or permanently barring violators from pursuing expungement relief for clients within its forum. This might generate a significant incentive to disclose readily available information that would be contrary to an expungement request. As a number of firms specialize in pursuing expungement requests for clients, the threat of losing access to the forum would be significant enough to shift behavior.

### C. Adjudicator Responses

#### 1. An Appointed Advocate

Adjudicators may also respond to adversarial failure by taking steps to restore adversarial scrutiny and increase the

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371. See Edwards & Rickey, *supra* note 39, at 1566 (“Disclosure-based reforms, however, have a limited track record of success and are unlikely to be a panacea on their own.”).

372. See Jessica Erickson, *The New Professional Plaintiffs in Shareholder Litigation*, 65 FLA. L. REV. 1089, 1135 (2013) (discussing absent disclosures in securities class action litigation).

373. See *Prudential Equity Grp. v. Ajamie*, 538 F. Supp. 2d 605, 608 (S.D.N.Y. 2008) (ruling that under New York law, arbitration does not qualify as the practice of law); see also *Siegel v. Bidas Sociedad Anonima Petrolera Indus. y Comercial*, No. 90 CIV. 6108 (RJV), 1991 WL 167979, at \*5 (S.D.N.Y. Aug. 19, 1991) (same).

374. See *Birbrower, Montalbano, Condon & Frank v. Super. Ct.*, 949 P.2d 1, 9 (Cal. 1998) (declining “to craft an arbitration exception to section 6125’s prohibition of the unlicensed practice of law in this state”).

likelihood of an informed decision. This idea has been raised before. Special masters have been proposed as a response to defects in class action settlement approval processes with one justice suggesting appointing a “devil’s advocate” to raise arguments against class action fee arrangements.<sup>375</sup> Delaware’s vaunted Chancery Courts have also considered recruiting assistances from an *amicus curiae* to overcome adversarial breakdown.<sup>376</sup> The PIABA Foundation also suggested a reform in this vein, arguing that “FINRA and/or the SEC create an investor protection advocate (“Advocate”) that is independent from FINRA to participate in every Expungement-Only case.”<sup>377</sup>

These ideas have real merit and may increase the likelihood that an adjudicator considering an expungement request will make a reasonably informed decision. At the very least, regular, experienced, and reasonably competent opposition would likely discourage some of the worst abuses.

## 2. Greater Control Over Process

Adjudicators could also take steps to mitigate adversarial failure by taking greater control over the process. Consider the benefits which might flow from adjudicators taking greater control over notice processes. At present, advocates enjoy substantial freedom to influence the notice process to increase the likelihood that they will receive favorable outcomes.<sup>378</sup> An adjudicator focused on increasing participation and surfacing information would likely provide notice in a different way.

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375. See *Laffitte v. Robert Half Int’l Inc.*, 376 P.3d 672, 691 (Cal. 2016) (Liu, J., concurring); see also William B. Rubenstein, *The Fairness Hearing: Adversarial and Regulatory Approaches*, 53 UCLA L. REV. 1435, 1475–77 (2006) (arguing for a devil’s advocate to evaluate substantive settlements in class actions).

376. See *In re Trulia, Inc. S’holder Litig.*, 129 A.3d 884, 899 (Del. Ch. 2016) (“[I]t may be appropriate for the Court to appoint an *amicus curiae* to assist the Court in its evaluation of the alleged benefits of the supplemental disclosures, given the challenges posed by the non-adversarial nature of the typical disclosure settlement hearing.”).

377. DOSS & BRAGANÇA, *supra* note 88, at 10.

378. See Humbach, *supra* note 340, at 995 (“While telling lies is definitely out of bounds . . . trying to bend others’ perceptions to the client’s best advantage is seen to be at the heart of good advocacy.”).

Notices would be crafted to encourage participation. They would be distributed repeatedly and with a substantial lead time before any hearing. A notice aimed at increasing customer participation would direct recipients to relevant information about any available pro bono assistance.

Improved processes would also distribute notice about the request more broadly to encompass all relevant stakeholders. State and federal regulators might opt to appear at the fact-finding stage if they were given notice and an invitation to participate. Investors with claims currently pending against a broker seeking an expungement might also opt to provide their perspectives and experiences with the broker. Essentially, adjudicators could shift the processes they use to solicit additional information in ways designed to encourage stakeholder participation.

### 3. *Eliminate Repeat Player Bias Risk*

In the expungement context, FINRA might attempt to eliminate the risk that arbitrators will favor industry interests in expungement hearings by removing the ability for parties to rank and strike arbitrators who hear expungement requests. To its credit, FINRA has considered and its board has approved a rule establishing a pool of arbitrators who receive additional trainings for expungements.<sup>379</sup> As the rule proposal has not yet been filed with the SEC, the precise contours of the rule remain uncertain.

A roster with additional training alone seems unlikely to substantially improve the process because selection effects will remain significant. The arbitrator selection process now allows brokers to cut known skeptics or arbitrators prone to asking too many probing questions from their list. As many expungement-only matters proceed without participation from parties with an interest in a skeptical arbitrator, the selection

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379. See Fin. Indus. Reg. Auth., Reg. Notice 17–42 Expungement of Customer Dispute Information 5 (Dec. 6, 2017), <https://perma.cc/HB2Z-YAV3> (PDF) (requesting comments on the proposed changes); see also FIN. INDUS. REG. AUTH., UPDATE: FINRA BD. OF GOVERNORS MEETING (Oct. 3, 2019), <https://perma.cc/ETT5-5S5W> (noting that the Board had approved the proposed changes).

pressures strongly favor arbitrators who routinely grant expungement requests. Removing the ability to rank and strike arbitrators in expungement matters would substantially mitigate this risk.

Importantly, the arbitrator roster for expungement matters should serve exclusively on expungement matters. Maintaining a limited, exclusive pool would generate real benefits. With a smaller pool, the overall cost of providing significant training would diminish. Setting the expungement roster aside from other customer or industry cases would also mitigate other selection pressures. The financial services industry always participates in customer or industry disputes and remains a repeat player, allowing it to accumulate knowledge about arbitrators. This creates pressure for expungement arbitrators to favor the industry to increase the likelihood they will be selected for other matters. In contrast, customers with disputes generally appear in the forum as single-shot players. Although past arbitration results are disclosed and some customer-claimant-side counsel operate as repeat players, the industry will generally have more knowledge and sophistication. The financial services industry always appears in these arbitrations as a party while customers will only sometimes secure representation from repeat player counsel. Completely insulating an expungement arbitrator roster from these selection pressures may do significant good.

Creating different rules for the expungement arbitrator roster and making it an exclusive body may also shift the way these arbitrators view their roles. In ordinary matters, the parties jointly select an arbitrator to resolve a dispute primarily concerning their interests. In expungement matters, the arbitrators must serve as gatekeepers for the public's interest in maintaining access to information. Although setting them up in this way falls far short of an alternative regulatory process, it would likely do significant good.

#### *IV. Conclusion*

Our system of securities laws relies heavily on disclosure to serve as disinfecting sunlight on the theory that when more information comes out, it will enable better decisions. In our dispute resolution systems, we expect adversarial processes, on

balance, to surface information and provide adjudicators with the information they need to make informed decisions. Yet these assumptions do not always hold. As this article shows, adversarial failure can leave adjudicators bereft of significant information. When these processes facilitate the deletion of public information, the failures affect society more broadly.

When it occurs, adversarial failure must be addressed to protect the integrity of decisions affecting significant groups of stakeholders. Although an ethics-oriented approach may shift behavior to a degree, it cannot entirely solve the problem. Ultimately, whenever adversarial failure occurs, society should consider alternative methods for deciding issues which better balance the interests at stake.