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SAC ROUNDTABLE DISCUSSION

Employment Issues in Securities Arbitration in the Wake of Epic Systems

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SAC: This is the sixth in SAC's series of roundtable discussions, in which people knowledgeable about and influential in the securities arbitration field will discuss issues and topics of moment in this area. The previous five podcasts are posted on SAC's YouTube Channel - easiest entry is from our Blog. This one will be available for viewing in early September.

SAC recorded this session on August 2, 2018 and picked, for our discussion topic the intra-industry or employment side of securities arbitration. Two recent events in this area guided the conversation: The U.S. Supreme Court decision in Epic Systems v. Lewis, *No. 16-825 (5/21/18), and the Broker Protocol disruptions (*see SAC, *Vol. 2017, No. 7, p. 1). Our group roamed more widely, though, covering promissory note cases, expungement developments, and more.*

This printed version of the podcast dialogue has been extended and modified in some ways and will vary from the actual transcript of the podcast. We thank our speakers for a stimulating and informative discussion. Their names are listed above and their credits appear in more detail at the end of this article. We ask our readers to understand that the statements, opinions, and projections of our speakers are their own personally and do not represent necessarily the views of the organization or institutions with which they are associated.

SAC: Dana, please tell us where things stand generally with respect to expungement and promissory note cases.

PESCOSOLIDO: Sure, Rick, thanks a lot. First, let me address the issue of expungement and then I'll move on to promissory notes. I think you're talking about the landscape here, and I think with respect to expungement, we're going to be seeing the landscape changing considerably, whereas on promissory note cases, it may be more just a trimming of the shrubs, so to speak. I'm not going to spend much time on these, because I know we want to get to the issue of *Epic Systems* and the Protocol.

The *Securities Arbitration Commentator* recently did a study on expungement cases, showing that brokers win expungement requests about 75 percent of the time, overall -- less often when it's part of the underlying case -- where they win the case but where the arbitrators have heard negative things about them. And, not surprisingly, they win more often than that, about 80 to 90 percent of the time, when it's after a settlement, or they file a separate case where the customers normally don't show up to tell their side of the story. And that's

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not inconsistent with statistics FINRA cited when it sought changes to Rules 2080 and 12805, which govern expungement, recently, when they submitted rule changes to the SEC.

But the really big news is that, in 2017, FINRA proposed sweeping changes, that I think are going to make it harder and more expensive for brokers to obtain expungement. What you want to be looking at here is Regulatory Notice 17-42. The comment period is now over, it ended in February, and the SEC's Investor Advocate's Office actually issued a letter in April, generally supporting these changes and making a few comments on them. But I think most of the people who live in this world fully expect most of the changes that have been suggested; they're going to come.

Just to give you a little bit of a highlight of what's coming, and we could do an hour on this very easily -- but just a real quick highlight. If a customer case proceeds to hearing, and the broker is named, he has to request expungement at least 60 days before the first hearing day. If he's not named, or if the case settles, meaning this broker doesn't really get his day in court on expungement, then he has to file a separate case at additional cost. The panel in that case is going to be sort of a blue ribbon, all-attorney panel, which has to be specially expungement-trained by FINRA. So that tells me they're going to be looking at attorneys, people with significant regulatory experience. You're not going to get what you would think of as public members. You're not going to get nurses on your panel. In order to grant expungement -- this is a big change -- it has to be unanimous. So the panel who hears your expungement request, no longer majority. It's got to be unanimous. And the panel also has to find, in addition to what they already have to find under 12805, that no investor protection or regulatory value exists with regard to the information that would be expunged. Pretty high hurdle! I think it's going to change things. In addition, from an expense standpoint, no more telephone hearings. Hearings will have to be in person or by video conference. So, it's going to be more expensive for brokers to go to the forum, have their attorneys go to the forum. It's going to add a lot. I think that really changes the landscape.

So for a while now, brokers have been winning maybe 75 percent of the time that they push for expungement, I think these changes are coming maybe this year, maybe later this year, and I think these win rates are probably going be going down.

Let me turn now to promissory note cases, because Rick mentioned in his introductory remarks that the number of these cases is ebbing. But it's still pretty significant. If you look at FINRA'S statistics page, you'll see that about 300 cases were filed in 2017. Still a fair number of cases. That is down about 40 percent from 2014. So, it went from almost 500 cases, down to under 300 cases.

Why is this? I don't know. I think we can all speculate. Is it because stable

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markets beget stable brokers? They're making good money; they're not as incentivized to leave. Maybe there are more early settlements and cases are avoided, so the filings aren't there. No one really knows for sure why this is. I suspect if we get into another hot market for brokers, these cases will come back up, in terms of their number.

Now, the conventional wisdom on these is that the firm always wins, and they're not worth fighting. I'll tell you, I've done a lot of research on this. I'm working with Rick now on an article that may get published in the relatively near future. I've done statistical analyses from 2015 through 2017, and I have to tell you, this conventional wisdom that the firm always wins, it's not entirely true. When registered reps are represented by counsel, and they fight the case all the way through hearing on the merits, firms didn't always win everything. They only won 100 percent of their principal about two-thirds of the time. So one-third of the time, the firm got less than 100 percent of the principal back, and they may have wound up owing the broker some money.

They only won attorney's fees about half the time, even though the promissory notes all say the firm is entitled to attorney's fees. And they only won pre-award interest under the note about 60 percent of the time, even though the promissory notes all provide for pre-award interest, often at higher default rates under the note. So it's only about half the time that they win these extras, and they only win 100 percent of the principal about two-thirds of the time.

Brokers who file counter-claims got satisfaction about 25 percent of the time. About three out of four cases, the broker's counter-claims were simply thrown out, but 25 percent of the time they got something, and at about one out of five cases, they completely washed out the firm's claim, and in some cases won net awards.

Now, there's no reason to think this is going to change any night anytime soon. I know we're going to discuss Rule 13806 soon, but I don't really think that's going to change the results. It's more procedural than substantive. Yet, as a mediator. I'm seeing a disconnect between what both sides see as winning cases versus what the real-life statistics show.

You know, these inflated statistics that get thrown around -- like firms win everything, 90 plus percent of the time -- that includes brokers who don't even post, and brokers who represent themselves, and they get hammered. It seems, in these cases, that both sides are more intransigent in their positions than what I see in customer cases. It seems like, in negotiating these cases, the best defense brokers seem to offer is, "I can't pay." And then they work out a deal.

But like I said, I'm currently working on an article with SAC. Now, hopefully the statistics that we can put into this article will serve as a guide, hopefully to help parties better appreciate the realities of these cases and how they get decided once they go to hearing. And I know, statistics, statistics. There's lies. There's damn lies and then there's statistics. We've all heard that. But if you take statistics with a grain of salt, they can be helpful in guiding our thinking, and getting folks to better assess the value of their cases.

So that's it, Rick, on expungement and on promissory note cases. Back to you.

SAC: Well thanks, Dana. Those are some interesting statistics. I look forward to your article. Jim, can we spend a few minutes just talking about panel composition in promissory note cases, a la FINRA Rule 13806.

KOMIE: Sure, Rick. As our audience may know, promissory note cases have their own special code provision at FINRA, Rule 13806, which was adopted in 2009. And the idea behind the adoption of a special rule for prom note cases I think was a good one. to try to simplify and streamline these cases. As Dana noted, these cases, prom note cases, do comprise a significant part of FINRA's docket. And so I think the goal of adopting a special prom note rule was a good one.

Now, the difference between the prom note rule and procedures under the regular FINRA arbitration rules principally has to do with the number of arbitrators you get, and also there's a provision for having a case heard on the papers, if the broker files an appearance, but does not answer or file a counter-claim.

The thing is, in my experience, that almost never happens, meaning the broker almost never simply files an appearance -- and the cases really aren't being heard on the papers only. Thus, the efficiencies that were, I think, the target of the changes in Rule 13806 really haven't been achieved. We are still facing protracted proceedings in these cases. Brokers almost always file defenses or counter-claims, and thus the cases go on for a year or two. That includes cases that, I think, if the case was being heard in court, the firm would be able to get rid of the defenses or counter-claims by motion. But that's not possible in FINRA's forum, as everyone knows.

So, at this point, I think FINRA should realize or face up to the fact that the prom note rule really isn't achieving what it was intended to achieve, and should consider making some additional modifications. Maybe something like the new simplified arbitration rule, which was recently promulgated, providing for a telephone hearing, with limitations on the length of presentations by each side. Each side gets two hours for its case in chief, half an hour for rebuttal, and limitations on the examination of witnesses. The rule puts more of the burden for questioning on the arbitrator. Maybe something like that. The details of a fix are beyond the scope of this discussion today, but I do think it's something that FINRA really should consider because, as Dana pointed out, even though prom note filings are down, they still are very significant part of the FINRA docket. 300 cases in 2017, and so I think it would be helpful for FINRA to take another look.

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SAC: That's a good suggestion Jim. We'll have to see how those new improvements work in the simplified cases. Alright, Jeff, could you walk us through the current rules framework governing employment cases generally?

LIDDLE: Sure. Employment cases can arise in many different contexts, so there are several rules and several areas within the overall set of rules that set forth different panel composition issues and different procedures that might be utilized. We're all familiar, I'm sure, with the sort of "normal" employment case where an employee, whether a broker or investment banker, brings a case against a member firm, and in that case, we have the requirement that the three arbitrators be two public and one non-public, and that the chairman must be a public arbitrator.

There can also be a promissory note case that is started either by the associated person or by the firm. If started by the firm and there's no counter-claim, it's going to be a one-arbitrator case, and there's a defined number of qualified arbitrators for those cases. If it's started by the firm, and the associated person brings a counter-claim on some other issue -- failure to pay a bonus, wrongful termination, or some other issue -- the arbitration panel will be, as it is in the normal course of what I described earlier as a regular dispute.

These cases are very much the standard and, shall we say, the most common cases that are brought. We're also focused recently on the statutory discrimination cases, because those cases require that both sides cannot agree to arbitrate those cases in advance of the dispute arising. Both sides are required to be willing to sign a submission agreement, and this usually requires some level of negotiation in advance as to whether or not the statutory discrimination case is best in FINRA arbitration, or at a different arbitration forum, or in court.

Several of the member firms have provisions requiring that statutory discrimination cases be held at the AAA, or some other forum. You can have those different rules apply to these cases, but if a statutory discrimination case is going to be held at FINRA, the arbitrator's qualifications are laid out in some detail in Rule 13802. 13802 requires that the chairperson have a number of qualifications, including a law degree, membership in the bar, substantial familiarity with employment law, and 10 or more years of legal experience, of which five must be in either a law practice, teaching law, government enforcement, equal employment opportunity statutes, experience as a judge, an arbitrator, or a mediator, or experience as an equal employment officer or in-house counsel of a corporation. These qualifications trim down the list quite a bit, and they are applied either to the single arbitrator or to the chairman of the three arbitrator panel.

Now, you start to have a little bit of a divergence as to who's going to be on your panel and how this is going to be organized when you get to the raiding cases. You could have a raiding case that's a member-member case, and their selection to that panel is governed by 13402(a). You can have a raiding case with a member actually suing, more along the lines of a non-compete, the associated person instead. That's governed by 13402(b). The difference is where the claim is all members, the panelists are all non public arbitrators. Where the case is a member versus an associated person, we go back to the two public, with one of them as chairman, and one non public arbitrator.

SAC: This seems a little curious, doesn't it Jeff? I mean, raiding disputes are quintessential member or industry kinds of disputes. Funny that FINRA would require the use of public arbitrators in those cases?

LIDDLE: Well they're quintessential industry disputes, but I think you have to take a look at the sections of 13402, because there could be a case that's essentially a raiding case, but it's against a former employee to try to proscribe the former employee's conduct without just going after the new employer to seek an injunction. When that occurs, then 13402(b) comes into effect, and you go back to the other type of panel composition.

SAC: Right.

LIDDLE: Other than that, the rules have become very, very detailed over the years on a number of points, and they include the two major sections on statutory discrimination cases, 13802 and 13803. They include an extensive and detailed set of procedures with regard to seeking either temporary injunction orders or permanent injunctive relief, when you go to court, when you can't go to court, and of course, there are rules with regard to these expungement cases and with regard to the promissory note cases that were discussed a little bit earlier.

SAC: Okay. But let me ask you...

LIDDLE: The one thing I would just add is that many of the expungement cases - at least that we handle - don't arise out of a customer case. They arise out of some sort of a "yes" answer to the item 7 questions under Form U5. And in those cases, the procedures that'll be followed will be very similar to any of the normal, regular employment law cases with a standard of expungement that will date back to that 1996 standard that simply, without any of the excess baggage, that there must be a finding from the panel that the U5 was defamatory in nature.

SAC: That gets to what I wanted to ask. Thanks, Jeff.

George, let's move on to the *Epic Systems* matter, and what it might mean for the employment arbitration cases in the securities field. To start us off, I'd like you, as our resident professor of law, to briefly describe the case and the core holdings.

FRIEDMAN: Sure. In 2017, the Supreme Court granted *cert.* in three cases that all are quite similar. The core issue was this: the National Labor Relations Act has a section saying employers can't

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interfere with "concerted activities" of employees. The Court addressed what that meant, as regards to the Federal Arbitration Act, specifically, if an employer uses a class action waiver, is that interfering with concerted activities of employees? The National Labor Relations Board sure thought so, and there were several decisions where they said employers can't use class action waivers in an arbitration clause. The circuits were split on this, and the Supreme Court took up the issue. And the core issue again was, which statute wins, the Federal Arbitration Act or the National Labor Relations Act?

What did they hold? In May, there was a 5-to-4 decision authored by Justice Gorsuch - as an aside, what's interesting is that he didn't ask a single question at oral argument. So, although I was fairly certain he'd come down on the pro-arbitration side, I wasn't positive because he didn't ask a question. Nevertheless, he authored the majority opinion.

There are three prongs to it. The first part says, look, under Section 2 of the Federal Arbitration Act, the courts must enforce the arbitration agreement according to its terms. Then it moved on to the question of the apparent conflict or tension, if you will, between the Federal Arbitration Act and the National Labor Relations Act, and the majority said, "Well, Congress, if it wants to ban arbitration, knows how to do that." Literally, that's what the quote said. And in that case Congress will explicitly say, "No arbitration." For example, Dodd-Frank says "no arbitration" of SOX whistleblower disputes. And in the Opinion, Justice Gorsuch goes through a long list of cases dealing with the Federal Arbitration Act and apparently conflicting federal statutes, and said, "We've said several times, if Congress means to ban arbitration, it will say so explicitly," quoting *Gilmer*, *McMahon*, *Rodriguez*, a lot of our favorites.

The third prong is often overlooked, but I think it's important. It dealt with deference to the federal agency. Most of us know about the *Chevron* holding, which basically gives deference to an agency's interpretation of the statute it is interpreting or applying. And the Court said, "Right, interpreting or applying that statute. The National Labor Relations Board is charged with applying and interpreting the National Labor Relations Act, not the Federal Arbitration Act." The NLRB was found to have gone outside its jurisdiction, if you will, and so the Court said, "We're not giving deference to your interpretation of the Federal Arbitration Act."

So, in a nutshell, that's what the case was about, and that was the holding.

SAC: Let's talk more about where the class action waivers came from. Before *Epic* there was *Concepcion*, another case that held that class action waivers in the consumer context were permitted under the Federal Arbitration Act. After that, Charles Schwab, as you remember, started using waivers in its customer account arbitration agreements. And FINRA went after Schwab. George, please provide some background on the *Schwab* case, and then relate that, if you would, to employment arbitrations.

FRIEDMAN: Sure, and again I can be brief. Basically, *Concepcion* comes down in 2011 and says class action waivers in consumer contracts are permitted. Schwab then started putting these in their customer agreements. As Rick said, FINRA took objection to that, and said, "Look, we got two rules we think you're violating." Rule 12204, among other things, says the customer can participate in a class action if they so choose. They don't have to go to arbitration. They can't do both, but the customer has an absolute right to go to arbitration, or participate in the class action. So this class action waiver is a problem, and it's compounded by Rule 2268, which has all kinds of language about customer agreements and what can be in the arbitration clause." FINRA noted that there's a provision in Rule 2268 that says you can't limit the right the customers have under the rules. So they went after Schwab. The hearing panel agreed there was a rule violation. It said Rule 12204 is quite clear, as is Rule 2268. But the hearing panel went with Schwab saying, "yes, but FINRA is preempted. The *Concepcion* decision preempts FINRA from legislating against class action waivers." Long story short, the FINRA Board called the case, which it can do, and reviewed the decision and affirmed on the violations. They said, there was a clear violation of the rules. But they said the rules are <u>not</u> preempted by *Concepcion* and the Federal Arbitration Act.

So, in a nutshell, where the hearing panel held several rules had been violated, the Board was with that, but they disagreed on preemption and said the rules on class actions - 12204 and 2268 - are not preempted. So that was the holding, and whether *Schwab* carries over to employment, I will answer: no, I don't believe it does.

SAC: Why's that?

FRIEDMAN: Well, there is a Rule 13204 in the Industry Code that clearly governs the rights APs have to participate in a class action if they so choose, but there is no Rule 2268 analog. There's no 2268-type rule on the industry side that says what you can and can't do regarding employment arbitration agreements. So while I have no doubt that FINRA would be troubled by a firm starting to put class action waivers in employment agreements, I think they will have a problem challenging that as things now stand.

The first thing a firm opposing this would say is, "Well, okay, let's go look at *Schwab*." Why? Because the Board in their decision said, "By the way, this doesn't apply to employment because there's no Rule 2268 analog, number one. And the opposing firm will refer to Reg Notice 16-25, which says the same thing, there's no analog on the industry side regarding employment arbitration agreements. So my bottom line at this stage, in the absence of a 2268-type rule on the industry side, coupled with the Board's language and FINRA's own

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language in 16-25, I think the analogy fails and it does not carry over as the rule currently exists on paper.

SAC: So what would you do about the current situation, then, since it seems to be in a very uncertain state?

FRIEDMAN: As you know, I wrote a feature article in *SAC* on this, and at the end of the day, I tried not to be a former director, but I did have some advice for FINRA on this, kind of going backwards. I think in the long run, FINRA should give employees a choice. Just have the analogy complete; whereas class action waivers are banned on the customer side, I think they should be banned on the employees' side. That's in the long term. In the shorter term, I don't think they can do that without promulgating a 2268-type rule. So in the intermediate term, they need to do that, in my opinion.

In the short term, I think FINRA should get a notice out very quickly stating its views on this issue, as in, "Look, we know all about *Epic Systems*. Here's what we think and what we're going to be working on. We're going to be taking a look at this." And I would think, as was done in 1999, almost 20 years ago, regarding expungements, they might declare a moratorium and say, "Look, until we figure out where we're going on this, firms should not be putting class action waivers in employment arbitration agreements." I think Reg Notice 16-25 gives them the authority to do that and that's what I would do in the very short run.

SAC: Thanks, George. Jeff, I want to call on you next. Some of the larger houses it seems have already adopted class action waivers in the employment agreements and, perhaps coincident with that, they've also looked to other forums to arbitrate their disputes, such as JAMS and AAA. Now, you've had, as I understand it, experience in those forums. I'd like to hear from you about the difference among the other major forums, compared to FINRA. And also give us a little bit on Reg Notice 16-25, please.

LIDDLE: Right, well, I think, Rick, that the first area to consider is this 16- 25, because until it came out, there had been a significant amount of both litigation in the courts and consternation among lawyers for employees, that some of the firms had made it impossible to go to FINRA by entering into pre-dispute arbitration agreements. One noted one of which was, of course, the one that had a mediation requirement, and then arbitration at JAMS. And when RN 16-25 came down, it pretty much set forth two points: one, that the rules could not be interpreted to allow an associated person to waive his right to a FINRA forum, and two, that if a firm tried to do that, that it would be considered a violation of the old standby rule 2010 on the standards of commercial honor and principles of trade.

So, FINRA only recommended that there is an agreement or a sentence accompanying any pre-dispute arbitration agreement, which might deflect you off into AAA or JAMS or some other forum, that the agreement itself does not prohibit or restrict you from filing an arbitration claim in the FINRA arbitration forum, as specified in FINRA rules. Jumping from that to the issue of class arbitrations, yes, class actions are allowed at the AAA. They have a whole supplementary set of rules on class actions, and it's been our experience that, although we've had a lot of cases that I think we would describe as the collective kind of group actions, the idea of bringing a class action in any one of the arbitration forums has numerous problems associated with it. I think just in the concept of, how is it going to be managed and is the forum capable of devoting the kinds of resources that would be necessary, that none of these sources would necessarily be good to have a class action.

SAC: What would arbitration practice be like at AAA and JAMS? I'd like to hear from you about how they compare to FINRA. Do you see the forums as different in any way?

LIDDLE: Oh, clearly! I think that you can probably sum up these forums in one or two sentences each. I think JAMS is a great place, but it's very judge heavy, and the proceedings are very formalistic -- in the sense of rules of evidence, motions for summary judgment, motions to dismiss even, and some amount of deposition discovery.

AAA has some discovery and it also has dispositive motions long before the hearing. Both of those forums are lacking, at least in my opinion, one of the things that's crucial to FINRA's success in handling these cases, which is there's no adherence to the arbitration rules of FINRA, which obviously have to be vetted and go through SEC approval. Nor is there any requirement that any of the arbitrators have any type of actual expertise in industry practice. With the advent of so many public arbitrators in these various cases, that's less of an advantage at FINRA than it used to be, but it's still there in virtually every case they hear. You've got at least somebody who has some experience in the industry and might understand the difference between a commission and a sales credit, for example.

I think FINRA is far superior in that regard. It's also far superior with the limitations that are placed on discovery and the like. To limit the use of dispositive motions represents a real plus for the FINRA forum as well.

SAC: Thanks, Jeff. I'm going to move over to George. I wanted to go back to the Supreme Court just for a moment if we could. We have a new Supreme Court Justice coming on. It may be Brett Kavanaugh, who's before the Senate right now for approval. What difference is that going to make, in your opinion, if there is a new Justice Kavanaugh on the Court?

FRIEDMAN: Well, I think he's going to be Gorsuch 2.0. *SAC* had a couple of excellent blog posts analyzing his decisions; for the most part they're pro-arbitration. He actually confirmed an NASD award dealing with arbitrators excluding evidence. I think we'll see more five to four votes. But I think

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he'll be a reliable pro-arbitration vote, whereas Kennedy was not always reliable. I think that's where the difference will lie. I think also, he'll be for limited review of arbitration awards.

One of the opinions I read indicates that he's going to be a little bit tight on agency deference. Not that there's time now, but readers should certainly look at the print article in *SAC*. I think SEC and FINRA will be put to the test and should not assume automatic deference from him.

SAC: Okay, thanks, panel, for that discussion on the *Epic Systems* case and the employment arbitration landscape. I'd like to shift to our final topic.

Several years ago, key broker dealers entered into a Protocol to address raiding. That Protocol has lasted and shown durability in the last 15 or so years. Lots changed over the last couple years, and Jim, I wanted you to talk about whether you think the Protocol may be expiring or evolving. You might describe the Protocol a little bit for us too.

KOMIE: Sure. The Protocol sets forth rules for member firms and financial advisors who are moving between firms to follow in connection with transitions, and provides that, if you follow the rules, then there's going to be no litigation.

As you said, Rick, it was adopted a number of years ago, maybe 10, 12, something like that.

SAC: Has the Protocol worked, Jim?

KOMIE: I think it has worked by and large. Both Dana and I were involved in this type of litigation in the bad old days. It used to be that there were TRO actions filed basically every week. One week the firm would be in court as a plaintiff acting outraged, and then the next week the same firm would be on the exact opposite side of the issue. It was getting a little silly, honestly, so they put together this Protocol and I do think it has really, really reduced the number of these cases that go to court.

Wth that background, it sets the stage for the recent development that, I think, we want to discuss here, which is that, at the end of last year -- Morgan Stanley in November and then UBS in December -- dropped out of the Protocol. One of the founding member firms and another very early member of the Protocol! There was some concern that that would lead to the quick unraveling and end of the Protocol. But there really hasn't been the rush for the exits that people were predicting. The other big firms, by and large, have stayed in the Protocol.

In fact, since Morgan Stanley and UBS withdrew, more than 100 new firms have joined. The new joiners have been RIAs or small independent firms, by and large. That's been the trend for several years and indeed was one of the reasons that Morgan Stanley cited for dropping out. They were sick of losing brokers to these small firms that joined the Protocol. It was only a one-way street to those small firms, without any reciprocity of brokers being hired from those firms by Morgan Stanley.

When people ask me, "What about movement, is there still a lot of movement going on between firms?" I'm not a recruiter obviously, but my sense is that hiring has slowed. Much of the movement has been to these RIA or independent firms. It certainly does seem to be the flavor-of-the-month in the industry. But the pendulum usually swings back in things like this. I think we may eventually see movement back to the wirehouse firms, especially if they start offering the kind of money that they once were. I hate to be cynical about the matter, but no matter how much some brokers may claim it's about "freedom" or getting out of the wirehouse environments so they can make the right decision for clients, for some of them it is really about the money. They will soon enough be looking to replenish their bank accounts and be willing to take a deal with one of the big firms.

SAC: Sure, that makes sense. Dana? Jeff? Do you have anything you want to add to our discussion?

PESCOSOLIDO: This is Dana. I'll say that there's been a lot of discussion about, could there be a Protocol version 2.0 that maybe Morgan Stanley, UBS would be willing to sign on to. I don't think that's going to be viable. I think some of the biggest objections that the big firms like Morgan Stanley and UBS had was being victimized, as Jim said, by the RIAs. But also the fact that, even among the bigger firms, there wasn't an all-in for the enterprise concept. In other words, you could have a bank with a broker affiliate, and the broker affiliate could opt in to the Broker Protocol, but then specifically carve out certain divisions, or the bank affiliated registered reps. That was a real problem, because you'd have people going back and forth between the bank side and the brokerage side, and some would say, "Well, we're not a member of the Protocol." "But your affiliate is." And they'd say, "So what?"

I think part of the problem was that a lot of the people were upset because these bigger firms who had affiliates and non-affiliates and non-bank-affiliates and BD affiliates, they'd be carving people out, which didn't seem right to them.

The other one was, there was no mandatory minimum sign on period. So you get these guys leaving for an RIA and just before he leaves, he creates his RIA as an entity and opts into the Protocol. Then he complies with the Protocol when he leaves the big firm, and then a month later, after he's complied with the Protocol, he drops out of the Protocol. I think a lot of people objected to that concept. I think until you get people on board and get unanimity with respect to at least those two situations, you're not going to see a Protocol version 2.0.

I agree with Jim. The withdrawals from the Protocol have been very few, and it's like, what is it Jim, something like 1700 members in it? It's huge.

KOMIE: That's right, yes.

PESCOSOLIDO: That's a huge number. That to me, I don't think you're

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going to see it collapse. Whether or not Morgan Stanley, UBS ever get back in, I don't really think matters all that much. I think what would be more interesting to see is, when cases actually start coming out and you get a Morgan Stanley or UBS broker who goes somewhere else, which is in the Protocol. If he follows the Protocol standards, meaning only taking the five fields of information the Protocol would permit, how are the arbitrators going to feel about that? I think that will be very interesting when it starts to happen.

SAC: So Dana, in your observation, since this change in the Protocol with the firms leaving, has it changed the landscape of raiding disputes, particularly at the beginning of the process with the calls for injunctive relief?

PESCOSOLIDO: No, I don't think so. Rick, I think the Protocol by its own terms specifically excludes raiding cases. Those cases really never were covered. Multiple broker defections causing significant injury to a business unit was being alleged. I think there's probably a diminution in the injunctive practice, but I think in terms of the cases carrying forward, I just checked FINRA's website, the statistics page. I think at the end of June, 18 raiding cases have been filed, which suggests 35 or 40 cases for the year, which would be on par with previous years.

I'm not saying that the Protocol hasn't had some effect on raiding cases. I did that study a couple years ago where I looked at win rates before the Protocol came in and win rates after. Before the Protocol came in, firms claiming raiding won 2/3 of their cases. After the Protocol came in, they only won half their cases. Which could be that, maybe, arbitration panels were more accepting of the standards that the Protocol permits, or the fact that the Protocol exists would suggest an industry standard or something. But disputes still exist and awards are still being given; I don't think there's any change about that. I still get a lot of calls about that. Jim, you'll remember that 2003 conference that we did in Philadelphia where we issued that report, *A Search for Consensus*. So there's still requests for that out there as well.

Yeah, Rick, I don't think much has changed in the raiding context. I think it's maybe a little harder to win a marginal raiding case where you don't have really good facts, but other than that, I don't think too much.

SAC: Dana, is there anything to report from the most recent Fischer and Phillips Broker Recruitment Seminar?

PESCOSOLIDO: As you know, we signed confidentiality agreements when we go to that, Rick, so I'm pretty tied in there. But I will say this. There's a sort of general consensus among those who attend these conferences that the Protocol is injured because of the departure of a couple of big firms. Some say it's on life support, others say no, it will continue, but in this sort of slightly degraded state.

I think a lot will depend on whether the other big firms decide to opt out as the next year or so moves on. If you lose the big firms, which represent a disproportionate number of brokers, then I think you may see the end of the Protocol. I don't think that regional firms or RIAs have any interest in going into the Protocol to protect themselves against each other. They go into the Protocol to protect themselves against the wirehouses.

SAC: Anybody else? Further remarks on that? Can we finalize this discussion?

Well, thanks. Thanks to you all for an excellent program. I want now, before we wrap up to ask each of you if you want to join in to make your predictions for the future about the topics that we discussed. George, if you'd lead off, I'd like you to talk about FINRA and where it's going to land.

FRIEDMAN: I think they're going to do what I suggest and class action waivers will be banned on the employment side. The wild card is whether one of the firms challenges the preemption argument because Schwab accepted the Board's decision. I think three years from now they're going to do what I say.

SAC: Okay. Jeff? You choose your topic. Financial industry, employment cases, FINRA or AAA. Who will have the most?

LIDDLE: I think that there's no question that FINRA will have the most. The real question is how many will there be three years from now, because I see a general decline in the number of cases and there are a lot of factors for that, certainly on the institutional side that relates to so much deferred comp being used to settle matters before they get to litigation. On the retail business, it's obviously changing greatly and the issues there are much less frequent, I think, for compensation related issues.

I think FINRA, for sure. I would also say one of the reasons would be that as long as the claimant in these cases, i.e., the employee, has a choice, it is highly unlikely that they'll choose a non-FINRA forum.

SAC: Let's hear next from Dana for his final remarks. You've already talked to us about whether or not you think the Protocol will still exist. Is there anything else you're able to foresee?

PESCOSOLIDO: I think one thing is clear and that's expungements are going to get tougher. There's probably going to be more careful selection by the brokers attorneys about what cases they think they can get it in. I think they already do a pretty good job of that.

I sort of bemoan the loss of the explained decision that you get in there because it's about the only time that you get a window inside the thinking of arbitrators and what's important to them. If you really took the time and read all of the expungement awards and understood why arbitrators grant expungement, is it really about the broker, is it about the claimant? It's sort of an interesting

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exercise. If you had unlimited time you could read them all, but...

SAC: Jim?

KOMIE: Sure. For my crystal ball prediction, I'm going to have to disagree a little bit with Dana about the future of the Protocol.

SAC: Oh good.

KOMIE: Although the Protocol did not evaporate, I do see continued pressure on the Protocol and changes ahead. The pressure won't come from competitive concerns, but from regulatory exposure on the privacy issues that are inherent in the taking of information that the Protocol allows. Raymond James got fined a few years ago with respect to privacy issues and its hiring practices under the Protocol.

It was very recently reported that Wells Fargo sent out an amended privacy notice to clients giving them the option of opting out of information sharing under the Protocol if their broker leaves the firm. Also that Wells Fargo created a database available to its brokerage force, showing which clients have opted out. Personally, I can't imagine that Wells did that, took those steps, of its own accord. I have to assume that FINRA was involved behind the scenes in some fashion, and that we may eventually see some sort of AWC announced.

I think that such regulatory pressures will continue to impact the Protocol and that there will be possibly some sort of Protocol 2.0 or maybe even two competing Protocols, the original one and a modified one addressing some of these privacy issues.

SAC: So, the Protocol's future may be impacted as much by regulatory pressures, as by the recruiting dynamics. Complex stuff! I want to thank you all for an excellent program. Dana, George, Jeff, Jim. Great job! And thank you too, audience, for your attention.

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Richard P. Ryder is the founder and President of Securities Arbitration Commentator, Inc. (SAC) and Editor-in-Chief of SAC's publications. SAC has been continually publishing since 1988 and today offers a variety of products and services designed for lawyers, experts, neutrals and academics in the field of securities arbitration and litigation. Mr. Ryder has, in his long career, worked as District Counsel and Director of Arbitration (NASD), head of litigation and advisory afairs with a national wirehouse, a litigator, mediator, arbitrator, and expert witness. He is also a member of the Board of Directors of the Securities Experts Roundtable.

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Dana N. Pescosolido retired from the active practice law in 2015 after thirty-six years representing all elements of the securities industry: firms, register representatives and customers. During a twenty-five year career in private practice, which included heading up the securities litigation group at Saul Ewing, followed by eleven years as Deputy General Counsel at Legg Mason, he handled or supervised well over a thousand cases of all varieties. In addition, he co-founded what is now known as the Fisher and Phillips Broker Recruitment seminar. He now serves as a FINRA-approved mediator, limiting his practice to securities-related matters. consistent with his expertise, and has made a valuable niche for himself as an author, writing articles based on research dealing with arbitration results and trends in the areas of customer cases, recruiting/raiding cases, and promissory note cases.