SECURITIES ARBITRATION ALERT 2017-30 (8/9/17)

SECURITIES ARBITRATION COMMENTATOR

SAC

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SAC GOES TO PRINT: *In the upcoming edition of the* Securities Arbitration Commentator *print newsletter, which will be distributed at the end of next week, we feature an article commemorating the 30th anniversary of* Shearson v. McMahon. *SAC Contributing Legal Editor and ADR consultant George Friedman discusses the case, the holding, and its impact on securities arbitration and dispute resolution in general. The article also features the recollections and observations of numerous individuals from varying perspectives, from the advocates themselves to other lawyers in the field, whose careers were impacted by SCOTUS's big game-changer. This article is a tribute to the arbitration process that* McMahon *catapulted into the limelight and a reminder of the impact of the law on society and our system of justice. Please watch for your copy of* SAC *to cross your desk. This issue is a souvenir edition!*

PLEASE NOTE: *Due to the length of this email, the full Alert may not show in some email accounts. Click "View entire message" at the bottom to open the whole Alert.*

SECURITIES EXPERTS ROUNDTABLE: LOOKING INTO THE CRYSTAL BALL. ***The annual Meeting and Conference of the Securities Experts Roundtable (SER) took place on Friday and Saturday, July 28-29, 2017 at the Union League Club in downtown Chicago and the workshops focused on the source of future claims.*** This membership organization, which is now nearly a hundred strong, has been meeting yearly since 1992 (25 years) and training, educating and assisting experts in their development as testifying witnesses in litigation and arbitration on an increasingly robust basis. In addition to the Annual Conference, SER operates a website that provides a library of securities-based materials, an email server to encourage member communications and referrals, and a search directory that allows attorneys to find experts that suit their case needs. At this July Conference, Ross Tulman (OH) replaced Jeffery Schaff (IL) as President of SER and Gordon Yale (CO) assumed the post of President-Elect.

The Program

While every conference on securities arbitration asks the question, "Where will the new claims come from?," solid predictions rarely follow. At SER, the President-Elect serves as Program Chair, so Mr. Tulman took direct aim at this question in shaping this Conference. Thus the morning program on Saturday was dedicated to three workshops in a row, all dealing with potential problem areas in the securities markets: private placements; fixed income; and investment advisors.

The first panel on "Due Diligence" (SER Members Bruce S. Foerster (FL) & Gordon Yale (CO)) delved into the "red flags" of fraud that forecast trouble with private placements, the importance of access to proper due diligence, and the role of the banker and broker-dealers who package and sell the securities. "Fixed Income Cases: Interests Rates Up? Next Big Wave," (SER Members Jerry Denigris (NJ) and Gerald A. Guild (NY)) focused on the accelerating impact of interest rate increases as yield or coupon rates go up and a similar effect as durations extend. Finally, Geraldine Genco Dube (FL) and Sander Ressler (FL) described the differing dynamics between an expert's approach to an RIA case, as contrasted with the more familiar broker cases.

While these presentations were somewhat technical in nature, the pivot point for fixed income (and private placements to a degree) relates to a lengthy low-interest rate environment in which retirees and other vulnerable investors have been "chasing" yield. Similarly, the two factors impressing attendees about investment advisor cases relate to the "vacuum of regulation" for RIAs vs. BDs (far lengthier exam cycles, no capital requirements, fewer regulations) and (could there be a correlation?) the huge number of brokers that have migrated to the RIA space in recent years.
*(ed: **The Wall Street Journal *(7/27/17) reported days before this Conference that the number of firms providing investment management (w/ discretion) and financial planning to individual clients (AUM >$100M) had grown from about 700 in 2002 to almost 4,000 in 2017. Even more striking, AUM has grown in that time to more than $5 trillion in 2017 from $500 billion (2003)! **FINRA published an "Investor Alert" back in March 2017 that warned of the impact of duration (time to maturity) on bond prices (see SAA 2017-13).)* (SAC Ref. No. 2017-30-01)

FINRA ODR AUGUST WEBSITE ADDITIONS. ***On August 2nd, FINRA announced by email several all-new updates and additions to the "Arbitration and Mediation" part of its Website.*** First, as reported in SAA 2017-27, FINRA filed with the SEC on July 10th SR-FINRA-2017-025, *Proposed Rule Change Relating to Revisions to the Definition of Non-Public Arbitrator.* It is described on the Website as "a proposed rule change to amend FINRA Rule 12100 of the Code of Arbitration Procedure for Customer Disputes ('Customer Code') and FINRA Rule 13100 of the Code of Arbitration Procedure for Industry Disputes ('Industry Code' and together, 'Codes'), to define a non-public arbitrator to mean a person who is otherwise qualified to serve as an arbitrator, and is disqualified from service as a public arbitrator under the Codes." The proposed rule was Noticed in the *Federal Register* on July 28th (Vol. 82, No. 144, P. 35248). Another item also covered in SAA 2017-27 advises that the Board authorized FINRA to publish a Regulatory Notice soliciting comments on, among other changes, "proposed amendments to FINRA's Membership Application Program rules to provide FINRA staff with rule-based authority to presumptively deny a new membership application if the applicant or its associated persons are subject to pending arbitration claims."

Upcoming Events
Third is an announcement that the *2017 Securities Dispute Resolution Triathlon* will take place October 14-15 at the lower Manhattan campus of St. John's University School of Law (see SAA 2017-14). The *Triathlon*, which now has its own Webpage, "is a joint initiative of the Hugh L. Carey Center for Dispute Resolution and the Financial Industry Regulatory Authority (FINRA)." The Authority encourages local FINRA neutrals to sign up to serve as judges, mediators and arbitrators. Any FINRA arbitrator or mediator is eligible to serve. Next, as reported in SAAs 2017-26 & -25, the Practising Law Institute's *Securities Arbitration 2017* will take place Wednesday, September 27th at the PLI's headquarters in New York City. The program "will provide an opportunity to hear about the latest developments and hot topics directly from FINRA Office of Dispute Resolution leadership, arbitrators, noted academics and experienced attorneys who represent both customers and industry parties. PLI's distinguished faculty will provide an update on upcoming developments in FINRA arbitration and mediation, tips for preparing for expungement hearings, a discussion on litigating against *pro se* parties and a practicum on insurance issues. In addition, the faculty will discuss ethical issues in cases involving senior investors." FINRA's Richard Berry and Ken Andrichik will serve as co-moderators, along with newcomer, Southeast Regional Director Manly Ray. FINRA neutrals get a 25% discount.

Portal Enhancements
Next, as reported in SAA's 2017-26 & -25, FINRA announced earlier this summer that it would soon be improving arbitrator disclosure reports "by publishing the date arbitrators last affirmed the accuracy of their disclosure reports." The Web update adds more details: "The affirmation date will appear prominently at the top of the disclosure report that parties review during the arbitrator selection process. Arbitrators can affirm the completeness of their disclosures by submitting an update through the DR Portal or by submitting an Oath of Arbitrator upon being assigned to a case." As usual, the email

closes with a link to the latest ODR statistics, and word of a new section, *Previous Year-End Dispute Resolution Statistics*, offering links to comprehensive reports going back five years.
*(ed: *Our usual thanks to ODR for keeping its constituents up-to-date. **Look for the affirmation date change in September 2017.)* (SAC Ref. No. 2017-30-02)

EXPLAINED AWARD: TULLIS v. AMERIPRISE FINANCIAL SERVICES, INC., FINRA ID #16-01261 (Portland, OR, 6/27/17). ***This Award includes a so-called "Dissenting Decision" that is largely a concurrence fleshing out in detail the majority's one paragraph "Findings" in favor of the customer claimants; the only disagreement in results between the arbitrators is that the dissenter would award pre-judgment interest (for reasons that he does not explain).*** The dissenter, one of three on an all-public panel, elucidated his purpose at the beginning of his opinion: "…[T]he Arbitrator considers that most decisions deserve to be explained in order to create a body of precedent unavailable now that most courts no longer have jurisdiction over most securities litigation. Hopefully, this decision may help contribute to that body of law."

What the Majority Says
Customers Jan and Scott Tullis brought their claim against their broker, Andrew Hall, and his employer, Ameriprise. The Panel finds Hall's investment strategy unsuitable in several respects. First, he raised the equity component of their asset allocation from 70% to 100% or, taking into account "expected margin leverage," 133%. Secondly, Hall invested in unit investment trusts ("UITs") comprised of closed-end funds ("CEFs"), many of which were leveraged, less liquid and more volatile than comparable investments, and further increased Claimants' equity exposure. Finally, he sold the original UITs and invested 50% of the proceeds in UITs of CEFs invested in master limited partnerships tied to oil prices and the remaining 50% in a UIT that was not properly diversified because it held only 12-13 individual stocks.

A Concurring "Dissent"
The third Arbitrator agrees that Hall did not "know his customer" and purchased securities unsuitable for the Claimants' financial situation and needs. The Claimants were $120,000 in debt, due mainly to Scott Tullis' occasional unemployment, business losses and their children's college educations, when they inherited $800,000 from Scott's mother in April 2014. According to the Arbitrator, Claimants had two options: "(1) paying off debts and using income from the balance to get back on their feet and (2) keeping the inheritance intact and using the income to try to pay off debt. The latter strategy "clearly encouraged their spendthrift behavior," which was "evident from the beginning," making that option unsuitable for Claimants. However, "Respondents failed to conduct even a cursory analysis of the pros and cons of the two approaches," merely "**because Claimants didn't want to consider it**" (emphasis in original), adopting the second option. And, indeed, Claimants' debt further increased to more than $140,000 by mid-2015. The fact that the second option made more money for Ameriprise (since it left more of the inheritance to invest) causes the Arbitrator to term it a conflict of interest as well. Nor do meeting Claimants' investment objectives – "Growth and Income" and risk tolerance – "Moderate to Aggressive" – satisfy Respondents' suitability obligations.

The UITs imposed their own suitability problems, given "the precarious nature of Claimants' financial situation" and their large debt. These include: (1) high up-front costs and penalties for early selling; (2) the riskiness of some UITs, such as those invested in CEFs, and (3) the increase in Claimants' equity exposure from 70% to nearly 100% or, considering margin borrowing, roughly 133%. Finally, the dissenter agrees with the majority's characterization of, and criticisms of, the final set of UITs Hall purchased for Claimants, noting that they were even riskier than the earlier set. "In sum, Respondents maximized the benefits they derived from Claimants' accounts instead of giving Claimants prudent 'investment' advice, after first obtaining all the pertinent facts about their customers, as required by FINRA rules."
*(ed: *We sincerely doubt that FINRA Arbitrators will develop a consistent corpus of law that can function as* stare decisis *the way judicial case law does, but we think that the "dissenter" has a point: although we would not go so far as to call them "precedents," we agree that other arbitrators may find previously-issued Explained Awards useful in framing their own decisions. This is one reason why we report on them here. **Another use of Explained Awards is to cast light on the thought processes of the arbitrators who issue them. It is for this reason that we make our Explained Award summaries, dating back more than 10 years, available through the "Awards Plus" feature of our Arbitrator Reports, both in ARBchek and in-house searches.)*

FINANCIAL SERVICES COMMITTEE STAFF REPORT RECOMMENDS CONTEMPT OF CONGRESS CHARGES AGAINST CFPB DIRECTOR CORDRAY. ***A Report issued by House Financial Services Committee staff concludes that there is "ample basis" to undertake contempt of Congress proceedings against CFPB Director Richard Cordray.*** We reported in SAA 2017-26 that House Financial Services Committee Chairman Jeb Hensarling (R-TX) had in July threatened Consumer Financial Protection Bureau ("CFPB") Director Richard Cordray with contempt of Congress charges for not responding to repeated Committee information requests related to promulgation of the Bureau's arbitration rule. As we reported in SAA 2016-18, the House Financial Services Committee in 2016 began investigating CFPB's "examination and possible regulation" of arbitration. Specifically, then-Oversight and Investigations Subcommittee Chairman Sean Duffy sent an April 20, 2016 letter to Director Cordray, demanding that the Bureau provide to the Committee by May 4th a large amount of information, including "all communications relating to pre-dispute arbitration agreements between the CFPB and the American Associations for Justice, National Consumer Law Center, National Association of Consumer Advocates, Alliance for Justice, and Public Justice."

No CFPB Compliance
Chairman Hensarling's one-page July 5th letter to Director Cordray was short and minced no words. It noted that the CFPB had not fully complied with Rep. Duffy's letter demanding certain records regarding promulgation of the rule, "despite repeated entreaties by Committee Members and staff to produce the requested records" and that an August 12, 2016 follow-up letter from Rep. Duffy had suffered a similar fate. Chairman Hensarling also observed that the Duffy follow-up letter had also sought assurances from

Director Cordray that the Agency would not finalize an arbitration rule until the CFPB "has fully and completely responded to the April 20th request and the Committee has had a chance to review the material provided … [but] you provided no such assurance." On April 4, 2017, "having waited nearly a year (350 days) for the Bureau to produce all records responsive to its requests," the Committee subpoenaed the records, demanding a response by May 2nd. The Committee on May 11th notified the Bureau that it was in default, "including with respect to Specifications 19 and 20, which concerns the Committee's arbitration requests."

July 5 Warning
Chairman Hensarling's July 5 letter closed with this pointed admonition: "I notify you that you are in default of the Committee's April 4, 2017 Subpoena. I have directed Committee Staff to prepare a Staff Report for public release detailing your contumacy. You are hereby notified that any effort by you or another Bureau employee to promulgate any rule affecting arbitration agreements prior to your curing your default as to … the Subpoena may lead to contempt proceedings." Despite the Hensarling demand that the Final Rule not be issued, the Rule was released five days later on July 10th and published in the *Federal Register* on July 19.

Not an Empty Threat
Chairman Hensarling was evidently not bluffing. On August 4th, Committee staff issued a Report methodically laying out the case: "This Staff Report details the defiance of the CFPB's Director, Richard Cordray, of two Specifications of a Congressional *subpoena duces tecum* issued to him on April 4, 2017…. These two Specifications, 19 and 20, relate directly to records requests concerning the CFPB's pre-dispute arbitration rule. The underlying requests have been outstanding for 471 days. Majority Committee Staff ('Staff') finds that Director Cordray has failed to comply with Specifications 19 and 20 of the Committee's Subpoena and there is a valid legal and factual basis for instituting contempt of Congress proceedings against Director Cordray to enforce Specifications 19 and 20…. For all of the foregoing reasons, Staff believes there is ample basis to proceed against Director Cordray for contempt of Congress due to his default …."

CFPB Responds
CFPB Communications Director Jen Howard said in an August 4th statement reported by CNN and several other news sources that the Bureau was "working diligently to comply with the Committee's oversight on a number of fronts." She added: "On this particular matter, we have produced thousands of pages of documents thus far, and by next week we will have completely responded to one of the [categories of records] at issue. We will continue our efforts to understand how we can respond to the Committee in a satisfactory manner."
*(ed: *A footnote advises that, while the Staff Report focuses only on Specifications 19 and 20, Mr. Cordray "is not in compliance with any of the Subpoena Specifications." **As we've opined before, our take is that Mr. Cordray is on borrowed time. While as of this moment the Director can only be fired for cause, we think a citation for contempt of Congress may qualify! ***Termination by the President may be the least of Mr. Cordray's problems. Conviction under 2 U.S.C. §192 provides these penalties: "a fine of*

not more than $1,000 nor less than $100 and imprisonment in a common jail for not less than one month nor more than twelve months." Just in time, the Congressional Research Service has issued a May 2017 Report, Congress's Contempt Power and the Enforcement of Congressional Subpoenas: Law, History, Practice, and Procedure.*)* (SAC Ref. No. 2017-30-03)

SHORT BRIEFS:

CALL FOR COMMENTS ON MEDIATION PROPOSAL: FINRA-ODR WANTS YOU! Have you filed your comments yet on what's alternatively called the "automatic mediation" proposal or the "mediation opt-out" proposal? FINRA's Office of Dispute Resolution (ODR) is actively seeking feedback (SAA 2017-26 & -27) on the desirability of implementing a program that all arbitration proceedings be subject to mediation, with the qualifier that any party may opt out. The concept was recommended unanimously for adoption by the Dispute Resolution Task Force (DRTF), but has not progressed further. FINRA staff has established a special email center (mediate@finra.org) and has invited comment from all concerned. FINRA ODR is particularly eager to hear from practitioners on either side of the aisle, but the invitation to all is sincere. We received a personal response after submitting our comment and have heard from members of the Task Force that they, too, have commented. In order to flesh out the issues relating to this proposal and to encourage others to comment as well, SAC has posted on its Blog an edited version of the comment submitted by SAC's Editor-in-Chief Rick Ryder (See SAC's Blog: "Should FINRA Have an Automatic Mediation Process with the Option to Opt Out?")
(ed: Please participate by emailing to mediate@finra.org. The DRTF advocated adoption in concept, leaving the details to the National Arbitration and Mediation Committee (NAMC). One important detail that we neglected to address is whether, under mediation opt-out, a mediator should be assigned to the case or whether the parties, having accepted the mediation process, may still appoint their own mediator. We feel that assigning a mediator may work with Simplified Claims (see FINRA's telephonic mediation program in this regard), but we also believe that mediator choice is key to mediation success in larger cases. What do you think?)

FINRA CONSOLIDATES ENFORCEMENT FUNCTIONS. FINRA announced on July 26th that it will be consolidating its enforcement functions into a single department. As described in a Press Release, the new unit "ultimately will bring together two distinct enforcement teams within the organization – one handling disciplinary actions related to trading-based matters found through Market Regulation's surveillance and examination programs, and the other handling cases referred from other regulatory oversight divisions including Member Regulation, Corporate Financing, the Office of Fraud Detection and Market Intelligence, and Advertising Regulation." The Release also advises that the department will be headed by Susan Schroeder, who has been promoted to Executive Vice President and Head of Enforcement. A steering committee comprised of senior FINRA executives will guide the consolidation, and will "seek input from FINRA's exchange clients for whom FINRA performs enforcement-related services."
(ed: Looks like the enterprise-wide 360 is bearing fruit. A July 26 tweet from @FINRA links the consolidation to the corporate 360.) (SAC Ref. No. 2017-30-04)

NFA ISSUES THIRD QUARTERLY INVESTOR NEWSLETTER OF 2017; REVAMPED WEBSITE LEADS THE WAY. The National Futures Association ("NFA"), which operates a dispute resolution forum, issued its quarterly electronic *Investor Newsletter* July 26th. The lead story in the link-rich *Newsletter* announces that the Association in late June substantially revamped its Website. "The redesign project was driven by Member feedback, analysis of usage patterns and benchmarking, with the primary goals of providing better navigation and a much-improved user experience." As part of NFA's website redesign, NFA updated its Investor section, which among other things has a link to past *Newsletters.* Next is an announcement that the International Organization of Securities Commissions ("IOSCO") will host a week-long global initiative known as World Investor Week, starting October 2, at which "IOSCO members around the world will provide a variety of educational resources and workshops." NFA will be participating (*ed: we found an* Implementation Guide *for the event that on page 10 indicates FINRA is also participating*). The *Newsletter* next reports that the Commodity Futures Trading Commission ("CFTC") recently launched a new video series, *True Fraud Stories*, featuring real-life fraud victims. "Through this video series, the CFTC demonstrates how cunning fraudsters lured smart investors into fraudulent schemes resulting in significant losses, and encourages investors to conduct due diligence." NFA also reports that the SEC's Office of Investor Education and Advocacy in May issued an Investor Bulletin, *Be Cautious of SAFEs in Crowdfunding* "to educate investors about a type of security, often described as a Simple Agreement for Future Equity (SAFE), that may be presented in crowdfunding offerings. A SAFE is an agreement between the investor and the company in which the company generally promises to give the investor a future equity stake in the company if certain trigger events occur. Despite its name, a SAFE may not be 'simple' or 'safe.'"
*(ed: *We like the redesigned Website! The arbitration part of the Website has also been updated, with easy-to-follow tabs for major functions: File a Claim (for Customers and for NFA Members); NFA Arbitrators; Arbitration Online Payment System; Arbitration Statistics; NFAs Arbitration Resources; and Arbitration FAQs). **As usual, NFA's* Newsletter *provides useful information.)* (SAC Ref. No. 2017-30-05)

AAA UPDATES ARBITRATOR/MEDIATOR STANDARDS TO REQUIRE FITNESS DISCLOSURES. Arbitrators and mediators serving on the American Arbitration Association's roster received an August 1 email from Senior Vice President Christine Newhall, advising them of changes to the Association's *Standards and Responsibilities for Members of the AAA Roster of Arbitrators and Mediators.* Panelists were also required to attest by September 15th that they had viewed a 20-minute video explaining the amendments, even if they had previously submitted their 2017 compliance certification. What's new in the *Standards* is a requirement that panelists only accept cases for which they are fit to serve, and that they *must* advise the AAA of "any personal, physical or mental condition that may impair their ability to fully execute their responsibilities during all phases of a case." This obligation extends to other panelists, even those not serving with the neutral. The video advises that the AAA will investigate and may place such arbitrators and mediators on temporary or permanent inactive status.

*(ed: *This is a worthwhile endeavor that of course is aimed at the integrity of the AAA's ADR program. Still, aspects of this new policy make us squeamish. Might there be Americans with Disabilities Act implications? For example, must an arbitrator disclose that he or she has mobility issues? The "hall monitor" obligation to report on other panelists – even if not serving on the same panel – really concerns us. Last, will the "accused" be given notice and an opportunity to be heard? While we are sure this change has noble intentions, we urge AAA to think through all the potential ramifications. Perhaps an FAQ is in order? **We suspect something happened to prompt the new policy, most likely an arbitrator or mediator with cognitive impairment issues, based on the examples offered in the video. ***Observant readers may have noticed that we didn't link to key resources, as we normally do. We would have done so, but we couldn't find the* Standards *on the AAA's Website. We respectfully suggest that, like FINRA's Office of Dispute Resolution, AAA make such documents available to the public.)* (SAC Ref. No. 2017-30-06)

AAA SEEKS ONLINE FEEDBACK FROM PANELISTS. ADR providers often seek feedback from parties and counsel about arbitrator – and their own – performance. Arbitrators are also sometimes asked to evaluate co-panelists. For example, FINRA asks parties to evaluate arbitrator and staff performance in each case, as does AAA. FINRA also conducts arbitrator peer evaluations that include questions about staff performance. Now comes the AAA, which by email July 13th is asking arbitrators to complete a short, anonymous online survey seeking their views on the Association's performance as an administrator. The Survey is accompanied by an introduction from CEO India Johnson: "As you know, we survey the parties and advocates at the end of every case about their experience. This is your chance to give us feedback as well." After asking Survey respondents to identify their panel (Commercial; Construction; International; Employment; Labor/management; or Other), panelists are asked to rate the Association on a scale of 1 to 5 (1 means "poor" and 5 means "excellent") in three major areas (*ed: repeated* verbatim): **AAA/ICDR Case Administration Competence** (Promptness and responsiveness; Professionalism, including clarity of communications; Knowledge of rules and procedures; Collection of deposits and payment of compensation; Collaborative efforts with you on administrative matters; Overall administration of the cases); **Panels Relations, Panels Education and Requirements** (Promptness and responsiveness; Professionalism, including clarity of communications; Satisfaction with Panel Relations Staff; Value of Information provided through *Arbitrator News Brief*, Reminders and Website; Quality of AAA arbitrator continuing education (ACE) programs); and **Technology for Panelists (**Quality of resources available on Panelist eCenter (tutorials, forms, announcements); Ease of use of Panelist eCenter in maintaining your profile/relationship with the AAA (updating panel information, updating compensation information, paying for panel fee and accessing information); Ease of using Panelist eCenter in managing cases to which you are appointed (Managing correspondence, reviewing case documentation, submitting awards, etc.). Each section permits comments as well. Ms. Johnson states the AAA is confident it will "get some actionable items" and promises to share the results at a future date.
*(ed: *We like this concept! **Our thanks to an anonymous SAC Editorial Board member for bringing this to our attention.)*

ONLINE FILING (FOR COUNSEL) COMING TO SCOTUS IN NOVEMBER. *PRO SES* MUST STILL USE PAPER (FOR NOW). The Supreme Court announced by an August 3rd Press Release that it will be inaugurating an online filing system on November 13. The Release says that official filing of documents will still be accomplished using paper, "but parties who are represented by counsel will also be required to submit electronic versions of documents through the electronic filing system." Thereafter, the documents will be posted to the SCOTUS docket and will be made available to the public via the "Electronic Filing" link on the Court's Website, https://www.supremecourt.gov/. *Pro se* parties won't be permitted to file online at least initially, but their documents will be scanned and uploaded by the Court's staff. Attorneys planning to use the system must register in advance to get login credentials. The Release says registration will be available four to eight weeks before the system goes live, and "[o]nce the system is in place, virtually all new filings will be accessible without cost to the public and legal community." A four-page FAQ provides more details. *(ed: *The system will be improved incrementally. The FAQ advises: "It is expected that electronic filing will become the official means of filing once the system has operated effectively for some period of time." **There will be an RSS feed that will allow the press and public to track developments in specific cases. ***We question why* pro ses *for the time being are shut out of the system? FINRA reports a very high voluntary* pro se *participation rate in its online filing system. We suspect that there are concerns about quality control. ****For those who can't wait, many case-related documents are already available at http://www.scotusblog.com. See, for example, the information on the* Epic Systems *case, set for argument in October.)* (SAC Ref. No. 2017-30-07)

CITING "FUNDAMENTAL DIFFERENCES BETWEEN BILATERAL AND CLASS ARBITRATION," EIGHTH CIRCUIT HOLDS COURTS, NOT ARBITRATORS, SHOULD DECIDE WHETHER CASE PROCEEDS AS A CLASS ARBITRATION UNDER AAA RULES. *Howsam v. Dean Witter Reynolds, Inc*., 537 U.S. 79 (2002), tells us that "gateway" arbitrability issues are to be resolved by courts unless the parties "clearly and unmistakably" delegated these issues to arbitrators. And many courts have held that, by adopting the AAA's rules, which in Rule R-7 provide that the "arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the validity of the arbitration agreement," the parties have effectively delegated arbitrability issues to arbitrators. Under these circumstances, does this mean that the parties have also delegated to arbitrators whether a case can proceed as a class arbitration? "No," says a unanimous Eighth Circuit in *Catamaran Corp. v. Towncrest Pharmacy*, No. 16-3275 (8th Cir. July 28, 2017), reversing the District Court in a case of first impression. First, the Court observes that there are significant differences between bilateral and class arbitrations: "After considering all of these fundamental differences, we conclude that the question of class arbitration belongs with the courts as a substantive question of arbitrability" absent a clear and unmistakable delegation to arbitrators. Turning to the parties 'arbitration agreement, the Court finds no delegation: "[W]e see[s] no mention of class arbitration. Each agreement states that any dispute or controversy that arises out of the agreement shall be resolved by arbitration under the AAA's applicable Rules. But regarding class arbitration, there is complete silence. And

silence is insufficient grounds for delegating the issue to an arbitrator." *(ed: *The Third, Fourth, and Sixth Circuits, have also held the same way. The Fifth Circuit is contra. **The Court intimates that it might have reached a different outcome if the arbitration agreements specifically incorporated the AAA's* Supplementary Rules for Class Arbitration *which, the Court notes, "permit class arbitration and give arbitrators the power to decide whether an agreement contemplates class arbitration." ***In SAA 2017-29, we reported on* Jock v. Sterling Jewelers, Inc., *No. 15-3947 (2d Cir. July 24, 2017), where the Court held that the arbitrator had no authority to certify a class arbitration that included non-consenting, absent members.)* (SAC Ref. No. 2017-30-08)

DOJ INVITED TO WEIGH IN AGAIN IN ANOTHER CASE ON CFPB's CONSTITUTIONALITY. Recall that we reported in SAA 2017-20 that the D.C. Circuit reheard *en banc* on May 24 *PHH Corporation v. Consumer Financial Protection Bureau*, 839 F.3d 1 (D.C. Cir. 2016). In that now-vacated decision, a divided D.C. Circuit had held that the Consumer Financial Protection Bureau's ("CFPB") structure, which has a single Director with virtually unlimited, unchecked authority, was unconstitutional. The Court had directed that the CFPB be restructured to make the director terminable-at-will by the President. The Department of Justice ("DOJ") filed an *Amicus* Brief last March ahead of May's oral argument, taking a position against the CFPB on the constitutionality issue. The Department has just been invited to do the same thing in *CFPB v. Ocwen Mortgage Corp.,* No. 9:17-CV-80495, a case pending in the United States District Court for the Southern District of Florida. As was the case in *PHH,* the CFPB's constitutionality is being questioned. Citing the DOJ's *Amicus* Brief in *PHH*, Ocwen filed a Motion on April 25, asking the Court "to invite the Attorney General of the United States to participate in anticipated briefing in this action over whether certain provisions in the Consumer Financial Protection Act, 12 U.S.C. §§ 5481 *et seq.* ('CFPA'), are unconstitutional." Ocwen also referenced 28 U.S.C. § 2403, which requires a Court to notify the AG when a constitutional challenge is raised in a case where the United States is not a party. On August 1, the Court granted the Motion in a two-page Order. *(ed: *We're confident the DOJ will accept the Court's offer, most likely repeating the points made in its* PHH Amicus *Brief. **Any DOJ brief is due October 2nd and can't be longer than 20 pages. ****PHH *is as of this writing not decided.)* (SAC Ref. No. 2017-30-09)

INCORPORATION BY REFERENCE IS INCORPORATION BY REFERENCE. ARBITRATION CLAUSE IN GENERAL CONTRACT BINDS SUBCONTRACTOR. *Frohberg Electric Co. v. Grossenburg Implement, Inc*., 297 Neb. 356 (July 28, 2017), has a simple fact pattern. The contract between the construction project owner and the general contractor contained a predispute arbitration agreement ("PDAA"). The contract between the general contractor and the electrical subcontractor incorporated by reference the general contract, and added that: "If arbitration of disputes is provided for in the General Contract, any dispute arising between ... Contractor and ... Subcontractor under this Subcontract, including the breach thereof, shall be settled by arbitration in the manner provided for in the General Contract" (ellipses in original). The question before the Nebraska Supreme Court was whether the owner and general contractor could compel arbitration of claims brought against them in court by the

subcontractor. "Yes," says a unanimous Court: "Because the subcontract included a mutually agreed-to arbitration clause governed by the FAA and Subcontractor's claims were subject to the clause, we conclude that the motion to compel arbitration in the manner provided for in the general contract should have been sustained. In other words, the parties should have been required to attempt mediation and, if that failed, to proceed to arbitration. We reverse the district court's order and remand the cause with directions that the court enter an order staying the action and compelling arbitration pursuant to the agreement."
(ed: Seems right to us. Hard to fathom a different outcome) (SAC Ref. No. 2017-30-10)

COMMENT PERIOD ENDS ON FURTHER DOL FIDUCIARY RULE IMPLEMENTATION. As we reported in SAA 2017-23, the Department of Labor's ("DOL") Fiduciary Standard Rule began to go into effect in phases starting June 9th for those offering retirement investment advice. Other aspects of the rule become operational in January 2018. In furtherance of a review ordered February 3 by President Trump, the DOL on July 6 released a Request for Information on possibly delaying the scheduled 2018 implementation of the rule's next phase. It also sought comments on how the rule is working so far (see SAA 2017-26). The comment period for the second set of questions ended August 7th, with over 500 comments received (*ed: comments on the possible delay were due July 21st*). To say the commenters' views are mixed would be an understatement. The pros and cons of a possible delay and the need for consistency between regulators were common themes, however. We will do a more thorough analysis in a future *Alert,* but for starters, we remind you of two comments we covered in SAA 2017-29: On July 25, SEC Commissioner Michael S. Piwowar issued a Public Statement and comment letter harshly criticizing the DOL's rule as "misguided rulemaking." The letter prompted a response from William F. Galvin, Secretary of the Commonwealth of Massachusetts, who wrote a three-page comment letter dated July 28 that focused almost exclusively on Mr. Piwowar's comments: "Despite the SEC's long history of protecting investors, this SEC Commissioner now turns a blind eye to the real abuses in the area of retirement account rollovers, which prompted the Department to act."
(ed: We noted a special Website Notification from DOL encouraging timely comments but intimating that late comments will be accepted: "The Department encourages commenters to submit responses within the initial timeframes to ensure their consideration as part of an expeditious process. Nevertheless, the Department's examination is ongoing as is its consideration of possible proposals for new exemptions or revisions to the Fiduciary Rule and PTEs [Prohibited Transaction Exemptions]. Accordingly, if commenters submit thoughtful comments … after August 7, 2017, the Department will endeavor to consider those comments.") (SAC Ref. No. 2017-30-11)

DOL: WE'RE PLANNING TO DELAY PHASE II IMPLEMENTATION EIGHTEEN MONTHS UNTIL JULY 2019. Our final editorial comment on the item above was set to read: "*Of course, the big question is where the DOL heads from here. We're betting on a delay to allow better coordination between DOL, SEC, FINRA and other regulators*." We struck it from the final *Alert* because just as we went to press we learned that the Department of Labor has filed a proposal to delay the fiduciary standard rule's planned Phase II January 2018 implementation to July 2019. The Department is

defendant in *Thrivent Financial for Lutherans v. Acosta*, No. 0:16-cv-03289, a challenge to the rule that was filed September 2016 in the District of Minnesota (see SAA 2017-08). On August 9, the DOL filed a Notice of Administrative Action advising the Court that it had that day filed with the Office of Management and Budget "proposed amendments to three exemptions, entitled: "Extension of Transition Period and Delay of Applicability Dates from January 1, 2018, to July 1, 2019; Best Interest Contract Exemption (PTE 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (PTE 2016-02); Prohibited Transaction Exemption 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters (PTE 84-24)."
*(ed: *The proposed amendments to the rule will be published in the* Federal Register *after interagency review. **Our thanks to* InvestmentNews *for reporting this development on August 8th. ***Readers may recall that Thrivent's challenge to the fiduciary rule was focused not on the entire rule but instead was directed only to the DOL's adoption of the Best Interests Contract ["BIC"] exemption. Although the rule allows use of predispute arbitration agreements in BICs, class action waivers are not permitted.)* (SAC Ref. No. 2017-30-12)

DOL ISSUES ANOTHER FAQ ON FIDUCIARY RULE. The Department of Labor ("DOL") in early August issued the next in a series of FAQs regarding its Fiduciary Standard Rule creating a uniform "best interest of investors" standard for individuals providing investment advice on retirement accounts. The six-page FAQ, titled *Conflict of Interest FAQs: 408B-2 Disclosure Transition Period, Recommendations to Increase Contributions and Plan Participation*, focuses on defined contribution plans. Specifically, the DOL's new guidance "is generally limited to advice concerning investments in IRAs, ERISA-covered plans, and other plans covered by section 4975 of the Internal Revenue Code." There is no reference to arbitration.
(ed: As we've reported several times, the DOL's fiduciary standard rule began to go into effect in phases starting June 9th. Other aspects of the rule become operational in January 2018. The DOL's rule is still under a review ordered February 3 by President Trump, and the agency is accepting comments on whether the January rollout should be delayed.) (SAC Ref. No. 2017-30-13)

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