BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C.

Admin. Proc. File No. 3-19019

In the Matter of the

Application of

TIMOTHY ARTHUR VANDERVER III

For Review of Action Taken By

FINRA

OPENING BRIEF

I. INTRODUCTION

This matter concerns the Securities and Exchange Commission's (the "Commission") Order Requesting Additional Written Submissions issued on August 19, 2020. Timothy Arthur Vanderver ("Mr. Vanderver") sought review of FINRA's action in prohibiting his access to the use of FINRA's Dispute Resolution Arbitration Forum ("FINRA's Forum") in seeking expungement of two customer dispute disclosures published within FINRA's Central Registration Depository ("CRD") and BrokerCheck website. After briefing, the Commission has determined that it has jurisdiction to review this application and have asked the parties to brief the merits of the action.

II. PROCEDURAL HISTORY AND BACKGROUND

FINRA is a not-for-profit corporation and self-regulatory organization ("SRO") registered with the Commission as a national securities association. FINRA, through its subsidiary, FINRA Regulation, Inc., has established the FINRA Office of Dispute Resolution, which carries out the sole function of operating an arbitration and mediation forum to resolve securities industry disputes. The Office of Dispute Resolution's authority is limited to administration of the forum, not regulatory policy decisions.

FINRA maintains an electronic database called the CRD and a public reporting system known as BrokerCheck.[1] This online, publicly marketed reporting system includes the wide-spread disclosure of customer complaints against each associated person of a FINRA member firm. The purpose of the CRD and BrokerCheck systems are to: (1) to create a regulatory system for financial advisors to improve overall regulation of advisors, (2) to make information about financial advisors available to the public, and (3) to provide financial advisors an efficient automated filing system. FINRA requires member firms to report all customer complaints that meet specific requirements to FINRA, and publicly discloses these complaints, absent any determination of merit or factual basis. To maintain the integrity and accuracy of the information published on the CRD and BrokerCheck systems, FINRA and the Commission established a *right* for advisors to seek expungement of customer dispute disclosures contained on those systems pursuant to FINRA Rule 2080.

Mr. Vanderver sought expungement in FINRA's Forum of two customer dispute disclosures published on his CRD and BrokerCheck records pursuant to FINRA Rule 2080. FINRA denied Mr. Vanderver access to FINRA's Forum claiming that his request was "not

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[1] 15 U.S.C. 78o-3(i)(1).

eligible for arbitration." Mr. Vanderver submitted an application for review to the Commission requesting that he be permitted to bring his claim in FINRA's Forum that he is both entitled to and bound to by the FINRA Industry Code Rules. Whether the customer dispute disclosures are eligible for expungement should be subsequently determined by a panel that is assigned in arbitration, in accordance with FINRA Industry Code Rules 2080 and 13805.

After briefing, the Commission found that it has jurisdiction to hear this action.

On August 19, 2020, the Commission issued an Order Requesting Additional Submissions on specific enumerated questions detailed in its decision. This brief addresses those questions.

III. LEGAL ANALYSIS

The Commission has requested that these questions be answered: (1) Exchange Act Section 15A(h)(2) provides that any determination to prohibit or limit a person's access to services shall be supported by a statement setting forth the specific grounds on which the prohibition or limitation is based." Did FINRA issue Vanderver a supporting "statement setting forth the specific grounds" for its determination as provided for by Section 15A(h)(2) of the Exchange Act of 1934 (hereafter, "the Act")? (2) What were FINRA's grounds for determining that Vanderver's claim was ineligible for arbitration, and was that prohibition of access consistent with FINRA's rules? (3) Can the Commission discharge its review function based on the record otherwise before it, or should it instead have to remand for FINRA to issue Vanderver a supporting statement as provided for by Section 15 A(h)(2) if one was not already provided to Vanderver?

(1) FINRA did not issue Mr. Vanderver a supporting "statement setting forth the specific grounds" for its determination as required by Section 15A(h)(2) of the Act.

As stated in Section 15A(h)(2) of the Exchange Act, a determination by the association to prohibit or limit a person with respect to access to services offered by the association or a member thereof requires that the association "notify such person" and "give him an opportunity to be heard" regarding the "specific grounds" upon which the association based the prohibition or limitation. 15 U.S.C.A. § 78o-3. The association's prohibition or limitation shall also be accompanied by a statement setting forth the specific grounds upon which it was based.

FINRA failed to comply with the Exchange Act's requirement that it accompany its limitation or prohibition with a "statement setting forth the *specific grounds* upon which…the prohibition or limitation is based." 15 U.S.C.A. § 78o-3 (emphasis added). When FINRA denied Mr. Vanderver's access to FINRA's Forum on January 30, 2019, the only grounds FINRA cited was that: "FINRA has determined that the claims you have alleged in your statement of claim are not eligible for arbitration. Therefore, pursuant to the Customer Code Rule 12203(a) or Industry Code Rule 13203(a), we decline to accept your claim." There are no specific grounds cited here at all. Therefore, FINRA failed to comply with the Exchange Act's requirements.

FINRA then attempted to cure its failure to comply with the Exchange Act by providing a letter dated February 20, 2020 – *over a year* after it denied Mr. Vanderver's access to FINRA's Forum and over a year after this application for review had already been filed with the Commission – alleging that Mr. Vanderver's access to FINRA's Forum was denied because the named respondent (Stanford Group Company ("Stanford")) was in receivership. FINRA then filed a Motion to Introduce Additional Evidence on February 25, 2020 attaching the February 20, 2020 notice, and in excuse for its failure to comply with the Exchange Act, claimed that it failed to adduce such evidence previously because "it is not Dispute Resolution's practice to provide publicly available information…when denying forum." This excuse however does not absolve

FINRA of its obligations pursuant to the Exchange Act and does not vindicate FINRA's violation of Mr. Vanderver's rights.

(2) FINRA had no grounds to determine that Mr. Vanderver's claim was ineligible for arbitration, and FINRA's prohibition of access is inconsistent with FINRA's rules.

FINRA had no grounds to deny Mr. Vanderver's right to the use of FINRA's Forum. In FINRA's initial denial letter dated January 29, 2019, although they failed to supply any reasoning, it is reasonable to conclude that their citation of Customer Code Rule 12203(a) or Industry Code Rule 13203(a) (hereinafter, "Rule 13203(a)")[2] was the basis for its denial. Rule 13203(a) states that:

> The Director may decline to permit the use of the FINRA arbitration forum if the Director determines that, given the purposes of FINRA and the intent of the Code, the subject matter of the dispute is inappropriate, or that accepting the matter would pose a risk to the health or safety of arbitrators, staff, or parties or their representatives. Only the Director may exercise the authority under this Rule.

As a preliminary matter, it is important to note that this denial letter was issued by "Hannah Yoo" a FINRA "Senior Case Specialist", indicating that this was not a determination made by the Director of FINRA, as required by Rule 13203(a). Further, the denial letter simply states that Mr. Vanderver's expungement request is "ineligible", without any supporting details, which is not outlined as a valid basis to deny forum pursuant to Rule 13203(a). FINRA's action is inconsistent with the purpose and intent of Rule 13203.[3]

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[2] The language of the rules is identical, and since Mr. Vanderver's Statement of Claim involved an action by an Association Person against a Member Firm, this action is classified as an "industry dispute."

[3] The purpose of providing the FINRA Director with this authority under Rule 13203 was to "give the Director the flexibility needed in *emergency* situations" and to "address circumstances that may require immediate resolution, such as security concerns and other unusual but serious situations." 72 Fed. Reg. 20 at 4580-4601 (2007) (emphasis added). "[T]his authority, *which cannot be delegated* by the Director…should be limited by application in *only a very narrow range of unusual circumstances.*" (emphasis added). *Id.* at 4602.

FINRA Rules 12203 and 13203 are the only FINRA rules that govern prohibition of access to the arbitration forum. Those rules provide only two grounds on which the Director may deny forum: when the subject matter is inappropriate for arbitration or when the case would pose a risk to health or safety. FINRA Rules 2080 and 13805 dictate that claims for expungement of customer dispute information are eligible for arbitration in FINRA's forum and are, therefore, appropriate subject matter. There is no argument that the *subject matter* of Mr. Vanderver's claim (expungement of a customer dispute disclosures) is inappropriate for arbitration under FINRA's rules. Further, there is no basis for an argument that Mr. Vanderver's claims posed any risk to the health or safety of any arbitrator, staff, party, or party representative. Therefore, denial of forum was not consistent with FINRA's rules.

As stated above, FINRA then altered its reasoning from its initial denial letter in its untimely issuance of a statement more than a year after-the-fact in an attempt cure to their deficiency. Although the language of the Exchange Act does not specify a timeframe for when FINRA must submit a "statement setting forth the specific grounds," when reviewing the provision as a whole, it is clear that the statement must be provided *contemporaneously* with its determination to prohibit or limit a person's access to services since the provision also requires an opportunity to be heard on FINRA's determination. Providing a statement more than a year after-the-fact and never providing Mr. Vanderver with an opportunity to be heard violates his rights and FINRA's obligations under the Exchange Act.

Regardless of the time, FINRA's explanation is insufficient and inconsistent with FINRA's rules. FINRA stated in its February 20, 2020 letter that because the named respondent, Stanford, is in receivership, FINRA is retrained and enjoined from serving Stanford with Mr. Vanderver's Statement of Claim to initiate the action. FINRA cites the February 16, 2009 United

States District Court for the Northern District of Texas order in *Securities and Exchange Commission v. Stanford Int'l Bank, Ltd., et al.,* Case No.: 3- 09CV0298-N (N.D. Tex.), as amended March 12, 2009 ("Court's Receivership Order"), which states, in relevant part:

> 9. Creditors and all other persons are hereby retrained and enjoined from the following actions, except in this Court, unless this Court, consistent with general equitable principals and in accordance with its ancillary equitable jurisdiction in this matter, orders that such actions may be conducted in another forum or jurisdiction: (a) The commencement or continuation, including the issuance or employment of process, of any judicial, administrative, or other proceeding against…any of the defendants…*arising from the subject matter of this civil action*; or (b) The enforcement, against…any of the defendants, or any *judgment that would attach to or encumber the Receivership Estate* that was obtained before commencement of this proceeding.
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> 10. Creditors and all other persons are hereby restrained and enjoined, without prior approval of the Court, from: (a) Any act to obtain possession of the Receivership Estate assets; (b) Any act to create, perfect, or enforce any lien against the property of the Receiver, or the Receivership Estate; (c) Any act to collect, assess, or recover a claim against the Receiver or that would attach to or encumber the Receivership Estate; (d) The set off of any debt owed by the Receivership Estate or secured by the Receivership Estate assets based on any claim against the Receiver or the Receivership Estate; or (e) The filing of any case, complaint, petition, or motion under the Bankruptcy Code….

(emphasis added). None of the outlined provisions in the Court's Receivership Order restrain or enjoin the service of process of a Statement of Claim where an advisor is asking *FINRA* to expunge customer dispute disclosures on the advisor's CRD and BrokerCheck records, as is the case here. Pursuant to FINRA Rules, which do not allow for single-party arbitrations or expungement requests, Mr. Vanderver was required to name the broker-dealer involved with the underlying customer dispute disclosures – Stanford – in his request for expungement. Stanford was named as a nominal party only with no allegations of wrongdoing made against them or any request for damages.[4]

[4] Although there was a request for $1 damages against Stanford listed in the Statement of Claim, this request is withdrawn throughout the proceedings. Furthermore, with the approval of SR-FINRA-2020-005, the $1 request is no longer applicable.

Allowing FINRA to unilaterally determine that a claimant is "ineligible" for arbitration without providing any basis, or based on a Senior Case Specialist's (flawed) reading of a court's receivership order, is inconsistent with FINRA's rules. Allowing FINRA to establish such a blanket rule would bypass the rulemaking procedures adopted by FINRA and codified in FINRA Rule 0110 that requires public notice and Commission approval for any new rules or rule changes.[5] A blanket rule that no advisor can seek expungement while the broker-dealer involved with reporting the disclosure is in receivership or bankruptcy proceedings would also have a chilling and disproportionately prejudicial effect on advisors who have to live with meritless disclosures on their record for years without the ability to seek relief.

FINRA has also failed to comply with the Exchange Act's requirement that provides Mr. Vanderver with "an opportunity to be heard" regarding the "specific grounds" upon which the association based the prohibition or limitation. 15 U.S.C.A. § 78o-3. Instead, FINRA simply dismissed Mr. Vanderver's claim unilaterally without any due process being afforded to him, in violation of the Act. Mr. Vanderver's only recourse was to initiate this application for review.

Assuming, for the sake of argument, that FINRA has the authority to make and implement such a rule, the de facto nature of it violates fundamental due process standards. In 1971, the U.S. Supreme Court heard a case involving a Wisconsin statute that allowed "designated persons" to post notices forbidding the sale or gift of liquor to persons who, because of excessive drinking, failed to provide for his or her family or threatened the peace of the community.[6] In deeming the statute unconstitutional, the Court stated that:

> It would be naive not to recognize that such 'posting' or characterization of an individual will expose him to public embarrassment and ridicule, and it is our opinion that procedural due process requires that before one acting pursuant to

[5] *See* FINRA Rulemaking Process https://www.finra.org/rules-guidance/rulemaking-process.
[6] *Wisconsin v. Constantineau*, 400 U.S. 433, 434 (U.S. 1971).

> State statute can make such a quasi-judicial determination, the individual involved must be given notice of the intent to post and an opportunity to present his side of the matter.[7]

Since 1971, federal courts have upheld that "where a person's good name, reputation, honor, or integrity is at stake because of what the government is doing to him, notice and an opportunity to be heard are essential."[8] In 1994, the 2nd Circuit Court of Appeals held that New York State's maintenance of a Central Register that identifies individuals accused of child abuse or neglect, and its communication of the names of those on the list to potential employers implicated a protectible liberty interest under the Fourteenth Amendment.[9]

While the constitutionality of FINRA's publication of customer disputes and other disclosures is not an issue before the Commission, it is important to note that the Commission has equated having disclosures to being "a con artist, an unscrupulous financial professional, or a disreputable firm."[10] Mr. Vanderver's disclosures call into question his good name, reputation, honor, and integrity. Further, FINRA Rule 3110 requires member firms to review and consider an investment advisor's CRD when making hiring, retention, and advancement decisions.[11] The disclosures have a tangible effect on the advisor's pursuit of their chosen profession. Therefore, it should be a presumption that Mr. Vanderver has the right to an evidentiary hearing to determine whether his disclosure should be expunged.

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[7] *Id.* at 436.

[8] *See, e.g. Bd. of Regents of State Colleges v. Roth*, 408 U.S. 564, 573, 92 S. Ct. 2701, 2707, 33 L. Ed. 2d 548 (1972).

[9] *Valmonte v. Bane*, 18 F.3d 992, 994 (2d Cir. 1994).

[10] *See,* https://www.sec.gov/investor/brokers.htm (last visited September 2, 2020).

[11] *See, e.g.,* FINRA Rule 3110(e).

(3) The Commission can and should discharge its review function based on the record before it.

Mr. Vanderver's appeal turns on the question of whether FINRA's unilateral decision to deny him access to its fundamental service of arbitration was consistent with FINRA's rules and authority under the Exchange Act. Upon the record before it, the Commission should determine that it was not.

The record before the Commission indicates clearly that FINRA did not provide Mr. Vanderver with the specific grounds on which its decision to deny forum in a timely fashion and did not allow Mr. Vanderver an opportunity to be heard on those grounds prior to closing his case. FINRA waited until after Mr. Vanderver filed his application for review with the Commission to create and provide an explanation to Mr. Vanderver. Even if this letter would have provided Mr. Vanderver with an opportunity to be heard on the grounds provided, the opportunity came too late, as Mr. Vanderver had already called upon the Commission to review FINRA's action.

Further, the record clearly indicates that FINRA's decision to deny Mr. Vanderver access to its forum was inconsistent with FINRA's rules and exceeded its authority under the Exchange Act. First, the decision appears to have been made by a Senior Case Specialist, and not the Director of Dispute Resolution. Moreover, Mr. Vanderver's claim for expungement of customer dispute disclosures is not inappropriate subject matter under FINRA's Code, nor did it pose a health or safety risk to any arbitrator, staff, party, or party representative – these are the only two grounds for forum denial present in FINRA's rules. FINRA gains its authority from the Exchange Act. Its rules are reviewed and approved by the Commission. Therefore, denying access to the arbitration forum on any grounds other than those enumerated in its rules that have

been approved by the Commission was in excess of its authority under the Exchange Act. The record clearly indicates that it was.

FINRA failed to fulfill its obligations under the Section 15A(h)(2) of the Exchange Act and exercised discretion inconsistent with its rules, and thus inconsistent with its authority under the Act. Allowing FINRA the opportunity to fulfill its obligations after it forced Mr. Vanderver to incur significant expenses and spend significant time appealing its actions to the Commission is contrary to basic principles of justice. FINRA should not receive this benefit, and the Commission should discharge its review function based on the record before it, and determine that Mr. Vanderver is entitled to access to the FINRA arbitration forum.

Dated: September 18, 2020.

Respectfully submitted,

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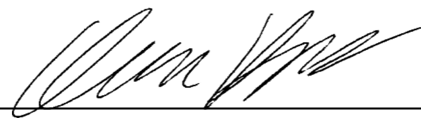

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CERTIFICATE OF SERVICE

I, James Bellamy, on September 18, 2020, served the foregoing Notice of Substitution of Counsel of the above listed Applicants on:

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[X] (BY EMAIL) I caused the documents to be sent to the persons at the e-mail address listed above. I did not receive, within a reasonable time after the transmission, any electronic message or other indication that the transmission was unsuccessful.

[X] (STATE) I certify (or declare) under penalty of perjury under the laws of the State of Colorado that the foregoing is true and correct.

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