

# BNA Insights

## BROKER-DEALERS

### Expungement of Defamatory Information From the CRD System: A Practical Guide to Cleaning Up Your Past to Protect Your Future



BY JULIAN W. FRIEDMAN AND NATHANIEL I. KOLODNY

**A**s many an Associated Person<sup>1</sup> working in the securities industry can attest, even a seemingly benign Form U5<sup>2</sup> filed by a former employer can become an impediment to future employment. The Financial Industry Regulatory Authority ("FINRA") requires

<sup>1</sup> FINRA Rule 1011(b) defines several categories of "Associated Persons." For purposes of this article, "Associated Person" shall refer to the following three enumerated categories: "(1) a natural person registered under NASD Rules. . . ; (6) any person engaged in investment banking or securities business controlled directly or indirectly by the Applicant whether such person is registered or exempt from registration under the FINRA By-Laws or NASD Rules; or (7) any person who will be or is anticipated to be a person described in (1) through (6) above." See FINRA Rule 1011(b).

<sup>2</sup> *Uniform Termination Notices for Security Industry Registration* [hereinafter Form U5].

*Julian W. Friedman is a partner with Ballard Spahr Stillman & Friedman LLP in New York; Nathaniel I. Kolodny is an associate with the firm. They frequently represent securities industry members in enforcement matters before the SEC, FINRA, and other state and federal regulators, as well as representing industry members in arbitrations such as the proceedings discussed in this article.*

its member organizations<sup>3</sup> to provide "timely, complete and accurate information on [a] Form U5 . . . no later than 30 days after terminating an Associated Person's registration."<sup>4</sup> This information is recorded in each Associated Person's CRD<sup>5</sup> file, and is made available to other member organizations for them to use to make "informed employment decisions."<sup>6</sup>

Anecdotal evidence indicates a growing trend in the securities industry whereby member organizations apply a strict mechanical approach to their review of a prospective employee's CRD file. Indeed, it seems that the greater the scrutiny of the industry itself by regulators, politicians and the press, the more likely industry members are to view anything other than a "plain vanilla" CRD file of a job applicant as a complete bar to employment. Indeed, some firms go so far as to refuse to hire an otherwise qualified prospective employee if there is any arguably negative historical information contained in the candidate's CRD file — a collateral consequence that often exceeds the intended salutary public purpose of the disclosure system.<sup>7</sup>

Whether this high degree of caution stems from the regulatory burdens placed upon member organizations or from a drastic overreaction to the fact that regulators have missed some remarkable frauds in recent years is

<sup>3</sup> See FINRA Manual, Incorporated NYSE Rules, Rule 2(b) (a "member organization" is defined in relevant part as "a registered broker or dealer . . . that is a member of the Financial Industry Regulatory Authority. . . . The term 'member organization' includes 'member firm' and 'member corporation'").

<sup>4</sup> See FINRA Regulatory Notice 10-39 (citing FINRA By-Laws, Art. V, Sec 3(a)).

<sup>5</sup> "The CRD system is an online registration and licensing system that contains information used by the Securities and Exchange Commission (SEC), FINRA, other self-regulatory organizations (SROs) and state securities regulators to make licensing and registration decisions, among other things. The CRD system contains administrative information (e.g., registration status with various regulators) and disclosure information (e.g., criminal charges and convictions) about securities firms and brokers." John Nachmann, *Expungement of Information From the Central Registration Depository in Intra-Industry Disputes*, 2 NEUTRAL CORNER: NEWSLETTER FOR FINRA NEUTRALS (2010) [hereinafter NEUTRAL CORNER]. The CRD system also includes information about the termination of employment that is taken from the Form U5 filed by an Associated Person's former employers.

<sup>6</sup> *Id.*

<sup>7</sup> See Anne H. Wright, *Form U-5 Defamation*, 52 WASH. & LEE L. REV. 1299, 1306 n.29 (1995).

a matter upon which the authors of this article do not hazard a guess. But regardless of the underlying cause, what is clear is that these new barriers to future employment in the industry place an even greater premium on prospective employees' ability to have input into their own CRD files where necessary to correct an entry that might bar them from future employment, even where there is no valid reason for such employment to be refused.

This article explains how certain information that may interfere with an Associated Person's future job prospects can be expunged from a CRD file. More specifically, it discusses the manner in which an Associated Person can use the FINRA arbitration process to obtain relief from information in his or her CRD file that is "defamatory" in nature — which relevant law defines as harmful to a person in his or her professional capacity — even if that information was true at the time of the filing of the Form U5 that introduced it into the CRD system.

## When the Past Does Not Remain in the Past

In today's marketplace, people working in the securities industry can be forced to pay too high a price if relatively innocuous information in their CRD files blocks their ability to change jobs and obtain other employment within the industry. But unbeknownst to many securities industry professionals — those who have not recently sought a new job, or who have nothing even potentially troublesome in their CRD files — just such a thing has been happening.

Under current practices at some firms, even the most seemingly innocuous explanation of the reason for the termination of a person's prior employment can impede that person's ability to procure a new position with a different employer. By way of example, a person whose employment a member organization decides to terminate may be able to negotiate for language in his or her Form U5 stating he or she was "Permitted to Resign." But a statement of any reason for termination other than "voluntary" requires that the former employer submit additional information on the Disclosure Reporting Page ("DRP") which is part of the Form U5. There may be opportunities for the departing employee to negotiate the precise language that the former employer is going to include in the DRP — for example, to show (if true) that there was never any finding of wrongdoing by the employee in question. There is room for such negotiation because the applicable standard requires only that the language used in the Form U5 provide sufficient detail "that a reasonable person may understand the circumstances that triggered the affirmative response."<sup>8</sup> However, firms are not required to give employees this opportunity, and even if they do, there is no assurance that the employee will be successful in attempting to negotiate more favorable language.

Moreover, even if an employee succeeds in influencing the language used by the employer, any such result may be for naught. The reason is that there is no prohibition against another member organization simply refusing to hire any person whose CRD file reports any termination other than a purely voluntary one — including not only that the person was discharged, but also

that he or she was permitted to resign. No matter how well the circumstances are explained — and even if the Associated Person avails him or herself of the right to update his or her own CRD file with a personal statement explaining the facts and circumstances of the termination — even the most anodyne description in the Form U5 may negate the possibility of future employment with at least those member organizations which, as a matter of policy, will not hire a person with any involuntary terminations in his or her CRD file, a category that includes some of the largest firms in the industry. The meaning and consequence of a "Permitted to Resign" entry in a Form U5 has drastically and retroactively changed — where once it clearly implied no admission of guilt, some employers now view it as sufficient to make a potential hire untouchable. And of course, if the former employer is not even willing to adopt the "Permitted to Resign" language — and instead insists on something more negative to the former employee — the latter will be in a situation where the Form U5 will have a more negative impact on his or her future employment prospects.

Fortunately, there is a mechanism available to minimize — and even, under certain circumstances, overcome — the negative implications of U5 language describing the employee's departure from a prior position as having been other than purely voluntary. Although this article does not constitute legal advice, the authors recommend that anyone who has had previous jobs in the securities industry review their CRD files to see what those files say about the reasons for the termination of such prior positions, and to determine whether they contain any information that may tend to detract from future job prospects. Upon discovery of any potentially injurious information in his or her CRD file, an individual has the option of initiating a FINRA arbitration proceeding against his or her former employer who filed the Form U5 containing the language in question. Such an arbitration proceeding can even be brought in cases in which the former employer is no longer a member organization. Indeed, it may actually be required in such situations, since the former employer, as a current non-member, lacks the ability to voluntarily amend the earlier Form U5.

Should the arbitration panel find for the claimant/former employee in such a proceeding, it has the power to direct expungement of defamatory information. For an example of the scope of the relief that can be obtained if such an arbitration proceeding is successful.<sup>9</sup> If such a favorable decision is obtained, one final step is required on the part of the claimant — to transmit the arbitration award to the FINRA Registration and Disclosure Department for expungement or alteration of the CRD file in conformity with the arbitration panel's decision.<sup>10</sup>

<sup>9</sup> See *In re Arbitration Between Brittany Marie Duran and Alamo Capital*, FINRA Dkt. No. 11-04240, 2012 WL 3776907 (Aug. 15, 2012) (recommending "expungement of the reason for termination and termination comment from Claimant's . . . Form U5. . . based on the defamatory nature of the information. The arbitrator recommends that the reason for termination be changed to 'Voluntary.' The termination comment shall be expunged in its entirety").

<sup>10</sup> FINRA has a separate process for expungement of information about customer complaints, in which the person seeking expungement must seek an order from a court in the state in which he or she resides. By contrast, the process for ex-

<sup>8</sup> See FINRA Regulatory Notice 10-39.



## What to Expect When Your Employment Is Terminated

FINRA's by-laws provide clear instructions as to how member organizations should handle the termination of any Associated Person's registration with the firm. Firms are required to file the Form U5 stating the circumstances of the termination within 30 days, and may be subject to administrative and civil penalties should they fail to comply with that deadline.<sup>11</sup> Moreover, member organizations have a continuing obligation to update previously filed Form U5s with "timely, complete and accurate information" within 30 days of any changes in the status of a person's termination.<sup>12</sup> Therefore, if an employee is "Permitted to Resign" when an investigation is underway, the member organization has an obligation to update the now-former employee's Form U5 with the ultimate outcome of that investigation if it reaches a conclusion regarding the propriety of the employee's conduct.<sup>13</sup>

FINRA instructs its member organizations about the importance of getting the information in the Form U5 right:

It is imperative that firms file complete and accurate Forms U5 in a timely manner because the reported information is used by a number of constituencies for a variety of reasons. For instance, FINRA uses the information to help identify and sanction individuals who violate FINRA rules and applicable federal statutes and regulations. FINRA, other self-regulatory organizations and state regulatory and licensing authorities also use the information to make informed registration and licensing decisions. Firms use the information to help them make informed employment decisions. Further, investors use the Form U5 information that is displayed through BrokerCheck when considering whether to do business with a registered (or formerly registered) person.<sup>14</sup>

Importantly, Section 3 of the Form U5 requires firms to give a Reason for Termination — the only choices are "Discharged"; "Other"; "Permitted to Resign"; "Deceased"; or "Voluntary" — and to provide a further Termination Explanation if the reason given is "Discharged"; "Permitted to Resign"; or "Other." Such an explanation must "provide sufficient detail when responding to Form U5 questions such that a reasonable person may understand the circumstances that triggered the affirmative response."<sup>15</sup> Further, a member organization filing a Form U5 "may not parse through the questions in a manner that would allow the firm to

punging information filed by prior employers, remains simpler than the expungement of customer dispute information. The only requirements are the arbitration and the minimal interactions with the FINRA Registration and Disclosure Department described in this article.

<sup>11</sup> See NEUTRAL CORNER, *supra* note 5.

<sup>12</sup> *Id.* (Whenever a member organization updates a Form U5 filing, it is required to provide the effected Associated Person with a copy of the updated Form U5 simultaneously with the filing of that document).

<sup>13</sup> Because there is no formal enforcement mechanism by which a former employee of a member organization can compel the member organization to revise a Form U5, the only means of cleaning up a CRD file for some people will be to seek an expungement recommendation from an arbitration panel.

<sup>14</sup> See FINRA Regulatory Notice 10-39.

<sup>15</sup> *Id.*

avoid responding affirmatively to a question."<sup>16</sup> For example, with respect to Question 7F(1) ("Did the individual voluntarily resign from your firm, or was the individual discharged or permitted to resign from your firm, after allegations were made that accused the individual of violating investment-related statutes, regulations, rules or industry standards of conduct?") — a particularly damaging question if a former employer provides an affirmative response — FINRA instructs member organizations to construe the term "investment-related" expansively, and states that it does not relate only to securities.<sup>17</sup>

## You Can Get a Second Chance to Make a First Impression

So what can an Associated Person do if his or former employer filed a Form U5 containing any information about the end of their employment relationship saying anything other than that the employee's departure was voluntary — especially information that reflects negatively on the employee's performance of his or her job responsibilities? FINRA has long provided a means by which an Associated Person can seek an arbitration award<sup>18</sup> recommending the expungement of information from his or her CRD file.<sup>19</sup>

FINRA arbitration panels have the power to order the expungement of information in the CRD system which is "defamatory in nature."<sup>20</sup> For the panel to order expungement, "the dispute must be between a firm and a current or former Associated Person and [the] arbitrators must clearly state in the 'Award' . . . that they are

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*; see also Form U5 and Form U5 Instructions.

<sup>18</sup> See FINRA Rule 13401 (For claims seeking more than \$100,000 in damages, three arbitrators will be appointed and the associated costs will be greater); FINRA Rule 13800 (If the only relief sought is expungement and less than \$50,000 in damages, the claimant can file a "Simplified Arbitration" — to be decided by only one arbitrator in a streamlined hearing process and at reduced cost).

<sup>19</sup> Claims for expungement must be filed within six years after the filing of a Form U5. See FINRA Rule 12206 (providing that "[n]o claim shall be eligible for submission to arbitration under the Code where six years have elapsed from the occurrence or event giving rise to the claim. The panel will resolve any questions regarding the eligibility of a claim under this rule").

<sup>20</sup> See NASD Notice to Members 99-54, at 352 (FINRA's policy regarding expungement of defamatory information in the CRD, as stated in the 1999 Notice to Members, remained unchanged by the rules adopted in 2003 and 2008 relating to the expungement of customer dispute information, which, as noted above, requires a court order); see also FINRA Notice to Members 08-79 ("The rules do not affect FINRA's current practice of permitting expungement, without judicial intervention, of information from CRD as directed by arbitrators in intra-industry arbitration awards in which the arbitration panel states that expungement relief is being granted because of the defamatory nature of the information ordered expunged.") (citing NASD Notice to Members 04-16, at 215 n. 4) ("Consistent with the 1999 moratorium, NASD may continue to expunge, without a court order, arbitration awards rendered in disputes between registered representatives and firms that contain expungement directives in which the arbitration panel states that expungement relief is being granted because of the defamatory nature of the information.").



ordering expungement relief based on the defamatory nature of the information in the CRD system.”<sup>21</sup>

Should a firm purposely make false, disparaging statements about the now-former employee, the firm exposes itself to risk of civil liability for defamation.<sup>22</sup> However, if the employee who commences an arbitration proceeding is not seeking damages against his or her former employer, and is only seeking expungement, a purposeful false statement is not a prerequisite to obtaining the relief sought.

If information in question is defamatory in nature, the standard for expungement is satisfied even if a defamation claim for damages could not have been brought on the basis of the statement in question — for example, because the statement was true at the time it was made, or because the employer did not act with the malice required in order to recover damages. Thus, in finding information to be defamatory, an arbitrator is “not required to state explicitly in the award that [he has] found that all of the elements required to satisfy a claim in defamation under governing law have been met.”<sup>23</sup> Rather, the only such element that is relevant for expungement purposes is that the statement itself be defamatory.<sup>24</sup>

If the arbitration panel finds that the information contained in the CRD was defamatory, it may recommend expungement. This recommendation can come after an in-person hearing,<sup>25</sup> a telephonic hearing<sup>26</sup> or after reviewing the papers submitted by the parties.<sup>27</sup> It can even come after a settlement has been reached by all sides except as to the issue of expungement.<sup>28</sup>

Recent FINRA Arbitration Panel Decisions provide guidance as to how an arbitration panel will likely proceed if it concludes that challenged information in a CRD file is defamatory, and comfort that such panels are willing to direct effective corrective action so as to ameliorate the risk of harm to the employee’s future career in the industry.<sup>29</sup> In *In re Arbitration Between Steven Eric Schneiderman and RBC Capital Markets LLC*, the Panel recommended that “Yes” answers to Questions 7B and 7F(1) of the Form U5 be changed to “No,”

that the termination reason in the body of the Form U5 be changed to “Voluntary,” and that the separate Disclosure Reporting Page be deleted (because no further explanation is required for voluntary departures).

Similarly, several other recent FINRA Arbitration Panel decisions found that information in the CRD system that injured or prejudiced a person in his or her professional occupation was defamatory, and should therefore be expunged. For example, in *In re Arbitration Between Edward D. Jones & Co., L.P. and Ellen E. Boyce*,<sup>30</sup> the Respondent had been terminated by Claimant and then allegedly competed with Claimant in violation of Pennsylvania Trade Secrets Act. The Arbitration Panel recommended the expungement of the “Reason for Termination and Termination Explanation . . . based on the defamatory nature of the information.”<sup>31</sup> To effectuate this result, the Panel’s specific recommendations included changing “Yes” answers in the Form U5 to “No,” and deleting the accompanying DRP entirely.<sup>32</sup>

It should be noted that in many of the above cases recommending expungement based on the defamatory nature of the statements in question, the decisions themselves contain little detail about exactly what the defamatory statements were. However, such generalized discussion of the challenged statements — often without even specifying their contents — is consistent with the purpose underlying these decisions. In order for expungement to be meaningful, the defamatory information must be excised completely from the public record — whether in the CRD or in the expungement decision itself. Once it is determined that the information should be expunged, it should not be repeated in any forum.

## The Broad Understanding of ‘Defamatory in Nature’ in Expungement Proceedings

Although there is an absence of specific discussion in the FINRA cases as to what kind of information is “defamatory,” these decisions make clear that the issue should be examined in light of applicable state law — including the law declaring that certain statements constitute defamation *per se*. As discussed above, the expungement of “defamatory” information from an Associated Person’s CRD file does not require that Associated Person be able to plead and prove each element of

<sup>21</sup> NASD Notice to Members 99-54, at 352.

<sup>22</sup> See, e.g., *In re Arbitration between Maxim Minevich and Wells Fargo Advisors LLC*, FINRA Dkt. No. 10-04973, 2011 WL 6299747 (Dec. 8, 2011) (recommending expungement of defamatory information from former employee’s CRD file and awarding \$100,000 in compensatory and \$400,000 in punitive damages to defamed former employee).

<sup>23</sup> NASD Notice to Members 99-54, at 352.

<sup>24</sup> *Id.*

<sup>25</sup> See, e.g., *In re Arbitration Between Steven Eric Schneiderman and RBC Capital Markets, LLC*, FINRA Dkt. No. 11-0395, 2012 WL 6085439 (Nov. 28, 2012).

<sup>26</sup> See, e.g., *In re Arbitration Between David G. Simms and Avalon Partners, Inc.*, FINRA Dkt. No. 12-01478, 2012 WL 4847075 (FINRA Oct. 5, 2012).

<sup>27</sup> See, e.g., *In re Arbitration Between Brittany Marie Duran and Alamo Capital*, FINRA Dkt. No. 11-04240, 2012 WL 3776907 (Aug. 15, 2012).

<sup>28</sup> See *In re Arbitration Between Eric Michael Goldstein and Fifth Third Securities, Inc.*, FINRA Dkt. No. 10-04426, 2011 WL 6961634, at \*5 (FINRA, Dec. 28, 2011); *In re Arbitration Between Robert Stevens and Park Avenue Securities, LLC*, FINRA Dkt. No. 02-04567, 2004 WL 3120015 (FINRA, Dec. 16, 2004).

<sup>29</sup> See, e.g., *In re Arbitration Between Steven Eric Schneiderman and RBC Capital Markets, LLC*, FINRA Dkt. No. 11-03951, 2012 WL 6085439 (Nov. 28, 2012).

<sup>30</sup> FINRA Dkt. No. 11-04009, 2012 WL 6085441 (Nov. 27, 2012).

<sup>31</sup> *Id.* at \*3.

<sup>32</sup> See also *In re Arbitration Between RBC Capital Markets and Emmett Johnson*, FINRA Dkt. No. 12-00103, 2012 WL 5928176 at \*2 (Nov. 16, 2012) (Panel recommended expungement, changing “Yes” answer to “No” and deletion of DRP, “based on the defamatory nature of the information.”); *In re Arbitration Between David G. Simms and Avalon Partners, Inc.*, FINRA Dkt. No. 12-01478, 2012 WL 4847075, at \*1 (Oct. 5, 2012) (recommending expungement of “the Reason for Termination and Termination Explanation in Section 3 of Claimant’s . . . Form U5 filed by [Respondent]”); *In re Arbitration Between Brittany Marie Duran and Alamo Capital*, FINRA Dkt. No. 11-04240, 2012 WL 3776907 (Aug. 15, 2012) (recommending expungement of the reason for termination and termination comment from Claimant’s Form U5 based on the defamatory nature of the information, that the reason for termination be changed to “Voluntary,” and that termination explanation be expunged in its entirety).



a claim for defamation. Most importantly, while the defense of truth at the time the statement was made will defeat a claim for defamation, it is not a barrier to expungement. Instead, the expungement issue turns solely on the character of the statement itself.

New York law is helpful on this issue. Under New York law, a statement is defamatory *per se* if it injures or prejudices a person in his professional occupation.<sup>33</sup> Therefore, a statement will be considered defamatory *per se* if it involves allegations of professional “misconduct” or “lack of professional competence.”<sup>34</sup> Moreover, based upon a review of both FINRA expungement awards<sup>35</sup> and other state court opinions,<sup>36</sup> it appears that other states have similar standards of *per se* defamation to include statements that injure a person in his or her profession.

New York’s highest court has explained the principle that a statement that injures or prejudices a person professionally is *per se* defamatory.<sup>37</sup> In *Carney v. Mem’l Hosp. & Nursing Home of Greene County*, the Court of Appeals reversed a lower court, and reinstated a claim for “defamation based on publication of the statement that plaintiff was discharged ‘for cause’.”<sup>38</sup> The Court noted that the plaintiff alleged that the statement about “for cause” dismissal was “untrue and intended to injure him in his profession by indicating that he is incompetent to perform his professional duties. As such, it states a valid cause of action in libel.”<sup>39</sup> The Court of

Appeals also made clear that “to the extent that defendants argue that the statement is not defamatory because it means only that the hospital administrators had a ‘reason,’ which may or may not be valid, for dismissing plaintiff, their argument must be tested against the understanding of the average reader.”<sup>40</sup> While employing a double negative, the *Carney* Court made its reasoning clear: “[i]t cannot be said as a matter of law that the average reader of the statement that plaintiff was discharged ‘for cause’ would not interpret it as meaning that plaintiff had actually been derelict in his professional duties.”<sup>41</sup> And since discharge for cause can be equated with dereliction of duty, such a statement injured the person in his professional capacity, and therefore constituted defamation *per se*.

Therefore, under New York law, even general statements “to the effect that someone was discharged for ‘misconduct’ or ‘for lack of professional competence’ or ‘for cause’ ” are actionable.<sup>42</sup>

### Mechanics of Getting Your Expungement Recommendation Correct

If a person now works in the securities industry — or previously worked in the industry and may want to do so again in the future — and any of his or her former employers filed a Form U5 containing negative information about the end of the person’s employment relationship with that firm, such information will end up on the CRD system and follow the person for the remainder of his or her career unless it is expunged. As discussed above, the way to seek expungement is to file an arbitration claim. But an Associated Person should not simply seek an arbitration award expunging “any and all defamatory information,” because such an award would be too general to guarantee meaningful relief. Rather, the best approach is to be very specific when filing a Statement of Claim initiating the arbitration and delineate all requested changes to the CRD file. “FINRA can expunge information from the CRD system in intra-industry disputes only to the extent that it is directed to do so in an arbitration award.”<sup>43</sup> If an arbitration award does not provide enough detail or specificity, FINRA’s expungement — even if the Claimant was successful in the arbitration — may be incomplete and may mean that negative information will remain on the Associated Person’s CRD report.

There are particular challenges for expunging employment information from a Form U5 that must be kept in mind in articulating the demand for relief in an expungement proceeding. The first is that termination-related information can appear in multiple places in an Associated Person’s CRD file.<sup>44</sup> Therefore, the arbitration award should address all references to information in the broker’s CRD record that should be expunged.<sup>45</sup> The second point to keep in mind is that a FINRA arbitration award cannot expunge a termination explanation without providing language to replace the words being expunged, since an arbitration panel cannot de-

<sup>33</sup> *Arts4All Ltd. v. Hancock*, 5 A.D.3d 106, 109, 773 N.Y.S.2d 352 (1st Dept. 2004).

<sup>34</sup> See *Davis v. Ross*, 754 F.2d 80, 84 (2d Cir. 1984); *Haugh v. Schroder Investment Management North America, Inc.*, 2003 WL 21136096, at \*1 (S.D.N.Y. 2003).

<sup>35</sup> See, e.g., *In re Arbitration Between Eric Michael Goldstein and Fifth Third Securities, Inc.*, FINRA Dkt. No. 10-04426, 2011 WL 6961634, at \*5 (FINRA, Dec. 28, 2011) (citing *VanHome v. Muller*, 705 N.E.2d 898 (Ill. 1998) for the proposition that a “statement is considered defamatory if it tends to cause such harm to the reputation of another that it lowers that person in the eyes of the community or deters third persons from associating with him”); see also *In re Arbitration Between RBC Capital Markets and Emmett Johnson*, FINRA Dkt. No. 12-00103, 2012 WL 5928176 (Nov. 16, 2012) (Texas-based arbitration panel ordered expungement of defamatory information from CRD file, although panel made no reference to the legal authority for deeming the information to be defamatory).

<sup>36</sup> See, e.g., *Great Coastal Exp., Inc. v. Ellington*, 334 SE 2d 846, 849 (Va. 1985) (words are defamatory *per se* that “impute to a person unfitness to perform the duties of an office or employment of profit, or want of integrity in the discharge of the duties of such an office or employment [and] [t]hose which prejudice such person in his or her profession or trade.”); *Slaughter v. Friedman*, 32 Cal. 3d 149, 153 (Cal. 1982) (Under California law, a statement is defamatory if it exposes any person to hatred, contempt, ridicule, or obloquy, or which causes him to be shunned or avoided, or which has a tendency to injure him in his occupation.”) (Italics in original); *Corabi v. Curtis Pub. Co.*, 441 Pa. 432, 441 (1971) (defamation defined as that “which tends to blacken a person’s reputation or to expose him to public hatred, contempt, or ridicule, or to injure him in his business or profession.”); *Campbell v. Jacksonville Kennel Club*, 66 So. 2d 495 (Fl. 1953) (“an oral communication is actionable *per se* . . . if it imputes to another . . . conduct, characteristics, or a condition incompatible with the proper exercise of his lawful business, trade, profession, or office . . .”).

<sup>37</sup> See *Carney v. Mem’l Hosp. & Nursing Home of Greene County*, 64 N.Y.2d 770, 772 (1985).

<sup>38</sup> *Id.* at 772.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> See *id.*

<sup>43</sup> See NEUTRAL CORNER, *supra* note 5.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

lete the entire Form U5 or order a firm to withdraw it and file a new one.<sup>46</sup>

To help in addressing these challenges, FINRA provides the following guidance to its arbitrators:

When the information is to be expunged from Section 3 [Full Termination] on Form U5, the arbitration award should identify the specific filing at issue and address both (1) the reason for termination and (2) the termination comment. If the reason for termination is to remain or be changed to 'Discharged,' 'Other' or 'Permitted to Resign,' there must be a termination comment. In these circumstances, the award should provide a termination comment if there is none or replacement language if the original termination comment is to be changed . . . When the information to be expunged is located in a disclosure question DRP, the arbitration award should set forth the information to be expunged but it should not reference a specific filing from which the information is to be removed;<sup>47</sup>

This guidance to arbitrators is equally applicable to counsel preparing an Arbitration Demand initiating an expungement proceeding, and provides a helpful checklist to follow.

Therefore, a Statement of Claim seeking expungement should specifically identify:

- whether the Associated Person is requesting a change in the reason for termination;
- if so, what he or she would like the reason changed to; whether the Associated Person is requesting a change in the commentary regarding the termination;
- if so, what he or she would like the commentary changed to; whether the Associated Person is requesting that an affirmative answer in a disclosure question, such as Question 7F(1), and its accompanying explanation be changed; and

■ if so, how he or she wants the new language to read. This level of specificity will assist the arbitration panel, should it decide to direct expungement, in drafting an award that will accomplish completely the purpose for which the arbitration was commenced.

As we have previously discussed, there are firms that refuse to hire a candidate for employment with any involuntary termination language in his or her CRD file. In such cases, the arbitration panel should be asked to recommend changing the termination reason from "Permitted to Resign" (or "Other" or "Discharged" depending on the language of the challenged Form U5) to "Voluntary," and that the accompanying DRP that explained the termination (as well as any supplemental in-

formation the Associated Person may have provided) be expunged. Once the claimant receives the expungement award, he or she must still forward it to the FINRA Registration and Disclosure Department. Then, and only then, will the entire slate be wiped clean and harm to future career prospects be limited.<sup>48</sup>

## Conclusion

Although we commend the increased focus on compliance in the securities industry, neither the industry nor the public benefit from having qualified individuals be denied employment opportunities because of an excessively formalistic approach to hiring based on a mechanical reading of the CRD files.

By refusing to look into the details of an Associated Person's employment history whenever the person's CRD file shows anything other than "voluntary" resignations, firms appear to be acting out of fear — fear that should anything ever go wrong within their organization, it may be alleged that they should have been on notice of the risks based upon their employees' prior work history.

Such a fear-based approach that substitutes mechanical reactions for good judgment in the hiring process does not benefit the public or the hiring firm itself (which can be deprived of the services of qualified individuals). Moreover, it can affirmatively harm the applicant, whose future employment opportunities are restricted or — if enough firms adopt the mechanical approach — effectively foreclosed.

The burden of preventing or correcting such an unfair result rests on the Associated Person him- or herself. But he or she is not without recourse should the ability to obtain a new position be restricted because of information contained in his or her CRD file. The FINRA arbitration process discussed above provides a way to seek expungement of the harmful information, and open the door to future employment opportunities for which the person is qualified.<sup>49</sup>

<sup>48</sup> See, e.g., *In re Arbitration Between Steven Eric Schneiderman and RBC Capital Markets, LLC*, FINRA Dkt. No. 11-03951, 2012 WL 6085439 (Nov. 28, 2012); *In re Arbitration Between Edward D. Jones & Co., L.P. and Ellen E. Boyce*, FINRA Dkt. No. 11-04009, 2012 WL 6085441 (Nov. 27, 2012); *In re Arbitration Between RBC Capital Markets and Emmett Johnson*, FINRA Dkt. No. 12-00103, 2012 WL 5928176 at \*2 (Nov. 16, 2012); *In re Arbitration Between David G. Simms and Avalon Partners, Inc.*, FINRA Dkt. No. 12-01478, 2012 WL 4847075, at \*1 (Oct. 5, 2012); *In re Arbitration Between Brittany Marie Duran and Alamo Capital*, FINRA Dkt. No. 11-04240, 2012 WL 3776907 (Aug. 15, 2012).

<sup>49</sup> For more information about arbitrations seeking expungement of defamatory information, consult the FINRA website or counsel.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*