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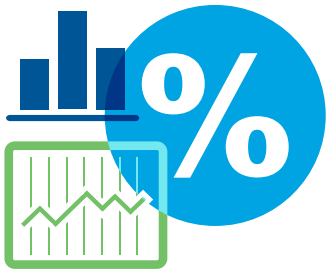

Financial Services Employment Arbitration Q&A

A Rock And A Hard Place: How Do I Handle Simultaneous Arbitration and Regulatory Inquiry?

By: *Nicholas De Baun*

A particularly thorny issue is presented when you are defending an arbitration and your regulator (FINRA, or perhaps the SEC) launches an inquiry into the very same facts that led to the dispute. Suppose for example that you fire a financial advisor for serious repeated compliance violations. Based on your statements on the employee's U-5, FINRA launches an inquiry into the alleged violations. At the same time, the broker sues you for wrongful termination, expungement of the U-5, and his unpaid bonus.

This scenario presents the obvious (and ugly) problem that you now have disclosure underway on two tracks. On one track, your broker is demanding documents relating to his termination and supporting your U-5 statements. On the other track, your regulator is demanding documents relating to the alleged compliance issue - a substantially overlapping set of documents. The problem is compounded if your regulator compels you to produce a far broader set of documents than your broker or the arbitrators would compel you to disclose. It is further exacerbated if your regulator is pursuing a failure-to-supervise line of investigation that requires you to assemble documents that could be very damaging to your prospects in the arbitration.

A good plaintiff's lawyer who is aware of the likelihood of a regulatory inquiry and the problems such an inquiry can pose to you will demand production of all documents and information you have produced in response to any related regulatory inquiry. These documents, if disclosed, can not only damage your case but could also adversely affect the regulatory inquiry. What to do?

The Regulator is King

The most important thing to bear in mind is that your duties to your regulator are paramount. In addition, any pleas that you be allowed to withhold documents from the regulator because of potential prejudice in the arbitration will surely fall on deaf ears. The best (and perhaps only realistic) approach is to make your regulator your ally, and to take every possible step to ensure that documents you turn over to the regulator will be protected from disclosure in the arbitration.

- The first and most important step you can take is to maintain open lines of communications with your regulator. Discuss the existence of the arbitration and raise your concerns early on about protecting documents and information from disclosure. Your regulator almost certainly does not want this information disclosed to the broker any more than you do.

- Document the issue and your concerns in writing. In the cover letter accompanying any disclosures, expressly state that the disclosures are being made solely in response to an inquiry by the regulator. State that you expect the regulator to protect the information and documents from disclosure to any third party (including the broker) and that you expect to be advised promptly if any such requests are made.
- Finally, immediately inform your regulator of any demands by the broker that you produce documents you disclosed to your regulator. If possible, secure the agreement of your regulator (which shouldn't be hard to get) that you should not produce any such documents. Panels will typically defer to instructions like these from regulators. If they don't defer, or if your regulator declines to instruct you not to produce the documents, be prepared to escalate the issues promptly to the Director of Arbitration and if necessary to the appropriate court.

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