09-1556-cv(L)

09-1863-cv(XAP)

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

JOHN J. FIERO and FIERO BROTHERS, INC.,
Plaintiffs-Counter-Defendants-Appellants-Cross-Appellees,

against

FINANCIAL INDUSTRY REGULATORY AUTHORITY, INC.,
Defendant-Counterclaimant-Appellee-Cross-Appellant.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF FOR PLAINTIFFS-COUNTER-DEFENDANTS-APPELLANTS-CROSS-APPELLEES

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Dated: October 19, 2009

CORPORATE DISCLOSURE STATEMENT

(FRAP 26.1(a))

Plaintiff-Appellant Fiero Brothers, Inc., a nongovernmental corporation, has no corporate parents, and thus no publicly held corporation owns 10% or more of its stock.

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PRELIMINARY STATEMENT

This is an appeal by plaintiffs-counter-defendants-appellants-cross-appellees John J. Fiero ("Fiero") and Fiero Brothers, Inc. ("Fiero Brothers") (collectively, the "Fieros") from the judgment entered July 24, 2009, in favor of defendant-counterclaimant-appellee-cross-appellant Financial Industry Regulatory Authority, Inc. ("FINRA")[1] in the amount of $1,010,809.25 with costs and interest (the "Judgment" (SPA-50)).[2] The Judgment is based on two published decisions and orders of United States District Judge Victor Marrero.

The first decision and order, dated and filed April 2, 2009 (SPA-4-40) (published at 606 F. Supp.2d 500), granted FINRA's motion to dismiss the Fieros' declaratory judgment complaint, and denied the Fieros' motion to dismiss FINRA's counterclaim. After remand by this Court granting Judge Marrero's request to "correct" the prior judgment, the second decision and order, dated July 23, 2009, filed July 24, 2009 (SPA-45-49) (2009 WL 2355777, to be published in ___ F. Supp.2d ___), ordered the Clerk to enter the money judgment in favor of FINRA (even though no party had moved for summary judgment and no party had been afforded an opportunity to oppose summary judgment).

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1 Formerly, National Association of Securities Dealers, Inc. ("NASD").

2 "SPA-__" references the Special Appendix; "A-__" the Joint Appendix.

JURISDICTIONAL STATEMENT

Subject matter jurisdiction is an issue in this case. The case concerns FINRA's attempt to collect a disciplinary fine from the Fieros, even though FINRA (or NASD) had never until recently ever attempted to judicially collect a disciplinary fine, which heretofore had been considered the exclusive province of the Securities Exchange Commission ("SEC").

The Fieros commenced this declaratory judgment action asserting original jurisdiction pursuant to 28 U.S.C. § 1331, as arising from the laws of the United States (A-10 ¶ 7). The Fieros alleged that the liability at issue here, asserted by FINRA, arises out of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a, *et seq.* ("Exchange Act" or "SEA"), and rules thereunder, and that exclusive federal jurisdiction was conferred by Section 27 of the Exchange Act, 15 U.S.C. § 78aa (A-10 ¶ 7). FINRA filed counterclaims asserting the same federal question subject matter jurisdiction (A-91 ¶ 5), as well as diversity jurisdiction pursuant to 28 U.S.C. § 1332 (A-91 ¶ 7). If there is no exclusive federal subject matter jurisdiction here, then there is diversity jurisdiction.

The district court determined – opposite of what the New York Court of Appeals had determined as between these parties, Financial Industry Regulatory Authority, Inc. v. Fiero, 10 N.Y.3d 12, 882 N.E.2d 879, 853 N.Y.S.2d 267 (2008) (A-223-26) – that the claim asserted was not pursuant to the Exchange Act, and

that exclusive federal subject matter jurisdiction was lacking (SPA-9-16). The district court therefore proceeded under diversity jurisdiction (SA-16-17).

Appellate jurisdiction exists pursuant to 28 U.S.C. § 1291 as an appeal from a final decision of a district court. The district court originally issued a judgment entered March 30, 2009 (SPA-3). From that judgment, the Fieros filed a Notice of Appeal on April 14, 2009 (A-535) and FINRA filed a Notice of Cross-Appeal on April 29, 2009 (A-536). This Court thereafter issued a Mandate dated July 15, 2009, allowing a limited remand for the district court to correct the Judgment, and providing a procedure for restoring the appeal after the district court concluded all proceedings (SPA-44). The district court issued what it deemed a corrected Judgment on July 24, 2009 (SPA-50). Upon timely letter-requests of the parties, this Court reinstated the appeals by Order dated August 12, 2009 (SPA-51).

STATEMENT OF THE ISSUES

1. Whether an action by FINRA to collect a disciplinary fine is a liability of exclusive federal subject matter jurisdiction. *See* Point I

2. Whether the district court violated the Full Faith and Credit Act, 28 U.S.C. § 1738, when it recognized FINRA's claim as one for breach of contract under New York State law, when the New York Court of Appeals had already dismissed FINRA's contract cause of action against the Fieros on grounds that the claim was preempted as within exclusive federal subject matter jurisdiction. *See* Point II.

3. (a) Whether FINRA's counterclaim against the Fieros is, as a matter of law, barred by the one-year statute of limitations applicable to arbitration awards, in that the underlying disciplinary proceeding was technically an arbitration, which is private dispute resolution. *See* Point III.

(b) Whether FINRA's counterclaim is, alternatively, barred by the two/five year periods for civil actions based on securities fraud (28 U.S.C. § 1658(b)). *See* Point IV(A).

(c) Whether FINRA's counterclaim is, alternatively, barred by the federal five-year limitations period for recovery of civil fines, penalties and forfeitures (28 U.S.C. § 2462). *See* Point IV(B).

4. Whether FINRA can judicially enforce collection of a disciplinary fine, which for over 65 years was the province of only the SEC, and whether the SEC has conferred collection authority upon FINRA. *See* Point V.

5. Whether the district court erred in granting FINRA a money judgment *sua sponte* when the only pending motions were to dismiss the pleadings, no notice of motion conversion was provided and no opportunity was afforded the parties to oppose summary judgment. *See* Point VI.

STATEMENT OF THE CASE

A. Nature of the Case and Summary of the Argument

1. Background

This case arises out of a 1995 massive pump-and-dump securities fraud that artificially inflated stock prices, ultimately causing firm insolvencies and investor protection by the Securities Investor Protection Corp. *See* Mishkin v. Ageloff, 299 F. Supp.2d 249, 251 (S.D.N.Y. 2004) (*see also* A-60). The scheme, however, reportedly was ignored by the NASD and other regulators until it was over, despite pointed warnings. *See* Gary Weiss, Did the NASD Look the Other Way?, Business Week, Dec. 16, 1996 (web updated June 14, 1997).[3]

Fiero was alleged to have been on the opposing side of the scheme, short-selling the artificially-inflated stocks, "manipulat[ing] the market downward" (A-62 n.30). In the disciplinary proceeding underlying this case, the NASD ultimately charged and found that the Fieros manipulated the market (A-49) and it did not matter "even if 'the goal [was] to get the stock to a price more reflective of its '"true worth."'" (A-62 n.30 (quotation source omitted)).

The fallout of this scheme, and the regulators' inaction, apparently embarrassed the regulators. The NASD thereafter brought a number of disciplinary proceedings against Fiero and his firm. In Fiero v. SEC, Docket No.

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[3] Available at http://www.businessweek.com/1996/51/b35068.htm

98-4103, 1999 WL 3395214, 1999 U.S. App. LEXIS 38873 (2d Cir. Jan. 20, 1999) (A-529-32), this Court vacated sanctions that had been imposed by the NASD and sustained by the SEC. This Court held that the NASD (which had refused requests of Fiero's counsel for certain accommodations) acted without authority in requiring Fiero to appear before it, and thus could not sanction him for leaving an interview.

The NASD then held the disciplinary proceedings underlying this case, resulting in a disciplinary fine being imposed against the Fieros, expelling them from the securities industry (A-49-83, 122-73). The NASD thereafter filed a state court action against the Fieros to collect the disciplinary fine, but was ultimately rebuffed by the New York Court of Appeals, which held that its claim was preempted by federal law. Financial Industry Regulatory Authority, Inc. v. Fiero, 10 N.Y.3d 12, 882 N.E.2d 879, 853 N.Y.S.2d 267 (2008) (A-223-26).

2. Summary of this Action

The Fieros then filed this action seeking declaratory judgment that they have no legally cognizable liability on the claim that FINRA asserts by its counterclaim, *i.e.*, recovery of fines and costs assessed in the disciplinary enforcement proceeding (A-9-14, 90-98). Both parties moved to dismiss the other's pleading (A-15 & 99). Deciding those motions, the district court disagreed with the New York Court of Appeals, and held that there was no federal subject matter

jurisdiction (SPA-9-16). Based on diversity jurisdiction (SPA-16-17), however, the district court recognized FINRA's contract counterclaim (SPA-38-39) – even though it had already been adjudicated to finality in the state court system. The district court granted FINRA a money judgment *sua sponte* (SPA-45-50).

3. Summary of the Arguments

The initial question is whether FINRA's claim is one created by state law or federal securities laws, providing for exclusive federal subject matter jurisdiction (Point I). The New York Court of Appeals and the district court came to opposite conclusions, neither court fathoming a claim within the sphere of its core jurisdiction (see Point V). The Fieros have no gripe with the district court's conclusion that it lacked federal subject matter jurisdiction, however, as that should have ended FINRA's attempt to obtain a money judgment.

This is because the New York Court of Appeals had already determined to finality that FINRA had no contract claim. The district court should have been bound by that prior determination, as a matter of collateral estoppel under state law and by operation of the Fair Faith and Credit Act, 28 U.S.C. § 1738, which requires federal courts to give the same preclusive effect to state court determinations as state courts would. Clearly, FINRA could not have gone back to state court to prosecute its claim again, as it already had its day in court and litigated its claim to finality, with no right of do-over (Point II).

Even if FINRA's claim was a federal one, it would be time-barred, as based on an arbitration award, due to the one-year limitations period in section 9 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 9, and/or section 215(5) of New York CPLR (Point III). The award FINRA seeks to enforce arose out of a disciplinary proceeding that essentially was, in form and substance, an arbitration. Where a private adjudicatory tribunal, pursuant to the parties' agreement, takes and hears evidence and issues a determination, that is arbitration. That is so regardless of whether the parties call the process "arbitration," and even if they stipulate that it is *not* arbitration, and even if the process is adjunct to another process called arbitration. As has been recognized, any controversy can be arbitrated, even one not otherwise justiciable in court. The underlying disciplinary proceeding was a fair proceeding, quasi-judicial in nature, with captions, pleadings, motions, hearing officers, representation by counsel, and the like. The district court raised point after point as to why the disciplinary proceeding supposedly could not be arbitration (SPA-21-24), but each aspect the district court noted has been found in other recognized arbitrations. The district court might as well observed that a car was not a car because it had a steering wheel, passenger seat and flower vase – none of course disavowing a car as a car. The district court apparently was looking for a "prototypical arbitration" (SPA-22). The proceeding may not have been a "prototypical" arbitration, but it was still an arbitration, required to be confirmed or

sued upon within one year. FINRA filed no case within one year of the award or delivery thereof, time-barring its claim (Point III).

Alternatively, even if the underlying disciplinary proceeding was not arbitration – which it clearly was – an action on a federal claim would nevertheless be time-barred by either the two/five year period for civil actions based on securities fraud (28 U.S.C. § 1658(b)) (Point IV(A)), or the federal five-year limitations period for recovery of civil fines, penalties and forfeitures (28 U.S.C. § 2462) (Point IV(B)).

It is understandable that neither the state court nor the federal district court could fathom a claim within its core jurisdiction, because substantively, there is no claim for FINRA to assert (Point IV). Since its registration in 1939 as a national securities association under the Exchange Act, until just recently – for over 65 years – FINRA (then NASD) had never sought to judicially collect on a disciplinary fine. To date, the right to judicially collect on disciplinary fines has belonged to the SEC, pursuant to the statutory scheme of the Exchange Act. Traditionally, the NASD did not seek payment of its disciplinary fines unless and until a member or associated person sought reinstatement, and then sought payment only as a condition to such reinstatement (A-103 ¶ 4).

Recently, however, NASD has attempted to expand its authority, testing the waters by filing a handful of actions in New York State court, including the one

against the Fieros. No authority to enforce judicial collection of a disciplinary fine has been conferred upon FINRA by the SEC, as would be required. The FINRA by-laws and rules do not provide for collection of sanctions. Neither do the SEC-promulgated registration forms upon which FINRA relies. NASD's Notices to Members cannot provide such authority because they were not SEC-approved, as required for rule change. There are no comparable provisions for FINRA to judicially collect awards, as exist for the SEC under the Exchange Act and for parties under FINRA arbitration rules and the FAA. The applicable NASD manual also provided that disciplinary procedures were not designed to recover damages or obtain relief for a party. The disciplinary decision which FINRA seeks here to enforce recites the consequences of nonpayment, but not judgment or collection (A-83). Case law provides that the right of a membership association to impose a fine on a member does not necessarily confer the right to collect the fine, and that a membership association cannot recover damages it determines itself in an arbitrary or unliquidated amount. There is also case law suggesting that the outcome of a securities disciplinary proceeding is not enforceable in a parallel civil suit, especially as the standard of proof for fraud in a disciplinary proceeding is lower than that required in a civil case. In any event, any supposed "contract" must be construed against FINRA, as the drafter. Finally, there was no expectation by the

Fieros that the NASD could turn the disciplinary determination into a judicially enforceable judgment, and thus no meeting of the minds.

Finally, the district court erred in granting FINRA a monetary judgment *sua sponte* when the only pending motions were to dismiss the pleadings, no notice of motion conversion was provided and no opportunity was afforded the parties to oppose summary judgment (Point VI). The district court's disregard of the protections afforded by the Federal Rules of Civil Procedure is matched only by its disregard of the New York Court of Appeals' determination of FINRA's contract claim, its disregard of the limitations periods that bar FINRA's claim, and its disregard of the rules that require FINRA to obtain SEC approval prior to competing with the SEC in judicially collecting disciplinary fines.

B. Factual Background

1. NASD/FINRA

FINRA is a private non-profit Delaware corporation, and membership organization (A-25). FINRA is also the only officially registered "national securities association" under section 15A of the Exchange Act, 15 U.S.C. §§ 78*o*-3, *et seq.* National Ass'n of Secs. Dealers, Inc. v. Securities and Exchange Commission, 431 F.3d 803, 804 (D.C. Cir. 2005), *rehearing en banc denied* (2006) ("NASD v. SEC"), having been so authorized by the SEC since 1939. *See* In the

Matter of Application by National Ass'n of Secs. Dealers, Inc., 5 S.E.C. 627, Rel. No. 2211, Rel. No. 34-2211, 1939 WL 36389 (Aug. 7, 1939).

Two provisions of the Exchange Act define FINRA's quasi-governmental authority to adjudicate actions against members who are accused of unethical or illegal securities practices and the Commission's oversight of that authority: Sections 15A and 19 of the Exchange Act. NASD v. SEC, 431 F.3d at 805.

Section 15A, 15 U.S.C. § 78o-3, lays out the specific duties of a registered national securities association. It sets out disciplinary functions which FINRA, as a registered national securities association, must perform. Where FINRA members have allegedly violated either association rules or federal securities law, FINRA has the authority to consider disciplinary action in the first instance. NASD v. SEC, 431 F.3d at 805. Among the possible sanctions allowed is a "fine." SEA § 15A(b)(7), 15 U.S.C. § 78o-3(b)(7). If FINRA proceeds against a member, it must provide a minimum level of process, including notice of the specific charges, an opportunity to be heard, and a statement of subsequent findings. *See* SEA § 15A(h), 15 U.S.C. § 78o-3(h). Fair disciplinary procedures are a prerequisite for registration of a national securities association. SEA § 15A(b)(8), 15 U.S.C. § 78o-3(b)(8); NASD v. SEC, 431 F.3d at 805.

Given the statutory requirements of Section 15A, FINRA has established an elaborate adjudicatory arm to address disciplinary actions, and elaborate published

rules setting forth detailed procedure for same (*see* A-227-29). Under the NASD Code of Procedure applicable here, decisions are made by a Hearing Panel of the NASD. Those decisions are appealable to the NASD National Adjudicatory Council ("NAC"). NAC decisions could be appealed to the SEC, and from the SEC, at least by a disciplined respondent, to the United States Court of Appeals. NASD v. SEC, 431 F.3d at 804-05.

Section 19 of the Exchange Act, 15 U.S.C. § 78s, sets out the SEC's supervisory duties over self-regulatory organizations ("SROs"). FINRA is an SRO by virtue of it being a "registered securities association" under Section 15A. *See* SEA § 3(a)(26), 15 U.S.C. § 78c(a)(26).

Section 19 strictly limits FINRA's rule-making authority. Section 19(b)(1) of the Exchange Act states that when proposing a rule change an SRO "shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization . . . The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. *No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection."* 15 U.S.C. § 78s(b)(1) (emphasis added).

With respect to adjudications, the SEC's oversight begins with the obligation of SROs to notify the SEC of any final disciplinary sanction imposed on a member or associated person. SEA § 19(d)(1), 15 U.S.C. § 78s(d)(1). The statute also provides the SEC with plenary review powers to review disciplinary actions. SEA § 19(e), 15 U.S.C. § 78s(e). FINRA's authority to discipline its members for violations of federal securities law is entirely derivative of the authority belonging to the SEC. Congress gave SROs disciplinary power over their members, by allowing them to levy economic sanctions. NASD v. SEC, 431 F.3d at 806-07.

The Exchange Act requires persons utilizing exchange facilities in order to effect transactions to register with the SEC in such form as the SEC by rule prescribes. SEA § 15, 15 U.S.C. § 78o. The SEC has adopted Form BD for FINRA members and Form U-4 for registered representatives associated with FINRA members. *See* SEA § 15(b)(2)(A), 15 U.S.C. § 78o(b)(2)(A) (on such form as the Commission, by rule, may proscribe); Rule 15b1-1(a), 15 C.F.R. § 240.15b1-1(a) (proscribing Form BD); Rel. No. 11424, Rel. No. 34-11424, 7 S.E.C. Docket 2, 1975 WL 162750 (S.E.C. May 16, 1975) (adopting Forms BD & U-4).

By becoming a FINRA member, and/or executing these forms, the member or registered representative agrees to comply with all provisions of FINRA's rules and regulations. During the period relevant here, the Form U-4 stated that the

applicant agrees "to comply with all provisions, conditions and covenants of the statutes, constitutions, certificates of incorporation, by-laws and rules and regulations of the jurisdictions and organizations as they are or may be adopted, or amended from time to time" and "to be subject to and comply with all requirements, rulings, orders, directives and decisions of, and penalties, prohibitions and limitations imposed by the jurisdictions and organizations, subject to right of appeal or review" (A-41 ¶ 2)).

2. The Fieros

Since 1990, until their expulsion and bar, Fiero Brothers was an NASD member firm and a broker-dealer registered with the SEC, and Fiero was a registered representative and employee of Fiero Brothers (A-26-27). Upon registering, Fiero Brothers (in predecessor form) executed Form BD (A-42-47) and Fiero executed Form U-4 (A-39-41).

3. The Underlying Disciplinary Proceeding

In February 1998, the NASD Department of Enforcement initiated a disciplinary complaint against the Fieros (and others) in regard to short-selling activities (A-105-21). The Fieros appeared by counsel, who represented them throughout the enforcement proceedings (A-103 ¶ 3).

Thereafter, hearings were scheduled "at the reasonable convenience of the parties, witnesses and Hearing Panel members" (A-124). The hearings were held

on multiple days before an Extended Hearing Panel that included a Hearing Officer and two industry members (*id.*). Numerous witnesses testified for, and exhibits were submitted by, all parties (A-124-25). The parties submitted post-hearing briefs, which were considered by the Hearing Panel pursuant to schedule (A-125).

Based on the hearings and submissions, the Hearing Panel issued a decision dated December 6, 2000, consisting of 48 pages of double-spaced type (A-122-70). By its decision, the Hearing Panel expelled Fiero Brothers from NASD membership, barred Fiero from associating with any member firm in any capacity, fined both Fiero and Fiero Brothers $1 million (jointly and severally), and ordered them to pay costs (jointly and severally) in the amount of $10,809.25 (A-169).

The Fieros appealed to the NAC in accordance with NASD rules. Pursuant to a predetermined schedule, the parties submitted briefs to the NAC, upon the record of the Hearing Panel hearing (A-103 ¶ 3).

The NAC issued its decision on October 28, 2002 (A-49-83), consisting in its original form of 48 single-spaced pages. The NAC Decision affirmed the Hearing Panel, and issued the identical sanctions. The NAC Decision concludes with an instruction that failure to pay will result in a membership suspension, expulsion and revocation:

> Pursuant to NASD Procedural Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-

> payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.

(A-83 n.63)) Consistent with the NASD's practice, and lack of authority in the NASD Code of Procedure, the award says nothing about the NASD having any right to judicially recover the assessment.

The NAC Decision was transmitted to counsel for the Fieros on or about October 28, 2002 (A-171-73). Had the Fieros appealed to the SEC, as was their right, and had the SEC affirmed, the SEC has taken the position that it has the statutory authority to bring an action in federal court to collect the fine imposed. *See, e.g.*, SEC v. Pinchas, 421 F. Supp. 2d 781, 783 (S.D.N.Y. 2006). The Fieros declined to appeal the NAC decision to the SEC (A-362).

C. The State Court Proceedings

On February 23, 2004 – more than a year after the October 28, 2002 NAC Decision – the NASD filed an action in state court seeking a money judgment against the Fieros based on the NAC Decision. While the New York Court of Appeals ultimately dismissed the action on grounds of federal preemption, we believe that the Court recognized the deficiencies of the opinions below on their merits. The Fieros' motion for leave to appeal, which the Court granted, did not identify any jurisdictional issue (A-190-217). It was only in the appeal briefs, after leave was granted, that the Fieros raised the jurisdictional deficiency (A-219).

While the decisions and orders of the trial court and appellate division have been vacated by the mandate of the New York Court of Appeals – and thus have no legal effect – we address them briefly to relate how unsatisfying they are.

1. <u>At the Lower Court</u>

Justice Carol Edmead issued two, among other, decisions relevant herein.

(a) <u>Rejecting Time-Bar as Arbitration</u>

In a decision entered December 22, 2005 (A-174-82), Justice Edmead denied the Fieros' motion for summary judgment to dismiss the action as time-barred as based on an arbitration award. She began by noting that the NASD did not seek to "confirm" the underlying determinations, but that it simply sought to collect on the fine imposed (A-178). That observation should have been no help to the NASD, however, as CPLR § 215(5) bars *any* action upon an arbitration award not commenced within one year.

She then noted that the NASD relied on provisions of its by-laws and rules that allow "imposition" of fines (A-178). Such provisions do not provide for "collection" of such fines – as has been expressly provided to the SEC – and cases recognize the distinction between "imposition" and "collection." In any event, when the fines due are determined in a proceeding deemed arbitration, any action upon it must be commenced within one year.

She then stated that NASD disciplinary proceedings are commenced to discipline firms and brokers, "and therefore is not and [sic] 'alternative' to court" (A-180). That observation, however, overlooked that CPLR § 7501 specifically provides that arbitration may encompass issues not otherwise justiciable in court.

She then noted that there is no "specific agreement between NASD and the Fieros to arbitrate the type of underlying claims by NASD's Department of Enforcement" (A-180). However, the parties clearly agreed to such hearings as were conducted, and arbitration need not be called arbitration to be deemed arbitration, when it possesses the aspects of arbitration.

She then espoused that the NAC was not a neutral third party (A180). In that observation, Justice Edmead overlooked that the members of both the Hearing Panel and NAC must be unbiased, and are subject to the same recusal standard as federal judges.

Finally, she concluded that the NASD's complaint was based on the Fieros' agreement to pay fines or sanctions, supposedly subject to the limitations period for breach of contract (A-180). Among other problems, an arbitration of a breach of contract claim still carries with it a one-year limitations period from the date of the award. Without the underlying proceeding, there are no fines or sanctions due. It was undisputed that the action there was commenced more than one year from the NAC Decision.

(b) Rejecting Lack of Authority to Collect

In a decision entered June 1, 2006 (A-182-87), Justice Edmead granted the NASD's separate summary judgment motion, facially rejecting the Fieros' affirmative defenses.[4] Following recitation of the summary judgment standard (A-184-86), she devoted just a quarter-page (A-186) to the various arguments that took the Fieros pages to list single-spaced in their table of contents (*see*, *e.g.*, A-219-22). She then noted that the "case really amounts to a collection action to recover fines and costs levied by NASD against the Fiero defendants in a NASD disciplinary proceeding" (A-186). She then addressed the Fieros' "selective enforcement" affirmative defense (which was their sixth and lesser among a dozen affirmative defenses asserted there) (A-186).

Justice Edmead did not address various of the Fieros' stronger arguments, including: that the NASD has not been given collection authority by the SEC; the NASD by-laws and rules do not provide for collection of sanctions; the NASD Manual provides that disciplinary procedures are not designed to recover damages or obtain relief for a party; the underlying NAC Decision recited the repercussions for nonpayment without mentioning judgment or collection; the NASD did not traditionally seek to enforce collection of fines until the member sought

[4] Justice Edmead apparently recognized that a separate summary judgment motion, apart from the earlier motion, was required in order to grant judgment – a concept that seems to have alluded the district court here.

reinstatement; under case law the right to impose a fine does not *per se* grant a right to collect; a membership association cannot recover an assessment that the association itself determined in an arbitrary or unliquidated amount; there was no meeting of minds that the supposed "contract" included the right to collect fines; and the NASD's historical policies equitably estop its collection attempt; among others.

2. At the Appellate Division

A panel of the Appellate Division, First Department, issued a short decision and order, affirming. National Ass'n of Secs. Dealers, Inc. v. Fiero, 33 A.D.3d 547, 827 N.Y.S.2d 4 (1st Dep't 2007) (A-188-89). The panel began by observing that "[p]laintiff's action to collect the disciplinary fine it had imposed was not a proceeding to confirm an arbitration award, and was thus not subject to a one-year limitation period (CPLR [§] 7510)." Id. at 548, 827 N.Y.S.2d at 5. The panel did not address whether the disciplinary decision was in fact an arbitration award. The panel also did not address the principal section of the CPLR that the Fieros had raised below and on their appeal, CPLR § 215(5), which bars an action based on an arbitration award more than one year after such award, irrespective of whether the action was brought as a motion to confirm.

The opinion then recites that the NASD was "authorized by Congress to promulgate and enforce rules governing the conduct of its members," that the

"instant fine was authorized by plaintiff's bylaws and rules, and any sanction upheld by its National Adjudicatory Council was subject to review by the Securities Exchange Commission and, ultimately, by the United States Court of Appeals." Id. The opinion continues, stating that "the Form U-4 executed by the individual defendant obligated him to comply with any penalty imposed by plaintiff." Id. The opinion does not specifically address whether or how a "fine" or "penalty imposed" would be enforceable as a judgment.

The opinion then echoes the lower court's rebuttal of selective enforcement (a point the Fieros do not press in this federal case). The decision concludes by rejecting the Fieros' counterclaims (claims not raised in this federal case). Id.

3. The New York Court of Appeals

As already noted, the New York Court of Appeals granted leave to appeal, 8 N.Y.3d 814, 870 N.E.2d 160, 838 N.Y.S.2d 840 (2007) (table). Thereafter, using the NASD's new name, the court reversed, with costs, on grounds of federal preemption, dismissing the action. Financial Industry Regulatory Authority, Inc. v. Fiero, 10 N.Y.3d 12, 882 N.E.2d 879, 853 N.Y.S.2d 267 (2008) (A-223-26). Significantly, FINRA did not seek review at the United States Supreme Court.

D. This Federal Action

1. Initial Proceedings & Initial Judgment

The Fieros commenced the instant action on February 8, 2008, seeking a declaratory judgment of no liability (A-9-14). FINRA filed a counterclaim reasserting its claim under contract theory (A-90-98). Each party moved to dismiss the other's pleading (A-15-89, 99-379). The district court held neither a party conference nor oral argument.

On March 30, 2009, the district court issued a perplexing order (SPA-1-2) stating in part that "FINRA has to [sic] right to collect the fees it imposed on the Fieros and the defenses raised by the Fieros to the collction action are without merit" (SPA-1 (emphasis added)). It was unclear whether the court was stating that "FINRA has no right to collect the fees . . ." or that "FINRA has the right to collect the fees . . . ." The March 30 order stated that the findings, reasoning and conclusions for the court's rulings would be set forth in a subsequent decision and order. The court noted that it was granting FINRA's motion and denying the Fieros' motion, but it ordered the Clerk to withdraw any pending motions and close the case, apparently without any monetary judgment to FINRA.

On the same day, March 30, 2009, a Judgment issued (SPA-3), based on the district court's order of that date. The Judgment recited that FINRA's motion to

dismiss the complaint was granted, the Fieros' motion to dismiss the counterclaims was denied, any pending motions were withdrawn and the case was closed.

As a decision had not yet issued, and as the Fieros' complaint sought a declaratory judgment of no liability, the result of the case being closed without a money judgment appeared as a possible Fiero win. Thus, as of that date, a Judgment had issued, the case was closed and the time period to appeal had begun, but neither party knew for sure whether it had won or lost.[5]

2. Dismissal Opinion

On April 2, 2009, the district court issued its Decision and Order on the motions to dismiss ("Decision") (SPA-4-40). The court found that, contrary to the New York Court of Appeals determination, there was no exclusive federal subject matter jurisdiction (SPA-9-16). That would have been the end of the case, except that the district court also had diversity jurisdiction (SPA-16-17).

Sitting as a diversity court – effectively a state court – the district court determined, opposite of what the New York Court of Appeals had already determined as to the state claim among the parties, that FINRA *did* have an enforceable state contract cause of action (SPA-16, 25-27, 38-39). The district court rejected the Fieros' contention that the New York Court of Appeals decision was *res judicata* as to FINRA's state law claims (SPA-18-19). The district court

[5] There were no exigencies involved that would have warranted or explained the court's issuance of a judgment prior to the supporting decision.

reasoned that a dismissal for lack of subject matter was not a dismissal on the merits, and that the New York Court of Appeals decision therefore was not preclusive (SPA-19). That reasoning neglects, however, that FINRA had already adjudicated its state law claim though the state system to finality and could not have gone back into state court to do so again. The district court, sitting in diversity, was so bound.

Continuing, the district court determined that the state contract claims were not preempted because, in its view, the Exchange Act entrusted SROs with the responsibility of regulating their members, including to pursue contract claims (SPA-20-21). The court overlooked, however, that under the comprehensive scheme of federal regulation, an SRO's rules must specifically be approved by the SEC, and no NASD rule allowed FINRA, as they do the SEC, to collect upon a disciplinary award. Apparently, in the district court's understanding, the NASD could create side-contracts allowing it to compete with the SEC in collecting disciplinary fines, without needing SEC approval as required for rule-making under the Exchange Act.

The district court also rejected the notion that the disciplinary proceedings constituted an arbitration, which would have required the disciplinary determination to be confirmed or sued upon, if at all, within one year (SPA-21-24). The district court noted that the disciplinary proceedings were quasi-prosecutorial

and that the Fieros did not have the mutual right to initiate the process, and to participate in the selection of an impartial arbitrator (SPA-22). This logic is faulty, however, as in various types of arbitrations one party, but not the other, has a unilateral right to initiate the arbiration process. Moreover, arbitration is not defined by the party's absolute right to select the arbitrator, as both the FAA and CPLR provide for the court to choose the arbitrator(s) where required. Further, under NASD rules, as mandated by the Exchange Act, the NASD hearing officers and NAC members were required to be neutral, under the same recusal standards as apply for federal judges. Further, the law is clear that any dispute, even those otherwise not justiable in court, may be arbitrated. The district court also noted that the disciplinary process here provided for access to levels of appellate review, including by the SEC and federal Court of Appeals (SPA-23). Again, the district court small-mindedly confused the "prototypical arbitration" (SPA-22) with the broad array of arbitration types that are subject to the one-year limitations period, including arbitrations that occur outside the constraints of the CPLR and FAA (such as multistep labor greivances, arbitrations from other jurisdictions, and attorney-client fee disputes under New York court rules). Essentially ignoring the fair-hearing process underlying FINRA's claim, the district court concluded that the six-year limitations period for contracts would apply (SPA-24), even though a

contract dispute arbitrated would have only one year in which to be confirmed or sued upon.

Addressing the Fieros' state law defenses, the district court determined that the contracts between the parties were not ambiguous in providing that the NASD could collect upon a displinary fine (SPA-25-26). Had the contracts been at least ambiguous, they would have to be construed against NASD as the drafter. Of course, if the contracts were so clear – they were not – one wonders why NASD was compelled to issue notices to "clarify" that it intended to collect fines and costs rendered in disciplinary decisions (A-85-89; *see* SPA-28-29) – which right was never set forth in the bylaws as required (*see* SPA-26-27 & 31-34 (district court reviewing organization's certificate of incorporation or bylaws for powers)).

The district court then addressed the implication of the NASD's failure to collect over the years, noting that it would not constitute an estoppel (SPA-27-30). More to the point, however, the NASD's failure to pursue collection since its inception and for over 65 years suggests concretely that such power was never conferred in the first place. Indeed, the NASD's failure to assert another reputed power has led the District of Columbia Circuit to determine that the NASD thus had no such power. The district court nonetheless rejected that principal of construction here (SPA-29).

The district court also determined that private organizations can use the court system to enforce penalties against members (SPA-31-36), misconstruing the Fieros' argument. The Fieros do not challenge FINRA's right to sue and be sued. Rather, we point out the recognized distinction between the right to impose a fine and the right to collect. The district court blurs the two as if synonymous. They are not, and while the NASD had the right to impose a fine, it was never afforded – and the bylaws do not provide for – the right to collect a fine, which thus far has been preserved for the SEC. As such, FINRA can go into court, but it will do so with no claim.

Apparently hedging the bets made on its jurisdictional determination, the district court continued with the astounding assertion that even if state law was insufficient to enable FINRA to enforce its contractual rights, FINRA's federal quasi-governmental character empowered it to collect disciplinary fines (SPA-36-37). Without saying so, the district court apparently recognized a federal common law right not previously recognized in the annals of jurisprudence from the founding of our republic to now. As will be shown, however, there is no federal common law right, and especially not one created under the Exchange Act if there is no federal subject matter jurisdiction, as the district court has determined.

Lastly, the district court rejected the notion that FINRA was using the disciplinary proceeding as evidence from a parallel proceeding, concluding that

FINRA was merely seeking to enforce a contract (SPA-37). But there is no contract entered into by the Fieros that specifies the amounts FINRA seeks. Rather, FINRA's claim is based on the discplinary proceedings – FINRA's pleadings confirm this – but case law bars the outcome of a disciplinary proceeding from being used as evidence, or adopted, in a related civil case.[6]

Based on the above, the district court granted FINRA's motion to dismiss the Fieros' declaratory judgment action, and denied the Fieros' motion to dismiss FINRA's counterclaim (SPA-40).

3. Appeal and Limited Remand Back to District Court

On April 14, 2009, the Fieros filed their Notice of Appeal (A-535), from the March 30, 2009 Judgment. At around the same time, FINRA requested that the district court issue a monetary judgment, to which the Fieros objected (*see* SPA-42). On April 17, 2009, the district court issued an order recognizing that its jurisdiction had been ousted by the Fieros' filing of their Notice of Appeal, but requesting a "limited remand" to the district court so it could fix the "inadvertant omission" in its Decision and Order and grant FINRA judgment in the amount of

[6] The district court also addressed the argument that FINRA was not actually damaged (SPA-30), a defense recited in the Fieros' pleading as having been raised previously (A-13), but which the Fieros did not specifically raise in their motion and do not press here on appeal.

"$1,010,809.25 with costs and interest" (SPA-41-43).[7] FINRA filed its Notice of Cross-Appeal on April 29, 2009 (A-536).

By Order dated June 24, 2009 (issued as Mandate on July 15, 2009), this Court granted the district court's request for a limited remand to correct the Judgment, providing a procedure for restoring the appeal after the district court concluded all proceedings (SPA-44).

On July 16, 2009, undersigned counsel for the Fieros wrote to the district court, contending that the prior Judgment violated the Full Faith and Credit Act, 28 U.S.C. § 1738, and the Rooker-Feldman doctrine (A-538-39). We wrote (in pertinent part):

> One issue we wish to bring to Your Honor's attention is that Court's previous judgment (and underlying decision) violates the Full Faith and Credit Act, 28 U.S.C. § 1738, in that it recognizes FINRA's cause of action as one for breach of contract under New York State law, when the New York Court of Appeals had already dismissed FINRA's contract cause of action against the Fieros on grounds that the claim was preempted as within exclusive federal submit matter jurisdiction. Had FINRA reasserted its contract claim in state court after the New York Court of Appeals dismissed it in its final unappealed order, FINRA clearly would have been thrown out of court with sanctions. A federal judge may act no differently, especially one acting, as this Court did, solely in diversity. To rebuff the New York Court of Appeals on its

[7] The Fieros had objected to the district court, and later to this Court by motion, that the the modification sought by FINRA was untimley under Fed. R. Civ. P. 59(e), and otherwise was no mere ministerial act, and that FINRA had made no motion for judgment on the pleadings or summary judgment that would have authorized then granting a monetary award.

> determination also violates the Rooker-Feldman doctrine, which holds that lower federal courts have no power to review state court decisions, especially as to state causes of actions; only the U.S. Supreme Court can review a state court judgment. The underlying judgment violates these principles of federalism and finality.

(A-538) While the letter purposely did not cite specific case law, we requested a court conference to address those and related issues.

4. <u>Opinion on Full Faith and Credit Act and Rooker-Feldman</u>

Rather than allow the parties address these legal issues – which the court conceded were "serious" (SPA-47) – the district court on July 23, 2009, issued another Decision and Order (SPA-45-49). In short, the court concluded that the Fieros' concerns were "wholly without merit" (SPA-47). In essence, the district court reiterated its prior conclusion that FINRA's contract claim was not barred by the New York Court of Appeals decision, reasoning that the dismissal was based on lack of subject matter, and that the merits of the claim had not been decided (SPA-48-49). What the district court overlooked, however, is that FINRA had its opportunity in the state court system on its state law claims and lost, and such determinations, even those based on jurisdictional grounds, are afforded the same full faith and credit as would be afforded in the state courts. The district court did not state that FINRA could have prosecuted its contract claim in state court again, as clearly FINRA could not have. Otherwise stated, FINRA had been there, done that, to a point of finality.

5. "Corrected" Judgment and Reinstatement of Appeal

The district court issued what it deemed a corrected Judgment on July 24, 2009, in favor of FINRA in the amount of $1,010,809.25 with costs and interest (SPA-50). Upon letter-requests of the parties, this Court reinstated the appeals by Order dated August 12, 2009 (SPA-51).

STANDARD OF REVIEW IS *DE NOVO*

Because all of the issues for review either were, or can be, determined as a matter of law, the standard of review is *de novo*.

ARGUMENT

I.

THE FIEROS TAKE NO POSITION ON WHETHER EXCLUSIVE FEDERAL SUBJECT MATTER JURISDICTION APPLIES

The Fieros had argued successfully to the New York Court of Appeals that FINRA's claim was a matter of exclusive federal subject matter jurisdiction (A-416-20, 503-09). FINRA had argued there that its claim was a state claim within the general jurisdiction of the state courts (A-487-88).[8] Neither party briefed the issue of subject matter to the district court, nor did the district court request that they do so.

[8] *See also* 2008 WL 2346201 (Jan. 2, 2008 oral argument at New York Court of Appeals) (Case No. 2008-0002).

At this point in the process – with the Federal Court as FINRA's only remaining forum for recovery – the determination that there is no federal subject matter jurisdiction actually *benefits* the Fieros, as it should effectively end the proceedings (*see* Point II, *infra*). The Fieros thus are not aggrieved by the district court's jurisdictional determination. Even were FINRA to enter the jurisdictional fray, the Fieros would respectfully abstain from now arguing a position diametrically opposed to the one they proffered to the New York Court of Appeals, understanding that this Court has an independent duty to consider the jurisdictional issues.

II.

THE DISTRICT COURT JUDGMENT, BASED ON FINRA'S CONTRACT CLAIM, VIOLATES THE FAIR FAITH AND CREDIT ACT

The district court violated the Fair Faith and Credit Act, 28 U.S.C. § 1738, by recognizing a state claim that had been fully and fairly litigated by the parties and decided to finality through the state system, in which state system and with which claim FINRA would be precluded from re-prosecuting against the Fieros.

Section 1738 reads, in relevant part: "The records and judicial proceedings of any court of any . . . State . . . shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken." 28 U.S.C. § 1738. Under this statute,

federal courts must give the same full faith and credit to state judgments as courts of the state would. The preclusive effect of a state court determination is governed by that state's law (SPA-48, *citing* Marrese v. American Academy of Orthopaedic Surgeons, 470 U.S. 373, 380 (1985)).

Here, the New York Court of Appeals had dismissed FINRA's contract claim on grounds of preemption. In that court's view, FINRA's claim was one that arose exclusively under federal law. FINRA v. Fiero, *supra*, 10 N.Y.3d at 17, 853 N.Y.S.2d at 270 (dismissing due to federal preemption, concluding that "NASD is not seeking to adjudicate a state law claim") (A-226).

There is no question that the New York courts here had personal jurisdiction over the parties, who vigorously litigated the dispute, including the issue of subject matter jurisdiction. Indeed, as plaintiff in the New York State proceeding, FINRA had initially obtained a judgment, since vacated by the New York Court of Appeals (A-9 ¶ 3). FINRA did not seek review of that state determination by the United States Supreme Court, which time to do so has passed.

The district court – ironically, acting in diversity (SPA-16-17) – reasoned that the New York Court of Appeals decision had no *res judicata* effect, because the dismissal was for lack of subject matter jurisdiction and not on the merits of the underlying claim (SPA-49, 18-19). The district court thus granted FINRA judgment on its state contract claim (SPA-38-39).

The district court failed to consider the effect of collateral estoppel, or to ask whether, with the district court decree that FINRA's claim was not federal, FINRA could have gone back into state court to prosecute its claim against the Fieros. Clearly, the answer would be no, due to principles of preclusion (under New York law), as FINRA had already prosecuted its state claims to finality.

As an initial matter, a state court judgment is entitled to full faith and credit – even as to questions of jurisdiction – when the second court's inquiry discloses that those questions have been fully and fairly litigated and finally decided in the court which rendered the original judgment. *See* Durfee v. Duke, 375 U.S. 106, 111-116 (1963) (where Nebraska state court determined it had jurisdiction of suit to quiet title to land situated in river by boundary between two states, federal district court could not re-determine whether state court had jurisdiction over subject matter, as undoubtedly Nebraska courts would give full *res judicata* effect to Nebraska judgment).

Based on these notions, where a state court (as here) dismissed plaintiff's state claim on grounds of federal preemption – "rightly or wrongly" – plaintiff's subsequent federal case in which plaintiff re-filed those claims would be deemed barred. They would be barred either by the doctrine termed *res judicata*, *see* Wikberg v. Moore North Amer., Inc., No. 00-2007, 234 F.3d 1275, 2000 WL 1521768 (7th Cir. Oct. 6, 2000) (unpublished) (third-party beneficiary contract

claims determined as preempted by state court – "rightly or wrongly" – were *res judicata*, requiring dismissal by federal court giving full faith and credit to state court determination), *aff'g in relevant part*, No. 99 C 3812, 1999 WL 1101301 (N.D. Ill. 1999), or collateral estoppel (also known as issue preclusion), *see* Smith & Johnson, Inc. v. Hedaya Home Fashions Inc., No. 96 Civ. 5821 MBM, 1997-1 Trade Cases ¶ 71,697, 42 U.S.P.Q.2d 1386, 1996 WL 737194 at *2-*3 (S.D.N.Y. Dec. 26, 1996) (dismissing on collateral estoppel grounds same state law claims that had been determined preempted in prior state court action), *aff'd on other grounds by summary order*, 125 F.3d 844, 1997 WL 593030 (2d Cir. Sept. 23, 1997) (table).

The preclusive effect of state court determinations of federal jurisdiction is informed by Article 4 of the U.S. Constitution, which commands that "Judges of every State shall be bound" by the Federal Constitution, laws and treaties. Thus, "state courts . . . are presumed competent to resolve federal issues." Chick Kam Choo v. Exxon Corp., 486 U.S. 140, 150 (1988).

Looking to the effect under New York law of the prior dismissal, a jurisdictional determination – right or wrong – is preclusive. As stated in Buechel v. Bain, 275 A.D.2d 65, 713 N.Y.S.2d 332 (1st Dep't 2000), *aff'd*, 97 N.Y.2d 295, 740 N.Y.S.2d 252 (2001), *cert. denied*, 535 U.S. 1096 (2002), where the defendants' privies had failed to raise a preemption defense in the prior suit,

"implicit in a court's entry of judgment is a determination of its power to render it and, similarly, the preemption of State law was an issue necessarily resolved in [the prior litigation] with preclusive effect against the parties and their privies. 275 A.D.2d at 74, 713 N.Y.S.2d at 340. The court further explained:

> [R]es judicata is founded upon the belief that "it is for the interest of the community that a limit should be prescribed to litigation, and that the same cause of action ought not to be brought twice to a final determination. Justice requires that every cause be once fairly and impartially tried; but the public tranquility demands that, having been once so tried, all litigation of that question, and between those parties, should be closed forever."

Id. at 71, 713 N.Y.S.2d at 337-38 (intermediate source citation omitted (quoting Greenleaf's Evidence §§ 522-523)); *see also* Brewery Workers Pension Fund v. New York State Teamsters Conference Pension & Retirement Fund, 62 A.D.2d 1046, 1047-48, 404 N.Y.S.2d 158, 161 (2d Dep't) ("[D]efendants are barred from raising preemption issues by the doctrine of res judicata . . . Defendants have had their day in court."), *appeal & leave to appeal dismissed*, 45 N.Y.2d 706 & 776, 408 N.Y.S.2d 1025 & 1978 WL 54052 (1978) (table).

A state court finding of lack of subject matter jurisdiction has similar effect, under the theory of collateral estoppel. Smith & Johnson, *supra*, 1996 WL at *3. As recited by Judge Mukasey, citing New York law: "Collateral estoppel requires: 1) an identity of issues; 2) that the issue in question was necessarily decided in the prior proceeding; and 3) that the party against whom the bar is sought had a full

and fair opportunity to litigate the issue in the prior proceeding." Id. All those requisites clearly are met here.

The district court below issued its decision on the Full Faith and Credit Act (SPA-45-49) without meeting the parties' counsel or having the matter briefed. The opinion below contains no collateral estoppel analysis.

Moreover, the district court opinions cite no federal case where – as here – a state court first determined that federal preemption applied. We cite two such cases –Wikberg, *supra*, and Smith & Johnson, *supra* – and in each the prior determination was preclusive as to the claim asserted.[9]

Further, the district court here, as a result of its determination that there was no federal subject matter jurisdiction (SPA-9-16), would have had no jurisdiction at all, but for the fortuitous existence of diversity jurisdiction (SPA-16-17). Acting in its diversity capacity, and construing state law, the court was constrained to act

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[9] The district court's cases addressing the *res judicata* effect of dismissal for lack of subject matter jurisdiction are inapposite in any event (SPA-19), as none of them involved a prior state court order or judgment. *See* St. Pierre v. Dyer, 208 F.3d 394, 400 (2d Cir. 2000) (effect of prior federal district court dismissal; prior dismissal for lack of standing had no *res judicata* effect because plaintiff's claims, for indemnity and contribution, arose subsequent); Nowak v. Ironworkers Local 6 Pension Fund, 81 F.3d 1182 (2d Cir. 1996) (federal court construing state law to determine eligibility under pension benefit plan, no prior state court decision, dismissal on merits affirmed); Thompson v. County of Franklin, 15 F.3d 245 (2d Cir. 1994) (first action removed to federal court was dismissed for lack of standing, thus never reaching merits for *res judicata* effect). Here, the district court in its second opinion (SPA-45-49) merely referred back to its faulty *res judicata* analysis in the first opinion (SPA-48-49, 18-19).

as a state court, as any extant federal interest would have been deflated to insignificance. *See* Marrese v. American Academy of Orthopaedic Surgeons, 470 U.S. 373, 390 n.4 (1985) (Burger, Ch. J., concurring).

FINRA's state-based claim expired with the edict of the New York Court of Appeals, which was not reviewed by the United States Supreme Court. FINRA thus is precluded from reasserting its claim in the New York courts, and barred in Federal Court by the Fair Faith and Credit Act.

III.

FINRA'S CLAIM IS UNTIMELY AS BASED ON AN ARBITRATION AWARD

FINRA's assertion of liability is untimely. FINRA has failed to file any action within one year of the NAC decision and/or delivery of same, and/or even from one year of December 2, 2002, the date FINRA asserts the award became final (A-35 n.3).

A. The NAC Decision Is An Arbitration Award

As will be shown below, the one-year limitations period applies because the disciplinary proceeding was an arbitration and the NAC Decision an arbitration award, enforceable only within a year. As such, any action would be time-barred, and assertion of the claim untimely.

1. Characteristics of Arbitration

(a) Process of Private Binding Dispute Resolution Through Fair Hearing Is Arbitration

Arbitration is essentially a means of private dispute resolution, *i.e.*, "a mode of settling differences through the investigation and determination, by one or more persons selected as a domestic tribunal for such purpose, of some disputed matter submitted to them by the contending parties for decision and award, in lieu of a formal court proceeding for a judgment." 5 N.Y. Jurisprudence 2d *Arbitration* § 1 at 14 (1997).

According to Black's Law Dictionary, arbitration is

> [a] process of dispute resolution in which a neutral third party (arbitrator) renders a decision after a hearing at which both parties have an opportunity to be heard." Arbitration is a form of alternative dispute resolution almost wholly independent of the court system.

Black's Law Dictionary 105 (6th ed. 1990) (*as quoted in* Kabia v. Koch, 186 Misc.2d 363, 368, 713 N.Y.S.2d 250, 254 (Civ. Ct. New York County 2000)).

As demonstrated herein, the dispute resolution process need not even be denominated as "arbitration" to be arbitration.[10]

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[10] There is a distinction between arbitration and appraisal. In New York, appraisals fall under CPLR 7601, are less formal than arbitrations, and usually resolve only part, rather than all, of a dispute. Penn Central Corp. v. Consolidated Rail Corp., 56 N.Y.2d 120, 451 N.Y.S.2d 62 (1982). Nevertheless, an appraisal under CPLR 7601 can, if it resolves the entire dispute, be confirmed. Id. (affirming confirmation of appraisal brought under CPLR § 7510). Here, the enforcement

(b) Arbitration Need Not Be Denominated "Arbitration"

Various types of out-of-court dispute resolution tribunals not denominated as "arbitration" are considered arbitration fora if so in character, subjecting them and their determinations to treatment as arbitration. *See, e.g.*, Kingsbridge Center of Israel v. Turk, 98 A.D.2d 664, 666, 469 N.Y.S.2d 732, 734 (1st Dep't 1983) (**Beth Din** [Rabbinical Court] is effectively arbitration tribunal, affirming confirmation of award); Kabia v. Koch, *supra* (TV's **People's Court** was a virtual arbitration, entitling the "judge" to absolute arbitral immunity); General Drivers, Warehousemen & Helpers, Local Union No. 89 v. Riss & Co., 372 U.S. 517, 519-20 (1963) (**grievance procedure** under Labor Management Relations Act ("Labor Act") was arbitration, notwithstanding that word "arbitration" did not appear in agreement); International Standard Elec. Corp. v. Cunard S. S. So. (The Mauretania), 80 F.2d 225, 229 (2d Cir. 1935) (written consent of parties referring suit to **special commissioner** to hear evidence, and that interlocutory court decree be entered in conformity with commissioner's findings and conclusions, held to express intent to "arbitrate" that could be confirmed through limited scope of review of commissioner's decision).

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proceeding at issue was well-planned, formal and fully resolved the dispute, thus comprising arbitration.

(c) The Process May Be Arbitration Even Where the Parties Specify That It Is *NOT* Arbitration

A dispute resolution process has been deemed arbitration where it was so in character, even where the parties declared in their agreement that the proceeding should *not* be deemed arbitration. *See* Merritt v. Thompson, 27 N.Y. 225, 230 (1863) (during pendency of lawsuit, submission to referee pursuant to voluntary stipulation that specified it was *not* arbitration was in fact arbitration, and decision was cognizable and enforceable).

(d) The Process May Be Arbitration Even Where It Exists Adjunct To Another Process Called Arbitration

Processes of dispute resolution have been declared arbitration even where there existed a related process that *was* called arbitration. In International Longshoremen's Association, AFL-CIO v. Hellenic Lines, Ltd., 549 F. Supp. 435 (S.D.N.Y. 1982), there existed a three-step grievance process culminating with a Labor Relations Committee ("LRC"), following which step 4 provided for formal arbitration only when a party waived the preliminary steps of the grievance procedure, or in the case of a deadlock among the LRC members. The dispute there made it to the LRC during step 3, whose decision defendant contended the court lacked jurisdiction to enforce under the Labor Act because the grievance hearing process "did not constitute actual arbitration." Id. at 437. The court, per Judge Lasker, found jurisdiction, and granted petitioner's motion to confirm the

arbitration award, holding that the process under step 3 was essentially an arbitration, and that it was immaterial that formal arbitration proceedings were available only under step 4 of the agreement.

A similar grievance structure, preliminary to the formal arbitration level, was found to be an arbitration in Webb v. Local 1814, No. CV-94-2739, 1996 WL 75302 (E.D.N.Y. Feb. 9, 1996), *aff'd by sum. order*, 210 F.3d 356 (2d Cir. 2000) (table).[11] The court application based on the determination was barred by the limitations period applicable to arbitration awards. There, Chief Judge Sifton dismissed on statute of limitations grounds that part of the complaint concerning debits applied to plaintiffs in connection with their unavailability to work when attending a 1991 convention, which issue had been determined in step 3 of their grievance, without any formal arbitration that formed the template of step 4 of the process. The court found that the third step of the proceeding was the equivalent of arbitration, and that the decision constituted "an arbitral award." Id. at *10. Accordingly, the plaintiffs would "be required to cast their action for retrospective relief as one for vacatur under the Federal Arbitration Act," which claims are governed by the three month statute of limitations. Id. The plaintiffs having failed to file their action within that period, their claims with respect to those issues were time-barred. Id.

[11] The unpublished district court opinion in Webb is reproduced at A-364-79.

(e) Controversy Arbitrated Need Not Be Otherwise Justiciable

The district court observed that the underlying proceedings were "quasi-prosecutorial" (SPA-22) and resulted in a "one-sided imposition of a punitive fine" (SPA-23) and thus were not "the prototypical arbitration" (SPA-22) that "ordinarily results in an award of proven contractual damages" (SPA-23). This appears to be a variation of FINRA's position that since NASD disciplinary proceedings are commenced to discipline firms and brokers, they are not disputes that could be brought in court, and therefore not subject of an alternative to court, such as arbitration (A-36).

However, a controversy need not be justiciable to be arbitrated. *See, e.g.*, CPLR § 7501 ("any controversy" is arbitrable "without regard to the justiciable character of the controversy"). Thus, to be arbitrable, "the dispute need not be one 'which may be the subject of an action.'" 7B Vincent C. Alexander, Practice Commentaries to CPLR § 7501, ¶ C7501:2, at 288 (McKinney 1998) (source citation omitted).[12]

(f) Arbitrations May Be Mandated By Organization Rules

Further, arbitrations that are mandated by rules of a self regulatory agency are recognized as proper, and subject to the confirmation procedure. *See, e.g.*,

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[12] *See also* Capano v. Wilmington Country Club, No. Civ. A. 18037-NC, 2001 WL 1359254 at *2 (Del. Ch. Nov. 1, 2001) (cited by district court at SPA-32-33) (involving an arbitration that upheld a membership expulsion).

King v. Nikko Secs. Co. Int'l, Inc., 179 AD.2d 490, 491, 578 N.Y.S.2d 171, 172 (1st Dep't 1992) (even assuming NASD arbitration was compulsory, affirming confirmation of award).

2. The Underlying NAC Decision Here Is An Arbitration Award

(a) The Disciplinary Proceedings Here Had All the Elements of Arbitration

The disciplinary proceedings resulting in the NAC Decision had all the elements of arbitration. To the extent the NAC Decision itself is enforceable as a monetary judgment, it is enforceable only as, and in the manner of, an arbitration award.

As an initial matter, the disciplinary process is a quasi-judicial proceeding. The process commenced with a complaint that resembles a court pleading, labeled "complaint" (A-105-21). It has a caption listing the forum, the parties (identifying them as "complainant" versus "respondents") and proceeding number. The complaint contains allegations in numbered paragraphs, causes of action, a prayer for relief, and signature block signed by in-house counsel.

(i) The Proceedings Were Undertaken Pursuant To Agreement of the Parties

The district court observed that "[a]n agreement to arbitrate must be voluntarily made" (SPA-21-22), but never otherwise concluded that the parties did not agree to the process that occurred. Indeed, since the court determined that the

NASD rules were contractual in nature (SPA-16, 25-27, 38-39), it would be odd if the process mandated by those rules was determined not to constitute a contract, especially as the parties performed by participating in the disciplinary process. The disciplinary proceeding was clearly undertaken pursuant to agreement of the parties. *See* Sloan v. NYSE, 489 F.2d 1, 4 (2d Cir. 1973) ("when appellants became members of the Exchange they consented, quite knowingly and intelligently to disciplinary procedures"). The case Waldron v. Goddess, 61 N.Y.2d 181, 473 N.Y.S.2d 136 (1984), cited by the district court (SPA-22), addresses the issue of whether the disputing parties were to go to court or private dispute resolution. Here, the parties already participated in the private dispute resolution proceeding.

In any event, "[c]ommon-law arbitration based on oral agreements or written ones which do not comply with the statutory requirement continues to exist under the CPLR." 13 Weinstein, Korn & Miller, New York Civil Practice [hereafter, "Weinstein, Korn & Miller"] ¶ 7501.10 (Lexis Nexis Matthew Bender Apr. 1988).[13]

[13] Enforcement of awards resulting from such common law arbitrations in New York are subject to the one-year limitations period of CPLR § 215(5). *See* 1 Weinstein, Korn & Miller, ¶ 215.13 (Sept. 2002); *see also* Hellman v. Wolbrom, 31 A.D.2d 477, 482 n.* 298 N.Y.S.2d 540, 545 n.* (1st Dep't 1969).

(ii) **The Parties Had Notice, an Opportunity to be Heard, a Fair Hearing and Counsel of Their Choice**

As noted above, the parties had notice and an opportunity to be heard, as required by the Exchange Act. *See* Exchange Act § 15A(h), 15 U.S.C. § 78o-3(h). Here, extensive hearings took place over multiple days, at which the parties, having had advance notice, were heard and presented evidence (A-124-25). Moreover, the procedure and proceedings were fair. The 48-page decision of the hearing panel (A-122-70) was appealed and reviewed by the NAC, which issued its own single-spaced 48-page decision (in original form), explaining its rationale (A-49-83); the adjudicators were found to be fair, impartial and unbiased (A-77-79); the Fieros had opportunity for further review (SPA-7-8); and the parties were represented during all stages by counsel of their choice (A-103 ¶ 3).

(iii) The Adjudicators Were Fair and Impartial

Under NASD rules (Rules 9160, 9234 and 9332 (A-230-36)), hearing officers and NAC subcommittee members must be fair and impartial and "may be disqualified if a conflict of interest or bias exists or circumstances otherwise exist where the fairness of the Hearing Panel or Subcommittee member may reasonably be questioned" (A-78). The standard for conflict of interest of a member of the hearing panel or NAC member is the standard utilized by federal courts for judges (*id.*). That standard requires disqualification in any disciplinary proceeding where the adjudicator's "impartiality might reasonably be questioned." Department of

Enforcement v. [redacted], NASD Regulation, Inc., OHO Order 02-02, Case No. CAF010028 (Office of Hearing Officers Jan. 28, 2002) (A-238-39).

In the underlying disciplinary proceeding here, the fairness of the members of the panel and the NAC were challenged and found to be unbiased, and the Fieros' requests for disqualification on grounds of bias were denied (A-77-79).

Indeed, in order to achieve greater fairness in its disciplinary proceedings, the NASD reorganized by SEC sanction in or about August 1996 to provide for greater participation of non-industry members, "and to change its disciplinary processes to include hearing officers and add procedures aimed at achieving greater efficiency and fairness." *Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the NASDAQ Market* (SEC Aug. 1996) (hereafter, "SEC Report") (at 7 (A-251)).[14] In so doing, the "NASD ha[d] undertaken to institute the participation of professional hearing officers, with legal training, to preside over disciplinary proceedings." *Id.* at 50 (A-294). Such measures were undertaken to "enhance the dispassionate application of the rules and fairness in the disciplinary process." *Id.* In that reconstituted form, industry members no longer presided over hearings, but still constituted a majority of each hearing panel. *Id.*

[14] SEC Report available at "http://www.sec.gov/litigation/investreport/nasdaq21a.htm".

In any event, in Westinghouse Electric Corp. v. New York City Transit Authority, 82 N.Y.2d 47, 50 & 52-58, 603 N.Y.S.2d 404, 405-08 (1993), *considering answer to certified question*, 14 F.3d 818 (2d Cir. 1994), the New York Court of Appeals approved as not violative of public policy an arbitration where the designated arbitrator was an employee of one of the parties, personally involved factually in the underlying dispute.

(iv) The NAC Proceedings Were Quasi-Judicial

Moreover, the NAC disciplinary proceeding is in fact quasi-judicial in nature. *See* People ex rel. Wilson v. Medical Society of the County of Dutchess, 84 Hun. 448, 32 N.Y.S. 415, 416 (Sup. Ct. Gen. Term 2d Dep't 1895) (private membership organization "removing or suspending a member is doubtless, in one sense, judicial or quasi judicial"). As such, it would be properly considered arbitration.

(v) Lack of Mutuality is No Bar to Arbitration

The district court observed that "the Fieros had no right to institute a similar action against FINRA" (SPA-22) and thus the "mutuality characteristic of an arbitration is lacking" (SPA-23). Mutuality, however, is not required for arbitration.

NASD's own arbitration rules have allowed a customer to commence an arbitration against a member or associated person, without giving the member or

associated person that mutual right, absent private agreement. *See* Rule 10301(a) of NASD Code of Arbitration Procedure (applying to pre-April 16, 2007 filings) (A-300) ("Any dispute, claim, or controversy eligible for submission under the Rule 10100 Series between a customer and a member and/or associated person arising in connection with the business of such member or in connection with the activities of such associated persons shall be arbitrated under this Code, as provided by any duly executed and enforceable written agreement or upon the demand of the customer" (emphasis added)); John Hancock Life Ins. Co. v. Wilson, 254 F.3d 48, 58 (2d Cir. 2001) (construing Rule 10301(a)).

New York State's attorney-client fee dispute rules similarly give the client, but not the attorney, the choice to resolve eligible disputes by arbitration under the rule. *See* N.Y. Rules of the Chief Administrator of the Courts, 22 N.Y.C.R.R., Part 137 (hereafter, "N.Y. Fee Dispute Program") (where Part 137.2(a) provides these rights to the client but not the attorney) (A-358-61). Such awards are nonetheless subject to confirmation under Article 75 of the CPLR as arbitration awards. *See* Edelstein v. Greisman, N.Y.L.J., Mar. 18, 2009, at 28, col. 1, 23 Misc.3d 1115(A), 2009 WL 1067407 (Sup. Ct. Kings County Mar. 9, 2009) (granting motion

pursuant to CPLR 7510 to confirm award rendered under the fee dispute program).[15]

(vi) Level of Control over Choice of Adjudicators Did Not Make Process Not Arbitration

The district court noted that in "the prototypical arbitration," parties have a mutual right "to participate in the selection of an impartial arbiter" (SPA-22), but here "the designation of the hearing officers and the adjudicator are entirely unilateral steps" (SPA-23). If these are the agreed-upon rules of selection for arbitrators, however, it is no less an arbitration than the "prototypical" arbitration.

For it is no hallmark of arbitration that a party must choose the particular arbitrator(s), especially once a forum is agreed upon. This is apparent from the FAA, which allows a court to appoint an arbitrator, providing that "if no method be provided therein [in the arbitration agreement], or if a method be provided and any party thereto shall fail to avail himself of such method, or if for any other reason there shall be a lapse in the naming of an arbitrator or arbitrators or umpire, or in filling a vacancy, then upon the application of either party to the controversy the court shall designate and appoint an arbitrator or arbitrators . . . ." 9 U.S.C. § 5

[15] The district court's own case on membership organizations, Capono v. Wilmington Country Club, No. Civ. A. 18037-NC, 2001 WL 1359254 (Del. Ch. Nov. 1, 2001) (cited at SPA-32-33), involved a bylaw whereby a member could, and did, challenge in arbitration any procedural noncompliance with the section for suspension or expelling members Id. at *2. Since the club takes the membership action, such arbitration would only be invoked by the member, not the club.

(emphasis added); *see also* CPLR § 7504 (court appointment of arbitrator). A party therefore need not have power to choose arbitrators in order for the process to be arbitration.[16]

(vii) The Standard of Review Does Not Change the Character As Arbitration

The district court found that the standard of review that applies to a disciplinary proceeding is different than that which applies under the FAA, and thus cannot be arbitration (SPA-23). A different standard of review, however, does not change the character of the matter as arbitration. *See* Westinghouse, *supra* (approving alternative dispute resolution structure with different standard of review than that provided by Article 75); *see also* N.Y. Fee Dispute Program, *supra* (New York State Court System rules governing attorney-client fee-disputes, providing for "arbitration" with possibility for "*de novo*" court review (Part 137.8)) (A-358-61); Edelstein v. Greisman, *supra* (granting motion pursuant to CPLR 7510 to confirm award rendered within the N.Y. Fee Dispute Program).

(viii) The Route of Review Does Not Change the Character As Arbitration

That the NAC determination would not otherwise be immediately reviewable by court (SPA-23) does not change its character as arbitration. *See*

[16] In any event, the Fieros did have a say over the composition of the adjudicators, indirectly by virtue of membership and association with the NASD, and directly by virtue of receiving notice and an opportunity to object, and in fact did so challenge a member of the hearing panel and of the NAC (A-77-79).

Webb, *supra*, at *10 (dismissing as untimely that portion of claim attacking 1991 grievance decision of Contract Board as not having been brought as vacatur of arbitration award within three months of award, where after determination of Contract Board, pursuant to multi-step procedure, plaintiffs properly applied to National Labor Relations Board challenging Contract Board decision) (A-371-72); *see also* N.Y. Fee Dispute Program (providing for "arbitration" with possibility for court review within 30 days under 22 N.Y.C.R.R. § 137.8) (A-358-61); Edelstein, *supra* (confirming fee-dispute program award).

. That the private dispute resolution forum here can be reviewed by a mechanism other than normal court review pursuant to the FAA or CPLR Article 75 does not make the underlying proceeding not arbitration. Courts in New York, for instance, have enforced, as arbitration awards, awards determined in arbitrations that have taken place outside of New York and pursuant to processes external to the FAA or CPLR. *See, e.g.*, Gilbert v. Burnstine, 255 N.Y. 348, 354 (1931) (reversing dismissal of action based on award of arbitration that took place in London pursuant to Arbitration Law of Great Britain, noting that defendants' agreement to arbitrate in London according to English arbitration statute "necessarily implied a submission to the procedure whereby that law is there enforced" and that "[t]hey contracted that the machinery by which their arbitration might proceed would be foreign machinery operating from the foreign court");

Engelbrechten v. Galvanoni & Nevy Bros., Inc., 59 Misc.2d 721, 724, 300 N.Y.S.2d 239, 242 (N.Y.C. Civ. Ct. New York County 1969) (enforcing foreign arbitration award made by Hamburg (Germany) Amicable Court of Arbitration: "foreign award of arbitrators will support a domestic action at law"), *later proceeding*, 60 Misc.2d 419, 302 N.Y.S.2d 691 (N.Y.C. Civ. Ct. New York County 1969).

(ix) Internal Forum Does Not Make Matter Not Arbitration

Moreover, there is no reason that an NASD disciplinary proceeding would be (as it would) arbitration if administrated by an outside service (such as JAMS), but not if done internally. *See, e.g.*, Westinghouse Elec. Corp., *supra* (arbitrator was party's employee).

(x) NASD is a Private Organization

Finally, there is no question that FINRA is a private organization (A-32), thus satisfying the "private" element in the definition of arbitration.

(b) A NAC Decision Has Already Been Judicially Characterized as An Arbitration Award

A decision of the NAC has in fact been referred to by New York Justice Ira Gammerman, perhaps instinctively, as an "arbitration award." In NASD, Inc. [sic] v. Raphael Pinchas, Index No. 602057/04 (Sup. Ct. N.Y County) (*see* A-310-57), the NASD brought an action – as here – seeking recovery of a NAC disciplinary

determination, although there *modified by SEC order*. Justice Gammerman referred to the action as one that "seeks a judgment on an arbitration award" (Feb. 18, 2005 Tr. at 2 (A-353)). FINRA's counsel there concurred without dispute (*id.* at 3 (A-354)).

For all of the reasons set forth above, the NAC proceeding here was an arbitration.

B. The Limitations Period for an Action Based on an Arbitration Award is One Year, Under Either Federal Law or State Law

1. The FAA Applies

Under the Federal Arbitration Act (FAA), "a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Because the underlying relationships of the parties here affect interstate commerce, the FAA applies.[17]

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[17] There may possibly be an issue whether, in federal court, the FAA preempts state law on enforcement of arbitration awards. The FAA has no preemption clause, and is not calculated to completely displace state law. *See* Volt Info. Sciences, Inc. v. Leland Stanford Jr. Univ., 489 U.S. 468, 477 (1989). It has been suggested that there should be no preemption applying the FAA's backend issues (FAA §§ 9-12), involving enforcement of arbitration awards. *See, e.g.*, Prefatory Note to Uniform Arbitration Act, 7 ULA 4 (2005) (promulgated by National Conference of Commissioners on Uniform State Law) (*quoted in* Ames v. Garfinkel, 2006 WL 304796 at *3, N.Y.L.J., Feb. 27, 2006, at 19, col. 1, 11 Misc.3d 1051(A), 814 N.Y.S.2d 889 (table) (N.Y. Sup. Ct. New York County Jan. 26, 2006)). As under both federal and New York state law a one-year limitations period applies, barring FINRA's counterclaim, there is no conflict requiring

(a) The One-Year Time Bar Applies To Confirmation of an Award Under the FAA

Enforcement of an arbitration award under FAA is by confirmation (FAA § 9), subject to a *one-year* limitations period. Photopaint Technologies, LLC v. Smartlens Corp., 335 F.3d 152, 155-60 (2d Cir. 2003).

(b) Plenary Enforcement Under Federal Law Looks To Most Analogous State Law

The only other route to enforcement under federal law is through common law plenary enforcement, in which the law that applies is the most analogous of the state in which the forum sits. *See, e.g.*, Consolidated Rail Corp. v. Delaware & Hudson R.R. Co., Inc. (In re Consolidated Rail Corp.), 867 F. Supp. 25, 32 (D.D.C. 1994) (enforcement barred by 1 year of FAA § 9, and 3 years of most analogous state statute (there 3-year catchall)) (*citing* Guaranty Trust Co. of N.Y. v. York, 326 U.S. 99, 100 (1945)). Here, that would turn to the CPLR, and its one-year limitations period.

2. The CPLR One-Year Time-Bar

Under the CPLR, an action brought upon an arbitration award must be commenced within one year, whether enforcement is by confirmation or plenary action. Confirmation is a summary procedure to turn an arbitration award into a judgment, found in Article 75 of the CPLR. Under CPLR § 7510, "[t]he court

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application of the FAA, but neither a reason to decide this issue, which is academic under currently existing case law.

shall confirm an award upon application of a party made within one year after its delivery to him . . . ." Under CPLR § 215(5), however, "an action upon an arbitration award" – thus *any* such action – must be commenced within one year.

This statutory scheme was set up "to prevent parties from bringing action on awards rather than moving to confirm to circumvent the one-year limitation of CPLR 7510." Protocom Devices, Inc. v. Figueroa, 144 Misc. 2d 738, 740, 545 N.Y.S.2d 527, 528 (Sup. Ct. N.Y. County 1989) (staying arbitration where award in prior arbitration involving identical issues had not been confirmed within one year); *see also* 7B Vincent C. Alexander, Practice Commentaries to CPLR § 7510 at 739 (McKinney 1998) ("Any attempt by a party to circumvent the one-year period of CPLR 7510 by bringing an independent action on the award instead of applying for confirmation will fail; CPLR 215(5) imposes a one-year statute of limitations for 'an action on an arbitration award'").

Hence, courts will reject any "attempt to circumvent the one-year limitations period for confirmation of an arbitration award." Ulster Elec. Supply Co., Inc. v. Local 1430, Int'l Brotherhood of Electrical Workers, 253 A.D.2d 765, 677 N.Y.S.2d 485 (2d Dep't 1998) (affirming stay of arbitration premised on same

claim as prior arbitration award in favor of appellant which was not confirmed within one year pursuant to CPLR § 7510). [18]

C. Any Attempt To Enforce the Liability Would Be Untimely

As no action was commenced on the liability within one year of either the date of the NAC Decision (October 28, 2002) or the date that FINRA asserts it became final (December 2, 2002 (A-35 n.3)), any attempt to enforce the liability would be untimely.

IV.

ALTERNATIVELY, THE CLAIM IS BARRED BY THE TWO/FIVE-YEAR TIME LIMITATION FOR SECURITIES FRAUD (28 U.S.C. § 1658(b)) OR THE FEDERAL FIVE-YEAR TIME LIMITATION FOR RECOVERY OF CIVIL FINES, PENALTIES AND FORFEITURES (28 U.S.C. § 2462)

Alternatively, should the NAC Decision not be deemed an arbitration award, the only other federal limitations provisions possibly relevant are 28 U.S.C. sections 1658(b) or 2462. The district court addressed neither of these provisions, which under the district court's jurisdictional determination would not apply.

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[18] The time period for enforcing an award by confirmation begins running at delivery of the award, as stated in § 7510. Theoretically, the time period of section 215(5) may begin to run sooner (such as date of award) and thus expire sooner than section 7510. Here, any possible difference is not determinative, as the award was delivered on or about the date of issuance, and no action was commenced within the year thereafter.

A. The Action Would Be Time-Barred By Section 1658(b)

Section 1658(b) applies to private rights of action for fraud under the securities laws and reads, in relevant part:

> [A] private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of –
>
> (1) 2 years after the discovery of the facts constituting the violation; or
>
> (2) 5 years after such violation.

28 U.S.C. § 1658(b). Section 3(a)(47) defines the term "securities laws" to mean the various securities acts, including the Exchange Act. The fines at issue here arguably arose under the Exchange Act.

FINRA concedes that its claim accrued no later than December 2, 2002 (A-35 n.3). The instant action, in which FINRA asserts a counterclaim, was filed on February 8, 2008 (A-1-2) – more than five years later. If section 1658(b) applies, it would therefore bar FINRA's counterclaim.

B. The Action Would Be Time-Barred By Section 2462

The district court mentioned 28 U.S.C. § 2462, but did not reach this issue, as it found that FINRA's claim was timely as a contract claim (SPA-24). Section 2462 reads, in relevant part, that "[e]xcept as otherwise provided by Act of

Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued . . . ."

For the reasons stated above, section 2462, if applicable, would bar FINRA's counterclaim.

V.

FINRA CANNOT JUDICIALLY ENFORCE COLLECTION OF A DISCIPLINARY FINE

Disregarding the multitude of evidence to the contrary, the district court determined that FINRA had authority to judicially enforce collection of a disciplinary fine (SPA-24-39). For over 65 years, however, the NASD had not sought to collect such a fine (A-100 ¶ 4). As shown herein, that is the province of the SEC, and FINRA has not been afforded such authority by the SEC or through SEC-approved by-law or rule. The SEC forms that FINRA relies upon do not state that *FINRA* (or indeed any body) may collect. FINRA's Notices to Members are of no effect because only SEC-approved rule changes can confer such authority. No provisions exist for FINRA similar to that which allows the SEC to obtain judgment, and in FINRA's arbitration rules and the FAA authorize court action and judgment. Various FINRA writings undermine FINRA's collection notion. Courts have recognized the distinction between the right to "impose" and the right to "collect." Nor is there any implied or federal common-law right never heretofore

recognized. As such, there was no expectation by the Fieros that FINRA could enforce the fine as a civil judgment, and for such reason they did not appeal the disciplinary determination to the SEC (A-362).

A. Only The SEC, If Any, Can Enforce Collection Of Disciplinary Awards

Under the statutory scheme of the Exchange Act, if any body can initiate collection of a disciplinary award, it is the SEC. As an initial matter, the SEC has the right, on its own, to review an SRO disciplinary determination (including of the NAC). SEA § 19(d)(2), 15 U.S.C. § 78s(d)(2). The Exchange Act contains a subsection entitled "Collection of Penalties," expressly allowing the Attorney General to recovery penalties for the SEC in federal court. SEA § 21(d)(3)(c)(ii), 15 U.S.C. § 78u(d)(3)(c)(ii). Another section confers jurisdiction to the federal courts for such applications. SEA § 21(e), 15 U.S.C. § 78u(e). Another section allows SEC action where the SRO "is unable or unwilling to take appropriate action against such person in the public interest and for the protection of investors, or . . . such action is otherwise necessary or appropriate in the public interest or for the protection of investors." SEA § 21(f), 15 U.S.C. § 78u(f). Significantly, this provision contemplates that the SRO might be "unable" to take appropriate action. To date, enforcement of disciplinary awards has been by the SEC only, in federal court. *See, e.g.*, SEC v. Vittor, 323 F.3d 930 (11th Cir. 2003) (enforcing order sustaining NASD monetary sanction).

B. No Such Authority Has Been Conferred By the SEC or FINRA By-Law or Rule

1. The SEC Has Not Conferred Collection Authority Upon FINRA

As set forth above, FINRA obtains its regulatory authority from the SEC, which must approve FINRA's rules. Exchange Act § 19(b)(1), 15 U.S.C. § 78s(b)(1). The SEC has conferred no such authority upon FINRA to collect on a disciplinary award. *See* SEC v. Vittor, *supra*, 323 F.3d at 937 n.2. (Black, J., concurring in part, dissenting in part) ("enforcement mechanisms available to the NASD are limited").

2. FINRA By-Laws & Rules Do Not Provide For Collection of Sanctions

The FINRA by-laws and rules relied upon by district court (SPA-27) – Article XIII of the FINRA By-Laws and NASD Rule 8310(a) (A-304-05) – allow FINRA to "impose" sanctions – and that it may suspend, expel and/or revoke membership or membership association – but do not provide any right to judicially "collect" or obtain a judgment upon such sanctions.

For instance, as noted in the NAC Decision (A-83), Rule 8320 provides the consequences for, and effect of, not paying the fine or sanction. That consequence is a summary suspension or expulsion, or summary revocation of registration. The rule provides, in relevant part:

8320. Payment of Fines, Other Monetary Sanctions, or Costs; Summary Action for Failure to Pay

. . .

(b) Summary Suspension or Expulsion

After seven days notice in writing, the Association may summarily suspend or expel from membership a member that fails to:

(1) pay promptly a fine or other monetary sanction imposed pursuant to Rule 8310 or cost imposed pursuant to Rule 8330 when such fine, monetary sanction, or cost becomes finally due and payable; or

(2) terminate immediately the association of a person who fails to pay promptly a fine or other monetary sanction imposed pursuant to Rule 8310 or a cost imposed pursuant to Rule 8330 when such fine, monetary sanction, or cost becomes finally due and payable.

(c) Summary Revocation of Registration

After seven days notice in writing, the Association may summarily revoke the registration of a person associated with a member if such person fails to pay promptly a fine or other monetary sanction imposed pursuant to Rule 8310 or a cost imposed pursuant to Rule 8330 when such fine, monetary sanction, or cost becomes finally due and payable.

(A-306)

At best, Rule 8320(a) provides that "all fines and monetary sanctions shall be paid to the Treasurer of the Association and shall be used for general corporate purposes" (A-306). But that provision similarly does not expressly authorize a

right to enforce collection, and merely informs where such payments are to be made, and for what purposes they are to be used.[19]

3. The SEC-promulgated Registration Forms Do Not State Anything About Payment, Judgment or Collection

The registration Forms U-4 and BD, relied upon by the district court (SPA-26), contain no provision providing for payment, judgment or collection. At best, the Form U-4 (but not Form BD) provides that the registrant agrees "to be subject to and comply with … penalties" (A-41 ¶ 2). The forms do not state that FINRA, as opposed to the SEC, may enforce such penalties. As explained earlier, these forms were promulgated by the SEC pursuant to specific provision of the Exchange Act. Moreover, as just discussed, the bylaws, rules and regulations referenced in the Form U-4 do not provide for collection. Also discussed elsewhere, imposition of a fine is not equivalent to right to collect. Thus, these forms do not have the significance the district court accorded them.

4. NASD's Notices to Members Cannot Confer Collection Authority Because They Were Not SEC-Approved

Neither can NASD's Notices to Members, relied upon by the district court (SPA-28-29), confer collection authority, because they were not SEC-approved as required under Section 19(b)(1) of the Exchange Act (15 U.S.C.§ 78s(b)(1)).

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[19] While Rule 8320(a) addresses fines and monetary sanctions (which are assessed pursuant to Rule 8310), it does not address "costs" (which are addressed by Rule 8330) (A-305-07). The NAC Decision imposed both fines and costs (A-83).

FINRA cannot circumvent the requirement for SEC approval of its rules by terming the new procedure, as accepted by the district court, a "policy change" (SPA-29). *See* General Bond & Share Co. v. SEC, 39 F.3d 1451, 1460 (10th Cir. 1994) (When "prohibition sets a new standard of conduct for its members . . . the NASD is required by statute to submit such a change to the SEC prior to enforcing it"); In the Matter of the Applications of Higgins, et al., Securities Exchange Act Rel. No. 34-24429, 38 S.E.C. Docket 301, 1987 WL 757509 (May 6, 1987) (NYSE denial of permission to member to use cell phone on NYSE floor tantamount to new rule proposal, required to be approved by SEC; ordering NYSE to allow member's cell phone use until SEC approves such rule); Request for Public Comment Concerning Communications To and From Exchange Trading Facilities, Securities Exchange Act Rel. No. 34-13594, 12 S.E.C. Docket 760, 1997 WL 175743 at *2 (June 3, 1977) ("unpublished policies which would impose restrictions or other requirements not found in published NYSE rules should be filed for consideration by the Commission and public comment under Section 19(b) of the Act"). If anything, these notices prove that when the NASD wanted to address "collection" of disciplinary fines, it knew how to make the issue clear.

5. There Are No Comparable Provisions Authorizing Collection or Entry of Judgment, As Exist for the SEC in the Exchange Act and in FINRA's Arbitration Rules and the FAA

As devastating to FINRA's position is the notable lack of any provision authorizing the collection or entry of judgment of a disciplinary award, as exists for the SEC in the Exchange Act and as is found in FINRA's arbitration rules and the FAA. As shown above, the Exchange Act includes a provision providing for collection of penalties (Point V(A)). The statute continues, stating that "actions authorized by this paragraph may be brought in addition to any other action that the Commission or the Attorney General is entitled to bring," SEA § 21(d)(3)(c)(iii), 15 U.S.C. § 78u(d)(3)(c)(iii). The statute says nothing about any national securities exchange, like FINRA, having authority to bring such action.

FINRA's own arbitration rules include a similar provision, entitled "Awards." That provision states, in relevant part: "Such awards may be entered as a judgment in any court of competent jurisdiction." Code of Arbitration Procedure (for cases filed prior to April 16, 2007) Rule 10330(a) (A-302). Not so for disciplinary awards.

The FAA contains a similar provision in 9 U.S.C. § 9. That section reads: "If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then . . . any party to the arbitration may apply to the court so specified for

an order confirming the award, and thereupon the court must grant such an order . . . ." Id. (emphasis added)). There is no comparable provision anywhere allowing FINRA to collect or enter such award as a judgment.

6. The Contemporaneous NASD Manual Provided That Disciplinary Procedures Were Not Designed To Recover Damages or Obtain Relief for a Party

FINRA's lack of authority in this regard is reflected in its manual dating from the period of the underlying disciplinary proceeding. The NASD Manual dated April 2000 states that "NASD disciplinary procedures are not designed to recover damages or to obtain relief for any party" (National Association of Securities Dealers Manual, at 153 (Apr. 2000)) (A-309).

7. The NAC Decision Provided the Consequences of Nonpayment, Without Mentioning Judgment or Collection

Consistent with the NASD having no such authority, the NAC Decision itself concludes with an instruction that failure to pay will result in a membership suspension, expulsion and revocation (A-83). Notably, it does not mention judgment or collection.

8. By Longstanding Practice, NASD Did Not Collect Fines

Moreover, it has been the NASD's longstanding practice to suspend any fine assessed against an associated person or member firm unless and until said person or firm sought to re-enter the industry (A-103 ¶ 4, *see also* A-85-89). This

established practice weighs heavily against FINRA, signifying its lack of authority to enforce collection of a disciplinary award.

This is the lesson of NASD v. SEC, *supra*, 431 F.3d 803 (D.C. Cir. 2005), where the United States Court of Appeals for the District of Columbia Circuit held that the NASD had no authority to seek judicial review of an SEC order that had reviewed an NASD disciplinary decision. The court relied in large part on the nearly 70 years in which the NASD had never sought judicial review of an SEC order that had reviewed an NASD disciplinary decision, stating:

> [B]oth NASD and the Commission confirmed that this is the first case in nearly 70 years in which NASD has sought judicial review of a SEC order when the association is acting in its adjudicatory capacity.
>
> The Supreme Court has noted that:
>
> > . . . the want of assertion of power by those who presumably would be alert to exercise it, is . . . significant in determining whether such power was actually conferred.
>
> *Fed. Trade Comm'n v. Bunte Bros., Inc.*, 312 U.S. 349, 352 (1941). Similarly in *Bankamerica Corp. v. United States*, 462 U.S. 122, 131 (1983), the Court found that "the Government's failure for over 60 years to exercise the power it now claims … strongly suggests that it did not read the statute as granting such power." Although we are not legally bound by NASD's past practices under the Act, "it is surely noteworthy that [those practices] do not in any way endorse the current position of [NASD]." *Ry. Labor Executives' Ass'n v. Nat'l Mediation Bd.*, 29 F.3d 655, 670 (D.C. Cir. 1994) (en banc). The parties' "longstanding practice" under the Exchange Act "makes it clear that, until recently, there never has been even the slightest confusion" over the fact that Congress never meant to authorize self-regulatory organizations to seek judicial review of SEC decisions reversing disciplinary actions of such organizations. *Id.*.

> * * *
> . . . '"Congress is unlikely to intend any radical departures from past practice without making a point of saying so."' *Wilson*, 290 F.3d at 360 (quoting *Jones v. United States*, 526 U.S. 227, 234 (1999)).

NASD v. SEC, *supra*, 431 F.3d at 811-12 (emphases added).

C. Case Law Prohibits FINRA From Collecting Amounts Imposed In Disciplinary Awards

1. "Impose" Does Not Equal "Collect"

The district court treated "imposition" and "collection" as if there were no distinction (SPA-34-35). However, the "right or power of a private corporation to impose a fine is one thing, and the right to sue thereon or to employ judicial process for its collection is quite another." Merchants Ladies Garment Ass'n, Inc. v. Coat House of William M. Schwartz, Inc., 152 Misc. 130, 273 N.Y.S. 317 (Mun. Ct. Manhattan 1934) (plaintiff, an association, being a private corporation, could not enforce fine upon member, but would have to rely for its collection and payment upon the voluntary action of member, without judicial coercion); *see* Thomas v. Musical Mutual Protective Union, 121 N.Y. 45, 55-56 (1890) (where union bylaws provided that that offenders found guilty shall be fined, "no process is provided by which the corporation can collect them; and their payment, if made at all, must necessarily be by the voluntary action of the [member]"); *see also* Varley v. Tarrytown Associates, Inc., 477 F.2d 208 (2d Cir. 1973) (no

confirmation of award where there was no explicit clause in arbitration agreement, pursuant to FAA § 9, that judgment should be entered upon arbitration award).

The district court reasoned that modern law allows corporations to recover penalties through suit (in New York at least since 1970) (SPA-35), and that the Exchange Act "chose to use corporations and not regulatory agencies to carry out these functions" (SPA-21). However, when the Exchange Act was promulgated in 1934, the law was as espoused in Merchant Ladies Garment Association, and the Exchange Act was never amended to provide otherwise.

Further, the point is not the power of the corporation to enforce collection, but its right to do so and the expectations arising from more than 65 years of no collection. The proposition these cases represent is that the right to "impose" a fine is not equivalent to the right to "collect." This proposition was recognized by the NASD itself when it issued Notices to Members taking pains to announce that it intended to pursue collection of fines imposed (though without obtaining required SEC approval) (A-85-89).[20]

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[20] In any event, the cases cited by the district court are generally inapplicable. Neither of the two Delaware cases (SPA-32-33) involved a monetary award, as here, but rather concerned membership termination and, in one, a corresponding compulsory stock transfer. *See* Capono v. Wilmington Country Club, No. Civ. A. 18037-NC, 2001 WL 1359254 (Del. Ch. Nov. 1, 2001) (expulsion and compulsory stock transfer); Haas v. Indian River Volunteer Fire Co., Inc., No. 1785, 2000 WL 1336730 at *2 n.6 (Del. Ch. Aug. 14, 2000) (written reprimand, temporary suspension and expulsion as Life-Member category of membership), *aff'd*, 768 A.2d 469 (Del. 2001) (table). It is noteworthy, however, that the internal expulsion

2. Membership Association Cannot Recover Self-Determined Damages in an Arbitrary or Unliquidated Amount

A membership association cannot assess its own damages in an unliquidated amount that it determined itself (whether or not it suffered actual damages) and collect them. *See* American Men's & Boys' Clothing Mfrs.' Ass'n, Inc. v. Proser, 190 A.D.164, 168-69, 179 N.Y.S. 207, 210 (1st Dep't 1919). The underlying fine here was arbitrary and unliquidated, as not having been made pursuant to any sanction guideline (A-82 ("there is no Sanction Guideline for the type of market manipulation involved in this case")), and not representing any injury to the NASD itself.

3. The Outcome of a Disciplinary Proceeding Is Not Enforceable in a Parallel Civil Suit

As an additional reason why the disciplinary determination is not enforceable in a civil action by FINRA, the outcome of a disciplinary proceeding is

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proceeding in Capano was referred to as an "arbitration." 2001 WL 1359254 at *1-*2. The case Sigma Phi Soc., Inc. (Alpha of New York) v. Renssalaer Fraternity Managers Ass'n, Inc., 114 A.D.2d 711, 494 N.Y.S.2d 532 (3d Dep't 1985), cited by the district court (SPA-34), involved a member who, wishing to remain a member, paid and then sought reimbursement, and thus did not involve collection. Id. at 712, 494 N.Y.S.2d at 533 ("amounts were deducted from plaintiff's subsequent payments into the fund"). The other New York case, Harbor Hills Landowners v. Manelski, 65 Misc.2d 682, 318 N.Y.S.2d 793 (Dist. Ct. Suffolk County 1970) (SPA-35), involved annual assessments where the "obligation to pay runs with the land." Id. at 684, 318 N.Y.S.2d at 796. In any event, the complexities of disciplinary collection was not in front of, and will not be determined by, a Suffolk County District Court judge presiding in 1970 in another matter.

not meant for use as evidence in a parallel civil case. *See* Sloan v. New York Stock Exchange, 489 F.2d 1, 4 (2d Cir. 1973) (suggesting that outcome of NYSE disciplinary proceeding would not be admitted as evidence in related civil suit by NYSE based on essentially same claims of misconduct); Lang v. French, 974 F. Supp. 567, 569 (E.D. La. 1997) (where private party seeking to enforce restitution award, district court "does not have the authority to adopt the judgment of a self-regulatory body as its own and enforce it"), *aff'd on other grounds*, 154 F.3d 217 (5th Cir. 1998).

For among other reasons, the standard of proof applied for fraud in the disciplinary proceeding was preponderance of the evidence (A-81), whereas in a civil court case it would be clear and convincing evidence. Katara v. D.E. Jones Commodities, Inc., 835 F.2d 966, 970-71 (2d Cir. 1987).

The district court overlooked all this when it stated that FINRA is not trying to prove the underlying violation, but rather just collect on its award (SPA-37). The district court correctly states what FINRA is trying to do, but that is why it is improper for the court to allow FINRA to use its underlying award as a *fait accompli*, unchallenged by the respondents, and unchecked by the SEC, to collect upon.

4. The Supposed "Contract" Must Be Construed Against the Drafter

Moreover, the rules, regulations, notices, forms and "contractual" provisions the FINRA might rely upon – even if otherwise contractually enforceable – were all drafted by the regulator, without input of the Fieros, and thus must be construed "most strongly" against it as drafter. Cowen & Co. v. Anderson, 76 N.Y.2d 318, 323, 559 N.Y.S.2d 225, 228 (1990). The district court avoided this principle by finding no ambiguity requiring interpretation (SPA-25-27). Such finding of clarity is virtually incomprehensible, however, in view of the mountains of evidence, history and avenues all pointing to FINRA having no such right to collect. Here, FINRA never made plain by rule change or agreement that it had the right to turn the disciplinary fine into a judgment. *Compare* Cook v. NASD Regulation, Inc., 31 F. Supp. 2d 1245, 1246 (D. Colo. 1998) (noting provision in settlement agreement with confession of judgment "giving NASDR the ability to obtain a judgment for the full amount of the $5 million fine").

5. There Is No Implied Private Right of Action By Which To Collect

Although the parties previously have not addressed the issue, to the extent exclusive federal subject matter jurisdiction applies, FINRA's claim cannot be construed as constituting an implied private right of action under the securities laws. In its jurisdictional analysis, the district court recognized that there is no private right of action comparable to FINRA's claim (SPA-14-16).

No such right can be implied because implied rights of action are disfavored; collection authority for disciplinary violations has been supplied to the SEC; there is no history of FINRA enforcing collection of disciplinary fines; there is no constitutional right involved (where courts are more willing to recognized implied rights of action); injury to FINRA is both intangible and dubious; and other deterrence exists, such as the potential of suspension or bar from the industry and SEC action. *See, e.g.*, Stoneridge Investment Partners, LLC v. Scientific-Atlanta, 552 U.S. 148, 128 S. Ct. 761, 771-73 (2008); Advanced Magnetics, Inc. v. Bayfront Partners, Inc., Index No. 92 Civ. 6879 (CSH), 1997 WL 299430 (S.D.N.Y. June 4, 1997).

6. There Is No Federal Common-Law Contract Claim for FINRA to Assert

Although the district court found federal subject matter jurisdiction lacking, the court nevertheless implied that FINRA, as a federal "quasi-governmental agency," had some *sui generis* right to recover (SPA-36 ("FINRA is not simply a creation of state law"), SPA-37 ("letting recovery of fines depend on the minute variations of state law would be an obstacle to FINRA's mandate. For these reasons, should Delaware state law fail to empower not-for-profit corporations to sue members to collect fines, FINRA's status as a quasi-governmental agency removes that disability.")).

To the extent the district court recognized – for the first time ever – a federal common law right of recovery for FINRA, it erred. "Federal courts, unlike state courts, are not general common-law courts and do not possess a general power to develop and apply their own rules of decision." City of Milwaukee v. Illinois & Michigan, 451 U.S. 304, 312 (1981). Consideration of federal preemption of state law "start[s] with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." Id. at 316 (source citations omitted). Federal preemption of state law therefore must overcome concerns of federalism, including due regard for "diffusion of power" between the state and federal systems. Id.

In the federal realm, "'we start with the assumption' that it is for Congress, not federal courts, to articulate the appropriate standards to be applied as a matter of federal law." Id. at 316-17. Accordingly, only Congress or the SEC can provide FINRA with the rights of collection. Such rights, especially never before recognized, are not to be found lurking in the interstices of statutes as federal common law.

D. There Was No Expectation That FINRA Could Enforce The Award

Finally, the Fieros "had no expectation of the NASD's right to enforce the fine as a civil judgment" (A-362 ¶ 3). For this reason, there was no meeting of the minds between the parties. Due to their reasonable lack of expectation that the

NASD could enforce the fine, the Fieros did not further appeal the disciplinary determination to the SEC (*id.*).

Further, the district court determined that application of equitable estoppel is inapplicable because there is no injustice in allowing FINRA's collection (SPA-27), and "[e]quitable estoppel cannot be used to create loopholes in the securities laws" (SPA-30). The district court has it backwards. The loopholes (if that is how one deigns to characterize them) exist, and it is plain wrong to allow FINRA now to circumvent the Congressionally-mandated requirements and SEC rules, just to suit its own wants and desires. A federal district judge, if anyone, should recognize, in the words of John Adams, that we are a nation of laws, not men. Any policy reasons why FINRA should have the right to collect on fines would best be addressed to the SEC, not be judicially promulgated here.

VI.

THE DISTRICT COURT ERRED IN *SUA SPONTE* GRANTING FINRA A PRE-DISCOVERY MONEY JUDGMENT WITHOUT AFFORDING THE FIEROS AN OPPORTUNITY TO OPPOSE SUMMARY JUDGMENT

The only motions made by the parties were to dismiss the other's pleading. The district court denied the Fieros' motion, and granted FINRA's motion. At that point, FINRA should have had a counterclaim to prosecute, but the district court prematurely issued a judgment providing no liability, and closed the case.

Thereafter, attempting a course correction (causing this Court to remand

back to the district court), the district court instead overshot, leaping to the end of the case, *sua sponte* granting FINRA a money judgment. Neither party had moved for summary judgment, however, and discovery had not commenced. If the district court had intended to convert any of the motions to summary judgment, it provided no notice of the conversion or opportunity to oppose summary judgment. This was reversible error. *See, e.g.*, First Financial Ins. Co. v. Allstate Interior Demolition Corp., 193 F.3d 109 (2d Cir. 1999) (*sua sponte* grant of summary judgment to plaintiff seeking declaration was reversible error when only motion pending was to dismiss some of the defendant's counterclaims, and no notice of conversion of motions or opportunity to oppose was provided).

Had the Fieros been apprised that summary judgment was being contemplated, they would have raised, in addition to the legal reasons why they were entitled to summary judgment, genuine issues of material fact as to why FINRA was not entitled to summary judgment. Bearing on these issues are questions that might be explored in discovery, such as why had the NASD never collected fines, what communications if any were made between the NASD and SEC on the matter, and what NASD internal communications exist on the matter. While this list is by no means exhaustive, it suggests that there may be issues of fact that would preclude summary judgment to FINRA. The Fieros had no opportunity to raise these issues, because the pending motions focused on the pure

sufficiency of the pleadings. The district court's unorthodox disregard of federal procedure is prejudicial and requires reversal.

CONCLUSION

For the foregoing reasons, this Court should reverse and remand with direction to the district court to (a) vacate the Judgment and (b)(i) grant the Fieros' motion to dismiss FINRA's counterclaims and deny FINRA's motion to dismiss the Fieros' complaint (and/or do so after converting the motions to summary judgment), or alternatively (ii) grant summary judgment in favor of the Fieros and against FINRA, or alternatively (iii) allow discovery to proceed, and (c) grant an award of costs and disbursements to the Fieros, among any such other and further relief the Court deems just and proper.

Dated: New York, New York
October 19, 2009

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), I hereby certify that this brief was produced in Times New Roman (a proportionally-spaced typeface), 14-point type and contains **18,225** words (based on the Microsoft word processing system word count function). A motion to exceed type-volume limitation is being submitted to this Court along with this brief.

Dated: New York, New York
October 19, 2009

Brian D. Graifman

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