Laurence S. Moy
Outten & Golden, LLP
January 12, 2011

PREPARING FOR ARBITRATION – ARBITRATION BEFORE FINRA

Introduction

This paper is meant to be used as an informal supplement to the chapter on *Preparing for Arbitration: A Plaintiff Lawyer's View,* [1] and will focus more specifically than the book chapter on FINRA arbitration in particular. FINRA is the self-regulatory organization charged with the responsibility for overseeing all securities firms doing business in the U.S., and, through its Dispute Resolution operation, resolving disputes involving securities firms. In recent years, about 5,000 to 7,000 cases are filed with FINRA Dispute Resolution each year.[2] These figures include customer complaints, but employment cases make up a significant proportion (roughly 25-30 %) of all filed cases.

FINRA Arbitration Generally

The FINRA Code of Arbitration Procedure for Industry Disputes (the "Code") requires that "any dispute"[3] "must be arbitrated under the Code if the dispute arises out of the business activities of a member [i.e., a broker-dealer firm] or an associated person and is between or among … Members and Associated Persons; or Associated Persons."[4] Based on this requirement, employees of member firms must arbitrate all of their employment disputes with their employers and their supervisors if the employees have a securities registration. These registered employees includes investment bankers, traders, and analysts working at broker-dealers, but it also includes other registered persons such as compliance department employees, managers, in-house counsel, and others who might not seem at first blush to be financial services employees. If an employee had signed a Form U-4 application for securities registration at the time they joined their employers, she or he must arbitrate any disputes with that employer.

---

[1] A chapter in the book *How ADR Works*, copyright © 2002 by the American Bar Association and published by BNA Books. A copy of the chapter is provided as part of the program materials.
[2] See http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/.
[3] Rule 13101(a). All references to "Rule _" are referring to Rules of the FINRA Code of Arbitration for Industry Disputes.
[4] Rule 13200(a).

These employees might be junior-level workers whose income is not particularly remarkable or they might be senior managing directors earning eight-figure annual compensation.

Typical employment cases brought before FINRA involve claims by employees for bonuses and other compensation based on alleged guarantees or contracts, or claims alleging termination of employment in violation of an agreement or a statute (e.g., a SOX whistleblower retaliation claim). These cases also include claims by employers against employees based on restrictive covenants, promissory notes, or loans. Another category is claims by employees complaining that their employer filed damaging information on their Form U-5 termination of registration forms.

The exception, under Rule 13201, is statutory discrimination claims. A discrimination claim may be arbitrated "only if the parties have agreed to arbitrate it, either before or after the dispute arose."[5] In other words, the parties must be obligated to arbitrate discrimination claims by an agreement separate from the Form U-4 in order to arbitrate such claims. Generally, if a firm has a dispute resolution program, such program will call for arbitration of discrimination claims, and will be written in a manner sufficiently broad to require arbitration of such claims pursuant to the Rule 13201 exception.

So FINRA arbitration cuts a broad swath. If you will be handling cases against financial services firms that will involve more than negotiating offer letters and severance agreements or counseling employees, becoming comfortable with handling arbitrations before FINRA is a must.

Preparing the Statement of Claim (Complaint)

The book chapter discusses suggestions for how to approach preparation of the statement of claim generally, and all of those suggestions apply to FINRA arbitration. Before putting pen to paper to write a FINRA pleading, however, it is important to make sure you have the proper parties named. The employer must be a member of FINRA, and this can be checked on the FINRA "BrokerCheck" (http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/).

[5] Rule 13201.

If you will be bringing a claim against a broker-dealer and want to name additional respondents (e.g., parent or affiliate companies, a pension plan, individuals who are not FINRA registered persons), you will only be able to pursue claims against them in a FINRA arbitration case if they submit to the jurisdiction of FINRA voluntarily. Sometimes, respondents will agree to do so because they prefer the FINRA forum or because they prefer to resolve a dispute in one proceeding including all of the related parties. But otherwise, you may need to proceed against some parties in FINRA and others in court. This sometimes requires an employee who cannot afford to litigate on two fronts to make a choice and proceed only against one party after consideration of which party is the principal defendant/respondent.

It is not a hard and fast rule, but when you are arbitrating an employment dispute at FINRA as opposed to a general commercial dispute before the American Arbitration Association ("AAA"), for example, being concise in your pleading is even more important than usual. FINRA arbitrators are often eager to get to the hearing, and take the approach that the hearing is where they will find out the most information in the most efficient manner. So it is important to make your points crisply and without excess. Even claims involving millions of dollars might be asserted in a FINRA pleading that takes up no more than three to five single-spaced pages.

FINRA imposes a six-year filing deadline.[6] This deadline does not extend any applicable statutes of limitation,[7] so care must be taken to meet both the relevant statute of limitation and the six-year FINRA time limit.

Choosing Arbitrators

Doing your best to try to select appropriate arbitrators will be one of the most important parts of your representation of your client at arbitration. Your ability to have input into the decision makers is one of the most significant differences between an arbitration case and a court proceeding. This opportunity should not be wasted or taken lightly.

Since the book chapter was written, the information provided directly by FINRA concerning arbitrators has improved. Generally, you will see a full list of all of the FINRA arbitration awards (decisions) by each proposed arbitrator. It is important to look at each of

[6] Rule 13206(a).
[7] Rule 13206(c).

these awards. You will be able to weed through these case decisions quickly because many will be off-topic (e.g., customer complaint decisions), and you will likely find yourself with only a handful of employment cases addressing issues similar to yours.

FINRA will also provide a very brief biographical summary sheet. It should be viewed as merely a starting point for further research into the backgrounds of the potential arbitrators. As an example, it may show a private law firm affiliation, and more information may be available at the law firm's website to clue you into whether the potential arbitrator has represented principally management or principally individuals in her or his private practice work.

I always end up calling at least a handful of the attorneys who have appeared previously before some of the proposed arbitrators. This yields much higher quality information than the information you will receive on paper. The mere fact that a proposed arbitrator had awarded a prior claimant a big award -- or denied an employee's claims entirely -- does not tell the whole story, and it's impossible to get a sense of the merit of the parties' positions or any tendencies on the part of a particular arbitrator just from a paper award.

FINRA will have you list and rank your proposed arbitrators. For cases involving over $100,000, you will have a Panel of three arbitrators[8] so you will be given three lists of proposed arbitrators with ten names on each list. For each list, FINRA will ask you to strike up to four names and rank the remainder. Your adversary will be doing the same thing, and FINRA will match up the lists to take the highest-ranking candidates appearing on both lists. If there is no overlap, then FINRA will appoint someone whose name did not appear on the lists at all. This obviously involves substantial risk. Ending up with an arbitrator about whom you know nothing, and whom you had no role in selecting, could mean someone fantastic or devastating for your case. For this reason, care should be taken when deciding how many candidates should be stricken off of the proposed arbitrator lists. Often times, it is not prudent to use all of the available strikes.

[8] Rule 13406(b).

Discovery

It is probably not hyperbolic to say that cases are frequently won or lost based on the fairness and effectiveness of the discovery process fares. The variety of discovery devices usually permitted in FINRA, however, is more limited than what you would be used to seeing under the Federal Rules or under most local state court procedure. Depositions are rare in arbitration, for example. So it is critical to fight to ensure that the arbitrators permit paper discovery within an appropriately broad scope.

You should seek to work out whatever discovery disputes you can, but the arbitrators will expect that the parties will have discovery disputes despite everyone's best efforts. Make sure that you do not delay in scheduling a pre-hearing conference to address discovery (to argue the parties' motions to compel and /or objections to discovery requests or applications for protective orders) at the earliest possible time. As in court litigation, it is often necessary to serve follow-up discovery, so it is important to push for prompt rulings on any lingering discovery disputes so there is sufficient time to serve requests for additional discovery prior to any discovery cut-off date.

The Hearing/Trial

The hearing during a FINRA arbitration does not differ substantially from other types of arbitration (or, for that matter, from a jury or bench trial). It is a virtual certainty that your FINRA Chair will be an attorney, and she or he will be accustomed to ruling on objections and the like. The principal difference between an arbitration hearing and a court trial will be the willingness of the arbitrators to accept evidence. Since the arbitrators are the finders of fact as well as the judges on matters of law, there is a tendency for arbitrators to let in evidence if it is a close call as to whether particular testimony should be allowed or a particular document should be admitted into the record. Arbitrators tend to have confidence in their ability to weigh evidence. It is different from the court scenario, where a judge might view herself or himself as a gatekeeper regarding what a (less sophisticated) jury should be allowed to consider given, for example, concerns about the prejudicial impact of proffered evidence.

Familiarity with the Arbitration Code and arbitration practices and procedure generally is helpful because your ability as a practitioner to affect the proceedings in FINRA is somewhat enhanced given the manner in which most arbitrators preside over hearings as compared to how judges tend to preside over trials. That being said, obviously, some arbitrators keep a tighter rein over the proceedings than others. But, in general, FINRA arbitrators are more open than judges and AAA arbitrators to considering how the parties and their counsel believe a case should proceed – in terms of scope of discovery, how evidence is presented, the order of witnesses, the form of the decision/award (no rationale for the Panel's determination v. a reasoned or explained award), and almost every other aspect of the proceeding. So the advantage goes to the counsel (and, sometimes, the party) who establishes credibility as reasonable and seasoned. If you are about to participate in your first FINRA arbitration, read the Code up and down, talk to as many lawyers as you can who have appeared before FINRA, second chair a hearing in another case, if possible, and the like.

Expert Testimony

As noted in the book chapter, arbitrators are accustomed to expert witness testimony. But consider carefully whether experts are necessary in your particular case, taking into account that the Panel will be comprised of individuals who are already familiar with the financial services industry. For some topics (e.g., explaining the industry custom within a certain industry), experts are critical, but many arbitrators will tell you that expert testimony is often overused and unnecessary -- despite how often the parties and attorneys tend to think it appropriate to present experts.

Conclusion

It is interesting to consider the various advantages and disadvantages to proceeding in FINRA as opposed to arbitrating in a different forum or asserting a claim before a court, but if your client is a registered person asserting a claim against a FINRA member firm, those considerations are academic only: you won't have a choice other than to resolve your client's

claim before FINRA, with all of its advantages and flaws. That being said, there are certain advantages to resolving your case before FINRA, including:

- a somewhat more streamlined process than a court proceeding;
- a quicker resolution (typically about a year to 16 months from pleading to hearing);
- no delay from interlocutory appeals;
- more finality with an arbitration award than with a court judgment given that arbitration awards are not subject to appeals (only motions to vacate or modify); and
- an easier time collecting your award if you prevail since FINRA provides penalties for failure to honor an award, and member firms will be intent on remaining members in good standing.

In addition, in FINRA, absent a settlement, cases generally will proceed to a hearing as opposed to being resolved through dispositive motions (which can be a blessing or a curse depending on the case), but your client will at least come away with the satisfaction -- and, if all goes well, the vindication -- of having his or her claims resolved through the presentation of testimony and documents. Oddly enough, an employee's best chance of getting her or his "day in court" may be through arbitration.