"INTRODUCTION TO FINRA ARBITRATIONS –
A VIEW FROM BOTH SIDES OF THE BAR"
By
Dawn Stith Evans and Page A. Poerschke
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History of FINRA

The Financial Industry Regulatory Authority (FINRA) was created through the consolidation of the National Association of Securities Dealers (NASD) and the member regulation, enforcement and arbitration operations of the New York Stock Exchange (NYSE). FINRA began its operations on July 30, 2007. It is a non-profit organization and is the largest independent regulator for all securities firms doing business in the United States. FINRA oversees nearly 4,400 brokerage firms and over 630,000 registered securities representative.

FINRA is involved in virtually every aspect of the securities business – from registering and educating industry members to examining brokerage firms; writing rules; educating the investing public, and administering the largest dispute resolution forum for investors and registered firms. FINRA has the authority to fine, suspend, or expel firms or individual brokers from the securities business. FINRA also maintains the largest and most sophisticated online registration and reporting system in the world which is known as the Central Registration Depository (CRD). FINRA also reviews all broker advertisements, websites, and sales brochures.

Claims eligible for FINRA Arbitration

FINRA handles both arbitration and mediation of securities disputes between an investor(s) and an individual or entity registered with FINRA. FINRA also handles disputes involving only industry parties such as cases between brokerage firms, between brokers, etc. This CLE will focus on the former category of disputes – those between investors and FINRA members.

An investor must arbitrate at FINRA if:

- Arbitration is required by a written agreement;
- The dispute is with a member of FINRA (broker and/or brokerage firm); and
- The dispute involves the securities business of the broker and/or brokerage firm.

If an investor requests arbitration, a broker or brokerage firm must arbitrate at FINRA.

Eligibility Rule

Customer Code Rule 12206 allows a claim to be filed within 6 years of the occurrence of an event giving rise to the cause of action.

Brokercheck

FINRA offers a free tool that provides an investor or attorney with critical information about FINRA-registered firms and brokers, as well as investment adviser firms and representatives. It's FREE and easy to use! Brokercheck works whether you have a client with potential claims against a broker or are researching your own broker. The website address is www.finra.org/brokercheck.

Brokercheck contains licensing and disciplinary information on nearly 1.3 million current and former securities brokers and more than 17, 000 current and former FINRA-registered firms. It also contains professional background information on approximately 441,000 current and former investment adviser representatives and 45,700 current and former investment adviser firms.

The information contained in Brokercheck comes from FINRA's Central Registration Depository, The securities industry's central licensing and registration system from brokers and firms and the SEC's Investment Adviser Public Disclosure (IAPD) database.

Information contained in a Brokercheck report includes:

- Employment history
- Licensing status
- Criminal events
- Regulatory actions
- Investor complaint information
- Pending investigations and regulatory proceedings

Publicly Available Awards

Arbitration is generally confidential and documents submitted in arbitration are not publicly-available, unlike court filings. However, if an award is issued, FINRA posts it in its Arbitration Awards Online Database, which is publicly available. This database enables an investor or attorney to search FINRA and historical NASB arbitration awards. The site also contains historical awards for the New York Stock Exchange, the American Stock Exchange, the Philadelphia Stock Exchange and the Municipal Securities Rulemaking Board. The site may be searched using case numbers, document text, and date of award. The website address is http://finraawardsonline.finra.org/.

Filing a Claim

In order to initiate an arbitration claim before FINRA, an investor must:

- File a Statement of Claim
- File a signed Submission Agreement
- Pay the appropriate filing fees

Once these filing requirements are met, FINRA will serve the Statement of Claim on the respondents identified in the Statement of Claim and Submission Agreement. If all deficiencies are not cured within 30 days, FINRA will close the case without serving the Statement of Claim.

Statement of Claim

The arbitration process begins with a party filing a Statement of Claim with FINRA. The party filing the Statement of Claim is called a Claimant. The party or parties against whom the Statement of Claim is filed is called the Respondent. The Statement of Claim can take many forms. Some attorneys prefer to file in the same format as a Complaint filed in state or federal court. Others prefer to file them in a letter format. Regardless of the format, the Statement of Claim should provide the details of the dispute including all relevant dates, names of entities and individuals involved, the type of relief requested and the respondents from whom the claimant is seeking the relief or damages.

When drafting a Statement of Claim, you should always remember who the audience will be. Unlike a complaint to be filed in state or federal court, a FINRA Statement of Claim may be read by any and/or all of the following:

- In-house counsel
- Outside (defense) counsel
- Broker-dealer management
- An insurer
- Three diverse arbitrators (who may or may not have a legal or securities experience)
- Regulators

FINRA Statements of Claim also different from court complaints because they require more than "notice pleading." FINRA arbitration is more of a fact driven process than based substantively in the law. Thus, the fact should be presented in a narrative fashion reading more like a story rather than a "short and plain statement of the claims" as required under Rule 8 of the Rules of Civil Procedure.

Submission Agreement

In addition to the Statement of Claim, a claimant must also file an original signed Submission Agreement with FINRA. The Submission Agreement signifies that the claimant elects to submit a claim to FINRA and to abide by selected arbitrator(s)' decision. Once the Submission Agreement is signed and filed with FINRA, the procedures and timing set out in the Codes become operative and binding. A copy of the Submission Agreement has been provided for reference.

Filing fees

Rule 12900 sets forth the initial filing fee to be paid by a claimant when filing a Statement of Claim. Part of the initial filing fee is non-refundable and a portion is potentially refundable.

Amount of Claim (exclusive of interest and expenses)	Filing Fee
$.01 to $1,000	$50
$1,000.01 to $2,500	$75
$2,500.01 to $5,000	$175
$5,000.01 to $10,000	$325
$10,000.01 to $25,000	$425
$25,000.01 to $50,000	$600
$50,000.01 to $100,000	$975
$100,000.01 to $500,000	$1,425
$500,000.01 to $1 million	$1,575
Over $1 million	$1,800
Non-Monetary/Not Specified	$1,250

If a claim is settled or withdrawn more than 10 days before the date that the hearing on merits under Rule 12600 is scheduled to begin, a party paying a filing fee will receive a partial refund of the filing fee. *See* Customer Code Rule 12900(c).

In the award, the arbitration panel may order a party to reimburse another party for all or part of any filing fee paid. *See* Customer Code Rule 12900(d).

Claim Information Sheet

A claimant may elect to complete the Claim Information Sheet. FINRA does not require that this form be completed. It provides a synopsis of the information contained in the Statement of Claim. The Claim Information Sheet is not a substitute for a Statement of Claim.

Answer of Respondent

A Respondent must file with FINRA an answer within 45 days of the receipt of the Statement of Claim. A Respondent also must file the signed Submission Agreement along with its Answer. *See* Customer Code Rule 12303.

Amendment to Pleadings

Rule 12309 governs Amending Pleadings. A party may amend a pleading at any time before the arbitrator panel had been appointed. Once a panel has been appointed, a party may only amend a pleading if the panel grants a motion to amend filed in accordance with Rule 12503.

Arbitrator Selection

The number and class of arbitrators appointed to a case depends on the amount and type of relief requested in the Statement of Claim.

Public v. Non-public Arbitrators

Public Arbitrators

FINRA defines the term "public arbitrator" as a person who is otherwise qualified to serve as an arbitrator and:

(1) is not engaged in the conduct or activities described in paragraphs (p)(1)–(4);

(2) was not engaged in the conduct or activities described in paragraphs (p)(1)–(4) for a total of 20 years or more;

(3) is not an investment adviser;

(4) is not an attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past two years from any persons or entities listed in paragraphs (p)(1)–(4);

(5) is not an attorney, accountant, or other professional whose firm derived $50,000 or more in annual revenue in the past two years from professional services rendered to any persons or entities listed in paragraph (p)(1) relating to any customer disputes concerning an investment account or transaction, including but not limited to, law firm fees, accounting firm fees, and consulting fees;

(6) is not employed by, and is not the spouse or an immediate family member of a person who is employed by, an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the securities business;

(7) is not a director or officer of, and is not the spouse or an immediate family member of a person who is a director or officer of, an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the securities business; and

(8) is not the spouse or an immediate family member of a person who is engaged in the conduct or activities described in paragraphs (p)(1)–(4). For purposes of this rule, the term immediate family member means:

> (A) a person's parent, stepparent, child, or stepchild;
> (B) a member of a person's household;
> (C) an individual to whom a person provides financial support of more than 50 percent of his or her annual income; or
> (D) a person who is claimed as a dependent for federal income tax purposes.

For purposes of this rule, the term "revenue" shall not include mediation fees received by mediators who are also arbitrators, provided that the mediator acts in the capacity of a mediator and does not represent a party in the mediation.

Non-public Arbitrator

FINRA defines the term "non-public arbitrator" as a person who is otherwise qualified to serve as an arbitrator and:

(1) is, or within the past five years, was:

> (A) associated with, including registered through, a broker or a dealer (including a government securities broker or dealer or a municipal securities dealer);
> (B) registered under the Commodity Exchange Act;
> (C) a member of a commodities exchange or a registered futures association; or
> (D) associated with a person or firm registered under the Commodity Exchange Act;

(2) is retired from, or spent a substantial part of a career engaging in, any of the business activities listed in paragraph (p)(1);

(3) is an attorney, accountant, or other professional who has devoted 20 percent or more of his or her professional work, in the last two years, to clients who are engaged in any of the business activities listed in paragraph (p)(1); or

(4) is an employee of a bank or other financial institution and effects transactions in securities, including government or municipal securities, and commodities futures or options or supervises or monitors the compliance with the securities and commodities laws of employees who engage in such activities.

For purposes of this rule, the term "professional work" shall not include mediation services performed by mediators who are also arbitrators, provided that the mediator acts in the capacity of a mediator and does not represent a party in the mediation.

Arbitrator Disclosure Report

FINRA supplies each party with an Arbitrator Disclosure Report of each potential arbitrator for the case. The Disclosure Report contains background information about the potential arbitrator, including the arbitrator's name, classification, skills, employment, education, training, conflict information, and any publicly available awards the arbitrator issued.

Claims $50,000 or less

For all claims $50,000 or less (exclusive of interest and expenses), FINRA will appoint one arbitrator (unless the parties agree in writing otherwise). FINRA will process the claim using the Simplified Arbitration rule. These type claims are also "paper" or "small claims" cases. No hearing will be held unless the claimant requests one. The arbitrator, therefore, will render an award based on the pleadings and other materials submitted by the parties.

Claims More than $50,000 up to $100,000

Generally for these claims, the parties will select and FINRA will appoint one arbitrator (unless the parties agree in writing to three arbitrators). The arbitrator will be a public arbitrator selected from the public chairperson roster. FINRA will send one list of 10 chair-qualified arbitrators to each of the parties. Each separately represented party may strike up to four arbitrators on the list, leaving at least six names on each party's list. FINRA combines the parties' ranked lists and appoints the highest ranked available arbitrator from each list to serve on the panel.

Claims More than $100,000

The parties will select and FINRA will appoint three arbitrators. Beginning on January 31, 2011, investors have the option of choosing an arbitration panel with two public arbitrators and one non-public arbitrator (Majority-Public Panel) or a panel of all public arbitrators (All-Public Panel). Investors have the option to choose an all public arbitration panel, neither brokerage firms nor brokers may choose. If the investor declines to elect a panel selection, the Majority Public Panel will apply.

Under either panel selection, FINRA will send three lists to the parties – one with 10 chair-qualified public arbitrators, one with 10 public arbitrators and one with 10 non-public arbitrators. The difference applies to the striking process. Under the Majority Public Panel option, the parties may strike up to four arbitrators from each of the three lists, leaving at least six arbitrator names remaining on each list. Under the Optional All Public Panel option, the parties may strike up to four arbitrators on each of the chair-qualified public and public lists. This option, however, allows each party to strike up to all 10 non-public arbitrators thereby leaving the panel appointment to the highest ranked public and chair-qualified public arbitrators.

See Customer Code Rule 12403.

Prehearing Conference

Once the arbitrator panel is appointed, FINRA will schedule an Initial Prehearing Conference (IPHC). The IPHC is similar to a Rule 26 Party Planning Meeting in federal court. The IPHC is usually held by telephone and the purpose is to set the schedule for the case including evidentiary hearing dates, discovery deadlines, motion deadlines, briefing schedules and address any other preliminary matters. The parties also can waive the IPHC and provide agreed-upon dates to the arbitrator panel.

Discovery

Rules 12505-12511 of the Customer Code address the FINRA discovery process. For investor cases, FINRA provides what is known as the Discovery Guide, which are guidelines to help parties and arbitrators during the discovery process. In 2011, FINRA revised the Discovery Guide, to contain only two lists of documents the parties should exchange automatically and are presumed to be discoverable in all arbitrations between an investor and a FINRA member. These Document Production Lists, however, do not apply in Simplified Arbitrations.

Unless the parties agree otherwise, within 60 days of the date the answer to the Statement of Claim is due, the parties must either produce all documents on these two lists, explain the reason they cannot be produced or object as provided in Rule 12508.

In addition to the Discovery Guide lists, the parties may also request additional documents from any party by serving written requests. Requests for information (similar to an interrogatory) are generally limited to identification of individuals, entities, and time periods related to the dispute. *See* Customer Code Rule 12507. Standard interrogatories, however, are generally not permitted in arbitration. Responses to discovery requests are due within 60 days from the date of a discovery request.

Objections to discovery

Customer Code Rule 12508 sets forth the guidelines related to objecting to discovery.

Depositions

Depositions are generally not permitted in FINRA cases, but will be allowed under very limited circumstances:

- To preserve the testimony of ill or dying witnesses;
- To accommodate essential witnesses who are unable or unwilling to travel long distances for a hearing and may not otherwise be required to participate in the hearing;
- To expedite large or complex cases; and
- If the panel determines that extraordinary circumstances exist.

See Customer Code Rule 12510.

Motions to Compel

Should the parties be unable to resolve a discovery dispute, Customer Code Rules 12503 and 12509 address motions to compel discovery.

Sanctions

Customer Code Rules 12511 and 12212 allow for the issuance of sanctions by the arbitrators if a party fails to produce documents or information required by a discovery order. Sanctions may include assessing fees or penalties, including attorneys' fees, prohibiting a party from admitting evidence, drawing an adverse inference. Sanctions can go so far as to dismiss a claim, defense or the entire case.

Subpoenas

In FINRA arbitrations, only arbitrators, not attorneys for the parties, may issue a subpoena to non-parties. The party seeking issuance of the subpoena must make a written motion to the arbitrators.

See Customer Code Rule 12512.

Motions to Dismiss

In response to the increasing number of motions to dismiss being filed before a hearing on the merits, FINRA adopted Rule 12504, which became effective February 23, 2009. FINRA was concerned that parties were spending additional resources to defend against these motions, thereby increasing the costs and processing time. This new rule sets forth specific procedures governing motions to dismiss filed prior to the conclusion of the claimant's case in chief and ensures that the parties have their claims heard in arbitration.

Under the new rule, the arbitration panel is limited to two grounds on which to grant a motion to dismiss:

- If the parties previously had settled their dispute in writing; or
- The moving party was not associated with the account, security or conduct at issue.

Motions to dismiss must be filed in writing and must be filed at least 60 days in advance of a hearing on the merits. Parties will have 45 days to respond. The full panel must decide the motion, a hearing must be held, and the decision to grant such a motion must be unanimous and in writing.

If a motion to dismiss is denied, a party may not refile it unless specifically permitted by panel order. If the motion is denied, the panel must assess forum fees against the party who filed the motion. Furthermore, if the panel deems the motion frivolous, it must award reasonable costs and attorney's fees to the party who opposed the motion. If the motion is determined to have been filed in bad faith, the panel may issue other sanctions.

A separate motion to dismiss may be filed under Rule 12206 relating to the existing six-year limit on the submission of arbitration claims. These motions must be filed at least 90 days before a scheduled hearing on the merits, with a 30 day response time. This motion also must be decided by the full panel, a hearing must be held, and the decision to grant the motion must be unanimous and in writing.

Hearing Location

Effective May 3, 2010, FINRA Rule 12213(a) was amended to expand the criteria for selecting a hearing location. Specifically, the rule now states that the Director will select the hearing location closest to the customer's residence at the time of the events giving rise to the dispute, unless the hearing location closest to the customer's residence is in a different state. In that case, the customer may request a hearing location in the state where the customer resided at the time of the events giving rise to the dispute. If the assigned hearing location is inconvenient, due to size or location, the parties may ask FINRA to move the hearing to a different location. If made jointly by the parties, and is reasonably accessible to the panel (near an airport, etc) the request is typically granted.

Hearing Procedures

FINRA arbitrations are conducted in much the same manner that a court trial is conducted. FINRA rules require that here must be a record kept of every FINRA arbitration hearing. FINRA provides the arbitrators with a digital tape recorder for this purpose. Often the parties will agree to hire a court reporter. Although this adds a significant expense, having a transcript of the proceedings can be invaluable in the case of an appeal. It can also be very useful to be able to show the arbitrators actual testimony in the closing of the case.

At the beginning of the case the arbitrators are required to restate to the parties any disclosures previously made by the arbitrators as well as any additional disclosures they feel necessary. The arbitrators will then ask whether any of the parties and counsel to this matter know of any potential conflicts between the arbitrators and any party, counsel or witness in this matter. The arbitrators will then ask the parties if they accept the composition of the Panel. While counsel will usually state that they accept the Panel, it is wise to base such acceptance on the disclosures made by the arbitrators.

Typically each party makes an opening statement, which is followed by the introduction of evidence by the claimant, motions for directed verdict, introduction of evidence by the respondents, and closing arguments. Parties are entitled to make objections, cross-examine and redirect witnesses, and may, in the discretion of the arbitrators, present rebuttal testimony. The arbitrators may ask questions as they deem appropriate. The chairperson runs the hearing, but has no greater vote on any issue than the other arbitrators. Sometimes the chairperson may make rulings throughout the hearing without consulting the other panelists.

FINRA Rule 12604 provides that the panel will decide what evidence to admit. The rule also provides that the panel is not required to follow state or federal rules of evidence. Arbitrators tend to be very lenient in admitting evidence. Witnesses are placed under oath, and examined by counsel in the same manner as in a trial. The Arbitrators can, and invariably do, ask questions of the witnesses.

The FINRA rules do not provide for any type of witness schedule. It can be quite helpful to work out a witness order with opposing counsel, particularly because often witnesses are out of state. Panels will typically allow counsel to work out whatever arrangement suits them and will allow for witnesses to be taken out of turn where necessary in order to accommodate their schedules.

Generally, each claimant calls witnesses to testify on his or her behalf as to facts within the witnesses' personal knowledge. In addition, each claimant can ask expert witnesses who have specialized training or knowledge to testify as to their opinion on a technical matter to help the arbitrators draw conclusions and render a decision. Examples of areas of expert testimony are: damages, suitability, compliance, adequacy/failure of supervision, specific issues as to a particular type of product – especially if the product is esoteric (i.e., non-traded REITS, structured finance products, leveraged municipal bond arbitrage funds, auction rate securities, etc) Following the claimant's direct examination, each respondent is entitled to cross examine the claimant's witnesses and the arbitrator(s) may also question these witnesses. Witness examinations in FINRA arbitration are often slightly more relaxed than courtroom examinations, and leading questions are sometimes allowed on direct, at least with regard to non-controversial matters. Occasionally, counsel will take advantage of the "relaxed" atmosphere. Most chairpersons will act to correct such behavior, but opposing counsel can and should object if such behavior becomes the norm at a hearing.

Cross examination in FINRA arbitration is very different from courtroom examination in one respect – you will rarely, if ever, have taken the witness' deposition prior to questioning him on the stand. This can make the adage about not asking questions you don't know the answer to rather difficult. One way to deal with this is to stick to the documents. Counsel can use cross-examination as a way to focus attention on certain key documents, such as language from a compliance manual or the "smoking gun" email warning of the risks can be an effective way to proceed. Another tactic is to identify points that the witness will have to concede in order to maintain any credibility (for example, "you would agree with me that even suitable investments can lose money?" or "you agree that you have a duty to make suitable recommendations?"). This gives you a low risk opportunity to make the points of your case through the opposing party's witnesses. Once you get a feel for a witness' veracity, you can determine how far you want to go with questions for which you do not know how the witness will answer. You may find that you cannot get a true admission from a witness, but you can make them appear evasive. If at all possible, be certain to leave something in reserve to ask the witness so that you can end on a high note.

At the hearing you will need enough copies of any exhibits to give one copy to each arbitrator, the witness and opposing counsel (and one for yourself of course!). Organize exhibits for convenient reference by the arbitrator. It can also be helpful to use an elmo or projector or to

use Trial Director or a similar litigation software. to be able to display documents on a large screen. If you choose to do this it is advisable to have a screen for the witness as well so that the witness does not have to turn around to look at the screen during his or her testimony.

FINRA Rule 12504(b) governs motions to dismiss after a party concludes its case-in-chief. The restrictions set forth in FINRA Rule 12504(a) do not apply to FINRA Rule 12504(b) motions to dismiss after a party concludes its case-in-chief. After the claimant has presented its case—including all documentary evidence and testimony—but before the respondent presents its case, the respondent may ask the panel to dismiss the claim on the grounds that the claimant failed to prove the allegations in the statement of claim or failed to prove a right to recovery. Generally, these motions are made orally at the hearing after the claimant's presentation.

Assuming the claimant's case survives a motion to dismiss the respondent(s) will then present their case. At the resolution of the respondent's case the parties will typically give closing arguments. Occasionally the arbitrators will ask that closing arguments be made via written submissions. This can be a risky proposition. A good litigator will not want to pass on the opportunity to argue his or her case to the arbitrators. Often this is the only chance to put some of the evidence in context. It is also important to remember that arbitration is a forum of equity in which arbitrators are committed to serve justice as they deem appropriate for particular factual situations, making certain that they thoroughly understand the fact situation is key. Although it can seem counterproductive to try to persuade the arbitrators to listen to closing arguments, the parties are entitled to a **full** and fair hearing and should urge the arbitrators to allow live closing arguments.[1] Even when closing arguments are live, arbitrators will occasionally ask for or permit written post-hearing submissions.

It is important to remember that FINRA arbitrators are not paid for their preparation time. Thus, FINRA arbitrators are not inclined to spend a lot of time outside of the hearing poring over your exhibits and written submissions - - especially when they know that an eleventh-hour settlement is highly likely to render their preparation a waste of valuable time. Accordingly, you should make sure that you convey to the arbitrators whatever you believe they need to know, during the hearing itself. Also, be careful not to assume that the arbitrators are familiar with the statutory or common law elements needed to prove your claim or defense. You need to educate them on the applicable law.

At the close of the hearing, arbitrators will normally ask the parties to restate their respective claims. For parties requesting damages, arbitrators will also typically ask for a

[1] Arbitrators are compensated at the rate of $200 per hearing session, with an additional $75 per day if the arbitrator serves as the chairperson at the hearings on the merits. Pursuant to FINRA Rule 12100(n), hearing sessions are defined as any meeting between the parties and arbitrator(s) of four hours or less, including a hearing or a prehearing conference. There is no provision in the rules for compensation for reviewing submissions.

summary of their final request for damages, if one has not already been provided. Arbitrators are free to award rescission damages, punitive damages, attorneys fees and any other damage award allowed by law or equity.

Executive Sessions

Executive sessions are privately held discussions among the arbitrators outside the presence of the parties and their representatives, witnesses and stenographers. An executive session may be requested by any arbitrator for any reason provided they facilitate a full and fair hearing. Arbitrators may call such sessions to discuss procedural or substantive motions or to discuss a question, concern or observation from any member of the panel, at any time during the hearing. All executive sessions are off the record.

Avoiding Ex Parte Communications

Unless operating under the Direct Communication Rule, FINRA Rule 12211 provides that no party, or anyone acting on behalf of a party, may communicate with any arbitrator outside of a scheduled hearing or conference regarding an arbitration unless all parties or their representatives are present. Communications include an exchange about the arbitration case, as well as an exchange of pleasantries or casual comments. Parties and their counsel should avoid being in the hearing room with any arbitrator when fewer than all of the parties are present. This can be particularly difficult for some clients to remember during the course of a lengthy arbitration. It is important to remind clients that they cannot speak to the arbitrators, even just to talk about the weather, outside the presence of the opposing party.

The Award

FINRA Rule 12904 provides that arbitrators should endeavor to render an award within 30 business days from the date the record is closed. Pursuant to FINRA Rule 12608, the panel will decide when the record is closed. FINRA Rule 12904 requires that all awards must be in writing and signed by a majority of the arbitrators. All awards rendered are final and are not subject to review or appeal within FINRA.

Awards do not have to be unanimous. The rules provide that a majority of the panel must agree with the award and sign the final award document. An arbitrator who disagrees with the award may note the dissent. FINRA Rule 12904 provides that the parties may require the arbitrators to write an explained decision if the parties submit a joint request at least 20 days before the first scheduled hearing date. The explained decision is a fact-based award stating the general reason(s) for the panel's decision. Arbitrators are not required to include legal authorities and/or damage calculations in the decision. Absent a joint request from the parties for an

explained decision, arbitrators may still include a written decision to be published within the body of the award if they believe that an explanation for the award would benefit the parties. Although, typically an award contains little more than a bare bones statement of the allegations and procedural history, a ruling as to whether the claimant's claims are granted or denied, and if granted, a dollar amount of the award, as well as summary of the costs and forum fees incurred in the hearing.

The arbitration award does not, by law, have to be in any particular form, and most states simply require that the award be in writing, and signed by the arbitrators. Arbitrators do not have to provide a reason for their decision, or even a statement as to how they arrived at a damage figure.

The total amount of forum fees arbitrators assess is based on the number of hearing sessions. A hearing session includes any meeting between the parties and arbitrators that lasts four hours or less. For example, if a hearing runs two full days, the parties would be billed for four hearing sessions. At the close of the hearing, the arbitrators must determine how to assess forum fees against the parties. The arbitrators have discretion to allocate forum fees among the parties in a manner they deem appropriate. In deciding how to assess the forum fees, the arbitrators may consider the following factors:

- temporary waivers of filing fees or hearing session deposits because of financial hardship;
- actions by any party that may have prolonged the hearing;
- the legitimacy of arguments made or positions taken;
- disruptions or time delays caused during hearing sessions; and
- the ultimate merits of the case (i.e., who prevailed or substantially prevailed).

Challenges to an Arbitration Award

If a claimant is awarded damages, the respondent must pay within thirty days of receiving the written award, unless the respondent files a motion to vacate. A motion to vacate is a challenge to the validity of the award. Courts decide these motions and can either vacate (or overturn), confirm, or modify the award. A confirmed award stands as issued by the arbitrators. An award vacated by the courts is voided.

FINRA does not have an appeals process through which a party may challenge an award. This means that FINRA does not hear appeals on arbitration awards. However, under federal and state laws, there are limited grounds on which a court may hear a party's appeal on an award. Specifically, the law permits a district court to vacate or overturn an arbitration award if it finds that:

- the award was procured by corruption, fraud, or undue means;
- there was evident partiality or corruption in the arbitrators;
- the arbitrators were guilty of misconduct in refusing to postpone the hearing, even in light of sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy, or of any other misbehavior by which the rights of any party have been prejudiced;
- the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made;
- the arbitrators disregarded a clearly defined law or legal principle applicable to the case before them (Manifest Disregard of the Law); or
- there is no factual or reasonable basis for the award (Complete Irrationality).

For more information, view the Federal Arbitration Act, 9 U.S.C. §10.

Evident partiality and manifest disregard of the law are probably the two mostly widely used grounds for appeal. Following *Hall Street Assocs. LLC v. Mattel Inc.*, 552 U.S. 576 (2008), the Circuits have disagreed whether manifest disregard survives as an independent ground for vacatur. The 1st, 5th, 7th, 8th, and 11th Circuits have held that manifest disregard is not an independent ground for vacating awards under the FAA.[2] However, the 2nd[3], 4th[4], 6th[5], 9th[6], and 10th[7] Circuits still recognize manifest disregard. The 3rd Circuit remains undecided.

Evident partiality requires vacatur of an arbitration award "when either (1) an actual conflict exists, or (2) the arbitrator knows of, but fails to disclose, information which would lead

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[2] See, *Ramos-Santiago v. United Parcel Service*, 524 F.3d 120, 124 n.3 (1st Cir. 2008) (dicta because not decided under the FAA); *Citigroup Global Markets Inc. v. Bacon*, 562 F.3d 349 (5th Cir. 2009); *Frazier v. CitiFinancial Corp*., 604 F.3d 1313 (11th Cir. 2010); *Affymax Inc. v. Orth-McNeil-Janssen Pharm. Inc.*, 660 F.3d 281, 284-85 (7th Cir. 2011) *Medicine Shoppe Int'l Inc. v. Turner Investments, Inc.*, 614 F.3d 485, 489 (8th Cir. 2010).

[3] See, *Jock v. Sterling Jewelers*, 646 F.3d 113, 121-22 (2d Cir. 2011), cert. denied, 646 F.3d 113, --- S.Ct. ---- (2012); See also, *Goldman Sachs Execution & Clearing, L.P., et al. v. The Official Unsecured Creditors' Committee of Bayou Group, L.P., et al.*, 10-5049-cv (lead) (2d Cir. 2012)

[4] *Wachovia Securities v. Brand*, 671 F.3d 472 (4th Cir. Feb. 16, 2012), (stating "manifest disregard continues to exist as either an independent ground for review or as a judicial gloss," but declined to decide which of the two is the correct, because the claim failed under both.)

[5] See, *Coffee Beanery, Ltd. v. WW, LLC*, 300 Fed. App'x 415, 419 (6th Cir. 2008) (holding, in an unpublished decision, that the manifest disregard standard, as a judicially-invoked ground for vacatur, continues to be viable after *Hall Street* because the Supreme Court only rejected contractual expansion of the grounds in §§ 10 and 11 of the FAA and did not address judicial expansion of those grounds).

[6] See, *Biller v. Toyota Motor Corp.*, --- F.3d ----, 2012 WL 336135, at *5-6 (9th Cir. Feb. 3, 2012) (court considered manifest disregard of law as grounds for vacatur, but did not find manifest disregard under the facts presented). See also *Johnson v. Wells Fargo Home Mortgage, Inc.*, 635 F.3d 401, 415 n. 11 (9th Cir. 2011) (reaffirming that in the Ninth Circuit the manifest disregard standard has survived *Hall Street*).

[7] See, *Lynch v. Whitney*, 419 Fed. Appx. 826 (10th Cir. 2011).

a reasonable person to believe that a potential conflict exists." *Univ. Commons–Urbana, Ltd. v. Universal Constructors Inc.*, 304 F.3d 1331,1339 (11th Cir. 2002). The standard applied and relevant inquiry in cases in which a party is moving to vacate based on "evident partiality" differs depending on whether the party is moving based on allegations of actual bias or based on allegations of failure to disclose. In the "actual bias" cases, the party must prove evident partiality by showing that the arbitrators were biased in their actions and decisions at the hearing. *Schmitz v. Zilveti*, 20 F.3d 1043, 1046-47 (9th Cir. 1994). Thus, in actual bias cases, the testimony, rulings, and evidence introduced at the underlying arbitration are centrally relevant to the court's decision. In "failure to disclose" cases, however, it is the arbitrator selection process, not the validity of the award, that is at issue, and the events of the underlying arbitration proceeding become largely irrelevant. *Lexington Ins. Co. v. S. Energy Homes, Inc.*, No. 1091617, __ So. 3d __, 2012 WL 3538231, at *15 (Ala. Aug. 17, 2012) (quoting *Schmitz*, 20 F.3d at 1046-47) (in nondisclosure cases, "[w]hether the arbitrators' decision itself is faulty is not necessarily relevant.").

"[A]n arbitrator is obligated to disclose those facts that 'create a reasonable impression of partiality' or put another way, 'information which would lead a reasonable person to believe that a potential conflict exists.'" *Id.* (citations omitted). "The party seeking vacatur must point to evidence of an actual conflict of interest or identify a business or other connection that might create a reasonable impression of possible bias that the arbitrator failed to disclose." *Aviles v. Charles Schwab & Co., Inc.*, 435 Fed. Appx. 824, 828-29 (11th Cir. 2011). However, a party need not show an actual conflict of interest or actual bias in order to establish that grounds for vacatur under 9 U.S.C. § 10(a)(2). Instead, evident partiality under Section (a)(2) exists where "the arbitrator knows of, but fails to disclose, information which would lead a reasonable person to believe that a potential conflict exists"- that is, where the facts would "create a reasonable impression of partiality." *Univ. Commons–Urbana, Ltd.*, 304 F.3d at 1339. *See also Waverlee Homes, Inc. v. McMichael*, 855 So. 2d 493, 508 (Ala. 2003) (Alabama has adopted the "reasonable impression of partiality" standard).

"An arbitrator's nondisclosure of facts showing a potential conflict of interest creates evident partiality warranting vacatur even when no actual bias is present." *Lexington*, ___ So. 3d___, 2012 WL 3538231, *14 (quoting *Schmitz v. Zilveti*, 20 F.3d 1043, 1045 (9th Cir.1994)) (Alabama Supreme Court's emphasis).

Under FINRA Rule 12405, *any* circumstance that might preclude the arbitrator from rendering an objective and impartial decision must be disclosed. Pre-arbitration disclosure is particularly important in arbitration, because unlike in judicial proceedings, FINRA arbitrators seldom provide any justification for their rulings, and review of a panel's award is severely curtailed. *See* 9 U.S.C. §10(a). In an effort to keep the arbitration process free from partiality or corruption, the FAA drafters added subsection 2 to § 10(a), which provides that the losing party

may protest an arbitration award "[w]here there was evident partiality or corruption in the arbitrators…." 9 U.S.C. § 10(a)(2).

Failure to Pay an Award or Settlement

Under FINRA rules, industry parties must pay arbitration awards within 30 days or risk suspension by FINRA. Specifically, FINRA Rule 9554 contains expedited suspension procedures that address a brokerage firm's or broker's failure to pay FINRA arbitration awards. FINRA can suspend or cancel the registration of a broker or brokerage firm if that party does not comply with an arbitration award or settlement related to an arbitration or mediation. However, a brokerage firm or broker may assert four defenses to the expedited suspension process:

1. the brokerage firm or broker paid the award in full;
2. the parties have agreed to installment payments or have otherwise settled the matter;
3. the brokerage firm or broker has filed a timely motion to vacate or modify the award and such motion has not been denied; and
4. the brokerage firm or broker has filed a petition in bankruptcy and the bankruptcy proceeding is pending or the award has been discharged by the bankruptcy court.

View Regulatory Notice 10-31 for additional information[8].

Expungement

When a broker is named as a respondent in a customer-initiated arbitration, the arbitration claim and any allegations of wrongdoing are required to be reported on the broker's Form U4. Brokerage firms must submit a disclosure report when a broker is the "subject of" allegations of sales practice violations made in arbitration claims or civil lawsuits, but is not a named party to the arbitration or lawsuit. Once reported, this information is recorded on the broker's record in the Central Registration Depository (CRD®) System and becomes available to the public upon request through FINRA's BrokerCheck program.

Brokers may seek to have a reference to allegations or to involvement in an arbitration removed from their CRD® System records. The process of removing this information from the CRD® system is called "expungement." Before ruling on a request for expungement, the arbitrators must review and follow the procedures provided under FINRA Rules 2080, 12805 and 13805.

FINRA Rule 2080 contains standards and procedures for expungement of customer dispute information from CRD. The rule requires that a court of competent jurisdiction confirm an arbitration award granting expungement relief or order such expungement. It also requires

[8] FINRA Regulatory Notices can be found at http://www.finra.org/Industry/Regulation/Notices/2012/index.htm

that firms or associated persons name FINRA as an additional party in any court proceeding in which they seek an order to expunge customer dispute information or request confirmation of an award containing an order of expungement. FINRA will generally oppose confirmation of the expungement portion of the arbitration award in most cases in which it participates in the judicial proceeding.

Upon request, however, FINRA, in its discretion, may waive the requirement to name FINRA as a party in these proceedings provided the arbitration award directing expungement contains at least one of the following judicial or arbitral findings:

1. the claim, allegation or information is factually impossible or clearly erroneous;
2. the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds; or
3. the claim, allegation or information is false.

FINRA Rules 12805 and 13805 provide enhanced safeguards to ensure that arbitrators have the opportunity to consider the facts that support or weigh against a decision to grant expungement. These rules also provide that expungement occurs only when the arbitrators find and document one of the narrow grounds specified in FINRA Rule 2080. Under FINRA Rules 12805 and 13805, the panel must follow the outlined procedures in order to grant expungement of customer dispute information under FINRA Rule 2080:

1. The arbitration panel must hold a recorded hearing session by telephone or in person regarding the appropriateness of expungement.
2. In cases involving settlements, the arbitration panel must review the settlement documents, consider the amount paid to any party and consider any other terms and conditions of the settlement that might raise concerns about the associated person's involvement in the alleged misconduct before awarding expungement.
3. The arbitration panel must indicate which of the grounds for expungement under FINRA Rule 2080(b)(1)(A)-(C) serves as the basis for their expungement order, and provide a brief written explanation of the reasons for ordering expungement.
4. The arbitration panel must assess against the parties requesting expungement relief all forum fees for hearing sessions in which the sole topic is the determination of the appropriateness of expungement.

How to Become an Arbitrator

FINRA maintains a roster of more than 6,000 arbitrators. FINRA has two classifications of arbitrators: public and non-public. Public arbitrators are select individuals who are not required to have knowledge of the securities industry. Non-public arbitrators have a more extensive securities industry background.

If you have at least five years of full-time, paid business or professional experience—**inside or outside of the securities industry—**and at least two years of college-level credits, you may be eligible to be included on FINRA's public arbitrator roster. Before serving on a case, arbitrators must first successfully complete FINRA's Basic Arbitrator Training Program. You

can apply online or obtain a paper application from FINRA's website[9]. You must submit completed and signed Consent to Background Search and Investigation form; obtain two letters of recommendation, neither of which may be from a family member and pay a non-refundable $80 fee. It is critical that FINRA have a fair pool of individuals to provide to the parties.

[9] http://www.finra.org/ArbitrationAndMediation/Arbitrators/BecomeanArbitrator/ApplyNow/index.htm

Summary Arbitration Statistics October 2012

New Case Filings through October:

2010	2011	2012	2012 vs 2011
4,768	4,027	3,706	-8%

Number of Cases Closed through October:

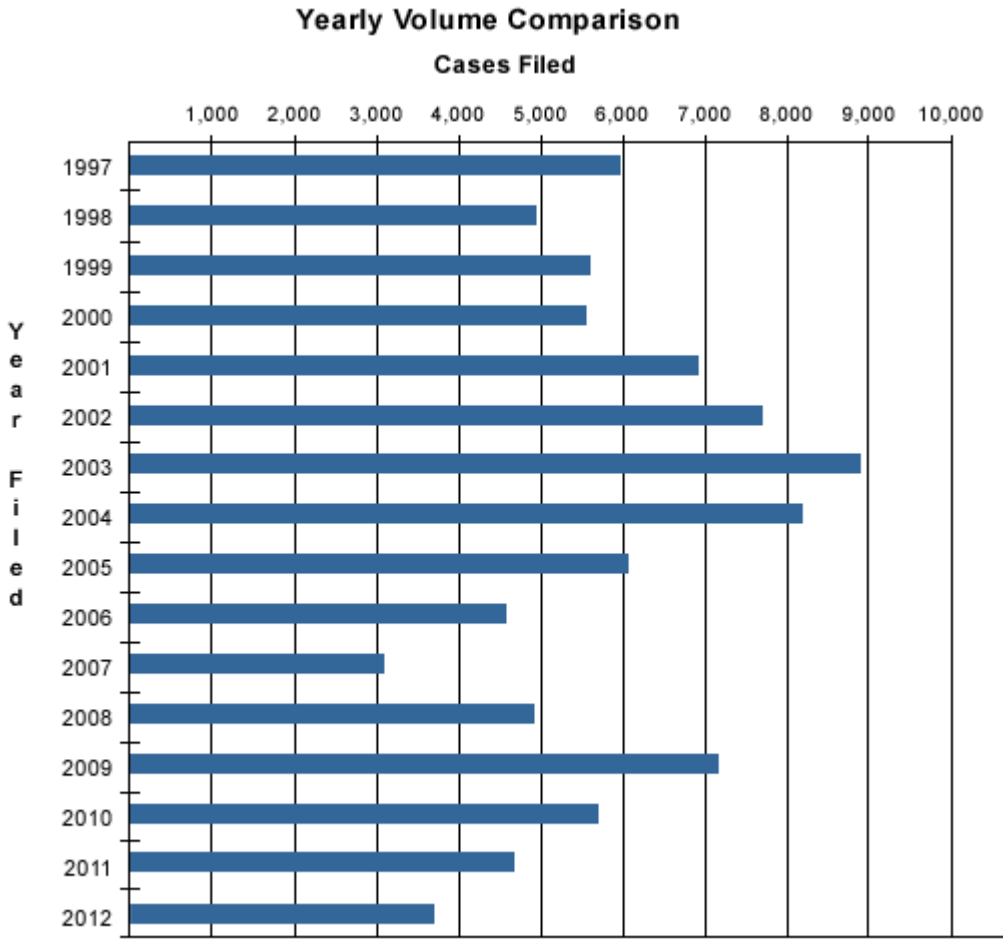
2010	2011	2012	2012 vs 2011
5,129	5,183	4,123	-20%

Turnaround Time[1] (in months) through October:

	2010	2011	2012	2012 vs 2011
Overall	12.5	14.2	14.5	2%
Hearing Decisions	14.9	15.9	16.7	5%
Simplified Decisions	6.4	6.3	7.2	14%

1 *The timing* of the arbitration process is heavily influenced by Code of Arbitration Procedures time limits, the parties, and the panel.

Source:
http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/



Source:
http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/

FINRA ARBITRATION Submission Agreement

Claimant(s)

In the Matter of the Arbitration Between

Name(s) of Claimant(s)

and

Name(s) of Respondent(s)

1. The undersigned parties ("parties") hereby submit the present matter in controversy, as set forth in the attached statement of claim, answers, and all related cross claims, counterclaims and/or third-party claims which may be asserted, to arbitration in accordance with the FINRA By-Laws, Rules, and Code of Arbitration Procedure.
2. The parties hereby state that they or their representative(s) have read the procedures and rules of FINRA relating to arbitration, and the parties agree to be bound by these procedures and rules.
3. The parties agree that in the event a hearing is necessary, such hearing shall be held at a time and place as may be designated by the Director of Arbitration or the arbitrator(s). The parties further agree and understand that the arbitration will be conducted in accordance with the FINRA Code of Arbitration Procedure.
4. The parties agree to abide by and perform any award(s) rendered pursuant to this Submission Agreement. The parties further agree that a judgment and any interest due thereon, may be entered upon such award(s) and, for these purposes, the parties hereby voluntarily consent to submit to the jurisdiction of any court of competent jurisdiction which may properly enter such judgment.
5. The parties hereto have signed and acknowledged the foregoing Submission Agreement.

Claimant Name (please print)

Claimant's Signature Date
State capacity if other than individual (*e.g.,* executor, trustee or corporate officer)

Claimant Name (please print)

Claimant's Signature Date
State capacity if other than individual (*e.g.,* executor, trustee or corporate officer)

If needed, copy this page.

FINRA ARBITRATION Submission Agreement

Respondent(s)

In the Matter of the Arbitration Between

Name(s) of Claimant(s)

and

Name(s) of Respondent(s)

1. The undersigned parties ("parties") hereby submit the present matter in controversy, as set forth in the attached statement of claim, answers, and all related cross claims, counterclaims and/or third-party claims which may be asserted, to arbitration in accordance with the FINRA By-Laws, Rules, and Code of Arbitration Procedure.
2. The parties hereby state that they or their representative(s) have read the procedures and rules of FINRA relating to arbitration, and the parties agree to be bound by these procedures and rules.
3. The parties agree that in the event a hearing is necessary, such hearing shall be held at a time and place as may be designated by the Director of Arbitration or the arbitrator(s). The parties further agree and understand that the arbitration will be conducted in accordance with the FINRA Code of Arbitration Procedure.
4. The parties agree to abide by and perform any award(s) rendered pursuant to this Submission Agreement. The parties further agree that a judgment and any interest due thereon, may be entered upon such award(s) and, for these purposes, the parties hereby voluntarily consent to submit to the jurisdiction of any court of competent jurisdiction which may properly enter such judgment.
5. The parties hereto have signed and acknowledged the foregoing Submission Agreement.

Respondent Name (please print)

Respondent's Signature Date

State capacity if other than individual (*e.g.*, executor, trustee or corporate officer)

Respondent Name (please print)

Respondent's Signature Date

State capacity if other than individual (*e.g.*, executor, trustee or corporate officer)

If needed, copy this page.