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SECURITIES ARBITRATION OF INVESTOR DISPUTES: A PRIMER FOR THE UNWARY PRACTITIONER

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SO YOU'RE SITTING IN YOUR OFFICE ONE DAY when your client, a retired teacher, comes in and tells you how her financial advisor managed to squander nearly her entire life's savings via poor advice and misrepresentations. Always willing to help, you dutifully prepare her petition and file it in your local district court. A month later the financial advisor and his company file their answer. With the answer, you also notice they have included a "Motion to Compel Arbitration," asking the Court to abate your case pending arbitration conducted by someone named "FINRA." You scratch your head thinking, "who the heck is FINRA and how does this arbitration thing work?" This article was written with practitioners like you in mind. Unless otherwise noted, the opinions expressed below are solely those of the author.

FINRA is the Financial Industry Regulatory Authority, Inc., a private corporation that acts as a Self-Regulatory Organization ("SRO") over all securities firms that do business with the public ("Broker-Dealers" or "BD"), as well as their registered representatives.[1] FINRA was born in 2007, upon the consolidation of the enforcement arm of the New York Stock Exchange, and the National Association of Securities Dealers, Inc.[2] FINRA's arbitration forum is a continuation of those maintained by these predecessors. Since the U.S. Supreme Court gave its official nod in favor of arbitration back in 1987,[3] virtually all investor disputes which traditionally would have been resolved by a judge and a jury are subject to mandatory, binding arbitration before FINRA. Why is this? It is because all BDs include a predispute arbitration agreement in their account agreements with their customers that encompasses virtually any dispute that later arises.[4] While there are exceptions, they are generally few and far between.

"So there is an agreement to arbitrate, now what?"
Just because there is an alleged agreement to arbitrate doesn't mean you're off to FINRA just yet. The burden is still on the BD to offer that agreement into evidence.[5] This is typically a cursory matter, but it is a point where you may be able to extract some leverage for your client. While the Courts have repeatedly stressed that a trial court should indulge a presumption or preference in favor of arbitration, those presumptions only come into play once an agreement to arbitrate has been established.[6] Did all of your clients sign the agreement in all of their legal capacities? Has the alleged agreement been superseded? Unless your client's case is barred by a legal defense (i.e. limitations), you're usually going to be better off with a judge and a jury deciding your fate. Thus, when a BD or its financial advisors contend your client must arbitrate his or her dispute, hold them to their burden.

While the Courts have repeatedly stressed that a trial court should indulge a presumption or preference in favor of arbitration, those presumptions only come into play once an agreement to arbitrate has been established.

"Okay, they met their burden. What happens now?"
Once the BD has established a valid agreement to arbitrate, that agreement will usually be enforced by the Court. As one U.S. District Court recently commented, "you can't walk within six blocks of an arbitration agreement without it being enforced against you in this day and age." While a Court can dismiss a case when compelling arbitration,[7] the more common practice is for the Court to enter an order abating the case pending the completion of the arbitral process. This makes sense because one of the parties may come back at a later date and ask the Court to enter judgment on the arbitrators' award.

"So how do I assert the client's claims in FINRA arbitration?"
While initiating the arbitration process may appear intimidating at first, fear not, for FINRA has a published Code of Arbitration Procedure for Customer Disputes to guide you in your travels.[8] The current version of the code applies to all claims filed on or after April 16, 2007.[9] The first step in initiating your client's arbitration is having them sign a submission agreement agreeing to be bound by the process and preparing your client's statement of claim specifying

the relevant facts and remedies requested.[10] Your client's statement of claim is essentially the arbitration version of his or her state court petition. Your plaintiff client is now the claimant and the former defendants are now respondents. These items need to be filed with FINRA's director of arbitration. This can be done quickly and easily using FINRA's Online Arbitration Claim Filing system.[11] You will also need to pay filing fees, which vary based upon the amount of monetary relief your client is requesting.[12] FINRA will check your filings for any deficiencies and, assuming it finds none, serve the respondents, who will have 45 days from the receipt of your client's statement of claim to file their submission agreement and answer.[13] FINRA maintains offices in Dallas and Houston and you can ask FINRA that the hearing on the merits of your case take place in either locale.[14]

Picking an arbitration panel is much like picking a jury, in that you might not know who you want, but you usually know who you *don't* want to hear your case.

Choosing your arbitrator(s)

Once initial pleadings have been exchanged, your next order of business is to choose the arbitrator(s) who will hear your case. FINRA rules provide that a single arbitrator will hear your case if the monetary relief you seek does not exceed $100,000.[15] Relief requests in excess of that amount are generally heard by a panel of three arbitrators.[16] To choose your panel, FINRA will send out three lists of ten arbitrators to each of the parties. Two of these lists contain "public" arbitrators, while one contains "non-public" arbitrators. The "non-public" arbitrator is someone presently employed in or affiliated with the industry.[17] The "public" arbitrator moniker, however, can often be misleading, as technically a person employed by a broker-dealer for 19 years can become a "public" arbitrator by being out of the industry for 5 years.[18] You will be permitted to strike up to 4 arbitrators from the "public" arbitrator lists and rank the remaining 6 in order of preference.[19] You may do the same for the "non-public" arbitrator list, but a recent rule change now permits striking all the "non-public" arbitrators and having your panel appointed from whoever remains on the two "public" lists after all strikes have been exercised.[20]

So who do you rank and who do you strike? Well, picking an arbitration panel is much like picking a jury, in that you might not know who you want, but you usually know who you *don't* want to hear your case. FINRA will provide you with background information on each arbitrator as well as a list of any award(s) they have made in the past. You can download these awards for free from the FINRA website.[21] While they are no substitute for a jury verdict or findings of fact and conclusions of law, they can be indicative of how a potential arbitrator may rule in your case. Review and analyze the awards. Another great resource is the Public Investors Arbitration Bar Association.[22] ("PIABA") PIABA's membership is made up of lawyers who devote a significant part of their practice to disputes like yours and can usually tell you a little bit about some of the proposed arbitrators on your lists.

Also, keep in mind that the system is not perfect. If BDs seem to frequently pick a particular arbitrator, there is probably a good reason for that. Many of the arbitrators on your lists are retirees who supplement their retirement income by becoming arbitrators. If they enter a big award against a BD, they usually will never sit on a panel again. Arbitrators can become jaded with experience as well. What appears outrageous the first time an arbitrator sees it, understandably becomes less so when that person has been presented with much more egregious conduct in his or her last 25 cases. This is usually your only chance to participate in this process, so be sure you get it right. Be prepared and choose wisely.

"I've submitted my strikes and rankings. What happens now?"

Once you have submitted your strikes and rankings, FINRA will send you a letter identifying the members of your arbitration panel, as well as its chair. This letter will also usually identify a time and dial-in number for your Initial Pre-Hearing Conference.[23] ("IPHC") The IPHC is held telephonically and a number of things usually take place during that conference, including but not limited to:

- The arbitrators will take their oaths;
- The parties will be asked to accept the panel or offer any objections;
- The parties may argue any pending motions if the panel is inclined to hear them;
- The parties and the panel will discuss their availability and preferences for the scheduling order that will ultimately govern their dispute, frequently including a discovery cutoff date, a date by which dispositive and other prehearing motions must be filed and a date for a hearing on the merits.

The panel can and frequently will take up other items during the IPHC. In any event, you should call your opposing

counsel and try and iron out some of these issues prior to the IPHC. It usually results in a much shorter and more organized hearing for all involved.

Discovery and Other Prehearing Matters

Discovery in FINRA arbitration is far more narrow than what you might traditionally ask for and be entitled to in a lawsuit at the Courthouse. You generally will not be entitled to depose any of the witnesses you expect to testify at your hearing on the merits.[24] You are, however, entitled to document production from any party and can also ask the panel to subpoena items from third parties if needed.[25] Additionally, and in part to curtail rampant discovery abuses by BDs in the past, FINRA has published a discovery guide for parties and arbitrators which specifically provides that a BD or associated person shall produce certain specific documents in customer disputes.[26] Notwithstanding, BDs and associated persons frequently ignore the guide and attempt to limit your right to discovery to those documents you already have – statements, account agreements, happiness letters, etc. Your experience will vary based upon the integrity of your opponents and their counsel and your arbitrators' tolerance for discovery abuse and chicanery.

Pretrial motions are also far less frequent and dispositive motions are expressly discouraged.[27] As there is usually going to be some issue that must be heard on its merits, arbitrators are generally inclined to err on the side of letting such matters be heard and resolved at your final hearing. You will usually have a final prehearing conference sometime in the 60 days before your final hearing. Also, unless the parties agree or the panel has ordered otherwise, the parties are required to exchange witness and exhibit lists 20 days prior to the final hearing.[28] If something is not disclosed or exchanged at this time or prior to this time, the arbitrators will likely refuse to consider it.[29]

Final Hearing and Award

Your final hearing on the merits will usually proceed in a conference room or classroom in FINRA's offices in Houston or Dallas. The proceedings are usually recorded on cassette tapes and that record is preserved for review if necessary.[30] Arbitrators will generally defer to counsel to put on their respective claims and defenses and offer their evidence.[31] Likewise, although you can raise evidentiary issues with the panel at your final hearing, arbitrators generally are going to let all of the evidence come in rather than risk being reversed for failing to consider something a reviewing tribunal deems relevant. Upon closing of the record, a majority of the arbitrators render a written award. FINRA rules suggest that the panel render its award within 30 days of the closing of the record,[32] but they generally do so long before the 30 day period has expired. Although BDs often pay the awards immediately when relief is afforded to the customer, a judgment can be entered upon the award in any court of competent jurisdiction.[33]

This article is not intended to be a comprehensive guide to the FINRA arbitration process, but rather a primer to familiarize the unwary practitioner with some of the more basic aspects of the process. Your experience may vary. Good luck and be vigilant!

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1 http://www.finra.org/web/groups/corporate/@corp/@about/documents/corporate/p118667.pdf

2 Johnson, Carrie. "SEC Approves One Watchdog For Brokers Big and Small". *The Washington Post*. July 27, 2007. Page D02.

3 *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 231, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987).

4 http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p036466.pdf

5 *See, e.g., In re Kellogg Brown & Root, Inc.*, 166 S.W.3d 732, 737 (Tex. 2005); *In re Oakwood Mobile Homes, Inc.*, 987 S.W.2d 571, 572-73 (Tex. 1999).

6 *In re Jebbia*, 26 S.W.3d 753, 757 (Tex. App.--Houston [14th Dist.] 2000, orig. proceeding).

7 *Alford v. Dean Witter Reynolds, Inc.*, 975 F.2d 1161, 1164 (5th Cir. 1992).

8 http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4096

9 FINRA Code of Arbitration Procedure for Customer Disputes, Rule 12101.

10 http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@tools/documents/arbmed/p007954.pdf

11 http://www.finra.org/ArbitrationAndMediation/Arbitration/Process/FileClaim/

12 http://apps.finra.org/ARbitrationMediation/ArbFeeCalc/1/Default.aspx

13 FINRA Code of Arbitration Procedure for Customer Disputes, Rules 12302 and 12303.

14 Rule 12213.

15 Rule 12401.

16 Rule 12401.

[17] Rule 12100(p).
[18] Rule 12100(u).
[19] Rule 12403(c).
[20] Rule 12403(d).
[21] http://finraawardsonline.finra.org/
[22] http://www.piaba.org
[23] FINRA Code of Arbitration Procedure for Customer Disputes, Rule 12500.
[24] Rule 12510.
[25] Rules 12505 and 12506.
[26] http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@arbrul/documents/arbmed/p123494.pdf
[27] FINRA Code of Arbitration Procedure for Customer Disputes, Rules 12503 and 12504.
[28] Rule 12514.
[29] Rule 12514(c).
[30] Rule 12606.
[31] Rule 12607.
[32] Rule 12904.
[33] 9 U.S.C. § 9.