FINRA Arbitration Deskbook

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INTRODUCTION

Like all legal proceedings, FINRA Arbitrations are complex and ripe with potential "landmines" for the unwary. For the last ten years, I have represented investors in hundreds of FINRA arbitration matters across the United States. I am proud to say that I have successfully helped these investors recover hundreds of millions of dollars.

Contact me at (212) 658-1501 to discuss your case.

Marc Fitapelli

DISCLAIMER

The contents of this ebook are being provided “as is, where is” with no representations or warranties. This ebook is designed to be educational and is not legal advice. If you considering filing a FINRA arbitration, you should contact a lawyer immediately.

THE FINRA ARBITRATION PROCESS

INTRODUCTION

What Is the Financial Industry Regulatory Authority (FINRA)?

FINRA is a watchdog organization with a mission of protecting investors in the United States by policing honesty and fairness in the securities industry. It is the major regulator for all securities firms that do business in the United States. It was created in 2007 through consolidation of the National Association of Securities Dealers (NASD) and the regulation, arbitration and enforcement unit of the New York Stock Exchange. FINRA oversees all areas of the securities sector including education, writing/enforcing rules for federal laws regarding securities, trade reporting and running the major dispute resolution service for NASDAQ, The New York Stock Exchange and for other exchanges that lack their own dispute resolution service.

ARBITRATION PROCESS

What Is FINRA Arbitration?

FINRA arbitration is a dispute resolution service that efficiently resolves employment, monetary and business disputes between investors, securities firms and security firm employees. The process is overseen by the Securities and Exchange Commission (SEC) and the SEC must approve its rules. The recommendations of the National Arbitration and Mediation Committee (NAMC) are also taken into consideration for FINRA rules regarding how arbitrations and mediations are conducted and approving candidates for the roster of arbitrators and mediators. Every case is assigned an administrator to ensure that inquiries are handled promptly and information specialists are available to answer case specific questions that come up during the process.

THE FINRA ARBITRATOR

Qualifications of a FINRA Arbitrator

FINRA arbitrators and mediators are recruited from a wide range of professionals with expertise in various areas of the securities industry. FINRA arbitrators and mediators are available in 69 hearing venues, a minimum of one in each state and one in Puerto Rico. FINRA has no part in deciding an award or mediation recommendation, but promises to make every possible effort to provide knowledgeable, impartial, highly trained independent arbitrators and mediators. FINRA Rule 12214 controls compensation for arbitrators, requiring payment of $300 for each hearing session. There is an additional $125 fee per day if the arbitrator will be acting a chairperson at a hearing on the merits. A "hearing" is defined as a meeting between the parties and the arbitrator that is four hours in duration or less. For example, a full day hearing would be considered two hearings for the purpose of compensation. All FINRA arbitrators must complete the Basic Arbitrator Training Program (BATP) covering stages of the process including a module on the expungement process. Applicants must successfully complete assessment before being seated on the roster. Many FINRA arbitrators also complete Advanced Arbitrator

Training (AAT) in a specific area such as Anti-Money Laundering, Chairperson Training and Explained Decisions. FINRA occasionally requires additional training in specific areas for all arbitrators that must be completed in order to remain on the roster.

Duties of a FINRA Arbitrator

Ethical Responsibilities

One of the most important responsibilities of a FINRA arbitrator is to review the Code of Ethics for Arbitrators in Commercial Disputes on an ongoing basis to ensure that they are always clear about their ethical duties. One of the most important considerations is neutrality that extends to parties, agents, counsel, witnesses and co-panelists. Arbitrators must be neutral in fact and appearance because they are acting as informal judges with binding authority. It's actually even more important for an arbitrator to be perceived as fair because their decisions cannot be overturned on appeal. An arbitrator must carefully consider whether there is a conflict before accepting a case. Once an arbitrator is on case, they must be exceedingly careful not to commence any business or personal relationship that might give the impression of bias. It is also important to avoid conflicts for a reasonable period

of time after the decision for the case is made. An arbitrator is ethically required to refuse an appointment where firmly held beliefs about the issue at hand or any of the parties may hinder neutrality. One of the major goals of alternative dispute resolution is the prompt resolution of cases, so arbitrators must also ensure that they are available before accepting a matter. Arbitrators must also pay scrupulous attention to securing the confidentiality of all personal information for a case, including but not limited to:

- Drivers license numbers;
- Social security numbers;
- Business taxpayer IDs;
- Bank, brokerage and other financial account numbers;
- Criminal history;
- Fingerprints;
- Expunged records and
- Medical records.

This means that arbitrators must be cautious when transporting, using, storing and disposing of case materials by locking paper materials away, securing electronic materials with solid passwords and/or encryption and not discussing matters in a manner that might allow for eavesdropping.

Duty to Disclose

Part of the process of being selected to join FINRA's arbitration roster is submitting detailed biographical information that FINRA uses to create an Arbitrator Disclosure Report that is distributed to parties for review before an arbitrator is chosen for a case. The disclosure report is updated with the awards previously rendered by the arbitrator and the current cases the arbitrator is assigned to. FINRA requires all arbitrators to frequently update their disclosure reports to ensure that the entire process is considered a cornerstone of the trust built by FINRA that enables effective dispute resolution. Updated disclosure includes any new articles written, lawsuits of any type where the arbitrator is a party, professional memberships, board membership or anything else that has even the slightest chance of being relevant. The duty to disclose is important because an error or omission can lead to a vacated award, and, in such cases, the arbitrator is likely to be removed from the roster.

How to Choose A FINRA Arbitrator

The parties are allowed to challenge the appointment of a particular arbitrator to their case and there are several methods at their disposal. If all parties ask an arbitrator to recuse themselves, recusal is required and the arbitrator should immediately honor the request. If less than all the parties would like the arbitrator to withdraw, the arbitrator is within their rights to remain on the panel if they believe the challenge is unsubstantiated and that they can decide the case fairly. That said, FINRA prefers arbitrators to recuse themselves when it's requested to avoid situations where the arbitrators must step down mid-proceeding or an award that is vacated after the matter is complete. The FINRA Arbitrator

How To Challenge and Disqualify A FINRA Arbitrator

Another method for eliminating an arbitrator is a challenge for cause under FINRA Rule 12407. In order to remove an arbitrator, it must be shown that they are biased, lack impartiality or have a direct or indirect interest in the outcome of the case. The bias of interest cannot be speculative or remote, it must be reasonably demonstrable and definite. The challenge must be made in writing before the first hearing session begins and all opposing parties must be given the opportunity to submit their response. FINRA will review the challenge for cause and the responses and make a decision about whether to remove the arbitrator. These are some examples of specific types of challenges for cause:

- **Personal Relationships** by blood or marriage to an attorney, witness or party;
- **Business Relationships** such as ever having been a business partner, vendor, customer or client or a party, guarantor of a party, creditor or shareholder or a corporate party, any type of business association with a party or a parent, guardian, spouse or child of a party or officer of a corporate party;
- **Opinion or Bias** such as a personal bias towards a party, witness or attorney or a firm opinion or belief about the subject matter of a case;
- **Current Involvement** is anything adverse to the parties, attorneys or witnesses or an arbitrator is currently acting as an expert for a party;
- **Prior Involvement** includes situations where a party, witnesses and attorneys have previously accused an arbitrator of wrongdoing, have filed a motion to va-

cate, the arbitrator has issued a complaint against the parties, witnesses or attorneys or the arbitrator had a recent business or personal association with a party, attorney or witness.

- **Financial Interest** such as being a fiduciary or having a financial interest in the dispute at hand or having an immediate family member that does.
- **Expert Witness** for or against a party during the previous five year period or retained without testifying during the last three years.

In addition to actions from parties, the director of FINRA may remove an arbitrator after the first hearing session if information becomes available that shows that the arbitrator failed to disclose relevant information to the parties.

FINRA PRE-HEARING PROCEDURES

Scheduling Issues

Similar to how speedy trials can be arranged for civil actions for senior or seriously ill parties, FINRA staff will expedite administrative procedures in such cases. In order to be eligible, one of the parties must either be sixty five years of age or older or have a documented serious health condition. The timeline can be shortened further by mutual agreement, but cannot be shortened unilaterally from what the Code requires to give parties enough time to prepare. The arbitrator has the discretion to set discovery, but FINRA recommends that the panel limit discovery motions after three months from the first hearing. Arbitrators should take into consideration the age and health of the parties and important witnesses and to avoid postponements unless there's an actual emergency. There is no specific deadline for arbitrators to return orders and decisions to FINRA, but they are expected to use electronic distribution and signatures to expedite the process.

Pre-Hearing Conferences

In order to maximize the efficiency of the process, FINRA rules require an Initial Prehearing Conference (IPHC) that

is generally handled by telephone. The parties are notified of the conference date and time at least twenty days in advance. At the hearing, the panel will address preliminary matters and schedule dates for:

- The evidentiary hearing;
- Discovery;
- Briefing and
- Motions.

The panel will also confirm that signed submission agreements have been filed. If they have not been filed, failure to do so within thirty days is sanctionable. The goal is for the evidentiary hearing to be held within nine months of the IPHC, but it is possible to extend the time if necessary. Arbitrators are expected to review all pleadings and motions submitted before the IPHC as well as the Code of Arbitration Procedure and FINRA guidelines. FINRA provides arbitrators with a script to be utilized for pre-hearing conferences to ensure that all important points are covered. It's important that the arbitrator cover these key issues:

- Identifying the participants on the call, including parties, attorneys and other individuals on the line;
- Requesting that each individual identify themselves before they speak;
- Reading of the case name and number;
- State for the record that the panel is a body of neutrals that are not employees of FINRA and
- Ask the parties to confirm that the panel is acceptable.
- After the hearing concludes, the chairperson is responsible for submitting the IPHC hearing to FINRA

via the portal with "Initial Prehearing Conference Order" as the type of submission.

Discovery

FINRA discovery, like discovery in a civil action, is the exchange of information between the parties prior to the evidentiary hearing. FINRA provides a "Discovery Guide" that specifies what should be exchanged for firm/associated persons, customers and other classes of parties. An arbitrator has the discretion to reduce discovery requirements for simplified cases, add discovery not listed in the Guide or decide that parties do not have to produce a certain discovery item for a particular case. It's important to note that the Guide rules are intended to ensure that parties cannot withhold relevant information, but does not preclude parties from exchanging information in a different way if they agree by stipulation. FINRA Rule 12506 requires parties to produce or explain why they cannot produce what's been requested as discovery. The party that cannot produce information must:

- State in writing that it searched for the information in good faith;
- Describe the details of the search that's been conducted and
- State that the search was not able to locate the information and that the information is not in the control, possession or custody or the party.

Parties have a right to object to the production of any information. The objection must be in writing and served on all parties in the same manner, and at the same time, and then chairperson of the panel will make a decision. The chairperson's role is to decide for the entire panel on all discovery matters such as issuing subpoenas, ordering the production of information and documents, directing appearances, estab-

lishing deadlines and issuing of any other orders the chairperson believes will expedite the proceedings and allow the case to be fully developed. Arbitrators on the panel should support this effort by encouraging all parties to agree to joint submissions, enter into stipulations and to narrow the disputed issues. Arbitrators have the discretion to decide whether briefs or legal memoranda are required for a particular case and to set schedules for submission. Rule 12512 mandates that only arbitrators may issue subpoenas for the forum directing witnesses to appear or documents to be produced. The opposing parties are given an opportunity to present their objections to the propriety and scope of the subpoena within ten calendar days and the party requesting the subpoena is given ten days to respond to the objections. After the arbitrator rules on the subpoena, an additional determination will be made about how any costs, if any, for the subpoena will be distributed. If the subpoena is approved, the party that made the request must serve in the same manner and at the same time on all parties and the subpoenaed party. Third-party subpoenas to regulatory authorities are problematic because they often contain Personal Confidential Information (PCI) such as:

- Social Security Numbers;
- Financial Account Numbers and
- Other Personal Information.

When a regulatory authority objects to a subpoena based on PCI, the arbitrators must consider the following:

- Modifying the scope of the subpoena;
- Ordering the redaction of PCI;
- Confidentiality agreements or
- Protective orders that limit the scope of PCI.

Rule 12513 provides arbitrators with the power to order the appearance of an employee or associate of a firm or the production of specific documents that are in the possession or control of such persons. Arbitrators are encouraged to use orders to avoid the need for subpoenas and parties requesting appearances or documents from non-parties should generally bear the costs involved. Depositions are discouraged, but will be allowed if necessary for one or more of the following reasons:

- To preserve testimony if witnesses are terminally ill;
- To accommodate witnesses that are not available to testify at the hearing;
- To simplify proceedings for extremely complicated cases and
- For extraordinary circumstances.

Information requests in the form of an interrogatory are more commonly used and are limited in scope to seeking information and facts. For example, asking "Who is the head of the department" would be appropriate, but "Were you opposed to the policy" would not. The FINRA rules require that questions of opinion be left to the evidentiary hearing. When a party objects to the document production based on privacy or confidentiality, arbitrators usually try to encourage a non-disclosure stipulation. If the parties cannot agree, the party claiming confidentiality has the burden of proving that

the information being requested is entitled to be treated as confidential. This is what arbitrators must consider:

- Whether broad confidentiality would prejudice the requesting party;
- Whether the information has not already been released to the public;
- Whether the information contains trade secrets;
- Whether harm would come from the transfer of information and
- Whether it is an unwarranted invasion of privacy.

The arbitrator may order that the information is confidential and preclude or determine that it's confidential, but can be redacted and/or exchanged with other precautions or is confidential and need not be exchanged. The same process applies to claims that information is privileged. Product cases, where there are allegations that a specific security or type of securities has been mismarketed or otherwise defective have special considerations applied for the following reasons:

- The high volume of documents;
- Multiple claims seeking the same documents;
- Likelihood of a concurrent regulatory investigation;
- Likelihood of a concurrent class action lawsuit and
- Other factors.

In product cases, parties often raise issues of the cost and burden of production. In such cases, the panel must decide whether the need for the documents merits the cost and burden imposed. It's important to note that even when other decisions have been rendered on the product, they are not

binding for other arbitrations. Electronic discovery such as computer files and emails are considered documents and disputes can arise over the format that is being exchanged. For example, a party may send a printout of a Word document, but the requesting party wants the original computer file. If these issues cannot be resolved between the parties, the arbitrator will rule on the issue taking the appearance, searchability, availability of metadata and maneuverability of the document into consideration. If a party fails to comply with the discovery rules either by failing to produce what's been ordered or by harassing and burdening their opponents with unwarranted discovery requests, the panel is empowered to impose sanctions as severe as dismissing the claim with prejudice.

Motions

The panel's authority to rule on motions is final and binding and a large range of motions can be brought. These are some examples of the most commons types of motions that arise in FINRA arbitrations:

- **Motion to Amend a Claim**: Parties may amend their pleadings until a panel is appointed and by motion to the panel thereafter. An exception is that a new party cannot be added once the ranked arbitrator lists are due. In such cases the amendment to add a new party must be done by motion after the panel is seated.
- **Motion to Consolidate Claims**: Parties may consolidate claims if the claims assert a right to joint and several relief or the claims arise out of the same transaction or from the same series of occurrences or transactions. Another basis for consolidation is when the claims contain common questions or law or fact.

- **Motion to Sever Claims**: Parties may request that their claim be heard separately from other claims based on the same considerations used to consolidate claims.

- **Motion to Change the Hearing Location**: In cases involving firms and customers, the hearing location will be the one closest to the customer's residence at the time when the events of the dispute arose. If there are several parties in disparate locations, the decision about where to hold the hearing will be based on:

    - Signed agreements to arbitrate that indicate locations;
    - Who initiated the business at issue and
    - The location of documents and witnesses.

- **Motion to Compel Discovery:** Any party may make a motion to compel other parties to produce information that has been requested, but not received. The request must include the original discovery request, any objections presented and the efforts involved with attempting to get the other party to comply. The panel will determine the relevancy of the information and consideration the burden of production before issuing a ruling and will try whenever possible to order redaction when issues of privacy and confidentiality arise.

- **Motion to Postpone a Hearing**: The arbitrators may postpone a hearing twice if all the parties agree, but may dismiss the case without prejudice if a third postponement is requested. Arbitrators may also postpone a hearing on their own initiative or upon the request of a party if good cause exists based on the following factors, and not agreeing to a postponement can give rise to a motion to vacate the arbitration order:

- The substantive merits of the request;
- The objectives of the opposing party;
- Fairness to all parties;
- Prior postponements and
- What will best achieve a hearing that is productive.

- **Motion to Dismiss**: A motion to dismiss may request that all or some of the claims should be dismissed because they are time barred, failed to state a claim or are otherwise ineligible for relief. Motions to dismiss can only be made by the full panel.

If the panel denies a motion, the panel must also determine whether or not to charge fees to the party that initiated the motion payable to the party that opposed the motion. This is only done if the panel determines that the motion was frivolous or made in bad faith.

THE EVIDENTIARY FINRA HEARING

How to Prepare for the Hearing

Rule 12514 mandates that copies of all documents that will be relied upon for the hearing and witness lists be served on the panel and all parties at least twenty days from the hearing, but the time period can be lengthened or shortened by agreement. Arbitrators will review the case again for conflicts as new counsel, professional and personal relationships may have developed from the time the case was initiated in addition to checking the witness list for conflicts.

Right To Counsel

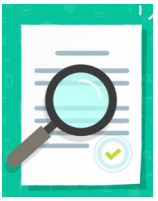
Parties may represent themselves at a hearing, a partnership may be represented by a partner of a corporation, association or trust may be represented by a bona fide officer. A party may also be represented by a non-attorney unless it's prohibited by law in the state where the hearing is being held, the person is presently barred or suspended from the securities industry or the person is presently barred or suspended from the practice of law or disbarred. At any stage of the arbitration a party has a right to be represented by a lawyer that's been admitted for practice in The District of Columbia or any state, territory or possession of the United States

and/or the Supreme Court of the United States unless it is prohibited by state law. Some states have strict rules about out-of-state counsel representing parties in an arbitration, specifically Florida, California, New York, Illinois, New Jersey and Michigan.

Witnesses

There are two main types of witnesses that testify at FINRA arbitrations: expert witnesses and fact witnesses. Expert witnesses give their opinions, interpretations based on their experience in a particular area and apply them to the facts of the case. Fact witnesses testify about the facts surrounding the case and are usually sequestered from other parts of the arbitration. A non-party fact witness has the right to be represented by an attorney while testifying at a FINRA hearing, but their role is limited to asserting privileges such as attorney/client work product or against self incrimination.

Evidence



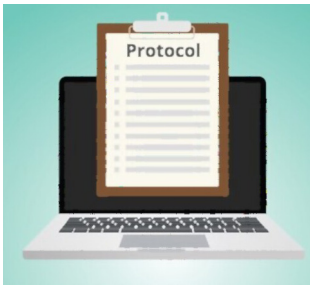
Rule 12604 empowers the panel to make decisions about admitting evidence and does not require arbitrators to base these decisions on state or federal law, as is the practice of the majority of arbitration forums. These are the factors employed by FINRA panels to determine the admissibility of evidence:

- Whether the document was properly exchanged in discovery;
- The significance of the document;

- Whether the document is sought for impeachment or rebuttal;
- Whether the document should have been produced and
- Whether the request should have been objected to.

Documents not exchanged in discovery are only admitted into evidence if there is a valid excuse for not exchanging the document earlier, otherwise the documents should be excluded. FINRA rules don't allow evidence to be submitted for the purpose of surprise that might prejudice a party. Arbitrators may also exclude witnesses not identified unless there is an overwhelming reason why the witness could not be identified sooner and there will be no prejudice with the introduction of the witness.

Hearing Protocols



Hearings are usually held at a FINRA office, a Regus Conference Center or at a hotel. Logistics for the hearings are handled exclusively by FINRA staff. FINRA has strict protocols for civility for the panelists, parties and counsel with hearings suspended for a recess if profanity, shouting or inappropriate remarks ensue. Leading questions are allowable only to establish agreed upon facts for the record to save time, and never to "put words in the mouth" of witnesses. Arbitrators have the right to intervene whenever they believe that a party is using the informality of the hearing to their advantage. Ex parte communication is prohibited, making all contact by parties with members of the panel outside the hearing that are not simply casual remarks to be barred.

Arbitrators should go out of their way to avoid the appearance of impropriety by avoiding being seen with any of the parties when all parties, and their representatives, are not present. The Hearing Script provided by FINRA to the panel outlines everything that must take place to ensure that no procedures are omitted and that a complete record of the hearing is kept. All FINRA hearing a electronically recorded on digital media and the panel member in charge of recording is responsible for:

- Identifying the recording with its case name/number and hearing date;
- Assigning a recording number;
- Clearly identifying the date of each hearing session;
- Ensuring the proper functioning of the recording device;
- Ensuring that the device is turned off for all executive sessions,
- Restarting the device after all executive sessions, lunch and other breaks and
- Returning the recording to FINRA when the hearing is completed.

Parties may elect to make their own stenographic records of the proceedings, but the official recording will be considered the record for hearing. The hearing must include these elements:

- Explanation of procedures;
- Opening statements;
- Each parties presentation;
- Questions to clarify and elicit facts;

- Rulings on the admissibility;
- Rulings on motions and
- The option to facilitate some testimony via telephone or affidavit.

Arbitrators should be sensitive to the needs of pro se parties that may not be fluent in the workings of arbitrations, and may explain the following during the hearing:

- Arbitration is not mediation - the results of an arbitration are binding;
- The panel may explain the sequence of testimony and questions, but may not take over for the pro se party and make their case;
- Evidence should not be presented during an opening statement;
- It is improper to argue with a witness and
- Other points that will not prejudice parties, but will move the proceedings along is a more orderly fashion.

Arbitrators have wide discretion to assess monetary penalties as sanctions for failure of parties to comply with any section of the rules. Cases may be dismissed with prejudice as a sanction for material and intentional failure to comply with an arbitrator's order, especially in situations where prior warnings have been issued. At the end of the hearing, the panel will ascertain the final damage requests from the parties and requests for costs.

AFTER THE FINRA HEARING

Deliberations

After the hearing has concluded and the panel is in receipt of all of the evidence, the arbitrators may wish to review the hearing record, pleadings, submissions and notes before the beginning of the deliberation process. Once all members have reviewed the case individually, the chairperson will ask each member to express their opinion about the case so that all opinions are heard and considered. The deliberations should proceed in this order:

- Determine the facts of the case by an analysis of the credibility of the witnesses;
- Determine the facts of the cases based on the relevance and strength of the documents;
- Apply the rules to the facts and
- Issue a decision.

The decision will result from the opinion of the majority of the arbitrators on the panel, and at least two panelists must agree for a decision on liability. The reasoning behind the de-

cision can be different, but there must be a majority on the result. Arbitrators are not bound to precedent like judges, but they may not flagrantly disregard the prevailing law.

The Award

All awards must be in writing and signed by the arbitrators on the panel. They are considered final and there is no appeal process within FINRA. The award information sheet should be submitted to the FINRA portal as soon as the decision has been made. The award must always include the following information:

- Names of all parties;
- Names of all party representatives;
- Acknowledgment by the arbitrators that they have read the pleadings and other materials for the case;
- A summary of the issues and nature of the controversy;
- Damages requested;
- Damages awarded;
- Statement of other related issues resolved;
- Allocation of forum and other fees;
- Names of the arbitrators;
- The date the claim was filed;
- The award rendered;
- The number of sessions and their dates;

- The physical location of the hearings and
- Signatures of all arbitrators on the panel.

Arbitrators with the minority opinion may note their dissent and parties may require, upon request, for the arbitrators to explain their decision. The cost for this service is $400 and this request must be made before the first scheduled hearing date. Arbitrators may choose to explain their decision even if it is not requested, but will not receive the $400 honorarium. The panel may award actual and/or statutory damages as compensation for net out of pocket expenses as well as "benefit of the bargain" expected value of the investment. "Benefit of the bargain" compensation is awarded to the claimant what they would have been entitled to if the misrepresentation by the firm representative had been true, rather than what the investment is actually worth. In some cases the award can be the difference between what a portfolio yielded and what a portfolio that's well managed should yield. Other remedies include "recission," intended to place the claimant in the position they would have been in without the investment or "disgorgement" which may require the respondent to give back money. Specific performance may be required in the interest of justice if there is no other way to award damages. Industry cases may include injunctive relief or punitive damages.

Motions to Vacate the Award

Motions to vacate the decision of a FINRA panel must be made through the courts in an appropriate jurisdiction. An award can be challenged based on the arbitrator's conduct, their partiality, exceeding authority, prejudicial conduct at the hearing, failing to disclose conflicts, mistakes, bribery, corruption, fraud, unreasonable refusal to allow evidence or witnesses, postponements or gross disregard for the law.