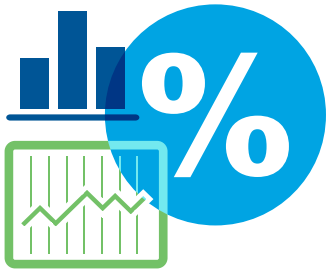
SEYFARTH SHAW



Financial Services Employment Arbitration Q&A

FINRA Arbitration Task Force Issues Final Report Recommending Major Changes

By Robert Whitman, Cameron Smith, and Samuel Sverdlov

On December 16, 2015, the Financial Industry Regulatory Authority (FINRA) Dispute Resolution Task Force, a 13-member group representing a broad range of securities industry professionals, issued its Final Report (available here). As previewed in its July 2014 interim report (see here), the Task Force has recommended 51 changes to FINRA's dispute resolution program. The proposals will be presented to FINRA's National Arbitration and Mediation Committee (NAMC) for further review.

Below are some of the key recommendations that may affect arbitration of employment-related claims at FINRA.

Class-Action Waivers

Class action waivers in broker-dealers' pre-dispute arbitration agreements (PDAAs) have long been a source of dispute at FINRA, and recent decisions have left the viability of such provisions subject to question for member firms. In April 2014, in Dep't of Enforcement v. Charles Schwab & Co., the Board of Governors held that, in light of Rule 12204, which provides that customer class actions may not be arbitrated at FINRA, and notwithstanding the Supreme Court's approval of class action waivers in PDAAs under the Federal Arbitration Act, member firms may not restrict public investors from bringing class actions in court. Then, on June 30, 2015, the Second Circuit held, in Cohen v. UBS Fin. Servs., Inc., an employment case, that Rule 13204 (the counterpart to the above rule for intra-industry cases) does not prohibit the use of class action waivers in PDAAs. Rather, the court said, the rule allows parties to enter into additional agreements beyond the scope of the Industry Code. Quoting from Schwab, the Cohen court explained, "there are no restrictions upon firms regarding the content of pre-dispute arbitration agreements with employees."

The Task Force has now recommended that member firms be prohibited from using class action waivers in PDAAs with customers. It has not proposed any similar modification of the Industry Code, which governs employment cases. In light of Cohen, which stated that the existing rules under the Industry Code do not preclude the use of waivers, it seems unlikely that the NAMC will take a broader approach and suggest that FINRA prohibit class action waivers in PDAAs between member firms and their employees.

Arbitration Selection and Disclosure Requirements

The Task Force stated that it hoped to strengthen disclosure requirements and develop a process for *voir dire* of proposed arbitrators so that parties can have more access to information. In June 2015, FINRA revised the definition of a "public" arbitrator, which now generally excludes anyone who worked in the financial services industry for any part of his or her career and those who represent investors or the industry as a significant part of their business. (See our blog post on this change here.)

This revised definition had drawn criticism as being somewhat arbitrary. While some members of the Task Force "expressed concern that the effect of the definitions is to remove from the pool of public arbitrators highly qualified individuals who would in all respects conduct themselves as neutrals," other members "believed that the definitions should strengthen public confidence in the forum because they will avoid even the appearance of bias of past affiliation." The Final Report does little to resolve this tension. The Task Force merely recommended that "FINRA monitor the application of the recently adopted definitions of public and non-public arbitrators in light of concerns that individuals with substantial process and subject matter expertise are stricken from the list of public arbitrators." However, it expressed "doubts that making otherwise qualified individuals ineligible for service because of family member's industry affiliation is warranted."

Expanded Grounds for Motions to Dismiss

Under existing FINRA procedural rules, motions to dismiss prior to the conclusion of the claimant's case in-chief may be brought for only three reasons: naming the wrong respondent, the six-year eligibility rule, and an executed release among the parties. In the Final Report, the Task Force recommends including an additional ground on which an arbitrator can grant a motion to dismiss: "in instances where arbitrations involve claims previously adjudicated by a court or arbitrated by an arbitration panel." Even after this narrow expansion, motions to dismiss prior to conclusion of the claimant's case-in-chief would remain disfavored.

Explained Decisions

Currently, parties seeking an explained decision must submit a joint request no later than the 20-day prehearing exchange. The Task Force, however, recommends changing the rule "to require an explained decision unless any party notifies the panel before the Initial Pre-Hearing Conference that it does not want it." Although it characterizes this as "a modest change that may or may not result in any appreciable increase in explained decisions," the Task Force cautioned that, if it "subsequently becomes clear that one party frequently blocks an explained decision, a different approach may be warranted."

Mandatory Procedures for Large Claims

Building on the Large Case Pilot Program that FINRA established in 2012, which gives parties the leeway to choose certain procedures and take broader discovery than is normally permitted if the case involves claimed damages of at least $10 million, the Task Force proposed in its Interim Report that the Large Case Pilot Program be mandatory for claims involving damages of at least $20 million. The Final Report does not include a recommendation on this point, but the Task Force included its discussion of the issue "for the information of the NAMC."

Expungement

Although the Task Force declined to make a recommendation regarding expungement proceedings in the Interim Report, it does recommend in the Final Report that FINRA create a pool of trained, experienced arbitrators to conduct hearings in settled cases brought solely for the purpose of expungement. Such cases would have to be already settled before they reach the expungement hearing stage. As the Task Force explained, "[t]his group of arbitrators would conduct hearings on expungement requests and make determinations as to whether to grant expungement requests. All members of special arbitration panels should be experienced individuals from the chairperson roster who have received enhanced training on expungement…" Even though the other claims will have been settled, an expungement hearing before a Special Arbitration Panel would nonetheless likely mean that parties would still delve into the merits of the underlying dispute in order to determine the propriety of expungement relief.

Automatic Mandatory Mediation with Opt-Out Procedure

Finally, based on the "overall success of FINRA's [existing] mediation program," the Task Force has recommended that FINRA create an automatic mediation process subject to an opt-out by any party. This program would include financial incentives for early successful mediation, including a schedule to refund part of the mediation and arbitration fees to parties who are successful at early mediation, training to increase the pool of experienced FINRA mediators, efforts to increase diversity among mediators, special mediation rosters, alternatives to mediation, and a mediator self-assessment program. The Task Force touted the success of FINRA's existing mediation program, under which 80% of mediated cases result in early settlement, to say that it hopes mandatory mediation will help further reduce arbitration time and costs while still achieving an equitable result for both parties.

As always, we will continue to follow and keep you informed of further developments on these recommendations as they make their way to the NAMC. Please direct any questions or concerns you may have concerning FINRA arbitration to our experienced team of attorneys.

Robert Whitman and Cameron Smith are partners in Seyfarth's New York office, and Samuel Sverdlov is an associate in the New York office. If you would like further information, please contact your Seyfarth Shaw LLP attorney, Robert Whitman at rwhitman@seyfarth.com, Cameron Smith at casmith@seyfarth.com, or Samuel Sverdlov at ssverdlov@seyfarth.com.