The Neutral Corner

Volume 4 – 2010

Mission Statement

We publish *The Neutral Corner* to provide arbitrators and mediators with current updates on important rules and procedures within securities dispute resolution. FINRA's dedicated neutrals serve parties and other participants in the FINRA forum by taking advantage of this valuable learning tool.

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Reintroducing the Direct Communication Rule

By David E. Robbins

I represent parties in FINRA and American Arbitration Association (AAA) arbitrations, and often serve as chairperson of arbitration panels at these forums. I have long been a proponent of FINRA's direct communication rule (Rule 12211, Direct Communication Between Parties and Arbitrators) to conduct fair and efficient hearings. However, I have noticed that many of my fellow chairpersons choose not to use direct communication.

As arbitrators of FINRA's dispute resolution forum, we are in the service business, and communicating directly with the parties to resolve prehearing disputes and expedite hearings allows us to better serve them. While arbitrators may be reluctant to allow direct communication due to its abuse in previous cases by some parties, a strong chairperson can set strict guidelines for using direct communication effectively. The parties need improved communications, and proceeding under Rule 12211 addresses this need.

What Does the Rule Provide?

Rule 12211 provides that:

- All parties and arbitrators must be in agreement before proceeding under the direct communication rule.
- Only parties that are represented by counsel may use direct communication. If during the proceeding, a party chooses to appear without counsel, the rule no longer applies.
- Parties may send the arbitrators only items that are listed in the Order on Request for Direct Communication between Parties and Arbitrators, which is sent to FINRA and distributed to the parties.

FINRA
Financial Industry Regulatory Authority

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Message from the Editor

Comments, Feedback and Submissions

In addition to comments, feedback and questions regarding the material in this publication, we invite you to submit suggestions for articles and topics you would like addressed. We reserve the right to determine which articles to publish.

Please send your comments to:

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You may also email Jisook at *Jisook.Lee@finra.org*.

Reintroducing the Direct Communication Rule *continued*

- Parties may send the items to arbitrators by mail, overnight courier, facsimile or email, as long as all the arbitrators, the parties and FINRA receive the items in the same manner and at the same time.
- Documents exceeding 15 pages must be sent to FINRA by mail or overnight courier.
- FINRA must receive a copy of any arbitrator orders and decisions made as a result of direct communications.
- Parties may not communicate orally with any of the arbitrators outside the presence of all parties.
- Any party or arbitrator may terminate the direct communication order at any time, after giving written notice to the other arbitrators, the parties and FINRA.

In summary, everyone has to agree, and no party can directly communicate with the arbitrators without the other party being simultaneously apprised. This assures a level playing field for everyone involved in the case.

Instructing Parties on the Direct Communication Rule

The Initial Prehearing Conference (IPHC) script instructs arbitrators to summarize the direct communication rule and ask parties if they wish to proceed under the direct communication rule.

If all parties and arbitrators agree, the chairperson completes the Order on Request for Direct Communication between Parties and Arbitrators, which is sent to FINRA and distributed to the parties. The order remains in effect unless amended by the arbitration panel, or canceled upon written notice by a party or an arbitrator. All parties agree to notify FINRA if a party is no longer represented by counsel. When a party is no longer represented by counsel, the order is automatically rescinded. At that time, all parties cease direct communication with the arbitrators, and direct all communication to FINRA, with the appropriate number of copies for distribution to the arbitrators.

Although the rule is straightforward and FINRA provides specific guidelines on how to proceed, some chairpersons dismiss the option during the IPHC and skip its description entirely. Others preface its description with the admonition that they are against it. Still others, after reading the script, tell their fellow arbitrators that proceeding under the direct communication program is not worth the effort—based on a negative experience in the past. And they inform counsel that they will not use direct communication.

How Can the Chairperson Ensure that Parties Abide by the Rule?

My experience with direct communication shows that with strong and experienced chairpersons, it reduces prehearing discovery disputes and expedites substantive hearings. Sometimes, however, at both FINRA and the AAA, attorneys send frequent emails with long attachments, ranging from discovery requests that have not been discussed with the opposing party, to motions of all varieties, adjournment requests and, even requests for directions to the hearing.

How can arbitrators ensure that parties follow the rules of the direct communication program? Proceeding smoothly and effectively under the direct communication rule begins with a strong chairperson who takes charge of the arbitration proceedings, starting at the prehearing. The chairperson must have a presence that pulls everyone together to make the proceeding a coherent and fair one. The chairperson sets the tone for civility and decorum at a hearing and should:

1. Control the prehearing process and the pace and atmosphere of the hearing.
2. Be consistent in discovery rulings and remain neutral when questioning witnesses.
3. Be sensitive to all the parties.
4. Make prehearing decisions promptly, and be available to the parties in between hearings.
5. Be confident.

Reintroducing the Direct Communication Rule continued

With this in mind, the chairperson should rule with a firm hand, but with sensitivity to the parties and a sense of ease that comes from confidence in oneself and experience in the process. Taking a firm hand through the direct communication process helps set that tone.

Conclusion

Prehearing direct communication with the arbitrators will go a long way in assuring expeditious substantive hearings. Most importantly, it will show the parties that you are serious about your mandate to provide them a full and fair opportunity to be heard.

The views expressed in this article are solely the author's, and do not necessarily reflect FINRA's views or policies.

**David E. Robbins is a partner in the New York City law firm, Kaufmann Gildin Robbins & Oppenheim LLP, where he represents investors, brokers and firms. He is a FINRA and AAA arbitrator and mediator and the author of Securities Arbitration Procedure Manual (Matthew Bender & Co., LexisNexis Group, 2009) and McKinney's Consolidated Laws of New York: Practice Commentary on Securities Arbitration for the New York Practitioner (West Publishing 2010).*

Dispute Resolution and FINRA News

Case Filings and Trends

Arbitration case filings from January through August 2010 reflect a 24 percent decrease compared to cases filed during the same eight-month period in 2009 (from 4,994 cases in 2009 to 3,778 cases in 2010). Customer-initiated claims decreased by 30 percent in 2010 from 2009.

From January through August 2010, arbitration cases filed identified the following securities (listed in order of decreasing frequency): common stock, mutual funds, corporate bonds, preferred stock, annuities, options, limited partnerships and certificates of deposit. In 2010, the top two causes of action alleged have been breach of fiduciary duty and negligence.

SEC Investor Advisory Committee

On May 17, 2010, Linda Fienberg, President of FINRA Dispute Resolution, participated on a panel before the Securities and Exchange Commission's (SEC) Investor Advisory Committee. The panel discussed mandatory arbitration amongst other topics. Panelists included Patricia Cowart, a representative from the securities industry, and academics Barbara Black and Jennifer Johnson. Ms. Fienberg explained FINRA's view that a determination about whether brokerage firms should be allowed to include pre-dispute arbitration agreements in investor contracts is best made by Congress or the SEC. She emphasized that if Congress or the SEC decides to prohibit or limit mandatory arbitration, FINRA believes that it is vital for investor protection to have FINRA's rules continue to permit investors to require arbitration with firms and brokers.

Neutral Workshop: FINRA's Information Security Policy

On July 21, 2010, FINRA recorded a neutral workshop and posted it on its website. The workshop introduces arbitrators and mediators to FINRA's Information Security Policy. The workshop faculty reviews the details of the Information Security Policy and explains FINRA's compliance obligations. The faculty also discusses the roles of FINRA arbitrators and mediators in safeguarding confidential and personal information, and outlines steps to take if a breach of the Information Security Policy occurs.

FINRA's Richard Berry, Senior Vice President and Director of Case Administration and Regional Office Services, and Laurie Dzien, Chief Privacy Counsel and Associate General Counsel, provided the workshop.

FINRA also published a Notice to Parties about information security. The Notice provides guidance to parties, as well as arbitrators and mediators, about the importance of information security and what each participant in the arbitration process can do to protect confidential information.

Note: FINRA's neutral workshops are pre-recorded; this allows neutrals to listen at a time and place most convenient for them, and to pause and to playback the audio file.

Practising Law Institute (PLI) Program

On August 11, several staff members participated on panels at PLI's program, Securities Arbitration 2010. Staff discussed new developments, the impact of important rules on practice and issues surrounding arbitrator selection and challenges. In addition, FINRA staff participated on a panel to discuss recent legislative developments and the future of mandatory securities arbitration. FINRA arbitrators received a 25 percent discount off the registration fee.

Expanding Arbitrator Rosters in Underserved Hearing Locations

FINRA implemented a plan to expand arbitrator rosters in underserved hearing locations. FINRA identified the underserved hearing locations based on the number of arbitrators who serve in a hearing location and the number of arbitration cases filed in that location.

FINRA reached out to arbitrators in surrounding hearing locations to determine their interest in serving in these locations. FINRA pays reasonable travel, meal and accommodation expenses for service in the additional locations. As a result of its efforts, through August 2010, FINRA has added 1,326 arbitrators to its underserved hearing locations.

Update: Guidelines for Arbitrator Reimbursement

FINRA recently updated the Guidelines for Arbitrator Reimbursement to amend our policy on receipts. FINRA no longer requires receipts for expenses that are under $10. When submitting Travel and Expense forms for reimbursement of expenses associated with an arbitration hearing, arbitrators must submit receipts only for expenditures of $10 or more.

Enhancements to the Online Filing System

On September 27, FINRA updated the online filing system to allow parties to pay their filing fee online by credit card. FINRA will deem **all** online claims filed on the date when the claimant submits the claim online—regardless of whether the claimant pays the filing fee by credit card online or by check. Please note that checks should be made out to FINRA Dispute Resolution and mailed, along with the tracking form, to:

FINRA Dispute Resolution
165 Broadway, 27th Fl.
New York, NY 10006.

Legislative Update

Public Law No. 111-203 – Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010,[1] President Obama signed the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. The legislation calls for a recurring study by the United States Government Accountability Office (GAO) of the SEC's oversight of national securities associations, including FINRA and its arbitration forum. One of the provisions of the legislation authorizes the SEC to limit or prohibit use of pre-dispute arbitration agreements (PDAAs) "if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors." The law does not set a date by which the SEC must take action. The law also bars mandatory arbitration of "whistleblower" disputes.

The SEC is now examining the arbitration issue, and we will update you on future developments.

SEC Rule Filings

Disciplinary Referrals Made During an Arbitration Proceeding

On July 12, 2010, FINRA filed a proposed rule change (SR-FINRA-2010-036) with the SEC to amend Rules 12104 of the Code of Arbitration Procedure for Customer Disputes (Customer Code) and Rule 13104 of the Code of Arbitration Procedure for Industry Disputes (Industry Code) to broaden the arbitrators' authority to make referrals during an arbitration proceeding. The amendment would allow arbitrators to make a disciplinary referral during the pendency of an arbitration when they have reason to believe that conduct poses a serious, ongoing, imminent threat to investors that requires immediate action. The proposed rule change would also create new Rules 12902(e) and 13902(e) to address the assessment of hearing session fees, costs and expenses if an arbitrator makes a referral during a case that results in panel withdrawal.

On September 17, the SEC published the proposed rule amendment for comments. The comment period ends on October 14. Please visit our website for more information about SR-FINRA-2010-036.

Discovery Guide

On July 12, 2010, FINRA filed a proposed rule change (SR-FINRA-2010-035) with the SEC to amend the Discovery Guide, which includes Document Production Lists, and to make conforming changes to Rules 12506 and 12508 of the Customer Code. The proposed rule change would expand the guidance that FINRA provides to parties on the discovery

process and would update the Document Production Lists. FINRA extended the time for SEC action on the proposed rule change until October 8, 2010.

Please visit our website for more information about SR-FINRA-2010-035.

All-Public Arbitration Panel

FINRA will file a rule proposal in October with the SEC that would allow all investors filing arbitration claims the option of having an all-public panel, greatly increasing investor choice in the FINRA arbitration program. The rule proposal would expand to all investor claims a two-year-old FINRA pilot program that gives investors filing an arbitration claim against certain firms the option of choosing an all-public panel. If approved by the SEC, the rule would give all investors, regardless of which firm they file an arbitration against, the option of choosing an arbitration panel that has two public arbitrators and one non-public arbitrator, as is now the case, or an all-public panel.

Please review the news release published on September 28 for more information about this rule proposal.

SEC Rule Approvals

Expanded Arbitrator Lists

Effective September 27, 2010, FINRA increased the number of proposed arbitrators available for review when parties choose arbitration panels from lists generated randomly by the Neutral List Selection System. The amendments to Rules 12403 and 12404 of the Customer Code and Rules 13403 and 13404 of the Industry Code apply to lists generated on or after the effective date.

The amendments increase the number of arbitrators on lists to 10 from the current eight for each type of arbitrator on a three-member panel—public, public chair-qualified and non-public. Lists of available arbitrators for cases involving less than $100,000, which are heard by a single, chair-qualified public arbitrator, will also expand from eight to 10 names. While the rule change increases the number of arbitrators on each list by two, the number of available strikes will remain at four per party. The purpose of this change is to increase the likelihood that the parties will get panelists they chose and ranked, even when FINRA must appoint a replacement arbitrator.

See *Regulatory Notice 10-37* for more information about the rule amendments.

Attorney Representation of Non-Party Witnesses in Arbitration

Effective October 14, 2010, a non-party witness' attorney may attend an arbitration hearing while the witness is testifying. Unless otherwise authorized by the arbitrators, the attorney's role will be limited to asserting recognized privileges, such as the attorney-client and work product privileges and the privilege against self-incrimination. The amendments to Rule 12602 of the Customer Code and Rule 13602 of the Industry Code apply to all hearings that take place on or after the effective date.

See *Regulatory Notice 10-40* for more information about the rule amendments.

Endnote:

1 See H.R. 4173.

Question and Answer: Background Verification Project

Question: I understand that FINRA Dispute Resolution is verifying the background information of arbitrators—like me—who were approved to the roster before October 2003. If you're using an outside vendor to verify my educational background, why was I asked to supply FINRA with a copy of my diploma or transcript as proof of my educational degree?

Answer: Recently, FINRA Dispute Resolution staff sent an email to a small number of arbitrators requesting a copy of the diploma or transcript received from the educational institution listed in their Disclosure Report. FINRA needed to request this information directly from the arbitrators either because the vendor did not receive a timely response from the institution confirming the arbitrator's education or the institution responded that it had no record of the arbitrator's degree.

As a rule, the vendor contacts each named educational institution a limited number of times. Sometimes, the institution fails to timely respond to the vendor's inquiry. In other cases, the vendor makes contact with the educational institution, but the institution has no record of the arbitrator/alumnus, either because of a name change or incomplete/inaccurate recordkeeping. In either event, the vendor returns the search to FINRA as "unable to verify." To ensure the accuracy of the information provided by arbitrators on the Disclosure Reports, which is distributed to the parties during the selection process, FINRA has reached out to a small number of arbitrators for their assistance.

Editor's Note: For background information on the verification project, please see *The Neutral Corner—Volume 1, 2010*.

Mediation and Business Strategies Update

2010 Case Statistics

From January through August 2010, parties initiated 562 mediation cases, a 72 percent increase from the same eight-month period in 2009. During this same time, FINRA closed 615 cases, a 46 percent increase from 2009. Approximately 83 percent of these cases concluded with successful settlements. The average case turnaround time during this eight-month period was 100 days, a one percent improvement from the same period in 2009.

Annual Fee for FINRA Mediators

By September 1 of every year, mediators must renew their membership to remain active on FINRA's mediator roster. Mediators may submit their annual $200 membership fee online or by regular mail.

In 2009, FINRA instituted an annual membership fee for mediators, allowing FINRA to simplify the fee structure and continue to provide a wide range of benefits that include:

- FINRA credential. Each FINRA mediator must undergo an extensive application process for admission to the securities mediator roster. This credential provides FINRA's mediators with a competitive advantage.
- Marketing resources. FINRA Dispute Resolution promotes mediation to parties who file arbitration cases and provides parties with detailed information about qualified mediators.
- Prompt payment. FINRA collects fees directly from the parties and pays mediators once the mediation has concluded.

Arbitrator Training

New Online Training: Motions to Dismiss

This course focuses on the motions to dismiss rules that went into effect in February 2009. This course explains the three types of motions to dismiss that may be filed, and provides guidance to arbitrators on how to address motions to dismiss during an arbitration. This training does not require registration and may be accessed immediately from our website.

Live Video and Classroom Training

FINRA provides the option to complete the classroom segment of its required Basic Arbitrator Training Program by WebEx. Over the next three months, FINRA will conduct the following WebEx training sessions. (All training start times are Eastern Time.)

October 13, 2010	9:30 a.m. – 1:30 p.m.
October 26, 2010	1:00 p.m. – 5:00 p.m.
November 9, 2010	9:30 a.m. – 1:30 p.m.
November 30, 2010	1:00 p.m. – 5:00 p.m.
December 7, 2010	1:00 p.m. – 5:00 p.m.
December 16, 2010	9:30 a.m. – 1:30 p.m.

Please send an email to *ArbitratorTraining@finra.org* to register for a live video training.

Arbitrator Training continued

FINRA continues to conduct in-person training sessions in each regional office—Boca Raton, Chicago, Los Angeles and New York City—for arbitrators who prefer this method of training.

Over the next three months, FINRA will conduct the following in-person training sessions.

Northeast Region

- **November 17, 2010**—New York, NY

If you are interested in attending this in-person training, please contact *Cicely.Moise@finra.org* or (212) 858-3963.

Midwest Region

- **December 1, 2010**—Chicago, IL

If you are interested in attending this in-person training, please contact *Deborah.Woods@finra.org* or (312) 899-4431.

West Region

- **October 19, 2010**—Los Angeles, CA

If you are interested in attending this in-person training, please contact *Hannah.Yoo@finra.org* or (213) 229-2362.

Arbitrator Tip

Verify Case Numbers and Case Captions

When sending case-related documents to FINRA, arbitrators should ensure that all documents have the correct FINRA case number and case caption. Case number errors can cause delays in processing documents, or cause documents to be misfiled or sent to the wrong party. Arbitrators serving on more than one case should be especially careful to verify the accuracy of case numbers and captions. To ensure that FINRA promptly processes your submissions, including any requests for qualified reimbursements, please verify the correct case number and caption. Please confirm that the case number contains the correct year. If you are uncertain about the correct case number or caption, please contact your regional office to verify the information.

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