Regulatory Notice 12-21

Arbitration of Whistleblower Disputes

SEC Approves Amendments to Align FINRA Rules With Statutes That Invalidate Predispute Arbitration Agreements for Whistleblower Disputes

Effective Date: May 21, 2012

Executive Summary

The SEC approved amendments to FINRA Rule 13201 of the Code of Arbitration Procedure for Industry Disputes (Industry Code) to provide that a dispute arising under a whistleblower statute that prohibits the use of predispute arbitration agreements is not required to be arbitrated under the Industry Code.[1] Parties may arbitrate such a dispute only if they have agreed to arbitrate it after the dispute arose. The rule change aligns the Industry Code with statutes that invalidate predispute arbitration agreements for whistleblower disputes. The rule change also makes a conforming change to FINRA Rule 2263 (Arbitration Disclosure to Associated Persons Signing or Acknowledging Form U4).

The amendments to Rule 13201 are effective on May 21, 2012, for all whistleblower disputes arising under a statute that prohibits the use of predispute arbitration agreements, regardless of when the predispute arbitration agreement was executed. The amendments do not apply to any pending matters at FINRA. The conforming change to FINRA Rule 2263 also is effective on May 21, 2012.

The text of the amendments is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

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- Margo A. Hassan, Assistant Chief Counsel, Dispute Resolution, at (212) 858-4481 or *margo.hassan@finra.org*.

April 2012

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Registered Representatives

Key Topics

- Arbitration
- Code of Arbitration Procedure
- Form U4
- Predispute Arbitration Agreement
- Whistleblower Dispute

Referenced Rules & Notices

- FINRA Rule 1010
- FINRA Rule 2263
- FINRA Rule 13201

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Background & Discussion

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)[2] amended the Sarbanes-Oxley Act of 2002 (SOX) by adding a new paragraph (e) to 18 U.S.C. § 1514A[3] to provide that:

1. **Waiver of Rights and Remedies**—The rights and remedies provided for in this section may not be waived by any agreement, policy form, or condition of employment, including by a predispute arbitration agreement.
2. **Predispute Arbitration Agreements**— No predispute arbitration agreement shall be valid or enforceable, if the agreement requires arbitration of a dispute arising under this section.

Prior to the Dodd-Frank Act, FINRA required parties to arbitrate SOX whistleblower claims under the Industry Code. In light of the changes set forth in the Dodd-Frank Act that invalidate predispute arbitration agreements in the case of SOX whistleblower claims, FINRA is amending FINRA Rule 13201 of the Industry Code to make clear that parties are **not** required to arbitrate SOX whistleblower claims. While the main impetus for the rule change is the need to update FINRA staff's stated position on SOX whistleblower claims, FINRA made the rule text broad enough to cover any statutes that prohibit predispute arbitration agreements for whistleblower claims.[4]

Rule 13201 of the Industry Code currently provides that a claim alleging employment discrimination, including sexual harassment, in violation of a statute, is not required to be arbitrated under the Industry Code. Such a claim may be arbitrated only if the parties have agreed to arbitrate it, either before or after the dispute arose. FINRA is amending Rule 13201 to add a new provision to provide that a dispute arising under a whistleblower statute that prohibits the use of predispute arbitration agreements is not required to be arbitrated under the Industry Code. The revised rule states that such a dispute may be arbitrated only if the parties have agreed to arbitrate it after the dispute arose.

FINRA is making a conforming amendment to FINRA Rule 2263, which requires firms to provide each associated person with certain written disclosures regarding the nature and process of arbitration proceedings whenever the firm asks an associated person, pursuant to FINRA Rule 1010 (Electronic Filing Requirements for Uniform Forms), to manually sign a new or amended Form U4, or to otherwise provide written acknowledgment of an amendment to the form. FINRA is amending Rule 2263 to add a disclosure provision stating that a dispute arising under a whistleblower statute that prohibits the use of predispute arbitration agreements is not required to be arbitrated under FINRA rules, and that such a dispute may be arbitrated only if the parties have agreed to arbitrate it after the dispute arose.

Effective Date

The amendments to Rule 13201 are effective on May 21, 2012, for all whistleblower disputes arising under a statute that prohibits the use of predispute arbitration agreements, regardless of when the predispute arbitration agreement was executed. The amendments do not apply to any pending matters at FINRA. The conforming change to FINRA Rule 2263 also is effective on May 21, 2012.

Endnotes

1. *See* Securities Exchange Act Rel. No. 66575 (March 12, 2012), 77 Federal Register 15824 (March 16, 2012) (File No. SR-FINRA-2011-067).
2. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (2010).
3. *See* Dodd-Frank Section 922(c)(2), adding 18 U.S.C. § 1514A(e) (Nonenforceability of Certain Provisions Waiving Rights and Remedies or Requiring Arbitration of Disputes).
4. The Dodd-Frank Act also invalidated predispute arbitration agreements in other whistleblower statutes, including, for example, 7 USCA § 26(n) relating to Commodity Exchange Whistleblower Incentives and Protections.

Attachment A

New language is underlined; deletions are in brackets

Code of Arbitration Procedure for Industry Disputes

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13201. Statutory Employment Discrimination Claims and Disputes Arising Under a Whistleblower Statute that Prohibits the Use of Predispute Arbitration Agreements

(a) Statutory Employment Discrimination Claims

A claim alleging employment discrimination, including sexual harassment, in violation of a statute, is not required to be arbitrated under the Code. Such a claim may be arbitrated only if the parties have agreed to arbitrate it, either before or after the dispute arose. If the parties agree to arbitrate such a claim, the claim will be administered under Rule 13802.

(b) Disputes Arising Under a Whistleblower Statute that Prohibits the Use of Predispute Arbitration Agreements

A dispute arising under a whistleblower statute that prohibits the use of predispute arbitration agreements is not required to be arbitrated under the Code. Such a dispute may be arbitrated only if the parties have agreed to arbitrate it after the dispute arose.

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2263. Arbitration Disclosure to Associated Persons Signing or Acknowledging Form U4

A member shall provide an associated person with the following written statement whenever the associated person is asked, pursuant to FINRA Rule 1010, to manually sign an initial or amended Form U4, or otherwise provide written (which may be electronic) acknowledgment of an amendment to the Form U4:

The Form U4 contains a predispute arbitration clause. It is in item 5 of Section 15A of the Form U4. You should read that clause now. Before signing the Form U4, you should understand the following:

(1) You are agreeing to arbitrate any dispute, claim or controversy that may arise between you and your firm, or a customer, or any other person that is required to be arbitrated under the rules of the self-regulatory organizations with which you are registering. This means you are giving up the right to sue a member, customer, or another associated person in court, including the right to a trial by jury, except as provided by the rules of the arbitration forum in which a claim is filed.

(2) A claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute is not required to be arbitrated under FINRA rules. Such a claim may be arbitrated at FINRA only if the parties have agreed to arbitrate it, either before or after the dispute arose. The rules of other arbitration forums may be different.

(3) A dispute arising under a whistleblower statute that prohibits the use of predispute arbitration agreements is not required to be arbitrated under FINRA rules. Such a dispute may be arbitrated only if the parties have agreed to arbitrate it after the dispute arose.

([3]4) Arbitration awards are generally final and binding; a party's ability to have a court reverse or modify an arbitration award is very limited.

([4]5) The ability of the parties to obtain documents, witness statements and other discovery is generally more limited in arbitration than in court proceedings.

([5]6) The arbitrators do not have to explain the reason(s) for their award unless, in an eligible case, a joint request for an explained decision has been submitted by all parties to the panel at least 20 days prior to the first scheduled hearing date.

([6]7) The panel of arbitrators may include arbitrators who were or are affiliated with the securities industry or public arbitrators, as provided by the rules of the arbitration forum in which a claim is filed.

([7]8) The rules of some arbitration forums may impose time limits for bringing a claim in arbitration. In some cases, a claim that is ineligible for arbitration may be brought in court.

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