

## Arbitration Panel Composition

### SEC Approves Amendments to the Panel Composition Rules of the Arbitration Code for Industry Disputes

Effective Date: August 31, 2009

#### Executive Summary

Effective August 31, 2009, the criteria for determining the panel composition for an arbitration when the claim involves an associated person<sup>1</sup> will change. The amendment to the Arbitration Code for Industry Disputes will apply to claims filed on or after the effective date.

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

Questions concerning this *Notice* should be directed to:

- Kenneth L. Andrichik, Senior Vice President, Chief Counsel and Director of Mediation and Strategy, Dispute Resolution, at (212) 858-3915 or [ken.andrichik@finra.org](mailto:ken.andrichik@finra.org); or
- Mignon McLemore, Assistant Chief Counsel, Dispute Resolution, at (202) 728-8151 or [mignon.mclemore@finra.org](mailto:mignon.mclemore@finra.org).

#### Background and Discussion

Currently, FINRA Rule 13402(a) of the Industry Code requires an all non-public panel for disputes between member firms, and for employment disputes between or among member firms and associated persons that relate exclusively to employment contracts, promissory notes or receipt of commissions.<sup>2</sup> In all other disputes between or among member firms and associated persons, Rule 13402(b) requires a majority public panel, where one arbitrator would be a non-public arbitrator and two would be public arbitrators.<sup>3</sup>

July 2009

#### Notice Type

- Rule Amendment

#### Suggested Routing

- Compliance
- Legal
- Registered Representatives
- Senior Management

#### Key Topics

- Arbitration
- Code of Arbitration Procedure
- Dispute Resolution
- Panel Composition

#### Referenced Rules & Notices

- FINRA Rule 13402
- FINRA Rule 13403
- FINRA Rule 13406

The amendments to Rules 13402, 13403 and 13406 of the Arbitration Code for Industry Disputes (Industry Code) change the criteria for determining panel composition when the claim involves an associated person in industry disputes.<sup>4</sup> Specifically, the amendments to the rules of the Industry Code:

- ▶ require that the parties receive a majority public panel for all industry disputes involving associated persons (excluding disputes involving statutory employment discrimination claims, which require a specialized all public panel);<sup>5</sup>
- ▶ clarify that in disputes involving only member firms, parties will receive an all non-public panel; and
- ▶ provide that if a party amends its pleadings to add an associated person to a previously all-member firm case, parties will receive a majority public panel.

### Employment Disputes Involving Associated Persons

Currently, in employment disputes between or among member firms and associated persons, FINRA requires that the panel consist of all non-public arbitrators in cases that arise out of the employment or termination of employment of an associated person, and that relate exclusively to employment contracts, promissory notes or receipt of commissions. However, if a party adds a claim that does not meet these criteria, the parties receive a majority public panel.

The amendments to Rule 13402 provide that for all employment disputes between or among member firms and associated persons (except for statutory employment discrimination cases), the parties must select a majority public panel. To implement this change, FINRA is deleting the title of Rule 13402(a), which contains the exceptions to the majority public panel requirement, and is replacing it with a concise description, which clarifies that Rule 13402(a) would apply to disputes involving only member firms (“Disputes Between Members”).

Further, FINRA is modifying the title of Rule 13402(b) to provide that for all industry disputes involving associated persons (excluding disputes involving statutory employment discrimination claims), the parties will select a majority public panel (*i.e.*, “Disputes Between Associated Persons or Between or Among Members and Associated Persons”). FINRA is also making similar, consistent title changes to Rules 13403(a) and 13403(b), which govern generating and sending lists to parties, and to Rules 13406(a) and 13406(b), which govern appointment of arbitrators and discretion to appoint arbitrators not on the list.

### Disputes Involving Only Member Firms

The amendments to the rule also clarify that, in all disputes involving only member firms, the parties will select an all non-public panel.

### Amendments to Pleadings that Add an Associated Person

Occasionally, in a case that begins with an all non-public arbitrator panel, a party will amend its pleadings in such a way that a majority public panel will be required. For example, if a party files a claim regarding only an issue of compensation (one of the three “causes of action” listed in the existing rule), FINRA currently requires parties to select an all non-public panel. However, if a party adds a claim that falls outside of those three causes of action (*e.g.*, adds a cause of action involving a tort), then the parties receive a majority public panel instead.

Under the new rule, if a member firm (in a dispute involving only member firms) amends a pleading to add a party who is an associated person, the parties will select a majority public panel.

The deadlines for arbitrator list selection determine how FINRA processes an amended pleading. For example, if lists of potential arbitrators have not been sent to parties, the Neutral List Selection System (NLSS)<sup>6</sup> generates three lists of arbitrators to send to the parties: a public chairperson list, a public arbitrator list and a non-public arbitrator list.<sup>7</sup> If the panel consists of one arbitrator,<sup>8</sup> NLSS will generate a public chairperson list, and FINRA sends only this list to the parties.<sup>9</sup>

If lists of potential non-public arbitrators have been sent to parties but the deadline for their return to FINRA has not yet passed, FINRA provides two new lists of public arbitrators to the parties, so that the parties may select a majority public panel. Specifically, FINRA sends a public chairperson list and a public arbitrator list to the parties,<sup>10</sup> and the parties select the two public arbitrators for the panel from these lists using the striking and ranking procedures set forth in the Code.<sup>11</sup> The arbitrator selected from the public chairperson list becomes the chairperson of the panel. The parties keep the non-public chairperson list previously provided to them, and select the non-public arbitrator from this list.<sup>12</sup> In a single arbitrator case, FINRA sends only a new public chairperson list to the parties, including the newly added party, so that the parties may select a public arbitrator.<sup>13</sup>

If the ranked lists of potential arbitrators are due to FINRA, then the parties may not amend a pleading to add a new party until a panel is selected and the panel grants a motion to add the party.<sup>14</sup> Once the panel is selected, if it grants the motion to add an associated person, FINRA retains the non-public chairperson from the panel, and removes the remaining non-public arbitrators.<sup>15</sup> The parties select two public arbitrators from new lists that FINRA sends to them in the same manner as if the ranked lists are not yet due to be returned to FINRA. The arbitrator selected from the public chairperson list becomes the chairperson of the panel. If the panel consists of one non-public arbitrator and the non-public arbitrator grants a motion to add an associated person, the non-public arbitrator will be replaced with a public chair-qualified arbitrator that the parties select from a new public chairperson list that NLSS generates.<sup>16</sup>

### Effective Date

The amendment becomes effective on August 31, 2009, and will apply to claims filed on or after this date.

## Endnotes

- 1 Exchange Act Release No. 60061 (June 5, 2009), 74 Federal Register 28318 (June 15, 2009) (File No. SR-FINRA-2009-011).
- 2 If the panel consists of one arbitrator, the arbitrator will be a non-public arbitrator selected from the non-public chairperson roster described in Rule 13400(c). *See* Rule 13402(a).
- 3 If the panel consists of one arbitrator, the arbitrator will be a public arbitrator selected from the chairperson roster described in Rule 12400(c) of the Code of Arbitration Procedure for Customer Disputes (Customer Code). *See* Rule 13402(b).
- 4 The amendments discussed in this *Notice* do not apply to claims filed under the Customer Code.
- 5 The amendments will not apply to disputes involving a claim of statutory employment discrimination. *See* Rule 13802.
- 6 The NLSS is a computer system that generates, on a random basis, lists of arbitrators from FINRA's rosters of arbitrators. The parties select their panel through a process of striking and ranking the arbitrators on lists generated by NLSS. *See* Rule 13400(a).
- 7 *See* Rule 13403(b)(2).
- 8 In a dispute between member firms, if the panel consists of one arbitrator, the arbitrator will be selected from FINRA's non-public chairperson arbitrator roster. *See* Rule 13402(a).
- 9 *See* Rule 13403(b)(1). FINRA has raised the amount in controversy that will be heard by a single chair-qualified arbitrator to \$100,000. *See* Securities Exchange Rel. No. 59340 (Feb. 2, 2009), 74 FR 6335 (Feb. 6, 2009) (File No. FINRA-2008-047); *see also* *Regulatory Notice 09-13*.
- 10 Each new list will contain eight arbitrators. *See* Rule 13403(b)(2).
- 11 *See* Rule 13404.
- 12 FINRA will send the list of non-public arbitrators to the new party, with employment history for the past 10 years and other background information for each arbitrator listed. The newly added party may rank and strike arbitrators in accordance with Rule 13404. *See* Rule 13407(a).
- 13 Notes 9 and 12.
- 14 *See* Rule 13309(c).
- 15 Under Rule 13407(b), the newly added party may not strike the non-public arbitrator, but may challenge the arbitrator for cause in accordance with Rule 13410.
- 16 Note 9.

## Attachment A

New language is underlined; deleted language is in brackets.

### Code of Arbitration Procedure for Industry Disputes

#### Industry Code

#### 13402. Composition of Arbitration Panels in Cases Not Involving a Statutory Discrimination Claim

*For disputes involving statutory employment discrimination claims, see Rule 13802.*

(a) [Disputes Between Members, or Employment Disputes Between or Among Member Firms and Associated Persons Relating Exclusively To Employment Contracts, Promissory Notes, or Receipt of Commissions] Disputes Between Members

(1) In an arbitration between members, the panel composition will be as follows:

- No change.
- No change.

(2) If an arbitration involves only members and a member amends a pleading, pursuant to Rule 13309(c) to add an associated person, the majority of the panel will be public arbitrators, as described in Rule 13402(b). Once an associated person has been added to the proceeding, the rules that apply to cases between associated persons and members will govern list selection and the administration of the arbitration proceeding.

(b) [Other] Disputes Between Associated Persons or Between or Among Members and Associated Persons

- No change.
- No change.

### 13403. Generating and Sending Lists to the Parties

*For disputes involving statutory employment discrimination claims, see Rule 13802.*

(a) [Disputes Between or Among Members, or Employment Disputes Between or Among Member Firms and Associated Persons Relating Exclusively To Employment Contracts, Promissory Notes, or Receipt of Commissions] Lists Generated in Disputes Between Members

(1) – (4) No change.

(b) [Other Disputes Between or Among Members and Associated Persons] Lists Generated in Disputes Between Associated Persons or Between or Among Members and Associated Persons

(1) - (4) No change.

(c) Sending Lists to Parties

No change.

\* \* \* \*

### 13406. Appointment of Arbitrators; Discretion to Appoint Arbitrators Not on List

*For disputes involving statutory employment discrimination claims, see Rule 13802.*

(a) [Disputes Between Members, or Employment Disputes Between or Among Member Firms and Associated Persons Relating Exclusively To Employment Contracts, Promissory Notes, or Receipt of Commissions] Appointment of Arbitrators in Disputes Between Members

(1) – (2) No change.

(b) [Other] Appointment of Arbitrators in Disputes Between Associated Persons or Between or Among Members and Associated Persons

(1) - (2) No change.

(c) No change.

(d) No change.

\* \* \* \* \*