

Arbitration Rules

SEC Approves Changes to Arbitration Rules on Definition of Associated Person, Distribution of the FINRA Discovery Guide and Applicability of Hearing Session Fees

Effective Date: January 18, 2010

Executive Summary

Effective January 18, 2010, amendments to the Customer and Industry Codes of Arbitration:

- clarify the definition of “associated person” and make it conform to the same term in the FINRA By-Laws;
- streamline a case administration procedure; and
- clarify that customers could be assessed hearing session fees based on their own claims for relief in connection with an industry claim.¹

The amendments will apply to claims filed on or after the effective date. The text of the amendments is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

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Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Senior Management

Key Topic(s)

- Arbitration
- Associated Persons
- Discovery Guide
- Fees

Referenced Rules & Notices

- FINRA Rule 12100(r)
- FINRA Rule 12506(a)
- FINRA Rule 12902(a)
- FINRA Rule 13100(r)

Background and Discussion

The SEC has approved a proposal to amend FINRA Rules 12100(r), 12506(a) and 12902(a) of the Code of Arbitration Procedure for Customer Disputes (Customer Code) and Rule 13100(r) of the Code of Arbitration Procedure for Industry Disputes (Industry Code) regarding the definition of “associated person,” the distribution of the FINRA Discovery Guide and the applicability of hearing session fees. Each amendment is discussed below.

Definition of “Person Associated with a Member”

FINRA has amended the definition of “person associated with a member” under the Customer and Industry Codes to make it conform to the definition of the same term in FINRA’s By-Laws.

The definition of a “person associated with a member” under Rule 12100(r) of the Customer Code and Rule 13100(r) of the Industry Code is similar to the definition in FINRA’s By-Laws,² with two exceptions.³ First, the current definition of associated person under the Codes could be interpreted to include corporate entities.⁴ Thus, FINRA has amended the definition to insert the word “other” before the second reference to “natural person” to clarify that the definition does not include corporate entities.

Second, the current definition of an associated person under the Codes does not pertain to individuals who have applied for registration with FINRA. Thus, FINRA has amended the definition to expand the forum’s jurisdiction to natural persons who have applied for registration. FINRA’s By-Laws make it clear that individuals who have signed and submitted a Form U4 are subject to FINRA’s rules.⁵ This conforming change to the Codes will ensure that such individuals also will be required to arbitrate a dispute that arises while they are awaiting their licenses.

Distribution of the FINRA Discovery Guide

During the arbitration process, parties can request the discovery of documents, names of witnesses and other information from each other to prepare their cases for the hearing. To help parties understand what information they should disclose, FINRA automatically provides a copy of the FINRA Discovery Guide⁶ to parties when it serves the statement of claim.⁷

In light of the availability of Dispute Resolution forms, guides and the claim filing system on FINRA’s Web site, FINRA believes that it is no longer necessary to distribute automatically a printed Discovery Guide to parties when they file a claim. Thus, FINRA has amended Rule 12506 to state that, when FINRA serves the statement of claim, it will notify parties of the location of the Discovery Guide (which includes the Document Production Lists) on FINRA’s Web site, but will not provide a printed copy except upon request.

Applicability of Hearing Session Fees

On January 24, 2007, the SEC approved the “Code Revision,”⁸ which reorganized the old Code of Arbitration Procedure (old Code) into three separate procedural codes: the Customer Code, the Industry Code and the Mediation Code. The Code Revision simplified the language of the old Code, codified current dispute resolution practices and implemented several substantive changes to dispute resolution rules.

Under the old Code, arbitrators could allocate hearing session fees against any party.⁹ Rule 10332(c)¹⁰ of the old Code protected customers from potentially higher forum fees (now hearing session fees) triggered by amounts sought in industry claims by prohibiting the arbitrators from assessing forum fees against customers if the industry claim was dismissed. Moreover, the rule protected customers from higher forum fees by requiring that the amount of the forum fees be based on the amount awarded to an industry party and not on the amount of damages requested by the industry claim. However, Rule 10332(c) also provided that customers could be subject to potential forum fees based on their own claims for relief in connection with the industry claim.

During the drafting of the Code Revision, FINRA inadvertently omitted from the corresponding rule in the Customer Code¹¹ the provision (in old Rule 10332(c)) that permitted the forum to assess fees against the customer based on the customer’s claim in an industry dispute. Thus, FINRA has amended Rule 12902(a)(4) to incorporate the omitted language, which makes it clear to customers that if they file a claim in connection with a claim filed by a firm, they may be subject to filing fees and hearing session fees based on their own claim for relief.

Effective Date Provisions

The amendments will become effective January 18, 2010, and will apply to claims filed on or after that date.

Endnotes

- 1 Exchange Act Release No. 60878 (Oct. 26, 2009), 74 Federal Register 56679 (Nov. 2, 2009) (File No. SR-FINRA-2009-041).
- 2 See By-Laws of Corporation, Article I, Definitions (rr).
- 3 The reference to Procedural Rule 8210 in the By-Law definition would not apply to FINRA's dispute resolution forum and, therefore, has not been added to the Code definitions.
- 4 See Rule 12100(r)(2) of the Customer Code and Rule 13100(r)(2) of the Industry Code.
- 5 Note ii. See also *Notice to Members (NTM) 99-95* (November 1999).
- 6 The Discovery Guide provides parties in customer cases with guidance on which documents they should exchange without arbitrator or staff intervention (called Document Production Lists) and provides guidance to arbitrators in determining which documents parties are presumptively required to produce. The Discovery Guide was approved by the SEC and was made available for use in arbitration proceedings involving customer disputes upon the publication of *NTM 99-90* (November 1999).
- 7 See Rule 12506 of the Customer Code.
- 8 See Securities Exchange Act Release No. 55158 (January 24, 2007); 72 FR 4574 (January 31, 2007) (File Nos. SR-NASD-2003-158 and SR-NASD-2004-011).
- 9 If the parties and arbitrators meet in connection with an arbitration proceeding, the meeting is called a "hearing session." FINRA charges the parties a fee for each hearing session; the fee is based on the amount in dispute. See Rule 12902(a)(1).
- 10 Rule 10332(c) of the old Code stated, in relevant part, that "no fees shall be assessed against a customer in connection with an industry claim that is dismissed; however, in cases where there is also a customer claim, the customer may be assessed forum fees based on the customer claim."
- 11 For example, if a firm filed a claim against a customer, and the arbitrators dismissed the claim, the customer would not be assessed any forum fees. However, if, in connection with the industry claim, the customer filed a counterclaim against the firm, the customer would be subject to potential forum fees based on the customer's own claim for relief.
- 12 See Rule 12902(a)(4).

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ATTACHMENT A

New language is underlined; deletions are in brackets.

Code of Arbitration Procedure for Customer Disputes and Code of Arbitration Procedure for Industry Disputes

Customer Code

12100. Definitions

(r) Person Associated with a Member

The term “person associated with a member” means:

(1) A natural person who is registered or has applied for registration under the Rules of FINRA; or

(2) A sole proprietor, partner, officer, director, or branch manager of a member, or [a] other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under the By-Laws or the Rules of FINRA.

12506. Document Production Lists

(a) Applicability of Document Production Lists

When the Director serves the statement of claim, the Director will [provide] notify parties of the location of the FINRA Discovery Guide and Document Production Lists on FINRA’s Web site, but will provide a copy to the parties upon request. Document Production Lists 1 and 2 describe the documents that are presumed to be discoverable in all arbitrations between a customer and a member or associated person. Other Document Production Lists may also apply, depending on the specific cause(s) of action alleged.

(b) – (c) No change.

12902. Hearing Session Fees, and Other Costs and Expenses

(a) Hearing Session Fees

(1) – (3) No change.

(4) If hearing session fees are allocated against a customer in connection with a claim filed by a member or associated person, the amount of hearing session fees the customer must pay must be based on the amount actually awarded to the member or associated person, rather than on the amount claimed by the member or associated person. No hearing session fees may be assessed against a customer in connection with a claim filed by a member that is dismissed; however, in cases where there is also a customer claim, the customer may be assessed a filing fee under Rule 12900(a), and may be subject to hearing session fees.

(b) – (e) No change.

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Industry Code

13100. Definitions

(r) Person Associated with a Member

The term “person associated with a member” means:

(1) A natural person who is registered or has applied for registration under the Rules of FINRA; or

(2) A sole proprietor, partner, officer, director, or branch manager of a member, or [a] other natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with FINRA under the By-Laws or the Rules of FINRA.

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