

## **Arbitrating in the FINRA Forum: Issues and Strategies**

Financial Industry Regulatory Authority (FINRA) Dispute Resolution resolves securities disputes between and among investors, brokerage firms, and individual financial advisors. With the goal of delivering an expeditious and cost-effective resolution process, the FINRA forum has unique characteristics that pose challenges for even the most experienced trial attorneys. The articles below provide practical advice for selecting FINRA fact-finders, cross-examining key witnesses, and preparing key witnesses for a challenging examination by opposing counsel.

### **FINRA Arbitrator Selection: Understanding the Process and Vetting Potential Arbitrators**

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#### ***I. Introduction***

With all things, you must know your audience. Your audience will determine what you present and how you present it. That is true for everything from bedtime stories to theatrical performances. It is also true for your FINRA arbitration. When you try a bench trial, you likely have little or no control over who the trier of fact will be, but even then you are as prepared as you can be, you research your judge with the hope of determining how to address issues in your case which may concern your judge. When you try a jury trial, you have somewhat more control over who your audience will be with preemptory challenges and challenges for cause. And you take full advantage of that limited ability to decide who will be your client's "peers." An arbitration is like a combination of a bench and jury trial. The trier of fact will also decide the law, but you have some influence over who will be sitting in the most important three seats in the room. So take full advantage of your ability to choose those individuals and do your homework.

This article seeks to familiarize you with the FINRA arbitrator selection process and to give you practical strategies for vetting your arbitration panel.

#### ***II. The Neutral List Selection Process***

##### ***A. Arbitrator Selection Timing***

An arbitration may have multiple Respondents, in which case each Respondent may be served with the Statement of Claim ("Claim") by the Director of the Office of Dispute Resolution (the "Director") at a different time. See ***FINRA Code of Arbitration Procedure Rules ("Rules") 12300(c)(1) and 12302(c)***. A Respondent's Answer is due 45 days after that Respondent's receipt of the Claim. ***Rule 12303(a)***. Therefore, in cases involving multiple respondents the Answers are not likely to be due all at the same time. Notwithstanding this, all parties will be provided with a list of potential arbitrators at the same time. Within 30 days after the last Answer was due (not filed but due), the parties are presented with a list of arbitrators

randomly generated by a computer system from FINRA's roster of arbitrators from which to select their panel. **Rules 12402(c), 12403(b) and 13403(c).**<sup>1</sup> This time period is not extended in cases where the parties have agreed to extend the time to answer.<sup>2</sup>

### ***B. The List***

The **Neutral List Selection System** is a computer system that generates random lists of arbitrators which are gathered in an attempt to avoid conflicts with the parties in the case. **Rules 12402(b)(2), 12403(a)(3) and 13403(a)(4).** Therefore, it should not be the case that your opposing counsel or an employee of the party broker-dealer is on the list. If there is such a conflict, contact your FINRA Administrator and request a new list. In addition to the FINRA initial screening for conflicts, FINRA sends the parties a list of proposed arbitrators with biographies to permit the parties to review conflicts for themselves and to select a panel of arbitrators through a rank and strike system. **Rules 12402(c), 12403(b) and 13403(c)(1).**

In most cases the arbitration panel will consist of three individuals; however, under certain circumstances, there may be a single arbitrator.

### ***C. The Number of Arbitrators***

The number of arbitrators on a panel, and consequently the number of names generated by the **Neutral List Selection System**, will depend on the nature of the case and the amount in controversy. A case which alleges compensatory damages of \$50,000 or less (the "Simplified Arbitration") will be given a list of 10 arbitrators from which they will select one arbitrator. **Rules 12401(a) and 13401(a).** That single arbitrator will decide the case on the written submissions. If the case claims more than \$50,000 in compensatory damages but less than \$100,000, then, unless the parties agree in writing otherwise, they will be given a single arbitrator which will preside over a hearing. **Rules 12401(b) and 13401(b).** In both of these cases, the parties will be given a list of 10 arbitrators from which each party may strike up to four arbitrators (without explanation) and rank the remaining arbitrators, with "1" being their favorite arbitrator. **Rules 12402(d) and 13402(d).** The lowest-ranked arbitrator will serve as the arbitrator for that case.

### ***D. The Three Arbitrators Case***

In cases consisting of three arbitrators, the **Neutral List Selection System** will generate three lists. For customer cases, those lists will consist of:

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<sup>1</sup> The FINRA Code is actually two Codes. The "Customer Code" "governs arbitrations between investors and brokers and/or brokerage firms" and is the 12000 series. The "Industry Code" "governs arbitrations between or among industry parties only" and is the 13000 series. See <http://www.finra.org/arbitration-and-mediation/code-arbitration-procedure>.

<sup>2</sup> **Rules 12402(c), 12403(b) and 13403(c)** were amended effective September 18, 2017, in an effort to expedite the arbitrator selection process. The amendment provided that the time period for delivery of the List Section was changed from 30 days from the filing of the last Answer to 30 days from when the last Answer was due without regard to any extensions granted by the parties to that due date. See RN 17-25 which can be found at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-17-25.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-25.pdf).

- (A) A list of 10 arbitrators from the FINRA non-public arbitrator roster;
- (B) A list of 15 arbitrators from the FINRA public arbitrator roster; and
- (C) A list of 10 public arbitrators from the FINRA chairperson roster.

**Rule 12403(a).** After the Claim is served, FINRA will advise the Customer that he/she has the right to elect a public arbitrators only option. The Customer then has 35 days in which to choose this option. **Rule 12403(b)(2).** If this option is chosen, either party may choose to strike all non-public arbitrators and compose a panel of solely public arbitrators. **Rule 12403(b)(1).**

*i. The Chair-Qualified Arbitrator*

The definition of who is who is defined by the Code. The category defined as “Eligible for Chairperson Roster” is defined differently in the Customer Code than it is in the Industry Code. Specifically,

**Eligibility for Chairperson Roster**

In customer disputes, chairpersons must be public arbitrators. Arbitrators are eligible for the chairperson roster if they have completed chairperson training provided by FINRA and:

- (1) Have a law degree and are a member of a bar of at least one jurisdiction and have served as an arbitrator through award on at least one arbitration administered by a self-regulatory organization in which hearings were held; or
- (2) Have served as an arbitrator through award on at least three arbitrations administered by a self-regulatory organization in which hearings were held.

The Customer Code – **Rule 12400(c) (emphasis added).**

**Eligibility for Chairperson Roster**

Arbitrators are eligible to serve as chairperson of panels submitted for arbitration under the Code if they have completed chairperson training provided by FINRA and:

- (1) Have a law degree and are a member of a bar of at least one jurisdiction and have served as an arbitrator through award on at least one arbitration administered by a self-regulatory organization in which hearings were held; or

(2) Have served as an arbitrator through award on at least three arbitrations administered by a self-regulatory organization in which hearings were held.

#### The Industry Code – **Rule 13400(c).**

The other two categories, “public arbitrators” and “non-public arbitrators,” are defined in reference to each other and are in flux, and will likely change by the time of the publication of this article or shortly thereafter. Therefore, the discussion regarding who falls within each category requires some background information.

#### *ii. Changing Arbitrator Categories*

As a brief historical note, FINRA, previously named the NASD (National Association of Securities Dealers) once had a category system in which the three arbitration panel seats were defined as: “public arbitrator,” who was an individual unaffiliated with the securities industry; “industry arbitrator,” who was an individual actively working for a brokerage firm, usually in a sales or compliance capacity; and the “chair,” who was in customer cases a public arbitrator with additional qualifications and training, and often an attorney. As time passed advocates for public investors raised concerns that the “public arbitrator” category included individuals who were not employees but had some affiliations with the securities industry and were, therefore, perceived to have some bias in favor of the industry parties to the arbitration. In an effort to improve the perception of fairness, the NASD and, thereafter FINRA, made changes moving these “public arbitrators” to the “industry arbitrator” category. However, the industry category soon became filled with individuals who were not really industry affiliates. To better describe this category it was renamed the “non-public arbitrators.” However, there continued to be concern voiced by the public investor advocates that the “public arbitrator” was still not public enough. Therefore, in 2015 FINRA removed from the “public industry” category any individual who once worked in the securities industry, had family members affiliated with the securities industry, represented industry members or associated persons in arbitrations or litigations, represented public investors against industry members or associated persons in arbitrations or litigation, or worked for entities where a fellow employee received \$50,000 or more from the securities industry.

Presently before the Securities and Exchange Commission for its approval is a FINRA proposed rule change regarding the definition of “non-public arbitrator.”<sup>3</sup> The proposal does not affect the definition of “public arbitrator.”

#### *iii. The Public Arbitrator*

The public arbitrator definition reflects the fine tuning that has occurred over the years in this category. It is long and somewhat complicated. In sum, it serves to exclude individuals with perceived industry connection, which may not be direct connections, from the public arbitrator category. In order to discuss who fits into the new proposed non-public

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<sup>3</sup> See SR FINRA-2017-025 which can be found at <http://www.finra.org/industry/rule-filings/sr-finra-2017-025>.

arbitrator category, it is necessary to see the definition of “public arbitrator” in full. The definition is:

***(y) Public Arbitrator***

The term “public arbitrator” means a person who is otherwise qualified to serve as an arbitrator, and is not disqualified from service as an arbitrator, as enumerated by any of the criteria below.

**Permanent Disqualifications Based on a Person’s Own Activities**

(1) A person shall not be designated as a public arbitrator who is, or was, associated with, including registered through, under, or with (as applicable):

(A) a broker or a dealer (including a government securities broker or dealer or a municipal securities broker or dealer); or

(B) the Commodity Exchange Act or the Commodities Futures Trading Commission, or a member of the National Futures Association or the Municipal Securities Rulemaking Board; or

(C) an entity that is organized under or registered pursuant to the Securities Exchange Act of 1934, the Investment Company Act of 1940, or the Investment Advisers Act of 1940; or

(D) a mutual fund or a hedge fund; or

(E) an investment adviser.

(2) A person shall not be designated as a public arbitrator who was, for a total of 15 years or more, an attorney, accountant, or other professional who has devoted 20 percent or more of his or her professional time annually, to any entities listed in paragraph (y)(1) and/or to any persons or entities associated with any of the entities listed in paragraph (y)(1).

(3) A person shall not be designated as a public arbitrator who was, for a total of 15 years or more, an attorney, accountant, expert witness or other professional who has devoted 20 percent or more of his or her professional time annually to representing or providing services to parties in disputes concerning investment accounts or transactions, or employment relationships within the financial industry.

(4) A person shall not be designated as a public arbitrator who was, for a total of 15 years or more, an employee of a bank or other financial institution who effects transactions in securities, including government or municipal securities, commodities, futures, or options or supervises or monitors the compliance with the securities and commodities laws of employees who engage in such activities.

#### **Temporary Disqualifications Based on a Person's Own Activities**

(5) A person shall not be designated as a public arbitrator who is employed by, or is a director or officer of, an entity that directly or indirectly controls, is controlled by, or is under common control with, any partnership, corporation, or other organization that is engaged in the financial industry unless the affiliation ended more than five calendar years ago.

(6) A person shall not be designated as a public arbitrator who is an attorney, accountant, or other professional who has devoted 20 percent or more of his or her professional time, in any single calendar year, to any entities listed in paragraph (y)(1) and/or to any persons or entities associated with any of the entities listed in paragraph (y)(1) unless the calendar year ended more than five calendar years ago.

(7) A person shall not be designated as a public arbitrator who is an attorney, accountant, expert witness or other professional who has devoted 20 percent or more of his or her professional time, in any single calendar year, to representing or providing services to parties in disputes concerning investment accounts or transactions, or employment relationships within the financial industry unless the calendar year ended more than five calendar years ago.

(8) A person shall not be designated as a public arbitrator if the person is an employee of a bank or other financial institution and the person effects transactions in securities, including government or municipal securities, commodities, futures, or options or supervises or monitors the compliance with the securities and commodities laws of employees who engage in such activities unless the affiliation ended more than five calendar years ago.

#### **Temporary Disqualifications Based on the Activities of Others at a Person's Employer**

(9) A person shall not be designated as a public arbitrator who is an attorney, accountant, or other professional whose firm derived \$50,000 or more, or at least 10 percent of its annual revenue, in any

single calendar year during the course of the past two calendar years, from any entities listed in paragraph (y)(1) and/or to any persons or entities associated with any of the entities listed in paragraph (y)(1), or from a bank or other financial institution where persons effect transactions in securities including government or municipal securities, commodities, futures, or options. A person whom FINRA would not designate as a public arbitrator under this subparagraph shall also not be designated as a public arbitrator for two calendar years after ending employment at the firm.

(10) A person shall not be designated as a public arbitrator, who is an attorney, accountant, or other professional whose firm derived \$50,000 or more, or at least 10 percent of its annual revenue, in any single calendar year during the course of the past two calendar years, from individual and/or institutional investors relating to securities matters. A person whom FINRA would not designate as a public arbitrator under this subparagraph shall also not be designated as a public arbitrator for two calendar years after ending employment at the firm.

#### **Temporary Disqualification Based on the Financial Industry Affiliation of an Immediate Family Member**

(11) A person shall not be designated as a public arbitrator if his or her immediate family member is an individual whom FINRA would disqualify from serving on the public arbitrator roster. If the person's immediate family member ends the disqualifying affiliation, or the person ends the relationship with the individual so that the individual is no longer the person's immediate family member, the person may, after two calendar years have passed from the end of the affiliation or relationship, be designated as a public arbitrator.

For purposes of this rule, the term immediate family member means:

(A) a person's spouse, partner in a civil union, domestic partner, parent, stepparent, child, or stepchild;

(B) a member of a person's household;

(C) an individual to whom a person provides financial support of more than 50 percent of his or her annual income; or

(D) a person who is claimed as a dependent for federal income tax purposes.

For purposes of the public arbitrator definition, the term “revenue” shall not include mediation fees received by mediators who are also arbitrators, provided that the mediator acts in the capacity of a mediator and does not represent a party in the mediation.

**Rules 12100(y) & 13100 (y) – Public Arbitrator.**

***iv. The Non-Public Arbitrator***

Presently the “non-public” arbitrator is defined as:

**(r) Non-Public Arbitrator**

The term “non-public arbitrator” means a person who is otherwise qualified to serve as an arbitrator, and meets any of the following criteria:

(1) is, or was, associated with, including registered through, under, or with (as applicable):

(A) a broker or a dealer (including a government securities broker or dealer or a municipal securities broker or dealer); or

(B) the Commodity Exchange Act or the Commodities Futures Trading Commission, or a member of the National Futures Association or the Municipal Securities Rulemaking Board; or

(C) an entity that is organized under or registered pursuant to the Securities Exchange Act of 1934, the Investment Company Act of 1940, or the Investment Advisers Act of 1940; or

(D) a mutual fund or a hedge fund; or

(E) an investment adviser;

(2) is an attorney, accountant, or other professional who has, within the past five years, devoted 20 percent or more of his or her professional time, in any single calendar year, to any entities listed in paragraph (r)(1) and/or to any persons or entities associated with any of the entities listed in paragraph (r)(1); or

(3) is an attorney, accountant, expert witness or other professional who has, within the past five years, devoted 20 percent or more of his or her professional time, in any single calendar year, to representing or providing services to parties in disputes concerning investment accounts or transactions, or employment relationships within the financial industry; or



(4) is, or within the past five years was, an employee of a bank or other financial institution who effects transactions in securities, including government or municipal securities, commodities, futures, or options or supervises or monitors the compliance with the securities and commodities laws of employees who engage in such activities.

For purposes of the non-public arbitrator definition, the term “professional time” shall not include mediation services performed by mediators who are also arbitrators, provided that the mediator acts in the capacity of a mediator and does not represent a party in the mediation.

### **Rules 12100(r) & 13100(r) – Non-Public Arbitrator.**

As a result of the fine tuning of the “public arbitrator” category, there are individuals who are otherwise qualified to be arbitrators who no longer fit within the definition of “public arbitrator” and also do not fit within the definition of “non-public arbitrator.” Therefore, they have in essence fallen into a black hole and presently cannot serve in any capacity on a FINRA panel. In its proposal, FINRA advises that:

Over 800 public arbitrators were disqualified from the public arbitrator roster under the revised public arbitrator definition. In addition, more than 100 of these disqualified arbitrators did not meet any of the criteria outlined in the non-public arbitrator definition for service on the non-public arbitrator roster. As a result of this eligibility gap, FINRA removed them from service at the forum...In addition to losing over 100 public arbitrators, the eligibility gap required FINRA to reject over 140 arbitrator applicants in 2016 who met FINRA’s minimum arbitrator qualifications.<sup>4</sup>

The example FINRA provides for these lost arbitrators is:

In most instances, the basis for removal from the roster was an affiliation relating to an arbitrator’s family members or co-workers. For example, a real estate attorney in a large law firm that has a securities practice would be disqualified from service as a public arbitrator if the firm derived \$50,000 or more in a calendar year from providing services to securities entities. In addition, employment as a real estate attorney would not qualify the arbitrator to serve as a non-public arbitrator under the current definition. Therefore, the arbitrator falls into the eligibility gap.<sup>5</sup>

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<sup>4</sup> SR FINRA-2017-025 pp. 5-6.

<sup>5</sup> Id. pg. 6.

The proposal before the SEC is simply an attempt to eliminate this black hole. It would redefine “non-public arbitrator” to be “**a person who is otherwise qualified to serve as an arbitrator, and is disqualified from service as a public arbitrator.**”<sup>6</sup>

As there has not been opposition to the proposed rule change, it is likely to be approved by the SEC.<sup>7</sup>

#### ***E. The Single Arbitrator Case***

In a single arbitration case, the arbitrator will be “chair qualified.”

In customer cases, this individual will be a public arbitrator. **Rule 12402(a)**. In industry cases, the individual will be a non-public arbitrator. **Rule 13402(a)(1)** with certain exceptions discussed below.

#### ***F. The Promissory Note Case***

For the most part, like customer cases, the number of panelists in industry arbitrations is determined by the amount in controversy. **Rule 13401**. An exception to this rule is the promissory note case. **Rule 13806**. Regardless of the amount at issue, promissory note cases are heard by a single arbitrator if the associated person does not file a counterclaim or third-party claim, or files a counterclaim or third-party claim that requests damages less than \$100,000. **Rule 13806(b)(1)**. If the amount is below \$50,000, the matter will be a simplified arbitration and decided on the papers. If it is above \$50,000, it is decided by a single arbitrator at hearing. However, if the associated person files a counterclaim or third-party claim that either requests no damages or requests damages of \$100,000 or more, then the Chairman will appoint three arbitrators to hear the matter. **Rule 13806(b)(2)**.

If the dispute is between only Members (FINRA registered broker-dealers are FINRA Members), then the single arbitrator will be a non-public arbitrator selected from the chair qualified list. If it is a three-person panel, all three will be non-public arbitrators. **Rule 13402(a)(1)**. However, if an associated person (Member employees are associated persons) is a party, the single arbitrator will be selected from the public arbitrator list. **Rule 13806(c)(1)**. In industry arbitrations involving an associated person where a three-person panel is called for, the Chair will be selected from a public chair qualified list and a second arbitrator will be selected from the public arbitrator lists. **Rule 13806(c)(2)**.

#### ***G. The Arbitrators in Statutory Discrimination Cases***

Employment disputes between Members and associated persons are governed by the Industry Code. **Rule series 13000**.

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<sup>6</sup> *Id.*

<sup>7</sup> See the August 30, 2017 letter of Margo Hassan, Associate Chief Counsel, which can be found at <https://www.sec.gov/comments/sr-finra-2017-025/finra2017025-2257938-160945.pdf>.

Statutory employment discrimination claims and statutory whistleblower claims are excluded from the pre-dispute arbitration agreement that binds employees to the FINRA Forum under most circumstances. **Rule 13201.** In employment discrimination cases (including sexual harassment), the arbitration agreement must explicitly cover statutory discrimination in order to be eligible for the FINRA Forum. **Rule 13201(a).** In statutory whistleblower cases, the parties must agree to the FINRA Forum post-dispute. **Rule 13201(b).**

If the discrimination claim alleges damages of \$100,000 or less, it will be heard by a single arbitrator. **Rule 13802(b)(1).** If the claim alleges damages over \$100,000, it will be heard by a panel of three arbitrators. **Rule 13802(b)(2).** The qualifications for arbitrators on these panels differ from other types of cases unless the parties agree they should not. Specifically, the Rules provide:

### (3) Special Statutory Discrimination Claim Qualifications

A single arbitrator or chairperson of a three-arbitrator panel in a case involving a statutory discrimination claim must have the following qualifications:

- (A) law degree (Juris Doctor or equivalent);
- (B) membership in the Bar of any jurisdiction;
- (C) substantial familiarity with employment law; and
- (D) ten or more years of legal experience, of which at least five years must be in either:
  - law practice;
  - law school teaching;
  - government enforcement of equal employment opportunity statutes;
  - experience as a judge, arbitrator, or mediator; or
  - experience as an equal employment opportunity officer or in-house counsel of a corporation.

In addition, a chair or single arbitrator with the above experience may not have represented primarily the views of employers or of employees within the last five years. For purposes of this rule, the term “primarily” shall be interpreted to mean 50% or more of the arbitrator's business or professional activities within the last five years.

#### (4) Waiver of Special Qualifications

If all parties agree, after a dispute arises, they may waive any of the qualifications set forth in paragraph (A) or (B) above.

#### **Rule 13802(c)(3) and (4).**

### ***III. Vetting Your Arbitrators***

Thirty days after the last served Respondent's Answer is due, FINRA will up load onto the FINRA Party Portal a memorandum addressed to the parties' counsel advising them that their case is ready for the appointment of arbitrators. It will advise that the parties' rankings are due 20 days from the date of the communication and must be accomplished online through the FINRA Portal. **Rule 12300(a)**. The communication will also have enclosed Arbitrator Disclosure Reports for each arbitrator on the list of proposed arbitrators. The Disclosures will be accompanied by a Table of Contents which lists each arbitrator and his/her corresponding FINRA identification number and a Ranking Form (previously used for the actual ranking but now available for use as a worksheet in preparation for the online ranking).

Each arbitrator has an ongoing obligation to disclose information that may compromise his/her ability to be neutral. **Rules 12405 and 13408**. Therefore, on the Disclosure Report each arbitrator will disclose identification information. This will include fundamental information about who the arbitrator is, *e.g.*, a) their name; b) arbitrator ID number; c) city; d) classification (public, non-public); e) chair status; f) skills; and g) if they are registered on the DR Portal (the arbitrator equivalent of the parties' FINRA Portal). It will also give information relating to the arbitrator's: 1) employment history; 2) education; 3) FINRA training (*e.g.*, Chairperson, Discovery, Expungement); and 4) conflict information (including where the arbitrator has their securities accounts, the names of broker-dealers the arbitrator has been opposed to as a party or attorney, bar associations, online activities (blogs), etc. The arbitrator will also provide a narrative describing their background and qualifications.

FINRA will provide the arbitrator's publically available award(s) as well as cases which are still pending for which the arbitrator is on the panel. These will be for both cases involving and not involving a public customer. Parties may also access information regarding arbitrators who are licensed with FINRA through FINRA's BrokerCheck.<sup>8</sup> They may also, of course, access any publically available information about the arbitrator.

In addition to this information, a party may access copies of the arbitrator's past awards without cost on the FINRA website.<sup>9</sup> A party may receive an analysis of an arbitrator's award history through private vendors.<sup>10</sup> A party may also ask FINRA to pose a question to an

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<sup>8</sup> FINRA's BrokerCheck may be found at <https://brokercheck.finra.org/>.

<sup>9</sup> Go to [www.finra.org](http://www.finra.org) and proceed to the hyperlink "Arbitration and Mediation" and then the hyperlink "Arbitration Awards Online."

<sup>10</sup> The Securities Arbitration Commentator offers various services for arbitrator analysis. These services are also offered by a number of experts who work in the FINRA space.

arbitrator if the background information provided is unclear. FINRA estimates approximately 10 days to respond to a party's PRODUCT-RELATED request. The parties will then have 20 days from that response to the PRODUCT-RELATED request to rank the arbitrators. No other request will toll the parties' initial 20-day period of time to rank the arbitrators.

With the information you gather you can strategically determine which arbitrators you would like to serve on your panel. You, therefore, now have the tools to strike and rank your arbitrators. While preemptory strikes are limited, strikes for cause are not. FINRA has given examples of when a challenge for cause will likely be granted.

### **Challenges for Cause**

The following list, though not exhaustive, shows examples of circumstances where a challenge for cause would likely be granted. Generally, absent good cause, a party's ability to challenge an arbitrator(s) may be deemed waived if the challenge is not timely filed after a new disclosure is discovered by a party.

### **Opinion and Bias**

- Arbitrator has a firm opinion or belief as to the subject of a case for which he or she is an arbitrator.
- Arbitrator has a personal bias toward a party or party representative.

### **Personal Relationships**

- Arbitrator is or was related by blood or marriage to a party, its attorneys or witnesses.
- Arbitrator is or was a party's guardian.

### **Business Relationships**

- Arbitrator is or was a business partner, vendor, customer or client of a party.
- Arbitrator is a surety or guarantor of the obligations of a party.
- Arbitrator is currently a creditor or shareholder of any corporate party, or has any business relationship with a party.
- Arbitrator is or was a conservator or conservatee, employer or employee, principal or agent, or debtor or creditor of either a party or an officer of a corporation which is a party.
- Arbitrator is the parent, spouse or child of a person who is or was a conservator or conservatee, employer or employee, principal or agent, or debtor or creditor of either a party or an officer of a corporation which is a party.

### **Current Involvement**

- Arbitrator is adverse to a party, its attorneys or witnesses.

- Arbitrator is a party to or the subject of a complaint, arbitration or litigation involving a securities investment.
- Arbitrator is currently an expert witness for a party.

### **Previous Involvement**

- A party, its attorneys or witnesses previously accused an arbitrator of wrongdoing in a prior action.
- A party, its attorneys, or witnesses filed a motion to vacate challenging an award in a case in which the arbitrator had participated and signed the award.
- Arbitrator issued a complaint against a party, its attorneys or witnesses, in an action instituted or resolved during the past five (5) years.
- Arbitrator or any member, shareholder or associate of, or of counsel to his or her law firm, has had an attorney/client relationship with a party within three (3) years of the filing of the arbitration claim.
- Arbitrator or any member, shareholder or associate of, or of counsel to his or her law firm, has had an attorney/client relationship adverse to a party within three (3) years of the filing of the arbitration claim.

### **Financial Interest**

- Arbitrator knows that he or she has, individually or as a fiduciary, a financial interest in the subject matter in controversy or in a party in the arbitration proceeding, or any other interest that could be substantially affected by the outcome of the arbitration proceeding.
- Arbitrator's immediate family member (as defined in Rule 12100) has a financial interest in the subject matter in controversy or in a party in the arbitration proceeding, or any other interest that could be substantially affected by the outcome of the arbitration proceeding.

### **Expert Witnesses**

- An arbitrator in this matter testified as an expert witness against a party during the past (5) years.
- An arbitrator in this matter testified as an expert witness for a party during the past (5) years.
- An arbitrator in this matter was retained as an expert witness (but did not testify) in an action involving a party during the past three (3) years.
- An arbitrator in this matter was retained as an expert witness by a party's counsel, or his or her law firm, in an action during the past three (3) years (where no party in this matter was involved in the earlier action)."<sup>11</sup>

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<sup>11</sup> FINRA website on the "Arbitration Process", which can be found at <https://www.finra.org/arbitration-and-mediation/arbitrator-selection>.

If you find your arbitrator has an actual conflict with your client, you must raise it as soon as you discover it.

This will prevent the inadvertent waiver of the conflict. If you wait to see if you are victorious before raising what would have been an appropriate challenge to an arbitrator serving on your panel, you would likely have waived that challenge. *See, e.g., Delta Mine Holding Co. v. AFC Coal Props., Inc.*, 280 F.3d 815, 821 (8th Cir. 2001) (holding that the party waived the issue of evident partiality by failing to raise it before the panel); *Fid. Fed. Bank, FSB v. Durga Ma Corp.*, 386 F.3d 1306, 1313 (9th Cir. 2004) (holding that, by waiting until award issued, the losing party waived its right to claim evident partiality); *Poston v. NFLPA*, No. 02CV871, 2002 WL 31190142, at \*4 (E.D. Va. Aug. 26, 2002).

#### **IV. CONCLUSION**

In arbitration, like trial, there are many variables you have no control over. Arbitrator selection is one variable you and your client can have input into, and for that reason it is worth the extra effort it takes to know your audience. Treat your arbitrator selection as you would jury selection. With that effort, while you may not get your ideal trier of fact, you are also unlikely to get your worst trier of fact.

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## Effective Strategies for Cross-Examination and Preparation of Key Witnesses in FINRA Arbitration

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It's a familiar adage for litigators: Never ask a witness a question to which you do not know the answer. In the FINRA forum, where attorneys rarely have an opportunity to take depositions, this guideline poses a distinct challenge. Without the benefit of prior testimony to impeach an adverse witness, how do you control his or her testimony and advance your client's position? Below are tips for cross-examining the two key witnesses in FINRA customer matters—the Customer and the Financial Advisor—as well as strategies to prepare these witnesses for a challenging cross-examination by opposing counsel.

### *The Financial Advisor*

In FINRA customer arbitrations, the Financial Advisor is often the first witness to testify. The Customer may claim that the Financial Advisor made an unsuitable investment recommendation, failed to disclose or misrepresented the key features and risks of the investment, or entered trades without the Customer's authorization. A successful examination by the Customer's attorney will (in the Customer's view) leave the Panel with the following impressions:

- **The Financial Advisor is not credible.** The outcome in a FINRA customer arbitration often hinges on witness credibility. If the Financial Advisor contradicts other competent evidence, answers questions evasively, or is unwilling to accept the obvious (such as industry standards of conduct), the Panel may give little weight to the Financial Advisor's testimony, setting the table for a Customer award.
- **The Financial Advisor lacks the training or skills needed to fulfill the duties owed to the customer.** In addition to credibility, the competence of the Financial Advisor is often a central issue. If the Financial Advisor cannot clearly describe the fundamental features and risks of the investment, explain why the investment was well suited for the Customer, or articulate why other investments were not offered for the Customer's consideration, the Panel may conclude that the Financial Advisor could not (and, hence, did not) fulfill his or her obligations to the Customer.
- **The Financial Advisor was motivated by financial gain, rather than the Customer's best interests.** The bare fact that a Financial Advisor earns a commission does not demonstrate that the Financial Advisor recommended an investment without regard to the Customer's interests. However, if the Financial Advisor is unable to articulate a reasonable basis for the investment recommendation and, at the same time, responds defensively to questions about compensation, the Panel may determine that the Financial Advisor was motivated by financial gain, to the detriment of the Customer. Particularly in cases involving investments with higher commissions or



proprietary products, Financial Advisors will be put to the test on issues of compensation.

To achieve these results, the Customer's counsel may employ the following cross-examination techniques, for which Respondent's counsel must prepare:

- **Begin with the “obvious” questions.** Without the benefit of prior deposition testimony, many skilled claimants' counsel begin their examination of the Financial Advisor with questions about what appears to be obvious—such as obligations imposed by FINRA Rules or firm compliance policies. The point of asking questions about such “obvious” matters can be made with the question itself, not the Financial Advisor's answer. For example, counsel may ask: “As a financial advisor, are you are obligated to comply with FINRA's Suitability Rule?” If the Financial Advisor agrees, the Customer has easily established one of the Financial Advisor's duties. If the Financial Advisor disagrees or equivocates in response to this straightforward question, the Financial Advisor may very well lose credibility with the Panel.
  - **Witness Prep Point:** Before providing cross-examination testimony, many witnesses are loaded for bear. In preparing the Financial Advisor, it is important to remind him or her to respond affirmatively where appropriate—particularly in response to questions concerning industry standards of conduct. At the same time, the Financial Advisor should not be lulled by what appear to be softball questions from opposing counsel. If the Financial Advisor is not actively listening to questions from Customer's counsel, he or she might concede that the Financial Advisor has more extensive duties than FINRA Rules and applicable laws impose (such as an ongoing duty to monitor events impacting the Customer's investments in a non-discretionary account—a frequent point of contention between claimants and respondents).
- **Conduct a document-driven examination.** Without the benefit of prior deposition testimony, counsel in FINRA arbitrations must rely on documents to control adverse witness testimony. Skilled claimants' counsel will present emails, written disclosures, and other documents and attempt to get the Financial Advisor to agree to words on the page that are helpful to the Customer's case. From the Customer's perspective, it almost doesn't matter what the Financial Advisor says in response. The Customer's “answer” is provided in the document itself. For example, the Customer's counsel may direct the Financial Advisor to isolated language in the prospectus to suggest that the investment was not consistent with the Customer's risk profile or objectives. After all, how can the Financial Advisor argue with the language in the offering documents? Often, not so easily, and not without adequate preparation.
  - **Witness Prep Point:** Just as opposing counsel will conduct a document-centric examination, Respondent's counsel should engage in document-focused preparation. To respond fully and accurately to questions from Claimant's counsel, the Financial Advisor must have a firm grasp of the relevant

documents. For every isolated email, there may exist another email, note, or document that gives full context to the communication with the Customer. Likewise, isolated words and phrases from a single document (such as a prospectus or a research report) can and should be clarified by pointing to other relevant language in the complete document. Before testifying, the Financial Advisor should review documents that are relevant to the account relationship to refresh his or her memory. Of course, the Financial Advisor may still be presented with unfamiliar documents or forget their contents. In such instances, the Financial Advisor should carefully read the complete document offered by Claimant's counsel before responding to questions concerning the document.

- **Ask narrow, leading questions and insist on yes or no answers—with rare exception.** A fundamental principle of cross-examination is to avoid open-ended questions. When straying from the “obvious” points or points that are rooted in documentary evidence, the leading question is a particularly important tool. As one attorney put it: “The object is to get the answer you want and not one word more. That means asking questions that can only be answered, ‘yes,’ ‘no,’ or ‘I don’t know’ most of the time.” Of course, by framing careful, leading questions, counsel can suggest the desired answer to the Panel—no matter how the witness responds.
  - **Witness Prep Point:** Cross-examination is not the same as a client meeting or a casual conversation—nor is it a boxing match. In preparing the Financial Advisor to testify, Respondent's counsel should remind him or her to listen carefully to the question asked and ask for clarification if the question is unclear. If the Financial Advisor does not know the answer or does not recall the facts, then “I don’t know” or “I don’t recall” are perfectly acceptable answers. Of course, if the Financial Advisor can accurately respond “yes” or “no,” then he or she must do so. Finally, if the Financial Advisor cannot reasonably provide a “yes” or “no” response because there is something fundamentally wrong with the question (for example, it misstates the facts in evidence), then it is the job of Respondent's counsel to make an appropriate objection. If the objection requires elaboration, Respondent's counsel should consider requesting that the Financial Advisor be excused from the hearing room to avoid any suggestion that counsel is coaching the witness.
- **Mine every last detail.** Skilled customer counsel will conduct an incredibly thorough examination of the Financial Advisor. A favorite teaching tool of Jenice Malecki, who regularly represents public investors, is the “jealous girlfriend/boyfriend” approach to cross-examination, “where every examination topic is mined to the last detail.” According to Malecki, “To achieve the ‘jealous girlfriend/boyfriend’ cross-examination, you need to know the facts cold, understand the witness (including his or her motivations and weaknesses), as well as care about a truthful outcome. That’s the winning strategy.”

- **Witness Prep Point:** It's a given that Respondent's counsel should prepare a Financial Advisor by asking open-ended questions and providing the Financial Advisor with the relevant documents. However, to prepare a Financial Advisor for relentless cross-examination, Respondent must conduct a mock-examination of the witness on key issues. To "win" the cross-examination, a Financial Advisor needs stamina and a cool head. These are best achieved through a thorough mock-examination before the final hearing.

### ***The Customer***

The Customer's attorney typically calls the Customer to testify after having examined the Financial Advisor and other witnesses employed by the brokerage firm (such as the Financial Advisor's manager). After the Customer's attorney elicits the Customer's testimony through direct examination, it's Respondent's turn to cross-examine the witness. Unlike a courtroom matter, where cross-examination is limited to the scope of the direct examination, the FINRA cross-examiner typically gets more leeway with the scope of his or her examination. The question is just how far Respondent's counsel should reach to elicit favorable testimony—and when to sit down. After a successful examination by the Respondent's attorney, the Panel may draw the following conclusions:

- **The Customer is not credible:** Skilled Respondent's counsel will demonstrate with precision each way that the Customer's testimony contradicts the documents in evidence, the Statement of Claim, or the Customer's earlier testimony on direct. The Customer's inconsistent testimony—as well as evasive answers and convenient memory lapses—will damage the Customer's credibility with the Panel.
- **The Customer understood the key features and risks of the investment, or could have understood them with reasonable diligence.** In addition to witness credibility, the Customer's understanding of the investment (or ability to understand the investment) is often a core consideration. To defend against claims of misrepresentation, Respondents will attempt to establish that the Customer has a reasonable level of education or business experience, has prior investment experience, had meetings with the Financial Advisor to review the investment, received accurate written disclosures, and (where possible) held the investment for a sufficient time to experience at least some of the investment risks firsthand.
- **The Investments Were Suitable for the Customer.** The vast majority of FINRA customer claims allege that the investment was unsuitable for the Customer. To demonstrate that the investment recommendation was in fact appropriate, a successful cross-examination by Respondent will demonstrate facts such as these: the Customer confirmed his or her objectives and risk profile in writing; the Customer's history of investing further corroborates her stated goals and tolerance for risk; the Customer's account withdrawals demonstrate a need or desire for greater investment returns; the Customer's other assets demonstrate that the Customer is not over-concentrated in the investment at issue; and (on a good day for Respondent) the

customer rejected other investment recommendations in favor of the investment at issue.

- **The Customer is not sympathetic.** Some Customers garner sympathy for reasons that are easy to identify (advanced age, poor health, low net worth, limited education). For other Customers, sympathy is not so easily earned. If the Customer is unwilling to accept any personal responsibility for his or her investment decisions, or if the Customer is defensive and evasive in responding to questions from opposing counsel, the Panel may view the Customer in a negative light.

To achieve the desired result, Respondent's counsel should consider the following advice:

- **Know when to say when.** As a general rule, effective cross-examination requires restraint, as almost every question entails some degree of risk. Before the Customer's direct examination, Respondent should identify all points that *must* be established through the Customer, as well as the points that Respondent's counsel can (and likely should) make through friendly witnesses. As the Customer testifies on direct examination, have a topical examination outline on hand and check off all areas of testimony that the Customer satisfies. On cross-examination, address the "must have" areas of testimony that remain. These may include: key documents signed by the Customer, communications authored or received by the Customer, disclosures and other written materials received by the Customer, and documents reflecting the Customer's other investments or assets. After obtaining as much of the "must have" testimony that you can, strongly consider sitting down.
- **Listen carefully to the Customer's direct examination.** In addition to identifying all favorable testimony that the Customer provides on direct examination, Respondent's counsel must listen carefully to identify all testimony that contradicts the documentary evidence in the case, as well as the Customer's own testimony. To win the credibility battle, skilled Respondent's counsel will expose these inconsistencies on cross-examination.
- **Have a document to support (almost) every cross-examination question.** As with Claimant's examination of the Financial Advisor, a successful cross-examination of the Customer should be rooted in the documents. For every response that contradicts a document, impeach the Customer with the document. By establishing control of the facts with documents early in the examination, Respondent's counsel may find that the Customer is willing to concede other points on cross-examination (sometimes out of fear that a corroborating document is waiting behind Door Number 3).
- **Plan for the unexpected.** Particularly when questions are not tied to documents, plan for the unexpected response. Follow a "decision-tree" approach for this type of examination. If the Customer maintains that she did not verify her investment objectives and risk profile on the new account documents, direct the Customer to the account statements that notified her of this information on a monthly basis. If the

Customer unexpectedly maintains that he did not authorize the transaction, direct the Customer to trade confirmations and account statements that the Customer received reflecting the transactions (and establish that the Customer never objected to the transaction as unauthorized until now). Of course, no one can plan for every contingency. If the Customer gives an unforeseen (and damaging) response, Respondent's counsel must appear unfazed. As one attorney advised, "Never let your expression indicate that you believe the response is harmful, or that you are surprised."

- **Use caution with open-ended questions.** Although leading questions are the bread and butter of cross-examination, not all open-ended questions are off-limits. But proceed with caution. Open-ended questions can be useful for establishing the who [did you meet with?], what [did you tell the Financial Advisor about your investment needs?], when [did you meet?], where [are your other investment accounts?], and why [did you decide to sell a portion of the investment?]. Also, by listening carefully to the Customer's direct examination, skilled Respondent's counsel may identify an area that the Customer's counsel tellingly avoided. Why? Consider asking that particular open-ended question (and good luck!).

### ***Conclusion***

By employing the above strategies, counsel for the customer and the member firm can effectively cross-examine and prepare key witnesses in the FINRA forum.