

**NATIONAL SOCIETY OF
COMPLIANCE PROFESSIONALS**

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**SECURITIES ARBITRATION:
WHAT TO DO AND WHEN**

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III(b) BD -- Arbitration

- What to do when:
 - A client sues
 - An ex-employee wants expungement
 - Dealing with outside counsel
 - Documenting production

- The Rules of Arbitration

WHAT TO DO WHEN A CLIENT SUES:

CLAIM INITIATION AND RESPONDING TO CLAIMS

A. Rule 12303: Answers

1. Respondent(s) must directly serve each other party with the following documents within 45 days of receipt of the statement of claim:
 - a. Signed and dated Uniform Submission Agreement; and
 - b. An answer specifying the relevant facts and available defenses to the statement of claim.
 - c. The respondent may include any additional documents supporting the answer to the statement of claim Parties that fail to answer in the time provided may be subject to default proceedings under Rule 12801.
2. The answer to the statement of claim may include any counterclaims against the claimant, cross claims against other respondents, or third party claims, specifying all relevant facts and remedies requested, as well as any additional documents supporting such claim. When serving a third party claim, the respondent must provide each new respondent with copies of all documents previously served by any party, or sent to the parties by the Director.
3. At the same time that the answer to the statement of claim is served on the other parties, the respondent must file copies of the Uniform Submission Agreement, the answer to the statement of claim, and any additional documents, with the Director, with enough copies for the Director and each arbitrator.
4. Practice Pointers:
 - a. Pre-answer investigation needs to be even more thorough
 - b. Always Reserve the right to amend
 - c. Try to hold claimant's Statement of Claim to same standard of fact investigation as Answer
 - d. Missing uniform submission agreement could lead to a "deficient" answer
 - e. Be prepared to argue vacatur standard of "failure to hear evidence" at hearing

B. “General Denials”

1. Rule 12308: “Loss of Defenses Due to Untimely or Incomplete Answer.”
 - a. “If a party answers a claim that alleges specific facts and contentions with a general denial, or fails to include defenses or relevant facts in its answer that were known to it at the time the answer was filed, the panel may bar that party from presenting the omitted defenses or facts at the hearing.”
 - b. Practice Pointers:
 - (i) The new rule is broader than the old rule because defenses or “relevant facts” can now be barred if they were “known” to a party when the Answer was filed and not included in the Answer.
 - (ii) There is no procedural guidance in the rule concerning how/when the decision to bar a defense or fact should be made. The rule does not provide substantive guidance on determining whether a Respondent “knew” a fact or defense and should have recognized its relevance at the time the Answer was filed. To comply with the rule, pre-Answer investigations need to be thorough so that potentially helpful facts are learned and can be included in the Answer.

{For more information, see Main Materials}

WHAT TO DO WHEN AN EX-EMPLOYEE WANTS EXPUNGEMENT:

- A. Expungement is an extraordinary remedy and arbitrators will not routinely grant requests for expungement.**
- B. Rule 2080 – effective August 17, 2009 (Former NASD Rule 2130)**
 1. A party may ask the arbitrators to order expungement as part of the award in his or her prayer for relief. If the arbitrators grant the request, the party must ask a court of competent jurisdiction to confirm the arbitration award.
 2. FINRA members or associated persons must name FINRA as an additional party in any court proceeding in which they seek an order to expunge customer dispute information or request confirmation of an award, unless FINRA waives that requirement. FINRA will generally oppose confirmation of the expungement portion of the arbitration award in most cases where it participates in the judicial proceeding.
 3. Expungement occurs only when the arbitrators find and document one of the following, narrow grounds specified in Rule 2080.

- a. the claim, allegation or information is factually impossible or clearly erroneous;
 - b. the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation or conversion of funds; or
 - (i) this standard would require an affirmative arbitral finding that the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds.
 - (ii) Dismissal of the claim alone would not be a sufficient basis for ordering expungement.
 - c. the claim, allegation or information is false.
4. Stipulated awards that request expungement relief are subject to the same requirements as contested claims. The award must clearly and expressly contain one or more of the affirmative findings in 2080.
- a. Arbitrators should consider whether expungement was a “quid pro quo” for settling a case, particularly when monetary settlement is involved. A “quid pro quo” settlement might be contrary to conduct rules.

C. Rule 12805

1. “In order to grant expungement of customer dispute information under Rule 2080 (or NASD 2130), the panel must:
 - a. hold a recorded hearing session regarding the appropriateness of expungement.¹
 - b. in cases involving settlements, review settlement documents.
 - c. indicate in the arbitration award which of the Rule 2080 grounds for expungement serve(s) as the basis for its expungement order and provide a brief written explanation of the reason(s) for its finding that one or more Rule 2080 grounds for expungement applies to facts of this case.

{For more information, see Main Materials}

¹ This is applicable even if a customer did not request a hearing on the merits.

WHAT TO DO WHEN DEALING WITH OUTSIDE COUNSEL:

A. Reasons Customers File Claims

1. Customer Grievances That Are Ignored
 - a. Client's claims are not properly reviewed or addressed when raised
 - b. Management fails to fully review the allegations
 - c. Management denies the claim without completing a full investigation
2. Disputes With Clients Who Have "Nothing to Lose"
 - a. Wealthy clients who are dissatisfied with their broker will be willing to finance a claim
 - b. Middle income clients, who have lost enough of their net worth, will feel as if they have no alternative
3. Disputes Related to a Broker or Firm Sanctioned by Regulators
 - a. Sales Practices
 - (i) Firms offering both Investment Advisor and Broker Dealer services
 - b. Failure to Supervise
4. Disputes Related to "High Risk" Accounts
 - a. Discretionary Accounts
 - b. Retirement Accounts
 - c. Elderly Customers

B. Types of Controversies Involved

1. Breach of Fiduciary Duty
2. Misrepresentation
3. Negligence
4. Breach of Contract

- a. Incomplete or old account opening documents
- 5. Unsuitability
 - a. High commissions
 - b. High Turnover
 - c. High cost to equity or break even ratios
 - d. Over-concentration
 - (i) Over concentration in single equities or “high risk” sectors
- 6. Failure to Supervise
- 7. Unauthorized Trading

C. Types of Securities Involved

- 1. Mutual Funds
- 2. Common Stock
- 3. Derivatives
- 4. Auction Rate Securities
- 5. Annuities

D. MAKE THE MOST OF THE ARBITRATION PROCESS

A cordial relationship with outside counsel is usually in your firm’s best interests. Be sure to abide by FINRA’s Code of Procedure, including good faith efforts regarding discovery. Because the arbitration process is, in many ways, more relaxed than litigation, a good relationship with outside counsel can do much to provide a reasonable and cost-efficient means to resolving dispute.

E. Selection of Arbitrators

- 1. Many Arbitrators are experienced industry professionals
 - a. Not laypersons
- 2. Arbitrators are selected through an automated system that produces lists

- a. One Private, One Public, and One Chairperson List, each including eight choices – See Section VI below
- b. Parties may remove any listed arbitrator for any reason

F. Cost-Effective

Arbitration is faster, less expensive, and less formal than litigation

G. Convenience

FINRA conducts arbitrations in 47 cities nationwide

Note: Hearing location is usually that closest to the customer's residence

H. Arbitration is final and binding

Awards are subject to very limited judicial review

I. Expediency

Total turnaround time is about 15 months for hearing decisions

Less than 7 months for Simplified Decisions

Award decisions are generally made within 30 business days after the close of the proceeding

{For more information, see Main Materials}

<p><u>WHAT TO DO WHEN DOCUMENTING PRODUCTION:</u></p>
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Documenting Production – Best Practices

1. bates numbers
2. cover letters
3. control sets kept at home
 - a. maintain a binder of documents produced, include date produced and category of document if needed.
4. Maintain index of documents received.

{For more information, see Main Materials}

THE RULES OF ARBITRATION:

(From FINRA.org; FINRA Manual)

12000. CODE OF ARBITRATION PROCEDURE FOR CUSTOMER DISPUTES

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{For more information, see Main Materials}