



Fox Rothschild LLP
ATTORNEYS AT LAW

Learn to Plan, Plan to Learn: FINRA Arbitration Training

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Introduction

We will discuss the FINRA arbitration process, considerations and preparation that needs to take place after the initial submissions are filed. Specifically, we will cover the following topics:

- **Pre-Arbitration Considerations**
 - ✓ Selecting an arbitrator
 - ✓ Selecting a venue
 - ✓ Pre-hearing conference prep
 - ✓ Approaches to discovery depending on type of case
 - ✓ Motions prep
- **Arbitration Considerations**
 - ✓ Virtual hearing challenges
 - ✓ What is admissible evidence?
 - ✓ Use of expert witnesses
- **Post-Arbitration Considerations**
 - ✓ Responding to post-hearing submission requests and appeals



Pre-Arbitration Considerations

Selecting an arbitrator

- General considerations and process:
 - ✓ Panel size depends on the amount of claim. Under \$100K – one arbitrator; over \$100K – three arbitrators
 - ✓ Investor v. industry cases
 - ✓ Arbitrator's background: public v. non-public
- Consider background, knowledge and experience of potential arbitrators, costs associated with having more than one arbitrator, and the ability of various arbitrators to collaborate.
- Challenging the appointed arbitrator



Pre-Arbitration Considerations (Cont'd)

Venue options:

- The hearing location closest to the customer's residence at the time of the events giving rise to the dispute
- If the hearing location closest to the customer's residence is in a different state, the customer may request a hearing location in the customer's state of residence at the time of the events giving rise to the dispute
- Before arbitrator lists are sent to the parties, the parties may agree in writing to a hearing location other than the one selected by FINRA
- By motion



Pre-Arbitration Considerations (Cont'd)

Pre-hearing conference purpose:

- ✓ Schedule evidentiary hearing dates: approx. within six months
 - ✓ Establish discovery deadlines
 - ✓ Set briefing and motion deadlines
 - ✓ Determine whether mediation is desirable
 - ✓ Other preliminary matters
- * Expedited schedule in matters involving senior or seriously ill parties



Pre-Arbitration Considerations (Cont'd)

Discovery: Overview

- Discovery mainly encompasses document production, e-discovery
- Depositions are discouraged and permitted, upon motion, in limited circumstances (to preserve testimony of ill or dying witness; to accommodate essential witnesses who can't travel for a hearing – not an issue with virtual hearings; to expedite large or complex cases)
- Any objections are filed and typically decided by one arbitrator (chairperson)
- Subpoenas may only be issued by an arbitrator (not a party attorney) via a motion request; other party may object



Pre-Arbitration Considerations (Cont'd)

Discovery: Customer Dispute

- ✓ For **customer disputes** only, FINRA provides the Discovery Guide, which lists documents that the parties are to exchange without arbitrator or staff intervention. The Discovery Guide contains two Document Production Lists of presumptively discoverable documents: One for firms/associated persons to produce and one for customers to produce.
- ✓ **For firms/associated persons the list includes:** Account records, customer's risk tolerance information, customer agreements, customer authorizations, correspondence with customers, etc.



Best Documentation Practices Pre-Claim: To Prepare For Discovery

- Detailed contemporaneous notes of oral communications
- Confirm and document oral communications related to trades to avoid mistakes and misunderstandings, in particular in a rapidly changing market
- Consistent characterization of transaction and events in various sources
- Document disclosures and advice, including advice that the client does not follow
- Highlight the risks and important information for the client

If the firm and individual brokers follow these practices, they should be well-positioned to address any customer complaints.



Best Documentation Practices: Gather All Documents in the Client's File

- Although a client's file should be current and complete at all times, it is particularly important for the advisor to ensure the accuracy of the file when faced with a complaint.
- Documents from all possible sources relevant to the client/broker relationship must be in the "file" (either hard or soft), including any documents that a managing principal may have in his/her possession regarding the complaining client.
- Compliance and/or legal will want to review the client file to analyze the substance of the complaint; an incomplete file hampers that review and may have a materially adverse impact on the defense of the claim.
- In particular, failure to gather all documents relating to the complaining client could lead to an incomplete analysis of the complaint, or, worse, disclosure in the middle of a trial by the managing principal that he or she failed to provide certain client-related documents notwithstanding a prior certification that all such documents were produced in the course of the legal proceeding.
- Such a disclosure in the middle of a trial will irreparably damage an otherwise defensible claim.



Best Documentation Practices: Never Alter the Contents of Your Files

- An advisor not only must gather all documents pertaining to the complaining client, but also must neither alter any of those documents, nor remove any documents from, nor add any documents to, the file.
- A proper analysis of any claim requires that the reviewer have a complete and accurate picture of the advisor/client relationship, not the picture that the advisor wants to portray.
- The advisor should never remove, for example, a completed know-your-customer questionnaire, or recreate notes of phone conversations that were never made in an effort to bolster his version of the events.
- Such conduct is not only dishonest, but also may destroy an advisor's credibility with his company and/or tribunal. In the end, the truth always prevails. An advisor should never try to play lawyer or compliance officer; there is a reason why those people are in their respective roles.
- Such conduct not only leads to harsh sanctions imposed on an individual broker but also to supervisor/firm's liability for failure to supervise and prevent such conduct.



Pre-Arbitration Considerations

- **Discovery: Product Cases**

- ✓ Cases in which there are allegations regarding the widespread mismarketing or defective development of a specific security or specific group of securities.
- ✓ Example: Many investors who purchased bond funds heavily invested in subprime debt filed claims after these funds declined greatly in value after the collapse of the subprime market in 2008-2009.



Pre-Arbitration Considerations: Discovery



**It started out as a simple analysis,
but piled up to information overload.**

In products cases, the volume of documents is significant, documents are not client specific, product is subject to regulatory investigation, class action, etc.

Document production may involve individuals who did not directly handle a client's account, e.g. persons who conducted due diligence analysis of the product.



Pre-Arbitration Considerations (Cont'd)

- **Discovery: Product Cases**

- ✓ Parties are not limited to FINRA Discovery Lists
- ✓ Typical requests to a firm include: Documents related to the creation of a product; due diligence documents; training or marketing materials; or post-approval review of a product.
- ✓ Discovery may get extensive and expensive quickly
- ✓ A party may object on this basis but should be strategic in its objections.
- ✓ Another arbitrator's decisions in other cases involving same product ordering production is not binding but may influence the discovery decision



Pre-Arbitration Considerations (Cont'd)

- **Motions**

- ✓ Depending on circumstances, parties may file various motions, typically after initial conference and before the evidentiary hearing.
- ✓ Types: Amend, consolidate, sever claim; compel discovery, motion to dismiss, prevent other party from introducing certain evidence and/or experts (motion *in limine*)
- ✓ Arbitrators typically don't favor "misuse of motions," e.g. filing for tactical reasons to delay the proceeding.
- ✓ The panel's interpretations and rulings are final and binding; must be made by a majority of the arbitrators, unless the parties agree, or the rules provide otherwise.



Arbitration Hearing Considerations

Virtual hearing challenges

- Due to uncertainties created by the pandemic, virtual hearings will continue to remain the default option. There are many practical considerations that practitioners and clients face now with regard to virtual hearings.
- **Technical aspects:** Need to be planned in advance, including the platform for the hearing; presentation of electronic evidence; recording and transcribing. Most of these technical aspects are better left to the professionals, rather than the attorneys, who should be focusing on the legal aspects of the hearing. Attorneys and clients should test the platform in advance to ensure that they are comfortable with the platform, they have working camera, microphone and internet connection, so on the day of the hearing they are able to focus solely on the legal aspects of the hearing.



Arbitration Hearing Considerations: Virtual Hearing

- **Confidentiality and privacy concerns:** It is prudent to consult your technical support team on ways to ensure confidentiality of the hearing, which may include password protected access to hearing links and electronic exhibits; monitoring of participants; and express prohibition from the panel to record or videotape the hearing. If the recordings are permitted, then there should be an agreed upon protocol in place, which discusses the conditions for release of such recordings.
- **Communications:** With everyone located in different places, it is important to ensure that there is an accessible channel of communication at all time during the hearing, whether via an email chain, WhatsApp, Microsoft Teams or similar application, virtual breakout room or instant messenger function. It might be useful to designate an associate to monitor communications and bring them to the chairs' attention.
- **Hearing Procedure:** It may take some time to adjust to virtual hearing. In addition to the technical aspects, lengthy virtual hearings in front of the computer can be tiring and strenuous for everyone involved, including witnesses, translators, reporters and attorneys. It is important to take breaks and, in certain cases, to limit the hearing to half a day.
- **Presentation of Witnesses and Evidence:** Witness testimony and evidence presentation might also need to be re-evaluated in order to adjust to a new presentation format and maintain effectiveness. Careful planning and practice is crucial for a successful virtual presentation.



Arbitration Hearing Considerations

- **Admissible Evidence**

- ✓ FINRA Rule 12604: The panel will decide what evidence to admit and is not required to follow state or federal rules of evidence.
- ✓ The panel has a broad discretion regarding evidentiary rulings. Arbitration is less formal than court and many evidence that would not be admitted in court, are admitted in arbitration.
- ✓ Objections during the hearing are primarily limited to privilege.



Arbitration Hearing Considerations (Cont'd)

- **Evidentiary Issues**

- ✓ The panel may exclude from evidence documents not exchanged in discovery if the party has no valid reasons why the document hasn't been previously produced
- ✓ Same goes to witnesses that were not identified prior to the hearing
- ✓ Letters closing FINRA investigation do not have evidentiary value unless introduced in rebuttal



Arbitration Hearing Considerations (Cont'd)

- Witnesses
- Two types of witnesses testify during an arbitration hearing: Fact witnesses and expert witnesses
- Fact witnesses testify on the material facts of the case and, besides their own testimony, might be excluded from the hearing
- Expert witnesses are typically present during the hearing and express their opinions on issues of interpretation of the facts or those issues that would require special knowledge and expertise



Arbitration Hearing Considerations (Cont'd)

- **Selecting an Expert**

- ✓ Selecting a competent expert witness who can concisely and persuasively explain the technical issues in the case to the panel is important and should not be delayed.
- ✓ An expert can provide assistance early in the case starting with arbitrator selection process and assistance with discovery requests.
- ✓ In selecting an arbitrator it is important to consider his/her familiarity and experience with the product at issue, prior testimony in other matters, whether the expert was ever precluded from testifying and on what basis (do your own research in addition to asking the expert), expert's publications on the topic, overall reputation in the financial industry.
- ✓ Limitation on former FINRA employees serving as expert witnesses: FINRA Rule 9242 No former officer of FINRA shall, within a period of one year immediately after termination of employment with FINRA, provide expert testimony on behalf of any other person under the Rule 9000 Series.



Post-Arbitration Considerations

- Responding to post-hearing submission requests
- When does a panel permit post-hearing submissions and what is submitted?
 - Panels typically limit post-hearing submissions in non-complex matters
 - Post-hearing briefing typically permitted in cases with more than five hearing days
 - Post-hearing submissions confined to a memorandum to address the facts and the law
 - Important to pre-plan if you expect a lengthy hearing because you may want a court reporter to transcribe the hearing in anticipation of a post-hearing submission



Post-Arbitration Considerations (Cont'd)

- **Appeal**

- ✓ All rendered awards are final and are not subject to review or appeal within FINRA
- ✓ Party may seek to vacate an award in a court
- ✓ Consult federal and local state law on procedure
- ✓ The Federal Arbitration Act, 9 U.S.C. §10
- ✓ In New York, a party must file an application seeking to vacate an award within 90 days after receiving the award. CPLR 7511



Post-Arbitration Considerations (Cont'd)

Appeal

✓ Limited grounds for vacating an award:

- where the award was procured by corruption, fraud, or undue means;
- where there was evident partiality or corruption in the arbitrators, or either of them;
- where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
- where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

✓ Arguments in the era of virtual hearings:

“During the last day of the Arbitration, March 12, 2020, the proceedings were held via Zoom videoconference due to concerns over the COVID-19 outbreak. Once again, the Panel was inattentive, with [one arbitrator] looking at other screens, typing, and eating during the course of the presentation. [Another arbitrator] even blocked her screen during the hearing, preventing the parties from confirming that she was even participating. And at one point during closing arguments for WSI and Mr. Wunderlich, Chairman [] walked away from his screen. The presentation resumed once Chairman [] returned to his screen.”



Conclusion

Since there is no appeal process and an award can be set aside in only limited circumstances, early preparation (which should begin prior to deterioration in client relationship) is key in FINRA. There are numerous considerations: from arbitrator selection to discovery to motion practice and, finally, the hearing that should be carefully planned in advance. If you have any questions now or later, please do not hesitate to reach out to us.



Thank You for Joining Us!

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