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Have the Changes to FINRA Arbitration Panels Helped the Customer?

09.01.2011

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Are brokerage customers getting a fair shake in mandatory arbitrations? For years state securities administrators and consumer groups have argued that customers could not be treated fairly under Financial Industry Regulatory Authority Rules because arbitrations had to be held in financial centers, public arbitrators were really just retired industry representatives, and most importantly, each panel had to have one industry panelist along with two other public arbitrators. The game has changed.

While courts or Congress has not yet rejected mandatory pre-dispute arbitration clauses which require customers to arbitrate with their brokers, the composition of arbitration panels has changed. No longer are customers required to have an industry member on the panel. Customers can choose to have an all-public panel. No longer are most public panel members jut retired stockbrokers and industry managers; now they look a lot more like the customers whose disputes they decide. Attorneys and accountants who derive a minimum level of compensation from brokerage firms are no longer permitted to serve as public arbitrators and are now classified as industry arbitrators. Parties are now given lists of potential arbitrators from which they can rank available arbitrators and challenge others. Finally, arbitrations are now held in the venue closest to the customer's residence rather than only in a big financial center.

Do all of these changes make any difference? Realistically, the difference is mostly in perception. While it is too soon to determine whether the all-public panel now favors customers, there is certainly a possibility that a perceived bias has been eliminated. The reality is that no one was really able to prove that the old system was biased toward the industry. There was just a perception that it was. While there have been studies which asked customers whether they felt they were treated fairly in the arbitration, there is no sense whether customers can truly judge fairness in the process. Arbitrators are still not required to reduce their decisions to writing beyond a simple articulation of who won or lost and how much one party receives or has to pay.

One of the possible problems with the all-public panel is that knowledgeable industry panelists, who are committed to weeding out bad brokers and who try to be fair will not get picked on a panel. On many panels that industry panelist guided the panel to an award for the customer that the other panel members might not have granted. That specialized knowledge is now gone from the process. Time will tell whether eliminating the industry panelist is a wise move. At least it cures the perception problem.

Local venues clearly make it more convenient, but they do not necessarily give the customer a better arbitration, just a closer one. Taking the arbitration out of New York or Boston and putting it in Hartford usually eliminates an overnight stay, but it does not necessarily give a better award. In locations where there is a smaller group of arbitrators, local practitioners do have one slight advantage in that they know the panelists and know which ones to cross off the list of potential panelists. Restricting a potential panelists' ties to the industry also probably un-stacks the deck. While one active industry panelist might help reach a just award, the retried industry member might just tilt the balance too much.

The real issues are whether mandatory pre-dispute arbitration clauses which have been blessed by the United States Supreme Court since 1987. A better question is whether these disputes might be better off in court than in an arbitration hearing. Today, many otherwise flimsy or even frivolous cases get a hearing. Those cases based on thin factual patterns and little proof will often be dismissed in the pre-trial stage of a court proceeding, but not in an arbitration. The costs in court are much higher as real discovery including depositions and real interrogatories multiply the proceedings and the time it takes to get to trial. Eliminating mandatory arbitration might not help the customer as much as consumer groups argue.

FINRA made a lot of changes to save their role in the arbitration process. It is a little too early in the change process to tell whether it really worked or whether the claims of bias were just a perception and not a reality. Right now, the game appears to be a lot less rigged. Ultimately, a fair arbitration panel will assess the facts and render an award. This process worked in many cases before. We'll see if it will be better now.

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