Special Report

Financial Industry Regulatory Authority Arbitration of Employment Disputes

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The Financial Industry Regulatory Authority, Inc. (FINRA) is an independent regulatory body, overseeing securities firms and their brokers and other registered personnel. Arbitration of employment disputes in the arbitration forum sponsored by the FINRA offers a number of industry-specific or unique considerations. Accordingly, employers should understand the risks and potential rewards of arbitrating in the FINRA arbitration forum and seek counsel from experienced FINRA practitioners.

FINRA

As a self-regulatory organization under the Securities Exchange Act of 1934 (Exchange Act), FINRA (formerly known as the National Association of Securities Dealers, Inc. or NASD) is the primary regulatory body for the broker-dealer industry.

FINRA is involved in almost every aspect of the securities industry in the United States. Among other things, FINRA registers (*i.e.*, licenses) industry participants, promulgates and enforces rules governing the ethical activities of its member broker-dealer firms and their employees who are also registered with FINRA, enforces the federal securities laws, conducts examinations of member firms and individuals for compliance with those rules, and educates the investing public. By recent count, FINRA oversees over 3,500 securities brokerage firms and over 624,000 registered individuals in the United States.

FINRA promulgates its own rules and regulations, subject to oversight by the Securities and Exchange Commission. The Exchange Act requires broker-dealers of securities to maintain membership with FINRA. As a condition of FINRA membership, broker-dealer members agree "to comply with ... the rules of [FINRA]." FINRA By-Laws, Art. IV, §1(a)(1).

Sources of Required FINRA Arbitration of Employment Disputes

In addition to regulating the activities of its member firms and registered individuals, FINRA operates the largest securities dispute resolution forum in the United States. FINRA Dispute Resolution, Inc. provides an arbitral forum and mediation services to handle employment disputes within the industry, as well as disputes between or among investors, brokerage firms, and individual brokers.

FINRA has a uniform set of rules for arbitration of disputes between or among member firms and their registered employees (termed as "registered representatives" or "associated persons" of a FINRA member). The FINRA Code of Arbitration Procedure for Industry Disputes (FINRA Rule 13000 *et seq.*) (Industry Code) governs the arbitration of some, but not all, disputes solely involving two or more member firms or their registered employees (*e.g.,* claims between securities brokerage firms or between FINRA-registered employees and their member firm employers). FINRA maintains a separate set of rules for arbitration of disputes between or among FINRA member firms or their registered employees and their customers, the FINRA Code of Arbitration Procedure for Customer Disputes, found at FINRA Rule 12000 *et seq.*

There are a number of potential sources of an agreement to arbitrate claims in the FINRA

Dispute Resolution arbitration forum, including:

1. *FINRA Rules.* With some exceptions, FINRA rules require disputes to be arbitrated under the Industry Code if the dispute arises out of the business activities of a member or an associated person and is between or among members, members and associated persons, or associated persons. *See* FINRA Rule 13200(a).
2. *Employment Contracts.* It is also commonplace for employers in the securities industry to include provisions in their employment contracts with registered (and sometimes non-registered) employees requiring or permitting arbitration of disputes between them in the FINRA arbitration forum.
3. *Form U-4 Arbitration Agreement.* Some employment disputes are obligated to be arbitrated under the Industry Code based on an industry Form U-4 (Uniform Application for Securities Industry Registration or Transfer). As a condition of employment in the securities industry, associated persons are required to sign a Form U-4 at the time they are initially registered with a member firm and each time they transfer their registration from one member firm to another. The Form U-4 requires the associated person to submit to arbitration any claim that is eligible for arbitration under the rules of the self-regulatory organization with which they are registered (*i.e.,* FINRA). Member firms must provide registered employees with an arbitration disclosure when they are asked to sign a Form U-4, specifically informing them that they are waiving their right to sue in court, including the right to a jury trial, for any covered claims. With some exceptions, Courts generally have found that the Form U-4 and the accompanying disclosure statement constitute an enforceable arbitration agreement.

Exceptions from FINRA Arbitration Obligation

Certain employment claims are expressly not arbitrable under Industry Code, including:

1. *Class Actions.* Class actions are expressly precluded from FINRA arbitration. FINRA Rule 13204(a).
2. *Collective Actions.* Collective actions under the Fair Labor Standards Act, the Age Discrimination in Employment Act, and the Equal Pay Act may not be subjected to FINRA arbitration. FINRA Rule 13204(b).
3. *Statutory Employment Discrimination Claims.* These claims are not arbitrable in FINRA unless the parties agree to arbitrate such claims *before or after* the dispute arose. FINRA Rule 13201(a).
4. *Certain Whistleblower Claims.* Claims under a whistleblower statute that prohibits the use of pre-dispute arbitration agreements (*e.g.*, a claim under Sarbanes-Oxley) may be arbitrated under the FINRA Code only if *all* parties agree to arbitrate the claim *after* the dispute arose; whereas claims under whistleblower statutes that do not prohibit arbitration (*e.g.*, Dodd-Frank claims) are arbitrable in FINRA. FINRA Rule 13201(b).
5. *Injunctive Relief.* In a dispute that is required to be arbitrated under the Industry Code, parties may seek temporary injunctive relief from a court of competent jurisdiction but, at the same time, must file a FINRA arbitration claim requesting permanent injunctive relief and all other relief with respect to the same dispute. FINRA Rule 13804(a).

Employment Claims Commonly Arbitrated Before FINRA

As reported by FINRA *(see* 2019 FINRA Dispute Resolution Statistics: Top 15 Controversy Types in Intra-Industry Arbitrations), the most common employment claims brought before FINRA include:

1. *Breach of Contract.* Contract matters arbitrated in the FINRA forum include claims for breach of restrictive covenants (non-solicitation of customer provisions and confidentiality or non-disclosure obligations), promissory notes (related to a common industry practice of employers providing transitional compensation to registered representatives recruited from competitors in the form of an up-front loan that is forgivable over a set number of years so long the representative remains employed with the firm), and breach of oral or written contracts following the break-up of a "team" or partnership.
2. *Compensation.* This includes compensation-related claims of any nature (*e.g.*, claims related to the payment of base compensation, bonuses, commissions, and deferred compensation).
3. *Defamation.* These claims run the gamut from common law libel, slander, or defamation claims, as well as defamation claims based on an industry rule obligating FINRA member firms to report to FINRA on a Form U-5 the reason for its termination of a registered employee (including when the firm permitted the employee to resign).
4. *Expungement.* Specific industry rules govern claims brought by a registered employee to have customer dispute information (reported on Form U-4) or termination-related information (reported on Form U-5) expunged from their industry records.
5. *Wrongful Termination.* This is a "catch all" category of generalized claims alleging "wrongful termination" of employment or some form of alleged unfairness or impropriety in the termination process.
6. *Statutory Employment Claims.* Included are claims for discrimination, harassment, or retaliation under federal or state statutes.
7. *Raiding.* Employee "raiding" or mass hiring disputes that might not be cognizable in court may have a better chance in an industry arbitration based on industry norms and practices and a body of arbitration law that has developed over time.
8. *Indemnification.* Indemnification claims are sometimes filed by a firm against a former employee based on the firm having paid to resolve a claim by a customer resulting from the former employee's conduct. Conversely, registered employees who have been sued by their former customers may seek contribution or indemnification from their former employers based on the common law or state statutes requiring defense and indemnification under certain circumstances.

Distinctive Features of FINRA Arbitration Forum

Employers who are required to or are considering whether to arbitrate in the FINRA arbitration forum should consider the following features of a FINRA arbitration proceeding, each of which may be a "pro" or "con" depending on the facts and circumstances of a particular matter:

1. *Private Arbitration Forum.* As FINRA is a private arbitration forum, pleadings, discovery information, and the like are not available to the general public or the news media (although the information will be available to the regulatory or enforcement department within FINRA).
2. *Regulatory Scrutiny.* Use of the FINRA forum avoids a potential dispute with the regulatory or enforcement arm of FINRA as to whether a member firm employer violated FINRA rules requiring industry arbitration by an agreement to resolve a dispute in another forum. Although rare, there is a potential for a panel that strongly believes industry rules were willfully violated to refer the perceived violator for review by FINRA's enforcement division.

3. *Arbitrator Selection.* FINRA utilizes a process whereby the parties are allowed to strike and rank according to their preference potential arbitrators from a pool of FINRA-approved, experienced arbitrators. Typically, a three-person panel of FINRA arbitrators will include lawyers or persons familiar with the financial services industry, which will be more akin to a "jury of peers" than were the case tried in court.
4. *Time to Resolution.* A typical FINRA arbitration case that is not settled (other than small claims done through a simplified process) will take about 12-to-14 months from case filing until an award is issued.
5. *Lower Administrative Costs.* FINRA is a relatively low-cost arbitration forum as compared to, for example, the American Arbitration Association (AAA). An employer's "all-in" costs for FINRA's administrative fees and arbitrator compensation typically would be in the $10,000 to $20,000 range; whereas administrative costs and arbitrator compensation in AAA may be in the mid-to-high five figures or into the six figures.
6. *Limited Discovery.* Absent extenuating circumstances, there are no depositions in a FINRA arbitration. Discovery is limited to document production and responses to information requests (which are greatly circumscribed as compared to court-style contention interrogatories). Expert witnesses are not required to prepare a written report and, other than witnesses opining as to economic damages, most do not. Third-party discovery is more limited and more difficult to obtain if not from FINRA members or associated persons. Given this, a FINRA arbitration hearing often is described as a "trial by fire" and counsel must be nimble and able to alter strategies mid-hearing if necessary.
7. *Limited Pre-Hearing Dismissals.* FINRA provides only limited bases for a motion to dismiss and has no rules allowing for summary judgment motions. Thus, unless settled, these claims typically go to a hearing (FINRA says 10%-15% of the claims result in a hearing and award). Respondents may make a motion to dismiss following the claimant's case-in-chief.
8. *Rules of Evidence.* There are no evidentiary rules expressly applicable in a FINRA arbitration. Rulings on admissibility of evidence typically are left to the panel chair. Most experienced chairs allow reasonably relevant evidence but would indicate the panel will give the evidence whatever weight it believes the evidence deserves.
9. *Arbitration Award.* With limited exceptions, FINRA awards are not reasoned or explained decisions unless all parties agree, which makes the awards less precedential. Because the panel need not explain its decision, there is a potential, rightly or wrongly, for the case to be decided based on the panel's view of what a fair resolution should be, as opposed to strict adherence to the letter of the law. In cases where a panel grants an employee claimant's request to have information expunged from a FINRA U-4 or U-5 filing, by rule, the panel will need to explain the bases for granting such relief. The award, however, will be publicly available in a database accessible on FINRA's website.
10. *Limited Appeal Rights.* Although the law varies from jurisdiction to jurisdiction, there are limited bases on which to overturn or vacate a FINRA award particularly when awards typically are not reasoned or explained, which then would require a reviewing court to speculate as to the grounds for the panel's decision.

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Given the complexities involved, financial services employers obligated to arbitrate or considering arbitration in the FINRA arbitration forum should seek advice and representation from counsel experienced in the arbitration of such claims. Please contact a Jackson Lewis

attorney to discuss these issues and your specific organizational needs.

Focused on employment and labor law since 1958, Jackson Lewis P.C.'s 1,000+ attorneys located in major cities nationwide consistently identify and respond to new ways workplace law intersects business. We help employers develop proactive strategies, strong policies and business-oriented solutions to cultivate high-functioning workforces that are engaged and stable, and share our clients' goals to emphasize belonging and respect for the contributions of every employee. For more information, visit https://www.jacksonlewis.com.