Financial Industry Regulatory Authority (FINRA) Arbitration Scheme for Industry

Introduction

1. This note looks at the US Financial Industry Regulatory Authority's Arbitration Scheme for Industry (**the FINRA Scheme**). The idea is that this may act as a useful case study, to see if the FINRA Scheme highlights useful points to bear in mind when exploring the scope for the greater use of arbitration for employment disputes in the UK (including drafting standard arbitration rules for employment claims).

2. FINRA considers that it has an interest in guarding and overseeing its own marketplace. It operates in a specialised arena, and its members owe particular duties to it as the regulatory authority. Points which arise may not be directly transferable to the majority of employment claims in the UK, but may nevertheless be of interest.

3. FINRA is the largest non-governmental regulator of broker-dealer firms doing business in the US and administers nearly all securities-related arbitrations in the US. FINRA has a uniform set of rules for arbitrating disputes between FINRA members and their customers. It also has rules that require arbitration of employment disputes between member firms and their employees http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4193

4. Save where otherwise specified, the statistics quoted in this note are taken from Lipsky, D. B., Seeber, R. L., & Lamare, J. R. (2010). The arbitration of employment disputes in the securities industry: A study of FINRA awards, 1986-2008. Dispute Resolution Journal, 65(1), 54-61. http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1785&context=articles This article reports on the results of the authors' 2010 study of 3,200 arbitration awards issued in employment cases administered under the auspices of FINRA, its predecessor the National Association of Securities Dealers (NASD), and the New York Stock Exchange (NYSE). The statistics and findings must be treated with a lot of caution, in particular as they are old and may be unreliable. However, the collation and analysis of these statistics is helpful to provide some substance and context to the points made. Some updated statistics on the FINRA scheme are available online http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics

Code of Arbitration Procedure

5. Attached is a copy of PLC's Code of Arbitration Procedure Flowchart for Industry Disputes under the FINRA Scheme, which summarises the process. Additional points to note (which may be of relevance in considering development of arbitration for employment claims in the UK context) include:

   i) Excluded claims

   Certain industry claims are not arbitrable under FINRA rules (class actions, collective actions under the Fair Labor Standards Act, the Age Discrimination in Employment Act, or the Equal Pay Act of 1963, Shareholder derivative actions.)

   ii) Special rules apply to statutory employment discrimination claims

   Where a dispute involves a claim of statutory employment discrimination, the parties may arbitrate it only if they all agree, either before or after the dispute arose.

   A party may assert in a FINRA Industry arbitration a claim for employment discrimination in violation of a statute. These claims are governed by the same rules as a regular industry arbitration, except that:

   - The threshold claim amount for the case to be heard by a three-person panel is $100,000 (see below);
   - The arbitrator who serves as a single arbitrator or chairperson of a panel must possess special qualifications (see below);
   - The FINRA rules provide for coordinating the arbitration claims with related claims asserted in court.

   iii) Whistleblowing Claims

   Where a dispute involves a claim under a whistleblower statute that prohibits pre-dispute arbitration agreements, the parties may arbitrate it only if all parties agree after the dispute arose.

   iv) Coordination with Court claims (special rules apply)

   v) Desired Number of Arbitrators

   The number of arbitrators who presides over a case depends on the nature of the dispute and the amount in controversy. Although the Industry Code generally

dictates the number of arbitrators, the parties in some cases may agree on one or three arbitrators, so the claimant should carefully consider how many arbitrators he/she wants.

For statutory employment discrimination cases:

- A case with claims up to $100,000 is heard by a single arbitrator;
- A case with claims of more than $100,000 is heard by three arbitrators.

For all other cases:

- A case with claims of up to $50,000 is heard by a single arbitrator as a simplified arbitration;
- A case with claims greater than $50,000, up to $100,000, is heard by a single arbitrator unless the parties agree to three arbitrators;
- A case with claims greater than $100,000, or unspecified or non-monetary claims, is heard by three arbitrators.

vi) Panel for Statutory Employment Discrimination Claims

A claim of statutory employment discrimination is heard by either:

- A single Public arbitrator;
- A panel of three Public arbitrators;

In addition, an arbitrator in a statutory employment discrimination case who serves as a single arbitrator or as the chairperson of the panel must not have represented primarily the views of employers or employees for the past five years, and must have the following additional qualifications, unless the parties agree to waive such qualifications:

- A law degree;
- Membership in the bar of any jurisdiction;
- Substantial familiarity with employment law.
- Ten or more years of legal experience, of which at least five years were: in a law practice; teaching; government enforcement of equal

employment statutes; or experience as an equal employment officer or in-house counsel.

vii) Costs and Fees

The claimant pays various costs and fees over the course of the case. These costs and fees include:

- An initial filing fee, the amount of which depends on the amount of the claims and the identity of the claimant (Member or Associated Person);
- Hearing session fees, which are based on the amount in dispute, the number of arbitrators and the number of sessions (each session is four hours). The panel may require the parties to deposit the full amount of the hearing session fees before the hearing, or may assess the hearing session fees as part of the award;
- Costs for recording preliminary conferences and hearings. Costs for the appearance or production of documents by a non-party;
- Fees of the arbitrators for postponements;
- Fees of the arbitrators for deciding a contested subpoena;
- Where a party's motion to dismiss a claim is denied, an assessment of the hearing fees charged on that motion;
- Where the arbitrators deem a party's motion to dismiss to be frivolous, an assessment of the reasonable costs and attorneys' fees to the opposing party.

The Respondent bears similar costs.

viii) FINRA's online claim filing system

ix) FINRA Case Administration

FINRA has case administrators, information specialists and support staff (each with specified roles) to assist the parties with administrative matters in a FINRA arbitration.

x) Training and standardised testing required for all FINRA arbitrators

xi) Option to agree to FINRA mediation

xii) Awards publicly available online on FINRA site with full identification of the parties to the arbitration.

xiii) FINRA arbitrators sometimes claim power to award punitive damages

6. **Criticisms of the Scheme**

As to be expected in the case of mandatory arbitration, particularly in the employment sphere, there are several criticisms made of and concerns raised in respect of the FINRA Scheme. These include:

I. Fairness/bias

- the debate over pre-dispute mandatory arbitration agreements for employment cases and their enforceability;
- "Repeat player effect" – concern that employers experienced in arbitration enjoy an advantage over inexperienced employees:
    - researcher Lisa Bingham uncovered the repeat player effect in several empirical studies of employment arbitration. For example, in a study of 244 employment arbitration cases, Bingham found an employee win rate of 29% when the case involved a repeat employer and a win rate of 62% when there was no repeat employer;
    - while there are higher win rates of the repeat players with the most experience in FINRA arbitration, there may not be a causal relationship between that experience and the size of the firms' awards.[1]
- Concern that the FINRA scheme does not protect employee civil rights;

[1] Lipsky, D. B., Seeber, R. L., & Lamare, J. R. (2010). The arbitration of employment disputes in the securities industry: A study of FINRA awards, 1986-2008. Dispute Resolution Journal, 65(1), 54-61.

- See below, under Effectiveness, the Size of the Monetary Awards.

7. Type of claim

I. Out of 3,200 FINRA cases analysed:

- in 28%, employees claimed the employer denied them compensation allegedly owed;
- in 27.4%, employees claimed the employer had defamed them in some fashion (e.g., by alleging they had "churned" a customer's account);
- in 13.5%, employees claimed they were wrongfully terminated; and
- in 8.4%, employees claimed their employer breached the contract.

Cases involving a claim of statutory discrimination constituted 17.1% of the total.

8. Effectiveness

I. How Arbitration Cases Close (both customer and industry/employment claims)[2]

Cases Decided by Arbitrators	2017 (% of Cases)	2016	2015	2014	2013
After Hearing	47 (14%)	593 (16%)	646 (19%)	683 (18%)	792 (18%)
After Review of Documents	20 (6%)	157 (4%)	182 (5%)	208 (5%)	236 (5%)
Total	67 (20%)	750	828	891	1,028

[2] http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics

		(21%)	(24%)	(23%)	(23%)
Cases Resolved by Other Means	**2017 (% of Cases)**	**2016**	**2015**	**2014**	**2013**
Direct Settlement by Parties	169 (49%)	1,812 (50%)	1,716 (50%)	1,942 (51%)	2,336 (52%)
Settled via Mediation	47 (14%)	433 (12%)	306 (9%)	329 (9%)	315 (7%)
Withdrawn	18 (5%)	341 (9%)	317 (9%)	358 (9%)	482 (11%)
All Others	41 (12%)	275 (8%)	294 (8%)	290 (8%)	297 (7%)
Total	275 (80%)	2,861 (79%)	2,633 (76%)	2,919 (77%)	3,430 (77%)

II. The Size of the Monetary Awards:

- In 61% of the cases, the arbitrator found sufficient merit in the employee's claim to award the employee an amount of money greater than zero.
- The average (or mean) award across all cases is about $146,000 [$467 million divided by 3,200]. However, the average award is elevated because of a handful of very large awards.

- The median amount claimed was $375,000, while the median amount awarded was only $1,000.[3]

III. Employee Win Rates

- Definition of "win"?
- If "win" defined to mean that the arbitrator awarded some amount of money to the claimant, regardless of how little the award or the relationship of the award to the amount claimed. Then the employee win rate in the FINRA cases studied is 61%, while the employer win rate is 39%.
- If "win" is defined to mean any case in which the award is greater than 50% of the amount claimed, the employee win rate drops to about 20% and the employer win rate jumps to 80%.[4]

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[3] Lipsky, D. B., Seeber, R. L., & Lamare, J. R. (2010). The arbitration of employment disputes in the securities industry: A study of FINRA awards, 1986-2008. Dispute Resolution Journal, 65(1), 54-61.

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