

## Arbitration Panel Composition

### SEC Approves Amendments to Customer Arbitration Code to Simplify Panel Selection in Cases With Three Arbitrators

Effective Date: September 30, 2013

#### Executive Summary

The SEC approved amendments to FINRA Rule 12403 of the Code of Arbitration Procedure for Customer Disputes (Customer Code) to simplify the arbitration panel selection process in cases with three arbitrators.<sup>1</sup> Under the amended rule, parties in all customer cases use the same panel composition method. Under this method, FINRA will provide the parties with lists of 10 chair-qualified public arbitrators, 10 public arbitrators and 10 non-public arbitrators. The parties may strike four arbitrators on the chair-qualified public list and four arbitrators on the public list. Any party may select an all-public arbitration panel by striking all of the arbitrators on the non-public list. If a party wants a non-public arbitrator on the panel, the party can limit its strikes on the non-public list. Limiting strikes does not guarantee that FINRA will appoint a non-public arbitrator to the panel in every instance as explained below.

The amendments are effective on September 30, 2013, for all customer cases filed on or after the effective date. The amendments are also effective for pending cases in which the 35-day time period for electing a panel composition method has not expired as follows: If a customer does not elect a panel composition method within the 35-day time period, panel composition will proceed under the amended rule, not under the default provision in the current rule.

The text of the amendments is set forth in Attachment A.

#### September 2013

##### Notice Type

- ▶ Rule Amendment

##### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Registered Representatives

##### Key Topics

- ▶ Arbitration
- ▶ Customer Code of Arbitration Procedure
- ▶ Panel Composition

##### Referenced Rules & Notices

- ▶ Regulatory Notice 11-05
- ▶ FINRA Rule 12401
- ▶ FINRA Rule 12403

Questions concerning this *Notice* should be directed to:

- ▶ Richard W. Berry, Senior Vice President and Director of Case Administration, Operations and Regional Office Services, Dispute Resolution, at (212) 858-4307 or [richard.berry@finra.org](mailto:richard.berry@finra.org); or
- ▶ Margo A. Hassan, Assistant Chief Counsel, Dispute Resolution, at (212) 858-4481 or [margo.hassan@finra.org](mailto:margo.hassan@finra.org).

## Background & Discussion

Parties in arbitration participate in selecting the arbitrators who serve on their cases. Since February 1, 2011, FINRA has provided customers in cases with three arbitrators<sup>2</sup> with a choice between two panel-composition methods.<sup>3</sup> The first method—the Majority-Public Panel Option—provides for a mixed panel of one chair-qualified public arbitrator, one public arbitrator and one non-public arbitrator. The Majority-Public Panel Option is the panel-selection method FINRA used in the forum prior to February 1, 2011. The second method—the All-Public Panel Option—was added February 1, 2011, and permits any party to select an arbitration panel consisting of three public arbitrators. FINRA Rule 12403 provides that a customer (not a firm or associated person) may choose a panel-composition method in the statement of claim (or accompanying documentation) or at any time up to 35 days from service of the statement of claim. In the absence of an affirmative choice by the customer for the All-Public Panel Option, the Majority-Public Panel Option is the default composition method.

FINRA staff reviewed the panel-composition elections customers made after implementation of the All-Public Panel Option. In the two years since implementation, customers in approximately three-quarters of eligible cases chose the All-Public Panel Option. Customers using the Majority-Public Panel Option did so by default 77 percent of the time, rather than by making an affirmative choice (*i.e.*, these customers did not make an election in their statement of claim or accompanying documentation, and did not respond to a request that they elect a panel-composition method). After reviewing these data, FINRA became concerned that customers without attorneys, and attorneys new to the practice of securities arbitration, might be using the Majority-Public Panel Option because they were not familiar with the Customer Code or because they did not appreciate the significance of making an election. FINRA also reviewed the awards issued by mixed panels and all-public panels. The awards issued during the first two years since implementation show that customers were awarded damages significantly more often when an all-public panel decided their case.

As a result of reviewing the election and award data, FINRA amended Rule 12403 to simplify the panel-selection process. Under the amended rule, FINRA no longer requires a customer to elect a panel-composition method. Parties in all customer cases with three arbitrators will get the same composition method. FINRA will provide the parties with lists of 10 chair-qualified public arbitrators, 10 public arbitrators and 10 non-public arbitrators. FINRA will permit each party to strike up to four arbitrators on the chair-qualified public list, up to four arbitrators on the public list, and any or all of the arbitrators on the non-public list. Any party may select an all-public arbitration panel by striking all of the arbitrators on the non-public list. If the parties collectively strike all of the non-public arbitrators on the list, or if no selected non-public arbitrators are available to serve, FINRA will not appoint a non-public arbitrator to the panel. If a party wants a non-public arbitrator on the panel, the party can limit its strikes on the non-public list, leaving any or all of the 10 non-public arbitrators on the list. However, leaving non-public arbitrators on the list does not guarantee that FINRA will appoint one to the panel. The parties may strike different non-public arbitrators from the list, and collectively they may strike all of the non-public arbitrators on the list. In addition, the selected non-public arbitrators may not be available to serve. Under these circumstances, FINRA will appoint an all-public panel unless the parties agree to request a supplemental list of non-public arbitrators.

FINRA believes that forum users will benefit by having one panel-composition method for a number of reasons. First, having one panel-composition method simplifies the arbitrator-selection process for all parties and for FINRA staff, while leaving in place the method affirmatively chosen by customers in approximately three-quarters of customer cases. Second, it ensures that every party has an opportunity to see the list of non-public arbitrators and rank or strike any or all of the arbitrators on the list. Third, the proposal ensures that customers will not miss the opportunity to select an all-public panel if that would have been their preference.

## Cross References

To implement the rule amendments, FINRA corrected several cross references.

## Effective Date

The amendments are effective on September 30, 2013, for all customer cases filed on or after the effective date. The amendments are also effective for pending cases in which the 35-day time period for electing a panel-composition method has not expired as follows: If a customer does not elect a panel-composition method within the 35-day time period, panel composition will proceed under the amended rule, not under the default provision in the current rule.

## Endnotes

1. See Securities Exchange Act Rel. No. 70442 (September 18, 2013) (File No. SR-FINRA-2013-023).
2. FINRA Rule 12401 provides that if the amount of a claim is more than \$100,000, exclusive of interest and expenses, or is unspecified, or if the claim does not request money damages, the panel will consist of three arbitrators, unless the parties agree in writing to one arbitrator.
3. See [Regulatory Notice 11-05](#) (February 2011).

## Attachment A

New language is underlined; Deletions are in brackets.

### Rule 12403. Cases with Three Arbitrators

#### **[(a)] Composition of Panels**

[The customer may elect to proceed with panel composition under either of the following options:

(1) Composition Rules for Majority Public Panel

Rule 12403(c) provides for limited strikes on each of the three lists. In each majority public panel case, the panel will consist of two public arbitrators and one non-public arbitrator.

(2) Composition Rules for Optional All Public Panel

Rule 12403(d) provides for limited strikes on the public and public chairperson lists and unlimited strikes on the non-public list. In optional all public panel cases, the panel may consist of three public arbitrators or two public arbitrators and one non-public arbitrator. Under this option, either party can ensure that the panel will have three public arbitrators by striking all of the arbitrators on the non-public list.

#### **(b) Customer Election**

(1) The customer may elect in writing to proceed under either the composition rules for majority public panel or the composition rules for optional all public panel in the customer's Statement of Claim, if the customer is a claimant, or at any time up to 35 days from service of the Statement of Claim.

(2) When FINRA serves the Statement of Claim, FINRA will notify the customer in writing that the customer may elect the composition rules for the optional all public panel within 35 days from service of the Statement of Claim.

(3) If the customer declines to make an affirmative election in writing by the 35-day deadline, the composition rules for majority public panel will apply.

**(c) Composition Rules for Majority Public Panel****(1) Generating Lists**

(A) The Neutral List Selection System will generate:

- A list of 10 arbitrators from the FINRA non-public arbitrator roster;
- A list of 10 arbitrators from the FINRA public arbitrator roster; and
- A list of 10 public arbitrators from the FINRA chairperson roster.

(B) The Neutral List Selection System will generate the chairperson list first. Chair-qualified arbitrators who were not selected for the chairperson list will be eligible for selection on the public list. An individual arbitrator cannot appear on both the chairperson list and the public list for the same case.

(C) The Neutral List Selection System will exclude arbitrators from the lists based upon current conflicts of interest identified within the Neutral List Selection System.

**(2) Sending Lists to Parties**

(A) The Director will send the lists generated by the Neutral List Selection System to all parties at the same time, within approximately 30 days after the last answer is due. The parties will also receive employment history for the past 10 years and other background information for each arbitrator listed.

(B) If a party requests additional information about an arbitrator, the Director will request the additional information from the arbitrator, and will send any response to all of the parties at the same time. When a party requests additional information, the Director may, but is not required to, toll the time for parties to return the ranked lists under Rule 12403(c)(3)(C).

**(3) Striking and Ranking Arbitrators**

(A) Each separately represented party may strike up to four of the arbitrators from each list for any reason by crossing through the names of the arbitrators. At least six names must remain on each list.

(B) Each separately represented party shall rank all remaining arbitrators on the lists in order of preference, with a "1" indicating the party's first choice, a "2" indicating the party's second choice, and so on. Each list of arbitrators must be ranked separately.

(C) The ranked lists must be returned to the Director no more than 20 days after the date upon which the Director sent the lists to the parties. If the Director does not receive a party's ranked lists within that time, the Director will proceed as though the party did not want to strike any arbitrator or have any preferences among the listed arbitrators.

(D) Parties are not required to send a copy of their ranking list to the opposing parties.

#### (4) Combining Lists

For each arbitrator classification (public, non-public, and chairperson), the Director will prepare combined ranked lists of arbitrators based on the parties' numerical rankings, as follows:

- The Director will add the rankings of all claimants together, and the rankings of all respondents together, to produce separate combined ranked lists for the claimants and the respondents.
- The Director will then add the combined rankings of claimants and the respondents together, to produce a single combined ranking number for each arbitrator, excluding all arbitrators stricken by a party.
- The Director will create separate combined ranked lists for each arbitrator classification.

#### (5) Appointment of Arbitrators; Discretion to Appoint Arbitrators Not on List

(A) The Director will appoint:

- The highest-ranked available non-public arbitrator from the combined non-public arbitrator list;
- The highest-ranked available public arbitrator from the combined public arbitrator list, and
- The highest-ranked available public arbitrator from the combined chairperson list, who will serve as chairperson of the panel.

(B) If the number of arbitrators available to serve from the combined lists is not sufficient to fill an initial panel, the Director will appoint one or more arbitrators of the required classification to complete the panel from names generated randomly by the Neutral List Selection System. If the Director must appoint a non-public arbitrator, the Director may not appoint a non-public arbitrator as defined in Rule 12100(p)(2) or (3), unless the parties agree otherwise. The Director will provide the parties information about the arbitrators as provided in Rule 12403(c)(2) and the parties will have the right to challenge the arbitrators as provided in Rule 12407.

(C) Appointment of arbitrators occurs when the Director sends notice to the parties of the names of the arbitrators on the panel. Before making any decision as an arbitrator or attending a hearing session, the arbitrators must execute FINRA's arbitrator oath or affirmation.

(6) Replacement of Arbitrators

(A) If an arbitrator is removed, or becomes otherwise unable or unwilling to serve, the Director will appoint a replacement arbitrator in accordance with this rule, unless the parties agree in writing to proceed with only the remaining arbitrators.

(B) The Director will appoint as a replacement arbitrator the arbitrator who is the most highly ranked available arbitrator of the required classification remaining on the combined list.

(C) If there are no available arbitrators of the required classification on the consolidated list, the Director will appoint an arbitrator of the required classification to complete the panel from names generated by the Neutral List Selection System. The Director will provide the parties information about the arbitrator as provided in Rule 12403(c)(2) and the parties shall have the right to object to the arbitrator as provided in Rule 12407.

(D) If the Director must appoint a non-public arbitrator under Rule 12403(c)(6)(C), the Director may not appoint a non-public arbitrator as defined in Rule 12100(p)(2) or (3), unless the parties agree otherwise.

**(d) Composition Rules for Optional All Public Panel]**



**[(1)] (a) Generating Lists**

[(A)] (1) The Neutral List Selection System will generate:

- [•] (A) A list of 10 arbitrators from the FINRA non-public arbitrator roster;
- [•] (B) A list of 10 arbitrators from the FINRA public arbitrator roster; and
- [•] (C) A list of 10 public arbitrators from the FINRA chairperson roster.

[(B)] (2) The Neutral List Selection System will generate the chairperson list first. Chair-qualified arbitrators who were not selected for the chairperson list will be eligible for selection on the public list. An individual arbitrator cannot appear on both the chairperson list and the public list for the same case.

[(C)] (3) The Neutral List Selection System will exclude arbitrators from the lists based upon current conflicts of interest identified within the Neutral List Selection System.

**[(2)] (b) Sending Lists to Parties**

[(A)] (1) The Director will send the lists generated by the Neutral List Selection System to all parties at the same time, within approximately 30 days after the last answer is due. The parties will also receive employment history for the past 10 years and other background information for each arbitrator listed.

[(B)] (2) If a party requests additional information about an arbitrator, the Director will request the additional information from the arbitrator, and will send any response to all of the parties at the same time. When a party requests additional information, the Director may, but is not required to, toll the time for parties to return the ranked lists under Rule [12403(d)(3)(C)] 12403(c)(3).

**[(3)] (c) Striking and Ranking Arbitrators**

[(A)] (1) Non-Public Arbitrator List

[i.] (A) Each separately represented party may strike any or all of the arbitrators from the non-public arbitrator list by crossing through the names of the arbitrators.

[ii.] (B) If any names remain on the non-public arbitrator list, each separately represented party shall rank all remaining arbitrators in order of preference, with a "1" indicating the party's first choice, a "2" indicating the party's second choice, and so on.

[(B)] (2) Chairperson and Public Lists

[i.] (A) Each separately represented party may strike up to four of the arbitrators from the chairperson list and up to four of the arbitrators from the public arbitrator list[s] for any reason by crossing through the names of the arbitrators. At least six names must remain on each list.

[ii.] (B) Each separately represented party shall rank all remaining arbitrators on the lists in order of preference, with a “1” indicating the party’s first choice, a “2” indicating the party’s second choice, and so on. Each list of arbitrators must be ranked separately.

[(C)] (3) The ranked lists must be returned to the Director no more than 20 days after the date upon which the Director sent the lists to the parties. If the Director does not receive a party’s ranked lists within that time, the Director will proceed as though the party did not want to strike any arbitrator or have any preferences among the listed arbitrators. A party’s failure to comply with the 20-day timeframe may result in the appointment of a panel consisting of two public arbitrators and one non-public arbitrator.

[(D)] (4) Parties are not required to send a copy of their ranking list to the opposing parties.

[(4)] (d) **Combining Lists**

For each arbitrator classification (public, non-public, and chairperson), the Director will prepare combined ranked lists of arbitrators based on the parties’ numerical rankings, as follows:

[•] (1) The Director will add the rankings of all claimants together, and the rankings of all respondents together, to produce separate combined ranked lists for the claimants and the respondents.

[•] (2) The Director will then add the combined rankings of claimants and the respondents together, to produce a single combined ranking number for each arbitrator, excluding all arbitrators stricken by a party.

[•] (3) The Director will create separate combined ranked lists for each arbitrator classification in cases with both public and non-public arbitrators.

**[(5)] (e) Appointment of Arbitrators; Discretion to Appoint Arbitrators Not on the List**

[(A)] (1) The Director will appoint:

[•] (A) The highest-ranked available non-public arbitrator from the combined non-public arbitrator list;

[•] (B) The highest-ranked available public arbitrator from the combined public arbitrator list, and

[•] (C) The highest-ranked available public arbitrator from the combined chairperson list, who will serve as chairperson of the panel.

[(B)] (2) If the number of arbitrators available to serve from the combined public or chairperson lists is not sufficient to fill an initial panel, the Director will appoint one or more arbitrators of the required classification to complete the panel from names generated randomly by the Neutral List Selection System. The Director will provide the parties information about the arbitrators as provided in Rule [12403(d)(2)] 12403(b) and the parties will have the right to challenge the arbitrators as provided in Rule 12407.

[(C)] (3) In cases in which the parties collectively strike all of the arbitrators appearing on the non-public list or when all remaining arbitrators on the non-public list are unable or unwilling to serve for any reason:

[i.] (A) The Director will return to the public list and select the next highest ranked available arbitrator (after the public arbitrator position has been filled) to complete the three member panel.

[ii.] (B) In the event no ranked arbitrators remain on the public list or when all remaining arbitrators on the public list are unable or unwilling to serve for any reason, FINRA will select the next highest ranked arbitrator appearing on the chair-qualified list (after the chair position has been filled) to complete the three member panel.

[iii.] (C) If the number of arbitrators available to serve from the chair-qualified list and public list is not sufficient to fill an initial panel, the Director will appoint a public arbitrator to complete the panel from names generated randomly by the Neutral List Selection System. The Director will provide the parties information about the arbitrator as provided in Rule [12403(d)(2)] 12403(b) and the parties will have the right to challenge the arbitrator as provided in Rule 12407.

[(D)] (4) Appointment of arbitrators occurs when the Director sends notice to the parties of the names of the arbitrators on the panel. Before making any decision as an arbitrator or attending a hearing session, the arbitrators must execute FINRA's arbitrator oath or affirmation.

**[(6)] (f) Replacement of Public Arbitrators**

[(A)] (1) If a public arbitrator is removed, or becomes otherwise unable or unwilling to serve, the Director will appoint a replacement arbitrator in accordance with this rule, unless the parties agree in writing to proceed with only the remaining arbitrators.

[(B)] (2) The Director will appoint as a replacement arbitrator the public arbitrator who is the most highly ranked available public arbitrator remaining on the combined public list.

[(C)] (3) If the next highest ranked available public arbitrator from the combined list is unable or unwilling to serve for any reason, the Director will return to the initial public list and appoint the next highest ranked available arbitrator to complete the three member panel.

[(D)] (4) If all remaining arbitrators on the public list are unable or unwilling to serve for any reason, the Director will appoint a public arbitrator to complete the panel from names generated randomly by the Neutral List Selection System.

[(E)] (5) The Director will provide the parties information about the arbitrator as provided in Rule [12403(d)(2)] 12403(b) and the parties shall have the right to object to the arbitrator as provided in Rule 12407.

**[(7)] (g) Replacement of a Chairperson**

[(A)] (1) If a chairperson is removed, or becomes otherwise unable or unwilling to serve, the Director will appoint a replacement arbitrator in accordance with this rule, unless the parties agree in writing to proceed with only the remaining arbitrators.

[(B)] (2) The Director will appoint as a replacement arbitrator the chair-qualified arbitrator who is the most highly ranked available arbitrator remaining on the combined chair-qualified list.

[(C)] (3) If the next highest ranked available chair-qualified arbitrator from the combined list is unable or unwilling to serve for any reason, the Director will return to the initial chair-qualified list and appoint the next highest ranked available arbitrator to complete the three member panel.

[(D)] (4) If all remaining arbitrators on the chair-qualified list are unable or unwilling to serve for any reason, the Director will appoint a chair-qualified public arbitrator to complete the panel from names generated randomly by the Neutral List Selection System.

[(E)] (5) The Director will provide the parties information about the arbitrator as provided in Rule [12403(d)(2)] 12403(b) and the parties shall have the right to object to the arbitrator as provided in Rule 12407.

**[(8)] (h) Replacement of Non-Public Arbitrators**

[(A)] (1) If a non-public arbitrator is removed, or becomes otherwise unable or unwilling to serve, the Director will appoint a replacement arbitrator in accordance with this rule, unless the parties agree in writing to proceed with only the remaining arbitrators.

[(B)] (2) In cases in which the parties collectively do not strike all of the non-public arbitrators from the initial list, the Director will appoint as a replacement arbitrator the non-public arbitrator who is the most highly ranked available non-public arbitrator remaining on the combined non-public list.

[(C)] (3) If the next highest ranked available non-public arbitrator is unable or unwilling to serve for any reason, the Director will return to the initial non-public list and appoint the next highest ranked available arbitrator to complete the three member panel.

[(D)] (4) In the event no ranked arbitrators remain on the non-public list or when all remaining arbitrators on the non-public list are unable or unwilling to serve for any reason, the Director will return to the public list and select the next highest ranked available arbitrator to complete the three member panel.

[i.] (A) In the event no ranked arbitrators remain on the public list or when all remaining arbitrators on the public list are unable or unwilling to serve for any reason, FINRA will select the next highest ranked arbitrator appearing on the chair-qualified list to complete the three member panel.

[ii.] (B) In the event no ranked arbitrators remain on the chair-qualified list or when all remaining arbitrators on the chair-qualified list are unable or unwilling to serve for any reason, the Director will appoint a public arbitrator to complete the panel from names generated randomly by the Neutral List Selection System.

[(E)] (5) The Director will provide the parties information about the arbitrator as provided in Rule [12403(d)(2)] 12403(b) and the parties shall have the right to object to the arbitrator as provided in Rule 12407.

\*\*\*\*\*

## 12213. Hearing Locations

### (a) U.S. Hearing Location

(1) No change.

(2) Before arbitrator lists are sent to the parties under Rule 12402(c)[, Rule 12403(c) or Rule 12403(d)] or Rule 12403(b), the parties may agree in writing to a hearing location other than the one selected by the Director.

(3) - (4) No change.

### (b) Foreign Hearing Location – No change.

\*\*\*\*\*

## 12309. Amending Pleadings

(a) – (b) No change.

(c) Amendments to Add Parties

Once the ranked arbitrator lists are due to the Director under Rule 12402(d)[,] or Rule 12403(c) [or Rule 12403(d)], no party may amend a pleading to add a new party to the arbitration until a panel has been appointed and the panel grants a motion to add the party. Motions to add a party after panel appointment must be served on all parties, including the party to be added, and the party to be added may respond to the motion in accordance with Rule 12503 without waiving any rights or objections under the Code.

(d) No change.

\*\*\*\*\*

## 12314. Combining Claims

Before ranked arbitrator lists are due to the Director under Rule 12402(d)[,] or Rule 12403(c) [or Rule 12403(d)], the Director may combine separate but related claims into one arbitration. Once a panel has been appointed, the panel may reconsider the Director's decision upon motion of a party.

\*\*\*\*\*

## 12404. Additional Parties

(a) If a party is added to an arbitration after the Director sends the lists generated by the Neutral List Selection System to the parties, but before parties must return the ranked lists to the Director, the Director will send the lists to the newly added party, with employment history for the past 10 years and other background information for each arbitrator listed. The newly added party may rank and strike the arbitrators in accordance with Rules 12402(d)[,] or 12403(c)[(3), or 12403(d)(3)]. If the newly added party returns the lists within 20 days after the date upon which the Director sent the lists to the party, the Director will include the new party's lists when combining rankings under Rules 12402(e)[, 12403(c)(4), or 12403(d)(4)] or 12403(d). If the Director does not receive the list within that time, the Director will proceed as though the party did not want to strike any arbitrator or have any preference among the listed arbitrators.

(b) Once the ranked lists are due to the Director under Rules 12402(d)(3)[, 12403(c)(3)(C), or 12403(d)(3)(C)] or Rule 12403(c)(3), no party may amend a pleading to add a new party to the arbitration until a panel is appointed and grants a motion to add the party. Motions to add a party must be served on all parties, including the party to be added, and the party to be added may respond to the motion in accordance with Rule 12503 without waiving any rights or objections under the Code. If the panel grants the motion to add the party, the newly added party may not strike and rank the arbitrators, but may challenge an arbitrator for cause in accordance with Rule 12407.

\* \* \* \* \*

## 12800. Simplified Arbitration

**(a) – (d)** No change.

**(e) Increases in Amount in Dispute**

If any pleading increases the amount in dispute to more than \$50,000, the arbitration will no longer be administered under this rule, and the regular provisions of the Code will apply. If an arbitrator has been appointed, that arbitrator will remain on the panel. If a three-arbitrator panel is required or requested under Rule 12401, the remaining arbitrators will be appointed by the Director in accordance with Rule 12403[(c) or Rule 12403(d)]. If no arbitrator has been appointed, the entire panel will be appointed in accordance with the Neutral List Selection System.

**(f)** No change.

\*\*\*\*\*

### 12903. Process Fees Paid by Members

(a) Each member that is a party to an arbitration in which more than \$25,000, exclusive of interest and expenses, is in dispute must pay:

- A non-refundable prehearing process fee of \$750, due at the time the parties are sent arbitrator lists in accordance with Rule 12402(c)[, Rule 12403(c) or Rule 12403(d)] or Rule 12403(b); and

- No change.

**(b) – (c)** No change.

\*\*\*\*\*