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In the Absence of an Agreement to Arbitrate, Officer of Non-FINRA Company Not Required to Arbitrate

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The Northern District of California recently issued a non-published decision enjoining FINRA arbitration proceedings against the officer of a brokerage firm's parent company, where neither the CEO nor the parent company were FINRA members. The ruling was based on a construction of Rule 12200 of the FINRA Code of Arbitration Procedure.

The former clients of the brokerage had brought FINRA arbitration claims against the brokerage and others, alleging negligent management of their investments. Later, they amended their claims to add as a respondent the CEO of the brokerage firm's parent company. Against the CEO they alleged claims of negligent supervision and a breach of section 25400 of California Corporations Code. In response, the CEO asked the District Court to enjoin further arbitration proceedings on the ground that he was not a proper party to arbitration because he was not a FINRA member and he was not a party to an agreement to arbitrate.

Rule 12200 requires that FINRA arbitration is proper when "the dispute is between a customer and a [FINRA] member or associated person of a member." The CEO was an indirect owner of the member brokerage, and the claimants asserted that this was enough to qualify him as an "associated person" as that term is defined in the rule. The District Court rejected this argument, opining that:

A more plausible reading of Rule 12200 is that any FINRA member can be compelled to arbitrate a claim if there exists a dispute between a customer and a person associated with the member, and if the dispute arises in connection with the business activities of the member or the associated person. Under this reading, Rule 12200 does not define the class of individuals that FINRA can compel to arbitrate; rather, it defines the range of disputes FINRA can compel its members to arbitrate.

The Court concluded that this CEO's relationship to the claimants was too tenuous, particularly in light of the fact that the dispute did not arise in connection with the CEO's business activities with the claimants. The decision is *Sykes v. Escueta*, 2010 U.S. Dist. LEXIS 131174