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FINRA's New Arbitration Program Vs. Going To Court

Law360, New York (August 29, 2012, 1:40 PM ET) -- Recently, the Financial Industry Regulatory Authority proposed a pilot program for customer-initiated arbitrations for claims involving $10 million or more. Historically, the industry has seen arbitrations as a way to resolve disputes without significant expense and before a panel that includes at least one industry expert; in other words, an expeditious and cost-effective dispute resolution process in a favorable and understanding forum.

Although the program is voluntary, it calls into question the reasons why broker-dealers have come to rely on the certainty and relative cost-effectiveness of arbitration. Under this pilot program, the parties have greater input into the selection of arbitrators, permitting the parties to select non-FINRA arbitrators. The parties can customize the exchange of pretrial arbitration, instead of the “20-day exchange” otherwise conducted in a FINRA arbitration. This program also authorizes depositions and interrogatories as you would have in a regular court proceeding.

Contrary to the pilot program, typical FINRA arbitration requires the selection of arbitrators from FINRA available lists. The FINRA lists of arbitratators include individuals who have experience with the issues that arise in these matters, but do not necessarily include anyone from the industry. In addition, depositions and interrogatories are not permitted in FINRA arbitration, with very limited exception in extenuating circumstances. Discovery is typically limited to document requests and information requests; information requests are a limited type of interrogatory. Document discovery is also covered by the “discovery guide,” which is comprised of lists of documents that must be produced by the broker-dealer and the customer in all cases.

So the question to be asked is whether this court-light program is really worth it. In my view, it is not. The problem with this program is that the broker-dealer is faced with having the litigation handled as if it were in a court, but without any safeguards otherwise available in the judicial context.

In a FINRA arbitration, there is no real ability to file a pre-answer motion to dismiss a meritless claim. In addition, the claimant and the claimant’s counsel are not subject to frivolous filing restrictions like those in Federal Rule of Civil Procedure 11 or similar state rules. Anti-frivolous filing rules put lawyers and their clients at risk of sanction if they file a complaint that is without any factual or legal foundation. Even after conducting discovery, which is now permitted in the pilot program, a defending party still has no ability to file a motion for summary judgment before trial. As such, you can be faced with a frivolous claim that you must litigate, through discovery, to a final trial on the merits, from which you almost have no chance of prevailing on appeal.

In short, the pilot program exposes broker-dealers to potentially more expensive litigation with absolutely no procedural protections. Faced with a decision to compel arbitration or pursue the dispute through the judicial process by requiring litigation in a particular forum, I believe the choice is clear. The judicial process at least provides multiple pretrial devices to legitimately seek an early dismissal of an otherwise baseless case.

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