

**WILL YOU HAVE THE SAME ARBITRATORS
AT THE END OF YOUR CASE?**

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When you go to a Financial Industry Regulatory Authority (“FINRA”) arbitration, your case becomes very solidly in the hands of one to three arbitrators, whom you have very little grounds to challenge once an award has been rendered. While any good attorney will research an arbitrator’s background online and review prior awards, arbitrator selection still heavily relies on an arbitrator’s self-disclosure of facts relating to their investments, employment and other key information that may color the impression of the arbitrator by the person striking and ranking the arbitrators.

When arbitrators fail to disclose something that becomes public, or make a disclosure late, or do something that clearly evidences bias, a party has a right to either ask that arbitrator to recuse themselves or ask for their removal by the Director of Arbitration. Of course, either course is difficult and might be fraught with peril if unsuccessful and disclosed to the subject arbitrator. In either case, you need some really meaty grounds to accomplish this and need to choose the right situations when trying to avail yourself of these rules.

Changes to how FINRA classifies arbitrators and the new mid-case referral rules also highlight other things to consider in your case that may impact whether the Panel first appointed will be the Panel that finishes the case.

THE IMPORTANT ROLE OF ARBITRATORS AT FINRA

Arbitrators provide an important role at FINRA, to act as neutral parties to hear disputes relating to the financial industry. Arbitrators are essentially an arm (or perhaps the fingers) of FINRA, and in many ways they are enabled to aid in investor protection mandates. There is generally no case law because of the industry-wide use of arbitration as a means of resolving disputes, so FINRA arbitrators enforce the FINRA Conduct Rules. As FINRA Enforcement certainly cannot take up each and every customer complaint due to economic constraints, arbitrators' civil enforcement of the Rules is important.

DISCLOSURES REQUIRED OF FINRA ARBITRATORS

As a result of their important role, their ability to act as a neutral and unbiased arbitrator is key. To start, what is required to be disclosed?

12405. Disclosures Required of Arbitrators¹

(a) Before appointing arbitrators to a panel, the Director will notify the arbitrators of the nature of the dispute and the identity of the parties. Each potential arbitrator must make a reasonable effort to learn of, and must disclose to the Director, any circumstances which might preclude the arbitrator from rendering an objective and impartial determination in the proceeding, including:

(1) Any direct or indirect financial or personal interest in the outcome of the arbitration;

(2) Any existing or past financial, business, professional, family, social, or other relationships or circumstances with any party, any party's representative, or anyone who the arbitrator is told may be a witness in the proceeding, that are likely to affect impartiality or might reasonably create an appearance of partiality or bias;

¹ This article will analyze the FINRA Rules for Customer Disputes and, aside for the manner in which the non-public list may be stricken, the rules on the topics discussed here are largely the same for intra-industry disputes.

(3) Any such relationship or circumstances involving members of the arbitrator's family or the arbitrator's current employers, partners, or business associates; and

(4) Any existing or past service as a mediator for any of the parties in the case for which the arbitrator has been selected.

(b) The obligation to disclose interests, relationships, or circumstances that might preclude an arbitrator from rendering an objective and impartial determination described in paragraph (a) is a continuing duty that requires an arbitrator who accepts appointment to an arbitration proceeding to disclose, at any stage of the proceeding, any such interests, relationships, or circumstances that arise, or are recalled or discovered.

(c) The Director will inform the parties to the arbitration of any information disclosed to the Director under this rule unless the arbitrator who disclosed the information declines appointment or voluntarily withdraws from the panel as soon as the arbitrator learns of any interest, relationship or circumstance that might preclude the arbitrator from rendering an objective and impartial determination in the proceeding, or the Director removes the arbitrator.

You can see by reviewing this rule that many of the disclosures require a diligent arbitrator and if properly done, will reveal information that may be difficult or impossible to discover absent hiring a private investigator.

FINRA tells arbitrators in the Arbitrators Reference Guide pp. 17-18 (October 2015 Edition):

Arbitrator disclosure is the cornerstone of FINRA arbitration, and the arbitrator's duty to disclose is continuous and imperative. Disclosure includes any relationship, experience and background information that may affect—or even appear to affect—the arbitrator's ability to be impartial and the parties' belief that the arbitrator will be able to render a fair decision. When making disclosures, arbitrators should consider all aspects of their professional and personal lives and disclose all ties between the arbitrator, the parties and the matter in dispute, no matter how remote they may seem. This

includes, but is not limited to, lawsuits (even non-investment related lawsuits); any publications (even if they appear only online); professional memberships; service on boards of directors; etc. If you need to think about whether a disclosure is appropriate, then it is: make the disclosure. Failure to disclose may result in vacated awards which undermine the efficiency and finality of our process. Failure to disclose may also result in removal from the roster.

FINRA Rule 12405 requires arbitrators to disclose any direct or indirect financial or personal interest in the outcome of the arbitration, as well as any existing or past, direct or indirect, financial, business, professional, family, social or other relationships with any of the parties, representatives, witnesses or co-panelists. The duty to disclose is ongoing. Therefore, arbitrators are also required to continually make reasonable efforts to inform themselves of relationships and interests including changes in their or their immediate family member's employment, job functions or clients since these facts can result in a change to their classification as a public or non-public arbitrator.

Arbitrators are continually asked to update their information,² even when sitting on a case. Unfortunately, late-arriving information can cause problems for the parties, hence

² Per the Arbitrators Reference Guide (pp.18-19), disclosures need to be made throughout the proceedings:

Disclosures Upon Appointment to Serve It is important that arbitrators ensure that they have no conflicts when they accept appointment to a case. Accordingly, when FINRA contacts arbitrators about possible case service, staff will disclose the following information about the case:

- names of the parties;
- names of current lawyers or agents representing the parties; and
- the nature of the case.

If an arbitrator determines that a potential conflict exists after learning the above information, the arbitrator must advise staff immediately. Arbitrators should disclose any circumstance that might hinder—or even appear to hinder—their ability to render an objective determination.

Disclosures After Appointment to Serve Once an arbitrator accepts an appointment, FINRA sends the arbitrator the Oath of Arbitrator (Oath), which includes the Arbitrator Disclosure Checklist (Checklist). These documents are forwarded to the arbitrator with the case packet materials, which contain—in part—the pleadings, the arbitrator disclosures, and the hearing scripts (for a single arbitrator case or a three-member panel case). Arbitrators should review carefully the pleadings, the witness lists and their co-panelists' Disclosure Reports followed by another thorough conflicts check. Only after these documents have been examined, the Checklist has been reviewed, and another conflicts check has been completed should the arbitrator sign the

the removal and recusal procedures. As you will see, these rules and procedures have limited use, given the high burden, unlike a parties' broad initial decision-making powers on the original arbitrator rank and strike lists before arbitrators are appointed.

REQUEST REMOVAL OR RECUSAL: BE CAREFUL WHAT YOU CHOOSE

Once an arbitrator is appointed, there are two methods to removing an arbitrator under the FINRA Code, as well as a third avenue worth considering. One method to remove an arbitrator is arbitrator recusal (“withdrawal” and this need not be your first try):

12406. Arbitrator Recusal

Any party may ask an arbitrator to recuse himself or herself from the panel for good cause. Requests for arbitrator recusal are decided by the arbitrator who is the subject of the request.

It does not take any stroke of genius to deduce that this method of removing an arbitrator is fraught with peril. You are basically telling the arbitrator that you want to remove that you do not want them on the panel, as you believe they may be biased in some way.

FINRA’s Arbitrator’s Reference Manual (October 2015 Edition) tells arbitrators:

Oath and return it to FINRA staff. This process is repeated for every case to which the arbitrator is appointed.

Disclosures at Hearings Arbitrators must repeat their disclosures on the record at the start of the Initial Prehearing Conference, and at the beginning of the hearing on the merits. The parties should acknowledge the information and state whether they have an objection to proceeding with the appointed arbitrators.

Disclosures in General Not every disclosure results in the arbitrator being removed from service on a case. When an arbitrator makes a disclosure, FINRA staff informs the parties of the facts disclosed by the arbitrator, and the parties decide whether to keep or replace the arbitrator. As a rule, when in doubt, always err in favor of making a disclosure. 3 The term “immediate family member” is defined as: (i) a person’s parent, stepparent, child or stepchild; (ii) a member of a person’s household; (iii) an individual to whom a person provides financial support of more than 50 percent of the individual’s annual income; or, (iv) a person who is claimed as a dependent for federal income tax purposes. Copyright 2015 FINRA, Inc. All Rights Reserved. 19 Arbitrators are deciding issues of great importance to the parties involved. Therefore, it is important that the parties believe that the arbitrators rendered a fair decision.

Arbitrators should not feel offended if they are asked to recuse themselves from a case since such requests are generally not based on the ability or competence of an arbitrator.

In some instances, an arbitrator may voluntarily choose to withdraw from a case. When in doubt, arbitrators should consult with FINRA staff. Even if the case has already proceeded, it may be less expensive for the parties if an arbitrator steps down in the middle of the proceeding than for the parties to complete the proceeding and file a motion to vacate the award. However, whether arbitrators choose to step down should be balanced by the significance of the disclosure, the disclosed relationships and the prejudice to the parties.

While a reasonable arbitrator will usually step aside if it seems that the reason is valid and the proceedings are not advanced, if the arbitrator (reasonable or not) does not step down, the arbitrator may already be sending the signal that your judgement is off, in their opinion, and they put a check in the proverbial column of “you and I are not on the same page.”

The standard itself is fairly open, as it states that the reason must be “for good cause”, but does not have any rigid standards. One would not want to whimsically make the request though. The process will proceed in a similar fashion to motion. If you adversary disagrees, they will be given an opportunity to oppose the request for recusal.

The other method of removing an arbitrator is to make a request to the Director of Arbitration that the arbitrator be removed. This method does not carry with it all the perils of asking the arbitrator themselves to recuse themselves. It is advisable to make it abundantly clear when submitted (both by a call to the case administrator and in the papers right up front) that you do not want any of the arbitrators consulted on the request. This method has more rigid, although still subjective standards associated with it:

12407. Removal of Arbitrator by Director

(a) Before First Hearing Session Begins

Before the first hearing session begins, the Director may remove an arbitrator for conflict of interest or bias, either upon request of a party or on the Director's own initiative.

(1) The Director will grant a party's request to remove an arbitrator if it is reasonable to infer, based on information known at the time of the request, that the arbitrator is biased, lacks impartiality, or has a direct or indirect interest in the outcome of the arbitration. The interest or bias must be definite and capable of reasonable demonstration, rather than remote or speculative. Close questions regarding challenges to an arbitrator by a customer under this rule will be resolved in favor of the customer.

(2) The Director must first notify the parties before removing an arbitrator on the Director's own initiative. The Director may not remove the arbitrator if the parties agree in writing to retain the arbitrator within five days of receiving notice of the Director's intent to remove the arbitrator.

(b) After First Hearing Session Begins

After the first hearing session begins, the Director may remove an arbitrator based only on information required to be disclosed under [Rule 12405](#) that was not previously known by the parties. The Director may exercise this authority upon request of a party or on the Director's own initiative. Only the Director or the President of FINRA Dispute Resolution may exercise the Director's authority under this paragraph (b).

“Challenges for Cause” before the first hearing session begins under Rule 12407(a) acts like a motion, all opposing parties are entitled to submit a response. On behalf of the Director of Arbitration, FINRA staff first reviews the challenge for cause and responses filed, if any, to determine whether to remove the arbitrator.

The rule’s standard is that a challenge for cause will be granted where it is reasonable to infer, based on information known at the time of the request, that the

arbitrator is biased, lacks impartiality or has a direct or indirect interest in the outcome of the arbitration. The interest or bias must be direct, definite and capable of reasonable demonstration, not remote or speculative, although close questions are supposed to be resolved in favor of the customer.

The Director of Arbitration's authority to remove an arbitrator after the first hearing session begins under FINRA Rule 12407(b), based only on information required to be disclosed that was not previously known by the parties. The basis of using only information not previously known to the parties prevents parties from raising challenges late in the process that should have been raised earlier.

Claims of actual partiality by an arbitrator during an arbitration proceeding must be established by clear and convincing evidence. Santana v. Country-Wide Ins. Co., 177 Misc. 2d 1, 7, 675 N.Y.S.2d 817, 821-22 (Civil Court, Queens 1998). "It is also well settled that mere 'occasional associations between an arbitrator and a party will not warrant disqualification of the arbitrator on the ground of the appearance of bias or partiality.' but rather "[i]t must be shown that the party or witness have some ongoing relationship." Id.

In Cross Properties, Inc. v. Gimbel Brothers, Inc., 15 A.D.2d 913, 914 (1st Dept. 1962) the Appellate Division of the Supreme Court of New York, First Department, set the New York standard in these types of matters and squarely addressed this issue in favor of keeping the arbitrator in a decision on a subsequent motion to vacate: "'Courts are loathed to sustain belated claims of disqualification after an adverse award' (Matter of Atlantic Rayon Corp. [Goldsmith], 277 App. Div. 554, 556) and particularly should this be so where the arbitration proceeding is a lengthy and involved one extending over a

period of years as is this case.” In Milliken & Co. v. Tiffany Loungewear, Inc., 99 A.D.2d 993, 101 A.D.2d 739, 473 N.Y.S.2d 443, 445 (A.D. 1st Dept. 1984), the Appellate Division stated that “insubstantial business dealings” do not establish bias or partiality. Accord J.P. Stevens & Co., Inc. v. Rytex Corp., 41 A.D.2d 15, 340 N.Y.S.2d 933 (App. Div. 1st Dept. 1973) (“It is true that mere proof of prior business relations with a party is insufficient to disqualify an arbitrator where that relationship is known to the opposing party.” See also, Commonwealth Coatings Corp. v. Continental Casualty Co. et al., 393 U.S. 145, at pp. 148--149, 89 S.Ct. 337, at p. 339, 21 L.Ed.2d 301 (1968)(It is true that arbitrators cannot sever all their ties with the business world, since they are not expected to get all their income from their work deciding cases . . .”).

It is historically fundamental in this area that knowledge, on the part of a party, of the existence of a disqualifying relationship between the party and an arbitrator, coupled with a failure to make timely objection, will be deemed a waiver of the right to press the objection; constructive knowledge is sufficient. Matter of City of Rochester, 208 N.Y. 188, 197, 101 N.E. 875, 877 (C.A. 1913). In the Matter of McLaughlin Piven Vogel Sec. Inc. v Ferrucci, 2008 NY Slip Op 51347(U), 20 Misc 3d 1114(A) (Sup, NYC June 20, 2008), Judge Rakower stated:

FINRA rules permit the removal of a panel member, but the objecting party is required to raise its objection prior to the first pre-hearing conference, or prior to the hearing, or upon disclosure of information that was not previously disclosed. Here, petitioners were aware of Leder's prior business relationships before the hearing commenced but did not object to his appointment. "It is well settled that occasional associations between an arbitrator and a party or witness will not warrant disqualification of the arbitrator . . . [for] bias or partiality. It must be shown that the arbitrator and the party or witness have some on going relationship."(Artists and Craftsman Builders, Ltd., v.

Schapiro, 232 AD2d 265 [1st Dept. 1996] internal citations omitted). Additionally, the party seeking vacature of an award on these grounds must meet a heavy burden. (Id.)

The paltry evidence provided by petitioners, coupled with a review of Leder's allegedly offensive questioning is insufficient to warrant the court signing a subpoena for Leder's employment records as it indicates that petitioners are on the proverbial "fishing expedition." Nor is petitioner's request for an order directing respondent to produce "certain documents" appropriate. In fact, petitioners want the respondent to provide it with the arbitration hearing transcript which they failed to get transcribed. The hearing was tape recorded in accordance with FINRA rules and a transcript is equally available to all parties.

ARGUMENTS ABOUT THE FAIRNESS OF THE PROCEEDINGS

A third avenue to explore is the very open-ended Director's Discretionary Authority:

12408. Director's Discretionary Authority

The Director may exercise discretionary authority and make any decision that is consistent with the purposes of the Code to facilitate the appointment of arbitrators and the resolution of arbitrations.

This is a not-as-often used method to consider when you do not squarely fall in the guidelines of 12407 and, perhaps you are concerned about attempting to use the FINRA Rule 12406 recusal rules.

According to case law in New York, FINRA should make every effort to ensure the integrity of its arbitration proceedings are beyond reproach. *See Matter of Shomron*, 286 A.D.2d 587, 589 (1st Dep't 2001) (because courts defer to arbitration awards "it is imperative that the integrity of the process, as opposed to the correctness of the individual decision, be zealously safeguarded"), *lv denied*, 97 N.Y.2d 607 (2001). In doing so, the courts have noted that "[t]he proper standard of review for the disqualification of

arbitrators is whether the arbitration process is free of the appearance of bias.” *Santana*, 675 N.Y.S. 2d at 819 (citing *Commonwealth Corp. v. Continental Co.*, 393 U.S. 145 (U.S. 1968)). The *Santana* court continued that “[i]t is only necessary to demonstrate the potential for bias, and even a suggestion of impropriety or partiality by an arbitrator will not be sanctioned.”

Moreover, Claimants or Respondents would be well within their rights under New York law to proceed to court seeking to disqualify an arbitrator if FINRA chooses not to do so. See *Matter of Astoria Med. Group*, 11 N.Y.2d 128 (N.Y. 1968). Regarding the *Astoria Med. Group* case, that decision explicitly states: “in an appropriate case, the courts have inherent power to disqualify an arbitrator before an award has been rendered.” *Matter of Astoria Med. Group*, 11 N.Y.2d at 132.

WHAT ARE CRITERIA FOR DISQUALIFICATION?
SHOULD THEY BE OFF THE LIST?

When thinking about whether to have an arbitrator removed, aside from the conflict or interest, bias or non-disclosure, consider whether there are reasons to disqualify the arbitrator from the pool either temporarily or permanently. One might want to look at FINRA’s Arbitrator’s Manual, which is what FINRA tells arbitrators regarding what the standards are for temporary or permanent disqualification:

Disqualification Criteria

Criteria for Temporary Disqualification

Temporary Disqualification will result in a temporary decline of new applicants and a status of "inactive" for currently enrolled arbitrators.

- **Pending Actions**

Arbitrator is the subject of, or is a party to, a pending investment-related civil action or arbitration claim initiated by a customer; or, civil action or administrative complaint initiated by a regulatory body; or, a civil action or regulatory complaint alleging discrimination or sexual

harassment. This provision excludes cases where the arbitrator's conduct in his or her role as an arbitrator is at issue.

- **Subject of Claims or Complaints**
Arbitrator is the subject of, or is a party to, three (3) or more claims or complaints (reportable on Form U-4) within the last ten (10) years regardless of outcome.
- **Filed a Statement of Claim or Complaint**
Arbitrator is a party (excluding representatives and unnamed parties to class actions) that has filed two or more investment-related civil actions or arbitration claims within the last ten (10) years.
- **Final Decisions, Awards**
Arbitrator is the subject of, or is a party to, a final, adverse investment-related court decision or arbitration award of \$25,000 or more within the past seven (7) years resulting from a customer-initiated complaint or claim.
- **Final Regulatory Action**
Arbitrator is the subject of, or is a party to, any final adverse decision issued by any regulatory authority within the past seven (7) years, where the adverse decision does not involve a technical violation or does not give rise to a statutory disqualification.
- **Director of Arbitration's Judgment**
The Director of Arbitration may temporarily remove an arbitrator, if, in his or her sole judgment, it is determined that the arbitrator is not otherwise properly included in the list of eligible neutrals.

Criteria for Permanent Disqualification

Permanent Disqualification means the application of any new applicant will be rejected, and enrolled neutrals will be removed from the roster without possibility of reconsideration.

Preamble

If an arbitrator answers in the affirmative to any questions contained in Question 15 of the Arbitrator Application Form, the arbitrator's explanation for the affirmative answer will be closely reviewed by the Director. If the affirmative answer does not constitute a statutory disqualification, the explanation for the answer will be disclosed to the parties—unless the information is non-regulatory or does not reflect negatively on the individual's character, and is not significant to an individual's performance as a neutral.

- **Misstatement/Omission**
Misstatement or failure to disclose material information.
- **Disciplinary Actions**
Final, adverse disciplinary action by any domestic or foreign regulatory or governing professional body on a finding of, including but not limited to, false statement or omissions, material violation of investment-related regulation, or the violation of a non-technical rule of such organizations or statute.
- **Misdemeanors**
Misdemeanor involving investments or investment-related activities.
- **Felonies**
Felony conviction, or plea of guilty or nolo contendere (no contest), to a felony charge.
- **Fraud**
Final adverse court decisions where there has been a finding of fraud.
- **Statutory Disqualifications**
Statutory disqualifications not included above.
- **Decisions, Awards, Involving Discrimination/Sexual Harassment**
Arbitrator is the subject of, or is a party to, a final, adverse regulatory decision or arbitration award involving any discrimination claims, including sexual harassment, in which the arbitrator was found to have engaged directly in sexual harassment or discrimination.
- **Director of Arbitration's Judgment**
The Director of Arbitration, upon approval from the National Arbitration & Mediation Committee, may remove an arbitrator if in his or her judgment the arbitrator is not otherwise properly included in the list of eligible neutrals.

While certain criteria re: bias and disclosures may be subjective, these criteria are a more certain to achieve the end of getting the arbitrator off the panel.

**RESHUFFLING OF THE DECK:
IS YOUR ARBITRATOR PROPERLY CLASSIFIED**

Effective June 26, 2015, the United States Securities and Exchange Commission (“SEC”) approved amendments to Arbitration Codes to revise the definitions of “Non-Public” and “Public” arbitrators.

(p) Non-Public Arbitrator

The term "non-public arbitrator" means a person who is otherwise qualified to serve as an arbitrator, and meets any of the following criteria:

(1) is, or was, associated with, including registered through, under, or with (as applicable):

(A) a broker or a dealer (including a government securities broker or dealer or a municipal securities broker or dealer); or

(B) the Commodity Exchange Act or the Commodities Future Trading Commission, or a member of the National Futures Association or the Municipal Securities Rulemaking Board; or

(C) an entity that is organized under or registered pursuant to the Securities Exchange Act of 1934, Investment Company Act of 1940, or the Investment Advisers Act of 1940; or

(D) a mutual fund or a hedge fund; or

(E) an investment adviser;

(2) is an attorney, accountant, or other professional who has, within the past five years, devoted 20 percent or more of his or her professional time, in any single calendar year, to any entities listed in paragraph (p)(1) and/or to any persons or entities associated with any of the entities listed in paragraph (p)(1); or

(3) is an attorney, accountant, expert witness or other professional who has, within the past five years, devoted 20 percent or more of his or her professional time, in any single calendar year, to representing or providing services to parties in disputes concerning investment accounts or transactions, or employment relationships within the financial industry; or

(4) is, or within the past five years was, an employee of a bank or other financial institution who effects transactions in securities, including government or municipal securities, commodities, futures, or options or supervises or monitors the compliance with the securities and commodities laws of employees who engage in such activities.

For purposes of the non-public arbitrator definition, the term "professional time" shall not include mediation services performed by mediators who are also arbitrators, provided that the mediator acts in the capacity of a mediator and does not represent a party in the mediation.

The amended definitions provide that persons who worked in the financial industry for any duration in their careers will always be classified as non-public arbitrators, and persons who represent investors or the financial industry as a significant part of their business will also be classified as non-public. The latter may become public arbitrators after a cooling-off period.

FINRA has been reclassifying arbitrators in the lists that are used for arbitrator selection and the classifications of your panel appointed should be closely scrutinized and may be subject to challenge.

**THE DREADED MID-CASE REFERRAL:
NO GOOD DEED GOES WITHOUT PUNISHING SOMEONE**

Finally, there is one other way arbitrators get off a case (not necessarily because of a request by a party), it is both controversial and fraught with a different peril, the mid-case referral rule, FINRA Rule 12104. FINRA proposed and the SEC adopted a mid-case referral process for arbitrators to inform FINRA enforcement of “ongoing or imminent ... harm to investors” during the course of an arbitration hearing. *See* SR-FINRA-2014-005; SEC Release No. 34-71534; *See also* SEC Release No. 34-64954 (July 25, 2011); it states (emphasis added):

12104. Effect of Arbitration on FINRA Regulatory Activities; Arbitrator Referral During or at Conclusion of Case

(a) Submitting a dispute to arbitration under the Code does not limit or preclude any right, action or determination by FINRA that it would otherwise be authorized to adopt, administer or enforce.

(b) During the pendency of an arbitration, any arbitrator may refer to the Director any matter or conduct

that has come to the arbitrator's attention during a hearing, which the arbitrator has reason to believe poses a serious threat, whether ongoing or imminent, that is likely to harm investors unless immediate action is taken. Arbitrators should not make referrals during the pendency of an arbitration based solely on allegations in the statement of claim, counterclaim, cross claim, or third party claim. If a case is nearing completion, the arbitrator should wait until the case concludes to make the referral if, in the arbitrator's judgment, investor protection will not be materially compromised by this delay.

(c) If any arbitrator refers a matter or conduct for investigation under paragraph (b) of this rule, the Director will disclose the act of making the referral to the parties. A party may request that the referring arbitrator(s) recuse themselves, as provided in the Code, no later than three days after the Director notifies the parties of the referral. If a party does not make the recusal request within the prescribed timeframe, the party forfeits the right to request recusal of the referring arbitrator(s).

(d) The President of FINRA Dispute Resolution or the Director will evaluate the arbitrator referral to determine whether to transmit it to other divisions of FINRA. Only the President or the Director shall have the authority to act under this paragraph (d).

(e) At the conclusion of an arbitration, any arbitrator may refer to FINRA for investigation any matter or conduct that has come to the arbitrator's attention during and in connection with the arbitration, either from the record of the proceeding or from material or communications related to the arbitration, which the arbitrator has reason to believe may constitute a violation of the rules of FINRA, the federal securities laws, or other applicable rules or laws.

Many claimants ask for a regulatory referral in their complaint; however, that needs to be considered by claimants more closely. This amendment, while magnanimous in its effort to attempt to avoid potential harm to non-party investors, may substantially burden a claimant's arbitration hearing by delaying the arbitration as a result of recusal of the arbitrator from the proceeding and by increasing the costs of prosecution.

It is important to note that should FINRA and the SEC act quickly to stop a larger fraud based on information from one investor's case, that investor's efforts to collect on any resulting judgment may be sacrificed. The SEC has the power to go to court to stay proceedings and freeze a wrongdoer's assets; the ability to step in front of the individual investor for the equitable treatment of all investors effectively renders the arbitration a fruitless process.³ Moreover, while the arbitration process is designed to be efficient, regulatory actions (particularly those aided by enforcement in the court system) could take many years to complete.

FINRA provided few reasons other than investor protection for support of mid-case referrals in SR-FINRA-2014-005. Without citation to any study or other evidence, FINRA states that it believed the rule change "would provide it with an important tool for detecting and addressing serious ongoing or imminent threats to investors that may only be known to the participants in the arbitration." *Id.* At pg. 18.

There are two interesting observations to make from this rule: (1) the important role FINRA arbitrators can have in the regulatory and enforcement process; and (2) the conflict between the arbitrator's role in a pending arbitration and his or her role as a part of the regulatory and enforcement process. It is important to note that there are other avenues for FINRA to get these important tips⁴

³ This potentially unjust result could be lessened or eliminated if FINRA would require all member firms and registered persons to carry appropriate insurance. As reported by the Wall Street Journal on October 4, 2013, FINRA is at least looking in to the idea of arbitration insurance, in response to the Journal's prior page-one article regarding "cockroaching" (the practice of registered persons jumping from one small defunct broker-dealer to another small, soon-to-be-defunct broker-dealer). *See also*, Bernstein, Scot, Broker Liability Insurance From the Claimants' Perspective (Practicing Law Institute, Securities Arbitration, 2003, Vol. 1) (seeking an investor recovery fund or requiring certain brokerage firms to carry insurance policies).

⁴ According to FINRA, it is dedicated to "investor protection and market integrity." *See* FINRA, "About FINRA," 2014 (<http://www.finra.org/AboutFINRA/>, last accessed May 3, 2014).

Despite positive aspects to FINRA's "greater good" argument, mid-case referrals present a bevy of issues. First, while many arbitration hearings are conducted in an efficient manner, mid-case referrals could cause additional delays due to the way FINRA has incorporated the idea of recusal into the proposed rule. Those who practice in this area know all too well how easy it is to knock an arbitration proceeding off track and into months of delay.

Second, recusal of the referring arbitrator would present at least one party with a Hobson's choice of starting the hearing over, continuing with only two arbitrators, or accepting an additional arbitrator, a prospect neither expected when they began the hearing. *See* Rule 12403 of the Customer Code; Rule 13411 of the Industry Code. It is not hard to imagine that referrals may generally be made by arbitrators who could favor one side's position. If that arbitrator leaves the hearing after being accused of bias, a party's selection could be upset, perhaps tilting the favor in the proceeding.⁵ More

Currently, FINRA already possesses substantial review, enforcement and regulatory power. FINRA Dispute Resolution provides all pleadings to the Central Review Group, part of the Office of Fraud Detection and Market Intelligence, which has the discretion to refer matters to FINRA Enforcement to commence investigations on that basis alone.

FINRA also possesses an Office of the Whistleblower. This office fields concerns from other FINRA offices as well as individuals with evidence or other material information concerning illegal or unethical activity. *See* FINRA, Office of the Whistleblower, 2014 (<http://www.finra.org/Industry/Whistleblower/>, last accessed May 3, 2014). The Dodd-Frank Act also has a procedures where tips can be filed with the SEC through a form known as a TCR and if more appropriate for FINRA can be routed there, as well as may have a financial bounty for the tipster to recover.

Fraudulent acts and schemes, such as the Madoff Ponzi scheme are an ever-present issue in the securities markets. Though this Ponzi scheme was not discovered through a FINRA arbitration referral, it is possible that mid-case referrals could inform regulators of imminent harm to investors, there are potential pitfalls to the mid-case referral.

⁵ Federal laws, by their own terms, are less stringent than FINRA's rule, and do not expressly provide for recusal as a result of a criminal referral. For instance, criminal referrals are required under the Bankruptcy Code when:

Any judge, receiver, or trustee having reasonable grounds for believing that any violation under chapter 9 of this title [18

troubling, it is conceivable the recusal process could be misused to simply delay the proceeding.

Conclusion

As you can see, there are many ways you can lose an arbitrator under the FINRA Rules, although for the most part, there must be a clear event or circumstance and there are difficult hurdles to meet. However, there is one way we did not discuss, though,

USCS §§ 151 et seq.] or other laws of the United States relating to insolvent debtors, receiverships or reorganization plans has been committed, or that an investigation should be had in connection therewith, shall report to the appropriate United States attorney all the facts and circumstances of the case, the names of the witnesses and the offense or offenses believed to have been committed.

18 U.S.C. § 3057(a). This code section does not provide for recusal, though motions have been made by affected parties in reported cases. *See, e.g., Washington 1993, Inc. v. Hudson (In re Hudson)*, 420 B.R. 73 (N.D.N.Y. 2009) (noting that § 3057 provides for no due process right to notice or to be heard before criminal referral is made, and that the motion for recusal was denied); *Seidel v. Durkin (In re Goodwin)*, 194 B.R. 214, 223 (9th Cir. 1996) (“it is clear that Goodwin has no right to notice and an opportunity to respond before a criminal referral is made. The statute itself does not create any such right. The result would be nonsensical”).

Motions for federal judge recusal are generally made pursuant to 28 U.S.C. § 455. § 455(a) states that “[a]ny justice, judge, or magistrate [magistrate judge] of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned,” while § 455(b) sets forth several grounds where recusal would be mandatory, including “personal bias or prejudice concerning a party” or where the judge served as a lawyer in the controversy while in private practice. 28 U.S.C. § 455(b)(1) and (2). “Judges are presumed to be impartial.” *Tripp v. Executive Office of the President*, 104 F. Supp. 2d 30, 34 (D.D.C. 2000) (citing *United States v. Fiat Motors*, 512 F. Supp. 247, 251 (D.D.C. 1981)). The U.S. Supreme Court has held that

[J]udicial rulings alone almost never constitute a valid basis for a bias or partiality motion... [and] only in the rarest circumstances evidence the degree of favoritism or antagonism required ... when no extrajudicial source is involved.

Liteky v. United States, 510 U.S. 540, 555 (U.S. 1994) (citing *United States v. Grinnell Corp.*, 384 U.S. 563, 583 (U.S. 1966)). Even when considering facts learned through a proceeding, the *Liteky* Court noted that

[O]pinions formed by the judge on the basis of facts introduced or events occurring in the course of the current proceedings, or of prior proceedings, do not constitute a basis for a bias or partiality motion unless they display a deep-seated favoritism or antagonism that would make fair judgment impossible.

Liteky, 510 U.S. at 555.

arbitrator apathy. If you have a long or complicated case, you may want to spell that out upfront to the panel appointed. Some arbitrators do not want to sit on a long case, or cannot afford to. If an arbitrator drops off your panel, without good reason, FINRA should be notified, as such conduct undermines the integrity of the process.