



## **SECURITIES INDUSTRY EMPLOYMENT ARBITRATION**

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## **Securities Industry Employment Arbitration**

**By: Michael Delikat, Jill Rosenberg & Lisa Lupion**

In the securities industry, the majority of all employment disputes are resolved through binding arbitration. This mandatory arbitration system is managed through a unique industry forum under the self-regulatory entity Financial Industry Regulatory Authority (FINRA). When disputes arise between brokers and investors, FINRA administers the largest forum specifically designed to resolve securities-related disputes between and among investors, securities firms and individual brokers.<sup>1</sup> In total, in FINRA there were 3,435 arbitrations filed in 2015, 3,822 in 2014, 3,714 in 2013 and 4,299 in 2012.<sup>2</sup> Most of the arbitrations handled by FINRA's Dispute Resolution arbitration process - roughly 60% to 70% of the cases filed - are disputes between customers and the brokers and securities firms that handle their investments.<sup>3</sup>

Although customer disputes reflect the majority of arbitrations filed at FINRA, a substantial number of "intra-industry" disputes are filed each year.<sup>4</sup> As reported by FINRA, intra-industry FINRA arbitration filings can be broken down as follows:

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<sup>1</sup> See <http://www.finra.org/about/what-we-do>

<sup>2</sup> See FINRA Dispute Resolution Statistics, available at <https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics>.

<sup>3</sup> Id.

<sup>4</sup> Id.

## Top 15 Controversy Types in Intra-Industry Arbitrations

A single arbitration case may include multiple controversy types.

CONTROVERSY		2016 CASES SERVED	2015	2014	2013	2012
Promissory Notes	Through March	99	86	123	161	218
	Year-End	99	401	476	632	802
Breach of Contract	Through March	93	79	105	123	209
	Year-End	93	373	347	465	652
Compensation	Through March	41	30	44	40	120
	Year-End	41	140	146	155	316
Libel/Slander/Defamation	Through March	34	22	27	20	23
	Year-End	34	115	99	101	109
Wrongful Termination	Through March	29	33	27	31	26
	Year-End	29	123	79	117	110
Libel or Slander on Form U-5	Through March	25	33	33	28	17
	Year-End	25	119	110	99	106
Discrimination*	Through March	16	12	17	8	17
	Year-End	16	54	43	53	49
Commissions	Through March	15	17	21	22	83
	Year-End	15	73	77	85	213
Raiding Disputes	Through March	7	8	9	8	10
	Year-End	7	40	39	21	41
Breach of Fiduciary Duty	Through March	5	3	18	20	60
	Year-End	5	28	52	78	143
Negligence	Through March	3	6	7	6	25
	Year-End	3	21	25	11	43
Partnerships	Through March	3	2	2	1	0
	Year-End	3	12	5	6	9
Retaliation	Through March	3	3	7	3	3
	Year-End	3	10	15	11	6
Manipulation	Through March	2	0	1	1	0
	Year-End	2	1	5	1	3
Indemnification	Through March	2	3	3	4	3
	Year-End	2	12	16	17	17

\* This category combines the following discrimination controversy types: disability, age, gender, race, sexual orientation, national origin, religion, employment discrimination, and sexual harassment. This number does not represent the number of cases served, as one case may have multiple discrimination claims.

This paper focuses on arbitration of discrimination and other statutory claims in FINRA arbitration.

### **FINRA Rules for Employment Arbitrations**

Employment disputes handled under FINRA auspices are governed by the Code of Arbitration Procedure for Industry Disputes (the “Code”).<sup>5</sup> The Code, and any changes or amendments to the Code, must be approved by the Securities Exchange Commission.

As stated in the Code, any dispute that arises out of the business activities of a member or an associated person and is between or among: (i) members; (ii) members and associated persons; or (iii) associated persons, must be arbitrated.<sup>6</sup> Notwithstanding the broad jurisdiction that FINRA enjoys, under the Code, FINRA will not accept all statutory employment claims. FINRA will not accept claims alleging employment discrimination, including sexual harassment, in violation of a statute unless the parties expressly agree to arbitrate such a claim either before or after the dispute arose.<sup>7</sup> Similarly, many claims arising under a “whistleblower” statute are excluded from FINRA arbitration. Specifically, if the statute prohibits the use of predispute arbitration, FINRA will arbitrate the claim under the Code only if the parties agree to arbitrate it after the dispute arose.<sup>8</sup> The Code also excludes class action claims and collective action claims under the Fair Labor Standards Act, the Age Discrimination in Employment Act, and the Equal Pay Act of 1963.<sup>9</sup>

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<sup>5</sup> FINRA maintains a separate set of rules for customer-broker disputes. The Code of Arbitration Procedure (Customer Code) governs arbitrations between investors and brokers and/or brokerage firms. Both the Customer Code and the Industry Code are available at: <http://www.finra.org/ArbitrationAndMediation/Arbitration/Rules/CodeofArbitrationProcedure/index.htm>

<sup>6</sup> Code R. 13200.

<sup>7</sup> Code R. 13201(a).

<sup>8</sup> Code R. 13201(b).

<sup>9</sup> Code R. 13204.

Employees looking to assert a claim that is based upon the same facts and law as a court-certified class or collective action, can pursue their claims before FINRA only if the employee can provide some assurance that he or she will not participate in the class or collective action pending in court.<sup>10</sup>

If the parties agree to arbitrate their discrimination claims, an arbitration is initiated when a statement of claim specifying the relevant facts and remedies requested is filed with FINRA.<sup>11</sup> In FINRA and unlike in court, failing to assert facts sufficient to state a legally cognizable claim will generally not make the claim susceptible to a motion to dismiss. In fact, the Code specifically provides that a motion to dismiss prior to the conclusion of the party's case in chief is "discouraged."<sup>12</sup> If a motion is filed, the FINRA arbitrators will be permitted to dismiss a party or a claim only if the non-moving party previously released the claims(s) in dispute by signing a settlement agreement or release or if the moving party was not associated with the account, security or conduct at issue.<sup>13</sup> If the conduct is alleged against the correct party (*e.g.*, the claim is asserted against a registered FINRA entity that did in fact employ the broker / former employee), the Code does not authorize early dismissal of the claim, even if, assuming the facts to be true, the claim would not be viable as a matter of law. The respondent party is expected to file an answer specifying the relevant facts and available defenses to the statement of claim within forty-five (45) days of receipt of the statement of claim.<sup>14</sup> If a party fails to provide a timely answer, or if a party answers a claim that alleges specific facts and contentions with a general denial, or fails to

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<sup>10</sup> Code R. 13204.

<sup>11</sup> Code R. 13302.

<sup>12</sup> Code R. 13504(a)(1).

<sup>13</sup> Code R. 13504(6).

<sup>14</sup> Code R. 13303.

include defenses or relevant facts in its answer that were known to it at the time the answer was filed, the arbitrators can bar the answering party from presenting a defense or the omitted defenses or facts at the hearing.<sup>15</sup>

Generally, FINRA arbitrators are not required to have any formal legal training as a lawyer or judge.<sup>16</sup> However, arbitrators serving as the chairperson or single arbitrator in a case involving claims of employment discrimination must have additional qualifications including a law degree, membership in a state bar, substantial familiarity with employment law, and ten or more years of legal experience, of which at least five years must be in law practice, law school teaching, government enforcement of equal employment opportunity statutes, experience as a judge, mediator or arbitrator, or experience as an equal employment opportunity officer or in-house counsel.<sup>17</sup> The arbitrators not serving as the chairperson are not required to have the additional qualifications to serve on a panel in an employment discrimination arbitration.

### **Statutory Discrimination Claims**

After many challenges and much debate over the appropriateness of requiring arbitration of statutory discrimination claims in the 1990's, in 1999, the SEC approved a proposed rule, which became effective in 2000, to exclude discrimination claims from the general regulatory requirement that all intra-industry disputes are arbitrated before FINRA and to make arbitration of

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<sup>15</sup> Code R. 13308.

<sup>16</sup> The requirements for arbitrators are slightly different in customer disputes. In customer disputes, chairpersons must be public arbitrators. Arbitrators are eligible for the chairperson roster if they have completed chairperson training provided by FINRA and: have a law degree and are a member of a bar of at least one jurisdiction and have served as an arbitrator through award on at least two arbitrations administered by a self-regulatory organization in which hearings were held; or have served as an arbitrator through award on at least three arbitrations administered by a self-regulatory organization in which hearings were held. Customer Code R. 12400 (c).

<sup>17</sup> Code R. 13802(c)(3).

employment discrimination claims at FINRA voluntary.<sup>18</sup> In connection with this amendment, the Code was also modified to require arbitrators acting as the chairperson in a case involving statutory discrimination claims to have the additional qualifications described above.<sup>19</sup>

After FINRA's changes to the rules became effective, there have been fewer discrimination claims arbitrated at FINRA.<sup>20</sup> Several reasons, in our opinion are likely motivators for this decreased willingness to arbitrate these statutory claims: the more structured environment in court provides all parties with a better ability to ascertain their respective case, along with their strengths and weaknesses; there are broader discovery tools (including depositions), but discovery that is based on rules, provides parties with necessary but not extraneous information; the time it takes to conclude a FINRA arbitration on a discrimination claim is not necessarily faster or less expensive than a court litigation; there is a meaningful opportunity to limit claims in motion practice; and a legitimate ability to appeal the outcome.

In an earlier study completed by the authors, we looked at all employment discrimination awards issued in FINRA arbitrations between January 2009 and December 2012, and concluded that claimants recovered an award in approximately 25% of the cases in which discrimination claims were asserted.<sup>21</sup> Since 2012, there have been another 150 FINRA arbitration awards filed

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<sup>18</sup> See David B. Lipsky, Ronald L. Seeber and J. Ryan Lamare, *The Arbitration of Employment Disputes in the Securities Industry: A Study of FINRA Awards, 1986-2008*, 65 Dis. Res. J., 54, at 55 (2010).

<sup>19</sup> See *id.*; see also discussion of Chairperson requirements above.

<sup>20</sup> See Lipsky, *supra note* 18, at 59 (noting that from 1986 through 1999, there were 288 discrimination awards and 50 discrimination awards from 200 to 2008).

<sup>21</sup> See Michael Delikat & Lisa Lupion, *Employment Arbitration in the Securities Industry*, published in *Beyond Elite Law* (eds. Saumel Estricher & Roy Radice), 506-17. By contrast, when evaluating 186 securities industry arbitration decisions from April 1997 to July 31, 2001, claimants prevailed on their claims in 46.2% of the cases. See Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintiffs Better Vindicate Their Rights?*, 58 Dispute Resolution J. (No. 4, Jan. 2004). The awards in the earlier study were rendered prior to the changes in the Code, which allowed discrimination claimants to proceed outside of FINRA arbitration and also theoretically improved the quality of the decisions in statutory discrimination cases before FINRA given the enhanced arbitrator qualifications. As such, the decline in the number of cases in which claimants prevailed on their



that contained at least one claim of employment discrimination.<sup>22</sup> Focusing on the awards rendered during that time period, there were 46 awards issued since 2012 where an employment discrimination claim was identified in the award as a claim at issue.<sup>23</sup> Of those 46 decisions, the claimant was awarded some monetary damages in 22 of those decisions. The size of the awards, however, ranged dramatically, with the vast majority of the damages awarded constituting only a small percentage of the damages claimed. In fact, in another study conducted on FINRA employment arbitration awards, the research demonstrated that the size of the awards rendered on discrimination claims was lower than in other types of employment awards issued in FINRA arbitrations.<sup>24</sup> Specifically, when looking at the actual amount of the monetary award, the win rate (i.e. the number of cases in which the employee won his or her claim) and the percentage of the individual's claim relative to the amount awarded, employees pursuing claims of discrimination achieved lower awards than those pursuing other types of employment claims.<sup>25</sup>

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statutory discrimination claim reported in this later study may be a reflection of FINRA rule changes rather than any evidence of bias towards claimants.

<sup>22</sup> See Arbitration and Mediation Statistics, available at <https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics>.

<sup>23</sup> Because of the lack of consistent available information in FINRA awards, we cannot determine whether other awards encompassed discrimination claims. We only looked at those awards where the term discrimination was referenced or there was a reference to a federal, state or local anti-discrimination statute. Because FINRA does not utilize any uniform coding system when claims are filed and there are no uniform requirements as to how arbitrators describe the claims asserted in a case in their awards, the information is imperfect in analyzing the awards. Moreover, an award might indicate several claims at issue, including a statutory claim, identify the damages sought, and the damages won, but not include a breakdown of how the damages were allocated between claims or the basis for that award.

<sup>24</sup> J. Ryan Lamare and David B. Lipsky, *Employment Arbitration in the Securities Industry: Lessons Drawn from Recent Empirical Research*, 35 Berkely J. Emp. & Lab. L. 113, 126 (2014).

<sup>25</sup> *Id.* At 126-27.

## **What Can Explain the Outcomes in Discrimination Claims Arbitrated At FINRA**

Employment discrimination claims constitute one of the small carve outs for mandatory employment arbitration at FINRA. A fundamental question, therefore, as to whether litigants *should* arbitrate statutory discrimination claims at FINRA or whether those claims are best resolved in court. As discussed above, employees recovered damages in less than half of the awards issued where discrimination claims were addressed and that those awards were comparatively smaller than the awards employees were awarded in non-discrimination claims. At the outset, however, it is important to note that those percentages might not be indicative of failures by employees pursuing employment discrimination claims in FINRA. To illustrate, the Equal Employment Opportunity Commission, which is charged with enforcing all federal anti-discrimination statutes, issues reasonable cause determinations in approximately 3% of its charges.<sup>26</sup> If the EEOC only finds that there is reasonable cause to believe that discrimination occurred in about 3% of the complaints it receives, it is not apparent that employees raising discrimination claims in FINRA arbitrations receiving awards in less than 50% of cases should be considered a flaw of the system.

Moreover, the demands in FINRA arbitration often suffer from “inflation” where a claimant will ask for a large damages award that the employee might not assert in court. Because in court litigation the employee would be expected to produce discovery to justify its damages and the damages sought would be scrutinized by a judge before it was ever presented to a jury, the damages requested are more likely to be rooted in legal theories than in FINRA arbitration where there is no review of the damages requested unless and until a hearing on the merits is completed.

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<sup>26</sup> See EEOC Charge statistics, available at <https://www.eeoc.gov/eeoc/statistics/enforcement/all.cfm>

The fact that the damages awarded are often less than those requested, therefore, might not be suggestive of any limitations of the FINRA arbitration system.

Even if employees win less than what was demanded and win fewer cases than they lose in employment discrimination claims at FINRA, we are unable to find evidence that there is an impediment for effective vindication of statutory rights on the part of employees in FINRA arbitration. For example, the “repeat player” effect of arbitration is an often discussed potential flaw in the arbitration process. The concept is that because employers have more arbitration experience in the forum as compared to an individual employee who is likely to be appearing in the forum for the first time, that there is an inherent benefit to the employer.

As discussed in our earlier study, we have not identified any evidence that employers fare better than employees in arbitration due to the relative frequency in which they litigate in FINRA. As compared to other arbitral fora, we suggest that the claimant’s bar is relatively small and well-known to FINRA arbitrators. The arbitrators who hear the employment disputes are the same arbitrators that also resolve the customer disputes, and allegations of misconduct by the financial institution could actually undermine any perceived benefit the company might receive as the repeat player. In addition, claimants are often represented by the same attorneys who handle employee-side representation in FINRA. In other words, the claimants, like the institutions, are often represented by attorneys who are also experienced FINRA litigators. Repeat involvement in arbitration may be less significant in this industry because FINRA hears cases in approximately 71 different locations in the United States,<sup>27</sup> generally with arbitrators who live and work near the hearing locations, and FINRA arbitrations are often resolved by three-party panels such that there

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<sup>27</sup> See, FINRA Dispute Resolution Regional Offices and Hearing Locations, available at: <http://www.finra.org/ArbitrationAndMediation/Contacts/DRRegionalOfficesHearingLocations/>.

are varying viewpoints weighing in on every case. Others who have evaluated this issue have similarly concluded that the repeat player effect is unlikely to explain any differences in employees' success in FINRA employment arbitration.<sup>28</sup>

So what explains for the outcomes in employment discrimination claims if there is not inherent bias by the system? We suggest that the lack of motion practice available in FINRA arbitration might be the greatest factor in explaining the arbitration awards in discrimination cases. In court litigation, motions to dismiss and, even more consistently, motions for summary judgment, result in dismissal of employment discrimination claims prior to any hearing on the merits. Indeed, researchers have reported summary judgment dismissal in as many as 70% or more of employment cases.<sup>29</sup> Further, in cases that do not get dismissed on summary judgment, parties often settle rather than face the costs of a jury trial in court.

Contrast that to FINRA arbitration where there is virtually no pre-arbitration motion practice to dismiss or narrow the claims. Once an arbitration claim is filed at FINRA, a claimant is almost guaranteed a hearing before a panel of arbitrators unless the parties decide to settle. In other words, while in court litigation the weakest employment discrimination cases are dismissed on motion papers, in FINRA those claims would be tried before a panel and could explain for the relatively low monetary awards issued. In fact, we suggest that employees might fare better in a FINRA arbitration than in court where an employee would have to proffer evidence of

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<sup>28</sup> See *Lamare*, *supra* note 24, at 123-24 (concluding that FINRA's automated panel selection and arbitrator disclosure requirements could explain for the lack of repeat-player effect in FINRA arbitration); *Lipsky*, *supra* note 18, at 58, 60 (concluding that while there was a statistically significant difference between the top five and ten users of the FINRA employment arbitration process when compared to the rest of the firms, other factors, such as the size of the claim and the nature of the charge, are likely more influential to the outcome of the case).

<sup>29</sup> See, e.g., Hon. Denny Chin, *Summary Judgment in Employment Discrimination Cases: A Judge's Perspective*, 57 N.Y.L. Sch. L. Rev. (2012-2013), p. 673.

discrimination before trying those claims. Without motion practice or a requirement that they issue reasoned awards, FINRA arbitrators are susceptible to imposing “rough justice” or “split the baby decisions” that are unexplained to the public and not firmly rooted in law.