SECURITIES ARBITRATION COMMENTATOR

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SAC ROUNDTABLE DISCUSSION

The FINRA Dispute Resolution Task Force Has Issued Its Final Report. Now What?

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SAC: *Welcome to our fourth podcast in a series of Roundtable discussions about topics and issues of concern in securities arbitration today. Our attention in this current SAC Roundtable focuses on the work at the FINRA forum, now known as the Office of Dispute Resolution, as it studies how to implement the 51 recommendations for change that recently issued from the FINRA Dispute Resolution Task Force (DRTF). This discussion was recorded in mid-April 2016 and, as with the earlier talks, a video podcast of the session will be posted on SAC's YouTube Channel shortly after publication of this newsletter.*

The video podcast includes an accompanying PowerPoint presentation and differs in other respects from this modified transcript. The podcast is most easily accessible through a "button" link on the HomePage of SAC's Blog. We are proud of the fact that, if one goes to the YouTube HomePage and searches "securities arbitration," SAC's podcasts occupy three of the top ten responsive slots – search "securities mediation" and we are right on top! While these rankings will vary, we view that indication of interest as a positive sign of the value of these Roundtable Discussions in educating interested parties about the issues that face our practice.

Our speakers are introduced briefly above; more detailed bios appear at the end of this article. We thank our guest speakers for participating in this conversation about important and likely changes to the FINRA Arbitration Code over the next few years and for their insights and views about the DRTF Report. We ask our readers to understand that the statements, opinions and projections of our speakers are their own personally and do not necessarily represent those of the organizations or institutions with which they are associated. We also invite our readers to suggest future topics for Roundtable treatment.

Background

FRIEDMAN: This is a wonderful, wonderful panel. I thank you all for participating here today. I'd like to start by asking Professor Barbara Black to give us a brief overview of the Task Force and what it did. I'm sorry to disappoint you, she is not going to tell you who said what -- that would be unfair -- but just give us some idea what the Task Force set out to do and what it accomplished. Barbara?

BLACK: The 13-member Task Force was formed in June 2014 to focus

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on suggesting strategies to improve the transparency, impartiality, and efficiency of FINRA's securities dispute resolution forum for all participants. The Task Force and its ten subcommittees met 57 times, had its own area on FINRA's website, and an email address for receiving suggestions and comments. We received 188 comments, via the mailbox, almost all of which came from individuals who self-identified as arbitrators.

In addition, the Task Force solicited written comments from a number of organizations and individuals and also conducted telephonic interviews with various representatives of organizations. The Task Force looked at every aspect of FINRA's dispute resolution forum, as it relates to customers' disputes. The Report runs 70 pages, including appendices, and contains 51 recommendations to improve the system.

FRIEDMAN: Thank you, Barbara. Time of course doesn't permit us to cover each of the recommendations. We're going to try to focus on the ones we think are of most interest. This will be our approach: First, the "Core Four" recommendations. We'll explain those in just a minute. Next, what happens to the major no-consensus items? There are a couple that we're going to talk about. And then the third, and this is my favorite part, where do we expect to be in three years? The reason it's my favorite part is, we can all disagree, but we can't definitively say anyone is wrong, unless we claim to be from the future.

The Core Four Task Force Recommendations

Okay, so let's move on to the Core Four recommendations. The first one is **improving arbitrator professionalism**. With all of these, we're going to ask Barbara to tee up our discussion. Just tell us, Barbara, about the main thrust of each recommendation and what it intends to accomplish.

BLACK: It was the unanimous, strongly held opinion of the Task Force that the most important investment in the future of the FINRA forum is in its arbitrators. The responsibilities and time commitments expected from arbitrators have increased in recent years and we expect they will continue to increase.

Therefore, the Task Force recommends **increasing arbitrator honoraria from $300 to $500 per hearing session**, which would be from $600 to $1000 a day, in the typical two-session day. In addition, there would be adjustments for inflation every two years.

We also recommend **enhanced recruitment to expand the diversity and depth of the arbitrator pool, more continuing education training for all arbitrators and increased training for chairs, expanded arbitrator disclosure mechanisms, including earlier disclosure of case-**

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specific information, so that parties can select arbitrators on a more informed basis.

In a related area, we recommend the **creation of a pool of trained, experienced arbitrators to conduct expungement hearings in settled cases**, and in all cases where claimants did not name the associated person as the respondent. In addition, the Task Force recommends **enhanced training for all chairs who decide expungement cases.**

FRIEDMAN: Thank you. Now, you know, the obvious observation is, you can't run an arbitration forum without arbitrators. So this clearly is the first in priority among the Core Four. Barbara, as long as you have the floor, let me start with this question. How should the arbitrator honorarium increase be funded? Should FINRA foot part of the bill? Should it fall on the industry? What's your take on that?

BLACK: The Task Force reviewed a rough estimate of the additional honorarium expenses that would result from these increases and felt that FINRA and the industry could manage the additional expenses. The Task Force also hoped that the additional cost would be assessed consistent with the current allocation of fees between industry members and customers. Currently, member firms and associated persons are assessed 84% of total fees, while customers are assessed 15%. The Task Force believes it's important that the FINRA forum is accessible to retail investors, consistent with the investor protection mandate of the Exchange Act.

F**RIEDMAN:** Thanks. Steve, let me pose a question to you on one of the components of the recommendation, which is **expungement.** SAC has done many surveys, finding that arbitrators tend to grant expungement relief more frequently when a case is settled, rather than after a hearing on the merits, after all the evidence is in. Do you think that needs to be fixed? And do you think the expungement panel idea is one way to do that?

CARUSO: One of the things I would say, George, in response to your question is, post-settlement expungement awards are currently at an excessive level. During the 39-month period between January 1, 2013 and March 31, 2016, there were approximately 857 post-settlement awards issued by FINRA, involving public customers, that requested expungement. And, of those awards, expungement was granted in 756 of them, which equates to about 88.21% of all of the awards.

Now, while this is an excessive number compared to overall expungements, at the same time, recognition, I think, needs to be given to FINRA's continuing education and training of arbitrators, which is evidenced in the award percentage granting expungement.

In 2013, that was over 91%. In 2014, it went down to 88%. In 2015, approximately 85%. And for the first quarter of this year, it was down to 74%. So clearly the expungement issue, post-settlement, is an issue that FINRA will continue to address in the coming months.

FRIEDMAN: A follow-up question. What's your take on this special panel being one way to address the problem?

CARUSO: The idea of having a special panel of specially-trained arbitrators, I think is going to be critical. You know, there is a macro-question evolving as to whether arbitrators should even be involved in expungements at all and there are two distinct camps on that issue. I think the idea of having specially-trained arbitrators, who understand the significance of expungement and understand the long-term ramifications for investor protection, is a very viable alternative.

FRIEDMAN: Okay, thanks. Briefly, I'll ask the rest of the panel to weigh in on a different issue, which is, the recommendation for **expanded arbitrator disclosure**. Any reason to be against that? I'll start with Noah.

SORKIN: No, George. I think so long as the disclosure requirements are relevant -- and, as was noted in the Task Force Report, they're not too burdensome -- when the disclosure requirements don't act to deter qualified arbitrators from wanting to serve. I think disclosure is always a good thing. I particularly liked the recommendations from the Task Force that would have the pool of 30 potential arbitrators provide, I think what was referred to as, case-specific disclosures, relating directly to the particular arbitration claim for which they're being considered.

I think that kind of disclosure process would not only be extremely useful to the parties, but it wouldn't be overly burdensome for the arbitrator candidates who were being considered for a particular panel.

FRIEDMAN: Okay, thanks. Jill, and following Jill, Dave, briefly, any reactions to expanded disclosure?

GROSS: To me, it is definitely a desirable change. The more disclosure you have from arbitrators, the better off the disputants can assess whether the neutral is somebody they want to pick. Certainly, parties are entitled to a neutral decision-maker, so this would certainly help in that direction.

FRIEDMAN: Good, Dave?

FRANCESKI: George, thanks. First, by the way, let me thank you, George and Rick and the *Securities Arbitration Commentator* for inviting me to participate in this podcast.

Turning to the issue of expanded disclosure, I think being against it would be like opposing common sense. I think the current FINRA application, which I myself filled out less than two years ago, was very thorough, and anything we can do to

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improve on that will only make the process better. As long as it isn't too intrusive, as Noah suggested.

I would go one step further with this process. I think that we've lost some very fine arbitrators by the elimination in most cases of the industry arbitrator. I would frankly go to only two lists, one that's, say, a chairman's list, and one that is an "other" list, if you will. Include the backgrounds of everyone and let the parties choose or strike based on whatever part of the background the party thinks will be best for their case.

FRIEDMAN: Thank you. That's an interesting concept. And would be fun to bat around, but we don't have enough time to talk about it here. I would weigh in and say that expanded disclosure is the way to go. Obviously, you can't get to the point where you have to have a family reunion to do your conflict check, every time you get in a potential case.

Okay, let's move on to the next of the Core Four. This is something that goes back to 2005, at least, but it's **explained decisions as a default choice**. Again, why are we doing this? Barbara, may I ask you to tee it up for us?

BLACK: Certainly. The current rule requires arbitrators to provide a brief, fact-based explanation of their award when requested by **all** parties to the dispute. In fact, few explained decisions have been written since the adoption of the rule. In the view of the Task Force, expanding the use of explained decisions is one of the most important things FINRA can do to increase transparency in the system.

Therefore, the Task Force recommends that the FINRA rules should be amended to require explained decisions, unless any party notifies FINRA prior to the initial pre-hearing conference that it does not want an explained decision.

The current brief, fact-based format of the explanation should be retained, but with the addition of some summary explanation of the reasons behind any damage calculation. And finally, before any plan to expand the use of explained Awards is implemented, FINRA must **develop and administer a training program on how to write explained decisions.**

FRIEDMAN: Thank you, Barbara. Now, the key thing is that any party can opt out. So let me start with Noah. Some, not necessarily me, but some believe the proposal is not going to change anything really, because the firms will simply opt out of an explained decision at every opportunity. As inside counsel, do you think that observation is correct?

SORKIN: You know, it's a fascinating area. At first, I thought that the answer here would be yes, George, that many firms would always opt out of having an explained decision, to avoid unnecessary delays in reaching a final decision, and probably more importantly, to forestall the possibility of constant appeals from arbitration decisions that are viewed as favorable to the defending firm.

But after giving it more thought, I'm not sure that I'm correct on that. So, I thought of the following scenario. Imagine a case brought by an investor which the firm views as being wholly frivolous and without merit. Attempts to resolve the matter by paying a nominal, nuisance-value sum don't work, and the matter does proceed to arbitration.

It might very well be advantageous for defense counsel to ask for an explained award, where the firm believes that any decision from the panel granting payment to the claimant would be reversed on appeal.

I think the bottom line here is that the decision to opt out of an explained award will probably vary depending upon the facts of the case and the particular strategy that defense counsel and plaintiff's counsel bring to bear.

FRIEDMAN: Thanks, Noah. Let's go to the other side. Steve, I realize you're not representing every customer's attorney, but I think back over 10 years ago to the original explained awards rule, there was some unexpected resistance to the original proposal from the customers' bar. So how do you think it's going to fare, this time around?

CARUSO: My opinion, George, is that there's still going to be a continuing amount of resistance to having an explained decision. And my opinion is primarily predicated on the fact that any mistake -- anything that's in an award that could constitute a ground to vacate the award -- is something that claimant's counsel has been and will continue to be very concerned about. You know, the idea conceptually sounds good, but I'm not sure what it adds to the process, and at the end of the day, if there is not finality in an arbitration award, and it's going to be used as a tool to vacate, that is going to be, and I anticipate it will continue to be, a serious concern.

FRIEDMAN: Thank you. Dave, We've heard from inside counsel, as outside counsel, do you think you'd be recommending your clients opt out, or does it really depend on a case-by-case?

FRANCESKI: Well, George, I think some of my comments are very much like Noah's. Let me say from the start, I actually don't think that explained awards will generate more appeals. I really think it's the result, rather than the reason, that generates the appeals. And we know that the standards for vacating are so high, that most cases aren't reversed on appeal anyhow. I actually think that explained awards might make defending good results -- where the firm is not assessed anything in the arbitration -- might make it easier to defend those awards, because oftentimes we're in front of a judge, trying to prove a negative to the judge: why didn't the panel award something to the claimant? We're now

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going on 28 years, since *Shearson-McMahon* -- without much in the way of meaningful written development of the law to guide firms and customers on some pretty thorny issues. Not that explained awards themselves would do that, but they might at least lead courts to weigh in a bit more.

Still, there are a few instances where I might recommend opting out. One would be where I see an adversary, either party or counsel, that has a history of challenging negative awards. I might opt out of that one.

Second might be, early in a line of cases, where I know that the firm's going to be faced with similar claims. I may want to see a few of those results before I see some, if you will, precedent developing for how those awards are rendered. And I know that the explained awards aren't supposed to be precedential, but we know that they will be used, or parties will try to use them, in that fashion.

And the third area might be where an arbitrator, as the Chair, has developed some history of issuing peculiar explained awards. I might want to avoid that one.

The key here, I think, will be training and crafting of the explained awards.

FRIEDMAN: Speaking of arbitrators, Jill, you're on arbitration panels for several ADR providers. What's your reaction? Do you like this? How does it sit with you as an arbitrator?

GROSS: Well, I would say I'm cautiously pleased with the recommendation. I'm not overly enthusiastic, because I share some of the current concerns that have already been expressed by the others, about the problems that could be generated with an explained award.

But, as an arbitrator, particularly when I think, and the panel thinks, that the parties in the case, or the lawyers in the case, have a real lack of understanding of the value of the case, or the merits, or the credibility of their witnesses, I think it's important to give them a little bit of insight into the arbitrator's thinking, give them a little bit of transparency in the decision, so that they're not completely unsatisfied, that they get some sort of closure, at the end.

They may not like the result, certainly, the explanation isn't going to change their reaction, but it is going to add a little bit to their perception that at least their argument was heard. And so, for those reasons, I support the recommendation. I think overall, it's a good idea, even though I do recognize that there are some downsides to it.

FRIEDMAN: Thanks for that very interesting discussion. Let's move on to our next topic: what's called an **"intermediate approach" for smaller claims.** You know, much has changed since the Uniform Code was created back in 1980. So I'll ask Barbara, again, to tee this up. What's this one about?

BLACK: All right. Let me start with the current rule. The current rule provides simplified arbitration procedures for small claims, currently defined as arbitrations involving $50,000 or less. A principal difference between standard arbitration and simplified arbitration is that there's usually no hearing in a simplified arbitration, unless it's requested by the customer. In the absence of a hearing, the arbitrator decides the dispute, based on the pleadings and the other documents submitted by the parties.

So, what we are proposing is this intermediate approach to small claims -- more than papers, but less than a full hearing -- in which the claimant and the respondent would appear before an arbitrator and have the opportunity to explain their positions and respond to their adversary's positions. Arbitrators would be specially qualified and trained for this role. And parties would be able to appear, in whatever manner they prefer, in person, by phone, or by video conference.

FRIEDMAN: Okay, Jill, let me push it back to you. You're a former clinic director, so I know you're very familiar with the small claims process. As I recall, you've written a law review article on the topic, with the idea of changing it. So, may I assume you're glad to see this recommendation?

GROSS: Yes, I mean, this is a recommendation that I cheered when I saw it in the Report. It's something I've been advocating for a number of years now. My research and my experience with small claims claimants was that they felt a strong lack of an ability to be heard. There was no affordable option for them to actually appear before a live person, to have their cases heard. It is particularly important to be heard in very fact-based cases, where credibility of the respective parties can be critical.

By allowing the parties to choose an affordable intermediate option, having arbitrators hear their case without substantially increasing the cost, the parties will achieve what I view as a much stronger sense of procedural justice, the opportunity to be heard, to feel that they've been listened to, that their arguments and facts and evidence has been taken into account. The research shows over and over that those factors significantly contribute to the disputants' perception of the fairness of the process -- which is a win for FINRA.

FRIEDMAN: Thanks. Let's move on to the fourth topic, which is **improving and expanding use of mediation**. The program has been around for a little over 20 years, founded in 1995, at FINRA. The Task Force is encouraging greater use of it. So, again, Barbara, what does that entail from the Task Force's perspective?

BLACK: Some of our recommendations include: automatic mediation process for cases filed

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in arbitration, subject to an opt-out provision by any party. Financial incentives for parties who have achieved a final, complete resolution of their dispute through mediation, by refunding part of their fees. Development of a formal, mandatory, continuing education and mentoring program for new mediators and a continuing education program for all mediators. Develop opportunities for beginning mediators to gain experience and training. And, finally, aggressive efforts to recruit, train, and encourage the use of more diverse mediators.

FRIEDMAN: So, in this "opting option," again, the default would be that the case is in mediation unless any party objects, correct?

BLACK: Yes.

FRIEDMAN: Okay. With that in mind, Dave, let me start with you. Generally speaking, on a gut level, what do you think you'd recommend to your clients, in terms of what I'm calling the "opting option."

FRANCESKI: Well, George, first of all, I'm a big fan of mediation, and frankly, I think that in reality the opt-out process both from the claimant's side and the respondent's side is almost here already, by practice. Mediation saves a great deal of time. It saves a great deal of money. Oftentimes, you get better overall results, factoring in both the cost of an arbitration and the result of going through a full hearing. As I say to my clients, would you rather pay me and get the risk of proceeding with the hearing, or would you rather pay the claimant, and get certainty?

So, I think we're almost here. Still, again, like the situation we talked about earlier, there are some instances where I might opt out of mediation. One would be where I don't think I'm going to get, or don't seem to be getting, the initial discovery that I think I need to develop the case, and from the respondent's side, that's not too many different items, quite frankly. The second would be, if the case doesn't really merit settlement, I don't go into mediations, I don't like going into mediations, where I don't intend to have my client pay something. It's not just a process for show. And the third is probably where I feel that a settlement would just generate more meritless claims. Even a small settlement generating more meritless claims, I probably wouldn't take that one to mediation. I might opt out and I would use the case to send a message.

Again, I think to make this process work, we're going to need more mediators, and we're going to need well-trained mediators.

Last comment I would make is, even if I opted out, George, in my view, "no" doesn't necessarily mean "no" forever. So, I would revisit the process as the case goes along.

FRIEDMAN: Thanks. Steve, as you know, mediation has until now been consensual. Both parties have to agree, and more often than not, the costs and fees are split -- not always, but more often than not. Do you think that dynamic changes, where it's an automatic system that gets you into mediation unless a party opts out?

CARUSO: Well, George, I think there are a couple of things concerning the mandatory mediation and cost is definitely one of them. There hasn't been a procedure set up yet that would detail how those costs would be allocated, so I think it's going to be a case-by-case, claimant-by-claimant, perspective on what it's going to cost, money-wise. I think another consideration is what it's going to do time-wise, as far as the ultimate resolution of a case. Is this going to delay the hearing on the merits?

Obviously, as Dave just said, you're going to need to have discovery done before you can even engage in a mediation, to make it viable for either side. So there are a number of factors, and the devil will be in the details concerning my opinion as to whether I stay in mediation, or opt out on any given case.

FRIEDMAN: Okay, thanks. Now, Jill, I'm making an assumption, but, you know, I built a career on the words "assume" and "presume," so let me ask you this question: Can I take it that the clinics will like the "opting option," primarily because it's good for the clients and, probably secondarily, because a nice by-product is the students likely to get to experience the life cycle of a case. Am I correct on that?

GROSS: Yes, I think you are correct. I think small investors, the kind that the clinics represent, will welcome the mediation process. Sometimes it's hard for the clinics to persuade the opposing party to agree to mediate, so this is a way to get into the mediation process without having to show their hand. Obviously it would be case-by-case, but assuming it's good for the client, then, for sure, the students will have the opportunity to get through, as you said, the life cycle of the case from beginning to end, possibly in one semester, if not, in one academic year. So, that is a good experience.

FRIEDMAN: Thanks. Noah, let me throw one other related question to you. The Task Force's recommendations about **mediator training, mentoring, diversity** -- any reactions to that?

SORKIN: I think it is terrific that the Task Force is supporting and encouraging mediation, for all the reasons that the other panel members have given. I particularly liked two things that kind of stood out to me. The mentoring program, whereby, as I envision it at least, new mediators can shadow experienced mediators during the process, actually be with them during a mediation, and learn from someone that's been doing it for a number of years.

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And the other suggestion, about seeking to add to the diversity of the overall mediator pool, by actively recruiting candidates from affinity groups, with diverse populations, I think that's a terrific idea, and I'm hoping that there will be a lot of effort in that direction.

What happens to the "no-consensus" items?

FRIEDMAN: All right, now time to move on to our next major discussion area, which is what happens with the **no-consensus items**? There are a few of them. We're going to look at two of the major ones, which is no consensus on mandatory arbitration and no consensus on unpaid awards. Related to the latter, there's a PIABA proposal for an unpaid award recovery pool.

But, before we begin, there's a key question I think we have to get answered, so I'll ask Barbara: was this on purpose? In other words, can you tell us whether **mandatory arbitration** became no-consensus on purpose -- was it discussed -- was it a conscious decision, or did you guys just not get to it?

BLACK: The Task Force felt it was important to take up the issue of mandatory arbitration and, indeed, the Task Force spent considerable time discussing it and debating it. Despite considerable discussion, however, the Task Force was not able to reach consensus. Rather, it concluded that the debate over mandatory securities arbitration is, to a large extent, a philosophical or policy question about which thoughtful, informed individuals disagree and one which the Task Force could not settle.

FRIEDMAN: Okay, I'm going to weigh in and ask myself a question, which is, what happens with mandatory arbitration? I'll start by saying, this could all change if the presidential election results in a Democratic President -- and Congress goes Democratic -- and as a result, the composition of the Supreme Court changes. But, for now, I don't think mandatory arbitration gets banned. Briefly, the Commission has authority in Dodd-Frank to ban mandatory arbitration, but it has not moved in almost six years since the enactment of Dodd-Frank, and I think they would be hard-pressed to ban mandatory arbitration agreements, because they'd have to say, essentially: "Look, we've been oversighting this system for decades, and we just realized it's terribly unfair. So we're going to ban mandatory." I just don't see that happening.

Second, in early April, the Department of Labor issued regulations establishing uniform fiduciary standards for those giving investment advice on retirement accounts. Related to that was the authorization to have what's called a best-interest contract -- establishing the fiduciary relationship between the person providing the advice and the investor -- and to my surprise, they said, the use of an arbitration clause is okay. They looked at the FINRA system and said: "Mandatory is okay. We're going to allow it." Given that endorsement, I think the Commission will be very hard-pressed to ban the right to contract for arbitration.

Finally, there's the Consumer Financial Protection Bureau, which also has authority under Dodd-Frank to ban PDAAs in contracts for financial goods and services. I don't think they will exercise the authority to ban either. In fact, the CFPB Director has said their focus is on getting rid of class-action waivers. So again, unless something changes dramatically, I just don't see the Arbitration Fairness Act, Restoring Statutory Rights Act or the Investor Choice Act being enacted. I think *status quo* is going to remain.

That's my short and sweet on that, but I'll ask people to react to this. I'll start with Steve, and then go to Noah, and David, and Jill. What do you think is going to happen with mandatory arbitration?

CARUSO: My belief, George, is that mandatory arbitration is here to stay. Which is fine by me, I'm an advocate for arbitration. I believe in the process. I believe in the integrity of the FINRA forum and I think it provides a very cost-efficient method of dispute resolution, even recognizing that it's not a perfect system. So, I'm in favor of staying in arbitration.

FRIEDMAN: Noah? Reaction?

SORKIN: I agree with Steve's remarks. I think, for the foreseeable future, mandatory arbitration is going to be the rule of the road. I think, too, that the mandatory nature of securities arbitration will become more acceptable, to the extent the perceived advantages of arbitration become a reality -- or remain a reality -- the speed, the reduced cost, the informality, and, if the pool of arbitrators is perceived as being well-qualified and fair.

The only other comment I would make is that, if we can also add to this mix -- along with mandatory arbitration -- the possibility of giving investors a wider choice of dispute resolution forums to choose from, then I think that the requirement that an investor go to arbitration, or that any party go to arbitration, probably won't be perceived as being so draconian.

FRIEDMAN: Thanks, Noah. Dave?

FRANCESKI: George, I too think that mandatory arbitration is here to stay. I think there's a huge difference between mandatory, pre-dispute arbitration agreements hidden in the fine print of a consumer contract, and the full disclosure of a heavily-regulated, thoroughly scrutinized pre-dispute arbitration agreement in a broker-dealer's customer agreement. I think it's here to stay. As Steve has said, I think FINRA has done a great job of ensuring fairness in the process, and judging from the Task Force Report, I can see that it will continue to evolve in that direction.

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FRIEDMAN: And Jill?

GROSS: I have come out, similar to Steve, in favor of the whole FINRA arbitration program, so I'm not running to have the SEC ban mandatory arbitration. I have discovered, just to add a new factoid to the discussion, that the SEC is the one that, originally -- way back in 1935, when it was first created -- came up with the idea, and suggested to the stock exchange members, at the time, that if they wanted to circumvent the customers' unilateral right to choose arbitration, that they could then add pre-dispute arbitration clauses in customer agreements. So, like George said, the SEC is not going to, all of a sudden, turn around and say: "Well, this program that we've encouraged and supervised for all these years is now no longer acceptable."

FRIEDMAN: And again, I think the Department of Labor's action just makes it even that much more difficult, because as part of the process, they looked at FINRA and said: "You know, that seems to be a good system" and cited it with favor.

Okay, on to **unpaid awards**. Briefly, again, Barbara, same questions. On purpose? How did that issue come to be "no consensus"?

BLACK: The Task Force reviewed FINRA's actions against broker-dealers or associated persons who did not pay awards and, in particular, the problem of unpaid awards resulting from firms and associated persons that are no longer in business. In 2014, FINRA considered imposing an insurance requirement for payment of awards, but decided against it. The Task Force discussed whether to recommend reconsideration of an insurance requirement for payment of awards, but reached no consensus.

FRIEDMAN: This issue of unpaid awards has been around at least for my 14 years at FINRA. As Barbara says, typically, the problem involves smaller firms that have gone out of business. So, one proposal that we heard recently came from PIABA, which was to create a recovery pool, if you will, for unpaid awards. Steve, can you tell us a bit more about that?

CARUSO: Sure, the concept that was floated by PIABA was basically the creation of a pool that would fund unpaid arbitration awards. There were a number of alternatives, as to how to fund that pool, included within the PIABA report, all of which would clearly have to be fleshed out, and while the issue of unpaid arbitration awards clearly presents a public relations problem for FINRA, it is a problem that FINRA has recognized, and I believe that it is a problem that FINRA will address in the coming months. There have already been statements from Rick Ketchum at FINRA that he recognizes this as a problem, and although I haven't seen any numbers to quantify the extent of the problem, it is clearly something that is going to need to be remedied.

FRIEDMAN: Just to clarify, I think Rick Ketchum was asked this question while testifying on a different topic. When he reacted, and said they were thinking of a recovery pool for smaller claims, there was no quantification. Any reactions from the others? Jill?

GROSS: I'm certainly encouraged to hear that FINRA is exploring the idea, but I'm not really sure why limiting it to small claims is wise. An investor, for example, who lost $200,000 and it was their only savings in the world, should not have less priority to such a recovery pool than a millionaire who lost $10,000. So, I'd have to understand the rationale better, and how the small claims would be chosen.

Where will we be in three years?

F**RIEDMAN:** I'll segue to predictions. On this, I think, something is going to happen over the next several years -- something, I'm not sure what. But, there is a clear signal from the chairman of FINRA that something will happen.

All right, let's go on to our last topic, and, again, my favorite part, because you can disagree, but you can't say anyone's particularly wrong. I'm not going to ask the panel to react to every question we have discussed, but we are looking for predictions. If we meet again three years from now and look back, what's going to be implemented and what will not? Will those changes have any impact on what the SEC does? And, at the end of the day, when Barbara looks back at this, and the accomplishments of the Task Force, what will it most be remembered for? So let me ask our panel to weigh in. I'm going to start with Barbara, though. First question is, **what's FINRA's approach to considering the ideas and implementing them?**

BLACK: Okay, well the recommendations of course are those of the Task Force members and any change to a FINRA rule, has to go through the customary vetting process. Our Task Force Report is now before the National Arbitration and Mediation Committee, and my understanding is that they have already begun to consider our recommendations. FINRA also has various other channels that they vet proposals through. Their constituents, other advisory committees, and of course, the FINRA Board. Finally, of course, any rule change would have to be approved by the SEC.

FRIEDMAN: All right, so in our final "lightning round" here, I'm going to ask our panelists to briefly weigh in on **where they think things are going.** Steve?

CARUSO: My prediction, George, is that a handful of the recommendations will be approved and implemented. A handful will be rejected. The majority will still be under discussion and vetting three years from now, and, on the bigger topic of the SEC's decision on arbitration and making it mandatory or not, it will be in the same position we've been in for the past five or ten years -- no decision.

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FRIEDMAN: Hmm! Okay, very good. Dave?

FRANCESKI: My comments aren't terribly different from Steve's, George. I think that this Task Force report is more evolutionary than revolutionary, and some things will be adopted, and some won't. What I'm going to pay most attention to, as we move forward here, is again, the first recommendation, the arbitrator pool. I think that the quality of this process depends on the arbitrator pool and, I think, that's the thing that three years from now, we're going to be looking at most closely. I hope that we can continue to improve it.

FRIEDMAN: Thank you, Jill?

GROSS: Well, I was struck in the Report by the line that Barbara repeated at the beginning of today's panel, which is, the most important investment in the future of the forum is in the arbitrators. I think we're going to see a return on that investment, if FINRA actually does this right. Maybe not in three years -- maybe in a five to 10-year horizon -- but certainly, I think there will be some return on that investment in terms of FINRA being more transparent, more accountable, and having a higher quality pool of arbitrators. One final point is that, I think other arbitration providers and agencies in other regulated areas, will continue to look at FINRA as a model for how to set up a regulated arbitration forum.

FRIEDMAN: I agree, thank you. Noah?

SORKIN: I think the Task Force wrestled with and decided any one of a number of really interesting and important points, but when I look in my crystal ball, there are two that kind of stand out and that I hope we will see more of in the coming years. First of all, I think there will be a defined, single arbitrator hearing approach for small claims. And I think that's going to be terrific, once we get that clarified and implemented.

And finally, I expect to see increased use of mediation, as a result of the training efforts, and the diversity efforts, et cetera. The statistics that were cited in the Report, to me, at least, were heartening -- that mediation stands to become a much more valuable tool, a much more implemented tool, and not only in terms of resolving disputes, but in terms of helping to quell the volume of arbitrations or matters that actually go to hearing.

FRIEDMAN: Thanks. I'll weigh in briefly, on the third bullet point. I think the importance of the Task Force's work is that it now **gives the SEC a path for dealing with its Dodd-Frank responsibilities.** Really the SEC doesn't have obligations, it doesn't really have to do anything on arbitration under Dodd-Frank, but, I've said before, I think politically that it's untenable not to act. So, now, the Commission has an opportunity to build on what the Task Force did, and I think at some point, they will study arbitration, make note of whatever changes FINRA is going to implement from the Task Force, and then say, like Department of Labor, "we conclude the process is fair. These other changes make it even better. Have a nice day."

That's my view on this, but, you know, time will tell. We'll do this again in a few years.

Wrap-up

Okay, it's time to wrap up. I want to thank our panel, and *SAC,* for a great program.

Barbara, Jill, Dave, Noah, Steve, great job! A lot of fun. As usual, time went very quickly, and I want to thank our audience for their attention. Be sure to follow the panelists and *the Securities Arbitration Commentator* on social media.

FACULTY BIOS:

George H. Friedman is an ADR consultant and *SAC* Board of Editors member. He retired in 2013 as FINRA's Executive Vice President and Director of Arbitration, a position he held from 1998. Before that, he held a variety of positions at the American Arbitration Association, most recently as Senior Vice President from 1994 to 1998. For the last 20 years, George has been an adjunct professor of law at Fordham Law School, teaching arbitration. He serves as Chairman of the Board of Directors of Arbitration Resolution Services, Inc. and is the principal of George H. Friedman Consulting, LLC. He is also on the AAA's panel of arbitrators, is a certified regulatory and compliance professional and holds a J.D. degree from Rutgers Law School.

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Barbara Black served as Chair of the FINRA Dispute Resolution Task Force. She is a past member of FINRA's National Adjudicatory Council and has been a FINRA arbitrator for over 20 years. She retired as a law professor and Director of the Corporate Law Center at the University of Cincinnati College of Law in 2014, after over 40 years in academia and legal practice. Professor Black has written frequently on securities arbitration, broker-dealer regulation, and securities fraud; her publications are available at www.ssrn.com. She has a J.D. degree from Columbia University and is licensed to practice law in New York.

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Steven B. Caruso, the resident partner in the New York City office of Maddox Hargett & Caruso, P.C., has concentrated his practice on the representation of public investors in securities arbitration and litigation proceedings since the firm was founded in 1991. Prior to joining Maddox Hargett & Caruso, Mr. Caruso was associated with several brokerage firms in the securities

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industry and was engaged in the private practice of securities law, which concentrated on providing representation in securities arbitration and litigation matters. He is the immediate past Chairman of FINRA's National Arbitration and Mediation Committee and the current Chairman of the FINRA Discovery Task Force. His prior securities-related positions include having served as General Counsel for a national brokerage firm with approximately 500 institutional and retail account executives in 15 branch offices; Managing Director of Corporate Finance and Investment Banking for a national brokerage firm with approximately 900 institutional and retail account executives in 33 branch offices; and Chairman of the Board of Directors of an Underwriter of an open-ended investment management company. He has a J.D. from Hofstra University School of Law, and is admitted to practice in New York, the U.S. Supreme Court, and several other federal courts.

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Professor Jill I. Gross is a nationally known expert in the field of securities dispute resolution. Professor Gross teaches several securities-related courses at Pace Law School, and was Director of the Investor Rights Clinic from 1999 to 2015. She has published numerous law review articles in the area of dispute resolution and investor justice, and has been quoted in the national media on issues relating to securities arbitration, speaks often on the topic, and has authored numerous articles. She is an arbitrator for AAA, FINRA Dispute Resolution and the National Futures Association, and is a former Chair of the Practising Law Institute's annual Securities Arbitration continuing legal education program. She was a public member of the FINRA National Arbitration and Mediation Committee. Before entering legal education, Professor Gross was an attorney representing clients in white collar criminal and securities enforcement proceedings, securities arbitrations, and other commercial litigation. She has a J.D. degree from Harvard University School of Law and is admitted to practice in New York, Massachusetts, and the Southern and Eastern Districts of New York.

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