**Commercial Arbitration**

**“Ethical Obligations of the Tribunal”**

Group Training Vignettes (with Suggested Reference Materials)

By George H. Friedman

*Note:* These role plays map to the FINRA Codes of Arbitration Procedure (and, for comparative purposes to the American Arbitration Association’s Commercial Arbitration Rules) and the revised (2004) AAA/ABA *Code of Ethics for Arbitrators in Commercial Disputes.* There are also some references to the AAA/ABA/ACR *Model Standards of Practice for Mediators*, and the *ABA Model Rules of Professional Conduct* for attorneys, and the *FINRA Arbitrator’s Guide*.

*There are not always clear-cut answers in either the Code of Ethics or the FINRA Codes of Arbitration Procedure. In many instances, you may find rules that apply to the situation, but you will be challenged to apply reason and judgment to the fact pattern at hand.*

*Please note that the views expressed in this document are those of the author, and not necessarily those of Fordham Law School or Arbitratuion Resolution services, Inc. Any material in* ***bold/underline/italics*** *is emphasis added by the author.*

**1. OUTRAGEOUS CONDUCT**

**Arbitration was commenced by an Associated Person (employee) against a brokerage firm (employer), for wrongful termination. During the course of the arbitration, you determine that the employer’s treatment of the former employee was unfair, unconscionable, and bordered on malicious. In addition to awarding all compensatory damages claimed by the employee, you also award the employee $100,000 in punitive damages, although an award of punitive damages was not sought. Considering the actions of the employer, is such an award appropriate or permissible?**

Text of Key Sections of Interest:

**Federal Arbitration Act, section 10(a)(4):** In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration … where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

**FINRA Code of Arbitration Procedure Rule 12409:** The panel has the authority to interpret and determine the applicability of all provisions under the Code. Such interpretations are final and binding upon the parties.

**FINRA Rule 2268(d):** No predispute arbitration agreement shall include any condition that … (B) limits the ability of a party to file any claim in arbitration .. [or] … (D) limits the ability of arbitrators to make any award.

**AAA Rule R-49(a):** The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract.

2. **STIPULATED OR CONSENT AWARD**

**(a) After five days of hearings, the parties announce that they have reached a mutually acceptable settlement of their dispute. They would like the terms of their settlement to be reduced to a stipulated award and signed by you, the arbitrator. Can this be done? If so, how?**

**(b) Suppose in a securities case the parties (the investor, the brokerage firm, and the individual broker) settle their case and decide that as part of the settlement, the broker’s record in the Central Registration Depository (CRD) be expunged (wiped clean). Can this be done? How?**

**(c) Suppose you are not satisfied with the propriety of the award or question whether all pertinent facts or circumstances have been disclosed? Are you obligated to sign it? What should you do?**

Text of Key Sections of Interest:

**Code of Ethics Canon V(D):** In the event that all parties agree upon a settlement of issues in dispute and request the arbitrator to embody that agreement in an award, the arbitrator may do so, but is not required to do so unless satisfied with the propriety of the terms of settlement. Whenever an arbitrator embodies a settlement by the parties in an award, the arbitrator should state in the award that it is based on an agreement of the parties.

AAA Rule R-50(a): (a) If the parties settle their dispute during the course of the arbitration and if the parties so request, the arbitrator may set forth the terms of the settlement in a “consent award.”

**FINRA Rule 2080** (formerly 2130) went into effect in 2004. Under this rule arbitrators can order expungement of customer dispute information contained in the CRD **only** when they have **affirmatively found** that:

* + the claim, allegation or information in the customer dispute is **factually impossible or clearly erroneous**; **OR**
  + the registered person was **not involved in the alleged misconduct**; **OR**
  + the claim, allegation or information **is false**.
* In 2009FINRA implemented **Rule 12805/13805** that requires arbitrators to **take specific steps** **before recommending expungement** **of customer dispute information** related to arbitration cases from a registered person’s CRD record (for expungement orders ordered on or after the effective date).
* This rule change is designed to **assure that expungement occurs only when one of the three narrow grounds** specified in Rule 2080 is determined and documented by the arbitrators.

**Rule’s Requirements**

* In addition to the current requirement that the arbitrators state expressly which of the narrow grounds for expungement serve as the basis for their order, the new rule **established a procedure** arbitrators **must** follow in considering expungement requests for customer complaints:
  + requires that arbitrators **hold a recorded hearing** session by telephone or in person to ensure that arbitrators consider the facts for and against expungement;
    - Note: this is particularly important in cases in which the parties have settled and seek a stipulated award, and the terms of the settlement agreement require the customer to consent to a request for expungement.
  + in the case of a **settlement**, requires the arbitrators to **review the settlement documents** to examine the amounts paid to any party and any other terms and conditions of the settlement before awarding expungement;
  + requires arbitrators to provide a **brief written explanation** (**explain the factual basis)** for their ruling; and
  + Assess forum fees for hearing sessions held solely for the purpose of considering expungement against the parties requesting the relief.

**3. DISCLOSURES AT HEARING**

**(a) You are one member of a three-arbitrator panel. The first hearing is about to begin. You and your fellow arbitrators are in the hearing room when the parties enter. Immediately you recognize the expert witness for the claimant. However, you can't place her. What should you do at this point?**

**(b) Suppose that during the course of the arbitration you learn that a close friend of yours was an investor in the stock that is the subject of the arbitration. Should you disclose this?**

Text of Key Sections of Interest:

**FINRA Code of Arbitration Procedure Rule 12405(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.

**FINRA Code of Arbitration Procedure Rule 12407(a)(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 direct, 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

**FINRA Code of Arbitration Procedure Rule 12407(b):** 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).

**Code of Ethics Canon I(G):** The ethical obligations of an arbitrator begin upon acceptance of the appointment and continue throughout all stages of the proceeding. In addition, as set forth in this Code, certain ethical obligations begin as soon as a person is requested to serve as an arbitrator and certain ethical obligations continue after the decision in the proceeding has been given to the parties.

**Code of Ethics Canon II(A):** Persons who are requested to serve, as arbitrators should, before accepting, disclose:

1. Any known direct or indirect financial or personal interest in the outcome of the arbitration;
2. Any known existing or past financial, business, professional or personal relationships which might reasonably affect impartiality or lack of independence in the eyes of any of the parties. For example, prospective arbitrators should disclose any such relationships which they personally have with any party or its lawyer, with any co-arbitrator, or with any individual whom they have been told will be a witness. They should also disclose any such relationships involving their families or household members or their current employers, partners, or professional or business associates that can be ascertained by reasonable efforts;
3. The nature and extent of any prior knowledge they may have of the dispute; and
4. Any other matters, relationships, or interests which they are obligated to disclose by the agreement of the parties, the rules or practices of an institution, or applicable law regulating arbitrator disclosure.

**Code of Ethics Canon II(C):** The obligation to disclose interests or relationships described in paragraph A is a continuing duty which requires a person who accepts appointment as an arbitrator to disclose, as soon as practicable, at any stage of the arbitration, any such interests or relationships which may arise, or which are recalled or discovered.

**Code of Ethics Canon II(G):** If an arbitrator is requested by all parties to withdraw, the arbitrator must do so. If an arbitrator is requested to withdraw by less than all of the parties because of alleged partiality, the arbitrator should withdraw unless either of the following circumstances exists:

1. An agreement of the parties, or arbitration rules agreed to by the parties, or applicable law establishes procedures for determining challenges to arbitrators, in which case those procedures should be followed; or
2. In the absence of applicable procedures, if the arbitrator, after carefully considering the matter, determines that the reason for the challenge is not substantial, and that he or she can nevertheless act and decide the case impartially and fairly.

**FINRA Arbitrators Guide:** The duty to disclose is ongoing. Therefore, arbitrators are required to continually make reasonable efforts to inform themselves of relationships and interests including changes in their or their immediate family member’s[[1]](#footnote-1) employment, job functions or clients since these facts can result in a change to their classification as a public or non-public arbitrator. 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. As a rule, **w*hen in doubt, always err in favor of making a disclosure.*** 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.

**AAA Rule 18(a)**: (a) Any person appointed or to be appointed as an arbitrator, as well as the parties and their representatives, shall disclose to the AAA any circumstance likely to give rise to justifiable doubt as to the arbitrator’s impartiality independence, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their representatives. Such obligation shall remain in effect throughout the arbitration. Failure on the part of a party or a representative to comply with the requirements of this Rule may result in the waiver of the right to object to an arbitrator in accordance with Rule R-42.

(b) Upon receipt of such information from the arbitrator or another source, the AAA

shall communicate the information to the parties and, if it deems it appropriate to

do so, to the arbitrator and others.

(c) Disclosure of information pursuant to this Rule R-18 is not an indication that the

arbitrator considers the disclosed circumstance likely to affect impartiality or

independence.

**4. INDEPENDENT OUTSIDE RESEARCH**

**You are a member of a three-arbitrator panel. During your deliberations between the close of the hearings and issuing the award, the panel becomes hung up over the interpretation and applicability of a legal issue. The public chair of the panel, who is a senior partner in a large law firm, volunteers to have her staff do some research on the issue. The other public arbitrator on the panel, who is a CPA and who is CFO of his corporation, says he will have his corporate legal staff review the question and provide him with an opinion. The panel will then discuss the issue and decide it among themselves. What are the problems, if any, with the arbitrators conducting this type of independent investigation?**

Text of Key Sections of Interest:

**Code of Ethics Canon V(B):** An arbitrator should decide all matters justly, exercising independent judgment, and should not permit outside pressure to affect the decision.

**Code of Ethics Canon V(C):** An arbitrator should not delegate the duty to decide to any other person.

**Code of Ethics Canon VI(B):** The arbitrator should keep confidential all matters relating to the arbitration proceedings and decision. An arbitrator may obtain help from an associate, a research assistant or other persons in connection with reaching his or her decision if the arbitrator informs the parties of the use of such assistance and such persons agree to be bound by the provisions of this Canon.

**FINRA Arbitrators Guide**: Arbitrators should not make independent factual investigations of a case. When arbitrators are in doubt about an issue, legal or otherwise, they should request briefs from the parties. Nor should arbitrators ask FINRA staff to conduct independent investigations on their behalf. Staff members are not advocates, nor do they conduct legal research or provide legal advice. Staff may only provide guidance on administrative procedures. When deciding a case, arbitrators should not seek or accept a staff member’s opinion. Only the arbitrators may decide a case.

**AAA Rule R-56:** The expenses of witnesses for either side shall be paid by the party producing such witnesses. All other expenses of the arbitration, including required travel and other expenses of the arbitrator, AAA representatives, ***and any witness and the cost of any proof produced at the direct request of the arbitrator***, shall be borne equally by the parties, unless they agree otherwise or unless the arbitrator in the award assesses such expenses or any part thereof against any specified party or parties.

**6. NEWLY-RETAINED COUNSEL**

**(a) The first hearings are about to start in a relatively modest, single-arbitrator case between an investor and a brokerage firm. As far as you knew, neither side was to be represented by counsel. The respondent firm, however, shows up with an attorney. What should you do?**

**(b) Suppose the claimant has no problem with proceeding without counsel. Should this impact your conduct of the case? If so, how?**

Text of Key Sections of Interest:

**FINRA Code of Arbitration Procedure Rule 12208(b)**: At any stage of an arbitration proceeding held in a United States hearing location, all parties shall have the right to be represented by an attorney at law in good standing and admitted to practice before the Supreme Court of the United States or the highest court of any state of the United States, the District of Columbia, or any commonwealth, territory, or possession of the United States, unless state law prohibits such representation.

**FINRA Code of Arbitration Procedure Rule 12601(a)(2):** A hearing may be postponed…By the panel, in its own discretion….The panel may not grant a motion to postpone a hearing made within 10 days of the date that the hearing is scheduled to begin, unless the panel determines that good cause exists.

**Code of Ethics Canon IV(C):** The arbitrator should not deny any party the opportunity to be represented by counsel or by any other person chosen by the party.

**Revised Uniform Arbitration Act, section 16:** A party to an arbitration proceeding may be represented by a lawyer.

**Federal Arbitration Act, section 10(a)(3):** [an award may be vacated where] …the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; ***or of any other misbehavior by which the rights of any party have been prejudiced…***

**FINRA Arbitrator’s Guide:** At any stage of an arbitration proceeding held in a United States hearing location all parties have the right to be represented by an attorney at law in good standing and admitted to practice before the Supreme Court of the United States or the highest court of any state of the United States, the District of Columbia or any commonwealth, territory or possession of the United States, unless state law prohibits such representation.

**AAA Rule R-27**: Any party may participate without representation (*pro se*), or by counsel or any other representative of the party’s choosing, unless such choice is prohibited by applicable law. ***A party intending to be so represented shall notify the other party and the AAA of the name, telephone number and address, and email address if available, of the representative at least seven calendar days prior to the date set for the hearing at which that person is first to appear***. When such a representative initiates an arbitration or responds for a party, notice is deemed to have been given.

1. 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. [↑](#footnote-ref-1)