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PUBLIC INVESTORS ADVOCATE BAR ASSOCIATION

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Via Email Only @ Robert.Cook@finra.org

Robert Cook
President and Chief Executive Officer
FINRA
1700 K. Street NW
Washington, DC 20006

Dear Mr. Cook,

Re: Improper Application of FINRA Rule 12407(a)
Based on Arbitrator Service in Prior Cases

We write to address a serious and recurring problem with FINRA's application of Rule 12407(a). FINRA has been allowing parties to remove prospective arbitrators from ranking lists on the sole basis that the arbitrator previously decided a case involving the same registered representative or the same investment product. This practice significantly deviates from case law interpreting the "evident partiality" standard under Section 10(a) of the Federal Arbitration Act which is very similar to Rule 12407(a)'s language allowing removal of an arbitrator only if "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."

The case law defining evident partiality unequivocally excludes an arbitrator's service in a separate case as ever giving rise to evident partiality. To remain consistent with this body of case law, the FINRA Director cannot remove an arbitrator from the list under Rule 12407(a) merely based on service on a separate case, even where there is an overlapping respondent, broker, or investment at issue.

PIABA understands that FINRA Dispute Resolution has taken an arbitrator's prior service in FINRA cases and/or prior awards into consideration when ruling on removal under 12407(a) and that FINRA has repeatedly removed arbitrators under 12407(a) due solely to the arbitrator's service on a panel and issuance of an award. This admitted practice is irreconcilable with case law and the language of Rule 12407 and must cease immediately.

The Legal Standard for Evident Partiality

The law is well-settled that the evident partiality requirement set forth in Section 10(a)(2) of the FAA must be strictly construed. See *Torres v. Morgan Stanley Smith Barney, LLC*, 839 Fed. App'x 328, 330 (11th Cir. 2020); *Aviles v. Charles Schwab & Co*., 435 F. App'x 824, 828 (11th Cir. 2011). In order to vacate an arbitration award for evident partiality, a party bears a heavy

burden to prove that the alleged partiality was "direct, definite and capable of demonstration rather than remote, uncertain and speculative." *Aegis Capital Corp. v. Cohen*, 2019 WL 7168305, at *2 (S.D. Fla. Dec. 24, 2019) (quoting *Lifecare Int'l, Inc. v. CD Med., Inc*., 68 F.3d 429, 433 (11th Cir. 1995)). The mere appearance of bias or partiality is not enough to set aside an arbitration award. Rather, to satisfy this exceedingly high standard, a party seeking vacatur for evident partiality must either point to evidence of an actual conflict of interest or identify a business or other connection that might create a reasonable impression of bias that the arbitrator knew of and failed to disclose. *Cohen*, 2019 WL 7168305, at *2 (citing *Aviles*, 435 F. App'x at 829); *see also*, *Torres*, 839 Fed. App'x. at 331.

The standard for vacating an arbitration award based on evident partiality is even more exacting than the standard for recusal of a judge. *See Scandinavian Reins. Co. Ltd. v. Saint Paul Fire & Marine Ins. Co.*, 668 F.3d 60, 72 (2d Cir. 2012) (holding that unlike a judge who can be disqualified in any proceeding in which his impartiality might reasonably be questioned, an arbitrator is disqualified only when a reasonable person, considering all the circumstances, would have to conclude that an arbitrator was partial to one side); *Morelite Const. Corp. v. New York City Dist. Council Carpenters Ben. Funds*, 748 F.2d 79, 83–84 (2d Cir. 1984) ("something more than the mere 'appearance of bias'" is required to vacate an arbitration award); *see also Austin S. I, Ltd. v. Barton-Malow Co*., 799 F. Supp. 1135, 1142 (M.D. Fla. 1992) (same).

Case Law Uniformly Rejects Prior Service as Evidence of Bias

There is no case that holds that an arbitrator's service in a separate case can be grounds for inferring that the arbitrator is biased, lacks impartiality, or has a direct interest in the outcome of the arbitration. To the contrary, the case law uniformly rejects this proposition.

In *Liteky v. U.S.,* 510 U.S. 540 (1994), the United States Supreme Court observed that "it has long been held that judicial rulings alone almost never constitute a valid basis for a bias or partiality motion." 510 U.S. at 555. The *Liteky* Court specifically rejected the very premise underlying FINRA's current practice, stating: "Also not subject to deprecatory characterization as 'bias' or 'prejudice' are opinions held by judges as a result of what they learned in earlier proceedings. It has long been regarded as normal and proper for a judge to sit in the same case upon remand, and to sit in successive cases involving the same defendant." 510 U.S at 551. The Eleventh Circuit has similarly held that "simply presiding over two cases with the same plaintiff and with overlapping facts, and entering adverse judgments in each case, is no evidence of the sort of pervasive bias" that could have prejudiced a party in those proceedings. *Waller v. Roche*, 138 Fed. App'x 165, 167 n.2 (11th Cir. 2005). The court in *Waller* reaffirmed that a party seeking to disqualify a judge for bias must show that the judge's specific actions demonstrate "such pervasive bias and prejudice that it unfairly prejudices one of the parties." *See also United States v. Bailey*, 175 F.3d 966, 968 (11th Cir. 1999).

Multiple federal and state courts have reinforced this principle in various contexts. In *Miccosukee Tribe of Indians of Fla. v. Cypress*, 56 F.Supp.3d 1324, 1331 (S.D. Fla. 2014), the court denied recusal of a judge who had presided over a different case with similar parties. The Eleventh Circuit held in *McWhorter v. City of Birmingham*, 906 F.2d 674, 678 (11th Cir. 1990), that "ordinarily, a judge's rulings in the same or a related case may not serve as the basis for a

recusal motion." In *Maldonado v. Rhoden*, 2021 WL 1293425, at *1 (M.D. Fla. Apr. 7, 2021), the court explained that "a judge is not biased against a civil litigant merely because the judge participated in a criminal action involving the same litigant or related facts." And in *Santisteban v. State*, 72 So.3d 187, 194 (Fla. 4th DCA 2011), the Florida court held that the "mere fact that a judge made an adverse ruling" against a party on the issue of punitive damages "in a related civil case did not demonstrate that the judge was personally biased or prejudiced against" that party.

The Morgan Keegan Case Directly Addresses This Issue

The case of *Morgan Keegan & Co. v. Smythe*, 2014 WL 2462853 (Tenn. App. 2014), is particularly instructive because it addresses facts nearly identical to the situations FINRA now faces. In *Smythe*, Morgan Keegan sought to remove two of three appointed FINRA arbitrators on the grounds that they previously had entered adverse awards, including punitive damages, against the brokerage firm in "substantially similar" cases. *Id*. at *4-5. Those cases involved "presentation of the same or similar evidence, witnesses and testimony," the "same counsel for both parties," and claims that were "premised on the same theory" involving "the same issues and disclosures" regarding the same investment products. *Id*.

The arbitrators declined to recuse themselves. The brokerage firm then sought to have them removed by FINRA, which also declined to remove the arbitrators. 2014 WL 2462853 at *1. The arbitrators remained on the panel and entered an award against the brokerage firm which then sought to have the award vacated on the grounds that the arbitrators had previously "formed biases and opinions" about the evidence and issues in the case, and that their prior decisions demonstrated "evident partiality and misconduct" which prejudiced the brokerage firm. *Id*. The trial court granted the brokerage firm's motion to vacate and the investor appealed. *Id*.

The Tennessee Court of Appeals reversed and reinstated the award. In doing so, the appellate court held that the arbitrators' prior awards, including an award of punitive damages, in a substantially similar case involving the same investments, issues, and witnesses did not constitute actual bias or evident partiality. The court found that Morgan Keegan's assertion to the contrary was nothing more than mere "speculation." The court explained:

> Morgan Keegan does not allege that either Mr. Katz or Mr. Hill have a professional, social, or family relationship with any of the attorneys, witnesses, or parties involved. It also does not allege that Mr. Katz or Mr. Hill had any prior knowledge of the Smythe case or Smythe's circumstances. Rather, Morgan Keegan's argument, as we perceive it, is that Mr. Katz and Mr. Hill were pre-disposed to decide in Smythe's favor merely because they had decided in favor of previous claimants represented, in some cases, by the same attorneys and where some of the witnesses overlapped.
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> [I]t is not unusual that some proceedings would involve the same attorneys and sometimes the same witnesses, or that individual FINRA arbitrators would participate in more than one arbitration proceeding involving the RMK Funds. We agree with Smythe that Morgan Keegan's

> allegations of evident partiality based on Mr. Katz's participation in two similar arbitration proceedings and Mr. Hill's participation on a panel that awarded punitive damages against Morgan Keegan rest on speculation and not direct, definite evidence of improper motives. The fact that Mr. Katz and Mr. Hill served on previous FINRA arbitration panels involving Morgan Keegan and the RMK Funds is not direct, definite proof of improper motivation on their part.

Id. at *1-6 (emphasis added).

Additional cases reinforce this principle. In *Scandinavian Reins. Co. Ltd. v. Saint Paul Fire & Marine Ins. Co*., 668 F.3d 60 (2d Cir. 2012), the court held that arbitrators were not "evidently partial" even though two arbitrators failed to disclose their concurrent service as arbitrators in another, arguably similar arbitration that "overlapped in time, shared similar issues, involved related parties, and included a common witness." Similarly, in *Dealer Computer Services, Inc. v. Michael Motor Co., Inc.*, 485 Fed. App'x. 724 (5th Cir. 2012), the appellate court overturned a trial court's ruling to vacate an arbitration award specifically on the grounds that the arbitrator's prior service in a similar case had been adequately disclosed to the parties. *Id*. at 727.

To the extent that FINRA now interprets its rule differently than it did in the Morgan Keegan context, FINRA has given no explanation or public rationale for its change in practice. Regardless, a clear explanation of FINRA's policies and interpretation of this Rule should be provided to the public, particularly given the inconsistency of FINRA's definitions and interpretation compared to the consistent case law.

The Practical Problems with FINRA's Current Practice

FINRA's practice of removing arbitrators based solely on prior service in cases involving the same broker or investment is not merely legally incorrect but practically unworkable and leads to absurd results. This raises the question that if FINRA's apparent logic were applied consistently, what arbitrators would need to be removed from past service with the same broker dealers or the same products or types of claims.

Furthermore, FINRA's current practice unfairly benefits repeat-player respondents to the detriment of single-shot customer claimants. While large broker-dealers repeatedly appear in FINRA arbitrations, customer claimants would only do so on rare occasions. Hence, respondents are being allowed to remove any arbitrator that has previously ruled against them while customer claimants do not receive the same treatment. Functionally, this approach tells arbitrators that if they want to serve on panels, they should not award damages against brokerage firms.

The inevitable result of this approach is the systematic elimination of the entire pool of experienced arbitrators from all cases involving major parties or common investment issues. This transforms experience and expertise into liabilities rather than assets. The most qualified and knowledgeable arbitrators would be ineligible to serve precisely because of their relevant experience. Although parties with an arbitrator experienced with the product at issue might benefit from being able to present their case more efficiently to an informed audience, FINRA's current

approach seems designed to increase the cost of dispute resolution. Further, the practice of permitting parties to have arbitrators removed for past cases involving the respondent brokerage firm puts customer claimants at an additional significant disadvantage as significant information regarding the exact details of the past case, including the particular products and even broker and witnesses involved, are often not available for the customers to be able to issue such a challenge.

Given the realities of FINRA arbitration, including a limited pool of qualified arbitrators, the frequent appearance of major brokerage firms in numerous cases, the recurrence of common investment products such as REITs and structured products, and the repetition of legal theories including churning, suitability, and failure to supervise, FINRA's current policy makes it increasingly difficult or impossible to seat arbitration panels in cases involving major brokerage firms, common investment products, recurring legal theories, or experienced counsel who appear frequently before FINRA.

Improper Removal Grants an Unfair Additional Strike

The current practice of removing arbitrators under Rule 12407(a) based on prior service effectively grants one party an additional peremptory strike beyond what the rules allow. The arbitrator selection rules already provide parties with strikes precisely so they can eliminate arbitrators they prefer not to have on their panel. It is routine for PIABA lawyers to be forced to use their strikes on arbitrators who have never, not in ten or twenty cases, awarded an investor a dime. Respondents should have to do the same and instead not be allowed to take advantage of their status as a FINRA member to the disadvantage of investors. Likewise, given the full disclosure of all arbitrators' awards, a party or broker-dealer may use its allotted strikes to ensure that an arbitrator with a particular history does not serve on a particular case. This is one of the very purposes of the disclosure requirements.

When FINRA improperly removes an arbitrator under Rule 12407(a) based solely on prior service, it provides a party with an extra strike, defeats the balance and fairness built into the arbitrator selection process, and allows strategic manipulation of panel composition. This grants one party an unfair advantage and undermines the integrity of the entire arbitration system.

Conclusion

The case law interpreting Section 10(a) of the FAA is clear and consistent: an arbitrator's prior service in a separate case, even one involving the same parties, similar facts, the same investment products, or the same legal theories, does not constitute evident partiality. The legal standard requires proof that is "direct, definite and capable of demonstration," not speculation based on prior rulings. Courts have uniformly held that judicial or arbitral rulings alone almost never constitute a valid basis for a bias or lack of impartiality claim and that it is normal and proper for a decision-maker to preside over successive cases involving the same parties.

There is no reason that FINRA Rule 12407(a) should depart so dramatically from the consistent case law. For FINRA to remain consistent with the FAA and the judicial interpretations interpreting it, the FINRA Director must cease removing arbitrators from lists under Rule 12407(a) based solely on their service and awards in separate cases. This practice contradicts decades of

precedent, creates practical impossibilities in seating arbitration panels, transforms expertise into a disqualification, and provides parties with unfair additional strikes.

We respectfully but urgently request that FINRA immediately revise its application of Rule 12407(a) to conform to case law and the language of the Rule, and cease granting removal motions based solely on an arbitrator's prior service in cases involving the same broker-dealer, investment product, or legal theory. The current practice undermines the arbitration system, wastes FINRA resources on meritless removal motions, extends case timelines unnecessarily, and erodes confidence in the fairness of FINRA dispute resolution.

Sincerely,

Michael Bixby, President
Public Investor Advocate Bar Association

CC: Robert L.D. Colby, Executive Vice President and Chief Legal Officer
Richard Berry, Executive Vice President and Director of FINRA Dispute Resolution Services
Kay Miller, Senior Executive Assistant Office of the CEO