

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-83752; File No. SR-FINRA-2018-019)

July 31, 2018

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change Creating Fee and Honorarium for Late Cancellation of a Prehearing Conference

I. Introduction

On May 4, 2018, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend FINRA Rules 12500 and 12501 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and FINRA Rules 13500 and 13501 of the Code of Arbitration Procedure for Industry Disputes (“Industry Code” and together, “Codes”), to charge a \$100 per-arbitrator fee to parties who request cancellation of a prehearing conference within three business days before a scheduled prehearing conference. The proposed rule change would also amend FINRA Rules 12214(a) and 13214(a) of the Codes to create a \$100 honorarium to pay each arbitrator scheduled to attend a prehearing conference that was cancelled within three business days of the prehearing conference.

The proposed rule change was published for comment in the Federal Register on May 14, 2018.³ The public comment period closed on June 8, 2018. The Commission received one

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Exchange Act Release No. 83227 (May 4, 2018), 83 FR 23306 (May 14, 2018) (File No. SR-FINRA-2018-019 (“Notice”).

comment letter in response to the Notice, supporting the proposed rule change.⁴ This order approves the proposed rule change.

II. Description of the Proposed Rule Change⁵

Cancellation Fee

Parties to an arbitration typically schedule prehearing conferences with the arbitrator(s) before the hearing on the merits of the claim.⁶ During these conferences, the participants set discovery, briefing and motions deadlines, schedule subsequent hearing sessions, and address other preliminary matters.⁷ A prehearing conference may also address other outstanding matters, such as discovery disputes or substantive motions (e.g., motions to dismiss or motions to amend).⁸

FINRA stated that its arbitrators devote considerable time preparing for prehearing conferences and forgo other opportunities by reserving time on their schedules.⁹ Currently, however, parties can cancel prehearing conferences up to, and including, the day of the conference without penalty.¹⁰ Consequently, FINRA has found that late cancellations (in particular, those that occur within three or fewer business days of a scheduled prehearing

⁴ See Letter from Steven B. Caruso, Maddox Hargett Caruso, P.C., dated May 15, 2018 (“Caruso Letter”), available at <https://www.sec.gov>.

⁵ The subsequent description of the proposed rule change is substantially excerpted from FINRA’s description in the Notice. See Notice, 83 FR at 23306-23308.

⁶ See FINRA Rules 12100(w) and 13100(w).

⁷ See FINRA Rules 12500(c) and 13500(c).

⁸ See FINRA Rules 12501(b) and 13501(b).

⁹ See Notice, 83 FR at 23309.

¹⁰ Id.

conference) have negatively impacted its roster of arbitrators by creating scheduling inconveniences for, and uncompensated work by, arbitrators.¹¹

To help alleviate these burdens, FINRA is proposing to amend FINRA Rules 12500 and 12501 of the Customer Code and FINRA Rules 13500 and 13501 of the Industry Code,¹² which govern prehearing conferences, to provide that if a cancellation¹³ request is agreed to by the parties or requested by one or more parties within three business days before a scheduled prehearing conference and granted, the party or parties shall be charged a fee of \$100 per arbitrator scheduled to attend the prehearing conference (“late cancellation fee”).¹⁴ The date of the party’s or parties’ cancellation request would control whether the fee is assessed, not the date of the arbitrator or arbitrators’ decision on such a request, if a decision is required.¹⁵ If the arbitrator(s) cancel a prehearing conference on their own, the parties would not be charged.¹⁶

Under the proposal, if more than one party requests the cancellation of a prehearing conference, the arbitrator(s) would have the authority to allocate the fee in the award between or

¹¹ In the past, arbitrators have resigned from the roster because FINRA’s dispute resolution forum does not provide a payment to arbitrators for cancellations of prehearing conferences. FINRA notes that one reason former arbitrators have given for their resignation is the lack of compensation for prehearing conferences that are cancelled on short notice. FINRA has identified 17 separate complaints relating to 22 arbitrators with respect to the late cancellations of prehearing conferences. See Notice, 83 FR at 23307, note 12.

¹² To simplify this explanation, FINRA’s discussion of the proposed changes focuses on changes to the Customer Code. However, the proposed changes also apply to the Industry Code. See Notice, 83 FR at 23307, note 13.

¹³ References to cancellations of prehearing conferences include postponements of such conferences. See Notice, 83 FR at 23309, note 29.

¹⁴ See Notice, 83 FR at 23307.

¹⁵ A decision would be required if only one party requests that the prehearing conference be cancelled. See Notice, 83 FR at 23307, note 14.

¹⁶ See Notice, 83 FR at 23307.

among the requesting parties.¹⁷ However, depending on the facts and circumstances of the request, the arbitrator(s) could assess the fee to one party or to a non-requesting party or parties if the arbitrator(s) determine that these parties caused or contributed to the need for the cancellation.¹⁸

Under the proposal, however, if an extraordinary circumstance prevents a party from making a timely cancellation request, the arbitrator(s) would have the discretion to waive the late cancellation fee, provided they receive a written explanation of the circumstance.¹⁹ FINRA would notify parties and arbitrator(s) that the prehearing conference was cancelled and remind parties to provide an explanation, if applicable, before the close of the arbitration case.²⁰ If the fee is waived, the party's or parties' obligation to pay the fee would be eliminated. FINRA, however, would pay the \$100 per-arbitrator honorarium (discussed below) to the arbitrator(s) scheduled to attend the prehearing conference.²¹

Honorarium

In addition, FINRA is proposing to amend FINRA Rules 12214(a) and 13214(a) to provide that FINRA would pay an honorarium of \$100 to each arbitrator scheduled to attend a prehearing conference that was cancelled within three business days of the prehearing conference by agreement of the parties or was requested by one or more parties within three business days of the prehearing conference and granted. As discussed above, if the arbitrator(s) waive the fee, the

¹⁷ See Notice, 83 FR at 23307.

¹⁸ See Notice, 83 FR at 23307. See also FINRA Rules 12904(e)(8) and 13904(e)(8); see generally FINRA Rules 12601(b) and 13601(b).

¹⁹ See Notice, 83 FR at 23307

²⁰ Id.

²¹ Id.

obligation to pay the fee would be eliminated, but FINRA would still pay the \$100 per-arbitrator honorarium to the arbitrator(s) scheduled to attend the prehearing conference.

III. Comment Summary

As noted above, the Commission received one comment letter on the proposed rule change, supporting the proposal.²² The commenter states that late cancellations often result in scheduling inconvenience for, and uncompensated work by, arbitrators. The commenter believes that the proposal represents a “fair, equitable and reasonable” solution to these concerns because the fee and honorarium recognize the “considerable preparation by arbitrators . . . that is required prior to a prehearing conference.”²³ Accordingly, the commenter believes that the proposal would “lead to an improved and expanded roster of arbitrators.”²⁴

IV. Discussion and Commission Findings

After careful review of the proposed rule change and the comment letter, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities association.²⁵ Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,²⁶ which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and Exchange Act Section 15A(b)(5)

²² See supra note 4.

²³ Caruso Letter.

²⁴ Id.

²⁵ In approving this rule change, the Commission has considered the rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²⁶ 15 U.S.C. 78o-3(b)(6).

of the Exchange Act,²⁷ which requires, among other things, that FINRA rules provide for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system that FINRA operates or controls.

Public Interest

The Commission agrees with FINRA and the commenter that the proposed rule change would protect investors and the public interest by improving FINRA's ability to recruit and retain qualified arbitrators willing to devote the time and effort necessary to consider prehearing issues, which FINRA asserts is an essential element for it to operate an effective arbitration forum.²⁸ Currently, parties can cancel prehearing conferences up to, and including, the same day of the conference without penalty. Late cancellations of prehearing conferences do, however, penalize the arbitrators who would not receive compensation for the time and effort devoted to preparing for the conference, as well as the potential for lost personal or professional opportunities caused by reserving the scheduled meeting time. These burdens could negatively impact an arbitrator's decision to remain on the FINRA arbitrator roster or an individual's decision to join the roster. The proposed rule change would eliminate these disincentives by compensating arbitrators in the event of a late cancellation. For these reasons, the Commission believes the proposed rule change is consistent with the Section 15A(b)(6) requirement that FINRA rules be designed to protect the public interest.

Equitable Allocation of Fees

The Commission also agrees that the proposed rule change represents an equitable allocation of the fees associated with using the FINRA arbitration forum.²⁹ In particular, the

²⁷ 15 U.S.C. 78o-3(b)(5).

²⁸ See Notice, 83 FR at 23308.

²⁹ Id. See also Caruso Letter.

Commission notes the proposed late cancellation fee would be allocated among those parties responsible for canceling the meeting within three days of the prehearing conferences. Even if a party or parties did not request the cancellation, the proposed rule change would permit arbitrators to allocate all, or a portion of the fee, to those parties if the arbitrators determine that they caused or contributed to the late cancellation.³⁰

The Commission recognizes that the proposed rule change could increase the cost to parties of using the arbitration forum.³¹ However, the Commission also recognizes that the late cancellation fee would compensate arbitrators directly inconvenienced by the late cancellation of a prehearing conference and address a practice that negatively impacts the roster of arbitrators. In particular, the Commission notes that FINRA would compensate arbitrators for their preparation time and opportunity cost associated with reserving a meeting date when a prehearing conference is cancelled on short notice.³² The Commission believes that it is reasonable to compensate the inconvenienced arbitrators for the time and opportunity cost. Furthermore, the Commission notes that parties to an arbitration could avoid the proposed late termination fee by, among other ways, providing notice of cancellation more than three business days prior to a scheduled prehearing conference.³³ Furthermore, the Commission notes that the arbitrator(s) could assess the fee to one party or to a non-requesting party or parties if the arbitrator(s) determine that these parties caused or contributed to the need for the cancellation. Finally, if an extraordinary circumstance prevents a party from making a timely cancellation

³⁰ See Notice, 83 FR at 23308.

³¹ Id.

³² Id.

³³ See Notice, 83 FR at 23308.

request, the arbitrator(s) would have the discretion to waive the late cancellation fee, provided they receive a written explanation of the circumstance

For these reasons, the Commission believes the proposed rule change is also consistent with the Section 15A(b)(5) requirement that FINRA rules provide for the equitable allocation of reasonable fees among persons using any facility or system that FINRA operates or controls.

V. Conclusion

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Exchange Act³⁴ that the proposal (SR-FINRA-2018-019), be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁵

Robert W. Errett
Deputy Secretary

³⁴ 15 U.S.C. 78s(b)(2).

³⁵ 17 CFR 200.30-3(a)(12).