

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-60061; File No. SR-FINRA-2009-011)

June 5, 2009

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change as Modified by Amendment No. 1 Thereto to Amend the Panel Composition Rules of the Code of Arbitration Procedure for Industry Disputes

On March 4, 2009, the Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend the panel composition rules of the Code of Arbitration Procedure for Industry Disputes (“Industry Code”). On April 7, 2009, FINRA filed Amendment No. 1 to the proposed rule change. The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on May 4, 2009.<sup>3</sup> The Commission received no comments on the proposed rule change. This order approves the proposed rule change, as modified by Amendment No. 1.

I. Description of the Proposal

FINRA proposed to amend the Industry Code to change the criteria for determining the panel composition when the claim involves an associated person in industry disputes.

Currently, Rule 13402(a) of the Industry Code requires an all non-public panel for disputes between members, and for employment disputes between or among members and

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Exchange Act Release No. 59836 (April 28, 2009); 74 FR 20519 (May 4, 2009).

associated persons that relate exclusively to employment contracts, promissory notes, or receipt of commissions.<sup>4</sup> In all other disputes between or among members and associated persons, Rule 13402(b) requires a majority public panel, where one arbitrator would be a non-public arbitrator and two would be public arbitrators.<sup>5</sup>

FINRA proposed to amend the Industry Code to change the criteria for determining panel composition when the claim involves an associated person in industry disputes.<sup>6</sup> Specifically, FINRA proposed to amend Rule 13402 and related rules of the Industry Code to:

- require that the parties receive a majority public panel for all industry disputes involving associated persons (excluding disputes involving statutory employment discrimination claims which require a specialized all public panel);<sup>7</sup>
- clarify that in disputes involving only members, parties will receive an all non-public panel; and
- provide that if a party amends its pleadings to add an associated person to a previously all member case, parties will receive a majority public panel.

Thus, cases involving only members would have an all non-public panel; cases involving a member and an associated person (excluding cases involving a claim for statutory

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<sup>4</sup> If the panel consists of one arbitrator, the arbitrator will be a non-public arbitrator selected from the non-public chairperson roster described in Rule 13400(c). See Rule 13402(a).

<sup>5</sup> If the panel consists of one arbitrator, the arbitrator will be a public arbitrator selected from the chairperson roster described in Rule 12400(c) of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”). See Rule 13402(b).

<sup>6</sup> The proposed changes discussed in this order will not apply to claims filed under the Customer Code.

<sup>7</sup> The proposal would not apply to disputes involving a claim of statutory employment discrimination. See Rule 13802.

discrimination) would have a majority public panel; and cases involving an associated person with a statutory discrimination claim would have a specialized all public panel.<sup>8</sup> Moreover, if a member amends its pleadings to add an associated person, the case would receive a majority public panel, and the rules that apply to cases between associated persons and members would govern list selection and the administration of the arbitration proceeding.

#### Employment Disputes Involving Associated Persons

Currently, in employment disputes between or among members and associated persons, FINRA requires that the panel consist of all non-public arbitrators in cases that arise out of the employment or termination of employment of an associated person, and that relate exclusively to (1) employment contracts, (2) promissory notes, or (3) receipt of commissions. However, if a party adds a claim that does not meet these criteria, the parties receive a majority public panel.

FINRA proposed to amend Rule 13402 of the Industry Code to clarify that for all employment disputes between or among members and associated persons (except for statutory employment discrimination cases), the parties must select a majority public panel.<sup>9</sup> Rule 13402(a) would be amended to delete the title of the rule, which contains the exceptions to the majority public panel requirement, and replace it with a concise description, which clarifies that Rule 13402(a) would apply to disputes involving only members. Rule 13402(b) would be amended to modify the title of the rule to clarify that for all industry disputes

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<sup>8</sup> See Rule 13802(c) (panel composition rule for statutory employment discrimination claims).

<sup>9</sup> The proposed change would be consistent with the rules and procedures of the former New York Stock Exchange (“NYSE”) arbitration forum. In the NYSE arbitration forum, cases involving associated persons received a majority public panel because the rules classified associated persons as non-members, and non-members received a majority public panel. See NYSE Rule 607(a)(1).

involving associated persons (excluding disputes involving statutory employment discrimination claims), the parties would receive a majority public panel. FINRA also proposed to make similar title changes to Rules 13403(a) and 13403(b), which govern generating and sending lists to parties, and to Rules 13406(a) and 13406(b), which govern appointment of arbitrators and discretion to appoint arbitrators not on the list.

#### Employment Disputes Involving Only Members

FINRA proposed to amend Rule 13402(a) to clarify that, in disputes involving only members, the parties will receive an all non-public panel. FINRA noted that the proposed amendment to Rule 13402(a) is consistent with the current rule and its intent, which is that disputes involving only members should receive an all non-public panel.

#### Amendments to Pleadings that Add an Associated Person

FINRA proposed to add a provision to Rule 13402(a) to address amended pleadings that add an associated person as a party. Under the proposed rule change, if a member in a dispute involving only members amends a pleading to add a party who is an associated person, the parties will receive a majority public panel. If lists of potential arbitrators have not been sent to parties, the Neutral List Selection System (NLSS) would generate three lists as outlined in Rule 13403(b)(2) of the Industry Code. Specifically, FINRA would send a public chairperson list, a public arbitrator list, and a non-public arbitrator list. If the panel consists of one arbitrator,<sup>10</sup> NLSS would generate a public chairperson list, and FINRA would send this list only to the parties.<sup>11</sup>

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<sup>10</sup> In a dispute between members, if the panel consists of one arbitrator, the arbitrator will be selected from FINRA's non-public chairperson arbitrator roster. See Rule 13402(a).

<sup>11</sup> See Rule 13403(b)(1). FINRA has raised the amount in controversy that will be heard by a single chair-qualified arbitrator to \$100,000. The rule became effective on March 30, 2009.

If the lists have been sent to parties but are not yet due, FINRA would send two new lists to the parties: a public chairperson list and a public arbitrator list as outlined in Rule 13403(b)(2).<sup>12</sup> The parties would keep the non-public chairperson list provided to them as described in Rule 13403(a), and would select the non-public arbitrator from this list. The arbitrator selected from the public chairperson list would be the chairperson of the panel. If the panel consists of one arbitrator, FINRA would send only a new public chairperson list to the parties.<sup>13</sup>

If the ranked lists are due, then the parties may not amend a pleading to add a new party until a panel has been selected and the panel grants a motion to add the party.<sup>14</sup> If the panel grants the motion to add an associated person, FINRA will retain the non-public chairperson from the panel, and remove the remaining non-public arbitrators.<sup>15</sup> The parties would select two public arbitrators from new lists that FINRA would send to them in the same manner as if the ranked lists are not yet due. The arbitrator selected from the public chairperson list would be the chairperson of the panel. If the panel consists of one arbitrator and the arbitrator grants a motion to add an associated person, the arbitrator would be

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See Exchange Act Release No. 59340 (February 2, 2009), 74 FR 6335 (February 6, 2009) (File No. SR-FINRA-2008-047); see also Regulatory Notice 09-13.

<sup>12</sup> Pursuant to Rule 13407(a), FINRA will send the list of non-public arbitrators to the new party, with employment history for the past 10 years and other background information for each arbitrator listed. The newly added party may rank and strike arbitrators in accordance with Rule 13404.

<sup>13</sup> See note 8 *supra*.

<sup>14</sup> See Rule 13309(c) of the Industry Code.

<sup>15</sup> Pursuant to Rule 13407(b), the newly added party may not strike the non-public arbitrator but may challenge the arbitrator for cause in accordance with Rule 13410.

replaced with a public chair-qualified arbitrator that the parties select from a new public chairperson list that NLSS would generate.<sup>16</sup>

## II. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.<sup>17</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,<sup>18</sup> in that it is designed, among other things, to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest.

The Commission believes that the proposed rule change will protect the public interest by simplifying the criteria for panel composition in industry disputes, establishing an objective standard for determining panel composition, and ensuring that panel composition is determined by the types of parties involved, and not by the types of claims filed.

## III. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities association.

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<sup>16</sup> See note 8 supra.

<sup>17</sup> In approving the proposed rule change, the Commission has considered the rule change's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>18</sup> 15 U.S.C. 78o-3(b)(6).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>19</sup> that the proposed rule change (SR-FINRA-2009-011), as modified by Amendment No. 1, be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>19</sup> 15 U.S.C. 78s(b)(2).

<sup>20</sup> 17 CFR 200.30-3(a)(12).