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The Importance Of FINRA's Arbitrator Selection Process and Clarity in the "Evident Partiality" Standard in the Wake Of Morgan Keegan

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Cover Page Footnote

J.D. Candidate, Fordham University School of Law, 2013; B.B.A., Finance, Macaulay Honors College (Baruch–CUNY), 2010. For their comments and suggestions on earlier drafts, the author thanks Professor George Friedman, Seth E. Lipner, and Dale Ledbetter. The viewpoints and any errors expressed herein are the author's alone.

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ABSTRACT

In the past several years, many FINRA arbitration cases have been filed against Morgan Keegan, a regional investment firm. The cases are heard in a small number of locations with relatively small arbitrator rosters. On February 25, 2010, a Tennessee Chancery court vacated a FINRA arbitration award against Morgan Keegan citing the presence of two arbitrators who served on other Morgan Keegan cases involving the same products in the dispute before it.[1] On March 2, 2010, another court denied the identical motion to vacate by Morgan Keegan in a separate arbitration where an award was granted against Morgan Keegan.[2] Responding to the uncertainty concerning the finality of arbitration awards in such cases, FINRA has sought to solve the problem by recommending that parties avail themselves of FINRA rules for challenging arbitrator appointments.[3] Unfortunately, each of the likely players in such arbitration disputes—investment firms and investors—has significant incentive problems from the perspective of challenging arbitrator appointment. This Note argues that FINRA may be more successful in addressing challenges to arbitration awards by screening arbitrators to automatically eliminate those who have

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1. Morgan Keegan & Co. v. Smythe, III, No. W2010-01339-COA-R3CV, 2011 WL 1047717 (Tenn. Ct. App. Mar. 24, 2011) (opinion withdrawn on denial of rehearing).

2. Morgan Keegan & Co v. Smythe, III, No. W2010-01339-COA-R3-CV, 2011 WL 5517036 (Tenn. Ct. App. Nov. 14, 2011).

3. *See Guidance to Parties in Cases Involving Morgan Keegan and the RMK Bond Funds,* FINRA, http://www.finra.org/ArbitrationAndMediation/Arbitration/SpecialProcedures/P121240 (last visited November 1, 2012) [hereinafter *FINRA Guidance Report*].

presided or are currently presiding over cases involving identical products and parties.

Part I of this Note summarizes the mechanics of FINRA arbitrator selections and identifies the methods through which parties may challenge arbitrator appointment. Part II explores the result of such challenges in the Morgan Keegan line of cases, reviews the subsequent impact on FINRA proceedings, and outlines an alternative "auction rate case" model of screening arbitrators. Finally, Part III argues for an arbitrator selection system featuring the automatic screening method based on the "auction rate case" model as the solution to the basic risk inherent in high volumes of cases based on singular financial products.

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INTRODUCTION

Since the late 1980s, the Supreme Court has favored the arbitration process, particularly in the securities industry, because arbitration provides an efficient method for settling disputes. Going forward, arbitration will likely remain the predominant method through which securities claims are resolved. In response to challenges to arbitration practices under the Federal Arbitration Act ("FAA"), the Supreme Court has repeatedly described the FAA as establishing "a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary"[4] and "embod[ying] [a] national policy favoring arbitration."[5] In 1987, the Court emphasized that arbitration is a just and expeditious method of resolving securities claims.[6] The Supreme Court has recently reiterated that the principal purpose of the FAA is to assure contracting parties that the terms of their private arbitration agreements will be enforced.[7] In light of such legal precedent, the practice of arbitration is here to stay and will remain a significant force in the realm of securities disputes.

The Financial Industry Regulatory Authority ("FINRA") draws its power most directly from statutes and a long history of self-regulated organizations, and should be assessed through the lens of self-regulated organization policies.[8] Despite the efforts of the Securities Exchange Act of 1934 ("Exchange Act") to curb abuses in the market in the wake of the market crash of 1929, a regulatory void existed, prompting the enactment of the Maloney Act in 1938.[9] This law amended the Exchange Act to create a system based upon joint regulation, in which the task of regulating over-the-counter markets was principally performed by representative organizations (e.g. investment bankers, dealers, and brokers) under SEC supervision.[10] The Securities and

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4. *See* Moses H. Cone Mem'l Hosp. v. Mercury Constr. Co., 460 U.S. 1, 24 (1983); *see also* Hall St. Assocs. v. Mattel, Inc., 552 U.S. 576, 581 (2008).

5. *See* AT&T Mobility L.L.C. v. Concepcion, 131 S. Ct. 1740, 1749 (2011) (quoting Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 443 (2006); *Moses H. Cone*, 460 U.S. at 24).

6. *See* Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220 (1987) (holding that arbitration is a valid method of resolving claims under the Securities Exchange Act of 1934); *see also* Rodriguez de Quijas v. Shearson/Am. Express Inc., 490 U.S. 477 (1989) (holding that arbitration of claims under the Securities Act of 1933 may similarly be compelled).

7. *See AT&T Mobility,* 131 S. Ct. at 1748.

8. *See* Roberta S. Karmel, *Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?*, 14 STAN. J.L. BUS. & FIN. 151, 151-52 (2008).

9. *See* Kenneth B. Orenbach, *A New Twist to an On-Going Debate About Securities Self-Regulation: It's Time to End FINRA's Federal Income Tax Exemption*, 31 VA. TAX REV. 135, 143 (2011); *see also* 15 U.S.C.A. § 78o-3 (2010).

10. *See* Rohit A. Nafday, *From Sense to Nonsense and Back Again: SRO Immunity, Doctrinal Bait-and-Switch, and a Call for Coherence*, 77 U. CHI. L. REV. 847, 851 (2010).

Exchange Commission ("SEC") was tasked with exercising appropriate supervision in the public interest and exercising supplementary powers of direct regulation when necessary.[11] Under this governing system, regulatory responsibility for the financial sector, historically subject to governmental control, was transferred to registered national securities associations representative of the securities industry, with each such private regulator deemed a self-regulatory organization ("SRO").[12]

A principal goal of SROs is to support the efficient and expedient resolution of securities disputes in order to maintain a functional investment environment. Under the supervision of the SEC, SROs regulate trading on stock exchanges and are active in securities enforcement, policing market activity and broker-dealer misconduct.[13] Out of this policing function, FINRA[14] evolved from two larger SROs and currently operates the world's largest arbitration and mediation practice for the resolution of disputes between customers and FINRA members[15] (e.g. broker-dealers) and disputes between FINRA members and their employees.[16] As the largest independent regulator for securities firms doing business in the United States, FINRA is tasked with market regulation through contract with major U.S. stock markets, including the New York Stock Exchange, NYSE Arca, NYSE Amex, the NASDAQ Stock Market, and the International Securities Exchange.[17] Accordingly, analysis of FINRA policies and practices

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11. *See id.*

12. *See* Onnig H. Dombalagian, *Demythologizing the Stock Exchange: Reconciling Self-Regulation and the National Market System*, 39 U. RICH. L. REV. 1069, 1075–76 (2005).

13. Broker-dealers are required by the Exchange Act to become members of FINRA in order to be involved with securities transactions. *See* 15 U.S.C.A. § 78o(b)(8)-(9).

14. FINRA combined the National Association of Securities Dealers, Inc. ("NASD") and the member regulatory functions of NYSE Group, Inc. ("NYSE"). *See* Karmel, *supra* note 8, at 151–52.

15. For a list of FINRA member firms, see *FINRA List of Members*, FINRA, http://www.finra.org/AboutFINRA/MemberFirms/ListOfMembers/p012908 (last visited November 1, 2012).

16. *See About the Financial Industry Regulatory Authority*, FINRA, http://www.finra.org/AboutFINRA/ (last visited November 1, 2012).

17. *See* Christopher W. Cole, *Financial Industry Regulatory Authority (FINRA): Is the Consolidation of NASD and the Regulatory Arm of NYSE A Bull or A Bear for U.S. Capital Markets?*, 76 U. MO. KAN. CITY L. REV. 251, 257 (2007).

must incorporate the broader goal of SROs of supporting an efficient securities industry.[18]

Arbitration has become a widespread method used by broker-dealers and customers to resolve disputes and will continue to play a large role in disputes arising out of the financial crisis.[19] Arbitration, as well as mediation, is the prevalent method of dispute resolution between customers and brokerage firms because customers need to sign New Account Agreements to invest with brokerage firms, which are all FINRA members, and such forms generally includes mandatory arbitration clauses.[20] Even if a customer has not executed an arbitration agreement, brokers and brokerage firms are obligated to arbitrate disputes upon customer demand.[21] As the financial crisis continues to ripple through the economy, it is inevitable that investors will seek legal recourse against the broker-dealers from whom they purchased financial products.[22] Due to the mandatory arbitration clauses in customer

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18. *See* Dombalagian, *supra* note 12, at 1075–76.

19. The global financial crisis began with the inflation of the U.S. housing market bubble via: (1) government policies of purchasing subprime mortgages and related mortgage-backed securities in order to encourage home-ownership and affordable housing; and (2) unscrupulous lending practices. *See* Zachary J. Gubler, *The Financial Innovation Process: Theory and Application*, 36 DEL. J. CORP. L. 55, 55 (2011). This bubble eventually burst in 2007 as a result of financial engineering by which many financial firms, acting recklessly, took on excessive risk linked to the housing market and other complex financial products. *See id.*; *see also* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT (2011), *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf. The financial technology that enabled this risk to spread included, principally, securitization, but also derivatives. *See* Gubler, *supra*. These risks had been split, repackaged, and widely distributed throughout the entire economy. *Id.*

20. *See* Bradley J. Bondi, *Facilitating Economic Recovery and Sustainable Growth Through Reform of the Securities Class-Action System: Exploring Arbitration as an Alternative to Litigation*, 33 HARV. J.L. & PUB. POL'Y 607, 622 (2010). Supreme Court precedent has made it nearly impossible for investors to challenge a mandatory arbitration clause. *See* Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220 (1987).

21. *See* FINRA RULE 12200, http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=607; *see also* Oppenheimer & Co. v. Neidhardt, 56 F.3d 352 (2d Cir. 1995) (holding that securities broker-dealer was required to arbitrate dispute under NASD Rule 10301, superseded by FINRA Rule 12200, which requires broker-dealers to arbitrate disputes with customers if customer so demands).

22. *See* Bradley J. Bondi, *Securities Arbitrations Involving Mortgage-Backed Securities and Collateralized Mortgage Obligations: Suitable for Unsuitability Claims?*, 14 FORDHAM J. CORP. & FIN. L. 251, 256 (2009) (explaining the various impacts on investment firms as a result of their activity in subprime mortgage

agreements in conjunction with the far-reaching impacts of the financial crisis, FINRA policies will shape the jurisprudential landscape of securities arbitration for years to come.[23]

In light of the legislative changes imposed by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), FINRA will likely take on an even greater role. The Dodd-Frank Act, enacted in July of 2010, directed the SEC to look into the practices of financial advisers in response to high-profile fraud such as the Bernard Madoff Ponzi scheme.[24] According to the study conducted by the SEC, the agency needed to address its inability to inspect a sufficient number of investment advisers on a regular basis.[25] In response to this concern, Representative Spencer Bachus, Chairman of the Committee on Financial Services, proposed the Investment Adviser Oversight Act of 2011.[26] If passed, the Act would create a national investment adviser association or an SRO for investment advisers.[27] FINRA has already voiced its willingness to assume responsibility for this newly created SRO, which would regulate investment advisers.[28] Therefore, FINRA's regulatory role is likely to grow in the near future.

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products); *see also* Suzanne Barlyn, *Morgan Keegan Loses $1.95 Mln Auction-Rate Case*, THOMSON REUTERS (Feb. 22, 2012), http://newsandinsight.thomsonreuters.com/ Legal/News/2012/02_-_February/Morgan_Keegan_loses_$1_95_mln_auction-rate_case/ (describing a recent $1.95 million award by a FINRA panel stemming from bad investment in complicated financial products that crashed in 2008 when Wall Street imploded).

23. *See 2012 Regulatory & Examination Priorities Letter*, FINRA (Jan. 31, 2012), http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p125492.pdf (highlighting FINRA's new regulatory and examination priorities for 2012).

24. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

25. *See* STAFF OF THE DIVISION OF INVESTMENT MANAGEMENT OF THE U.S. SECURITIES AND EXCHANGE COMMISSION, STUDY ON ENHANCING INVESTMENT ADVISER EXAMINATIONS (2011), *available at* http://www.sec.gov/news/studies/2011/914studyfinal.pdf.

26. *See* Investment Advisor Oversight Act of 2011, H.R. 4624, 112th Cong. (2012).

27. *Id.* at 2.

28. *See* Jesse Hamilton, *FINRA 'Ready' to Oversee Investment Advisers,* BLOOMBERG (Sept. 13, 2011, 2:05 PM), http://www.bloomberg.com/news/2011-09-13/ketchum-says-finra-uniquely-positioned-to-oversee-advisers.html.

I. ARBITRATOR SELECTION AND CHALLENGE PROCESS

Part I of this Note examines the mechanics of FINRA arbitrations focusing specifically on how arbitrators are selected. Next, this part explains some of the requirements FINRA imposes on arbitrators to decrease the risk of the appearance of bias and increase the rights of parties to request new arbitrators. Finally, it compares the methods by which parties may challenge individual arbitrator appointments prior to and after the initial hearing and bring a judicial challenge of arbitral awards after the conclusion of arbitration.

A. STARTING AN ARBITRATION

FINRA's arbitration rules, called the Code of Arbitration Procedure,[29] provide a simplified method for selecting arbitrator panels.[30] The arbitration process begins when an aggrieved party files a Statement of Claim.[31] This written filing is similar to a complaint in a lawsuit: it states the facts of the dispute including pertinent dates, names, account numbers, and the request for relief.[32] Within forty-five days of the receipt of the Statement of Claim, respondents, counter-respondents, and cross-respondents must serve each other party with an answer.[33] After a proper filing, the parties are then free to select their arbitrators from a random computer-generated list[34] of proposed FINRA

29. "The Code of Arbitration Procedure (Customer Code) governs arbitrations between investors and brokers and/or brokerage firms." A different set of rules, "[t]he Code of Arbitration Procedure for Industry Disputes (Industry Code), governs arbitrations between or among industry parties." *See Code of Arbitration Procedure*, FINRA, http://www.finra.org/ArbitrationAndMediation/Arbitration/Rules/CodeofArbitrationProcedure/index.htm (last visited November 1, 2012).

30. This arbitration process is delineated in the FINRA Rule Manual. *See FINRA Rules*, FINRA, http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=607 (last visited November 1, 2012).

31. *See Arbitration Process: File a Claim,* FINRA, http://www.finra.org/ArbitrationAndMediation/Arbitration/Process/FileClaim/index.htm (last visited November 1, 2012).

32. *See* FINRA RULE 12302.

33. *See* RULE 12303.

34. FINRA uses the Neutral List Selection System (NLSS) on its MATRICS computer system to randomly generate lists of arbitrators from FINRA's arbitrator rosters who could serve as panel members. *See Arbitration Process: Arbitrator Selection*, FINRA, http://www.finra.org/ArbitrationAndMediation/Arbitration/

arbitrators.[35] FINRA provides a report about each arbitrator's background ("Disclosure Report") including the arbitrator's employment, education, and training, as well as a list of cases in which each of the arbitrators has issued a final decision.[36] Parties will then review the information, strike any arbitrators from the lists they do not want on the panel, and rank the remaining choices.[37] After parties have submitted their ranked lists, FINRA appoints the final arbitration panel.[38]

B. STRIKING AND RANKING ARBITRATORS

FINRA allows both sides to an arbitration to remove, or strike, some candidates from the arbitrator roster without cause, and then rank the remaining individuals in order of preference.[39] The list submitted to the parties consists of ten arbitrators from each of FINRA's non-public roster, public roster, and chairperson roster.[40] Each party may strike up

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Process/ArbitratorSelection/_(last visited November 1, 2012); *see also* Anna Lyons, *Voluntary Program to Reduce Extended List Arbitrator Appointments*, THE NEUTRAL CORNER, no. 1, 2012 at 1, 1, *available at* http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@arbtors/documents/arbmed/p125884.pdf.

35. *See* FINRA RULE 12400. For claims of $25,000 or less, FINRA appoints one arbitrator and the claim will be subject to the simplified arbitration procedures. *See* RULE 12401. If the amount of a claim is more than $25,000 but not more than $100,000, exclusive of interest and expenses, the panel will consist of one arbitrator unless the parties agree in writing to three arbitrators. *Id.* The remainder of this discussion focuses on claims of more than $100,000.

36. *See* RULES 12400–12405.

37. Upon acceptance to the roster, arbitrators are assigned to one primary hearing location. FINRA offers seventy-two hearing locations, including at least one in each state of the United States, one in San Juan, Puerto Rico, and one in London, United Kingdom. Generally, arbitrators are assigned to the closest in-state hearing location to their primary residence. When arbitrators complete their training and become active on the roster, their names will be generated on a random basis and included on arbitrator lists sent to parties in that primary hearing location. *See FINRA Hearing Locations,* FINRA,http://www.finra.org/ArbitrationAndMediation/Arbitrators/BecomeanArbitrator/HearingLocations/index.htm (last visited November 1, 2012).

38. *See* RULES 12400–12405.

39. RULE 12402(d).

40. A non-public arbitrator is an individual who has ties to the securities industry as defined by Rule 12100(p). Some examples of relevant ties include having been associated with, or registered through, a broker/dealer, or registered (or associated with a firm or person registered) under the Commodity Exchange Act within the past five years. Other individuals deemed non-public arbitrators include arbitrators who have

to four arbitrators for any reason; these reasons are generally based on independent research and arbitrator disclosures.[41] After the parties submit ranked lists, FINRA then creates a separate combined ranked list for each arbitrator classification.[42]

Customers[43] are provided with additional controls over whether the final arbitral panel will include public or non-public arbitrators. On January 31, 2011, the SEC approved a rule change to provide customers in cases with three arbitrators the option to choose between two panel selection methods: (1) All-Public Panel or (2) Majority Public Panel.[44] A customer may elect the optional All-Public Panel for up to thirty five days from FINRA's service of the Statement of Claim.[45] Under the All-Public option, a claimant may elect to strike up to all ten industry arbitrators.[46] If the customer declines to elect a panel selection method in writing by the thirty-five day deadline, the Majority-Public Panel will apply, providing for a panel of one chair-qualified public arbitrator, one public arbitrator, and one non-public arbitrator.[47] The Majority-Public

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retired after having spent a substantial part of a career engaging in the aforementioned activities. A public arbitrator, on the other hand, is a non-industry affiliated arbitrator. *See* RULE 12100(u).

41. RULE 12403(c)(3)(A).

42. RULE 12403(c)(4).

43. The FINRA Customer Code defines a customer as "not includ[ing] a broker or dealer." RULE 12100(i). Without a written agreement to arbitrate, only a customer of a FINRA member firm may demand arbitration of claims against the firm in a FINRA arbitration. *See* RULE 12200. Fortunately for investors, courts have broadly interpreted the term "customer" despite the vague definition provided by FINRA. This note focuses on FINRA arbitration cases in which the "customer" status is not in dispute. For a broader explanation of the "customer" issue in light of the *Morgan Keegan* line of cases, see Alexander Ziccardi, *Bucking the Trend: A Case for Rejecting an Emerging Narrow View of Who Qualifies as a Customer in FINRA Arbitration*, 19 PIABA B.J. 57 (2012).

44. *See* RULE 12403; *see also* Press Release, FINRA, SEC Approves FINRA Proposal to Give Investors Permanent Option of All Public Arbitration Panels (Feb. 1, 2011), http://www.finra.org/Newsroom/NewsReleases/2011/P122877.

45. *See Arbitrator Appointment Frequently Asked Questions*, FINRA, http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/FAQ/P123922 (last visited November 1, 2012).

46. *Id.*

47. *See id.*

and All-Public Panel Rules provide customers with significant control over the composition of a FINRA panel.[48]

In some circumstances, FINRA must extend the arbitrator list in order to appoint a final panel, a process that has recently become subject to greater party control.[49] When an appointed arbitrator withdraws or is removed from a selected panel, FINRA will initially attempt to replace the arbitrator by consulting the original arbitrator selection list completed by the parties.[50] If a replacement cannot be appointed using this method, FINRA extends the list in order to appoint a full arbitral panel.[51] Prior to February 1, 2012, extending the list consisted of using the MATRICS system to generate arbitrators randomly; such arbitrators could only be challenged for cause, which created many complaints among parties.[52] On February 1, 2012, FINRA began offering a voluntary short-list option, allowing parties to agree to strike one arbitrator and rank the remaining arbitrators in order of preference from a newly-generated list of three potential arbitrators.[53] The new short list option provides yet another method by which parties maintain control over arbitrator selection.[54]

C. DISCLOSURE REQUIREMENTS

FINRA imposes significant disclosure requirements on its arbitrators, which provide the basis upon which parties strike and rank potential panels. Before appointing a final panel, FINRA asks each potential candidate to make any further disclosures not included in the Disclosure Report based on information specific to the dispute.[55] Under these additional disclosure requirements, each potential arbitrator must reasonably learn of and divulge any conditions which would prevent

48. *See* Press Release, FINRA, SEC Approves FINRA Proposal to Give Investors Permanent Option of All Public Arbitration Panels (stating that the change greatly increases investor choice within FINRA Arbitrations Programs).

49. *See* Lyons*, supra* note 34 at 1–4.

50. *See id.* at 2.

51. *Id.*

52. *Id.* at 1–2.

53. *Id.* at 3.

54. *Id.* at 4.

55. For a list of the types of disclosures required and for examples, *see Arbitrator Disclosure*, FINRA, http://www.finra.org/ArbitrationAndMediation/Arbitrators/Responsibilites/Disclosures/ (last visited November 1, 2012).

unbiased reasoning and rendering of equitable decisions.[56] Such conditions include red flags like financial or personal interest in the decision and existing or previous relationships with any party, representative, or witness.[57] In addition, circumstances that are less clearly bias-producing may also give rise to arbitrator challenge such as associations involving members of the arbitrator's family or current employers, partners, or business associates, as well as present or past service as a mediator for any party.[58]

D. CHALLENGING ARBITRATORS (PRE-AWARD)

Under FINRA rules, parties are able to challenge the appointment of individual arbitrators for cause after the initial striking and ranking period.[59] Alternatively, parties may seek to vacate an award entirely after arbitration on one of several grounds that resemble for cause arbitrator challenges, such as "evident partiality."[60]

1. Pre-hearing Challenges (Rule 12407(a))

FINRA rules provide parties with an opportunity to challenge the appointment of arbitrators after the initial striking and ranking period. Under FINRA Rule 12407(a)(1), a party's request or motion to remove an arbitrator may be honored before the first hearing session if based on pre-motion information, the arbitrator's bias, lack of impartiality, or any interest in the outcome of the arbitration may be reasonably inferred.[61] In order to succeed on a removal request, the moving party must meet the burden of proof by reasonably demonstrating that a definite interest or bias exists.[62] Accordingly, FINRA rules provide parties with a mechanism by which to ensure the arbitral panel remains neutral.[63]

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56. FINRA RULE 12405(a).

57. *See Arbitrator Disclosure*, *supra* note 55 (listing arbitrator disclosure requirements, which include "any relationship, experience and background information that may affect-or even appear to affect-the arbitrator's ability to be impartial").

58. *Id*.

59. *See* RULE 12407(a).

60. *See* 9 U.S.C. § 10(a)(2) (2006).

61. RULE 12407(a).

62. *Id*.

63. *See Arbitrator Disclosure*, *supra* note 55.

2. Post-hearing Challenges (Rule 12407(b))

In order to further ensure the impartiality of arbitrators, FINRA Rule 12407(b) provides a FINRA Director[64] with the discretion to remove an arbitrator after the first hearing.[65] Before appointing an arbitral panel, a Director will notify potential arbitrators of the type of the dispute and the identity of the parties.[66] Each potential arbitrator must make reasonable efforts to learn of, and disclose to the Director, any circumstances that may preclude the rendering an objective and impartial finding.[67] Prior to 2001, the Director's authority to remove arbitrators ended after the first hearing or Initial Prehearing Conference.[68] The Customer Code was amended in 2001 to give the Director the power to remove an arbitrator who did not disclose information that should have been disclosed under Rule 12405.[69] The rule states that only the Director or President of Dispute Resolution may exercise this authority when such information is discovered after the first hearing session or prehearing.[70] Principally, the rule allows a party to challenge an arbitrator who failed to disclose a material relationship.[71] In conjunction with Rule 12405, Rule 12407(b) increases the fairness and efficiency of the arbitration process.[72]

E. CHALLENGING ARBITRATORS (POST-AWARD)

Once an award has been granted, parties may still have a limited opportunity for challenging such a verdict on similar grounds as allowed

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64. "The term 'Director' means the Director of FINRA Dispute Resolution. Unless [FINRA Rules] provide that the Director may not delegate a specific function, the term includes FINRA staff to whom the Director has delegated authority." RULE 12100(k).

65. RULE 12407(b).

66. *See* RULE 12405(a).

67. For examples of some of the necessary disclosures, see *supra* Part I.C.

68. *See* NASD Notice to Members 01-13, SEC Approves Amendments to Director's Authority to Remove Arbitrators for Cause 77 (Feb. 2001), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003916.pdf (announcing the December 8, 2000 SEC approval of amendments providing authority for the Director of Arbitration to remove arbitrators for cause after hearings have begun).

69. *Id.*

70. RULE 12407(b).

71. *Id.*; *see also* RULE 12405.

72. RULE 12405.

under FINRA Rule 12407. The FAA provides the authority for judicial review to confirm, vacate, or modify arbitration awards.[73] To vacate an award for an arbitrator's alleged bias, the party seeking vacatur must show that the arbitrator demonstrated "evident partiality,"[74] a term that has been broadly defined by different circuit courts.

The definition of "evident partiality" has changed several times since the Supreme Court defined the term in *Commonwealth Coatings Corp. v. Continental Casualty Co.*[75] Where parties have agreed to arbitrate, judicial review is severely limited and the arbitrator's decisions may be set aside only in exceptional situations.[76] Most relevantly, such circumstances include "evident partiality," defined originally by a plurality in *Commonwealth Coatings* as action or nondisclosure that conveys an appearance or impression of bias.[77] Subsequent district courts have adopted varying degrees of the "evident partiality" standard with some courts merely requiring an impression of bias while others requiring more than an appearance of bias in order to vacate an award.[78]

A review of "evident partiality" jurisprudence reveals a spectrum of analysis evolving in different circuits marked by two separate standards. "Evident partiality" in the Ninth and Eleventh Circuits ("impression

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73. 9 U.S.C. §§ 9–11 (2006).

74. The FAA states in relevant part that "[i]n 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 . . . (2) where there was evident partiality or corruption in the arbitrators, or either of them." *Id.* § 10.

75. 393 U.S. 145, 149 (1968).

76. First Options of Chi., Inc. v. Kaplan, 514 U.S. 938, 942 (1995); *see also* 9 U.S.C. § 10(a) (listing limited grounds, such as fraud and corruption, for vacating arbitration award).

77. Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145, 149 –50 (1968). The court reasoned that because of the combination of: (1) arbitrators having expansive freedom in their rulings and (2) arbitration awards not being subject to appellate review, an arbitrator's impartiality should meet the standards of Article III judges. The court defined such Article III standards by reference to the American Arbitration Association as well as the Canons of Judicial Ethics, which call for a judge to be "careful to avoid such action as may reasonably tend to awaken the suspicion that his social or business relations . . . influence[] his judicial conduct." *Id.*

78. *Compare* Crow Constr. v. Jeffrey M. Brown Assoc. Inc., 264 F. Supp. 2d 217, 220–21 (E.D. Pa. 2003) (adopting the appearance of bias standard while rejecting the need for proof of actual bias in order to vacate an arbitration award) *with* Morelite Constr. Corp. v. N.Y.C. Dist. Council Carpenters Benefit Funds, 748 F.2d 79, 83–84 (2d Cir. 1984) (finding that in order to vacate an arbitration award under Section 10(b) there must be something more than the mere appearance of bias).

circuits") may be met by a mere impression of bias while the Sixth, Seventh, and Tenth Circuits ("actual bias circuits") require something more than an appearance of bias in order for a moving party to successfully vacate an award.[79] The Second Circuit, on the other hand, appears to fall somewhere in the middle of the spectrum marked by the "impression circuits" and the "actual bias circuits."[80] The distinction between this emerging circuit split is best characterized by the higher burden imposed by "actual bias circuits," which treat the simple appearance of a lack of impartiality as insufficient to upset an arbitral award.[81] Impression circuits, on the other hand, will set aside an arbitral award in cases where, for example, an arbitrator's law firm formerly represented a parent company of one of the claimants, despite the lack of actual knowledge by the arbitrator of such a fact, or additional evidence to suggest that the arbitrator acted to the benefit (or detriment) of any party.[82] Courts will likely continue to use various factors for "evident partiality" analysis.

The trend in New York state courts and the Second Circuit appears to be a "reasonable person" standard, as recently upheld in *U.S. Electronics, Inc. v. Sirius Satellite Radio, Inc.*[83] and *Scandinavian Reinsurance Co. v. St. Paul Fire & Marine Ins. Co.*[84] In *Morelite Construction Corp. v. New York City District Council Carpenters Benefit Funds*, the Second Circuit first declined to follow the opinion of *Commonwealth Coatings*, holding that it did not have binding effect since the Supreme Court's opinion was a plurality rather than a

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79. *Compare* Schmitz v. Zilveti, 20 F.3d 1043, 1046 (9th Cir. 1994); Middlesex Mut. Ins. Co. v. Levine, 675 F.2d 1197, 1201 (11th Cir. 1982) *with* Health Servs Mgmt. Corp. v. Hughes, 975 F.2d 1253, 1264 (7th Cir. 1992); Apperson v. Fleet Carrier Corp., 879 F.2d 1344, 1358 (6th Cir. 1989); Ormsbee Dev. Co. v. Grace, 668 F.2d 1140 (10th Cir. 1982).

80. *See Morelite*, 748 F.2d 79, 84 (2d Cir. 1984); *see also In re* Andros Compania Maritima, S.A. (Marc Rich & Co., A.G.), 579 F.2d 691, 701–02 (2d Cir. 1978) (refusing to vacate an arbitration award based on a professional relationship between a challenged arbitrator and the operator of the vessel involved in the arbitration)..

81. *See e.g.*, *Health Servs. Mgmt. Corp.*, 975 F.2d at 1264 (requiring a showing of more than just an appearance of bias to set aside an award for arbitration partiality).

82. *See* Schmitz v. Zilveti, 20 F.3d 1043, 1049 (9th Cir. 1994) (holding that because Arbitrator Conrad had constructive knowledge of the presence of a conflict, his "failure to inform the parties to the arbitration resulted in a reasonable impression of partiality under *Commonwealth Coatings.*").

83. 958 N.E.2d 891, 893 (N.Y. 2011).

84. 668 F.3d 60, 64 (2d Cir. 2012).

majority.[85] Instead, the court adopted a "reasonable person standard," stating that "evident partiality" is present where a reasonable person would find that an arbitrator was biased in favor one party to the detriment of another in arbitration.[86] *U.S. Electronics* followed a plethora of case law from the Second Circuit,[87] reasoning that the stringent "evident partiality" standard could not be satisfied by a mere appearance of bias even though proof of actual bias is rarely established.[88] Most recently, in *Scandinavian Reinsurance Co.*, the Second Circuit reaffirmed this standard, holding that where non-disclosure by an arbitrator did not suggest a party suffered bias, then the mere suggestion of bias did not warrant vacatur.[89] Accordingly, the Second Circuit, as well as New York state courts adopt a "reasonable person standard" finding that it strikes a proper balance between threatening private arbitration and upholding the fairness to which parties are entitled.[90]

II. MIXED INCENTIVES VERSUS AUCTION RATE MODEL

Part II of this note examines the mixed incentives for FINRA parties to bring essentially identical claims involving analogous financial products twice because of the similarity between FINRA Rule 12407 challenges and "evident partiality" claims and the current arbitral panel selection model.[91] Next, this part explores the current panel selection model as applied to the Morgan Keegan line of cases and the threat to arbitration. Finally, it compares the current panel selection model with a model developed specifically for auction rate cases.

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85. *See Morelite*, 748 F.2d 79, 82 (2d Cir. 1984) (holding that the decision in *Commonwealth Coatings* was not binding because four justices did not constitute a majority of the Supreme Court and the opinion of Justice White, writing for himself and Justice Marshall, merely concurred in the result).

86. *Id.* at 84.

87. *See, e.g.*, Ecoline, Inc. v. Local Union No. 12 of Int'l Ass'n of Heat & Frost Insulators, 271 Fed. Appx. 70 (2d Cir. 2008); Applied Indus. Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi, A.S., 492 F.3d 132 (2d Cir. 2007); Lucent Techs. Inc. v. Tatung Co., 379 F.3d 24 (2d Cir. 2004).

88. *U.S. Elecs., Inc.*, 958 N.E.2d at 893.

89. *See Scandinavian Reins.,* 668 F.3d at 73.

90. *See Morelite Constr. Corp.,* 748 F.2d 79 at 84 ("In this way, we believe that the courts may refrain from threatening the valuable role of private arbitration in the settlement of commercial disputes, and at the same time uphold their responsibility to ensure that fair treatment is afforded those who come before them.").

91. *See supra* Part I.D.

A. CURRENT MODEL

Whether a court applies the original *Commonwealth Coating* "evident partiality" standard or the Second Circuit "reasonable person standard," or any other standards mentioned above, the grounds for challenging an arbitral award are highly similar to FINRA Rule 12407 challenges.[92] Under FINRA Rule 12407(a)(1), a party's request to remove an arbitrator may be honored before the first hearing session 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.[93] Under any of the standards articulated by courts in applying the "evident partiality" standard, a moving party must demonstrate some facts that support an appearance of bias in addition to possible other factors such as actual bias or arbitrator non-disclosure of information that would lead a reasonable person to believe a conflict exists.[94] The grounds for vacatur are analogous in many respects to arbitrator challenges under Rule 12407.[95]

1. "Evident Partiality" in the Investment Industry (Morgan Keegan)

In light of the close-knit investment industry, a limited number of arbitrators, and an "evident partiality" standard that is in flux, post-award challenges are likely to be frequent. The likelihood that parties to trade-specific disputes, such as in the securities industry, may have had dealings with another arbitrator,[96] party, or counsel in the ordinary

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92. *See id.*

93. *See supra* Part I.D.1.

94. *See, e.g.*, Woods v. Saturn Distribution Corp., 78 F.3d 424, 427 (9th Cir. 1996) (distinguishing the burden of proof in nondisclosure cases as requiring a lower threshold than the proof of actual bias required when actual bias is asserted); ANR Coal Co. v. Cogentrix of N.C., Inc., 173 F.3d 493, 500 (4th Cir. 1999) (citing Consolidation Coal Co. v. Local 1643, United Mine Workers, 48 F.3d 125, 129 (4th Cir. 1995)); Morelite Constr. Corp. v. N.Y.C. Dist. Council Carpenters Benefit Funds, 748 F.2d 79, 84 (2d Cir. 1984) (finding it nearly impossible to prove actual bias); *see also* Montez v. Prudential Sec., Inc., 260 F.3d 980, 983 (8th Cir. 2001) ("The absence of a consensus on the meaning of 'evident partiality' is evidenced by the approaches adopted by the different circuits.").

95. *See supra* Part I.D.

96. There are only a total of 6,430 public and non-public arbitrators. *Dispute Resolution Statistics*, FINRA (Sept. 2012), http://www.finra.org/

course of business, is high.[97] In many circuits, a claim of "evident partiality" cannot rest solely on a *per se* FINRA rule violation without some additional requisite facts that would lead a reasonable person to believe that an actual or potential conflict exists; however, this is not the case in all jurisdictions.[98] As a result, even though prospective arbitrators have a continuing duty to keep the Disclosure Statement current, including direct and indirect relationships to any party or their counsel, a post-award challenge may still be raised.[99] Accordingly, an "evident partiality" claim is more likely to be raised in a securities dispute, whether meritorious or not, because of the closed-knit nature of the investment business, limited number of arbitrators,[100] and a vague "evident partiality" standard.[101]

2. Morgan Keegan

The FINRA arbitration dispute against Morgan Keegan filed by William Hamilton Smythe III ("Mr. Smythe") is similar to many other disputes filed against the firm. Mr. Smythe concluded that Morgan Keegan had invested his money unsuitably in several funds, specifically with regards to the RMK family of funds.[102] After suffering significant losses to his accounts as trustee and individual, Mr. Smythe initiated an arbitration proceeding against Morgan Keegan.[103] In accordance with FINRA rules, the arbitrator selection process resulted in the selection of a final panel consisting of Arbitrators Buchanan, Katz, and Hill.[104]

On October 2, 2009, after other Morgan Keegan cases on which Arbitrators Katz and Hill served were resolved unfavorably to Morgan Keegan, the firm filed a recusal motion alleging that Arbitrator Katz was no longer impartial because of both his involvement in the previous arbitrations and relation to another claimant against Morgan Keegan

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ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/.

97. *See* Garfield & Co. v. Wiest, 308 F. Supp. 1107 (S.D.N.Y. 1970), *aff'd*, 432 F.2d 849 (2d Cir. 1970).

98. *See Montez*, 260 F.3d at 980.

99. *See supra* Part I.E.

100. *See supra* note 91.

101. *See generally* Kathryn A. Windsor, Comment, *Defining Arbitrator Evident Partiality: The Catch-22 of Commercial Litigation Disputes*, 6 SETON HALL CIR. REV. 191, 192 (2009).

102. *See* Morgan Keegan & Co v. Smythe, III, No. W2010-01339-COA-R3-CV, 2011 WL 5517036, at *1 (Tenn. Ct. App. Nov. 14, 2011).

103. *Id.*

104. *Id.*

arising out of the same investment Fund.[105] On October 12, 2009, Morgan Keegan filed an identical recusal motion based on Arbitrator Hill's serving as an arbitrator in the other Morgan Keegan proceedings."[106] Arbitrators Katz and Hill declined to recuse themselves from the Arbitral Panel.[107] The removal motions were then submitted to the Director of Arbitration for consideration under FINRA Rule 12410(a)(1), but the Director denied the motions for removal.[108]

Mr. Smythe's appeal challenging the trial court's decision to vacate the arbitration award and remand to FINRA was denied on the grounds of jurisdiction, but it still created uncertainty in future FINRA arbitrations.[109] As a threshold matter, the Tennessee Court of Appeals considered whether it had subject matter jurisdiction to hear Mr. Smythe's appeal.[110] The Court concluded that although the FAA applied to the substantive issues in the case, the Tennessee Uniform Arbitration Act ("TUAA") governed the appealability of the trial court's order.[111] Under the TUAA, the court dismissed the appeal for lack of subject matter jurisdiction.[112] Despite not ruling explicitly on the merits of the issues raised in the appeal as to whether the evidence presented by Morgan Keegan demonstrated "evident partiality" of arbitrators Hill and Katz, FINRA released a guidance report on arbitrators serving on multiple cases involving the same firm.[113]

B. MORGAN KEEGAN UNCERTAINTY

Morgan Keegan rulings threaten the essential purposes of arbitration. The purpose of arbitration is to provide an efficient and speedy mechanism for private dispute settlement.[114] Where an

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105. *Id.* at *2.

106. *Id.* at *2. Morgan Keegan "filed a petition in the trial court to vacate the arbitration award, alleging partiality and bias on the part of two members of the arbitration panel[,]" resulting in an order vacating the arbitration award. *Id.* at *1.

107. *Id. at *2.*

108. *Id.*

109. *See id.* at *18; *FINRA Guidance Report*, *supra* note 3.

110. *Morgan Keegan*, 2011 WL 5517036, at *3.

111. *Id. at *4.*

112. *Id. at *18.*

113. *See FINRA Guidance Report*, *supra* note 3.

114. Sobel v. Hertz, Warner & Co., 469 F.2d 1211, 1214 (2d Cir. 1972); *see also* Bernhardt v. Polygraphic Co. of Am., 350 U.S. 198, 203 (1956) (holding that the

agreement to arbitrate is present, an arbitrator's decisions should be set aside only under limited circumstances.[115] The geographic concentration of Morgan Keegan RMK fund cases resulted in numerous arbitrators being assigned to multiple proceedings, which involved the same company or fund.[116] Based on such a concentration and the reasoning of the court in Morgan Keegan, parties are more likely to bring "evident partiality" claims in the future. Accordingly, the ease of challenging an arbitral award undermines the efficiency of the process.

Furthermore, although Morgan Keegan failed in the Rule 12407 challenge, it simply awaited a final award and went on to make a successful petition for vacatur under an "evident partiality" theory largely identical to the FINRA Rule 12407 challenges.[117] Morgan Keegan's motion to FINRA alleged that Arbitrators Katz and Hill were biased due to both having served as arbitrators on cases with the same investments or fund manager in which the panel held against Morgan Keegan. Specifically, the petition cited that Arbitrator Hill had previously rendered a judgment for punitive damages in a claim related to investments in the same fund and Arbitrator Katz had an indirect financial interest in the claims disposition.[118] The trial court adopted the "reasonable person standard" finding that a reasonable person would have concluded that Arbitrators Hill and Katz would be perceived as biased based on evidence of the earlier hearings and conclusions involving Morgan Keegan.[119] Consequently, Morgan Keegan prevailed on obtaining vacatur of the arbitration award and remand to FINRA by instituting a post-award action similar to the arbitrator challenges brought during the selection of the panel.[120]

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sacrifice that arbitration entails in terms of legal precision is recognized and is implicitly accepted in the initial assumption that certain disputes are arbitrable).

115. *See* First Options of Chi., Inc. v. Kaplan, 514 U.S. 938, 942 (1995); *see also* 9 U.S.C. § 10(a) (2006) (listing limited grounds for vacating an arbitration award, including fraud and corruption).

116. *See FINRA Guidance Report*, *supra* note 3.

117. *Morgan Keegan*, 2011 WL 5517036, at *2.

118. *Id.*

119. *Id.* at *3.

120. *Id.*

C. AUCTION RATE CASE MODEL

FINRA has adopted an alternative form of arbitral panel selection in auction rate cases.[121] In a news release dated August 7, 2008, FINRA announced that it had established a special process for deciding auction rate securities ("ARS") based claims in its arbitration forum.[122] Under this "auction rate model," qualifying investors would have the option of having their claims heard by a three-person panel of arbitrators, none of whom would be affiliated with a firm that recently sold auction rate securities.[123] This new process came as a result of a procedure developed by FINRA for the SEC settlement with Citigroup Global Markets, Inc. ("Citi") in one of many ARS settlements arising out of the ARS crisis.[124] The proposed solution provided herein follows this basic "auction rate model."

The "auction rate model" has proven to be an efficient method to provide investors and broker-dealers with a high degree of fairness. As of August 7, 2008, more than 170 cases involving ARSs were filed in

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121. *See* Press Release, FINRA, FINRA Creates Process for Arbitrations Involving Auction Rate Securities (Aug. 7, 2008), http://www.finra.org/Newsroom/NewsReleases/2008/P039025. An auction rate security ("ARS") is a debt instrument that is typically sold through a Dutch auction. In a Dutch auction the price of the offering is set by incorporating all bids to determine the highest price at which the total offering can be sold. The auction begins with a high asking price, whereby investors place a bid for the amount they are willing to buy in terms of quantity and price until an accepted price/quantity combination is reached. Specifically with an ARS, this process results in an interest rate that will clear the market at the lowest yield possible. The interest rate is reset periodically at which point investors are generally able to sell their securities. *See Special Arbitration Procedures for Investors Involved in Auction Rate Securities Regulatory Settlements*, FINRA, http://www.finra.org/ArbitrationAndMediation/Arbitration/SpecialProcedures/ARS/index.htm (last visited Sept. 30, 2012).

122. *See* Press Release, FINRA Creates Process for Arbitrations Involving Auction Rate Securities, *supra* note 121.

123. *Id.*

124. *Id.* ARSs were often sold as a safe alternative to money-market funds, as investors could sell their shares at an auction that also determined the rate of interest they would receive. As the credit crisis deepened, however, these ARS auctions began to fail. As a result, investors who treated such securities as liquid, based on the advice of investment companies, found themselves short on available funds. *See* Gretchen Morgenson, *3 Firms Are Asked for Data On Auction-Rate Shares*, N.Y. TIMES, Mar. 29, 2008, at C2 (discussing the ARS crisis and the issuance of a subpoena for information relating to the sales of auction rate shares by Merrill Lynch, UBS Securities, and Banc of America Investment Services).

FINRA's Dispute Resolution forum.[125] Individuals who had either worked for a firm that sold ARSs or themselves sold or supervised the sale of such securities since January 1, 2005 did not appear on the non-public arbitrator lists given to parties in ARS cases.[126] According to the President of FINRA Dispute Resolution at the time, Linda Fienberg, "[I]n light of the settlement with Citigroup, FINRA believe[d] it [was] a matter of fairness that all investors with auction rate securities claims, regardless of the firm involved in the dispute, be handled in this manner."[127] Accordingly, the "auction rate model" has been adopted by FINRA in the past because it provided an efficient method by which to provide investors and broker-dealers with a high degree of fairness.[128]

III. FINRA GUIDANCE PROPOSAL

FINRA acknowledged the ambiguity caused by the Morgan Keegan line of cases.[129] In response, FINRA opted to advise litigants to follow current practices of timely challenges.[130] The "auction rate model" proposed hereto is based on an effective procedure previously adopted by FINRA in limited circumstances. Part III seeks to outline the weaknesses of FINRA's current framework. Next, it reintroduces the "auction rate" model as a means by which FINRA may reduce the ambiguity and inconsistency developing in securities arbitration.

A. FINRA GUIDANCE

FINRA issued guidance to parties involving Morgan Keegan and the RMK Bond Funds and changed the Disclosure Report.[131] The FINRA Guidance Report stated that FINRA did not believe that serving

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125. *See* Press Release, FINRA Creates Process for Arbitrations Involving Auction Rate Securities, *supra* note 121.

126. *Id.*

127. *Id.*; *see also* Press Release, SEC, SEC Finalizes ARS Settlements with Citigroup and UBS, Providing Nearly $30 Billion in Liquidity to Investors (Dec. 11, 2008), http://www.sec.gov/news/press/2008/2008-290.htm (discussing finalized settlements resolving the SEC's charges that Citigroup Global Markets, Inc. (Citi) and UBS Securities LLC and UBS Financial Services, Inc. (UBS) misled investors regarding the liquidity risks associated with ARSs that they underwrote, marketed, and sold).

128. *See supra* notes 116–22 and accompanying text.

129. *See FINRA Guidance Report*, *supra* note 4.

130. *See id.*

131. *See id.*

on several proceedings concerning the same firm automatically disqualified an arbitrator from serving on other cases or require removal on the grounds of bias.[132] FINRA further acknowledged that under Rule 12407, it would continue to honor timely challenges to arbitrator appointments.[133] Additionally, FINRA changed the Disclosure Report sent to parties to reflect cases currently assigned to arbitrators.[134] If a party knew or should have known that an arbitrator was assigned to other Morgan Keegan RMK fund matters but did not make a timely challenge to the arbitrator, that challenge will not be accepted later in the case.[135]

B. New Guidance Proposal

The current jurisprudential landscape creates ambiguity and inconsistency in securities arbitration. It is certain that disputes between the investing public and the securities industry will continue and arbitration will be a part of the resolution process.[136] Consistent with the overall purpose of SROs and arbitration, FINRA's securities arbitrations process must offer a fair hearing on the merits by knowledgeable and impartial arbitrators.[137] The existing conditions allow for multiple challenges to arbitrators under various standards of "evident partiality" and for various grounds such as serving on multiple panels related to the same case.[138] Though it is not unreasonable that some challenges may be meritorious, parties are currently able to bring similar claims in multiple venues and on multiple occasions, undermining the efficiency

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132. *Id.*

133. A "timely challenge" is one made promptly after the appointment of the arbitrator, but before the commencement of the next hearing session. *Id.* The FINRA Guidance Report specifically mentioned that timely challenges based on an arbitrator serving on multiple cases involving the same firm and product have been honored. *Id.*

134. Disclosure Reports now provide details regarding cases an arbitrator has been assigned to, including the securities firms and associated persons involved, the date assigned, and the role of the arbitrator on the panel. *See* FINRA, SAMPLE ARBITRATOR DISCLOSURE REPORT (2011), http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@neutrl/documents/arbmed/p122952.pdf.

135. *See FINRA Guidance Report*, *supra* note 4.

136. *See* Constantine N. Katsoris, *Securities Arbitrators Do Not Grow on Trees*, 14 FORDHAM J. CORP. & FIN. L. 49, 81 (2008).

137. *See id.*

138. *See supra* Parts I.D–E.

and award certainty of arbitration proceedings.[139] In order to avoid this problem, FINRA's Neutral List Selection System ("NLSS") should automatically exclude arbitrators having served on identical product cases or identical firm cases within a specified period from the list of potential arbitrators sent to parties.[140] Although this process may eliminate large groups of qualified professionals because of their experiences, this relatively simple solution will reaffirm fairness and efficiency in FINRA securities arbitration.

The downside to a rule that reduces the number of qualified arbitrators that may be empaneled is outweighed by the increase in the equity of proceedings. A system of automatically assessing arbitrator impartiality by rigid criteria discourages many qualified and likely impartial arbitrators from even applying.[141] Furthermore, such a system unnecessarily eliminates many capable and honest candidates simply because of their prior work experiences.[142] Nevertheless, as has been noted in many state and federal opinions on arbitral proceedings, it is of central importance that fairness not merely be found in rulings but also should be clearly visible throughout the arbitral process.[143] Although the proposed solution may reduce the number of qualifying arbitrators, the downside to such an outcome is outweighed by the necessity that FINRA proceedings not only provide equitable awards but also provide the appearance of fairness.

CONCLUSION

Reading *Morgan Keegan* in conjunction with *U.S. Electronics, Inc.*, it appears that the fundamental goals of arbitration, namely cost

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139. *See supra* Part II.

140. A similar model was adopted by FINRA in 2008 for ARS based cases. FINRA updated its arbitrator biographical information to identify arbitrators who, since January 1, 2005, worked for a firm that sold ARSs or sold or supervised someone who sold such securities. Non-public arbitrators who, since January 1, 2005, worked for a firm that sold ARSs or themselves sold or supervised someone who did were barred from serving on an arbitral panel. *See Panel Composition in Auction Rate Arbitration Cases*, FINRA, http://www.finra.org/ArbitrationAndMediation/Arbitration/SpecialProcedures/ARS/P124481 (last visited Apr. 12, 2012).

141. *See* Katsoris, *supra* note 136, at 80.

142. *Id.*

143. *See generally* Pedro Sousa Uva, *A Comparative Reflection on Challenge of Arbitral Awards Through the Lens of the Arbitrator's Duty of Impartiality and Independence*, 20 AM. REV. INT'L. ARB. 479, 485 (2009) (quoting R v. Sussex Justices, (1924) 1 K.B. 256).

efficiency, expediency, and award certainty will require additional FINRA guidance or legislative intervention.[144] Courts have struggled to clearly define the standard for when an arbitrator's appearance of an undisclosed conflict of interest will warrant the vacating of an arbitration award.[145] Furthermore, as seen in *Morgan Keegan*, there has been an increase in parties using the appearance of an arbitrator conflict to successfully vacate awards after already having raised individual challenges during the arbitrator selection process.[146] In light of the financial crisis, it is inevitable that multiple arbitrations will be brought against identical firms and financial products.[147] This proposed method for creating impartial arbitrator panels would effectively resolve some of the inconsistency found in prior judicial determinations and ensure not only the rendering of equitable awards but also the appearance of fairness.

144. *See* AT&T Mobility v. Concepcion, 131 S. Ct. 1740, 1751 (2011) (finding that parties choose arbitration in order to enjoy the benefits of lower costs, greater efficiency and speed, and the ability to choose expert adjudicators).

145. *See supra* Part I.D.

146. *See supra* Parts II.A.–B.

147. *See supra* Introduction.