

What Exactly Is Arbitration?

Ryan P. Smith

One of the items Congress is reviewing as it considers reforming financial regulation is the mandatory use of arbitration to resolve investors' disputes with financial advisors and brokerage firms. Of course, this can raise important concerns for investors: What exactly is arbitration? What rights do I give up by going to arbitration? This article provides a brief overview of the arbitration process for investors and highlights the major differences between it and traditional litigation.

At its core, arbitration is the same as litigation in that it offers parties the opportunity to present evidence, testimony and legal arguments to a neutral, who considers this information and decides their dispute. It starts with the investor filing a Statement of Claim with FINRA Dispute Resolution. FINRA Dispute Resolution is the part of the Financial Industry Regulatory Authority (FINRA) – which is the brokerage industry's self-regulatory organization – that handles almost all of the arbitration claims concerning the brokerage industry. In the Statement of Claim, the investor (referred to as the Claimant) describes how his financial advisor and/or brokerage firm (the Respondent(s)) harmed him and requests that the arbitration panel award him certain damages. As in litigation, the parties have the right to engage counsel to present their claim. The Respondent then files its Answer in which it responds to the allegations in the Statement of Claim.

Shortly after the parties exchange their respective pleadings they have the opportunity to select the arbitration panel. This is one of the major differences between arbitration and litigation.

- *You will not see a judge or a jury in arbitration.*

In litigation, a judge conducts the actual hearing and decides issues of law. A jury (or, from time to time, the judge) serves as the neutral and decides issues of fact as well as renders the verdict. In arbitration, these functions are consolidated in the arbitration panel, which is comprised of one to three arbitrators. These arbitrators may be attorneys, but are not required to be one or even have any formal legal training. All arbitrators, however, complete FINRA's training on the Code of Arbitration Procedure for Customer Disputes. An arbitration panel for disputes involving customers typically consists of one arbitrator that has current or past work experience in the brokerage industry and two arbitrators that do not.

As in the litigation process, the dispute then moves into a pre-hearing phase. In this phase, the parties confirm the arbitration panel and schedule the final evidentiary hearing and other deadlines. The parties also request documents and other information of the other and of certain third parties in a process called discovery. The parties may also ask the arbitration panel to resolve certain preliminary issues – such as issuing document subpoenas or compelling a party to provide certain documents – using pre-hearing motions. This pre-hearing phase can last many months.



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Also as in the litigation process, the parties are free at any point to settle their dispute. However, if the parties cannot resolve their differences, the arbitration panel conducts the evidentiary hearing. This is the trial. Here, the parties – starting with the Claimant – have the opportunity to present documents and testimony to the arbitration panel in support of their respective positions. This is also where arbitration greatly differs from traditional litigation.

- *The hearing is not in a courtroom.*

In traditional litigation, the trial is held in a courtroom, which is usually an impressive and solemn space. The parties sit at large tables at opposite sides of the room in front of the judge and the jury. This is not the case in arbitration. The hearing takes place in a conference room or, sometimes, in a hotel room. In addition, the parties do not sit at separate tables; rather, all of the parties (including the arbitration panel) sit at one large conference table.

- *Case law and the traditional rules of evidence do not apply.*

Another major difference between litigation and arbitration is that FINRA's Code of Arbitration Procedure for Customer Disputes governs all aspects of the arbitration. This means that case law and local rules of evidence do not control the proceedings. The arbitration panel may take this information under advisement but is not bound by it.

The evidentiary hearing typically lasts from one to four days, depending upon the issues presented. Once the hearing concludes, the arbitration panel reviews the evidence and returns its decision in a written award, usually within 30 business days. The arbitration panel may, but is not required to, detail its findings to the parties in the award.

- *The arbitration panel's decision is final.*

Under the Federal Arbitration Act and relevant case law, a party does not have the right to appeal an award in court unless the decision was the product of fraud or the result of the arbitration panel's "manifest disregard" of the law. This standard is extremely high and arbitration awards are virtually never overturned. Therefore, for all intents and purposes, an arbitration panel's award is final. This is in stark contrast to traditional litigation, which provides ample avenues for a party to appeal a verdict.

There is much more to the arbitration process than what is presented in this overview. Readers who are interested in learning more about arbitration are welcome to contact Ryan Smith at ryan@ryanpsmith.com or (804) 317-6832.



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