

Outside Counsel

Expert Analysis

FINRA To Preclude Non-Attorneys From Representing Arbitration Parties

The Financial Industry Regulatory Authority (FINRA), which regulates brokerage firms and their associated persons in the United States, also sponsors the largest forum for securities dispute resolution in the country. A majority of brokerage firms today require their customers to enter into an agreement which, among other things, requires that customers who have a dispute with the firm bring their claim in FINRA's arbitration forum rather than in civil court.

The FINRA Code of Arbitration for Customer Disputes (the Code) Rule 12208 addresses representation of parties in FINRA arbitration proceedings. As it currently stands, individual parties may represent themselves, and persons with bona fide legal authority may represent partnerships, corporations or limited liability companies. At any stage of a FINRA arbitration proceeding, all parties have the right to be represented by an attorney at

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law in good standing and admitted to practice before the U.S. Supreme Court or the highest court of any U.S. state, the District of Columbia, or any commonwealth, territory or posses-

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sion of the United States, unless—and this is key—state law prohibits such representation. Rule 12208 also permits parties to be represented by a non-attorney representative (NAR), unless: (1) state law prohibits such representation; (2) the person is currently suspended or barred from the securities industry in any capacity; or (3) the person is currently suspended from the practice of law or disbarred.

Several states' highest courts have ruled that representation by a non-

attorney in arbitration constitutes the unauthorized practice of law, including Arkansas, Arizona, and Ohio. Other states have, instead, provided guidance regarding the unauthorized practice of law in arbitration through bar rules and advisory opinions, such as Alabama, Florida, Illinois, Kansas, Louisiana, and Washington. Yet other states, like New York (where the largest number of FINRA arbitration claims are filed), permit NARs to represent investors, as long as FINRA's rules allow it. In California and Michigan, an attorney who is licensed in another state may not appear in the FINRA arbitration forum in a representative capacity unless he or she associates with an in-state attorney who will be attorney of record. In some states, there are other administrative requirements that must be adhered to in order for the out-of-state attorney to represent the party thereafter. For example, in Florida, an out-of-state attorney may appear in a representative capacity by filing a Verified Statement with, and paying a fee to, the Florida Bar in accordance with Florida Bar rules.

However, FINRA Rule 12208 may soon be in for a fundamental revision.

In October 2017, FINRA published Regulatory Notice 17-34 seeking public comments on the efficacy of changing its rules for customer arbitration claims to disallow compensated NARs from continuing to represent parties in FINRA arbitrations. In seeking public comments, FINRA clearly signaled its significant concerns about continuing to permit NARs to represent public customers in FINRA arbitrations.

Indeed, an overwhelming number of the published comments suggested that barring NARs from representing customers in FINRA arbitrations would be in the best interest of the investing public and uphold the integrity of FINRA's Dispute Resolution program. In response, in December 2018, FINRA's Board of Governors voted in favor of a rule change that would bar NARs from representing individuals in FINRA arbitration cases. The rule change must be approved by the Securities and Exchange Commission before it can become effective.

Moreover, in November 2018, the New York City Bar published a Committee Report in which it addressed FINRA's responsibility to assert its jurisdiction as to which, and under what circumstances, NARs should be permitted to represent parties before its tribunals. The Committee Report concluded, among other things, that, "In the absence of state regulation of its processes, FINRA has the primary responsibility to enact appropriate rules to protect parties in FINRA Customer Disputes. In furtherance of that responsibility, FINRA should enact rules to limit the ability of non-attorney advocates to appear

for customers in such cases as FINRA deems appropriate. At a minimum, the Committee recommend[ed] that FINRA consider one or more of the following measures:

- a. Amending its Rule 12208(c) to require parties, in all FINRA Customer Arbitrations except those to be decided by a single arbitrator under Rule 12401 or designated a Simplified Arbitration under Rule 12800, to be represented by licensed attorneys legally permitted to practice in arbitration under the law of the hearing location.
- b. Amending its Rule 12208(d) to empower arbitrators to regulate or prohibit non-attorney party representatives who the arbitrators determine are not qualified or are abusing the arbitration process.
- c. Prohibiting non-attorneys from representing customers for compensation, even when otherwise permitted by FINRA Rules, unless they have been trained in the proper conduct of arbitration advocacy, whether through FINRA or another entity, in such ways as FINRA deems appropriate."

See the Committee Report. These recommendations are prudent, and reflect the direction in which FINRA should move.

Equally important is the fact that when a NAR prepares and files Statements of Claim in arbitration, they are generally not aware of nor compliant with state and federal bar requirements that prohibit the filing of pleadings that contain baseless claims or making unsubstantiated allegations. NARs have no such restrictions as they

are unconstrained by legal, ethical, (and in certain cases) moral restrictions, and often file Statements of Claim that include baseless causes of action and include improperly named parties, for the sake of harassing and pressuring the firm's principals into making quick monetary settlements. Additionally, NARs do not carry professional liability (malpractice) insurance and are not regulated by any governmental authority, which can leave aggrieved clients with no remedy if the NAR fails to properly discharge its representation of a public customer.

As stated above, all proposed changes to the FINRA Code must be approved by the Securities and Exchange Commission before becoming effective. How FINRA's new requirements will impact claimants' ability to obtain representation in FINRA arbitration cases will depend on the NARs' next moves. Knowing now that this rule change is imminent, many NARs are aligning themselves with attorneys who would take their place as the "official" party representative should the rule become effective. But will this end the sometimes unscrupulous and unethical conduct exhibited by some NAR firms in the way they obtain client leads and solicit claimants? Only time, and the rigorous enforcement of the soon-to-be revised rule, will tell.