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WACHOVIA SECURITIES

April 11, 2008

**BY E-MAIL TO: RULE-COMMENTS@SEC.GOV**

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File No. SR-FINRA-2007-021
Proposed Amendments to Rules 12206 and 12504 of the NASD Customer Code and Rules 13206 and 13504 of the NASD Industry Code to Address Motions to Dismiss

Dear Ms. Morris:

Wachovia Securities, LLC ("Wachovia") appreciates this opportunity to comment upon the above-referenced proposed rule amendments of the Financial Industry Regulatory Authority, Inc. ("FINRA"). Wachovia submits this letter to request that the Securities and Exchange Commission ("SEC") decline to approve the rule in its current form.

## I. Introduction and Overview

Wachovia Securities is a full service brokerage firm serving clients in 50 states and the District of Columbia. It assists over 5.7 million active retail clients in purchasing a wide array of investment products. Through its First Clearing LLC affiliate ("First Clearing"), Wachovia also acts as the clearing firm for 150 introducing brokers. Given the size of the firm, it is natural that there are occasions where customer claims cause both parties to use the arbitration facilities managed by FINRA and supervised by the SEC. More than 20 years of experience has helped the regulators develop a dispute resolution system that swiftly, efficiently and fairly adjudicates these claims. We understand fully, therefore, FINRA's motivation to pass amendments it believes enhance the arbitration process.

Though FINRA's effort to eliminate abusive motion practices is a goal supported by all participants in the securities arbitration system, Wachovia is nonetheless concerned. As proposed, Rules 12504(a)(6) and 13504(a) would eliminate almost *any* prehearing dispositive motions. The Proposal accomplishes this result by strictly limiting to two circumstances the reasons for which a party could file a prehearing dispositive motion; the first where a non-moving party released all of the claims in dispute and the second when there is no connection between the moving party and the account, securities or conduct at issue. Wachovia writes this brief comment letter to urge the Commission to reject FINRA's Proposal in its current form. Wachovia further incorporates by reference the letter to the SEC by the Securities Industry and Financial Markets Association ("SIFMA") Arbitration Committee, Litigation Advisory Committee and Clearing Firms Committee dated April 7, 2008.

## A. The Proposed Amendments Substantially and Unnecessarily Restrict the Relief Available in Arbitration

FINRA has long recognized that arbitrators are authorized to award any relief that would be available in a court of law. Yet, the proposed amendments would effectively strip arbitrators of the ability to award certain types of prehearing relief that is normally available in court and in other arbitration fora. Limiting arbitrators in this fashion is contrary to established jurisprudence and public policy. Where, as here, there is no evidence that arbitrators have been improperly deciding prehearing dispositive motions, the proposal is vastly overbroad and needlessly undermines the broad powers of the arbitrators. Such a move is fatal to the public perception of the fairness of the arbitration process.

One of the foremost and basic arguments in favor of arbitration in securities disputes is that a litigant may obtain any relief that would be available in court. In other words, by agreeing to arbitration before FINRA Dispute Resolution, a party is not forced to waive any substantive rights. It is beyond cavil that in court and other arbitration fora, the early dismissal of factually and legally insufficient claims is an important remedy that is available to both sides. The availability of prehearing relief protects the rights of all parties by ensuring that plaintiff has (1) a cognizable claim and that a defendant is not required to defend itself against legally and factually baseless claims; and (2) an opportunity to prevail sooner rather than later where the facts are undisputed. Indeed, the ability to obtain prehearing relief is consistent with the twin goals of arbitration and the judicial system generally, to wit: fundamental fairness and efficient and timely adjudication of disputes.

FINRA and the courts have long maintained that arbitrators are competent to decide common law and statutory claims asserted in arbitration. Inasmuch as this principle assumes that arbitrators are competent to render awards at the *conclusion* of the case, it is also logical that arbitrators are qualified to rule on common law and statutory

claims at an *earlier date*, i.e., prior to a full evidentiary hearing. It simply cannot be that arbitrators are able to render *final awards* that encompass all of the issues before them but are simultaneously unable to make awards based on prehearing motions concerning the very same issues. Yet, in effect that is what the proposed amendments mean. It is difficult if not impossible to reconcile both positions and the resulting conclusion is irrational. The implied message is that arbitrators cannot make sound decisions without extreme guidance from FINRA. Unfortunately, that message will eviscerate public confidence in the fairness and quality of the entire arbitration process and substantially diminish the relief available in arbitration.

Moreover, limiting or eliminating previously accepted substantive grounds for prehearing relief, e.g., time-barred claims, improper parties, legal impossibility, the inability to establish a necessary element of a claim, improperly favors claimants. Prehearing relief in court is available to *both* parties; a plaintiff may make a motion for summary judgment based on undisputed facts without the necessity of a full blown hearing and extensive discovery costs. Conversely, a defendant may make a motion to dismiss where a plaintiff cannot demonstrate certain necessary elements of a claim. These motions enhance the judicial process by sharpening the legal and/or factual issues in a case, narrowing the scope of discovery and ultimately allow a more efficient presentation and consideration of the evidence. A motion to dismiss often affords a claimant the opportunity to amend her claim and therefore permits a respondent to properly prepare its defense. A motion for summary judgment allows a claimant to receive relief promptly without incurring added costs. Both outcomes are a win-win for the parties and the process.

The proposal to eliminate defensive dispositve motions in arbitration flies in the face of well settled law, limits the arbitrators ability to grant any relief that would be available in a court of law; and unfairly penalizes respondents because there is no similar restriction on claimants. A party is only entitled to the adjudication process if they have a plausible claim. The proposed amendments would allow nearly every claim, plausible or not, to proceed through the arbitration process. There is no reason to delay determining whether a claim raises legally cognizable issues until the close of the claimant's case. Barring prehearing motions, except on the exceedingly limited grounds as set forth in the proposed amendments, is detrimental to the process and contrary to strong public policy that has been recognized by the U.S. Supreme Court.

**1. The Proposal Requiring Unanimity Is Unfair to Movants and the Arbitrators.**

The proposed amendments require that decisions to grant a motion to dismiss be unanimous. This provision is unfair to movants because a single dissenting vote could guarantee the denial of a motion to dismiss or a motion for summary judgment even if the arbitrator had no rational basis to do so. Moreover, such a requirement interjects a

divisive element into panel deliberations. It is well settled that there are issues on which reasonable minds could disagree, for instance, scienter. Under such circumstances, it is patently unfair to force the dissenting arbitrator – whatever their decision – to change their vote merely to achieve unanimity and preserve harmony among the panel members. An arbitrator should be free to cast her vote based upon her understanding of the case and should not be coerced to adopt another view merely to forestall a deadlock. Nowhere else in the Code of Arbitration Procedure is unanimity required and FINRA has failed to present a compelling justification as to its necessity in this instance. The long history of fair outcomes resulting from majority decisions supports amending the proposed amendments to allow a majority decision on prehearing motions.

**2. The Assessment of Forum Fees and Sanctions Should Remain Within the Sound Discretion of the Panel.**

The proposed amendments require that where a panel denies a motion to dismiss that is filed prior to the conclusion of the claimant's case, the panel must assess all forum fees against the movant. Under the American system of jurisprudence, the decision to award costs – whether in court or arbitration – is generally given to the sound discretion of the tribunal. This principle should continue to apply in arbitration. The mere fact that a motion to dismiss is denied is not a demonstration of bad faith or evidence of frivolity. There are numerous reasons that a panel may decide to allow a case to proceed: a panel could believe that additional discovery will further define the issues or a panel could decide that hearing live testimony will assist them in making a reasoned decisions. These are all sound bases for denying a motion to dismiss prior to the conclusion of the claimant's case but these same reasons do not demonstrate bad faith on the part of the movant or lead to a conclusion of frivolity. Forcing a panel to assess fees and/or sanctions against a movant has a chilling effect on litigants. A party may refrain from making a proper motion merely to avoid the possibility of an award of costs and/or sanctions. Under these circumstances, a party's ability to fully and fairly litigate their case is unduly compromised. For these reasons, the proposed amendments should be changed to consign the award of forum fees and/or sanctions to the sound and unfettered discretion of the arbitrators.

**B. The Proposals Should Recognize Longstanding Substantive Grounds for Prehearing Dismissal.**

Wachovia certainly understands the need to provide adequate guidance to arbitrators with respect to prehearing motions. It further believes that the wording in the proposed amendments should not include the word "discouraged" but simply set forth factors for arbitrators and parties to consider. It is impossible to enumerate each situation that may warrant a prehearing motion for dismissal or summary judgment. Moreover, the letter submitted by SIFMA dated April 7, 2008 adequately sets forth numerous grounds for prehearing motions as do the comments of other entities. Wachovia will not

undertake to reiterate each and every basis for a prehearing motion and adds its brief comments as follows:

**1. Clearing Firm Cases Need Prehearing Dispositive Motions**

The proposed amendment's extremely limited grounds for filing would impose a clear and severe hardship on clearing firms. A significant portion of Wachovia's business involves its clearing firm operations. Offering a critical service to numerous brokerage firms, clearing firms perform back office and other services for the introducing brokerage firm. In many respects, this arrangement permits the introducing brokerage firms to offer valuable financial services to its customers, oftentimes in areas that otherwise might be underserved.

When a dispute arises between the introducing firm and a customer, the customer's counsel frequently litigates against the clearing firm as well. In many instances, the complaint clearly alleges misconduct by the introducing firm, but the sole allegation against the clearing firm is its status as clearing firm. Settled case law notes that clearing firms, either by rule or by the terms of the clearing agreement, do not owe a duty to the customer of the introducing broker. Simply put, clearing firms are not liable for the negligent or other tortious acts of the correspondent brokerage firm. Customers are notified in writing at the beginning of their relation of the respective duties of their broker and the clearing firm. Under the current rules, decision makers routinely grant a prehearing dispositive motion filed by the clearing firm in recognition of the weight of legal precedent supporting such a dismissal.

Wachovia is concerned that the Proposal would prohibit proper prehearing dispositive motions by clearing firms where customer claims provide no facts showing independent wrongful acts of the clearing firm. Such a result would then force those firms to defend legally unsupportable claims up to the arbitration hearing, hoping at that time the arbitrators will dismiss the case against the clearing brokers. Such a process will surely prolong the arbitration hearing as the clearing firm marshals evidence to prove a negative. Clearing firms incurring substantial legal fees will pass costs along, which the correspondent firm likely will pass on to their customers. The industry runs a real risk that some may leave this business altogether, potentially leaving investors inadequately served.

The Commission should amend the Proposal to permit appropriate prehearing dispositive motions such as those that might be filed by clearing firms. Note well, this recommendation does not flow from an argument that clearing firms are never proper parties to a claim.

**2. Prehearing Relief Should be Afforded to Defamation Claims**

There is another category of claims that frequently warrant dismissal prior to the close of the claimant's case, to wit defamation claims where there is an absolute or qualified immunity. Given that it is mandatory that a firm file a Form U-5 every time an associated person leaves a firm describing the reason for the termination and given the strong public policy underlying full disclosure, prehearing relief is appropriate where a claim is barred as a matter of law.

Recently, the Supreme Court for the State of New York held that Form U-5 disclosures are subject to an absolute privilege thereby barring defamation claims. *Rosenberg v. MetLife, Inc.*, 8 N.Y.3d 359, 866 N.E.2d 439 (2007). The court explained that strong public policy required employers to report potential misconduct in order to benefit the investing public without fear of reprisal or defamation claims by the employee. This comports with FINRA's wide mandate to "investigate, sanction and deter misconduct by its registered representatives." *Id.* at 367-68, 866 N.E.2d at 444-45 (citation omitted). Accurate disclosure is vital to FINRA and the investing public. Yet, an employer should not be forced to incur the costs of defense where such disclosures are mandatory and necessary to "[FINRA's] quasi-judicial process." *Id.*

Because the proposed amendments would not permit a motion to dismiss based on absolute privilege or even a qualified privilege, an employer would be forced to incur substantial expense to defend a case through a claimant's case-in-chief even where, at least under New York law, the claim is barred as a matter of law. Furthermore, even where the privilege is qualified, it is exceedingly difficult for a claimant to overcome the qualified immunity and make the requisite showing of malice. *See, e.g., Dawson v. New York Life Ins. Co.*, 135 F.3d 1158 (7th Cir. 1998) (under Illinois law, statements on form U-5 entitled to qualified privilege); *Glennon v. Dean Witter Reynolds, Inc.*, 83 F.3d 132 (6th Cir. 1996) (under Tennessee law, statements on form U-5 entitled to qualified privilege); *Eaton Vance Dist., Inc. v. Ulrich*, 692 So.2d 915 (Fla. App. 2 1997) (under Florida law, statements on form U-5 entitled to qualified privilege); *Southern Glass & Plastics Co. v. Duke*, 626 S.E.2d 19 (S.C. App. 2005) (Section 41-27-560 of the South Carolina Code provides that communications made from employer to Employment Commission are privileged; FINRA is analogous to Employment Commission).

In sum, numerous courts have confirmed that arbitrators have both the power and, implicitly, the ability, to grant prehearing dispositive motions. In these cases, the courts have determined that the arbitrators provided each party with a fundamentally fair process even though a full evidentiary hearing was not held. *See, e.g., Sheldon v. Vermonty*, 269 F.3e 1202, 1206 (10th Cir. 2001) (holding that NASD arbitration panel has authority to grant prehearing motion to dismiss based on the parties pleadings so long as no party is denied fundamental fairness); *Tricome v. Success Trade Sec.*, No. Civ.A. 05-

4746, 2006 WL 1451502, at *# (E.D. Pa. May 25, 2006) (stating that "arbitrators may grant a motion to dismiss without holding a full evidentiary hearing"). Concerns regarding abusive motion practice and delayed hearings can be addressed though the adoption of amendments that do not unduly restrict the arbitrators' authority or limit the grounds for prehearing relief.

Respectfully submitted,

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