MEMORANDUM

TO: File No. DF Title IX – Pre-Dispute Arbitration

FROM: Kevin Schopp
Division of Trading and Markets

DATE: January 14, 2016

RE: Meeting Relating to Section 921 of the Dodd-Frank Act

On January 14, 2016, Paula Jenson, Lourdes Gonzalez, Dan Fisher, Kevin Schopp, Stacy Puente, and Katherine England of the Division of Trading and Markets met with Jeffrey Riffer of Elkins Kalt LLP. The discussion included issues related to Section 921 of the Dodd-Frank Act, which authorizes the Securities and Exchange Commission to prohibit, limit, or condition the use of pre-dispute mandatory arbitration agreements. The discussion also included the attached documents.

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Posted On: **September 27, 2010** by Page Perry LLC

Brokerage Firms Continue to Abuse the Arbitration Process

Brokerage firms are trying to "browbeat" aggrieved customers who have filed arbitration claims against them into settling their claims by flooding them with overbroad and burdensome requests for documents and information, according an InvestmentNews article by Bruce Kelly. Firms engage in such intimidation with the express approval of the Financial Industry Regulatory Authority (FINRA), whose rules govern a system of mandatory arbitration of customer claims against brokerage firms and allow such practices. The industry knows it, and so do state regulators.

"The complaint we get from investors is that they are being overburdened with discovery requests from the firms," Tanya Solov, director of securities at the Illinois Securities Department, was quoted as saying at the annual meeting of the North American Securities Administrators Association Inc. ("NASAA") in Baltimore. The North American Securities Administrators Association, Inc. is the association of the 50 state securities regulators.

Discovery is the process by which opposing parties obtain documents and information that are related to the dispute and in the possession or control of the other party. Brokerage firms routinely try to stonewall investors' requests for documents and information, while at the same time demanding production of a vast array of personal documents that are unrelated or only marginally related to the dispute. Says Ms. Solov: "But now what's happening, too, is that the firms have started asking the investors for discovery information such as tax returns for a number of years, all the checking accounts you've had, all the investments you've ever had. It's becoming more common."

Brokerage firms' discovery practices are abusive and harassing and make FINRA arbitration more expensive and burdensome for investors than it should be.
"It drives the investors to often settle a case where they otherwise may want to litigate," Ms. Solov stated.

"Brokerage firms routinely employ this kind of overly intrusive and burdensome discovery practice aimed at intimidating public customers is just one more reason why Congress needs to make FINRA arbitration voluntary rather than mandatory as it is today," commented J. Boyd Page, senior partner of Page Perry, LLC in Atlanta.

Page Perry, LLC is an Atlanta-based law firm with over 125 years collective experience representing investors in securities-related litigation and arbitration. While past results are not indicative of future success, Page Perry's attorneys have recovered over $1,000,000 for clients on more than 30 occasions. Page Perry's attorneys have extensive experience in representing investors in securities matters. For further information, please contact us.

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Some Perspectives on FINRA Arbitrations

I. Arbitration implicates important public policy issues.

A. Recent New York Times articles.

1. Jessica Silver-Greenberg and Robert Gebeloff, *Beware the Fine Print | Part I: Arbitration Everywhere, Stacking the Deck of Justice*, THE NEW YORK TIMES, (Oct. 31, 2015) http://www.nytimes.com/2015/11/01/business/dealbook/arbitration-everywhere-stacking-the-deck-of-justice.html?smprod=nytcore-ipad&smid=nytcore-ipad-share

2. Jessica Silver-Greenberg and Michael Corkery, *Beware the Fine Print | Part II :In Arbitration, a 'Privatization of the Justice System*,' THE NEW YORK TIMES, (Nov. 1, 2015) http://www.nytimes.com/2015/11/02/business/dealbook/in-arbitration-a-privatization-of-the-justice-system.html?action=click&contentCollection=DealBook&module=RelatedCoverage&region=Marginalia&pgtype=article

3. Michael Corkery and Jessica Silver-Greenberg, *Beware the Fine Print | Part II: In Religious Arbitration, Scripture Is the Rule of Law*, THE NEW YORK TIMES (Nov. 2, 2015) http://www.nytimes.com/2015/11/03/business/dealbook/in-religious-arbitration-scripture-is-the-rule-of-law.html?action=click&contentCollection=DealBook&module=RelatedCoverage&region=Marginalia&pgtype=article

B. Consumer Financial Protection Bureau

1. Considering consumer arbitration issues.

a. One proposal under consideration is to require all arbitration claims to be submitted to the CFPB.

i. The March 2015 report and the proposals under consideration are at www.consumerfinance.gov.

C. Numerous recent U.S. Supreme Court cases.

II. Is FINRA a cost-effective alternative to civil litigation?

A. Preliminary Thought: Although reliable data is not easily to find in public databases, the parties that do have the data (large broker-dealers), whose officers and directors owe fiduciary duties to their firms, all require mandatory arbitration of customer disputes. The logical reason for such *unanimity* is that they must believe that FINRA arbitration (in contrast to civil litigation) is in their best interest. Otherwise, in a competitive industry, we would have expected to see some firms not require mandatory arbitration.

1. Further, through FINRA, industry disputes (*e.g.*, between financial advisors and their employers) are arbitrated too.

B. FINRA essentially has no competition.

III. Is FINRA arbitration faster than civil litigation?

A. There is no easy answer. Courts vary across the country. In Los Angeles, the average time to trial is about 1 year from filing in state and federal court. Virtually all FINRA arbitrations in Los Angeles that I've been involved in have taken more than a year, one recently took about 3 years. Arbitrators (unlike judges) are loath to set hearing dates without the consent of the parties and usually one side wants to delay. Continuances are also common.

IV. Does FINRA arbitration cost less than civil litigation?

A. No public database exists. However, FINRA arbitration can cost in the $500,000 - $1,000,000 range.

V. Is the quality of the outcomes in FINRA arbitration similar to civil litigation?

A. There is no public database that can compare the outcomes, both for (a) which party prevails and (b) the dollar amount, of FINRA arbitrations with civil litigation.

B. There is no easily accessible database of settlements.

1. Settlements can show up on BrokerCheck for advisors, but not firms.

C. However, as noted above, the parties who do have that information (large broker-dealers) know how much they paid in judgments and settlements prior to

mandatory arbitration and also know how much they pay in Awards and settlements today and they all require mandatory arbitration.

D. Why? See below.

E. FINRA Arbitrators.

1. "Repeat player" bias

a. "Various studies show that arbitration is advantageous to employers not only because it reduces the costs of litigation, but also because it reduces the size of the award that an employee is likely to get, particularly if the employer is a 'repeat player' in the arbitration system. (Bingham, Employment Arbitration: The Repeat Player Effect (1997) 1 Employee Rts. & Employment Policy J. 189; Schwartz, supra, 1997 Wis. L.Rev. at pp. 60–61.) It is perhaps for this reason that it is almost invariably the employer who seeks to compel arbitration. (See Schwartz, supra, 1997 Wis. L.Rev. at pp. 60–63.)" *Armendariz v. Found. Health Psychcare Servs., Inc.*, 24 Cal. 4th 83, 115, 6 P.3d 669, 690 (2000).

2. FINRA Arbitrators Are Significantly More Conservative Than Juries

a. Limited diversity

a. Panels are overwhelmingly older white men

i. Not representative of American society

F. Discovery.

1. Although the discovery rules are written neutrally, they benefit the broker-dealers.

a. "In its majestic equality, the law forbids rich and poor alike to sleep under bridges, beg in the streets and steal loaves of bread." Anatole France

2. There is no standard for FINRA discovery. No FINRA Rule states that discovery should be allowed if it is relevant to the subject matter or the issues or that "fishing expeditions" should be allowed. *See Leo v. Golfsmith GP, LLC*, No. D062262, 2013 WL 2705459, at *4 (Cal. Ct. App. June 14, 2013) ("Pursuant to Code of Civil Procedure section 2017.010, '[u]nless otherwise limited by order of the court ..., any party may obtain discovery regarding any matter, not privileged, that is relevant to the subject matter involved in the pending action ... if the matter either is itself admissible in evidence or appears reasonably calculated to lead to the discovery of admissible evidence.' (Ibid.) 'For discovery purposes,

information is relevant if it 'might reasonably assist a party in evaluating the case, preparing for trial, or facilitating settlement....' [Citation.] Admissibility is not the test and information, unless privileged, is discoverable if it might reasonably lead to admissible evidence. [Citation.] These rules are applied liberally in favor of discovery [citation]....' (Gonzalez v. Superior Court (1995) 33 Cal.App.4th 1539, 1546, italics deleted.)."); *Greyhound Corp. v. Superior Court*, 56 Cal. 2d 355, 384, 364 P.2d 266, 280 (1961) ("Apparently the phrase ['fishing expedition'] is intended to mean that the party seeking discovery does not know precisely what he seeks, but is attempting to obtain all possible information for the purposes of his case. This is no basis for holding, per se, that the request is improper. Inasmuch as discovery of all relevant material during the time of preparation is the aim of the statute, and since the statute intends that each party shall divulge, within limits, the information in his possession, there is nothing improper about a fishing expedition, per se.").

a. So, even the standard for discovery can be arbitrary.

3. FINRA arbitration has limited discovery. Although this looks "neutral" in theory, it is not neutral in fact because the large broker-dealers have greater access to documents and witnesses. *See generally Fitz v. NCR Corp.*, 118 Cal. App. 4th 702, 716, 13 Cal. Rptr. 3d 88, 97 (2004) ("This is because the employer already has in its possession many of the documents relevant to an employment discrimination case as well as having in its employ many of the relevant witnesses." (Mercuro, supra, 96 Cal.App.4th at p. 183, 116 Cal.Rptr.2d 671; see also Kinney v. United HealthCare Services, Inc. (1999) 70 Cal.App.4th 1322, 1332, 83 Cal.Rptr.2d 348 ["Given that [the employer] is presumably in possession of the vast majority of evidence that would be relevant to employment-related claims against it, the limitations on discovery, although equally applicable to both parties, work to curtail the employee's ability to substantiate any claim against [the employer]"].)").

4. "Presumptive" Discovery per FINRA Rules is widely ignored

5. Most brokerage firms sign termination agreements with senior executives that preclude them from talking with claimants (except for their testimony at a hearing).

    a. The same agreements require those executives to assist their former employers in any dispute

        i. The result is that the brokerage firm is able to interview all the witnesses to the events (other than claimants), but claimants have no access to any witnesses, even former employees until the witness testifies at the arbitration

1) Many attorneys believe that they should not ask a question at a hearing unless they know the answer because the risk of an adverse answer at a hearing is so high; the result is that brokerage firms have a tremendous tactical advantage

G. Discovery abuse.

1. See attached article.

VI. Special Public Policy Issues

A. Statements of Claim

1. Not in a public database.

a. No way to track if multiple parties are suing the same brokerage firm for the same wrong.

b. Terrible public policy. Even the press cannot find out customer claims against brokerage firms. Why are large public companies in a regulated industry entitled to such privacy over their business practices?

c. This is compounded because arbitrators rarely allow discovery of other similar claims against the brokerage firm. Such discovery is common in courts.

d. This impedes claimants' ability to locate the names of other relevant witnesses.

B. Protective Orders

1. Brokerage firms commonly demand that their standard Protective Orders be used

a. Those Protective Orders commonly prohibit claimants from disclosing to regulators information and documents produced by the brokerage firms in discovery

C. Special Issues Regarding Arbitration of Industry Employment Disputes in California

1. California has special requirements regarding arbitration of employment disputes.

a. In order to ensure that mandatory arbitration agreements are not used to curtail an employee's public rights, the California Supreme Court in Armendariz set forth five minimum requirements (the Armendariz requirements), one of which is: "an arbitrator in an [employment] case must issue a written arbitration decision that will reveal, however briefly, the essential findings and conclusions on which the award is based." *Armendariz v. Foundation Health Psychcare Serv, Inc.*, 24 Cal.4th 83, 107, 99 Cal.Rptr.2d 745, 6 P.3d 669 (2000).

b. FINRA awards rarely state anything more than the name of the claims and the party who prevailed (and if claimant, the amount of the Award). No "essential findings and conclusions" are provided.