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VIA EMAIL TO: rule-comments@sec.gov

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-7553

Re: ***File Number SR-FINRA-2007-021, As Amended February 13, 2008***
Proposal Amending Rules 12206 and 12504 of the NASD Customer Code, and Rules 13206 and 13504 of the NASD Industry Code

Dear Ms. Morris:

Thank you for the opportunity to comment on the above-referenced rule proposal (the "Proposal") submitted to the Commission by Financial Industry Regulatory Authority, Inc. ("FINRA"). As set forth below, if adopted as currently drafted, the Proposal will frustrate the most basic goals of FINRA (to provide a fair and efficient means of dispute resolution) and could have an unwarranted negative effect on the rights and interests of all participants in FINRA arbitration.

Although the Proposal includes a wide range of new provisions, most of which are well-reasoned and effectively designed to curb the abusive motion practices which prompted the Proposal, this comment will focus solely on Proposed Rules 12504(a)(6) and 13504(a)(6), which would expressly preclude arbitrators from considering any prehearing dispositive motion to dismiss unless it is based on one of two very narrow substantive grounds: (i) the release of the claims at issue by the non-moving party, or (ii) the fact that the "moving party was not associated with the account(s), security(ies), or conduct at issue."

If adopted, these specific Proposed Rules would eliminate the arbitrators' well-settled power and discretion to dispose of legally deficient claims before incurring the often substantial expenses of discovery, trial preparation and a full evidentiary hearing in cases where the arbitrators have unanimously agreed that there are no material issues of disputed fact. The provisions of the Proposal that would limit the substantive grounds for motions to dismiss should be rejected because (i) they are founded on an unsupported assumption that arbitrators are somehow not competent to correctly resolve prehearing motions to dismiss, and (ii) they are not necessary because FINRA's concerns about abusive dispositive motion practices are adequately addressed in the other, procedural amendments contained within the Proposal.

FINRA Arbitration Is Founded Upon Its Arbitrators' Competence and Discretion

The success and viability of FINRA arbitration is entirely dependent on the accepted belief that FINRA arbitrators are competent to hear and correctly decide the most complex factual and legal issues. Indeed, the United States Supreme Court has repeatedly upheld arbitrators' authority to decide all manner of legal claims based on this inherent assumption of competence.[1] That authority is now frequently exercised to decide claims worth millions of dollars (and at times tens or hundreds of millions of dollars) in FINRA arbitrations.

In deciding those claims, arbitrators have been given very broad discretion to run their cases as they see fit, including the power to rule on complex discovery issues (including electronic discovery issues that could result in production costs of tens or hundreds of thousands of dollars), resolve important issues relating to confidentiality and privileges, decide all evidentiary issues and generally control the course of the arbitrations on which they sit. This power has historically included the authority to partially or fully resolve dispositive legal issues in advance of a full evidentiary hearing.[2] The Proposal's substantive restrictions would effectively eliminate that power without any articulated justification.

Nothing in the Proposal expressly challenges the competence of arbitrators to decide dispositive legal issues. Instead, the Proposal's limitations on the substantive grounds for motions to dismiss necessarily rely on the assumption that FINRA arbitrators are somehow competent to decide critical legal issues ***after*** discovery and an evidentiary hearing, but ***not competent*** to decide those same issues at an earlier stage of the proceeding (even with the benefit of pleadings that state the factual basis for claims, written submissions on the relevant legal issues and oral argument from both parties' counsel) when the underlying claims are facially flawed and no set of facts could justify continued litigation.

Neither FINRA nor any regulatory authority or study group nor any commentator has offered any support for this inconsistent view of arbitrators' ability to decide pivotal legal issues. No one has offered any empirical or anecdotal evidence of arbitrator misconduct in improperly granting unfounded motions to dismiss. Although numerous regulatory agencies have looked

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[1] *See, e.g., Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987) (upholding arbitration agreements as they relate to federal statutory securities claims based on such competence); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 US 20 (1991) (upholding arbitrability of federal statutory age discrimination claims); *Circuit City Stores, Inc. v. Adams*, 532 US 105 (2001) (upholding arbitrability of state statutory employment discrimination claims).

[2] *See, e.g., Sheldon v. Vermonty*, 269 F.3d 1202, 1206 (10th Cir. 2001) ("[W]e hold that a NASD arbitration panel has full authority to grant a prehearing motion to dismiss with prejudice based solely on the parties' pleadings so long as the dismissal does not deny a party fundamental fairness."); *Warren v. Tacher*, 114 F. Supp. 2d 600, 602-03 (W.D. Ky. 2000) ("Petitioners were given adequate opportunity to respond to Bear Sterns' motion to dismiss and they did so. They were represented by counsel at oral arguments. Plaintiffs cite to no authority that they were automatically entitled to a full-blown evidentiary hearing following discovery, and the court is aware of none.").

directly at dispositive motion practice in securities arbitration, none have reached such a conclusion.[3]

To the contrary, courts have actually ***relied on*** arbitrators' competence to resolve threshold legal issues when ruling that such issues are not for the courts to decide. For example, in *Weaver v. Florida Power & Light Co.*, the Eleventh Circuit Court of Appeals reversed an order enjoining a pending arbitration involving a claim that was allegedly barred by *res judicata*. The court held that the party seeking an injunction had failed to establish the lack of an adequate remedy at law sufficient to warrant injunctive relief because ***the arbitrators*** had the power to dismiss the arbitration:

> FPL contends that the remedy available through arbitration is not adequate, because pursuing such a remedy will force it to undergo expensive and time-consuming adversarial proceedings that could be avoided by the issuance of an injunction. We see no reason why proceedings before a district court would be more costly than before a board of arbitrators. ***FPL can make its arguments about res judicata before the arbitrators at the outset of the arbitration proceedings; if its arguments are correct, the arbitrators (if they are competent -- as we must assume they are) will dismiss the arbitration.*** Such an outcome would be no more costly -- and probably less costly -- than prosecuting a motion for injunctive relief in district court.

172 F.3d 771, 774-75 (11th Cir. 1999) (internal quotation omitted) (emphasis added).

The *Weaver* court reiterated a confidence in arbitrators to correctly rule on dispositive legal issues at an early stage before substantial litigation costs have been incurred. This holding is consistent with virtually all courts that have reviewed arbitration awards which dismissed claims prior to an evidentiary hearing and concluded that such dismissals were proper so long as

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[3] *See, e.g.*, "Securities Arbitration Reform: Report of the Arbitration Policy Task Force," at 14 (January 3, 1996) (commonly referred to as the "Ruder Report" because former SEC Chairman David S. Ruder headed the task force) (recommending that "NASD should institute procedures to provide early resolution of statute of limitations issues in arbitration. Specifically, the NASD should codify procedures to permit parties to move to dismiss claims or counterclaims on statutes of limitations grounds prior to the merits hearing."); "Follow-up Report on Matters Relating to Securities Arbitration," GAO-03-162R, at 1 and 7 (April 11, 2003) (the "GAO Report") (considering a "concern about the use of motions to dismiss and motions for summary judgment to terminate NASD-administered arbitrations" and concluding that the "NASD rules are consistent with the practice of disposing of claims by motion. NASD rules allow prehearing conferences at which the presiding person can require the briefing of contested issues and address 'any other matters which will expedite the arbitration cases.'"); Letter from Annette Nazareth, Director of the Division of Market Regulation, SEC, to William O. Jenkins, Jr., U.S. General Accounting Office, at 1 (March 28, 2003) (Enclosure I to GAO Report) ("GAO [] observed that motions to dismiss are not used with great frequency. Used sparingly, as the draft report reflects, such motions can be used effectively to conserve the parties' resources or direct parties to a correct forum outside of arbitration.").

the losing party had been afforded a fair hearing in which he could submit written opposition and present oral argument.[4]

Under the Proposal as drafted, however, a party confronted with a similar claim that had been previously tried to conclusion ***could not*** move to dismiss based on *res judicata* and would be forced to try the claim again through full discovery and an evidentiary hearing even if the arbitrators felt those steps were entirely unnecessary.[5] Such a result would result in needless costs to all parties and egregiously contradict the FINRA goals of efficiency and finality.

Simply put, a select number of securities arbitrations involve a range of threshold issues that turn on legal determinations without regard to the underlying factual dispute. Such issues include but are not limited to *res judicata*, statutes of limitations and repose, and claims that are facially deficient as a matter of law even if all of their allegations are assumed to be true. In such circumstances, there is absolutely no basis to handcuff the arbitrators and eliminate their well-settled authority to dispose of a case if they unanimously agree (after the submission of pleadings and briefs and with the benefit of a hearing on the relevant issues) that there are no disputed issues of fact that would affect their decision on the legal viability of the claims.

The Proposal's Goal of Curbing Abusive Dispositive Motion Practice Can Be Met By Its Numerous Non-Objectionable Procedural Amendments

The substantive limitations in the Proposal are also unwarranted because the fundamental purpose behind the Proposal -- to curb abusive dispositive motion practices in FINRA arbitration -- is adequately addressed in the Proposal's numerous provisions implementing new procedures in connection with motions to dismiss. The non-objectionable procedural amendments provide appropriate safeguards to protect parties from any improper use of motions to dismiss while still preserving the arbitrators' power and flexibility to handle their cases as they deem proper (including the authority to dismiss clearly flawed claims before the costs of a full arbitration are incurred).

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[4] *See* GAO Report at 7 ("The case law consistently has recognized the authority of arbitrators to grant prehearing motions to dismiss.") and at 8 ("We have not found any cases that do not recognize arbitrators' authority to grant prehearing motions to dismiss."); *see also Sheldon*, 269 F.3d at 1206; *Warren*, 114 F. Supp. 2d at 602-03; *Tricome v. Success Trade Securities*, NO. CIV.A. 05-4746, 2006 WL 1451502, at *3 (E.D. Pa. May 25, 2006) (holding that "arbitrators may grant a motion to dismiss without holding a full evidentiary hearing."); *Wise v. Wachovia Securities, LLC*, 2005 WL 1563113, at *3 (N.D. Ill. May 4, 2005) ("although NASD did not conduct a formal evidentiary hearing, the Plaintiffs received an otherwise fundamentally fair proceeding.") *aff'd* 450 F.3d 265 (7th Cir. 2006).

[5] At first glance the Proposal's elimination of a party's right to seek summary dismissal on *res judicata* or similar grounds would appear to open the door for parties to go to court to enjoin such arbitrations (because they no longer have an adequate legal remedy). The United States Supreme Court's decision in *Howsam v. Dean Witter Reynolds, Inc.*, however, may have limited access to such relief by holding that courts will involve themselves in disputes subject to arbitration agreements only where there is a "substantive" issue of arbitrability, such as whether an agreement has been signed and it encompasses a given dispute. 537 U.S. 79, 84-85 (2002).

As set forth below, each of the primary criticisms of dispositive motion practice has been addressed in the Proposal's procedural amendments:

The Proposal Will Eliminate Delays

The proposal will effectively eliminate any delays associated dispositive motions by requiring a respondent to file a full answer before any motion to dismiss (Proposed Rules 12504(a)(2) and 13504(a)(2)),[6] requiring motions to dismiss to be filed at least 60 days before a scheduled hearing (Rules 12504(a)(3)), and prohibiting motions to dismiss from being re-filed without permission (Rule 12504(a)(8)). With the adoption of such procedures, any motions to dismiss will not affect the ordinary schedule of a FINRA arbitration. On the other hand, if the proposed substantive limitations are adopted, they certainly would delay the efficient resolution of claims that are legally barred on their face by prolonging the denial of such claims until the parties, arbitrators and administrators have incurred the substantial time and expense of discovery and an evidentiary hearing.

The Proposal Will Shift Costs From Non-Moving Parties to Moving Parties

The procedural amendments of the proposal will also eliminate the cost burdens on parties who defend against motion to dismiss. Specifically, under Proposed Rule 12504(a)(9), if a motion to dismiss is denied, "the panel ***must assess forum fees*** associated with the hearings on the motion against the moving party." This provision will not only deter the filing of baseless motions, but also ensure that non-moving parties are not unfairly burdened by costs associated with such motions.

Moreover, because many securities arbitration claimants are represented on a contingency fee basis, there most often will be no additional attorney's fees cost to parties defending motions to dismiss. Even in the cases when the non-moving party must pay hourly fees for defending against such a motion, the Proposal still provides a basis to shift the fee costs of such motions. Proposed Rule 12504(a)(10) authorizes FINRA arbitrators to award attorney's fees and costs to any party that successfully defended a motion deemed frivolous by the panel.

In light of these cost-shifting provisions, non-moving parties will rarely incur any significant costs associated with motions to dismiss. By contrast, if the Proposal's substantive limitations are adopted, all parties might incur substantial unnecessary costs if they are forced to fully litigate through final hearing claims that the arbitrators would otherwise unanimously dismiss based on fatal legal defects.

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[6] The relevant portions of Proposed Rule 12504(a) (included within the FINRA Customer Code) and Proposed Rule 13504(a) (including within the Industry Code) are identical for purposes of this comment. Accordingly, for ease of reference, from this point forward this comment will refer only to the Customer Code version of the rule.

The Proposal Will Strongly Deter Abusive Dispositive Motion Practice

To the extent that parties have previously filed improper motions to dismiss for purposes other than obtaining a ruling on relevant and potentially case-dispositive legal issues, the Proposal contains specific provisions that will deter and provide powerful sanctions to curb such practices. In addition to the provisions to eliminate delays and shift costs associated with motions to dismiss described above, the proposal also makes success on a motion to dismiss less likely by requiring a unanimous written ruling by the arbitrators. *See* Proposed Rule 12504(a)(7).

Additionally, the Proposal expressly authorizes sanctions to be assessed against parties who file motions frivolously or in bad faith. *See* Proposed Rule 12504(a)(10) and (11) (potentially including sanctions such as the assessment of attorney's fees or other monetary penalties, precluding a party from presenting evidence, making adverse inferences, or initiating disciplinary referrals). Such measures are sufficient to curb abusive motion practices without arbitrarily restricting the substantive grounds for motions to dismiss.

Arbitrators Are In Fact Required to Apply the Law

A number of comments submitted on the Proposal by attorneys who routinely represent securities claimants have incorrectly argued that ***no motions to dismiss*** should be permitted under the FINRA rules because the arbitrators should be guided by equitable principles and are not required to apply the law. Under this logic, a motion to dismiss would never be appropriate because all claims, regardless of how legally flawed (whether by *res judicata*, release, time bars, legal impossibility, or any other recognized threshold legal defense), should proceed to a full arbitration and final hearing. This position, while not entirely unexpected from the claimants' bar, runs contrary to the controlling law.

Every federal circuit court of appeals in this country has established the relevance of controlling law in arbitration by recognizing the manifest disregard of the law standard for vacating an improper arbitration award.[7] Indeed, courts have held that the very argument made above -- that arbitrators are not bound by the law -- could be grounds to vacate an arbitration award if made to arbitrators. *See, e.g., Montes v. Shearson Lehman Bros.*, 128 F.3d 1456, 1458 (11th Cir. 1997) (vacating award based on manifest disregard of the law standard where counsel

[7] *See Lessin v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 481 F.3d 813 (D.C. Cir. 2007); *McCarthy v. Citigroup Global Markets, Inc.*, 463 F.3d 87, 91-92 (1st Cir. 2006); *D.H. Blair & Co., Inc. v. Gottdiener*, 462 F.3d 95, 110-111 (2d Cir. 2006); *Dluhos v. Strasberg*, 321 F.3d 365, 370 (3d Cir. 2003); *Patten v. Signator Ins. Agency, Inc.*, 441 F.3d 230, 234 (4th Cir. 2006); *Apache Bohai Corp. LDC v. Texaco China BV*, 480 F.3d 397, 405 (5th Cir. 2007); *Mitchell v. Ainbinder*, 2007 WL 177896 *2 (6th Cir. Jan. 24, 2007); *George Watts & Son, Inc. v. Tiffany and Co.*, 248 F.3d 577, 581 (7th Cir. 2001); *McGrann v. First Albany Corp.*, 424 F.3d 743, 749 (8th Cir. 2005); *Coutee v. Barington Capital Group, L.P.*, 336 F.3d 1128, 1133 (9th Cir. 2003); *Hicks v. Bank of Am., N.A.*, 2007 WL 521175 *4 (10th Cir. Feb. 21, 2007); *Montes v. Shearson Lehman Bros.*, 128 F.3d 1456 (11th Cir. 1997).

argued in his opening and closing that the arbitrators should ignore the law and do "what equity demands").

Similarly, regulatory groups that have analyzed securities arbitration have likewise reiterated that arbitrators are bound to apply the law on issues directly relevant to the Proposal. *See, e.g.*, "Securities Arbitration Reform: Report of the Arbitration Policy Task Force," at 14 (January 3, 1996) (the "Ruder Report") ("The Task Force recommends that the NASD Code be amended to provide express directions to arbitrators that, *in deciding whether claims are time barred, they must apply the applicable statutory or common law statutes of limitations.*").

Accordingly, the controlling law is undeniably relevant to FINRA arbitrations and must be considered and applied by FINRA arbitrators. When a panel has unanimously concluded that the law clearly dictates the dismissal of a claim that is simply not viable regardless of the facts and evidence a claimant seeks to introduce at a final hearing, there is simply no rational basis to require the parties and arbitrators to nevertheless incur the expense and effort of a full-blown evidentiary hearing.

Conclusion

As set forth above, any valid concerns FINRA or its participants may have regarding abusive dispositive motion practices are effectively addressed by the Proposal's numerous new provisions relating to the procedures relating to motions to dismiss. To the extent that the Proposal seeks to dramatically restrict the substantive grounds for such motions to two narrow grounds, as provided in Proposed Rules 12504(a)(6) and 13504(a)(6), these amendments are unnecessary and unwarranted.

If enacted, these specific provisions would eliminate the arbitrators' well-settled power to dispose of facially flawed claims before incurring the often substantial costs of discovery, trial preparation, travel, expert witnesses and hearing attendance in cases that will nevertheless be dismiss as a matter of law. Accordingly, these provisions of the Proposal would directly frustrate FINRA's primary goal of providing a fair and expedient dispute resolution forum to the detriment of all participants in the FINRA forum.

Very truly yours,

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