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April 2, 2009

VIE E-MAIL TO RULE-COMMENTS@SEC.GOV

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

Re: SR-FINRA-2008-024

Dear Ms. Morris:

I have been representing investors in claims against the brokerage industry for more than the past 30 years and have represented investors in arbitration since the *McMahon* decision. I have also served as an arbitrator for the New York Stock Exchange and the National Association of Securities Dealers, and I currently serve as an arbitrator for the Financial Industry Regulatory Authority (FINRA). I am pleased to have the opportunity to comment on FINRA's proposal to amend the Discovery Guide.

I believe that FINRA's proposal to amend the Discovery Guide is fundamentally flawed, that it unfairly favors the brokerage industry, that it fails to recognize the interests of the *pro se* investors, and that it will unnecessarily complicate and prolong the arbitration process. The proposal is inconsistent with the basic principle that arbitration is designed to be an economical and expeditious dispute resolution process.

<u>Introduction</u>

While I have specific comments on individual proposals as set forth below, an overriding concern is that some existing rules which mandated the production of documents by the industry are being deleted, in part based upon the theory that they may be in the possession of the client or that the request for such documents may be made where a party deems they may be relevant. This approach effectively defeats one of the fundamental benefits of the Discovery Guide for investors. It is without question pro-industry and anti-investor. The primary reason for this is that the brokerage industry is almost always represented by attorneys who specialize in investor arbitration and who are fully familiar with the securities industry and the nuances of securities discovery.

The fact that a specific document is not identified in the Discovery Guide does not in any way prejudice their ability to identify a document, to request its production, and to make persuasive arguments why it should be produced. In contrast, a majority of investors are represented by attorneys who are not experienced in securities arbitration or aware of the documents that may be maintained by the brokerage firm. Even worse, *pro se* investors not only lack the knowledge and skill of counsel, they typically have no knowledge whatsoever of relevant documents. Thus, eliminating the references to specific documents that the industry may produce tilts the scales against the investor.

This Discovery Guide should not be approved. Instead, it should be re-reviewed, taking this principle into consideration. Specific classes of relevant documents should be listed in detail, and mandatory production must be specified in order to assure that the brokerage industry does not have a built-in advantage of secrecy in defending itself from its own wrongdoing.

Presumptively Discoverable

Although the documents in the Discovery Guide are "presumptively discoverable," many arbitrators construe this as a standard and impose Discovery Guide requirements absolutely. Furthermore, to avoid the obligation to discover, objections must be filed. Many attorneys are unaware of the issues that are presented concerning discovery that may potentially narrow the necessary production. *Pro se* investors are not in a position to effectively file objections. Therefore, from the perspective of the investor, the "presumptively discoverable" documents may well be considered mandatory. Here, of course, the brokerage industry has an advantage because it is familiar with areas where it can effectively narrow the production. Therefore, for practical purposes in considering this FINRA proposal, "presumptively discoverable" should be considered mandatory for the investor.

Confidentiality

FINRA has made no substantive change in the Discovery Guide section relating to confidentiality. This is indeed unfortunate and difficult to understand, particularly in view of the explanation of confidentiality and confidential treatment in *The Neutral Corner* April 2004 article entitled "Arbitrators and Orders of Confidentiality." The brokerage industry has taken advantage of the absence of confidentiality standards in the prior Discovery Guide. It is common for brokerage firms to refuse to produce manuals, compliance documents, and virtually any internal documents whatsoever, claiming that the documents are confidential and insisting that claimants sign a confidentiality stipulation in order to see these documents. Typically, the majority of the documents claimed to be confidential are not confidential and do not meet the tests of confidentiality as described in *The Neutral Corner* article. This necessitates the filing of a motion and a pre-hearing conference. It complicates and prolongs the arbitration and creates unnecessary expense for the claimants. Furthermore, inexperienced counsel who are unfamiliar with the standards of confidentiality as applied to the securities industry will often agree to the stipulation of confidentiality rather than spend the time and money to challenge the issue. By failing to incorporate the standards relating to confidential treatment as set forth in *The Neutral Corner*, FINRA is siding with the industry in its efforts to undermine the arbitration process. The confidentiality section should incorporate the standards as set forth in *The Neutral Corner*. The failure to incorporate such language must be deemed unfair to investors.

The FINRA Discovery Guide Puts the Investor on Trial

Investors who pursue claims in FINRA arbitration are effectively being put on trial themselves, and the FINRA Discovery Guide proposals are supporting this unfair procedure. Investors cannot comprehend why they should have to produce tax returns, financial information, loan documents, and other personal records that extend for many years prior to the time when they incurred their losses. The brokerage firms never request this type of information in connection with customer accounts, but they effectively put the investor on trial if a claim is pursued arising out of the brokerage firm's wrongdoing. These personal financial documents, extending back well over a decade in many cases, are used by the brokerage firms' attorneys to cross-examine investors as to every imaginable transaction which they had, often long prior to even opening their account wherein the wrongful activity occurred. Investors are subjected to hours of examination. The process is not only unfair, it is abusive and intimidating. When many investors are told about the documentation they must produce and the examination they must endure, they give up on the arbitration process and are forced into settlements that they would not otherwise accept. The intimidation for investors who are represented by counsel is bad enough. It is difficult to imagine how *pro se* investors are able to withstand such abuse. It is not surprising that almost 90 percent of *pro se* investors lose their cases. FINRA's encouragement of the brokerage industry in undermining the arbitration process must not be allowed.

The Five-Year Period for Production of Documents

Several of FINRA's proposed changes to the Discovery Guide obligate the investor to produce financial documents, including tax returns, financial statements, and loan documents relating to transactions which occurred up to five years prior to the first transaction at issue through the year the claim is filed, and in some cases through the discovery period in the arbitration. These discovery obligations apply to all cases, even though they may be totally irrelevant to the issues in the case. For example, customers' historical financial information can have little relationship to a case involving churning, misrepresentation, or negligence. Furthermore, the time period involved can extent well over a decade. For example, in suitability cases, arbitrators often rule that the first transaction at issue is the date that the customer opened the account, and in non-suitability cases, the customer has six years to file a claim, which means that the five-year period would extend potentially for eleven years. Producing complete tax returns, financial statements, and loan documents for eleven-plus years can run into thousands of pages and involves an incredible burden. The current rule applicable to discovery requires a production period of three years prior to the first transaction. This itself is a substantial burden. To extend this period arbitrarily in all cases is unfair to investors.

Pro Se Claimants

The Discovery Guide changes should be revised to take into consideration the problems of the *pro se* claimants who will be especially prejudiced by the burden and complexity of these rules. A review of approximately 500 three-arbitrator cases in 2007 showed that there were 46 *pro se* cases, 41 of which were dismissed. Investors' "win rate" of about 10 percent reflects an arbitration system which is failing the *pro se* investor. The concern is that rules that complicate the discovery process and burden claimants can only add to this abysmal failure.

Comments on Specific Discovery Guide Changes

Comments on specific Discovery Guide changes follow:

1. List 1, Items 2 and 3 – FINRA Has Proposed that These Items Be Deleted

The theory is that customers have retained account statements and/or confirmations, and requiring production of these documents in every case adds unnecessary delay and costs to the discovery process. This position fails to recognize that brokerage firms maintain account statements and confirmations electronically. Reproducing them takes little time and is very economical. In contrast, many investors do not maintain copies of these documents, and rarely can an investor locate an entire set of account documents or confirmations. Furthermore, to the extent they are retained, they must be located and physically copied at significant cost to the investor. It simply makes no sense to shift the burden to the investor of locating, copying, and producing these documents when the industry can do so much more economically and expeditiously. Allowing brokerage firms to object to this basic production procedure will only complicate and delay the discovery process. I might add that over the years, my routine practice has been to have the brokerage firm produce all the account statements and confirmations which are copied electronically, with the investor only producing those pages on which writing appears. Rarely, if ever, do brokerage firms object to this procedure since it is obviously the most economical and efficient.

This proposal also places an additional unfair burden on *pro se* claimants, who already are overwhelmed with the complexity of the arbitration system and fare poorly in this system.

2. **FINRA Proposal to Eliminate List 1, Item 4, Which Requires the Production of Holding Pages**

FINRA argues that holding pages generally are no longer in use. This position overlooks the fact that investor claims may date back several years and that firms which no longer use holding pages may have maintained them for the account in question prior to this discontinuance. Furthermore, simply because major firms do not use holding pages does not mean that those firms which continue to use them should not have to produce them. And often, the holding pages contain broker notes which are material to the case. The existing rule provides for those situations where holding pages are not maintained by stating that if they are not available, any electronic equivalent may be produced. There is no reason to change this rule, and doing so may allow the brokerage firm to withhold material information.

3. **FINRA Proposal to Adopt a New List 1, Item 4, Which Would Require the Production of Documents Evidencing Any Investment or Trading Strategies Utilized or Recommended in the Customer's Account**

This FINRA rule overlooks the necessity of producing documents evidencing investment or trading strategies which the customer maintains should have been utilized or recommended in the customer's account. For example, a common issue in customer cases is over-concentration in equities. Similarly, it may be contended that the broker has failed to diversify within equity classes. Brokerage firms commonly maintain documents describing these strategies, and they should be produced where investors contend the strategies should have been employed. Documents relating to management supervision with respect to these strategies should also be produced. It is particularly important that these areas of production be mandatory since such issues so commonly arise in customer claims. It is also important to recognize that *pro se* investors may not anticipate that the brokerage firms would have these documents. This item should therefore mandate production of documents describing strategies which the customer has alleged should have been employed in the customer's account.

4. FINRA Proposal to Delete the Mandatory Obligation to Provide Recordings as Set Forth in List 1, Item 7

FINRA contends that producing recordings in every case is labor-intensive, expensive, and unnecessary in those cases where there is no dispute relating to the conversations between the parties. This proposal strongly favors the industry, and it is inconceivable that a brokerage firm may refuse to produce all recordings of broker-customer conversations. The party who made the recordings should not be allowed to unilaterally judge whether such recordings are relevant. However, FINRA's new position would allow just that. FINRA contends that the recordings could always be requested on a case-by-case basis. The problem is that the party requesting the recordings does not know their contents and, therefore, cannot make a factual argument that the recordings are relevant, other than by the fact that they exist. The burden argument makes little sense because it will be necessary for the brokerage firm to listen to the recordings in all cases so it can argue their relevance. There should continue to be an affirmative rule requiring the production of all recordings. Removal of that rule will only assure that the brokerage industry will not produce relevant recordings. Having a mandatory rule also is essential for the protection of *pro se* investors who may not even understand that they must make an independent request for recordings.

5. FINRA Continues to Require the Production of Forms RE-3, U-4, and U-5 as Presently Set Forth in List 1, Item 8

This existing rule should be expanded. There is additional information which should be made available to investors, and that is documents relating to matters which may have been expunged. In recent years, FINRA has adopted several rule amendments concerning expungement in an attempt to minimize the acknowledged abuses in this area. Arbitrators have routinely approved expungements as a common settlement procedure. FINRA's effort to prevent the industry from expungement abuse by rule in 2008 is commendable. But it also is a recognition as to the fact that repeated expungement abuse has sealed the existence of hundreds of arbitration proceedings and settlements. Accordingly, any rule which relates to disclosure of arbitration proceedings must also require the disclosure of cases which were expunged prior to the effective date of the 2008 rule. The failure to require this disclosure improperly rewards the industry for its undermining FINRA's public disclosure system over the past many years.

6. **FINRA Proposes No Change in the Current List 1, Item 12, Which Requires the Production of Records for Disciplinary Action Taken Against the Associated Person by Any Regulator or Employer for All Sales Practices or Conduct Similar to the Conduct Alleged to Be at Issue**

The existing rule should be expanded. Limiting brokerage firms' obligation to produce disciplinary records to matters similar to the conduct alleged to be at issue has the effect of concealing potentially relevant and material documents. For example, virtually every case involves the broker's credibility, whether it relates to suitability, churning, negligence, rule violations, etc. Any disciplinary action by its very nature likely relates to broker credibility. The determination as to what is and is not relevant to the proceedings should not be limited by an abstract rule, nor should it be placed in the hands of the brokerage firm. This rule encourages nondisclosure by the firm of what may very well be relevant and material documents. The brokerage firm which withholds evidence based upon this rule should, at the very least, be required to submit such evidence to the chairperson for *in camera* inspection to determine whether it should be produced. Alternatively, all records of disciplinary action must be mandatorily produced. This is particularly true in *pro se* cases where investors do not have the knowledge to even pursue this issue.

7. **FINRA Proposal to Increase the Burden on the Investor Under List 2, Item 1, to Produce Tax Returns by Mandating Production of Entire Returns for a Customer and Customer-Owned Business for Five Years Prior to the First Transaction at Issue**

This is a FINRA change from requiring such production for three years from the first transaction at issue and also limiting production to pages 1 and 2 of Form 1040 and Schedules B, D, and E. This change imposes a substantial burden on the customer in all cases and merely allows the brokerage firm to engage in a fishing expedition. To the extent that these tax returns reflect the customer's financial condition, there is no reasonable argument that the brokerage firm should have to go back more than three years prior to the initial transaction. Furthermore, there is no reason to produce documents other than pages 1 and 2 of Form 1040 and Schedules B, D, and E. Typically, the focus relates to income, interest received, and capital transactions as set forth on these documents. FINRA is only adding to the burden to the investor, complicating the proceedings, and effectively playing into the hands of the industry.

It is noteworthy that FINRA has extended the period for production of financial statements to five years from the first transaction at issue. It is noted in the preliminary comments that this is a substantial burden on the claimant.

FINRA requests that these financial documents be produced in all customer cases regardless of the nature of the case. This clearly is an unfair burden on the customer. Production of such information even for three years is a burden on the customer, and financial information documents should be produced only in those cases where they are relevant. Of what relevance is an investor's financial information in a churning, misrepresentation, or negligence case? Production of tax information should be handled on a case-by-case basis and should be limited to the information essential to the arbitration; i.e., pages 1 and 2 of Form 1040 and Schedules B, D, and E.

Even more offensive is the footnote to List 2, Item 1, which allows the respondent to separately request individual income tax returns of the representative of a customer if the customer is a closely held corporation, partnership, trust, limited liability company, or ERISA plan. What possible relevance could the individual tax return of a representative of an entity in which the customer has an interest to the customer's claim against the brokerage firm? For example, if I am the trustee of a customer's trust, the assets of the trust and tax return of the trust could conceivably be relevant in a suitability case, but of what possible relevance could my personal tax return have? This extension is absolutely unnecessary and can only help to intimidate customers from pursuing claims against the brokerage industry.

8. FINRA Proposal to Increase Burden on Investors Under List 2, Item 2, that the Current Rule Requiring Production of Financial Statements or Similar Statements of the Customer's Assets, Liabilities, and/or Net Worth Shall Be Extended to Producing Such Statements from Three Years to Five Years Prior to the First Transaction at Issue

See Comment 7 to List 2, Item 1, concerning unnecessary burden on customer for production of financial information in cases where it may be irrelevant, ignoring the nature of the case.

FINRA's extension of a mandatory production of financial statements for such a lengthy period is certainly not in the interest of investor protection nor does it add to the efficiency of arbitration. Further, as noted above, the first transaction at issue in suitability cases is typically the date the account was opened. This means that an investor would have to produce financial information for not just himself but his business for a period of five years prior to opening the account. As noted above, this may extend for a period of eleven years or even much further, depending upon when the account was opened. To extend this period is an unconscionable burden on the investor, and the existing rule should not be modified.

9. FINRA Proposes to Retain the Obligation of the Customer Under List 2, Item 3, to Produce All Documents Received from the Firm

The customer should continue to be required to produce all documents received from the firm, with the exception of account statements. As noted above, account statements should be produced by the firm. This will reduce the burden on the customer and the firm is in a much better position to produce these documents than is the customer. See Comment 1.

10. FINRA Proposes to Amend List 2, Item 4, to Require the Customer to Produce Account Statements and Confirmations from Other Firms for Five Years Prior to the First Transaction Through the Completion of Discovery

This FINRA proposal materially adds to the burden of the investor, with no reasonable prospect of producing relevant documents. Expanding the period covered to include an additional two years prior to the first transaction and further extending it from the date the statement of claim is filed through the completion of discovery, have no material prospect of yielding relevant evidence and can only further complicate the arbitration proceedings.

It is noteworthy that requiring an investor to produce account statements and confirmations going back to five years prior to the first transaction through the completion of discovery is a particularly substantial burden. For example, producing over ten years of account documents from a brokerage account could involve well over 1,000 pages of documents, which may well be immaterial to the claims. This production issue should be handled on a case-by-case basis.

11. FINRA Proposes to Amend List 2, Item 6, Concerning the Production of Account Analyses and Reconciliations Prepared by or for a Customer Which Relate to the Account or Transactions by the Firm

FINRA proposes to retain this obligation of the customer essentially as it existed in the original Discovery Guide. In contrast, FINRA has proposed that the obligation of the brokerage firm to produce analyses and reconciliations should be limited only to those "prepared during the time period at issue." Thus, the customer must produce documentation prepared subsequent to the period at issue, while the brokerage firm may produce documentation only prepared during the period at issue. It is difficult to understand why FINRA should impose greater burden on the customer, and accordingly the customer's obligation should be limited to documents prepared "during the period at issue." The burden should be the same for both the claimant and the brokerage firm.

12. List 2, Item 8 – FINRA Retains the Obligation of the Customer to Produce All Recordings About the Customer's Account or Transactions Which Occurred with the Broker

FINRA has thus imposed an obligation on the customer which it refuses to impose on the brokerage firm. The brokerage firm need not produce all recordings but can filter them. The customer must produce all recordings. It is absolutely unfair to place a burden on the customer that FINRA is unwilling to place on the brokerage firm.

13. FINRA Proposes to Amend Current List 2, Item 9, to Include Correspondence Between the Customer and Third Persons

Obligating customers to produce all correspondence between customers and third persons is problematic because FINRA in its Web site encourages investors to file written complaints with FINRA even prior to contacting an attorney. These written complaints and related documentation would have to be produced in response to this request. There should be an exception to provide that they are protected communications. FINRA's objective of investor protection should require it to include such an exception to this mandated production. FINRA is encouraging investors to create important documents which will have to be produced under this rule which can only benefit the brokerage industry in defending claims. If FINRA is to mandate production of all communications to third parties, it should discontinue its efforts at persuading investors to provide details of their claims to FINRA which will subsequently be produced in arbitration.

14. FINRA Proposes to Amend List 2, Item 12 [Redesignated as Item 11], to Extend Time Period for Complaints/Statements of Claim and Answers Through the Completion of Discovery and to Allow Discovery of Settlement Documents and Information

FINRA's rule proposal concerning settlements would require disclosure of non-confidential settlements. In addition, a confidential settlement agreement, which by its terms does not preclude the identification thereof, may be obtained with an order of the panel, and the underlying documents must be identified. This provision is extraordinary. To allow a brokerage firm to meddle into a confidential settlement guarantees a motion and pre-hearing conference at the arbitration. It also raises complex issues concerning the customer's potential liability to a third party concerning the confidentiality. While the likelihood of such an agreement being in existence is rare, this does not justify meddling into settlement agreements related to independent proceedings. Furthermore, there is no indication as to what is an "underlying" document.

In any event, should such a rule be approved, a similar rule must also be put in place for the brokerage firm and broker. It makes no sense to require the customer to produce more information concerning settlements than it does the brokerage firm and broker. For example, expunged matters should be disclosed. Expunged matters are not confidential. The fact of the expungement itself is referenced in an arbitration award, and the brokerage firm's CRD also reflects the terms of the settlement that may have been the subject of the expungement. Furthermore, many expungements were achieved as a result of industry abuse which was addressed in the 2008 FINRA expungement rule. Therefore, matters which were expunged prior to that date should not be protected from disclosure.

FINRA's proposal to treat investors in arbitration by a more onerous standard than it imposes on the brokerage industry is unacceptable.

15. <u>FINRA Proposes to Adopt a New List 2, Item 12, that Would Require the Customer to Identify Loans Applied for or Guaranteed in the Five Years Prior to the First Transaction at Issue Through the Date the Statement of Claim Was Filed</u>

There is no precedent for this rule, and it is difficult to believe that it has been proposed by FINRA, which espouses investor protection. The customer would be required to identify and produce copies of loan applications or a written authorization for respondents to obtain the application directly from the lender. As noted above, the five-year period is unfair, unreasonable, and unacceptable in the interest of investor protection. This is another example of FINRA's providing encouragement to the brokerage industry to place the customer who seeks to recover losses on trial. FINRA claims that this would help obtain information concerning the customer's net worth, assets, and liabilities. The chances of such information being in existence, let alone being relevant, are remote, and the burden on the claimant is substantial. As noted above, the five-year period on its face is unreasonable and may require production of documents dating back well over a decade. Furthermore, investor loan applications may include mortgage loans, car loans, appliance loans, credit card applications, personal loans, etc. Requiring this production of these documents in all claims, regardless of the nature of the action, is inappropriate. If such documents can be shown to be relevant, brokerage firms can obtain their production without a mandatory omnibus provision.

Conclusion

The SEC has provided that FINRA shall be responsible for investor protection. In this regard, it is troubling indeed that FINRA should be proposing burdensome and unfair obligations upon investors in connection with arbitration discovery. FINRA investor arbitration has effectively failed investors based upon an examination of the arbitration results. Investors have been losing approximately 40 percent of the arbitrations and recovering approximately one-third of their claimed losses in the arbitrations which are classified as "wins." It is even worse for the *pro se* claimant. In 2007, three-arbitrator panels dismissed claims of approximately 90 percent of the *pro se* investors.

If anything, the changes to arbitration discovery should be designed to assist investors in arbitration discovery rather than burden them. This proposal dramatically increases the burden on investors, and the SEC's review of FINRA's proposed changes should be considered in this light. The SEC should address whether the Discovery Guide changes on balance favor the investor or favor the industry. Based upon this type of an analysis, it is submitted that the proposed modification of the Discovery Guide should be rejected in its entirety.

I understand that the SEC may accept comments filed after the April 3 deadline, and I therefore may file comments on changes proposed in connection with Lists 3-12 at a later date.

Thank you for your consideration.

Very truly yours,

Laurence S. Schultz

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