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Subject: File No. SR-FINRA-2009-008  
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I represent customers in FINRA Dispute Resolution arbitration proceedings. It is a forum in which customers receive nothing in more than 60% of the cases that go to hearing. If a customer does receive an award it is seldom more than 30% of legal damages and the customer has only a 50% chance of collecting that. With these already pathetic odds for the investing public attempting to recover losses due to broker fraud, an accurate record of other customer complaints against the broker is important. Brokers should be required to report arbitration claims against them at the time the arbitration is filed, not two years later when the claim results in a settlement, award, or hits the 24 month limit as a literal reading of the proposed rule provides.

#### BACKGROUND

It should be pointed out that this entire situation was invented by NASD when it made a seemingly innocuous change to Forms U-4 and U-5 in the 1990's changing the language from then Question 22H, "Have you ever been the subject of an investment-related, consumer-initiated complaint or proceeding . . ." (Emphasis Added) The revised U-4 contained Question 22I (1) and (2)<sup>1</sup> which divided the question into, "(1) Have you ever been named as a respondent/defendant in an investment-related, consumer initiated arbitration or civil litigation . . ." and "(2) Have you ever been the subject of an investment-related, consumer-initiated written complaint . . ."

In a stunning example of regulatory capture and disdain for public investors and state securities regulators, NASD then interpreted an arbitration claim, where the registered representative's actions and conduct were clearly stated as the subject of the complaint, as not being a written complaint at all and not reportable.

Only if the arbitration statement of claim is preceded or followed by a separate written complaint to the registered representative or firm, will the NASD consider it a

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<sup>1</sup> 22I is now designated 14I after subsequent revisions, but the language remains the same.

customer complaint under 14I(3), “Within the past twenty four (24) months, have you been the subject of an investment-related, consumer-initiated, written complaint, not otherwise reported under question 14I(2) above, which: (a) alleged that you were involved in one or more sales practice violations . . . “ An arbitration statement of claim does not qualify as a “customer complaint” under any of these three sections which remain unchanged. While common sense would again dictate that 14I(3) should apply, it doesn’t because an arbitration claim isn’t a “written complaint” as explained in SEC Release No. 34-59616, March 29, 2009:

If, however, a customer files a written complaint with a firm alleging that a registered person is responsible for the same sales practice violation(s), the firm and the registered person are responsible for reporting that customer complaint on the person’s Form U4 (Question 14I(3)) or Form U5 (Question 7E(3)).

That is the basis of FINRA’s statement that some (apparently unknown) “regulators” caused all this:

Regulators have interpreted Question 14I(1) on Form U4 and Question 7E(1) on Form U5 to mean that, even if a registered person is identified in the body of an arbitration claim or lawsuit as the person responsible for the alleged sales practice violation(s), the event is not required to be reported on the person’s Form U4 or U5 because he or she was not specifically named as a respondent/defendant in the arbitration or civil litigation. In other words, a “yes” answer to Question 14I(1) on Form U4 and Question 7E(1) on Form U5 is currently required only when the customer has sued a registered person or filed an arbitration claim naming the registered person as a respondent.<sup>2</sup>

The “regulators” were the NASD, now FINRA, doing their members yet another favor at the expense of public investors and state securities administrators who have no choice but to rely on the CRD system. The problem was the nonsensical interpretation, not the rule. The problem could just as easily be fixed by the same “regulators” sending a notice to its members that an arbitration or civil court action indentifying the registered person without naming him or her is, as common sense dictates, a customer complaint.

#### THIS AMENDMENT COULD CONTINUE TO HARM INVESTORS

Besides being totally unnecessary because FINRA could simply interpret an arbitration or civil suit a “complaint,” as logic dictates, the proposed rule encourages member firms defending arbitration claims to stall for up to two years in order to delay reporting an arbitration complaint. The key sections to Questions 14I are as follows:

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<sup>2</sup> Federal Register / Vol. 74, No. 58/ Friday, March 27, 2009/ Notices, page 13493.

**Answer questions (4) and (5) below only for arbitration claims or civil litigation filed on or after [insert effective date of proposed rule change]**

(4) Have you ever been the subject of an investment-related, consumer-initiated arbitration claim or civil litigation which alleged that you were involved in one more sales practice violations, and which:

(a) was settled for an amount of \$15,000 or more, or;

(b) resulted in an arbitration award or civil judgment against any named respondent(s)/defendant(s), regardless of any amount?

(5) Within the past twenty four (24) months, have you been the subject of an investment-related, consumer-initiated arbitration claim or civil litigation not otherwise reported under question 14I(4) above, which:

(a) alleged that you were involved in one or more sales practice violations and contained a claim for compensatory damages of \$5,000 or more (if no damage amount is alleged, the arbitration claim or civil litigation must be reported unless the firm has made a good faith determination that the damages from the alleged conduct would be less than \$5,000)

(b) alleged that you were involved in forgery, theft, misappropriation or conversion of funds or securities?

Given the above language, it is difficult to see how Finra's claim that persons identified in the body of a civil litigation complaint or arbitration claim would be treated the same way that other customer complaints are treated where, ". . . such matters would be required to be reported no later than 30 days after receipt by the firm."<sup>3</sup>

(Emphasis Added)

Subparagraph (4) clearly provides that the firm can delay reporting until 30 days after the arbitration claim is either (a) settled, or (b) resulted in an award. Why? Subparagraph (5) appears to give the firm two years to report if there is no settlement or award under subparagraph (4).

Subsections 14I(4) and 14I(5) apply only to new filings after the effective date. If 14I(5) doesn't apply to arbitration claims submitted prior to the effective date then, by its plain language, the 24 month time period must apply only to arbitrations filed after the effective date. The only logical reading is that members have 30 days to file with the CRD after the occurrence of either (a) or (b). It still arguably protects members from reporting customer complaints in a timely manner.

Considering that the same "regulators" will be interpreting this rule as the former, it appears that the result may be the appearance of reform while delaying the actual

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<sup>3</sup> SEC Release No. 34-59616; File No. SR-FINRA 2009-008

report for as long as possible.<sup>4</sup> Instead of never reporting the complaint, members have to report after two years. Respondents do not need extra incentive to drag out arbitration. Hearings are now over a year from filing and member firms will have no incentive to settle meritorious cases in an expeditious manner. To the contrary, the incentives would be to delay settlement or award in arbitrations and civil actions to the 24 month deadline to report under subparagraph 14I(5). That is not an improvement to the reporting system and it is another industry-friendly rule to disadvantage public customers in arbitration. It would give member firms as well as FINRA Dispute Resolution further incentive to drag out arbitration procedures, with the attendant endless motion practice preventing resolution as long as possible.

This is not rocket science. It doesn't need five sections and twelve subsections to require reporting of customer initiated legal actions. One sentence not subject to extensive over-lawyering would work, "Have you ever been the subject of an investment-related, consumer initiated legal or arbitration complaint or proceeding." Brokers should be required to report such claims within 30 days of service of the statement of claim. Because the member firm writes the CRD entry, reporting the event immediately is not cataclysmic. CRD reporting has increasingly become optional for member firms in any case. The disclosure reports actually filed routinely minimize and misrepresent the claims and maximize the denials, misrepresenting major felonies as minor parking tickets, what FINRA calls "context" without input from the customer. It should, at a minimum, be done in a timely manner.

Respectfully submitted

Barry D. Estell

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<sup>4</sup> Note that FINRA assured the Commission that the expungement rule would allow expungement only under rare circumstances, yet there are registered persons with over 20 expunged arbitration settlements that investors will never see.