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To: U.S. Securities & Exchange Commission

From: Richard A. Stephens, Esq.

Re: Comments on Proposed Changes to FINRA Discovery Guide

I have some significant comments on the proposed changes to the FINRA Discovery Guide. With an earlier draft submitted by FINRA to the SEC, I submitted some comments that apparently were adopted in the new version. I now have further comments as the proposal has been redrafted.

I think it would be helpful for you to understand some of my background to better understand my perspective. I was working on Wall Street in 1967 when I was 16 years old, before I even went to college at the University of Michigan, and worked for that major investment banking firm on Wall Street, Lazard Freres & Co., during my college summers. After earning a Juris Doctor from Cornell Law School and practicing law in New York City, I served as a Fellow at the Center for Study of Financial Institutions and Securities Markets, and received a Master of Laws degree in securities regulation from the University of Pennsylvania Law School. Thereupon, I served as an attorney with the U.S. Securities & Exchange Commission in Washington, D.C., for both the Division of Investment Management, and the Division of Enforcement. I have been exclusively practicing securities arbitration, mostly FINRA, since before the Discovery Guide was adopted in 1999, through the present. During this same period I have served as a FINRA arbitrator, and am currently on the active Chairman roster. I am a member of PIABA, and now act solely as an attorney for claimants. Based on my experience as a practitioner, and as a FINRA arbitrator, I have developed a wealth of experience with the Guide that I wish to share with FINRA and the SEC by these comments.

Biggest Concerns:

1. Elimination of the "Order tickets for the customer's transaction(s) at issue" requirement for unauthorized trading cases is a <u>serious mistake</u>. I would not mind

a modification to say "order tickets (or electronic equivalents with order times)" if that reduces a firm's burden.

The proposal seems to indicate that new List 1 items 4, 6, and 8 compensate for the removal of the order ticket requirement, but I cannot agree. For example, item 4 says "all documents relating to customer authorization of the transactions at issue." What does that mean? Does FINRA intend to go from specific requirements of "order tickets" (or equivalents) to some vague notion that can easily be ignored and lead to needless motion practice? Is FINRA trying to send arbitrators on a "wild goose chase" by receding from the importance of order tickets? This is a dangerous and needless change by FINRA that will make it more difficult to prove unauthorized trading by defrauders; and rather than enhance investor protection, provide a shield for crooks. Indeed, it is nonsensical, if you will indulge my venting.

The most definitive proof of unauthorized trading is a comparison of the telephone call times versus the times of the order tickets or equivalents for the transactions at issue. The order ticket machines (or bona fide electronic equivalents) provide an **undisputed time stamp in history**. Spreadsheets by attorneys representing claimant-victims are prepared chronologically reflecting the calls and order times to the minute and sometimes to the second, as the undisputed recorded history of the facts. If telephone calls are made by the broker solely after the time of the order, an arbitrator can see that the trade was unauthorized. Broker notes can lie, but **the times by the phone companies versus the order tickets do not lie. You can throw out all other documents in the Discovery Guide, and find a correct result just by comparing the order times to the telephone records, which is what I do for my defrauded clients several times per year**. Rarely is a burden argument raised by any respondent firm, since the requirement is to produce order tickets (or equivalents, such as the computer TAR reports by Citigroup) merely for the unauthorized transactions at issue. **There is no evidence more important in an unauthorized trading case.** FINRA's retraction of the order ticket requirement in unauthorized trading cases is tantamount to a rule of evidence disallowing security camera evidence of bank robbers in bank robbery cases.

In fact, FINRA is going in the opposite direction. In many unauthorized trading case, it has became indispensable to receive discovery of order tickets for the same security bought by the broker for other clients at around the same time to show a pattern of unauthorized trading. For example, I had one case last year where the defrauding broker entered purchases for several customers at the identical time as part of a massive fraud.

If FINRA reduces a firm's obligation to merely produce electronic equivalents that have the times of the order (instead of searching for written tickets), that would be fine if the electronic equivalent had the identical information; but **to eliminate the specific "order ticket" requirement in unauthorized trading cases serves only to perpetuate and conceal securities fraud at a time when FINRA needs to be serving the public interest by proving the tools for investors to prove such frauds.** The "order ticket" requirement must be kept, albeit with an electronic equivalent alternative that has the actual order times and other order entry information.

2. The List 1, item 10 "redacted to prevent disclosure of nonpublic personal information about complaining customers" is too ambiguous, and will cause thousands of motions annually. I am currently running into certain firms that routinely refuse to provide the identity of other complaining customers, giving "customer confidentiality" as the feigned excuse when the *real reason* is that they do not want claimants to find witnesses for the final hearing to establish a pattern of fraud and fraudulent intent under Fed. Rules of Evidence 404(b). This refusal to provide customer identities is rampant. The **"nonpublic personal information" should exclude identifying information such as the complainant's name, address, and identify of legal counsel,** and instead clarify as non-discoverable (for redaction) such items as social security numbers, and other customer medical or income tax information as "personal". Such a clarification would comport with the new version of List 1 item 10 or a Form U-4 to be "redacted to delete associated persons' social security numbers" or List 2 item 1 to redact "medical and dental expenses and the names of charities". The names and addresses of complaining customers are *not* " nonpublic personal information", and the proposal should so reflect that view, or else havoc will erupt with *every arbitration* having motions over this very point.

3. List 1, items 13, 14, 15, 16, and 17: To prevent rampant abuses, the Discovery Guide needs to clarify the phrases "related to the allegations in the Statement of Claim" and "conduct similar to the conduct alleged to be at issue", which are the cornerstones of numerous discovery requirement upon firms. **The phrase "sales practice violations" should be used instead** (e.g., other customer complaints of "sales practice violations"), **or else FINRA's solution to List 1 item 10 (to wit, "all" instead of "similar nature") should be utilized.** It is just too easy for brokerage firms lawyers (with ethical responsibilities to "zealously represent" their client) to simply exclude critical documents by a "creative interpretation" that the documents are "not related", or "not similar", and claimants will never get to know the truth and be deprived of documents that could have altered a panel's decision ... <u>and that "interpretation will never be challenged or</u>

adjudicated by arbitrators because claimants will never know of the existence of the documents. For example, if a claimant asserts that purchase of Microsoft by a broker was "unsuitable", a brokerage firm's lawyer could declare to his client that another customer complaint about unsuitability by the same broker buying "Cisco" is "not similar", which is absurd. The same with unauthorized trading, where the broker is accused of unauthorized purchases of Lehman preferred convertible, when a complaint was made by another customer of a Lehman non-convertible on the same day. Thus, another secret absurd "interpretation" results in the bastardization of the process.

Churning, unauthorized trading, unsuitability, are all "frauds", and all should be considered "similar" complaints, or involving "similar" disciplinary actions, or similar misconduct in audit or examination reports, because a broker who commits one securities fraud should be called to task for committing any type of securities fraud. A clear analogy is in criminal law, since fraud can be both civil and criminal. Robbing a bank or embezzling from a company or mugging an old lady are "related" in showing serious misconduct, and "interpretations" that they are not "similar" because it was a different type of theft, or the robbing of a different bank, and therefore concealed from a claimant or arbitrator is plain wrong. By the same token, if a firm has supervisory problems with churning in the branch, and supervisory negligence is claimed in an arbitration for unsuitability or unauthorized trades, the lack of supervision by not preventing fraudulent churning spills over to negligent supervision for all sales practice violations and should be produced, with the FINRA neutral arbitrators determining whether they are sufficiently "similar", not a brokerage firm's lawyer who obviously takes the view that nothing is "similar". This is currently a serious problem that will be perpetuated and expanded in the FINRA proposal.

In my view, the easiest way to handle this dilemma to plug the "loophole" is to refer to "**sales practice violations**" instead of using "similar" or "not related", and allow discovery of all sales practice violations. **Alternatively, a remedy can be instituted as FINRA has proposed for List 1 item 10, getting away from "other customer complaints of a similar nature" to requiring production of "all" other customer complaints for a specified period, thus preempting the overzealous "interpretations" by respondent counsel about what is "similar".**

Obviously, arbitrators may give little weight if a claimant attempts to use some purportedly unrated sales violation as part of a pattern, but that is for the FINRA arbitrators to decide, *not* for respondent firm's lawyer to decide in their client's best interest by concealing evidence under the guise of an "interpretation". FINRA seems to have solved the problem in its new List 1 item 10, and should expand the solution to List 1, items 13, 14, 15, 16, and 17.

4. List 2, item 15 adds a new burden upon claimants to produce "all materials the customer received **<u>from any source</u>** relating to **<u>other investment opportunities</u>**, including research reports, sales literature, performance or risk data, prospectuses, and other offering documents, including documents intended or identified as being 'for internal use only,' and worksheets or notes" (emph. added). As currently drafted, this is way overbroad, without any time or relevancy parameters, and extremely burdensome. "From any source" and unrelated to the transactions or products at issue makes no sense. A customer would be required to produce **every unsolicited piece of junk mail ever received from any brokerage firm or 'any other source" about any "investment opportunity"**, however that is defined. It has absolutely no evidentiary value and would require a packrat; who keeps all mail to get out of their garage boxes of documents offering goldmines in 1950, grave lots in 1990, or anything else, *even if unread or unsolicited.* This directly contrasts with the "other brokerage statements" for three years in other parts of the Discovery Guide that at least have some kinds of relevance and time limitations.

I would not be opposed to this overbroad and strange item if it were limited to all such documents received from the respondent firm for three years prior to the first transaction at issue until the date the statement of claim was filed, or also limited to the product at issue. At least then, it would make some sense and have some evidentiary value.

5. List 2, item 1, seeks to include "Schedule A" of a claimant's personal tax returns, which is an unnecessary invasion into a customer's privacy, even with the charitable contribution redaction. My experience is that Citigroup, as an example, uses the tax information to try to show that the customer violated tax laws, as an intimidation so that the customer would give up claims of broker fraud. This type of unsavory tactic is to be expected once you allow firms to try making a FINRA arbitration into an IRS tax audit. FINRA declares that it wants to be "customer-friendly", to encourage claims by allowing FINRA and SEC investigators to see frauds exposed. Imposing a broader tax return obligation on customers, especially with personal deductions, is unnecessary to resolve the real disputes, and will prove counterproductive by keeping defrauded victims from bringing claims. The expansion of presumptive discovery to Schedule A is unwise public policy with dubious evidentiary benefits.

6. List 1, item 11: It is helpful that the Neutral Corner criteria for "confidentiality" was officially made part the rules. However, FINRA should give

some specific confidentiality illustrations to the Panels, especially regarding compliance manuals (List 1, item 11) which should not be considered "confidential" for special treatment. *See Miller v. Smith Barney, Harris Upham & Co.*, Fed. Sec. L. Rep. (CCH) P92,498 (S.D.N.Y.1986):

> As Miller argues, as members of the National Association of Securities Dealers ("NASD"), SBHU and Shearson are required to establish and maintain supervisory regulations for overseeing their employees. NASD Rules of Fair Practice, Art. III, § 27(a). The New York Stock Exchange, Inc., ("NYSE"), moreover, requires its members to maintain a compliance manual and to make it available to all firm personnel. NYSE Rule 342.16. Given these external requirements to compile and make available internal regulations, SBHU and Shearson cannot support an argument of confidentiality or privilege.

Such an illustration by FINRA would obviate *thousands of motions annually* on that issue, particularly because of certain large firms (e.g., Merrill Lynch and Morgan Stanley) that keep raising confidentiality after producing their manuals as non-confidential repeatedly.

Other Comments:

I am pleased that FINRA chose to keep "footnote 1" as guidance for arbitrators with non-party subpoenas.

Thank you for the opportunity to raise my comments and concerns.

Respectfully,

Richard A. Stephens