

I submit this comment on FINRA's proposal to amend its Discovery Guide (SR-FINRA-2010-035). I cannot support the proposal.

I'm not opposed to the concept of a guide to discovery in arbitration. I am, however, very opposed to the way FINRA goes about giving guidance. I believe that, overall, the list-method of giving guidance is unwise. I also believe that the lists themselves are flawed.

OBJECTIONS TO THE METHOD

My first disagreement with FINRA's Discovery Guide is that its format wrongly injects FINRA into the substance (as opposed to the process) of arbitration by making pronouncements about what is relevant in an arbitration. I believe FINRA's administrators should have no role in whatsoever in deciding what the appropriate scope of discovery is. That is a matter for the arbitrators. FINRA's role should be limited to providing smooth administration.

A decade of experience operating under the existing Discovery Guide teaches that arbitrators today too-routinely defer to the Guide's lists to resolve discovery/relevance issues. That deference carries over to the hearing itself, because that which is "discovered" is, almost by definition, appropriate for use at the hearing. By contrast, that which was ruled outside the scope of discovery rarely gets considered at a hearing (because there was no evidence produced). Through the Guide, FINRA thus injects its views on relevance into places where FINRA does not belong.

An example of this phenomenon is occurring right now in so-called "product cases" – cases where it is alleged that the brokerage firm mis-marketed an investment product (such as a mutual fund, private placement or structured product) to its customers around the country. In such cases, Claimants want to discover, and ultimately show the arbitrators, evidence of improper firm-wide practices, executive knowledge of and indifference to improper sales practices, or a pattern of fraudulent conduct.

The Guide makes discovery of such evidence very difficult. Documents of this sort aren't covered by the Guide, where the lists effectively limit discovery to the individual broker and activity at the branch level. Claimants who seek documents tending showing patterns of fraud or executive-level knowledge face defense arguments that the absence of these types of documents from Discovery Guide lists means FINRA thinks they are outside the scope of a proper arbitration.

Arbitrators too-often accept this spurious argument. Claimants who seek such documents confront an uphill battle to obtain them to prove their case. FINRA's Guide – and FINRA's views of what is relevant in a securities arbitration – have in this way been injected into the case.

The same phenomenon takes place when it comes to documents that are FINRA's lists. FINRA's inclusion on the Claimant lists of a multitude of financial documents sends a message to the arbitrators that the contents of such documents are automatically relevant to every case. I have other objections to the breadth of the Claimant lists (which I express below). I mention this

issue here as another example of FINRA's Discovery Guide wrongly injects FINRA into relevance issues in securities arbitration.

My second objection to the Guide is that the list-approach assumes that it is possible to define in advance the categories of documents that will be relevant to a case that has not yet arisen. While the Guide breaks cases into the types of claims that one might make (e.g. unsuitability, misrepresentation, churning, etc.), it cannot anticipate the details and subtleties of individual cases. The law may have its neat pigeonholes, but reality is more messy. FINRA cannot predict what cases will be like in the future, nor can it know for a specific case what documents are key and what documents are beside the point.

The Guide inherently rejects the premise that the appropriate scope of discovery in an arbitration depends on the nature of the investment and the facts of the case. The Guide assumes that the title given to one's legal claims is, by itself, sufficient to define the scope of discovery in an actual case. In this way, the Guide's approach to discovery is simplistic and totally unrealistic, and it sends arbitrators the wrong message – the message that the scope of discovery is pre-defined by FINRA, and that their role is more mechanical than analytical.

FINRA's decision to continue to address discovery training through the its lists creates an uneven playing field that cannot be leveled. What the defense seeks from an investor is not case-specific; they want all tax returns and all investment records – no matter what the allegations. But what an investor's attorney needs is case-specific and investment-specific. The set-up of the Guide thus favors the brokerage firms because it is easy to pre-define what the defense wants out of discovery. Not so the claimant.

To address investor complaints that the existing Guide does not give them what they need effectively to prosecute a case, the proposed Guide expands the list of what brokerage firms must produce. While certain of my colleagues welcome this expansion, I'm not sure they'll be better off. I think they will still have to make specific requests for additional documents, and face FINRA's not "presumptively discoverable" hurdle. I fear that with the expanded lists, it will be even harder than it is now to obtain discovery of categories of documents that are not on the lists.

OBJECTIONS TO THE LISTS

My next objection is that the Guide damages Claimants because it is under-inclusive of the documents needed by Claimants to prosecute their cases, and because it is the over-inclusiveness of the lists of documents Claimants must produce to Respondents. The proposed changes do not correct this imbalance.

The content of the investor lists covers virtually every financial document the investor might have. I refer to the breadth of items on this list as requiring every investor to undergo a "financial colonscopy." (For the record, it is a description I have borrowed from a prominent defense lawyer who can neither claim authorship nor use the term in public.)

Investors in arbitration routinely view the Guide's broad lists of financial documents as an invasion of their privacy. The fact that they are aggrieved and have commenced an arbitration ought not to be treated as a complete and automatic waiver of the right to financial privacy. Yet brokerage firms believe – and they do not hesitate to tell arbitrators– that anyone who commences an arbitration opens him or herself up to total financial scrutiny. Indeed, they routinely seek, through subpoenas, even more financial documents than are listed in the Guide, and they often get it because of the Guide's breadth and message. The FINRA Guide supports the defense's assertion that wide swaths of financial documents are needed and that their contents are relevant, and arbitrators accept the assertion because of what FINRA has put in the Guide.

The inclusion of tax returns is the best example. Brokerage firms seek these documents not necessarily because they reveal information that is relevant; these documents typically reveal information that is irrelevant (e.g. income, in a misrepresentation case). But it is information the defense often uses at an arbitration, for example to show that Claimant is wealthy and thus not deserving of an award.

Indeed, the lists include the full tax returns of all claimant-owned businesses. These documents are presumed discoverable in every case – even if those businesses never made a single securities purchase. Why? The same is true for piles of statements from every investment account the claimant owned going years back. All are presumptively discoverable regardless of the facts of the case, even if the case involves allegations about fraud in the sale of a single security. Arbitrators are thus “trained” by FINRA to believe that the contents of all these documents are always relevant – after all, they are in the Guide!

Clients find the financial colonoscopy to be highly invasive. It can be quite burdensome, especially for elderly investors. The prospect of invasion discourages some people from pursuing their grievances. Often, the sheer number of documents sought is disproportionate to the size of the case.

But that's all the better for a lawyer wishing to burden an adversary and his client with a large copying job. And the search through a claimant's financial history of course sets the stage for an extended cross examination. Brokerage defense lawyers dig doggedly for sources of income and/or past investments – anything from which they can try to characterize the investor as a “sophisticated investor” – or worse yet a person who has “speculated” before. With a sheaf of documents in the hands of a relentless defense lawyer:

- => a retired investor who was told that a specific junk bond was safe will be made to justify his claim of fraud in that purchase by answering endless questions about other stock purchases made years before;
- => a wealthy investor who was sold an unsuitable stock by the respondent will have to answer questions about prospectuses for unrelated investments on the recommendation of other firms;
- => a physician whose practice grossed \$5 million will be fending off aspersions that he must be a sophisticated investor because \$5 million is a lot of money. He may even find himself questioned about a deduction or two.

Without the financial colonoscopy, brokerage firms would be forced to defend their cases with the information they actually had at the time of their recommendations. That would make sense, since, under the suitability rule, the broker's duty to recommend investments is measured against the information the firm had when they made the recommendation, not against information acquired in discovery in arbitration.

CONCLUSION

There was a time when I supported FINRA's efforts to develop a guide with lists, but 10 years of experience has convinced me the method is unworkable and unfair to Claimants.

The parties to an arbitration would be better served with a different kind of discovery guide – one that is more educational and less mechanical. A guide that explains instead of one that proclaims. A guide that is consistent with the expeditious nature of arbitration, by encouraging arbitrators to keep the parties focused on the case and its issues. A guide that leaves the lawyering to the lawyers – not a Guide through which FINRA injects itself into the relevance debate and, by extension, into the substantive issues in an arbitration.

I urge the SEC to reject the Guide. FINRA can and should do better.

I am Professor of Law at the Zicklin School of Business of Baruch College, CUNY. I am also a member of Deutsch & Lipner, a Garden City, NY law firm which represents investors in arbitration. I am the co-author Lipner & Long, Securities Arbitration Desk Reference (Thomson/West 2009), and numerous articles on securities arbitration, ADR, and other areas. I am a two-time past-president of PIABA, and served for 4 years on the NASD's National Arbitration and Mediation Committee. I write a column at Forbes.com on securities arbitration.