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August 24, 2010

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: SR-FINRA-2010-035**  
**Comments to Proposed Rule Change to FINRA Discovery Guide**

Dear Ms. Murphy:

I am writing to provide this firm's comments on the above-referenced proposed Rule Change to the FINRA Discovery Guide. Our firm has represented members of the securities industry since 1968. Our attorneys have handled thousands of securities arbitrations and continue to represent FINRA-registered members and associated persons in arbitrations. We represent all types of broker-dealers ranging from the largest national companies to regional firms to small local broker-dealers. We have been able to assess the impact of the current discovery process both on our clients and on the outcome of the arbitrations in which they are involved. Unfortunately, the current Discovery Guide never achieved its intended purpose of streamlining the arbitration process. The proposed Rule Change to the FINRA Discovery Guide only exacerbates the problem.

This letter addresses some of the more troubling changes in the proposed amended Discovery Guide.

**1. Discovery No Longer Based on Nature of the Claim**

FINRA proposes to combine the separate Discovery Guide lists that are currently based on the nature of the claimant's claims (e.g., suitability, churning, misrepresentations, etc.) into two separate lists of "presumptively discoverable" documents – one list for customers and one list for firms/associated persons. As FINRA acknowledged, production of documents in arbitrations will no longer be dependent on the nature of the claim. Thus, many types of documents that would only be produced in a small number of cases under the current Guide will now be "presumptively" produced in all cases.

It should be noted that under the current system, two of the additional lists – the lists for churning and failure to supervise claims – do not require any additional production from claimants. Thus, the proposed amendment to combine all the separate lists and to make all documents presumptively discoverable clearly weighs heavily on the firms/associated persons.

The current Discovery Guide has had the practical impact of removing from the discretion of the arbitrations decisions about the scope and extent of discovery. Although the Guide states that some measure of discretion remains with the arbitrations, in practice it has not functioned in that manner. Under the proposed Rule Change, FINRA will essentially decree the production of numerous documents that are wholly irrelevant to the claims or the scope of the action. This contradicts completely the fundamental goals of FINRA arbitration – to provide a fair and efficient forum for resolution of disputes.

## **2. Production of Documents Concerning Other Customers, Accounts and Transactions**

In at least three of the proposed items in List 1 relating to firms/associated persons – proposed items 10, 13, and 20 relating to customer complaints, exception/activity reports, and commission runs – FINRA suggests that certain documents be produced even though they may have no relationship to the claimants, the accounts at issue, and/or the transactions at issue. These three items are discussed below.

Currently, the Discovery Guide suggests the production of customer complaints only to the extent that such complaints either are identified in the Forms RE-3, U-4 and U-5 or are of a similar nature against the associated person handling the account at issue. In proposed List 1, Item 10, FINRA proposes an amendment that will allow the production of *all* customer complaints, regardless of their nature. The only limitation is that the complaints must have been generated three years prior to the first transactions at issue through the filing of the Statement of Claim. This amendment could permit claimants to delve into other customer complaints that have no bearing whatsoever on the issues in the case, including operational complaints not even related to sales practices and expunged complaints. Without some further demonstration by claimants that these other complaints have some probative value that outweigh their potential for prejudice, these types of unrelated and non-public complaints should not be deemed “presumptively discoverable.”

In proposed List 1, Item 13, FINRA suggests in cases involving failure to supervise claims the production of *all* exception reports, supervisory activity reviews and similar supervisory documents – including those for other customers – that are “related” to the allegations in the Statement of Claim. FINRA’s supposed limitations on this request – that it applies only in cases involving failure to supervise claims and that the supervisory documents be “*related*” to the claimants’ allegations – do not provide much protection to the respondents as a practical matter. Failure to supervise claims are made in virtually every customer dispute against a brokerage firm. In addition, many Statements of Claim fail to identify with any specificity the transactions at issue, but rather contain vague, open-ended and generalized allegations that could be interpreted to refer to every transaction in the claimants’ accounts over a long period of time. Thus, these types of supervisory documents pertaining to *other* customers would likely become discoverable under the proposed Discovery Guide in every customer case.

Finally, proposed List 1, Item 20 would require in claims relating to “solicited trade activity,” the production of trade runs of all trades for the associated persons who handled the claimants’ accounts – including trades of the associated person and trades of other customers. The trade run would have to reflect certain client identifiers, the type of account (IRAs, 401K accounts, etc.), the names of the securities traded, trade dates, whether the trades were solicited or unsolicited, and the gross and net commission of each trade. Like Item 13 discussed above, the fact that Item 20 is limited to a particular type of claim – for Item 20, claims for “solicited trade activity” – provides little to no protection to respondents. Claimants typically make the claim that their transactions were “solicited” and rarely admit that any of the trades at issue were “unsolicited.” This is yet another request that will be employed by claimants in virtually every case.

The scope and breadth of the materials subject to the above requests is extreme. Yet, the value of the information in any given case is dubious, at best. To the extent that this discovery is routinely permitted, it would encourage inevitable “mini-trials” within each hearing. Claimants will attempt to cast aspersions against firms and associated persons due to the “facts” of other customer complaints, recommendations that may have been made to other customers and transactions in other customers’ accounts. Respondents, therefore, will be required to call witnesses and present testimony to defend against those other complaints – including how those complaints were resolved – the suitability profiles of other customers, the handling of other customer accounts, and the reasons for recommendations made to other customers. The length and cost of hearings will be expanded greatly for both claimants and respondents, and the panel will be distracted from the real issues in the case.

### **3. Advertising Materials Sent to Customers Of The Firm**

Proposed List 1, Item 2 expands the current request for production of correspondence between the claimants and the firm/associated person relating to the transactions at issue to include production of all advertising materials *sent to customers of the firm* – not just the claimants – that refer to the securities and/or account types that are at issue. As noted above, claimants are not required to specify in their Statements of Claim the particular products or accounts “at issue” and often make very general allegations concerning their complaints. Thus, this expanded request for advertising materials will be difficult to implement in the large majority of cases that involve non-specific pleadings covering a long time period and numerous transactions. The practical effect is that firms will likely be required to search for, identify and collect firm-wide advertising materials for very broad periods of time. This overbroad and unduly burdensome request should be limited in time and, more importantly, should be limited to the materials received by or relied upon by the claimants, which are the only documents that are relevant to the claims at issue.

### **4. Research and Sales Materials**

The current Discovery Guide calls for a two-step procedure for the production, in certain types of cases, of materials prepared or used by the firm/associated person relating to the transaction or production at issue, including research reports, prospectuses, and other offering documents. The firm/associated person first must provide a list of such documents and, upon request by the claimants, must produce the identified documents. Now, under the proposed changes to the Discovery Guide, this two-step process is eliminated and, in all cases, firms/associated

persons are required to produce “all materials prepared or used and/or provided to the customers relating to the transactions or products at issue, including research reports, sales materials, performance or risk data, prospectuses and other offering documents.” Proposed List 1, Item 5(a). Again, because of the generalized nature of most claimants’ pleadings and often lengthy time periods involved, this requirement will place a heavy burden on firms to identify documents that are not even well-defined (such as “performance or risk data”) and that were not necessarily provided to the claimants (materials that were simply “used” by firms/associated persons). This is another request that should be amended to clarify the types of documents being sought and should be further limited in terms of time period and scope.

In sum, we do believe that the proposed Rule Change runs contrary to the purposes of arbitration and will serve only to make the process more expensive and time-consuming for all participants, without adding any additional value to the process. We appreciate the opportunity to provide these comments on the proposed Rule Change to the Discovery Guide.

Sincerely yours,

A handwritten signature in black ink that reads "Paula D. Shaffner /cmd". The signature is written in a cursive, flowing style.

Paula D. Shaffner

PDS/cmd