



**Cornell University  
Law School**

Lawyers in the Best Sense

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August 22, 2011

**Via Electronic Filing**

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

**Re: File No. SR-FINRA-2010-036 Amendment No. 1 (Arbitrator Referrals)**

Dear Secretary Murphy:

The Cornell Securities Law Clinic (“the Clinic”) welcomes the opportunity to comment on Amendment No. 1 filed by the Financial Industry Regulatory Authority (“FINRA”) regarding revisions to its Code of Arbitration Procedure for Customer Disputes (“Customer Code”) concerning the ability of arbitrators to make disciplinary referrals during arbitration proceedings pursuant to File No. SR-FINRA-2010-36 (the “Rule Proposal”). The Clinic is a Cornell Law School curricular offering in which law students provide representation to public investors and public education as to investment fraud in the largely rural “Southern Tier” region of upstate New York. For more information, please see <http://securities.lawschool.cornell.edu>.

On October 14, 2010, the Clinic filed its opposition to the Rule Proposal. A copy of that letter is attached. While Amendment No. 1 does address some of our prior concerns, we still do not support the Rule Proposal as drafted. We join in the concerns expressed in the August 18, 2011 letter filed by the Public Investors Arbitration Bar Association.

FINRA’s goal in allowing mid-case referrals is admirable, but we think it could be accomplished more simply and without creating negative consequences for public customers by a simple revision to current Rule 12104 in the Customer Code, as follows:

~~“(b) Only at the conclusion of an arbitration, a~~ Any arbitrator may refer to FINRA for disciplinary investigation any matter that has come to the arbitrator's attention during and in connection with the arbitration, either from the record of the proceeding or from material or communications related to the arbitration, which the arbitrator has reason to

Elizabeth M. Murphy

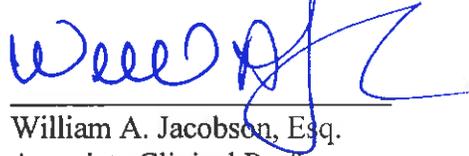
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believe may constitute a violation of NASD or FINRA rules, the federal securities laws, or other applicable rules or laws. Any referral made pursuant to this Rule shall not be grounds for recusal or removal of an arbitrator.”

This slight modification to the existing Rule would accomplish FINRA’s goal of increased regulatory vigilance without the negative consequences to public customers outlined in our prior letter and the PIABA letter.

Respectfully submitted,



William A. Jacobson, Esq.

Associate Clinical Professor

Director, Cornell Securities Law Clinic



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October 14, 2010

**Via Electronic Filing**

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

**Re: File No. SR-FINRA-2010-036 (Arbitrator Referrals)**

Dear Secretary Murphy:

The Cornell Securities Law Clinic (“the Clinic”) welcomes the opportunity to comment on the changes the Financial Industry Regulatory Authority (“FINRA”) is proposing to its Code of Arbitration Procedure for Customer Disputes (“Customer Code”) regarding the ability of arbitrators to make disciplinary referrals during arbitration proceedings pursuant to File No. SR-FINRA-2010-36 (the “Rule Proposal”).<sup>1</sup> The Clinic is a Cornell Law School curricular offering in which law students provide representation to public investors and public education as to investment fraud in the largely rural “Southern Tier” region of upstate New York. For more information, please see <http://securities.lawschool.cornell.edu>.

Together, the proposed revisions: (1) allow arbitrators to make referrals in the prehearing, discovery or hearing phase of arbitrations; (2) expand the scope of the referral standard; (3) require a new arbitration panel if a party requests one following a mid-case referral; and (4) cover some costs resulting from the delay in an arbitration following a referral. Thus, if an arbitrator makes a mid-case referral, either party may request a new arbitration panel, and the new panel decides whether to admit evidence or the record from prior hearing sessions. As a result, the request for a new panel may significantly delay the customer’s case.

Due to the burden these delays will place on customers, the Clinic does not support FINRA’s revisions without certain modifications. The Clinic understands FINRA’s need to detect fraud as early as possible, but believes the Customer Code changes unfairly burden victims of serious investment fraud. Many customers, having come to FINRA for help after suffering an injustice, may have limited time and resources to continue their arbitrations for additional time.

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<sup>1</sup> While the Rule Proposal also provides for analogous changes to the FINRA Code of Arbitration Procedure for Industry Disputes, the Clinic takes no position on the Industry Code.

Thus, the Clinic believes FINRA should allow mid-case referrals as added protection against fraud, but believes FINRA should do so without disrupting customers' arbitration cases.

### **1. The Clinic Supports Mid-Case Referrals as Added Protection for Customers Against Fraud**

Currently, arbitrators can refer to the FINRA Regulatory Policy and Oversight District Office certain matters uncovered during an arbitration for further investigation and possible disciplinary action.<sup>2</sup> The arbitrator has sole discretion in making these disciplinary referrals, but can only do so at the conclusion of an arbitration under the current Rule 12104(b). According to FINRA, arbitrators should only refer matters that suggest a serious wrongdoing has been committed, including conduct by a brokerage firm or its representative that is substantially unethical or dishonest, may have violated securities laws or FINRA rules, or involves abusive sales or trading practices.<sup>3</sup>

Under the Rule Proposal, arbitrators can make referrals in the prehearing, discovery or hearing phase of an arbitration, rather than waiting until the end. At the same time, the new rules remove the term "disciplinary" from "disciplinary referral" in the Customer Code to ensure the scope of potential referrals is not limited to disciplinary conduct. After recent, well-publicized fraud schemes, FINRA believes these changes will strengthen the agency's ability to regulate member organizations by alerting the agency earlier to situations indicating the existence of a market manipulation scheme or other ongoing fraud.<sup>4</sup>

The Clinic agrees that mid-case referrals will enhance FINRA's ability to protect customers by alerting FINRA to potentially serious wrongdoing earlier than is currently possible, and supports allowing arbitrators to make mid-case referrals. Currently, FINRA checks all customer complaints filed for evidence of fraud or other serious activity as they are filed with the agency.<sup>5</sup> However, FINRA receives thousands of complaints each year. Mid-case referrals will allow arbitrators to call attention quickly to any serious activity discovered that may not have been evident in the complaint FINRA received. This will be a valuable asset for FINRA in detecting and addressing fraud before it can harm any more investors than it already has.

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<sup>2</sup> FINRA Dispute Resolution Arbitrator's Reference Guide 133 (September 23, 2010 Edition), <http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@neutr1/documents/arbmed/p009424.pdf#page=133>.

<sup>3</sup> *Id.*

<sup>4</sup> Rule Proposal at 13.

<sup>5</sup> Press Release, FINRA, FINRA Announces Creation of "Office of the Whistleblower" (Mar. 5, 2009), <http://www.finra.org/Newsroom/NewsReleases/2009/P118095>.

## **2. The Clinic Does Not Support Allowing Parties to Request New Arbitration Panels During an Arbitration**

Under the Rule Proposal, if an arbitrator makes a mid-case referral, the Director must notify the parties. After being notified, either party may request the arbitration panel to withdraw from the case. Under the Rule Proposal, a party's request for a new panel following a mid-case referral is automatically granted; FINRA does not even approve the request. FINRA believes this change is necessary because parties may question the neutrality of the arbitrators going forward following the referral of a serious, ongoing, imminent threat to investors. (Rule Proposal, at 6) Recognizing this request would delay the arbitration until the parties settle, continue the case, or begin anew, FINRA has proposed to cover some of the costs associated with the delay.

FINRA defends the proposal on the grounds that it will actually encourage subjects of referrals to settle claims against them to avoid continuing the case, presumably because they are guilty of serious wrongs against the customer. However, the ability to request a new arbitration panel is the most disruptive feature of FINRA's proposed rule changes. The Clinic is concerned that the new referral process will encourage subjects of referrals to take advantage of the opportunity to delay the case by requesting a new arbitration panel. With the additional time from the delay, the subject of the referral can shift attention and resources to the impending investigation and avoid paying with the customer.

The effect of the Rule Proposal is to damage the customer who is the victim of the most egregious conduct, through a delay in the conclusion of an arbitration.

### **Conclusion**

The Clinic greatly appreciates the opportunity to comment on FINRA's proposed changes. While the Clinic supports the concept of mid-case referral, the Clinic cannot support the Rule Proposal so long as the Rule Proposal provides for delay in the resolution of a customer's arbitration.

Respectfully submitted,

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