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March 12, 2014
Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File Number SR-FINRA-2014-005 (Mid-Case Referral)

Dear Ms. Murphy:

We previously had the privilege of commenting on this proposal to extend FINRA arbitrators' authority to halt arbitration proceedings for the purpose of filing a referral for an enforcement investigation. FINRA responds to that earlier comment letter in the above-mentioned rule filing, so we do try to avoid being duplicative. Our view has not changed; the mid-case referral proposal is a misguided one. Our theme remains the same as well. FINRA's efforts to deputize arbitrators as regulatory whistleblowers, whilst they are in the midst of performing their arbitral duties, distorts their role and disserves arbitrating parties.

Thank you for the opportunity to file this comment with the Commission. As the editor/owner of a newsletter (Securities Arbitration Commentator) that follow securities arbitration developments, I have an interest in the fairness and effectiveness of the process. As an arbitrator, I am specifically concerned with this proposal on a number of levels.

FINRA's proposal stands akin to deputizing a judge during a civil bench trial and telling the judge that s/he must interrupt the trial and order the arrest of a defendant, whenever s/he becomes persuaded that the defendant has committed a crime – *whether related or unrelated* to the facts of the civil case. This is not the judge's job, not unless the offense relates directly to the integrity of the proceedings and is committed in the presence of the court! This proposal, if approved, will not prevent, but will jeopardize the integrity of the arbitration proceedings. It will upset the parties, compromise the judge's neutrality, disrupt the proceedings, and add to the length and cost of the trial.

Revelations in the Original Proposal

FINRA tracks the amendments it has made to this proposal in its Rule filing. To one who believes deputizing arbitrators has significant drawbacks for the integrity of the arbitration process, the original construction of the SR-FINRA-2010-036 confirms that FINRA perceives the same risks and drawbacks, but the Authority simply views the substantial costs as worth the prize.

FINRA originally provided that all three arbitrators could be removed, if one of the panel decided a mid-case referral was necessary. It recognized in that structure the fact that, should one arbitrator report the misdeeds of a party currently before the panel, it would taint the entire panel in the parties' perception. What was FINRA's solution to this untidy likelohood? It withdrew that proposal and replaced it with a provision making only the reporting arbitrator subject to recusal. Instead of making removal a right, a party must now persuade the tainted arbitrator to step down.

That may make it easier to go forward with the case, but it buries the valid concern, originally expressed by FINRA, that mid-case reporting of a party's misdeeds compromises the panel. Inherently implicit in a referral is the reporting arbitrator's conviction that serious violations have been committed. Drawing that conclusion at the end of a case is understandable – the arbitrator has listened to all of the evidence and has made a decision that will carry over into her verdict on the outcome of the case. Making that determination mid-hearing signifies that the arbitrator has made an irrevocable decision on the merits without hearing all of the relevant evidence.[1]

FINRA's original proposal anticipated that a mid-case referral would cause significant loss of momentum in the container case, leading to considerable additional costs and disruption -- but it was worth it. Accordingly, it proposed provisions to address the assessment of hearing session fees, costs, and expenses, when an arbitrator would make a mid-cae referral. FINRA saw that recusal motions, hearing adjournments, and the need to regroup were realities and offered the remedy of forgiving fee assessments. However, commenters provided a more disturbing picture of the high costs and damaging disruptions. FINRA response: shift gears, state that a referral would not oblige recusal and assert now that there no disruptions will result.

The original proposal simply empowered arbitrators to make mid-case referrals and erected no standards for their exercise. In the amended proposal, FINRA sets parameters on the arbitrator, asking that s/he only make a referral when s/he believed (setting a reasonableness threshold for belief is nonsensical, as an arbitrator who believes a referral is necessary will also believe his/her belief is reasonable) a "serious ongoing or imminent threat" was evident. Moreover, the arbitrator has to hear some evidence to that effect (although not all of it).

A collateral consequence of the higher hurdles, however, will be to make that arbitrator even more vulnerable to a bias challenge. By scaling these elevated levels of proof mid-way through the case, the arbitrator has certifiably reached a more emphatic conviction about demonstrably more serious violations. The more stringent standard may reduce the

[1] It should not be lost here that the reporting Arbitrator may very well be the only arbitrator making the final determination, after making a disciplinary referral and deciding to remain on the case. FINRA has arranged a much larger role for single arbitrators in the past few years, so that, today, according to SAC's Award Database, single arbitrators decide more than 40% of all Awards.

number of referrals, but it has the corresponding consequence of leaving the arbitrator more open to post-Award attack.[2]

As to each of the above revisions, FINRA simply switched from a proposal that forthrightly acknowledged concerns about compromising the integrity and operational smoothness of the process with a revised proposal to one that either denied the concerns or sought to end-run them. The consequences remain unaltered, however, and FINRA continues to allow its role as a regulator compromise its performance as a forum provider.

Not Madoff, Think Stratton

FINRA seems to believe that arbitrators will feel obliged to make mid-case referrals only in the "extremely rare circumstance" that a particularly insightful individual has an "aha" moment and uncovers an ongoing (or imminent) fraud that was previously unknown to the regulators. In that regard, proposal proponents are fond of citing the Madoff disaster, a circumstance that fits that model. A further assumption exists that, once alerted, the regulators will spring into decisive action and any procedural disruptions, displacement of justice, or additional costs in time and money in the halted arbitration will be justified by the decision to alert the Authority.

But, let's take the example of Stratton Oakmont, instead of Madoff. We are all familiar with the "Wolf of Wall Street" saga; there remains no question but that the operation of that broker-dealer was a fraud upon virtually every investor who held an account with the firm. It is difficult to look at the criminal enterprise and see how it could fail to represent to an arbitrator hearing a case against Stratton Oakmont a "serious threat, whether ongoing or imminent, that is likely to harm investors unless immediate action is taken." Recognizing that -- perhaps early in the hearing of a case in which Stratton was a respondent -- a diligent arbitrator could feel obliged to report to FINRA at the earliest practical opportunity.

Stratton's criminal conduct was not discovered and dealt with overnight. Jordan Belfort did not confess and turn himself in, as Madoff did. There were hundreds of arbitration claims against Stratton over a period of years -- in fact, so many at the end that FINRA established a special procedure in agreement with Stratton to deal with them. True, FINRA, the SEC and the FBI were pursuing Stratton throughout the pendency of all these

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[2] That FiNRA requires approval of the Director of Arbitration or the President of Dispute Resolution (note: these persons used to be two and are now one) in order to advance an arbitrator's referral avails the arbitrator process nothing. This safeguard may save Enforcement some work and aggravation, but it does not in any way prevent the disruption, cost and risks that the mid-case referral represents. Parties will be informed of the mid-case referral (presumably right away and not at the close of the case), whether or not the Director/President nixes it. That the arbitrator formed the conviction and acted on it is what matters in the context of a post-Award challenge or a recusal motion and case adjournment. That the Director/President might think the referral imprudent or ill-based, subsequently rejecting it, can only add to the risk of a bias challenge and determination.

claims, but would an arbitrator know that it was unnecessary, once appalled by the evidence mid-case of Stratton's felonious conduct, not to report what s/he had learned?

FINRA does not accord disciplinary referrals by arbitrators sufficient credit to make them public (whereas it credits customer complaints sufficiently to post them on the CRD). Thus, we are unable to say how many disciplinary referrals arbitrators made – post-Award – about Stratton when it was in operation. What we do know, from a review of some 155 FINRA Awards involving customer claims against Stratton Oakmont, is that arbitrators issued monetary awards against Stratton in 85% of the customer claims that went to decision. Arbitrators knew about Stratton Oakmont!

What would arbitrators have done with that knowledge, if FINRA were encouraging mid-case referrals back then? They would not necessarily be aware that the authorities were alerted; they would not necessarily know that scores of their colleagues had already filed mid-case disciplinary referrals; they would not know of any referrals made by arbitrators post-Award either, as FINRA maintains "radio silence" on all of these matters.
One can reasonably assume that many arbitrators, hearing cases involving Stratton Oakmont as a respondent and obliged by FINRA rules to consider mid-case referrals, would have utilized the procedures under this SEC-approved Rule.

And what would have been the result? First of all, the actions of all such arbitrators making these redundant referrals to FINRA would have been of marginal assistance to the authorities. But, the consequence to the individual proceedings could have been devastating. Upon learning of an arbitrator's referral, Stratton lawyers would have objected to the arbitrator's continuation in the case and requested recusal. If the arbitrator obliged, Stratton would have enjoyed a long hiatus in the case while the arbitrator was replaced, while the hearings were reset and the new arbitrator gained stride, and while Stratton filed its objections against any remaining, similarly tainted arbitrators. The cost to the customer-claimant would not only have been the expense of delay and re-preparation. The most dramatic cost could potentially be the cost of no recovery, as the delay might mean that Stratton would be judgment-proof by the time claimant received an Award. The preferred recourse of the guilty is the delay of justice.

Now, if the reporting arbitrator refused recusal, there would be delays in any case, while matters sorted out. Once there was an Award against Stratton, it would have valid avenues of appeal and, as it pursued vacatur on charges of bias and arbitrator misconduct, any monetary award in favor or the customer would be placed on hold. Broker-dealers who lose in arbitration must pay within 30 days, unless they pursue an Award challenge. Once a vacatur proceeding is commenced, the broker-dealer will not have to pay the customer anything until (at least) the conclusion of the initial vacatur action. What might happen in that interim period to thwart recovery by this deserving customer – and to what end?

Code of Ethics

One last point, by way of rebuttal. FINRA's response to the point in my original comment letter that arbitrators have a duty to maintain confidentiality under the Code of

Ethics is an artful one, but it misses the mark. True, arbitrators are bound by what the parties agree to, procedurally. Thus, if the parties agree, an arbitrator can write a blow-by-blow of the case's progress on a daily basis in the *New York Times*. But, my point about confidentiality was more philosophical -- how would that action alter and diminish the arbitrator's ability to provide justice and fairness to the parties? When arbitrators divulge the proceedings as the proceedings progress, they violate an ethical guideline that has not only short-term, but also long-term costs and consequences. If FINRA does not see that, I shall hope the Commissioners will.

Respectfully submitted,

Richard P. Ryder