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June 26, 2014

**VIA ELECTRONIC SUBMISSION**

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

**Re: File No. SR-FINRA-2014-005**

Dear Ms. Murphy:

The Pace Investor Rights Clinic at Pace Law School (“PIRC”),<sup>1</sup> operating through John Jay Legal Services, Inc., welcomes the opportunity to write this comment letter in partial support of FINRA’s proposed amendments to FINRA Rule 12104 to broaden arbitrators’ authority to make referrals during an arbitration proceeding. In our March 12, 2014 letter commenting on FINRA’s January 19, 2014, proposal, PIRC supported the amendment to FINRA Rule 12104 to allow for mid-case referrals, but urged FINRA to delete subsection (c)’s specific reference to a party’s right to request recusal of an arbitrator as a result of the referral, as the Code of Arbitration Procedure already provides that right.

On May 19, 2014, FINRA filed Partial Amendment No. 1 in which it proposed that a party that wishes to request recusal of an arbitrator following a mid-case referral must do so within three days of being notified of the referral. PIRC agrees with FINRA that this time limit should curb some adverse effects on individual claimants resulting from the request by preventing a party from strategically requesting recusal when it would best benefit that party.

However, in Partial Amendment No. 1, FINRA rejected PIRC’s suggestion to delete the Rule’s explicit reference to a recusal. FINRA’s filing did not explain why the proposed rule requires a specific reference to recusal, despite noting that a mid-case referral should not give rise to a claim of bias.

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<sup>1</sup> PIRC opened in 1997 as the nation’s first law school clinic in which J.D. students, for academic credit and under close faculty supervision, provide pro bono representation to individual investors of modest means in arbitrable securities disputes. See Barbara Black, *Establishing A Securities Arbitration Clinic: The Experience at Pace*, 50 J. LEGAL EDUC. 35 (2000); see also Press Release, Securities Exchange Commission, SEC Announces Pilot Securities Arbitration Clinic To Help Small Investors - Levitt Responds To Concerns Voiced At Town Meetings (Nov. 12, 1997), available at <http://www.sec.gov/news/press/pressarchive/1997/97-101.txt>.

PIRC remains concerned about the proposed rule's explicit reference to recusal. If FINRA adopts a rule suggesting, even implicitly, that an arbitrator could be biased once that arbitrator has heard enough evidence of wrongdoing, FINRA also may be suggesting that any arbitrator who has heard enough evidence of civil liability in any case, whether it deserves an enforcement referral or not, is thus biased. That makes no sense. In each and every dispute, an arbitrator decides one party's liability to an opposing party at some point in the proceeding, whether during the hearing or during deliberations. That is an arbitrator's primary function, and that is the power the parties grant to that arbitrator. Finding liability based on evidence presented does not mean, however, that the arbitrator is biased against the liable party sufficient to justify "good cause" for recusal; otherwise, the arbitrator would never be able to reach an unbiased decision in any case. Thus, PIRC urges FINRA to reconsider the specific reference to a recusal request in proposed amended FINRA Rule 12104.

**Would the proposal adversely affect retail investors? If so, how?**

As noted in our March 12 comment letter, PIRC is concerned about the negative impacts of mid-case referrals on individual claimants, but we recognize that such referrals could – in very limited circumstances – help prevent future harm or mitigate ongoing harm resulting from widespread fraud perpetrated on the investing public. We also still believe that explicitly allowing recusal requests under subsection 12104(c) could lead to unnecessary burdens on individual claimants, particularly those of modest means. While PIRC appreciates FINRA's proposals for educational outreach and Partial Amendment No. 1's three-day time limit for recusal requests after a mid-case referral, PIRC remains concerned about the negative impacts of such recusal requests and frivolous motions to vacate that could ensue if the arbitrator denies a recusal request.

**Should FINRA propose a different standard for referral? If so, what standard(s) would be appropriate?**

PIRC agrees with FINRA that the proposed reasonable belief standard for mid-case referrals is the appropriate standard. Arbitrators already apply this standard to post-case referrals under the current Rule 12104(b). The reasonable belief standard permits arbitrators to use their judgment, based on their assessment of the facts, evidence, and testimony during an arbitration proceeding, rather than a determination based on mere assumptions or inferences. This standard, coupled with the training suggested by FINRA, should help prevent arbitrators from making unnecessary mid-case referrals that could be made at the conclusion of the hearing. Applying the same standard that applies to post-case referrals should also facilitate a smoother transition for arbitrators in learning and applying the revised rule.

**Does Partial Amendment No. 1 ameliorate commenters' concerns that notifying parties of a mid-case referral could lead to adverse consequences to the claimant, including requests for recusal and challenges to an award? If not, should, FINRA amend the proposal to preclude the Director, or anyone else, from notifying the parties of a referral?**

As discussed above, PIRC does not believe Partial Amendment No. 1 fully ameliorates our concerns, primarily because of the explicit reference to recusal. Absent extraordinary circumstances, an arbitrator's mid-case referral should not provide any grounds for a recusal request or a motion to vacate an award. Moreover, for those extraordinary circumstances, Rule 12406 already provides parties with the right to request recusal.

However, PIRC does not believe that FINRA should amend the proposal to preclude the Director from notifying the parties of a mid-case referral. This procedure is consistent with the obligations of FINRA arbitrators to provide full disclosure to help ensure fairness for all parties. Such a disclosure requirement is a continuing duty and should encompass mid-case referrals.

PIRC commends FINRA's decision to publish a Regulatory Notice to explain the mechanics of the rule to arbitrators and parties to help alleviate this concern. Such guidance should help prevent arbitrators from making unnecessary mid-case referrals and limit adverse consequences to individual claimants. The Regulatory Notice will include a reminder about the courts' findings on what constitutes grounds for evident partiality, which should help curb the number of filings for motions to vacate following a mid-case referral, and thereby limit the increased arbitration costs to individual investors.

In addition, FINRA should monitor the effects of the proposed rule change – if approved – on a case-by-case basis, to determine whether it adversely affects individual investors and/or achieves the goal of preventing widespread fraud on the investing public. If the benefit is not found to adequately outweigh the harm, FINRA should consider further revising the rule or propose additional amendments to the rule to eliminate these adverse consequences.

In sum, while PIRC appreciates the proposed rule change's potential benefit of preventing fraud if used in limited circumstances, we remain concerned about the potential adverse consequences to individual investors of modest means. Although PIRC recognizes that partial Amendment No. 1 and FINRA guidance could help limit these consequences, individual investors, particularly those of modest means, are still vulnerable.

Respectfully yours,

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