Securities Arbitration Clinic
St. Vincent de Paul
Legal Program, Inc.

8000 Utopia Parkway
Queens, NY 11439
Tel (718) 990-6930
Fax (718) 990-6931
Email: sac@stjohns.edu
www.stjohns.edu/law/sac

March 12, 2014

Via Electronic Filing

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

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

Dear Secretary Murphy:

The St. John's University School of Law Securities Arbitration Clinic (the "Clinic") would like to thank you for the opportunity to comment on Amendment No. 1 to the proposed rule changes concerning the ability of arbitrators to make disciplinary referrals during an arbitration proceeding pursuant to File No. SR-FINRA-2014-005 (the "Rule Proposal"). The Clinic is a curricular offering where students represent public investors of limited means in disputes against their investment brokers pro bono.[1]

On July 26, 2011, FINRA submitted Amendment No. 1 to their prior proposed rule. Five comments were filed, all in opposition to the proposal. FINRA withdrew the Rule Proposal, but now has resubmitted it without making any changes. Despite the expanded reasoning that FINRA has provided for the Rule Proposal, we join in the concerns put forth by the prior comments and write to express our opposition to the Rule Proposal as drafted.

[1] For more information, please see http://www.stjohns.edu/law/securities-arbitration-clinic.

The existing Rule 12104 only allows arbitrators to make referrals to FINRA for disciplinary reasons at the end of an arbitration proceeding. The Rule Proposal seeks to expand this by allowing arbitrators to make a referral in the middle of a case when they suspect an ongoing or serious threat to the investing public. FINRA argues in the Rule Proposal that, although an individual claimant will incur costs when a mid-case referral is made, the Rules provide ways to minimize these costs. Additionally, FINRA argues that the costs borne by individual claimants, on balance, are outweighed by the potential costs saved by the investing public.

We disagree. While FINRA's goal in protecting public investors from ongoing frauds is commendable, we believe that the gains to the public are outweighed by potential harm to innocent claimants that will likely be caused if this Rule Proposal is enacted.

The Rule Proposal effectively creates a lose/lose situation for claimants following a mid-case referral. The likelihood that a respondent will request recusal following a mid-case referral is heightened by the inferences that parties to an arbitration are likely to draw about the referring arbitrator's view of the case. While it is true—as FINRA argues—that arbitrators are expected to form opinions based on the evidence presented in an arbitration hearing, and that such opinions are subject to change as the hearing proceeds following a mid-case referral, there remains a strong likelihood that the parties will infer that the referring arbitrator is leaning towards making an award in favor of the claimant if the arbitrator is making a referral. Whether or not a referring arbitrator chooses to grant a request for recusal, claimants stand to incur additional costs and delays because of the very request itself.

If a referring arbitrator does grant a request for a recusal, the claimant not only loses an arbitrator who likely viewed the claims favorably, but will also have to bear the substantial costs associated with finding a replacement arbitrator. Even if FINRA covers the costs associated with a new arbitrator's review of the case, the claimant will still endure additional costs, including taking off additional days from work, travel time, and paying for the additional time of witnesses. FINRA responds to this concern by stating that the parties could agree to continue with two arbitrators, or to stipulate to the rehearing of only a few key witnesses. However, if the parties fail to agree it will lead to substantial inconvenience and financial cost to individual claimants, some of whom will find these additional costs to be overly burdensome.

Furthermore, although the FINRA Dispute Resolution Arbitrator's Guide allows a single arbitrator on a three person panel to make a referral, it encourages arbitrators to discuss the matter with their co-panelists. FINRA assumes that only one arbitrator on a panel will make a referral, but what if an entire panel makes the referral? This would provide possible grounds for a respondent to ask all of the arbitrators to recuse themselves. This would eliminate the ability of the claimant to continue with the remaining arbitrators and would increase the additional costs and delays that are likely to follow from most mid-case referrals.

On the other hand, if a referring arbitrator does not grant a request for recusal, prevailing individual claimants still stand to incur additional costs when respondents invariably

move to vacate the award. FINRA argues that formation of an opinion based on the evidence presented at a hearing is not sufficient to show bias on the grounds of evident partiality, which is grounds for vacating an award under the Federal Arbitration Act, 9 U.S.C. § 10. However, regardless of whether a motion to vacate proves successful or not, individual claimants will still have to bear the cost of arguing against these motions. As expressed above, many of these claimants have limited means, and may not be able to afford these additional costs. Thus, those claimants who cannot afford the costs associated with defending such motions may be forced to settle for a lesser amount than they would have otherwise received.

FINRA has acknowledged that claimants would be subject to some additional costs, but evidently feels that these costs are outweighed by the potential benefits to the investing public by stopping these ongoing frauds. We disagree. Claimants are not in the best position to bear these costs and should not have additional costs imposed on them. Rather, FINRA should seek to impose costs of increased fraud protection on clearing firms and exchanges. These entities are in a better position to identify frauds than individual arbitrators. For instance, clearing firms have access to account statements from each of their customers while an arbitrator will likely only have access to a single customer's account statements. In addition, clearing firms can implement surveillance protocols that an arbitrator will be unable to utilize. Besides having better access to information than individual arbitrators, these entities are also more able to bear the additional costs of increased fraud prevention. Further, they are in a position to identify potential frauds well before the individual claimants have even brought disputes. If FINRA wishes to increase market fraud protections, it should do so by imposing the costs on the entities that are in the best position to implement such protections. Here, it is not individual claimants and arbitrators but, rather, clearing firms and securities exchanges.

FINRA does not clearly define the problem that they are trying to solve with this solution. The Rule Proposal only contains a vague reference to "recent and well publicized frauds that resulted in harm to investors" as justification for the Rule Proposal. It is difficult to predict the effectiveness of a proposal without clearly knowing the problem that it is intended to solve. Without concrete examples, arbitrators may need more guidance in determining the type of matters that FINRA desires to be referred. Further, the language of the rule allows an arbitrator to refer "any matter or conduct . . . which the arbitrator has reason to believe poses a serious threat . . . that is likely to harm investors unless immediate action is taken." Without increased guidance from FINRA, arbitrators are likely to vary in their interpretation of what "poses a serious threat." This may lead to an overabundance of referrals which will impose significant costs on the individual investors.

Further, the Clinic believes that it would be a rare situation that a mid-case referral would actually uncover the kind of ongoing fraud that FINRA alludes to. If the Rule Proposal is directed, as some suggest, at Ponzi schemes, by the time of referral, the scheme would probably already have collapsed and the damage realized. Much more likely is the situation where an arbitrator makes an unmeritorious mid-case referral, thus causing harm to the claimant with none of the benefits that FINRA argues that the proposed Rule would provide.

The Clinic agrees with the comment by Gary Berne that the arbitrative deliberative process and requirement to keep an open mind until all of the evidence and argument is concluded may be at risk by asking arbitrators to search for ongoing fraud. For example, there is nothing in the Rule Proposal that prevents an arbitrator from making a mid-case referral after only hearing the testimony of a single witness. Should an arbitrator be able to reach such a conclusion without hearing all of the evidence from both sides or partial evidence from one side?

Finally, the Clinic would like to address a possible ethical issue that would arise from the proposed Rule. As drafted, the proposed Rule puts a lawyer's duty to his client and his duty to the public good and the law at odds. It is possible that a mid-case referral that results in an investigation by a regulatory body could result in a prevailing claimant being delayed or, possibly, being unable to collect his or her award. When an arbitrator that was on the claimant's side is recused, it is possible that the replacement arbitrator might view the case less favorably, thus resulting in a lessened award or an award for the respondent. Thus, a claimant's attorney who is aware of a serious, ongoing fraud might be incentivized to refrain from presenting evidence of that fraud, at least until near the end of the hearing in order to avoid a mid-case referral. This would frustrate the very purpose of the proposed Rule because the presentation of evidence of ongoing fraud would be delayed, thus negating the head start that FINRA hopes to achieve. Having a mid-case referral can only harm the client, so a lawyer's duty to act in the best interests of the client would prevent him from acting to expose a serious threat.

On balance, the harm that this Rule Proposal could cause to innocent claimants outweighs the potential benefits, if any, that will be had. While detecting serious ongoing fraud is important, it is unfair that so much of the cost will be borne by innocent claimants who are often forced into the arbitration forum, and not the industry party that likely perpetrated the fraud.

Therefore, the Clinic believes that the Rule Proposal should be rewritten to more clearly identify the problem and to shift costs away from innocent claimants rather than merely attempting to minimize them. We thank you again for the opportunity to comment upon this Rule Proposal.

Respectfully submitted,

St. Vincent De Paul Legal Program, Inc.
Securities Arbitration Clinic
St. John's University School of Law
8000 Utopia Parkway
Queens, NY 11439
Tel: (718) 990-6930
Fax: (718) 990-6931

By:

/s/
Ryan Jennings
Legal Intern

/s/
Christian Corkery
Legal Intern

/s/
Daniel Coleman
Legal Intern