

April 24, 2015

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Notice of Filing of a Proposed Rule Change To Amend the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes To Increase The Late Cancellation Fee (File No. SR-FINRA-2015-003); Response to Comments

Dear Mr. Fields:

On February 5, 2015, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and the Code of Arbitration Procedure for Industry Disputes (“Industry Code”) (together, “Codes”) to increase the late cancellation fee. Specifically, the proposed rule change would require that if a postponement or cancellation request is made by one or more parties within 10 days before a scheduled hearing session and granted, the party or parties making the request would pay a fee of \$600 per arbitrator.¹

¹ See Securities Exchange Act Rel. No. 74289 (Feb. 18, 2015), 80 FR 9773 (Feb. 24, 2015) (File No. SR-FINRA-2015-003).

The SEC received 12 comment letters on the proposed rule change.² Their positions break down as follows: five support the proposed rule change;³ five support the goals of the proposed rule change, but suggest modifications;⁴ and two oppose it.⁵ FINRA is hereby responding to the comments received on the proposed rule change.

The commenters who support the proposed increase to the late cancellation fee, do so because they believe that it will assist the forum in its efforts to retain qualified arbitrators willing to devote the time and energy necessary to serve on arbitration panels.⁶ One commenter, who is a FINRA arbitrator, explained that the current \$100 late cancellation fee does not compensate adequately arbitrators for their time spent preparing for a case, and believes the proposed rule change is “a step in the right direction.”⁷ In urging approval of the proposed rule change, the commenters believe that it would provide a financial incentive for parties to begin negotiations and finalize settlements earlier in the process, as well as to provide arbitrators with fair compensation when late cancellations occur.⁸

The commenters who suggest that FINRA modify the proposed rule change or its policies generally support the goals of the proposed rule change.⁹ In expressing support, they note that, by increasing the time within which parties must seek to postpone or cancel a hearing and increasing the per-arbitrator fee for late cancellation, the proposed rule change would justly compensate arbitrators for lost opportunities due to scheduling hearings, and help FINRA recruit and retain a roster of high-quality arbitrators.¹⁰ However, they, along with the GSU Comment, which opposes the proposed rule change,

² Comments on the proposed rule change were submitted by: Steven B. Caruso, Esq., Maddox Hargett Caruso, P.C., February 20, 2015 (“Caruso Comment”); Philip M. Aidikoff, Aidikoff, Uhl & Bakhtiari, February 24, 2015 (“Aidikoff Comment”); George H. Friedman, Esq., George H. Friedman Consulting, LLC, March 1, 2015 (“Friedman Comment”); Ryan K. Bakhtiari, Aidikoff, Uhl and Bakhtiari, March 9, 2015 (“Bakhtiari Comment”); Joseph C. Peiffer, President, Public Investors Arbitration Bar Association (PIABA), March 9, 2015 (“PIABA Comment”); Nicole Iannarone, Assistant Clinical Professor, et al; Georgia State University College of Law Investor Advocacy Clinic, March 13, 2015 (“GSU Comment”); Patrick J. Paul, Student Intern; Elissa Germaine, Supervising Attorney; and Jill Gross, Director; Investor Rights Clinic, Pace Law School, March 16, 2015 (“PACE Comment”); Mark R. Harris, March 16, 2015 (“Harris Comment”); William A. Jacobson, Clinical Professor of Law, Cornell Law School, and Director, Cornell Securities Law Clinic, March 17, 2015 (“Cornell Comment”); Paige M. Szymanski, Law Student Clinician, Michigan State University College of Law, Investor Advocacy Clinic, March 17, 2015 (“MSU Comment”), Leonard Steiner, Steiner & Libo, April 7, 2015 (“Steiner Comment”) and Richard P. Ryder, Editor, Securities Arbitration Commentator, April 7, 2015 (“Ryder Comment”).

³ Caruso Comment, Aidikoff Comment, Friedman Comment, Bakhtiari Comment, and Harris Comment.

⁴ Cornell Comment, MSU Comment, PACE Comment, PIABA Comment and Ryder Comment.

⁵ GSU Comment and Steiner Comment.

⁶ See note 3, *supra*.

⁷ Harris Comment.

⁸ See note 3, *supra*.

⁹ See note 4, *supra*.

¹⁰ *Id.*

believe it could have a disparate impact on investors, particularly those with small claims and *pro se* claimants. In the following discussion, FINRA responds to the commenters' concerns and the suggested modifications they propose to address them.

Exempt Small Claims

Two commenters oppose the proposed rule change because they believe the increased cost of cancellation or postponement could discourage the parties from settling their claims and encourage them instead to arbitrate the claims.¹¹ To protect the interests of small investors, the GSU Comment suggests that FINRA create an exception to the proposed rule change for investors with claims of \$100,000 or less.¹² The Ryder Comment suggests that the proposed rule change should exempt claims of \$50,000 or less.

FINRA notes that claims of \$50,000 or less are subject to the simplified arbitration procedures,¹³ which means they are decided by one arbitrator on the pleadings¹⁴ submitted. This means that no hearings would be held; thus, the late cancellation fee would not apply. The simplified arbitration rules, however, permit customers who have claims of \$50,000 or less to request a hearing.¹⁵ If customers request a hearing, the late cancellation fee would apply, if the parties miss the deadline for requesting a postponement or cancellation of a scheduled hearing. Thus, under the Codes, customers with small claims of \$50,000 or less would be exempted from the proposed increase to the late cancellation fee, unless the customer requests that the case be decided at a hearing.

Further, as the GSU Comment notes, FINRA acknowledged that customers would be likely to pay some of the increased Late Cancellation Fee under the proposed rule change.¹⁶ FINRA indicated that the proposed rule change might have an effect on settlement negotiations, especially if the potential settlement amount is small compared to the Late Cancellation Fee.¹⁷ FINRA believes, however, that exempting claims of \$100,000 or less would not address the primary goal of the proposed rule change, which is to encourage parties to change their behavior. The commenter explains that "many matters settle on the eve of arbitration."¹⁸ When this happens, the current \$100 fee does not compensate adequately arbitrators for time spent preparing for a hearing or other opportunities foregone because of the time set aside to hear the case, regardless of the size of the claim. Thus, FINRA believes the proposed rule change should apply to all arbitration cases that have hearings scheduled.

¹¹ See note 5, *supra*.

¹² GSU Comment.

¹³ Rules 12800 and 13800.

¹⁴ A pleading is a statement describing a party's causes of action or defenses. Rules 12000(s) and 13000(s).

¹⁵ Rules 12800(c)(1) and 13800(c)(1).

¹⁶ See note 1, *supra* at 9775.

¹⁷ *Id.*

¹⁸ GSU Comment.

For claims of \$100,000 or less, FINRA appoints a single arbitrator, so, under the proposed rule, the late cancellation fee to be charged to the parties collectively would be \$600, and would be passed through to the arbitrators as is currently the case.¹⁹ FINRA notes, however, that the Codes provide parties with some cost mitigation options, regardless of their claim amount. Under the proposed rule change, parties would avoid the late cancellation fee by providing notice of a cancellation 10 or more days prior to the first scheduled hearing session.

If providing notice 10 or more days before a scheduled hearing is not possible, then a party may be able to avoid or possibly reduce the amount of the fee assessed. The arbitrators will allocate the fee equally among the parties, if the parties' settlement agreement does not address the fees.²⁰ So, for claims of \$100,000 or less, the customer could be assessed a half of the proposed late cancellation fee of \$600, which would be \$300. If one party waits until the eve of an arbitration hearing to begin settlement negotiations in earnest ("delaying party"), the party who is not the cause of the delay ("non-delaying party") can negotiate with the delaying party to pay all of the fee or a higher percentage thereof. Further, if the delaying party does not agree to assume the costs, arbitrators have the authority, under the Codes, to allocate all or portion of the per-arbitrator fee to the party or parties that caused or contributed to the need for the cancellation²¹ or postponement.²² This authority would not change under the proposed rule change.

Finally, the Codes permit the panel to waive the late cancellation fee, in the event that an extraordinary circumstance prevents a party or parties from making a timely postponement request.²³ This authority would not change under the proposed rule change.

For the reasons provided, FINRA declines to amend the proposed rule change to exempt claims of \$100,000 or less as suggested.

Eliminate Cost to Claimants in Event of Settlement

The PIABA Comment suggests that FINRA modify the proposed rule change so that customer claimants would not incur any additional costs in the event of a late settlement. The commenter contends that the customer claimant does not possess the same financial resources that member firms do and customer claimants do not control when the member firms will begin to consider settlement.²⁴

In 2014, the Commission approved amendments to the Codes that increased certain arbitration filing fees, member surcharges and process fees, and hearing session

¹⁹ See note 16, *supra*.

²⁰ Rules 12701(b) and 13701(b).

²¹ Rules 12902(d) and 13902(d).

²² Rules 12601(b)(2) and 13601(b)(2).

²³ *Id.*

²⁴ PIABA Comment.

fees for the primary purpose of increasing arbitrator honoraria.²⁵ To implement the honoraria increases, FINRA allocated a large portion of the arbitration fee increases to members by significantly increasing member surcharges and process fees.²⁶ These fees are imposed only on members and cannot be allocated to other parties.²⁷ In addition to these fees, member firms that are parties in an arbitration could incur filing fees, hearing session fees as well as other fees, such as late cancellation fees. When these fees are combined, member firms are currently paying significantly more than customers to facilitate the administration of arbitration claims in the forum.

In proposing the changes to the late cancellation fees, FINRA adhered to its philosophy that the cost of arbitration should be borne by the users of the forum. As customers or FINRA members may seek to postpone or cancel a hearing, FINRA believes it would be inequitable to presume that industry members should pay 100 percent of the proposed late cancellation fee. FINRA believes that customers and FINRA members benefit from the forum attracting and retaining qualified, dedicated arbitrators to decide their cases, and they should share in the effort to sustain and improve the forum. As described earlier, arbitrators have the power to re-allocate responsibility for the fees, if warranted. For these reasons, FINRA declines to amend the proposed rule change to shift the cost of the proposed late cancellation fees to FINRA members only.

Create Presumption that Only Members Would Pay Late Cancellation Fee

The Cornell Comment argues that the proposed increase to the late cancellation fee could undermine FINRA's objective of providing an affordable method to resolve disputes. To support this contention, the commenter suggests that the proposed rule change create a rebuttable presumption that either the member firm or associated person would pay the proposed late cancellation fee, unless the arbitrators determine that customer caused the need for the postponement.²⁸

FINRA does not believe that the proposed late cancellation fee would significantly affect the affordability of the dispute resolution forum for investors. The fee per party would range from \$300 (½ of \$600) in smaller claims to \$900 (½ of \$1,800) for claims of \$100,000 or more.²⁹ FINRA also notes that investors experience substantial savings in arbitration compared to litigation.³⁰ For example, claims in arbitration are typically resolved more quickly than claims in litigation, largely due to limits on discovery. In arbitration, investors avoid the expense of depositions and similar costs associated with discovery in litigation. Moreover, in arbitration, there are no delays or costs associated

²⁵ See Securities Exchange Act Rel. No. 73245 (Sept. 29, 2014), 79 FR 59876 (Oct. 3, 2014) (File No. SR-FINRA-2014-026) (Order Approving Amendments to Codes to Increase Arbitrator Honoraria and Increase Certain Arbitration Fees and Surcharges).

²⁶ *Id.* at 59879

²⁷ *Id.* See, e.g., Rules 12901(a)(4) and 12903(c).

²⁸ Cornell Comment.

²⁹ See Rule 12401. The fee per party would depend on the number of arbitrators who decide a case.

³⁰ See FINRA, Arbitration & Mediation, What to Expect, at <http://www.finra.org/web/groups/industry/@ip/@edu/documents/education/p117486.pdf>.

with appeals. Attacks on awards are rare and are based on narrow grounds under the Federal Arbitration Act.³¹ For these reasons, FINRA believes that the benefits and cost savings of arbitration make filing an arbitration claim a less costly option for investors, notwithstanding the potential costs of the proposed late cancellation fee.

While customers could pay some of the proposed late cancellation fee, the proposed rule change would permit parties to avoid the fee by providing notice 10 days before a scheduled hearing. In addition, the Codes provide parties with some mitigation strategies to use to potentially reduce the amount of the fee assessed.³² FINRA notes that the objective of the proposed rule change is not to penalize parties, but to create a more fair and efficient arbitration process for all participants. Under the current rules, late cancellations cause arbitrators to lose time spent preparing for a hearing, other work opportunities and anticipated honorarium from now-cancelled hearing sessions. The \$100 per-arbitrator fee does not adequately compensate them for these losses. FINRA has learned that the current rule raises concerns among arbitrators about continuing to serve as arbitrators in the forum. This sentiment could lead to a reduction in arbitrator rosters, which would ultimately increase parties' costs if the cause of this arbitrator dissatisfaction is not remedied.

Finally, FINRA believes that it would be unfair to create a presumption that either the member firm or associated person would pay the proposed late cancellation fee. This suggestion assumes that members are always the party in an arbitration that creates the need for a postponement or cancellation. There have been instances, however, in which customers have created the need for and requested a postponement. Further, customers and FINRA members use the arbitration forum to resolve their disputes, and, thus, benefit from the forum's ability to attract and retain qualified, dedicated arbitrators to decide their cases. FINRA believes, therefore, that it would be inequitable for industry members to pay 100 percent of the proposed late cancellation fee.

For these reasons, FINRA declines to modify the proposed rule change to create a presumption that member firms and associated persons pay the proposed late cancellation fee as suggested.

³¹ An award may be vacated upon the application of any party to the arbitration—

- (1) where the award was procured by corruption, fraud, or undue means;
- (2) where there was evident partiality or corruption in the arbitrators, or either of them;
- (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy, or of any other misbehavior by which the rights of any party have been prejudiced; or
- (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

See 9 U.S.C. §10(a).

³² See discussion under "Exempt Small Claims," supra.

Create Late Cancellation Fee Tiers

The GSU and Cornell Comments suggest that FINRA amend the proposed rule change to create separate tiers of late cancellation fees. Under their proposed modifications, the more notice that the parties give to postpone or cancel a hearing the smaller the late cancellation fee.³³

FINRA believes the proposed suggestion could be confusing for parties to understand and could make the proposed rule more complex and time-consuming for staff to implement. In addition, the use of fee tiers could lead to inaccurate fee assessments and create an added burden on staff resources to correct errors. Moreover, FINRA does not believe fee tiers would provide enough of an incentive to encourage parties to change their behavior, as explained previously.³⁴

Further, if the SEC approves the proposed rule change, incorporating the suggestion could delay implementation of the rule. Upon approval, FINRA would re-program its technology platforms to implement the changes. FINRA believes the additional timeframes and associated fees would make this re-programming more complicated, which could delay implementation.

The Ryder comment suggests that, if a customer with a claim of \$50,000 or less requests a hearing and then cancels it within the proposed 10-day cancellation period, the fees that FINRA would collect for a late cancellation would exceed the honorarium paid to the arbitrator.

FINRA would like to clarify any misperception that FINRA collects more in fees than it pays in honoraria to an arbitrator when a customer with a claim of \$50,000 or less requests a hearing that is later cancelled or postponed. Under the Codes, when a customer with a claim of \$50,000 or less requests a hearing,³⁵ FINRA pays arbitrators regular hearing session honoraria pursuant to Rule 12214. If a party in a dispute of \$50,000 or less postpones or cancels a hearing, the arbitrator receives no payments for the hearing sessions the arbitrator set aside. However, if a party postpones or cancels a hearing late, the late cancellation fee is charged to the parties collectively and that amount is passed through to the arbitrator. The proposed rule change would increase the cancellation period and the late cancellation fee, and it would continue to pass the entire late cancellation fee of \$600 through to the arbitrator.³⁶

The Ryder comment contends that, when a customer with a claim of \$50,000 or less requests a hearing that is cancelled late, FINRA should limit the fees for a late cancellation to the postponement fee only. FINRA believes the Ryder suggestion would create an added administrative burden for staff, as it would create a two-tiered fee schedule, which, for reasons stated previously, FINRA would like to avoid. FINRA notes

³³ GSU Comment and Cornell Comment.

³⁴ See discussion under "Exempt Small Claims," supra.

³⁵ When the customer requests a hearing, the arbitrator would not receive the \$350 honorarium under the simplified arbitration rules; this honorarium is paid only when an arbitrator decides the case on the papers. See Rules 12800(f) and 13800(f).

³⁶ See note 19, supra.

that, if the cost mitigation options discussed previously³⁷ prove unsuccessful, the customer could request that the panel waive the proposed late cancellation fee.³⁸ If the panel declines the request, FINRA could also waive the late cancellation fee.³⁹ A waiver of the fee by the panel or by FINRA would not affect payment of the honorarium.⁴⁰

FINRA believes, therefore, that one timeframe and one fee would be easier to understand, implement and apply. Thus, FINRA declines to incorporate separate fee tiers into the proposed rule change as suggested.

Arbitrators' Conflict of Interest

Three commenters express concern that the proposed late cancellation fee would create a conflict of interest for arbitrators when they would be required to decide whether to waive the fee in the event of extraordinary circumstance.⁴¹ The commenters suggest that arbitrators might deny the waiver request to ensure that they receive the increased fee.⁴² They also suggest that FINRA should guarantee that arbitrators would receive the fee in the event that they grant a waiver request.⁴³

Under the Codes, a panel may waive the late cancellation fee, in the event that an extraordinary circumstance prevents a party or parties from making a timely postponement request.⁴⁴ This authority would not change under the proposed rule change. Currently, it is the forum's policy to pay arbitrators the fee they would have received in the event the panel waives the late cancellation fee for the parties.⁴⁵ This policy will not change under the proposed rule change.

Additional Arbitrator Training

The PIABA Comment also suggests that FINRA provide additional arbitrator training on the types of extraordinary circumstances and verification that would be appropriate for the panel to waive assessment of the proposed late cancellation fee. The commenter suggests that arbitrators should be reminded that the rules permit them to excuse a late cancellation so that the requesting party would not be assessed a fee.⁴⁶

FINRA notes that it has not received any complaints from parties about arbitrators failing to waive late cancellation fees in the event of extraordinary circumstances. When

³⁷ See discussion under "Exempt Small Claims," *supra*.

³⁸ See Rules 12601(b)(3) and 13601(b)(3).

³⁹ Under the Codes, either the Director or the staff to whom the Director has delegated authority would have discretion to waive the fee. See Rules 12601(b)(3) and 13601(b)(3).

⁴⁰ See note 45, *infra*.

⁴¹ PIABA Comment, MSU Comment, and Cornell Comment (citing support for this issue raised by the PIABA Comment).

⁴² *Id.*

⁴³ *Id.*

⁴⁴ See Rules 12601(b)(2) and 13601(b)(2).

⁴⁵ See Securities Exchange Act Rel. No. 49545 (April 8, 2004), 69 FR 19887 (April 14, 2004) (File No. SR-NASD-2003-164) (Notice of Filing by NASD, Inc. Relating to the Adjournment of a Hearing Within Three Business Days of the First Scheduled Hearing Session), at 19889.

⁴⁶ PIABA Comment.

the Commission approved the three-day adjournment rule in 2004,⁴⁷ FINRA stated in *Notice to Members 04-53* that “there are some extraordinary circumstances that could prevent a party from making an adjournment request in time to avoid the additional fee assessment (e.g., a serious accident or a sudden severe illness).⁴⁸ This guidance would not change if the Commission approves the proposed rule change.

In keeping with current practice, however, if the Commission approves the proposed rule change, FINRA would review the applicable arbitrator training modules and scenarios and update them, where necessary. Moreover, FINRA would publish a *Regulatory Notice*,⁴⁹ which would explain how the rule would be applied, including any changes to the examples of what FINRA considers “extraordinary circumstances.”

Educate *Pro se* Claimants about Late Cancellations

Three commenters⁵⁰ express concern that the proposed rule change may harm small investors who choose to represent themselves (hereinafter referred to as “*pro se* claimants”) in the forum. The commenters suggest that FINRA provide additional education to these *pro se* claimants, so that they would be aware of the fee and the deadline by which they would be required to cancel or postpone the scheduled hearing to avoid the fee.⁵¹ The MSU Comment suggests that FINRA notify *pro se* claimants with claims under \$100,000 by letter 30 days before the scheduled hearing to inform the party of the fee and 10-day cancellation period.

FINRA believes that all parties should be reminded of the changes to the late cancellation rule, so that they are aware of the ramifications of postponing or cancelling a scheduled hearing inside of the proposed cancellation period. Thus, if the Commission approves the proposed rule change, in addition to publishing a *Regulatory Notice*,⁵² FINRA would train the arbitrators to advise the parties at the initial prehearing conference⁵³ (“IPHC”) of the 10-day deadline and the late cancellation fee that would be assessed if they request postponement or cancellation inside of the cancellation period. Further, FINRA would instruct the arbitrators to include this reminder in the IPHC

⁴⁷ See Securities Exchange Act Release No. 49716 (May 17, 2004), 69 FR 29342 (May 21, 2004) (File No. SR-NASD-2003-164) (Order Approving the Adjournment of an Arbitration Hearing Within Three Business Days of the First Scheduled Hearing Session).

⁴⁸ See FINRA, *Notice to Members 04-53* (Arbitration Hearing Adjournments), July 2004, <http://www.finra.org/sites/default/files/NoticeDocument/p006140.pdf>.

⁴⁹ *Notices to Members* are now referred to as *Regulatory Notices*. In most cases, FINRA will publish a *Regulatory Notice* after the Commission approves a proposal to inform parties, member firms and associated persons about the rule and to explain how the rule would be applied.

⁵⁰ PIABA Comment, PACE Comment (citing support for this issue raised by the PIABA Comment), and MSU Comment.

⁵¹ *Id.*

⁵² See note 49, *supra*.

⁵³ After the panel is appointed, the Director will schedule an initial prehearing conference for the parties and panel to meet to schedule the hearing dates, set a discovery schedule and provide a list of possible motions, for example. See Rules 12500 and 13500.

Scheduling Order⁵⁴ so that the parties would know at the outset of the case when the cancellation period starts and could prepare and plan their case accordingly.

* * * *

FINRA believes that the foregoing responds to the issues raised by the commenters. If you have any questions, please contact me on 202-728-8151 or mignon.mclemore@finra.org.

Sincerely,

/mm/

Mignon McLemore
Assistant Chief Counsel
FINRA Dispute Resolution, Inc.

⁵⁴ After the IPHC, the panel will issue a scheduling order to the parties. The order re-caps, among other things, the dates for case milestones, issues that would need briefing, and other procedures to which the parties have agreed. See FINRA, Arbitration & Mediation, Forms & Tools, Initial Prehearing Conference Scheduling Order, <http://www.finra.org/sites/default/files/IPHC%20Scheduling%20Order%20FINAL%202%2023.pdf>.