

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-85063; File No. SR-FINRA-2019-004)

February 6, 2019

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Expand Time for Non-Parties to Respond to Arbitration Subpoenas and Orders of Appearance of Witnesses or Production of Documents

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 29, 2019, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend FINRA Rule 12512(d) through (e) and FINRA Rule 12513(d) through (e) of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and FINRA Rule 13512(d) through (e) and FINRA Rule 13513(d) through (e) of the Code of Arbitration Procedure for Industry Disputes (“Industry Code” and together, “Codes”), to expand time for non-parties to respond to arbitration subpoenas and orders of appearance of witnesses or production of documents, and to make related changes to enhance the discovery process for forum users.

The text of the proposed rule change is available at the principal office of FINRA, on FINRA’s website at <http://www.finra.org>, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Introduction

The proposed rule change would amend FINRA Rules 12512, 12513, 13512 and 13513 that govern procedures for non-parties to object to subpoenas and for non-parties to object to arbitrator orders of appearance of witnesses or production of documents. The proposed rule change would help ensure that non-parties wanting to object to an order or subpoena have sufficient time to do so. The proposal will also make related changes to enhance the discovery process for forum users.

Background

In arbitration, the parties exchange documents and information to prepare for the arbitration through the discovery process. The Codes currently provide that parties in FINRA arbitration who seek discovery from a non-party may request the panel to issue: (1) an order of appearance of witnesses or production of documents if the non-party is subject to FINRA's jurisdiction as an associated person or member firm or (2) a subpoena if the non-party is not

subject to FINRA's jurisdiction.³ If the panel decides to issue the order or subpoena, FINRA will transmit the signed order or subpoena to the moving party to serve on the non-party. If a non-party receiving an order or a subpoena objects to the scope or propriety of the order or subpoena, the non-party may, within 10 calendar days of service of the order or subpoena, file written objections through the Director of the Office of Dispute Resolution (Director).

Concerns about Current Subpoena and Order Rules for Non-Parties

Forum users have raised concerns that the amount of time that non-parties have to respond to orders and subpoenas is insufficient.⁴ Since non-parties do not have access to the Dispute Resolution Party Portal (Party Portal),⁵ they are currently served using other means (first-class mail, overnight mail service, overnight delivery service, hand delivery, email or facsimile). Recipients of orders and subpoenas reported that the individual at a non-party firm who is responsible for responding to an order or subpoena (*e.g.*, legal staff) may not actually receive a copy of the order or subpoena through internal processes until after the tenth day from service has passed, thereby causing the non-party firm to risk waiving its ability to timely object to the order or subpoena.⁶ As a non-party to the arbitration, a firm is not able to anticipate the

³ See Rules 12512 and 12513. See also Rules 13512 and 13513.

⁴ See, *e.g.*, Letter from Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Jennifer Piorko Mitchell, Vice President and Deputy Corporate Secretary, FINRA, dated June 2, 2017 (responding to FINRA's March 2017 Special Notice on FINRA's engagement programs), www.finra.org/sites/default/files/notice_comment_file_ref/SN-32117_SIFMA-KevinCarroll_comment.pdf.

⁵ The Party Portal provides arbitration forum users with a secure, online location for claim filing and interactions relating to case administration. Parties use the Party Portal to, among other things, file claims, pay filing fees, receive documents from and send documents to FINRA, receive service of claims, submit answers to claims, submit additional case documents, view the status of cases, select arbitrators, schedule hearings and send documents to other Party Portal case participants.

⁶ See *supra* note 4.

arrival of an order or subpoena and instruct front line employees (*e.g.*, receptionists or mail room personnel) to route these high priority documents to the appropriate individual responsible for responding to the discovery request. Once the objection to an order or subpoena is waived, the non-party must respond to the order or subpoena or risk incurring sanctions or disciplinary action.⁷ Forum users have also raised concerns that the use of first-class mail is not an ideal option in discovery because it is slow. For these reasons, FINRA seeks to offer sufficient time for non-parties to provide the order or subpoena to the appropriate individual who would respond to the discovery request.

Proposed Rule Change

FINRA is proposing three amendments to the Codes to enhance the discovery process for forum users, particularly non-parties. First, FINRA is proposing to amend the Codes to extend the response time for non-parties to object to an order or subpoena from 10 calendar days of service to 15 calendar days of receipt of the order or subpoena. Receipt of overnight mail service, overnight delivery service, hand delivery, email or facsimile is accomplished on the date of delivery. FINRA believes that the proposed rule change would address forum users' concerns because the proposal would help ensure that non-parties wanting to object to an order or subpoena have sufficient time to do so.

Second, FINRA is proposing to amend the Codes to exclude first-class mail as an option to serve documents on the non-party and as an option for the non-party to file the objection to the scope or propriety of the order or subpoena.⁸ FINRA believes that by requiring forum users to

⁷ See Rules 12212 and 12511. See also Rules 13212 and 13511.

⁸ Filing and service by first-class mail is accomplished on the date of mailing, but it can take several days to confirm receipt. For purposes of this rule proposal, service by overnight mail, overnight delivery, hand delivery, facsimile or email is accomplished on the date of delivery.

serve or transmit discovery-related documents through overnight mail service, overnight delivery, hand delivery, email or facsimile, forum users are better able to confirm and facilitate the timing of discovery obligations.

Third, FINRA is proposing to amend the Codes to codify the current practice that the Director sends, at the same time, objections and responses to the panel after the reply date has elapsed, unless otherwise directed by the panel. The Director sends the complete set of motion papers to the panel to ensure that the panel receives the advocacy positions of all parties at the same time. FINRA believes that the proposed rule change will enhance forum users' understanding of existing case administration procedures and will improve transparency concerning forum operations.⁹

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be no later than 30 days following publication of the Regulatory Notice announcing Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁰ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. FINRA believes that the proposed rule change would enhance the discovery process for forum users by giving

⁹ FINRA notes that the proposed rule change would impact all members, including members that are funding portals or have elected to be treated as capital acquisition brokers ("CABs"), given that the funding portal and CAB rule sets incorporate the impacted FINRA rules by reference.

¹⁰ 15 U.S.C. 78o-3(b)(6).

non-parties additional time to respond to subpoenas and orders. Further, the proposed rule change addresses forum users' concerns on delays with first-class mail and would enhance their ability to confirm and facilitate the timing of discovery obligations. FINRA further believes that the proposed amendments would also enhance the user experience at the forum by standardizing certain procedures relating to subpoenas and orders and will improve transparency concerning forum operations.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. A discussion of the economic impacts of the proposed rule change follows.

Economic Impact Assessment

FINRA staff has undertaken an economic impact assessment, as set forth below, to analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how to best meet its regulatory objectives.

(a) Regulatory Need

Under the Codes, non-parties to an arbitration have a limited amount of time to object to an order or subpoena. Parties and non-parties may also use options to transmit or serve documents that are slow, further hindering the ability of non-parties to timely object.¹¹ This could cause non-parties to inadvertently waive their ability to timely object. Non-parties for whom the objection process would be valuable could incur costs associated with this outcome.

¹¹ See supra note 7.

(b) Economic Baseline

The economic baseline for the proposed amendments are the Codes that address the length of time for non-parties to respond to arbitrators' orders and subpoenas. The economic baseline also includes the Codes that address the options for parties and non-parties to serve or transmit documents. The proposal is expected to affect non-parties and parties to an arbitration.

Although FINRA does collect information describing orders and subpoenas, FINRA does not collect information specifically identifying orders or subpoenas to non-parties. The frequency in which parties currently request arbitrators to issue orders or subpoenas to non-parties, and whether non-parties respond or object, is therefore not available. Information is also not available to describe the frequency in which non-parties inadvertently waive their ability to timely object to an order or subpoena.

(c) Economic Impact

The proposed amendments would extend the response time for non-parties to object to an order or subpoena. The proposed amendments would also exclude first-class mail as an option to transmit or serve documents. The benefits and costs of the proposed amendments are discussed below.

The proposed amendments may benefit non-parties when responding to orders and subpoenas. The proposed amendments would increase the amount of time for non-parties to formulate sound objections and file these objections with the Director and requesting party. Further, non-parties that are able to timely object as a result of the proposed amendments, and

that receive a ruling in their favor, would not incur the costs associated with the release of proprietary or non-public information.¹²

The proposed amendments, however, may impose costs on requesting parties. Non-parties that are able to timely object as a result of the proposed amendments, and that receive a ruling in their favor, would not appear as a witness or produce documents. Requesting parties that would otherwise receive the information may be less able to present a case in arbitration and receive an award in their favor. This potential cost, however, is dependent on whether the information would have affected the arbitrators' award decision.¹³

The proposed amendments may have countervailing effects on the efficiency of the arbitration forum. The increase in the amount of time for non-parties to respond may lengthen the discovery phase of the arbitration proceedings, and therefore the amount of time until the resolution of the dispute. The exclusion of first-class mail as an option to transmit or serve documents, however, may increase the speed of delivery as well as the ability of parties to determine the sequence and timing of discovery. Whether the forum becomes more or less efficient as a result of the proposed amendments is dependent on the number of additional days non-parties take to file an objection to an order or subpoena, as well as the extent to which parties and non-parties transition to more efficient means of communication.

¹² See supra note 4. The letter notes the potential release of “proprietary, competitively-sensitive, or non-public personal information” as a result of the inability of non-parties to timely object to an order or subpoena. Non-parties would also not incur the costs to appear as a witness or to produce documents that are in excess of the reasonable amount paid as reimbursement by the requesting party.

¹³ If arbitrators rule in favor of non-parties with respect to the scope or propriety of the order or subpoena, then the information would not likely increase the ability of the requesting parties to present a case in arbitration and receive an award in their favor. Requesting parties, however, would not incur the costs of non-parties to appear as a witness or to produce documents.

The proposed amendments may also have additional economic impacts. For example, the exclusion of first-class mail may impose additional costs on parties and non-parties that transition to a different, more-expensive option to transmit or serve documents. The proposed amendments would also codify the current practice whereby FINRA holds all documents from objections and responses to orders or subpoenas before sending them at one time after the reply date has elapsed (unless otherwise directed by the panel). FINRA does not believe, however, that any economic impact from the clarification of procedures would be material.

(d) Alternatives Considered

The alternatives considered to the proposed amendments include not extending the response time for non-parties to object to an order or subpoena, or extending the response time but for a different number of days. Other alternatives considered include not excluding first-class mail as an option for transmitting or serving documents, or excluding different options.

FINRA considered the benefits to non-parties from extending the response time to object to an order or subpoena with the potential increase in the amount of time for discovery. FINRA also considered the benefits from excluding options to transmit or serve documents with the costs of reducing the number of options. FINRA believes that the proposed amendments increase the ability of non-parties to timely object to an order or subpoena, as well as the efficiency of the discovery process, while minimizing the potential costs to parties and non-parties.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds

such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2019-004 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2019-004. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those

that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2019-004 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Eduardo A. Aleman
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).