

**BRUNELLE & HADJIKOW, P.C.**

ATTORNEYS AT LAW  
39 BROADWAY - 33<sup>RD</sup> FLOOR  
NEW YORK, NEW YORK 10006  
TEL. (212) 809-9100 - FAX (212) 809-3219

GEORGE BRUNELLE  
ANNA HADJIKOW

JOHN LEONARD (Of Counsel)

SENDER'S EMAIL:  
gbrunelle@brunellelaw.com

July 19, 2016

Brent J. Fields, Esq., Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Re: Rulemaking Petition Regarding Complex Securities Arbitrations  
Pursuant to Rule 192(a) of the Rules of Practice of the SEC

Dear Mr. Fields:

Pursuant to Rule 192(a) of the SEC's Rules of Practice and Section 19(c) of the Securities Exchange Act, 15 U.S.C. § 78s(c), we submit the following Rulemaking Petition with regard to complex securities arbitrations conducted under the sponsorship of the Financial Industry Regulatory Authority ("FINRA").

**PETITIONER'S INTEREST IN THE MATTER**

For more than three decades, our firm has been engaged in representing brokerage firms and their associated persons in complex securities arbitrations, primarily but not exclusively before FINRA and its predecessor organizations. We have observed procedural weaknesses that increase the cost and reduce the efficiency and fairness of that process, and in this Petition we describe the most important of the weaknesses and propose SEC rulemaking action, pursuant to Section 19(c) of the Securities Exchange Act, to correct these weaknesses.

**BACKGROUND**

FINRA, through its subsidiary, FINRA Dispute Resolution, handles nearly all of the securities-related arbitrations in the United States. *See* [www.finra.org/AboutFINRA/WhatWeDo](http://www.finra.org/AboutFINRA/WhatWeDo), ¶ 5. In most instances, arbitration is mandatory for securities-related disputes when they involve a FINRA member or its associated persons, not only between or among themselves, but in disputes with their customers, pursuant to "a national policy favoring arbitration." *Schnabel v. Trilegiant Corp.* 697 F.3d 110, 118 (2d Cir. 2012), *codified in* the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* and in FINRA Rule 13200.

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The SEC oversees this process pursuant to Section 19 of the Securities Exchange Act, 15 U.S.C. § 78s (the “Act”); see GAO, *Securities Regulation: Opportunities Exist to Improve SEC’s Oversight of the Financial Industry Regulatory Authority* at pp. 7 & 10 (May 2012) (the “GAO Report”), available at <http://www.gao.gov/assets/600/591222.pdf>, and has the authority to create new Rules to improve the process, pursuant to Section 19(c) of the Act, 15 U.S.C. § 78c(b) & 78(c):

**(c) Amendment by Commission of rules of self-regulatory organizations.** The Commission, by rule, may abrogate, add to, and delete from (hereinafter in this subsection collectively referred to as “amend”) the rules of a self-regulatory organization (other than a registered clearing agency) as the Commission deems necessary or appropriate to insure the fair administration of the self-regulatory organization, to conform its rules to requirements of this chapter and the rules and regulations thereunder applicable to such organization . . .

### OBSERVATIONS AND PROPOSALS

The following comments reflect our experiences in complex arbitrations and represent common problems in almost any complex proceeding before FINRA Dispute Resolution.

- 1. The duration of arbitration proceedings should be better controlled by FINRA and monitored by the SEC. Proceedings of unusual length should be reviewed to improve the system’s efficiency and fairness.**

In FINRA arbitrations, arbitrators normally set their own schedules, with little or no scheduling control by FINRA staff members. As a result, in complex cases, hearings tend to be conducted episodically, sometimes over a period of years, in groups of two- and three-day sessions separated by a month or more. The intermittent scheduling substantially increases costs, including legal expenses, by requiring repetitive preparation for each group of hearing sessions. In addition, much time, effort and money is needlessly spent coping with the loss of continuity in witness testimony.

As a result, disputes that can and should be resolved in a few months take more than a year, and sometimes several years. Despite arbitration’s reputation for being cheaper and faster than litigation, FINRA arbitrations can be many times more expensive and time-consuming. To the extent this happens because arbitrators cannot, or will not, devote the time needed for a more compact hearing schedule, the problem can and should be addressed through regulatory action.

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Proposal:

- (1) The SEC should adopt a program of monitoring the length of time involved in arbitration proceedings from commencement to completion.
  - (2) For any proceeding that has been in progress for more than a year, FINRA should be required to report to the SEC the reasons for this expenditure of time, and the steps being taken either to conclude the matter if it is still in progress, or to prevent similar delays in future cases if the matter has already been concluded.
  - (3) In complex cases, specially trained FINRA staff members should be assigned to determine, before the proceeding begins, that the selected arbitrators can and will devote the time needed to conduct the hearing efficiently and continuously. When an arbitrator fails to fulfill such a commitment, the rules should permit the arbitrator to be replaced without interruption or repetition in the arbitration hearing.
2. **Motion practice relating to discovery in complex arbitrations should be monitored by FINRA staff members, to control costs, advise arbitrators on electronic discovery, and deter discovery noncompliance.**

Noncompliance with FINRA discovery Rules deprives parties of their right to a fair hearing, and it is the greatest source of unnecessary expense in these proceedings.

When noncompliance occurs, parties typically file a series of motions to compel production. In many instances, panelists require each motion to be made in writing, and require multiple sets of papers for each motion, including the initial motion, an answer to the motion, and a reply to the answer. When a ruling and order by the arbitrator(s) emerges from this process, the parties do not necessarily comply with it, or they may do so incompletely or improperly, and this prompts further motion practice and additional expense.

FINRA Rule 13503(a) allows a party to choose whether to file motions orally or in writing, expressing no preference for one over the other, and provides no limitation on the number, subject matter or frequency of motions. While silent about how or when oral motions should be made, the Rule provides detailed requirements for written motions, motion answers and replies to motion answers, implicitly establishing written motions as the norm. Meanwhile, FINRA's Rules and procedures do not effectively deter abusive motion practice.

Even when successful motions have made to compel discovery, and the motion was opposed frivolously, FINRA Rules do not require sanctions, but merely *permit* them [FINRA Rule 31212]. *Potential* sanctions include dismissal of the case [FINRA Rule 13504(e) and 13212(c)], monetary sanctions [FINRA Rule 13511, 13212(a)] and, at the end of the case, a disciplinary referral [FINRA Rule 13212(b)]. But arbitrators rarely exercise this authority,

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because it detracts from their perceived impartiality. For reasons that are less obvious, disciplinary actions initiated by FINRA staff members are also rare.

Among the most common occasions of noncompliance with FINRA discovery rules are, (a) deficient electronic discovery; (b) improper claims of confidentiality or privilege; and (c) illegible or unsearchable production, including obstacles erected, sometimes intentionally, against reading or searching large quantities of e-mail traffic that has been produced in illegible or unsearchable formats.

Arbitrators' reluctance to impose discovery sanctions can also be a product of inexperience. Although FINRA arbitrators are often lawyers, they may not have practiced law recently, or if they have, their practice may not have involved litigation, or if it did, it may not have involved recent experience with e-discovery. In short, many arbitrators lack the knowledge, experience and skill to anticipate, avoid and manage discovery problems, especially those involving electronic discovery. FINRA *does* have these resources, but does not dedicate them to the arbitration process. FINRA's Enforcement Department, for example, employs lawyers with extensive experience in discovery, including e-discovery, but FINRA attorneys with that experience are not assigned to assist FINRA arbitrators.

In fact, FINRA's Rule 13501(b) does not even require the arbitrators to address these issues, but merely *permits* them to do so: "At a party's request, or at the discretion of the panel, the panel *may* schedule one or more additional prehearing conferences regarding any outstanding preliminary matters, including: discovery disputes; motions; witness lists and subpoenas; stipulations of fact; unresolved scheduling issues; contested issues on which the parties will submit briefs; and any other matter that will simplify or expedite the arbitration." (Emphasis added.)

Proposals:

**(a) E-discovery issues should be addressed and resolved in prehearing conferences.** FINRA's rules should require, as an amendment to FINRA Rules 13500 and 13501, that the Initial Prehearing Conference and subsequent prehearing conferences include a detailed framework for electronic discovery. The required topics should include, at a minimum:

- the date range and permitted topics of discovery,
- the format and computer search terms to be used for electronic discovery,
- the permitted format(s) for production (paper, pdf, pst, etc.),
- a requirement that documents produced be legible and searchable,
- procedures for document identification (e.g., pre-marking with bates numbers),
- a schedule for the prehearing resolution of evidentiary issues,
- a deadline for required stipulations of evidentiary admissibility,
- a deadline for required stipulations of fact to avoid unnecessary witnesses and witness testimony,

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- arrangements for the allocation among parties of discovery costs,

To be most efficient, these procedures should emulate those of the Federal and State Courts, such as the “Checklist for Rule 26(f) Meet and Confer Regarding Electronically Stored Information” (US District Court, Northern District of Cal., December 1, 2015), *available at* [https://webcache.googleusercontent.com/search?q=cache:RTPGzNAZdtYJ:https://www.cand.uscourts.gov/filelibrary/1118/ESI\\_Checklist-12\\_-1-2015.pdf+&cd=1&hl=en&ct=clnk&gl=us](https://webcache.googleusercontent.com/search?q=cache:RTPGzNAZdtYJ:https://www.cand.uscourts.gov/filelibrary/1118/ESI_Checklist-12_-1-2015.pdf+&cd=1&hl=en&ct=clnk&gl=us), and its companion “Guidelines for the Discovery of Electronically Stored Information” (prepared by the New York State Supreme Court, Nassau County Commercial Division, *available at* [http://www.nycourts.gov/courts/comdiv/pdfs/nassau-e-filing\\_guidelines.pdf](http://www.nycourts.gov/courts/comdiv/pdfs/nassau-e-filing_guidelines.pdf)

**(b) Written discovery motions should be permitted only in exceptional circumstances.** Motions involving discovery should be oral in any but the most exceptional circumstances, and should be presented in telephonic prehearing conferences. Written discovery motions should require special permission of the Panel Chair. At present, FINRA Rule 13501(b) refers to “contested issues on which the parties will submit briefs,” and this should be amended to establish a presumption against briefing, except where the law is unsettled or unusually complex. The party requesting briefs should be required to justify his request and to reimburse the opposing party for briefing costs when the Panel finds the motion to have been frivolous.

**(c) Sanctions should be imposed automatically for improper discovery demands or improper discovery refusals.** FINRA Rules should require the automatic imposition of panel costs, and a \$1,000 minimum sanction, payable by any party responsible for unreasonable conduct necessitating a discovery motion.

**(d) Omnibus motions should be mandatory.** To the extent possible, all procedural, evidentiary and dispositive motions should be presented in a single motion to be heard at a single “omnibus motion” conference.

**(e) FINRA staff should monitor discovery compliance.** FINRA staff members with special training or experience in electronic discovery should be assigned to monitor all prehearing discovery conferences, to ensure compliance with FINRA’s arbitration rules and with the arbitrators’ rulings. In case of noncompliance, these staff members should be expected to recommend disciplinary sanctions or to make disciplinary referrals. Illustrating a model practice in the area are the Rules of the Commercial Division of the New York State Supreme Court, 22 NYCRR § 202.70, *available at* <https://www.nycourts.gov/rules/trialcourts/202.shtml#26>.

**3. FINRA Rules should require the prehearing identification, pre-marking and stipulation to the admissibility of most hearing exhibits, and the resolution of any known disputes about evidentiary admissibility in prehearing conferences.**

Much of the time spent in protracted hearings at FINRA is devoted to prolonged disputes over the admissibility of documentary exhibits. This is especially common when the parties have

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not identified, pre-marked and pre-stipulated to the admissibility of evidentiary exhibits, and where any remaining evidentiary disputes have not been resolved in a final prehearing conference. Piecemeal resolution of these issues during a hearing, with multiple objections, the need for extensive evidentiary foundations, and impromptu oral argument by counsel, interrupts and prolongs witness testimony, and can be extremely expensive to the parties. It can also be used improperly in a strategy of attrition.

Proposal:

FINRA Rules should require the identification, pre-marking and pre-stipulation as to the admissibility of most hearing exhibits, and should require any remaining evidentiary issues to be resolved in a final prehearing conference among the parties' counsel and the Panel Chair. Such procedures are routine in Federal and State Courts.

In FINRA's disciplinary hearings, such procedures are already in place, as detailed in FINRA Rules 9241 (Prehearing Conference) and 9242 (Prehearing Submission). These Rules provide for the prehearing organization and control of hearing exhibits by a FINRA-employed Hearing Officer, and a similar process should be implemented in arbitration hearings, as illustrated by the New York State Supreme Court, Commercial Division Rules, 22 NYCRR § 202.70, *available at* <https://www.nycourts.gov/rules/trialcourts/202.shtml#26>.

**4. A stenographic record of complex arbitrations should be prepared by FINRA automatically.**

FINRA does not stenographically record its proceedings. It allows parties to do so, which often causes disagreement when one party controls the stenographic reporter, or the parties cannot agree on the allocation of costs. The result may be a complete absence of a written record.

A predecessor of FINRA Dispute Resolution, the NYSE Arbitration Department, supplied a stenographic reporter automatically, for all proceedings, but converted the stenographic notes into an official transcript only when the parties requested and paid for it. Panelists decided on the allocation of this expense. FINRA, on the other hand, currently creates only an audio recording, whose quality is sometimes poor, and whose completeness depends on having one of the arbitrators turn the recording device on and off. Mistakes in this process are common, as is the loss of important testimony. Even when the recording process is error-free, it often leaves the parties without an appropriate evidentiary record.

Searching the audio recording of a FINRA arbitration hearing is all but impossible; FINRA has no system for indexing or searching it, and in a hearing that has been conducted intermittently over months or years, this factor becomes critical. Disputes over the underlying events are far worse when combined with disputes over what witnesses have said. At the end of a hearing, in summations, the result is a display of contested recollections and scrawled hearing notes, with actual testimony lying beyond anyone's recollection.

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Finally, when testimony has revealed a rule violation by a securities industry registrant, and a disciplinary referral seems warranted, efficient oversight by the SEC is difficult or impossible. There is no practical way to locate the relevant evidence, other than by listening to many hours of audio-recorded testimony.

Proposal:

A stenographer should be required at any complex arbitration, and an official transcript should be prepared at the request of the arbitrators, a party, FINRA or the SEC, with expenses to be allocated in the discretion of the arbitrators (in an ongoing proceeding), or as determined by FINRA's Director of Arbitration (in a concluded proceeding).

**CONCLUSION**

The problems described above are pervasive in complex FINRA arbitrations. By reviewing a representative sample of FINRA's published arbitration decisions, the SEC may observe several instances of hearings that have been prolonged beyond a year, and sometimes several years. Random review of these cases, by way of FINRA's audio recordings, would further show that discovery disputes, and a lack of effective prehearing procedures, contribute toward the extraordinary processing times. The additional problem of arbitrators who are unwilling or unable to sit from day-to-day in complex cases can also be observed, from FINRA's records and by interviewing the attorneys and arbitrators involved.

The problems described here are unlikely to be resolved without SEC intervention, and this rulemaking petition respectfully proposes that the issues be addressed through rulemaking and additional staff oversight.

Thank you for your consideration.

Respectfully submitted,

BRUNELLE & HADJIKOW, P.C.

By:   
George Brunelle