

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-58862; File No. SR-FINRA-2008-051)

October 27, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change Relating to Amendments to the Codes of Arbitration Procedure to Require Arbitrators to Provide an Explained Decision upon the Joint Request of the Parties

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 14, 2008, Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) 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 substantially 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 NASD Rules 12214, 12514 and 12904 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and NASD Rules 13214, 13514 and 13904 of the Code of Arbitration Procedure for Industry Disputes (“Industry Code,” and together with the Customer Code, the “Codes”) to require arbitrators to provide an explained decision upon the joint request of the parties. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Customer Code

12214. Payment of Arbitrators

(a) – (d) No change.

(e) Payment for Explained Decisions

(1) The chairperson who is responsible for writing an explained decision pursuant to Rule 12904(g) will receive an additional honorarium of \$400. The panel will allocate the cost of the honorarium under Rule 12904(g) to the parties.

(2) If the panel decides on its own to write an explained decision, then no panel member will receive the additional honorarium of \$400.

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12514. Pre-hearing Exchange of Documents and Witness Lists [Before Hearing], and Explained Decision Requests

(a) – (c) No change.

(d) Explained Decision Request

At least 20 days before the first scheduled hearing date, all parties must submit to the panel any joint request for an explained decision under Rule 12904(g).

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12904. Awards

(a) – (f) No change.

(g) Explained Decisions

(1) This paragraph (g) applies only when all parties jointly request an explained decision.

(2) An explained decision is a fact-based award stating the general reasons(s) for the arbitrators' decision. Inclusion of legal authorities and damage calculations is not required.

(3) Parties must make any request for an explained decision no later than the time for the pre-hearing exchange of documents and witness lists under Rule 12514(d).

(4) The chairperson of the panel will be responsible for writing the explained decision.

(5) The chairperson will receive an additional honorarium of \$400 for writing the explained decision, as required by this paragraph (g). The panel will allocate the cost of the chairperson's honorarium to the parties as part of the final award.

(6) This paragraph (g) will not apply to simplified cases decided without a hearing under Rules 12800 or to default cases conducted under Rule 12801.

(g) – (i) Renumbered as (h) – (j).

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Industry Code

13214. Payment of Arbitrators

(a) – (d) No change.

(e) Payment for Explained Decisions

(1) The chairperson who is responsible for writing an explained decision pursuant to Rule 13904(g) will receive an additional honorarium of \$400. The panel will allocate the cost of the honorarium under Rule 13904(g) to the parties.

(2) If the panel decides on its own to write an explained decision, then no panel member will receive the additional honorarium of \$400.

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13514. Pre-hearing Exchange of Documents and Witness Lists [Before Hearing], and Explained Decision Requests

(a) – (c) No change.

(d) Explained Decision Request

At least 20 days before the first scheduled hearing date, all parties must submit to the panel any joint request for an explained decision under Rule 13904(g).

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13904. Awards

(a) – (f) No change.

(g) Explained Decisions

(1) This paragraph (g) applies only when all parties jointly request an explained decision.

(2) An explained decision is a fact-based award stating the general reasons(s) for the arbitrators' decision. Inclusion of legal authorities and damage calculations is not required.

(3) Parties must make any request for an explained decision no later than the time for the pre-hearing exchange of documents and witness lists under Rule 13514(d).

(4) The chairperson of the panel will be responsible for writing the explained decision.

(5) The chairperson will receive an additional honorarium of \$400 for writing the explained decision, as required by this paragraph (g). The panel will allocate the cost of the chairperson's honorarium to the parties as part of the final award.

(6) This paragraph (g) will not apply to simplified cases decided without a hearing under Rules 13800 or to default cases conducted under Rule 13801.

(g) – (i) Renumbered as (h) – (j).

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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

FINRA is proposing to amend its Customer Code and Industry Code to require arbitrators to provide an explained decision upon the joint request of the parties. The explained decision would be a fact-based award stating the general reason(s) for the arbitrators’ decision; it would not be required to include legal authorities and/or damage calculations. Under the proposed rule change, parties would be required to submit any joint request for an explained decision at least 20 days before the first scheduled hearing date.<sup>3</sup> The chairperson would: 1) be required to write the explained decision; and 2)

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<sup>3</sup> The term “hearing” means the hearing of an arbitration under Rules 12600 and 13600 (see Rules 12100(m) and 13100(m)).

receive an additional honorarium of \$400 for writing the decision. The panel would allocate the cost of the additional honorarium to the parties as part of the final award.

The arbitrators would not be required to provide an explained decision in cases resolved without a hearing under simplified arbitration Rules 12800 and 13800 or in default cases conducted under Rules 12801 and 13801.

FINRA is not proposing to amend Rules 12904(f) and 13904(f), which provide that an award may contain an underlying rationale. This means that arbitrators would continue to be permitted to decide, on their own, to write an explained decision. Thus, as is currently the case, if the panel decides on its own to write an explained decision, FINRA would not pay an additional honorarium to any panel member.

#### Background

The absence of explanations in awards is a common complaint of non-prevailing parties in the FINRA forum, especially customers and associated persons. In order to address these complaints and increase investor confidence in the fairness of the arbitration process, in March 2005, FINRA filed a proposed rule change with the SEC that would have required arbitrators to provide explained decisions upon the request of customers, or of associated persons in industry controversies. The SEC published the original proposed rule change for comment in July 2005.<sup>4</sup> The SEC received almost two hundred comment letters in response to the original proposed rule change, many of them critical.

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<sup>4</sup> See Securities Exchange Act Release No. 52009 (July 11, 2005); 70 FR 41065 (July 15, 2005)(File No. SR-NASD-2005-032).

While FINRA was considering its next steps, there have been several new developments related to explained decisions in other contexts. FINRA filed with the Commission dispositive motions<sup>5</sup> and expungement procedures<sup>6</sup> proposals, both of which would require arbitrators to write an explanation for granting relief. In addition, the Securities Industry Conference on Arbitration (SICA) conducted a “Perceptions of Fairness” arbitration survey of participants in securities arbitration proceedings.<sup>7</sup> The survey results, released in February 2008, indicate that 55.5% of customers who responded to the survey would be “more satisfied if they had an explanation in the award.” In light of the comments, and these recent developments, FINRA has withdrawn the original proposed rule change as filed in SR-NASD-2005-032 and is filing a new proposed rule change. Key provisions of the proposed rule change are discussed in more detail below, together with related comments from the original proposed rule change.

#### Parties Must Jointly Request an Explained Decision

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<sup>5</sup> FINRA filed the proposed dispositive motion rule on November 2, 2007 (SR-FINRA-2007-021). The proposal was published for comment on March 20, 2008 (see Securities Exchange Act Release No. 57497 (March 14, 2008); 73 FR 15019). FINRA submitted a Response to Comments on September 15, 2008.

<sup>6</sup> On March 13, 2008, FINRA filed an expungement procedures proposal (SR-FINRA-2008-010). This rule would establish procedures arbitrators must follow when considering requests for expungement relief under Conduct Rule 2130. The proposal was published for comment on April 3, 2008 (see Securities Exchange Act Release No. 57572 (March 27, 2008); 73 FR 18308). FINRA submitted a Response to Comments on June 11, 2008, and a Supplemental Response to Comments on September 3, 2008.

<sup>7</sup> Jill I. Gross and Barbara Black, Perceptions of Fairness of Securities Arbitration: An Empirical Study, (February 6, 2008). The report can be downloaded at <http://digitalcommons.pace.edu/cgi/viewcontent.cgi?article=1477&context=lawfaculty>.

The original proposed rule change would have permitted a customer, or an associated person in an intra-industry controversy, to require an explained decision. Many commenters objected to the one-sided nature of that provision. Under the new proposed rule change, all parties to a case would have to agree to an explained decision. While the arbitrators will be resolving the entire matter and the explained decision would normally address all the claims asserted by the parties, the parties may request that an explained decision address only certain claims. Requiring the parties' joint agreement to an explained decision is consistent with FINRA's general policy to accommodate a joint request of the parties.

Parties Must Submit any Request for an Explained Decision 20 Days before the first scheduled hearing date

The proposed rule change would provide that parties must submit any joint request for an explained decision no later than 20 days prior to the first scheduled hearing date. This deadline coincides with the time that parties must exchange documents and identify witnesses they intend to present at the hearing. This approach would establish a clear deadline, give the parties sufficient time to request an explained decision, and provide notice to the arbitrators that an explained decision will be required before the hearing begins.

The Chairperson Must Write the Explained Decision

The new proposed rule change would require that the chairperson write the explained decision. The original proposed rule change contemplated that any of the arbitrators, or all of them, might draft the decision. Many commenters on the original proposed rule change were concerned that poorly written decisions might harm the public's perception of arbitration, or increase the likelihood of a party successfully

vacating an award. To address these concerns, the rule would require that the chairperson write the decision.

Under the Codes, arbitrators must meet specific experience and training criteria to serve as chairpersons in arbitrations.<sup>8</sup> Therefore, chairpersons may be more experienced than non-chairpersons and should be better able to produce higher quality explained decisions. Further, assigning this responsibility to the chairperson would eliminate any confusion over who would be responsible for drafting the decision and would streamline the decision writing process. Having one arbitrator draft the decision after all the arbitrators have been consulted would reduce the time required to complete the decision. Once the decision was drafted, the arbitrators still would be required to sign the decision as provided in Rules 12904(a) and 13904(a).<sup>9</sup>

#### The Explained Decision Must Be Fact-Based

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<sup>8</sup> Pursuant to Rules 12400 and 13400, arbitrators are eligible for the chairperson roster if they have completed FINRA chairperson training and:

- Have a law degree and are a member of a bar of at least one jurisdiction and have served as an arbitrator through award on at least two arbitrations administered by a self-regulatory organization in which hearings were held; or
- Have served as an arbitrator through award on at least three arbitrations administered by a self-regulatory organization in which hearings were held.

On June 23, 2008, the SEC approved a proposal to eliminate the Code provision allowing arbitrators to serve as Chairpersons provided they have “substantially equivalent training or experience” in lieu of completing FINRA Dispute Resolution’s Chairperson training course (see Securities Exchange Act Release No. 58004 (June 23, 2008); 73 FR 36579 (June 27, 2008) (File No. SR-FINRA-2008-009). This rule became effective on September 22, 2008.

<sup>9</sup> Rules 12904(a) and 13904(a) require all awards to be in writing and signed by a majority of the arbitrators or as required by applicable law.

Under the proposed rule change, the explained decision would be a fact-based award stating the general reason(s) for the arbitrators' decision.<sup>10</sup> The award would not be required to include legal authorities and damage calculations. FINRA believes that requiring only fact-based reasons in explained decisions will reduce the potential for misstatements in an award, thereby decreasing the possibility of a subsequent vacatur, modification or remand of an award and ensuring the continued finality of a FINRA award. FINRA believes the proposed rule change would provide the parties with the information they want while simultaneously maintaining the expediency, flexibility, and finality of arbitration.

#### Only the Chairperson Will Be Compensated for an Explained Decision

The original proposed rule change did not address who would have been responsible for preparing the explained decision and provided that each arbitrator would be paid an additional \$200 honorarium for cases in which an explained decision was required. Under the new proposed rule change, only the chairperson would write the decision, and only the chairperson would be paid an additional honorarium. The additional honorarium paid to the chairperson would reflect the increased effort involved in drafting an explained decision. Under the new proposed rule change, the panel may

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<sup>10</sup> While Rules 12604 and 13604 provide that the panel decides what evidence to admit and is not required to follow state or federal rules of evidence, FINRA intends that, as with current arbitration awards, explained decisions will have no precedential value in other cases. Thus, arbitrators will not be required to follow any findings or determinations that are set forth in prior explained decisions. In order to ensure that users of the forum are aware of the non-precedential nature of explained awards, FINRA plans to revise the template for all awards to include the following sentence: "If the arbitrators have provided an explanation of their decision in this award, the explanation is for the information of the parties only and is not precedential in nature."

allocate the cost of the honorarium to one party, or may allocate it between or among all parties.<sup>11</sup>

#### Parties May Not Require Explained Decisions in Some Cases

Under the proposed rule change, parties would not be able to require explained decisions in two types of arbitration proceedings. The first is simplified arbitrations that are decided solely upon the pleadings and evidence filed by the parties, as described in Rules 12800 and 13800. The second is arbitrations that are conducted under the default procedures provided for in Rules 12801 and 13801. Explained decisions would not be appropriate in either of these situations because of the abbreviated nature of these arbitration proceedings.

#### Arbitrators May Choose to Write Explained Decisions in Other Circumstances

Under the proposed rule change, arbitrators would continue to be permitted to decide, on their own or upon the motion of one party, to write an explained decision. Arbitrators would not receive an additional honorarium if the panel issues an explained decision that is not required under the proposed rules. The proposed rule change would not affect the current rule that permits arbitrators to include a rationale in an award, even if the parties have not requested it, and would not encourage arbitrators to write an explained decision when they are not asked to do so by all the parties.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>12</sup> which requires, among other things, that FINRA rules

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<sup>11</sup> Under the Customer and Industry Codes, the panel has the authority to assess fees in connection with discovery-related motions, contested subpoena requests, and hearing session fees to one party, or may split the fees between or among all parties.

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. The proposed rule change would increase investor confidence in the fairness of the arbitration process by allowing parties jointly to require arbitrators to write an explained decision.

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.

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 35 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 such proposed rule change, or

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

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<sup>12</sup> 15 U.S.C. 78o-3(b)(6).

#### 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](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2008-051 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-FINRA-2008-051. 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 Web site (<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 inspection and copying in the Commission's Public Reference Room, 100 F Street, NE,

Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. 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; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2008-051 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.<sup>13</sup>

Florence E. Harmon  
Acting Secretary

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<sup>13</sup> 17 CFR 200.30-3(a)(12).