Financial Industry Regulatory Authority

September 17, 2007

Ms. Nancy M. Morris
Secretary
U. S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No. SR-NASD-2006-109 – Amendments to the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes to Address Representation of Parties in Arbitration and Mediation; Response to Comments

Dear Ms. Morris:

The Financial Industry Regulatory Authority, Inc. (FINRA) (formerly known as the National Association of Securities Dealers, Inc. (NASD)) hereby responds to the comment letters received by the Securities and Exchange Commission (SEC) with respect to the above rule filing. In this rule filing, FINRA is proposing to amend the Code of Arbitration Procedure for Customer Disputes (Customer Code), the Code of Arbitration Procedure for Industry Disputes (Industry Code), and the Code of Mediation Procedure (Mediation Code) (collectively, new Codes) to address representation of parties in arbitration and mediation.[1] Of the five letters received, [2] one supports the amendments and four oppose.

The commenter supporting the proposal believes that the proposed rules codify "current practice to allow an attorney admitted to (and not suspended from) the bar of any state to represent parties in arbitrations and mediations in its forum without regard to jurisdictional boundaries."[3] Further, the commenter does not believe "that the practice of NASD arbitration or mediation differs from state to state and thus does not require the expertise of an attorney admitted to practice in the particular state of the hearing location."[4] Moreover, the commenter believes that the proposal "expand[s] the pool of

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[1] See Securities Exchange Act Rel. No. 55604 (April 9, 2007), 71 FR 18703 (April 13, 2007)(File No. SR-NASD-2006-109, Notice of Filing of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto Relating to Representation of Parties in Arbitration and Mediation).

[2] Comment letters were submitted by Richard Sacks, Investors Recovery Service, dated May 3, 2007 ("Sacks Letter"); Timothy A. Canning, Attorney at Law, dated May 4, 2007 ("Canning Letter"); Vincent DiCarlo, Esq., Law Office of Vincent DiCarlo, dated May 4, 2007 ("DiCarlo Letter"); Irwin G. Stein, dated May 4, 2007 ("Stein Letter"); and Jill I. Gross, Director, Sara Miro, Student Intern, and Reema Shah, Student Intern, Pace Investor Rights Project, Pace University School of Law, dated May 4, 2007 (" PACE Letter").

[3] See Pace Letter.

[4] Id.

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attorneys available to represent parties in the forum, and increase[s] the possibility that investors with small claims [can] obtain legal representation."[5]

The remaining commenters oppose the amendments on two principal grounds. First, two commenters object to the proposed rule on the ground that there should be a uniform national rule governing who can represent a party to a FINRA arbitration, rather than incorporation of state rules that may vary from jurisdiction to jurisdiction.[6] They suggest that FINRA should adopt a uniform rule that would preempt contrary state rules.

It is well-established that FINRA rules, if approved by the SEC pursuant to Section 19 of the Exchange Act, may preempt contrary or conflicting state laws.[7] For example, FINRA's rules governing arbitrator selection and the disclosure of information regarding disqualification apply nationally and preempt conflicting state laws.[8]

The regulation of attorneys and others who represent individuals and corporations in arbitration proceedings has traditionally been governed by state law, not a uniform federal rule.[9] FINRA has determined that there is no overriding need for a uniform rule in this area, and that continued compliance with state rules is in the best interests of all participants in its arbitration forum.

Contrary to the suggestion of these two commenters, FINRA's position in this respect does not conflict with the position the self-regulatory organizations and the SEC took in arguing, successfully, that certain California arbitration rules (the "California Standards") were preempted by federal law.[10] In that litigation, FINRA addressed this precise issue, and distinguished attorney qualification rules from rules regulating arbitration procedure:

> California has the undisputed authority to regulate the practice of law. *Cf.* Cal. R. Ct. 966 (eff. Nov. 15, 2004) (restating circumstances in which out-of-state attorneys may participate in, *inter alia*, California arbitrations). The California Standards, by contrast, purport to regulate arbitration procedure, a matter committed to federal law in the SRO context.[11]

Thus, the proposed rule is entirely consistent with this longstanding position.[12]

The second principal area of objection by the commenters concerns those who will be affected by the proposal. The commenters argue that the proposal penalizes

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[5] Id.

[6] Canning Letter at 2-4; Stein Letter at 2-3.

[7] *Credit Suisse First Boston Corp. v. Grunwald*, 200 F.3d 1119 (9th Cir. 2005); *Jevne v. Superior Court*, 35 Cal. 4th 935 (2005).

[8] Id.

[9] See, e.g., NASD Notice to Members 99-10 (Feb. 1999) (providing guidance for compliance with California law concerning attorney representation in arbitration proceedings).

[10] *Grunwald*, *supra*; *Jevne*, *supra*.

[11] Brief for Interveners NASD Dispute Resolution, Inc. and New York Stock Exchange, Inc., *Jevne v. Superior Court*, No. S121532 (Cal. filed May 12, 2004), at 26 n.15.

[12] See also NASD Notice to Members 99-10, *supra*.

retroactively those persons who are currently suspended or barred from the securities industry by prohibiting them from representing a party in an arbitration or mediation proceeding.[13] The commenters contend that the proposal imposes a new penalty on those who have had their misconduct adjudicated and sanctions imposed.[14] At a minimum, one commenter suggests, the proposal should be modified so that it applies only to those who are barred or suspended from the securities industry after the effective date of the rule.[15]

As FINRA states in the proposal, the rule is designed to protect investors, most of whom participate in arbitration or mediation only once in their lives and may lack experience with the process. If investors choose to be represented by someone who is not an attorney and thus who is largely unregulated, FINRA believes that the non-attorney should, at a minimum, not be a person whom a regulatory body has suspended or barred from representing clients or conducting securities business with the public. FINRA believes that the proposed criteria are appropriate safeguards to prevent potentially abusive practices in representation, and declines to amend the proposal.[16]

The commenters also contend that, under the proposal, firms could be represented by whomever they choose, but investors would be limited in their choice of representative.[17]

As noted above, the purpose of the rule is to protect investors. FINRA believes the criteria of the rule are appropriate.

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If you have any questions, please contact me on (202) 728-8151 or at mignon.mclemore@finra.org.

Very truly yours,

Mignon McLemore
Assistant Chief Counsel
FINRA Dispute Resolution

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[13] See Sacks, Canning, DiCarlo and Stein Letters.

[14] Id.

[15] See Canning Letter.

[16] The proposal will apply prospectively as to representation on or after the effective date. If a barred or suspended individual is representing a party in a case pending on the effective date of the rule, he or she may continue to serve on that case, but may not serve on new ones.

[17] See note 13, *supra*.