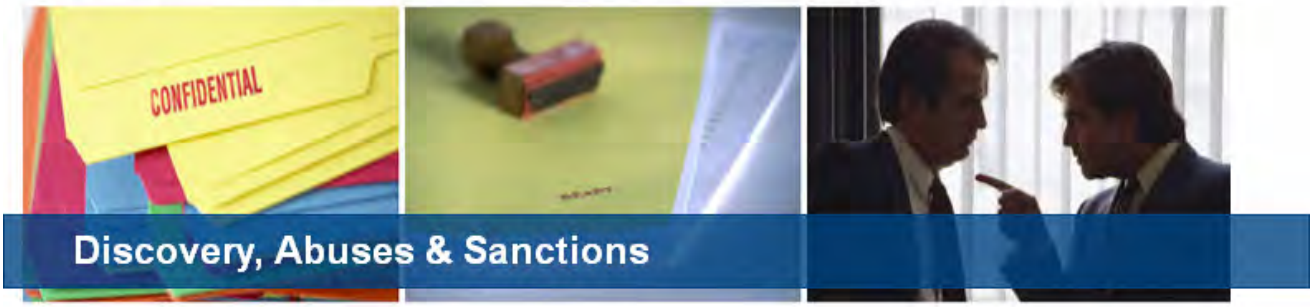
Dispute Resolution



Discovery, Abuses & Sanctions

Version: May 2012

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Discovery, Abuses & Sanctions Training and Exam

Dear Arbitrator:

The following is a print version of the Discovery, Abuses and Sanctions Training. You may complete this course and exam either through this printable version (instructions below) or online, depending on your individual preference and/or computing environment. Most arbitrators will be able to review the material, and complete the enclosed exam in one hour.

Please review the course material and complete the exam. After you complete the exam, you must send it to FINRA's Department of Neutral Management for grading. There is no minimum score required for the exam; **however, you must** complete **and return the exam to receive credit for the course**. We strongly recommend that you maintain a copy of the exam for your own records.

You may submit your exam to FINRA by fax or mail:

By Fax: FINRA Department of Neutral Management – FAX # 646-625-6028.

By Mail: FINRA
Attn: Luis Cruz – Neutral Management
One Liberty Plaza 165 Broadway, 27th Floor
New York, NY 10006

Because there is no minimum score required on the test, please do not expect a pass/fail letter from FINRA. After grading your exam, you can be assured that FINRA will update your arbitrator disclosure report to reflect your completion of the Discovery, Abuses and Sanctions Training. **Nothing further is required of you with regard to this course**.

We hope you enjoy the course.

Jisook Lee

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Course Objectives

The Financial Industry Regulatory Authority, Inc. (FINRA) developed a series of courses as part of its comprehensive Arbitrator Training Program. This course contains four components:

- Part I — Discovery Rules and Procedures
- Part II — Role of the Arbitrators in the Discovery Process
- Part III — Orders of Confidentiality
- Part IV — Discovery Abuse

Upon completion of all four components, you will be able to:

- Understand the Discovery Guide.
- Explain the respective duties of the parties and the arbitrator with regard to the discovery process.
- Describe why a party might request an order of confidentiality.
- Address requests for orders of confidentiality.
- Recognize and address discovery abuses.
- Understand the possible sanctions for discovery abuses.

Dispute Resolution's Mission Statement

FINRA Dispute Resolution’s mission is to have all of its constituents—the investing public, brokerage firms and their employees, and neutrals (arbitrators and mediators)—view FINRA's forum as the preeminent provider of dispute resolution services. To accomplish this goal, it is our standing pledge to provide impartial arbitrators who are dedicated to delivering fair, effective dispute resolution services.

For more on FINRA and its services, see FINRA's website.

FINRA's website :-http://www.finra.org/index.htm

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Precourse Work

Before proceeding with this course, please familiarize yourself with the FINRA Code of Arbitration Procedure (Code). Advance study will enhance the learning experience. Please refer to Rules 12505-12514 of the Code for information about FINRA's discovery procedures.

FINRA highly recommends that you study and understand the Discovery Guide before beginning this training course. The Discovery Guide serves as a guide to the parties and the arbitrators to facilitate the efficient exchange of documents and information in customer cases. The Discovery Guide contains two Document Production Lists of presumptively discoverable documents: one for firms/associated persons to produce and one for customers to produce.

Rules 12505-12514: http://www.finra.org/finramanual/rules/r12505

Discovery Guide: http://www.finra.org/ArbitrationMediation/Rules/RuleGuidance/DiscoveryGuide/index.htm

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Section 1: Part I - Discovery Rules and Procedures

Part I - Discovery Rules and Procedures

This portion of the course reviews:

- Discovery Guide and Document Production Lists;
- other document and information requests;
- interrogatories and depositions;
- objections; and
- motions to compel discovery.

Discovery Rules and Procedures

The timely exchange of relevant documents among the parties is vital to the fair and cost-efficient resolution of disputes. Under Rule 12505 of the Code, parties must cooperate to the fullest extent practicable in the exchange of documents and information, and to respond to discovery requests from other parties within a certain time.

When parties comply with this duty, the role of arbitrators in the discovery process is limited to resolving objections to the production of specific documents, or clarifying what documents are presumed to be relevant to the case. However, when parties fail to adhere to the Code and FINRA's procedures by ignoring discovery deadlines, making frivolous objections or failing to comply with discovery orders by the panel, arbitrators must be familiar with the Code and FINRA procedures and take an active role in managing the discovery process. Under the Code, failure to comply with discovery rules and procedures may result in sanctions, including dismissal of a claim, defense or proceeding.

Rule 12505: http://www.finra.org/finramanual/rules/r12505

Discovery Guide

FINRA's Discovery Guide, including the Document Production Lists (Lists), serves as a guide for the parties and the arbitrators. While the parties and arbitrators should consider the documents described in the Lists presumptively discoverable, the parties and arbitrators retain their flexibility in the discovery process. Arbitrators can: order the production of documents not provided for by the Lists; order that parties do not have to produce certain documents on the Lists in a particular case; and alter the production schedule described in the 12500 series of rules. However, arbitrators should generally assume that a document on the relevant List should be exchanged unless the party in control of the document demonstrates a compelling reason not to produce it. The Lists do not apply in non-customer cases.

(The standards for resolving discovery disputes are discussed in detail in Part II of this course.)

Although FINRA's Discovery Guide was not intended for use in simplified arbitrations (arbitrations decided exclusively on documentation, without an oral hearing), the presiding arbitrator may use relevant portions of the Guide in a manner that is consistent with the expedited nature of simplified proceedings.

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What Must Be Produced

In customer cases, the starting point in the discovery process is the Discovery Guide, including the Document Production Lists, which is available on FINRA's website. The Discovery Guide is especially important since the majority of FINRA arbitration claims involve public customer parties. The Discovery Guide also discusses additional discovery requests, information requests, confidentiality, privileged documents and admissibility of evidence.

Parties may also request documents that are not included on the Document Production Lists under Rule 12507 of the Code. Such requests should be specific and relate to the matter in controversy.

FINRA arbitration claims change with the times, and current case filings show that many claims filed now are alleging sales practice violations regarding non-conventional investments, including hedge funds, REITs and other investments that do not trade in the broad securities markets. The types of discovery materials relating to a firm's due diligence materials, sales literature and sales training materials for non-conventional investments may extend beyond the categories of items identified in the Discovery Guide for conventional investments. While not all of these documents are specifically identified as presumptively discoverable in the Discovery Guide, they may or may not be relevant to claims and defenses.

Rule 12507: http://www.finra.org/finramanual/rules/r12507

Electronic Discovery

Although documents may be stored electronically as ESI (electronically stored information), electronic files are still considered —documents" within the meaning of the Discovery Guide, and the arbitrators will decide any dispute that arises concerning the form in which a document will be produced. Despite the changes in the scope of discovery and the challenges surrounding the unique nature of electronic discovery, the standards arbitrators should apply when deciding discovery disputes have not changed. Arbitrators must still determine if a document is relevant or likely to lead to relevant evidence. Only after determining relevancy, should arbitrators consider the parties' cost or burden of production.

For additional guidance on electronic discovery, please see the document, "Managing Discovery of Electronic Information: A Pocket Guide for Judges," published by the Federal Judicial Center.

Managing Discovery of Electronic Information: A Pocket Guide for Judges:
http://www.fjc.gov/public/pdf.nsf/lookup/eldscpkt.pdf/$file/eldscpkt.pdf

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When Production Must Occur

Unless the parties agree otherwise, within 60 days of the date that the answer to the statement of claim is due, parties must either produce to all other parties all documents in their possession or control that are described in the Document Production Lists; identify and explain the reason that specific documents in the Lists cannot be produced within the required time; or object to the production of the specific documents. Parties must respond to all other requests for documents and information within 60 days from the date a discovery request was received according to Rule 12507.

Rule 12507: http://www.finra.org/finramanual/rules/r12507

Objections

Parties may object to producing listed or requested documents or information. However, this does not mean that parties can simply ignore either the Document Production Lists or other discovery requests on the grounds that they —bject" to them.

To comply with the Code, an objection must be:

- specific;
- timely; and
- in writing.

To be timely, an objection must be filed before the deadline for producing the document expires. Any objection not made within the required time is waived unless the panel determines that the party had substantial justification for failing to make the objection within the required time. To be specific, an objection must identify which document or part of a document it pertains to, and must explain the reasons for the objection. It is not sufficient for a party to simply object to producing any and all documents.

In addition, the fact that a party objects to the production of a specific document does not relieve it of the burden to produce documents not covered by the objection.

It is also not sufficient for a party to fail to respond to a discovery request on the grounds that no responsive information or documents exist. If no responsive information or documents exist, the party (or a person qualified to speak on behalf of the party regarding the existence of such documents), must:

- state in writing that he/she conducted a good faith search for the requested information or documents;
- describe the extent of the search; and
- state that based on the search, there are no requested documents in the party's possession, custody or control.

Motions to Compel Discovery

If the parties cannot resolve their discovery differences themselves, a party seeking a disputed document may file a motion to compel requesting the panel to order another party to produce the specific documents or information. Motions to compel discovery must be made, and will be decided, in accordance with Rule 12503. Such motions must include the disputed document request or list, a copy of any objection thereto and a description of the efforts of the party filing the motion to resolve the issue before making the motion.

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Motions to Compel Discovery (Continued)

FINRA compensates arbitrators in the amount of $200 to decide discovery-related motions without a hearing. For the purposes of this rule, a discovery-related motion and any replies or other correspondence relating to the motion will be considered to be a single motion. If more than one arbitrator considers a discovery-related motion, each arbitrator will receive an honorarium of $200. The panel will allocate the cost of the honoraria as part of the eventual arbitration award.

Rule 12503: http://www.finra.org/finramanual/rules/r12503

Other Requests for Documents or Information

The Code provides that parties may request documents or other information from any party by serving a written request directly on the party. In customer cases, such requests supplement the Document Production Lists; parties in customer cases do not need to request documents listed on the Lists. Arbitrators must use their judgment in considering requests for additional documents and may not deny document requests on the grounds that the documents are not expressly listed in the Discovery Guide. In all cases, such requests should be specific, relate to the matter in controversy and afford the party to whom the request is made a reasonable period of time to respond without interfering with the time set for the hearing.

Arbitrators should note that, as used in the Code, requests for ―information" are different from interrogatories. Requests for information are generally limited to the identification of individuals, entities and time periods related to the dispute and permitted by the Code. Such requests should be reasonable in number and not require narrative answers or fact finding. The purpose of an "Information Request" is to seek the information needed by a party to prepare its case. For example, a party might ask the name of a respondent's supervisor during the time of the matter in dispute. The purpose of the question is to help the party determine which witnesses to call for the hearing.

On the other hand, interrogatories, which are addressed in the next section, are written questions that go to the facts and merits of a case and are generally not permitted in arbitration. These types of questions should be asked and answered by a witness at a hearing. An example of an interrogatory might be a question such as ―after the investor complained to you about the stock transaction in question, did you speak with your supervisor?"

Depositions and Interrogatories

To keep arbitration as simple and efficient as possible, other discovery methods common in court, such as depositions and written interrogatories, are strongly discouraged in arbitration, and may only be used with permission from the arbitrators.

Depositions

Arbitrators should permit depositions only under very limited circumstances, such as to:

- preserve the testimony of ill or dying witnesses;
- accommodate essential witnesses who are unable or unwilling to travel long distances for a hearing and may not otherwise be required to participate in the hearing;
- expedite large or complex cases; and
- address unusual situations where the arbitrator determines that circumstances warrant departure from the general rule.

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Depositions and Interrogatories (Continued)

There is a limited exception in industry cases involving statutory discrimination claims under Rule 13510.

Rule 13510: http://www.finra.org/finramanual/rules/r13510

Interrogatories

Like depositions, interrogatories are also strongly discouraged. As discussed earlier, interrogatories are lists of detailed questions that could be asked at a hearing. By contrast, information requests are simple requests for information needed to prepare for a hearing. For example, it would be permissible for a party to ask the identity of a supervisor in order to know whom to call as a witness. It would generally not be permissible to send a detailed list of questions about the supervisor's conduct.

Unless the panel determines that certain interrogatories would streamline a large or complex case, the panel would rarely grant such requests.

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Test Yourself

The Discovery Guide was designed to help facilitate the exchange of documents among the parties in public customer cases. How does the Guide endeavor to accomplish this objective?

Answer.

To facilitate document exchanges, the Guide encourages the parties to discuss and agree on the exchange of documents. Absent party agreement, the Guide provides Document Production Lists indicating which documents the parties shall exchange and when to exchange them.

Test Yourself

Under what circumstances might a deposition be acceptable?

Answer.

The deposition of an essential witness may be appropriate to:

- preserve the testimony of ill or dying witnesses;
- accommodate essential witnesses who are unable or unwilling to travel long distances for a hearing and may not otherwise be required to participate in the hearing;
- expedite large or complex cases; and
- address unusual situations where the arbitrator determines that circumstances warrant departure from the general rule.

There is also a limited exception in industry cases involving statutory discrimination claims under Rule 13510.

Test Yourself

Parties may object to producing listed or requested documents or information. List the three things required of such an objection.

Answer.

Parties may object to producing listed or requested documents or information. To comply with the Code, an objection must be specific, timely and in writing.

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Section 2: Part II - Role of Arbitrators in the Discovery Process

Part II - Role of Arbitrators in the Discovery Process

This portion of the course reviews:

- the Initial Prehearing Conference;
- discovery prehearing conferences;
- the standards for deciding motions to compel; and
- issues of confidentiality and privilege.

The Initial Prehearing Conference

Ideally, arbitrators play a limited role in the discovery process. In practice, however, arbitrators often must take an active role in managing discovery by setting discovery schedules, deciding discovery disputes, and, when appropriate, sanctioning parties for failing to comply with discovery orders.

Generally, the first contact arbitrators have with parties and with the discovery process occurs at the Initial Prehearing Conference (IPHC). The purpose of the IPHC, which usually takes place by telephone, is primarily to schedule hearings and to address preliminary matters, including discovery.

During the IPHC, the arbitrators refer to the IPHC Script (Script) provided by FINRA. Among other things, the Script directs the arbitrators to remind all parties that they should review carefully the Discovery Guide and Document Production Lists, which can be downloaded from FINRA's website. The Script also reminds the panel to ask the parties to describe their progress in the discovery process, and to remind the parties of their duty to cooperate in the exchange of documents and information.

During the IPHC, the panel should also establish a discovery schedule with specific discovery cut-off dates, as well as deadlines for compliance, or for filing objections and responses. Even though the Code and the Discovery Guide provide deadlines for responding to discovery, it is helpful for the parties to know the exact dates of discovery deadlines for their case.

In setting discovery deadlines, or cut-off dates, the arbitrators should be very clear when referring to deadlines for making discovery requests, or for responding to them. (Sometimes the panel will need to set both.) Failing to do so can cause confusion. FINRA recommends that the arbitrators set cut-off dates for requests and responses that allow due time for the resolution of objections and disputes before the scheduled exchange of hearing exhibits. If any motions to compel discovery have been filed, but not yet responded to, the panel should also set a deadline for the response.

To coordinate discovery scheduling, arbitrators should have their current calendars/schedules at hand containing all case-related dates, including previously scheduled evidentiary hearing dates.

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Preparing for the Prehearing Discovery Conference

The Code authorizes the appointment of one member of a three-person panel to decide all unresolved discovery issues on the panel's behalf. The chairperson is usually selected to serve in this capacity. If a conference call is needed, the selected arbitrator must be prepared to effectively resolve or help facilitate party resolution of outstanding discovery issues. Before the discovery conference, the selected arbitrator should review:

- the filed claims, answer and other pleadings to refresh the arbitrator's recollection about the facts of the case;
- the Scheduling Order to ensure that the arbitrator is cognizant of all prior decisions or party agreements made at the Initial Prehearing Conference;
- the Discovery Guide, if the case involves a public customer party;
- the parties' motion papers (including exhibits and/or any previously exchanged document requests and responses contained therein). These materials should help the selected arbitrator decide all outstanding discovery issues. They also will help the arbitrator make other decisions that may facilitate the evidentiary hearings, including early identification and premarking of documentary exhibits and the scheduling of testimony;
- Rules 12505-12511 of the Code; and
- the procedures and guidelines contained in the Arbitrator's Guide.

Scheduling: http://www.finra.org/web/groups/arbitrationmediation/@arbmed/@neutrl/documents/arbmed/p009471.pdf

Discovery Guide:
http://www.nasd.com/ArbitrationMediation/Arbitration/DiscoveryGuideforArbitrationProceedings/index.htm

Arbitrator's Guide:
http://www.finra.org/ArbitrationMediation/Neutrals/ArbitrationProcess/ArbitrationCaseGuidanceResources/ArbitratorsReferenceGuides/

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Conducting the Prehearing Discovery Conference

At the conference, the selected arbitrator should follow these procedures:

Make Preliminary Introductions

- Identify the participants (parties, attorneys, other individuals listening to the call).
- Ask the participants to identify themselves each time before they speak.
- Read the case name and number.
- State that the panel is a body of neutral arbitrators who are not employees of FINRA.

Address the Issues

- Ask the party requesting the prehearing conference to explain the issue. Parties may ask the arbitrator to issue subpoenas, as permitted by applicable law, order the production of documents or witnesses, issue other orders that may expedite the arbitration and order the deposition of essential witnesses.
- Ask for the positions of the other party or parties, giving the moving party an opportunity to respond.
- Ask questions—as necessary—to identify and clarify the issues.
- Provide all parties with an opportunity to respond.

Make Rulings

- If the prehearing conference involves discovery issues, be specific and provide a reasonable timetable for compliance, including dates and places for the exchange of information or documents.
- Reread and confirm the panel's rulings with the parties (make sure all parties understand it fully).
- Be polite, but firm when delivering your order. Do not allow the parties to debate an issue once you have ruled.
- Document the panel's ruling in a prehearing order (the panel may request parties' counsel to submit a draft order for adoption or modification).
- Inform the parties of the maximum fee that the panel can assess for each prehearing session.
- Ask whether there are any other issues prior to concluding the prehearing.
- If the full panel is participating and wish to confer privately—either during the conference or after the parties have finished their presentations—make sure all the parties are off the phone before discussing the issues. Verify with the conference operator that only the arbitrators are connected to the call.

Follow-Up

- Send a copy of the written order, preferably typed, to the assigned FINRA staff person by fax or email for distribution to the parties.

Standards for Deciding Motions to Compel Discovery

The first question to ask in deciding whether to compel discovery of a disputed document is whether it is relevant or might lead to the discovery of relevant evidence.

There is no simple bright-line test for determining whether a document is relevant to a dispute, or whether production of a disputed document should be ordered. The arbitrator must decide the issue based on the facts and circumstances of a particular case. However, there are some basic principles to keep in mind.

- In customer cases, arbitrators should assume that, all things being equal, documents listed on the Document Production Lists are relevant and should be produced. The party objecting to produce such documents must show a compelling reason not to produce them.

- The Document Production Lists are only intended to provide guidance about what is generally relevant in such cases. Each case is different, and some things that are central to one customer case may be peripheral or irrelevant to another.

To help you decide whether a document is relevant, arbitrators should ask the party seeking it why it is needed, how it will be used, and whether the information sought is available in any other form.

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Standards for Deciding Motions to Compel Discovery (Continued)

The fact that a document is relevant for discovery purposes to help a party prepare its case does not necessarily mean that it is admissible at the hearing. Production of documents in discovery does not create a presumption that the documents are admissible at the hearing. A party may object to the introduction of any document as evidence at the hearing to the same extent that a party can raise any other objection at an arbitration hearing. Under Rule 12604 of the Code, arbitrators decide what evidence to admit; they are not required to follow state or federal rules of evidence.

Rule 12604: http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4096

Weighing the Relevance Against the Burden

A party may object to producing a document because of the cost or burden of production. If the party demonstrates that the cost or burden of production is disproportionate to the need for the document, the arbitrators should determine if the document is relevant or likely to lead to relevant evidence. If the arbitrators determine that the document is relevant or likely to lead to relevant evidence, they should consider whether there are alternatives that can lessen the impact, such as narrowing the time frame or scope of an item, or determining whether another document can provide the same information.

The selected arbitrator can refer any unresolved discovery issue to the full panel for a determination, if the arbitrator believes it will promote full and fair hearings.

Decisions Reserved for the Full Panel

On occasion, the arbitrator authorized to decide all unresolved discovery issues on the panel's behalf may be asked to resolve an issue that goes beyond straight document production. Although the selected arbitrator has important powers, the arbitrator may not make dispositive (final settlement or determination) decisions and certain nondispositive decisions.

If, while serving as the arbitrator assigned to decide unresolved discovery issues, a party makes a request for a dispositive decision or one of the following nondispositive decisions, the arbitrator should remind the parties that only the full panel has the authority to make such rulings.

The nondispositive decisions which may be decided **only** by the full panel include:

- accepting or rejecting proposed amendments to claims or counterclaims after the panel is appointed;
- consolidating arbitration proceedings or severing claims;
- excluding from evidence documents or witnesses that are part of a party's presentation that were not exchanged or identified at least 20 calendar days before the first scheduled evidentiary hearing date;
- taking action to enforce compliance with orders to produce documents or witnesses, including sanctions and barring the presentation of facts or defenses not included in timely filed answers;
- admitting or excluding evidence at the hearing;
- changing the time or location of the second or subsequent hearings; and
- adjourning hearings.

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Test Yourself

What procedure should you follow as the selected arbitrator at a Prehearing Discovery Conference if a party complains that a document was not produced as ordered according to the discovery schedule?

Answer.

You should permit the alleged noncomplying party to explain why the document was not produced. If the reason justifies the noncompliance, give the party a chance to produce the document. If the reason does not justify the noncompliance, refer the matter to the full panel for appropriate actions or sanctions.

Test Yourself

What types of issues can you decide as the selected to act on behalf of the panel for purposes of discovery?

Answer.

As the selected arbitrator, you may:

- issue subpoenas, where permitted by law;
- order the production of documents or witnesses;
- issue other orders that may expedite the arbitration, as permitted by applicable law; and
- order the deposition of essential witnesses who are:
    - physically unable to attend the evidentiary hearing, or
    - physically able to attend but unwillingly to do so, and cannot be ordered to attend.

Test Yourself

Can a party object to producing a document because of the cost or burden of production?

Answer.

Yes. If the party demonstrates that the cost or burden is disproportionate to the need for the document, the arbitrators should determine if the document is relevant or likely to lead to relevant evidence. If the arbitrators determine that the document is relevant or likely to lead to relevant evidence, they should consider whether there are alternatives that can lessen the impact, such as narrowing the time frame or scope of the requested item or determining whether another document can provide the same information.

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Section 3: Part III - Orders of Confidentiality

Part III - Orders of Confidentiality

This portion of the training is devoted to issues concerning orders of confidentiality in arbitration —a subject often tied to discovery. Upon completion of the second portion of this course, you will be able to:

- describe why a party might request an order of confidentiality;
- address requests for orders of confidentiality; and
- differentiate between confidentiality and privilege.

Discovery and Orders of Confidentiality

As stated in the Discovery Guide, if a party objects to document production on grounds of privacy or confidentiality, the arbitrator or one of the parties may suggest a stipulation between the parties that the document in question will not be disclosed or used in any manner outside of the arbitration of the particular case, or the arbitrator may issue a confidentiality order. In cases where it is appropriate, ideally the parties will agree on a stipulation, as described above. This relieves the arbitrator from having to decide whether to issue a confidentiality order that may not be acceptable to all parties involved.

When deciding contested requests for confidentiality orders, arbitrators should consider the competing interests of the parties. The party asserting confidentiality has the burden of establishing that the documents in question require confidential treatment.

In deciding questions about confidentiality, arbitrators should, taking into account the facts of a particular case, consider factors such as the following:

- Whether the disclosure would constitute an unwarranted invasion of personal privacy (e.g., an individual's Social Security number, or medical information).
- Whether there is a threat of harm attendant to disclosure of the information.
- Whether the information contains proprietary confidential business plans and procedures or trade secrets.
- Whether the information has previously been published or produced without confidentiality or is already in the public domain.
- Whether an excessively broad confidentiality order could be against the public interest or could otherwise impede the interests of justice. Keep in mind that securities arbitration is closely regulated by the Securities and Exchange Commission. The former SEC Director of Enforcement, William R. McLucas, has stated: —P[]rivate [securities] actions will continue to be essential to the maintenance of proper investor protection." Therefore, it might not be in the best interest of the process to declare the entire proceeding confidential.

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- Whether there are any legal or ethical issues which might be raised by excessive restrictions on the parties.

These are just some of the factors to consider before issuing a confidentiality order that has not been agreed to by all parties to an arbitration proceeding.

Privileged Documents

Parties often object to the production of documents on the grounds that they are privileged.

Parties are not required to produce documents that are otherwise subject to an established privilege, including the attorney-client privilege or the attorney work product doctrine. The arbitrators shall not issue an order or use a confidentiality agreement to require parties to produce documents otherwise subject to an established privilege, including attorney work product.

Like all objections, objections based on privilege must be timely, specific and in writing. Parties may not simply fail to respond to discovery on the grounds that a document is privileged. If a party challenges another party's claim of privilege, the arbitrator must determine whether or not a privilege exists based on the facts and circumstances of the particular case.

Concerns about confidentiality and privilege might also be raised regarding subpoenas issued to non-parties. As a matter of practice, FINRA permits a non-party to file an objection to a subpoena served upon the non-party. The arbitrator may set up a conference call with a non-party and the parties to discuss the non-party's objection to the subpoena. Staff advises the non-party and the parties of the arbitrator's decision. Non-parties also may ask the arbitrators to resolve questions concerning who pays the costs incurred as a result of producing subpoenaed documents.

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Test Yourself

What are some factors to consider before issuing an order of confidentiality?

Answer.

Before issuing an order for confidentiality the arbitrator should consider the following factors:

- Whether the disclosure would constitute an unwarranted invasion of personal privacy (e.g., an individual's Social Security number, or medical information).
- Whether there is a threat of harm attendant to disclosure of the information.
- Whether the information contains proprietary confidential business plans and procedures or trade secrets.
- Whether the information has previously been published or produced without confidentiality or is already in the public domain.
- Whether an excessively broad confidentiality order could be against the public interest or could otherwise impede the interests of justice.
- Whether there are any legal or ethical issues which might be raised by excessive restrictions on the parties.

Test Yourself

If a party challenges another party's claim of privilege, what must the arbitrator determine?

Answer.

Parties may not simply fail to respond to discovery on the grounds that a document is privileged, e.g., attorney-client privilege or work product doctrine. If a party challenges another party's claim of privilege, the arbitrator must determine whether or not a privilege exists based on the facts and circumstances of the particular case.

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Section 4: Part IV - Discovery Abuse

Part IV - Discovery Abuse

This portion of the course reviews:

- how to recognize discovery abuse;
- what steps FINRA is taking to address discovery abuse; and
- what arbitrators can do to address discovery abuse.

Discovery Abuse

Discovery abuse can mean a lot of different things, but, in a nutshell, it occurs when a party intentionally fails to comply with or repeatedly ignores discovery rules or orders, or otherwise undermines the discovery process, in a way that materially interferes with the fair and efficient resolution of the dispute.

Discovery abuse is a serious problem that can cost parties time, money and ultimately jeopardize the ability of arbitrators to reach a fair and equitable decision on the merits of a case. Unfortunately, it has become more prevalent in FINRA arbitrations, a trend which suggests that some parties believe that it is a routine and acceptable part of arbitration strategy. It is not.

FINRA has taken a number of steps to reverse this trend. Those steps include issuing a *Notice to Members* and a *Notice to Parties* to remind participants of their duties in the discovery process, and the possible consequences of failing to comply with those duties. FINRA has also initiated a process of reviewing all allegations of discovery abuse for possible disciplinary review.
FINRA is hopeful that these steps will reduce discovery abuse. In the end, it is the arbitrators who can best control discovery abuse in FINRA arbitrations.

Notice to Members :
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_003073.pdf

Notice to Parties : http://www.nasd.com/ArbitrationMediation/ResourcesforArbitratorsandMediators/NASDW_009517

Steps FINRA Is Taking to Address Discovery Abuse

FINRA has become increasingly aware of instances in which parties are not complying with their duty to cooperate in the exchange of documents requested by parties or listed on applicable Document Production Lists within the specified time.

In 2003, FINRA issued a *Notice to Members* (03-70) reminding firms and their associated persons of their obligation to comply with FINRA discovery rules and procedures for production of documents and materials in arbitration claims. This was followed by a *Notice to Parties*, posted on FINRA's website. Like the *Notice to Members*, the *Notice to Parties* reminds all parties of their obligation to comply with the discovery procedures and outlines similar information contained in the *Notice to Members*.

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Steps FINRA Is Taking to Address Discovery Abuse (Continued)

Notice to Members :
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_003073.pdf

Notice to Parties :
http://www.nasd.com/ArbitrationMediation/ResourcesforArbitratorsandMediators/NASDW_009517

The *Notice to Members* reminds parties that noncompliance with their duty to cooperate in the discovery process—to voluntarily turn over documents listed on the Document Production Lists, or requested by other parties under the Code of Arbitration Procedure—is not an acceptable part of arbitration strategy. Failure to comply with discovery rules and procedure may result in sanctions. Possible sanctions include: assessing monetary penalties payable to one or more parties; precluding a party from presenting evidence; making an adverse inference against a party; assessing postponement and/or forum fees; assessing attorneys' fees, costs and expenses; and dismissal of a claim, defense or proceeding.

Managing Discovery Abuse

Arbitrators have two main tools for addressing discovery abuse. They can issue sanctions against any party, and they can make disciplinary referrals at the end of a case for abuse by FINRA firms and associated persons.

Sanctions

Arbitrators may issue sanctions pursuant to Rules 12511 and 12212 if any party fails to cooperate in the exchange of documents and information as required under the Code, unless the panel determines that there is —substantial justification" for the failure to produce the documents or information, or frivolously objects to the production of requested documents or information.

12511: http://www.finra.org/finramanual/rules/r12511

12212: http://www.finra.org/finramanual/rules/r12212

Unless prohibited by applicable law, sanctions may include, but are not limited to:

- assessing monetary penalties payable to one or more parties.
- precluding a party from presenting evidence;
- making an adverse inference against a party;
- assessing postponement and/or forum fees; and
- assessing fees, costs and expenses, or attorneys' fees caused by noncompliance.

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The panel may dismiss a claim, defense or arbitration with prejudice—meaning that the claim cannot be filed or raised again—for material and intentional failure to comply with an order of the panel if prior warnings or sanctions have proven ineffective.

If assessing monetary penalties, arbitrators must instruct parties to make them payable to one or more parties. Monetary penalties should not be made payable to FINRA as FINRA is not a party to the arbitration.

Examples of Sanctions

Here are some examples of sanctions that have been imposed by arbitrators:

- A panel found that a party intentionally concealed documents, delaying the discovery process. The panel assessed the party over $10,000 in sanctions and $2,500 in attorney's fees.
- A panel awarded a party over $7,000 due to another party's failure to cooperate in the discovery process.
- A panel awarded a party $2,750 in attorney's fees as a sanction for another party's failure to provide discoverable material.

For more information about sanctions, refer to the following:

- Discovery Guide;
- Arbitrator's Guide;
- *The Neutral Corner*, —National Adjudicatory Council Affirms Sanctions" (June, 2002 edition);
- *The Neutral Corner*, "Proactive Arbitrators Keep the Case Moving" (October, 2003 edition);
- *The Neutral Corner*, —NASD Launches Initiative to Curb Discovery Abuse" (December, 2003 edition);
- *The Neutral Corner*, —The Role of Arbitrators in Discovery" (Volume 2, 2008);
- *Notice to Members 03-70*, and
- *Notice to Parties*.

Discovery Guide:
http://www.nasd.com/ArbitrationMediation/Arbitration/DiscoveryGuideforArbitrationProceedings/index.htm

Arbitrator's Guide:
http://www.finra.org/ArbitrationMediation/Neutrals/ArbitrationProcess/ArbitrationCaseGuidanceResources/ArbitratorsReferenceGuides/

The Neutral Corner:
http://www.nasd.com/ArbitrationMediation/ResourcesforArbitratorsandMediators/GeneralInformationandReference/TheNeutralCorner/index.htm

Notice to Members:
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_003073.pdf

Notice to Parties:
http://www.nasd.com/ArbitrationMediation/ResourcesforArbitratorsandMediators/NASDW_009517

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Disciplinary Referrals

Failure to comply with the Code, or with the discovery orders of the arbitrators, may constitute a violation of FINRA's just and equitable principles of trade. Because FINRA has no jurisdiction over parties who are not registered with FINRA, disciplinary referrals can not be made against such parties.

Arbitrators should follow these guidelines when drafting disciplinary referrals:

- Provide as much detail as possible in writing. Whenever possible, arbitrators should note the specific act(s) that caused the panel to determine referral was appropriate (i.e., the firm ignored repeated warnings, or a comment was made in a prehearing conference implying the firm's intent not to produce).
- Discuss, objectively, why the activity or behavior appears to violate FINRA rules. If the panel becomes aware of a specific rule violation, the referral should include a reference to the rule.
- Explain what factors stood out from normal practice.
- If the activity occurred in the distant past, discuss why the panel believes it may be ongoing or could occur again in the future.

A copy of FINRA's disciplinary referral form can be viewed on FINRA's website.

disciplinary referral form:
http://www.nasd.com/web/groups/med_arb/documents/mediation_arbitration/nasdw_009516.pdf

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Test Yourself

What is discovery abuse?

Answer.

Discovery abuse occurs when a party intentionally fails to comply with or repeatedly ignore discovery rules or orders, or otherwise undermines the discovery process, in a way that materially interferes with the fair and efficient resolution of the dispute.

Test Yourself

List possible sanctions an arbitrator may direct for a party's failure to comply with the Code or a panel's discovery order?

Answer.

Possible sanctions, outlined in Rule 12212 of the Code, include:

- assessing monetary penalties payable to one or more parties;
- precluding a party from presenting evidence;
- making an adverse inference against a party;
- assessing postponement and/or forum fees; and
- assessing fees, costs and expenses, or attorneys' fees caused by noncompliance.

The panel may dismiss a claim, defense or arbitration with prejudice—meaning that the claim cannot be filed or raised again—for material and intentional failure to comply with an order of the panel if prior warnings or sanctions have proven ineffective.

Test Yourself

What guidelines should arbitrators follow to draft an effective disciplinary referral?

Answer.

Referrals should:

- Provide as much detail as possible in writing. Whenever possible, arbitrators should note the specific act(s) that caused the panel to determine referral was appropriate (i.e., the firm ignored repeated warnings, or a comment was made in a prehearing conference implying the firm's intent not to produce).
- Discuss, objectively, why the activity or behavior appears to violate FINRA rules. If the panel becomes aware of a specific rule violation, the referral should include a reference to the rule.
- Explain what factors stood out from normal practice.
- If the activity occurred in the distant past, discuss why the panel believes it may be ongoing or could occur again in the future.

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Section 5: Conclusion

Summary

Having completed this course, you should be able to:

- Understand the Discovery Guide.
- Explain the respective duties of the parties and the arbitrator with regard to the discovery process.
- Address requests for orders of confidentiality.
- Recognize discovery abuses and understand the possible sanctions for discovery abuses.

Next Steps

To test your understanding of the course material, please complete the attached Discovery, Abuses and Sanctions Exam and mail or fax it to FINRA for grading. Thereafter, FINRA will update your Arbitrator Disclosure Report to reflect that you have completed this course. You must complete the exam to receive credit for the course.

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FINRA Dispute Resolution

Discovery, Abuses & Sanctions Training Exam

Name: _____ Arbitrator ID#: A_____

Return Fax Number: 646-625-6028

Directions:

After reviewing the course, you must complete and submit the following exam to demonstrate your understanding of the material. **There is no minimum score required for the test; however, you must submit it to receive credit for completing the course.** Upon completion of the course and test, FINRA will automatically update your disclosure profile to reflect that you completed the course.

CLEARLY mark your answer.

- Include your name and arbitrator ID# on EVERY page.
- When you have completed the test, please FAX your pages to FINRA – Neutral Management Department at 646-625-6028.

1: Scheduling dates for discovery production is an important activity during the Initial Prehearing Conference.

TRUE FALSE

2: FINRA's Discovery Guide, including the Document Production Lists, serves as a guide for the parties and the arbitrators, allowing them to retain their flexibility in the discovery process.

TRUE FALSE

3: The arbitrator selected to make discovery decisions on behalf of the three-person panel is authorized to take appropriate actions to enforce compliance with orders to produce documents or witnesses.

TRUE FALSE

4: A request for information is just another way of asking for interrogatories.

TRUE FALSE

5: If the panel determines that a disciplinary referral is a justified sanction, the referral should be in writing and as detailed as possible; indicate the specific act(s) that caused the panel to determine referral was appropriate; and be made as soon as possible after the case concludes.

TRUE FALSE

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Name: _____ Arbitrator ID#: A_____

Return Fax Number: 646-625-6028

6: Parties are not required to produce documents that are otherwise subject to an established privilege, including the attorney-client privilege and the attorney work product doctrine.

TRUE FALSE

7: The Code makes clear that, absent a written objection, or an agreement by the parties to the contrary, parties must exchange documents listed on the Document Production Lists within the specified time frames.

TRUE FALSE

8: All documents on the Document Production Lists in the Discovery Guide will be appropriate for every customer case.

TRUE FALSE

9: If the panel determines that the noncompliance with an order of the panel is material and intentional, and prior warnings or sanctions have proven ineffective, it may dismiss a claim, defense, or proceeding ~~-~~with prejudice."

TRUE FALSE

10: Under the Code, the panel may issue all of the following sanctions:

I. Assessing monetary penalties payable to one or more parties.
II. Precluding a party from presenting evidence.
III. Making an adverse inference against the noncomplying party.
IV. Assessing postponement and/or forum fees.
V. Assessing attorneys' fees, costs and expenses.
VI. Initiating a disciplinary referral of a noncomplying FINRA firm—or of a person associated with a firm—at the conclusion of an arbitration.
VII. Dismissing a claim, defense or arbitration with prejudice for material and intentional failure to comply with an order of the panel if prior warnings or sanctions have proven ineffective.

TRUE FALSE

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