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May 1, 2026

Via E-Mail (pubcom@finra.org)

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1700 K Street, NW
Washington, DC 20006

Re: Comments on FINRA Regulatory Notice 26-06

Dear Ms. Mitchell:

The Fairbridge Investor Rights Clinic at the Elisabeth Haub School of Law at Pace University ("the Clinic")[1] welcomes the opportunity to respond to FINRA's request for comments on its efforts to modernize the rules, guidance and processes that govern arbitrations at FINRA Dispute Resolution.

The Clinic, which is staffed by third-year law students, working under the supervision of an experienced attorney, serves the interest of retail investors of modest means. The Clinic fulfills this mission by providing *pro bono* representation and counseling to individual investors who have suffered losses in their investment accounts and by advocating for regulatory changes to ensure investor protection.

[1] The Fairbridge Investor Rights Clinic is the successor to the Pace Investors Rights Clinic, which was opened in 1997, and was the nation's first law school clinic dedicated to providing pro bono representation to individual investors of modest means in securities disputes. *See* Barbara Black, *Establishing A Securities Arbitration Clinic: The Experience at Pace*, 50 J. LEGAL EDUC. 35 (2000); *see also* Press Release 97-101, Securities Exchange Commission, *SEC Announces Pilot Securities Arbitration Clinic To Help Small Investors – Levitt Response To Concerns Voiced At Town Meetings* (Nov. 12 1997), *available at* http://www.sec.gov/news/press/pressarchive/1997/97-101.txt.

The Clinic receives requests for assistance from investors all over the United States. During the past three years, more than 100 individual investors has sought the Clinic's assistance in connection with losses that they suffered in brokerage accounts. These investors have included men and women of all ages, races, and backgrounds. We have received requests for representation from retirees, college students, professionals with advanced degrees, and blue-collar workers. While the investors who seek the Clinic's assistance are diverse, we have noticed a common thread in their experiences. These investors know they have suffered losses, but they frequently do not understand what caused their losses. In many instances, these investors made complaints to the broker-dealers that held their accounts before contacting the Clinic. Likewise, many of these investors attempted to retain counsel before contacting the Clinic, but they were unable to retain counsel because their losses were too small to make their claims attractive to lawyers who work on a contingency basis.

Unfortunately, the Clinic can assist only a small fraction of the investors who seek our assistance. Thus, the Clinic has a strong interest in ensuring that FINRA continues to provide a fair and efficient forum for the resolution of disputes between broker-dealers and their customers. Our comments reflect our mission of protecting the rights of investors of limited means, particularly those investors who cannot retain counsel and must proceed *pro se*.

Unrepresented litigants always face significant challenges. These challenges are magnified when the adversary is a well-funded broker-dealer, represented by experienced counsel. We applaud FINRA's efforts to ensure the fairness of FINRA arbitrations to all participants, particularly *pro se* investors. The Clinic believes that the efficiency and fairness of FINRA arbitrations would be enhanced if FINRA adopted enhanced qualification and training requirements for arbitrators and updated the rules governing discovery and discovery motions and the Discovery Guide. In addition, the Clinic recommends that FINRA consider adopting a rule similar to Rule 11 of the Federal Rules of Civil Procedure. Finally, the Clinic objects to any proposal that would prohibit FINRA arbitrators from imposing punitive damages.

A. Arbitrator Qualifications and Training

The Clinic respectfully submits that FINRA should adopt enhanced requirements for arbitrator qualifications and training. Virtually every broker-dealer includes a mandatory arbitration clause in their account agreements. Thus, FINRA arbitrations are the "primary means

of resolving disputes in the securities industry." FINRA Arbitrator Guide at p. 9.

FINRA does not require its arbitrators to have "legal, arbitration or securities experience." FINRA, Become an Arbitrator.[2] Rather, FINRA requires arbitrators to have four-year degrees and at least five years of full-time professional work and to complete FINRA's Basic Arbitrator Training Program. Notice 26-06 at pp. 16-19. This training covers each stage of the arbitration process. *Id.* at 19. Although FINRA offers additional training, it is voluntary. *Id.* Further, FINRA does not require arbitrators who serve as chairpersons to have law degrees or experience in the securities industry. *See e.g.,* Rule 12400 (c). Rather, in customer disputes, chairpersons "must be public arbitrators," who by definition, do not have experience in the securities industry or in litigating securities disputes. *See* Rules 12400(c); 12400(t); 12400 (aa). Public arbitrators can become chairpersons by completing chairperson training and by: (1) being a lawyer who has "served as an arbitrator through award on at least one arbitration administered by a self-regulatory organization in which hearings were held" or (2) being a nonlawyer, who has "served as an arbitrator through award on at least three arbitrations administered by a self-regulatory organization in which hearings were held." Rule 12400 (c). Thus, FINRA's arbitrator qualifications are unusual in the field of arbitration, where "the most sought after" arbitrators "are those who are prominent and experienced members of the specific business community in which the dispute to be arbitrated arose." *STMicroelectronics, N.V. v. Credit Suisse Securities LLC,* 648 F.3d 68, 77 (2d. Cir. 2011); *see also Commonwealth Coatings Corp. v. Continental Cas. Co*, 393 U.S. 145, 148-49; and 150 (White, J. concurring) (1968).

We understand that FINRA adopted these standards in response to complaints that arbitrators with work experience in the securities industry were biased. The Clinic applauds FINRA's efforts to recruit a diverse pool of neutral and impartial arbitrators. However, the Clinic respectfully submits that the current qualification standards may result in arbitrations being heard by arbitrators who lack a rudimentary understanding of securities law, FINRA rules, the securities industry, and/or investment products. The Clinic does not believe that this enhances either the fairness or efficiency of the FINRA forum.

Indeed, arbitrators who lack knowledge regarding the securities laws, the securities

[2] https://www.finra.org/arbitration-mediation/become-arbitrator

industry, or investment products may lack the ability to critically evaluate the arguments of counsel representing broker-dealers. This risk is amplified when investors appear *pro se.* For example, if a broker-dealer claims that an account is self-directed or that an investor directed trades and withholds certain documents identified on Document List No. 1, such as Form CRS, trade tickets, or trade blotters, the arbitrators may not ask to see this highly relevant, if not dispositive evidence. This is extremely prejudicial to the customer and is likely to undermine the integrity of the award.

Thus, it is imperative that all chairperson-qualified arbitrators have sufficient knowledge of the securities laws, FINRA rules, investment products, and the securities industry to make well-informed decisions. The Clinic respectfully submits that FINRA should require all chairperson-qualified arbitrators to have law degrees and to require them to successfully complete training concerning: (1) the relevant securities law and regulations which define a broker-dealer's duty of care (including, Regulation Best Interest, Form CRS, and FINRA Rules 2010, 2090, 2110, and 3110); (2) a broker-dealer's record-keeping obligations, (including FINRA Rules 4511 and 4512, and those portions of and Securities Exchange Act ("SEA") Rules 17a-3 and 17a-4, which pertain to customer accounts and customer transactions); and (3) certain common investment products. This mandatory training will ensure that chairperson-qualified arbitrators understand the relevant legal and business concepts and the existence and availability of relevant evidence. This will level the playing field and enhance the fairness and efficiency of the FINRA forum and the quality of decision making.

Furthermore, this training is a necessary safeguard because there is virtually no judicial review of arbitration awards.[3] Indeed, "courts may vacate an arbitrator's decision 'only in very unusual circumstances,'" and "an arbitrator's error – even his [or her] grave error – is not enough" to vacate an award. *Oxford Health Plans, LLC v. Sutter,* 569 U.S. 564, 568 (2013). Thus, for all practical purposes, an arbitration award is final and not subject to meaningful judicial review. Given the fact that many Americans plan for retirement by investing in individual retirement account, it is imperative that FINRA arbitrators have the training necessary

[3] Indeed, in *Hall Street Associates LLC v. Matel Inc.,* 552 U.S. 576, 581 -84 (2008), the Supreme Court held that a court may must confirm an arbitration award unless the party seeking to vacate the award can demonstrate it should be vacated or modified under one grounds identified in Sections 10 or 11 of the FAA. The Supreme Court has repeatedly reaffirmed *Hall Street,* and has emphasized that "[u]nder the FAA, courts may vacate an arbitrator's decision 'only in very unusual circumstances.'' *Oxford Health Plans, LLC v. Sutter,* 569 U.S. 564, 568 (2013)

to critically evaluate the parties' evidence and arguments and render fair awards. This is particularly important for *pro se* investors, who are frequently outmatched by respondents represented by experienced counsel.

B. Modification to the Rules and Procedures Governing Discovery and Discovery Motions

FINRA has made extensive efforts to ensure that FINRA arbitration "is a quick, fair, and relatively inexpensive alternative to litigation." Arbitrator Guide at p. 9. FINRA Rule 12505 requires the parties to cooperate in discovery and Rule 12506 requires parties to produce the presumptively discoverable documents identified in the Discovery Guide within 60 days of the answer. Thus, when discovery proceeds as contemplated by FINRA Rules and the Discovery Guide, all parties should have early access to the relevant documents. However, discovery abuses, including the failure to produce presumptively documents, continue. Notice 26-06 at p. 21. Discovery abuses do not only delay arbitrations, but they also undermine the fact-finding process and threaten the integrity of the arbitration process. This is especially true when a *pro se* investor is pitted against experienced counsel and the case is adjudicated by arbitrators who do not understand the content or relevance of the presumptively discoverable documents identified on Document List No. 1. The Clinic recommends modest amendments to Rules 12506 and 12511, and the Discovery Guide to ameliorate this problem.

1. Rule 12506 and Discovery Guide Should Require the Disclosure of Witnesses

Rule 12506 and the Discovery Guide require the early disclosure of relevant documents, but they do not require the parties to identify people with knowledge of the events at issue. Investors usually do not know the identity of the branch manager or the compliance/supervisory personnel who were responsible for supervising the registered representative or the activity in their account. Thus, investors must serve information requests to obtain this information, and they must wait sixty days for a response. *See e.g.,* Rule 12507. This impedes discovery because investors cannot engage in discussions about e-discovery and email searches, or evaluate the completeness of any document production, without knowing the names of these witnesses.

To streamline this process, FINRA could amend Rule 12506 and Document List No. 1 of the Discovery Guide to require member firms and registered representatives to produce organizational charts that identify the branch managers and compliance/supervisory personnel

who supervised the registered representative and/or reviewed the transactions in the customer's account. In addition, FINRA could amend Rule 12506 to require respondents to disclose the names of these individuals when they produce the documents identified in List No. 1.

This is not a novel or burdensome suggestion. Rule 26(a)(1)(A) of the Federal Rules of Civil Procedure, which governs all cases filed in federal courts, requires parties to disclose "the name, and if known, the address and telephone number, of each individual likely to have discoverable information, along with the subjects of that information, that the disclosing party may use to support its claims and defenses." Fed. R. Civ. Pro. 26(a)(1)(A). Further, respondents know the identity of these individuals. *See e.g.,* FINRA Rule 3110(a). Thus, the Clinic recommends amending Rule 12506 and Document List No. 1 to require respondents to identify branch managers and supervisory/compliance personnel within 60 days of the answer. This is not burdensome and it will greatly enhance the efficiency of discovery.

2. The Discovery Guide Should Describe Key Documents on Document List No. 1 and Summarize Broker-Dealers' Regulatory Obligations to Keep these Documents

FINRA Rule 12506 and the Discovery Guide, which identify "presumptively discoverable documents," provide a critical roadmap for conducting discovery. Litigators know that the designation of a document as "presumptively discoverable" reflects FINRA's judgment that these documents are relevant in virtually every case. However, *pro se* investors may not understand that FINRA has deemed these documents "presumptively discoverable" because they are almost always relevant to the dispute.

Similarly, investors and some arbitrators may not be familiar with some of the documents identified in Document List No. 1 of the Discovery Guide. Thus, they may not know what kind of information is reflected in these documents. Likewise, they may not understand Securities and Exchange Act ("SEA") Rules 17a-3 and 17a-4 and FINRA Rules 4511 and 4512 require broker-dealers to keep many of the documents identified in Document List No. 1. This knowledge gap allows broker-dealers and registered representatives to avoid producing these presumptively discoverable and clearly relevant documents by asserting boilerplate objections. *See e.g.,* Notice 26-06 at p. 21. This problem can be ameliorated by updating the Discovery Guide to include: (1) an explanation that "presumptively discoverable" are almost always relevant; (2) adding descriptions of key documents; and (3) addition a discussion of the record

keeping requirements.

For example, Document List No. 1 requires firms to produce many documents that reflect the firm's supervisory process, including order tickets, trade blotters, exception reports, concentration reports, and communications between supervisory personnel and the registered representatives assigned to the customer account. *See e.g.,* Document List No. 1, Items 1(a); 1(b), 3, 4, 6, 7, 9, 11, and 13. However, the Discovery Guide does not describe these documents or explain the information contained in these documents. It also does not explain the SEA Rules 17a-3 and 17a-4 and FINRA Rules 4511 and 4512 obligate firms to keep these documents.[4] Thus, firms routinely object to the producing these relevant documents on the ground that it is "unduly burdensome" to produce them.

It is plainly improper for firms to object to producing presumptively discoverable documents, which they have a regulatory obligation to keep, on the ground that production is burdensome. Indeed, in our experience, firms abandon these objections when confronted with a motion to compel that explains both the content of the documents and the regulatory obligation to keep the documents. However, *pro se* investors are unlikely to file such motions. Further, arbitrators who lack experience with the securities laws or industry may not be familiar with the content of these documents or a broker-dealer's obligation to keep them. Thus, respondents delay producing and sometimes succeed in concealing highly relevant and potentially dispositive documents by exploiting this knowledge gap. This is obviously prejudicial to investors.

These tactics could be avoided if the Discovery Guide described certain critical documents, such as order tickets, blotters, exception reports, and concentration reports, and explained that firms have an independent regulatory obligation to keep these documents. FINRA has already published such a document containing this information,[5] and could include a similar list or a hyperlink in the Discovery Guide. Providing this information in the Discovery Guide should curtail the use of boilerplate objections to producing these documents. It will also ensure that arbitrators have the information necessary to "determine if the document is relevant or likely

[4] Indeed, on September 24, 2024, the Securities and Exchange Commission ("SEC") took enforcement actions against multiple firms for failing to keep electronic communications and imposed civil penalties, which totaled over $88 million dollars. *See* https://www.sec.gov/newsroom/press-releases/2024-144

[5] *See e.g.,* https://www.finra.org/sites/default/files/2022-02/Books-and-Records-Requirements-Checklist-for-Broker-Dealers.pdf

to lead to relevant evidence" and "whether there are alternatives that can lessen the impact" of production. Discovery Guide at p. 1. These modest amendments will level the playing field between customers and member firms and may eliminate unnecessary delays and lead to better decisions.

3. The Discovery Guide Should Provide Examples of Frivolous Objections

Notice 26-06 indicates that commenters have expressed concern about "frivolous" and "boilerplate" objections to discovery requests. However, the Discovery Guide and the Arbitrator Guide do not contain any discussion of what constitutes "frivolous" objections. Thus, arbitrators who are not lawyers and *pro se* investors may not be able to identify frivolous objections. The Clinic believes the Discovery Guide should provide guidance about what constitutes a frivolous objection.

For example, it seems frivolous for firms to object to producing documents that they have a regulatory obligation to keep (such as blotters, trade tickets, exception reports, and emails) as "unduly burdensome." Likewise, it seems frivolous to object to producing documents by citing the number of pages of documents that have been produced, particularly where broker-dealers should have the vast majority of relevant documents, such as account opening agreements, blotters, trade tickets, written supervisory procedures, and account statements. While much of this information may seem obvious to lawyers, it may not be obvious to non-lawyer arbitrators or to *pro se* investors. Thus, including examples of frivolous objections may deter discovery abuses and will ensure that *pro se* customers and arbitrators understand how to evaluate objections.

4. Document List No. 1 Should Require Firms to Disclose Regulatory Actions Concerning Related Supervisory Failures and Sanctions Related to Discovery Abuses

The Clinic believes that Items 15, 16 and 17 of Document List No. 1 should be amended to require respondents to produce documents concerning disciplinary actions and investigations related to supervisory failures by the firm. The Clinic also believes that FINRA should add a new item to Document List No. 1, which requires the production of documents related to discovery abuses.

Currently, Item 15 requires respondents to produce documents related to disciplinary

action taken against the registered representative who managed the customer's account and the firm "for sales practice violations *or conduct similar to the conduct alleged*" in the Statement of Claim. Discovery Guide at p. 11 (emphasis added). Similarly, Item 16 requires respondents to produce documents concerning "investigations, charges, or findings by any regulator" and "the firm/associated persons' responses." *Id.* Finally, Item 17 requires the production of examination reports concerning "the associated person, the customer parties' claims, accounts, or transactions, or *the product or type of product at issue*, or that *discussed alleged improper behavior in the branch against other individuals similar to the conduct alleged in the Statement of Claim*." *Id.* at pp. 11-12 (emphasis added). Items 15, 16, and 17 require the production of documents that reflect what the firm knew about the registered representative's alleged misconduct, about similar misconduct within the registered representative's branch, and about issues with specific products. Although these documents clearly bear on the adequacy of a firm's supervision, Items 15, 16, and 17 they do not contain the word "supervision." The Clinic respectfully submits that these items should be amended to require the production of documents concerning the firm's supervision of the registered representative, the customer's account and the products at issue.

A failure to supervise is clearly a violation of a broker-dealer's duty of care under FINRA Rule 3110 and Regulation Best Interest. Supervisory failures, like sales practice violations, cause investor losses. Indeed, FINRA's statistics indicate that failure to supervise is the third most commonly pled claims in customer disputes.[6] Thus, documents concerning disciplinary actions, investigations, charges, findings or examination reports concerning similar supervisory failures are clearly relevant to the adequacy of the supervision, as it bears on the firm's knowledge of a potential problem and its response to that problem.

However, firms may rely on the absence of the word supervision to resist producing documents responsive to Items 15, 16, and 17. Indeed, the Clinic is aware of a situation where a firm failed to produce Acceptance, Waiver and Consent (AWC) resolving a disciplinary action concerning its failure to supervise the recommendation of the products at issue in an arbitration and then refused to produce the Wells Notice and Wells Response related to the AWC, as well as

[6] *See e.g.,* https://www.finra.org/arbitration-mediation/dispute-resolution-services-statistics#arbitrationstats

several documents referenced in the AWC when it was requested to do so. The firm argued it had no obligation to produce these documents because the AWC did not involve the registered representative who handled the customer's account or conduct within his branch. However, the AWC involved the same products, and the same supervisory failure and supervision was conducted by a central unit, rather than specific branches. Given the prevalence of failure to supervise claims and "product cases," the Clinic recommends that FINRA amend Items 15, 16, and 17 to require the production of documents concerning disciplinary actions, charges, findings, investigations concerning supervisory failures and specific products. This will ensure that parties and arbitrations have the documents necessary to evaluate the merits of failure to supervise claims and product cases.

In addition, the Clinic recommends that FINRA amend Document List No. 1 to require firms to produce documents concerning disciplinary actions related to record keeping and discovery violations and discovery sanctions imposed during customer arbitrations. Requiring such disclosures should deter refusals to produce presumptively discoverable documents and they should also help arbitrators recognize recurring patterns of misconduct. This will eliminate discovery delays and enhance efficiency of FINRA arbitrations.

5. The Discovery Guide Should Include a Standard Confidentiality Stipulation

Document List Nos. 1 and 2 require both customers and respondents to produce documents, such as account opening documents, account statements, and tax returns, which contain social security numbers and confidential financial information. The Discovery Guide recognizes that confidentiality stipulations *may* be appropriate, but it does not provide detailed guidance regarding the terms of an appropriate confidentiality stipulation. Discovery Guide at p. 4. The Clinic respectfully submits that confidentiality stipulations are *always* appropriate. We recommend including a standard confidentiality stipulation, which plainly states that it does not restrict an investor's ability to disclose documents to regulators, including FINRA, the SEC, and/or any other regulator or self-regulatory organization,[7] in the Discovery Guide.

Including a standard confidentiality stipulation in the Discovery Guide will enhance the

[7] *See e.g.,* Reg. Not. 14-40 at p. 3. The Arbitrator Guide explains that confidentiality agreements cannot restrict a customer's right to disclose information to regulators. Arbitrator Guide at p. 33.

efficiency and fairness of FINRA arbitrations. A standard confidentiality stipulation will eliminate unnecessary disputes about the need for and scope of such stipulations. Further, a standard confidentiality stipulation will assist *pro se* customers, who may be reluctant to proceed with FINRA arbitrations or who may accept inappropriately discounted settlement offers, when they learn they must produce tax returns and other financial documents. Similarly, it will ensure that *pro se* customers understand that they can disclose information to regulators, which will promote investor protection.

Adopting a standard confidentiality stipulation should not be controversial. Many courts, including New York's Commercial Division, have adopted standard confidentiality stipulations.[8] Thus, the Clinic strongly recommends that FINRA include a standard confidentiality agreement in the Discovery Guide.

6. FINRA Should Amend Rule 12511

The Clinic also believes that FINRA should consider amending Rule 12511, which governs the availability of sanctions for discovery violations. Rule 12511 makes no distinction between the sanctions that are available for violations of Rule 12506, which requires the automatic production of the presumptively discoverable documents identified in Document Lists 1 and 2, and the sanctions which are available for violations of Rule 12507, which govern additional discovery requests. However, the automatic disclosures required by Rule 12506 are integral to the efficient and fair resolution of every customer dispute. Indeed, FINRA's advanced discovery training emphasizes that the timely production of documents "is vital to the fair and cost-efficient resolution of disputes" and instructs arbitrators to "generally assume that a document" responsive to the Document Lists referenced in Rule 12506, should be produced, "unless the party in control of the document demonstrates a *compelling reason not to produce it.*" FINRA Discovery, Abuses and Sanctions Training (June 2021) at p. 5 (emphasis added).[9]

Violations of the duty to make the automatic disclosures required by Rule 12506 are both less excusable and more prejudicial than failures to respond to additional discovery requests under Rule 12507. As detailed above, broker-dealers have a regulatory obligation to keep many

[8] *See e.g.,* NYCRR 202.70, Rule 11-g; available at https://ww2.nycourts.gov/rules/trialcourts/202.shtml#70

[9] The Clinic believes that the Discovery Guide should include this instruction as well.

of the documents identified in Document List No. 1 and these documents almost always crucially relevant, if not dispositive, in many customer cases. Thus, the failure to produce these documents does not simply delay discovery, it is also prejudicial to the investor and unreasonable. Thus, motions to compel the discovery authorized by Rule 12506 should be treated differently then than motions to compel discovery under Rule 12507.

The Clinic recommends that FINRA amend Rule 12511 to require arbitrators to impose forum fees against broker-dealers who wrongfully refuse to produce documents responsive to Document List No. 1 and to require the award of attorney's fees when arbitrators conclude that broker-dealers asserted frivolous objections to producing these documents. There is precedent for both automatic sanctions and presumptions in favor of sanctions in the FINRA Code of Arbitration Procedure. Rule 12504, which governs motions to dismiss, requires arbitrators to award forum fees when they deny a motion to dismiss. Rule 12504(a)(9); Arbitrator Guide at p. 48. Rule 12504 also requires arbitrators to award reasonable costs and attorney's fees when they find that a motion to dismiss is frivolous. Rule 12540(a)(10); Arbitrator Guide at pp. 48-49. Finally, Rule 12504 allows arbitrators to impose any sanction identified in Rule 12212 if they determine that a motion to dismiss is filed in bad faith. Rule 12504 reflects FINRA's judgment that pre-hearing motions to dismiss should be discouraged because "parties have a right to a hearing in arbitration." Arbitrator Guide at p. 49; Rule 12504(a)(1). Inherent in the right to a hearing, is the right to a fair hearing, where both parties have access to the relevant documents. The Clinic respectfully submits that failures to disclose the documents identified in Document List No. 1 impede the right to a hearing as much as baseless motions to dismiss.

The Clinic understands that the automatic, but modest, sanctions set forth in Rule 12504 have deterred the filing of baseless motions to dismiss. Thus, we believe that FINRA should amend Rule 12511 to require arbitrators to award forum fees when it grants motions to compel the production of documents identified on Document List No. 1. We also believe that FINRA should amend Rule 12511 to require arbitrators to award reasonable costs and attorney's fees

when broker-dealers assert frivolous objections to producing these documents. [10]

The Clinic does not recommend that FINRA require automatic sanctions against investors who fail to produce documents responsive to Document List No. 2 for several reasons. First, unlike broker-dealers, investors do not have an independent regulatory obligation to keep the documents identified on Document List No. 2 and they are not generally repeat players at FINRA arbitration. Thus, producing some of the documents on Document List No. 2 may be either impossible or genuinely burdensome for investors, even when they are represented. Second, complying with Document List No. 2 is a daunting task for *pro se* investors. They should not be sanctioned for their inability to function as lawyers.

In sum, the Clinic believes that an amendment to Rule 12511, that requires mandatory, but modest, sanctions against broker-dealers who refuse to produce the documents identified on Document List No. 1, will enhance the efficiency and fairness of FINRA arbitrations.

C. FINRA Should Adopt a Rule Defining Frivolous Conduct

FINRA Rule 12504(a)(9) requires arbitrators to award reasonable costs and attorney's fees against a party who files "a frivolous" motion to dismiss before the conclusion of a party's case in chief. Similarly, IM-12000 indicates that failing to submit a claim to arbitration or failing to produce documents as required by the Code may be deemed inconsistent with "just and equitable principles of trade" and a violation of Rule 2010. Moreover, commenters have expressed concern over frivolous objections to discovery requests. Notice 26-02 at p. 21.

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[10] Specifically, the Clinic recommends that FINRA amend Rule 12511(a) as follows:

(a) Failure to cooperate in the exchange of documents and information under the Code is improper and inconsistent with just and equitable principles of trade.
  (1) If the panel grants a motion to compel the production of documents responsive to Document List No. 1 as required by Rule 12506; the panel must order the respondent to pay the forum fees associated with the motion;
  (2) If the panel finds that a respondent has asserted frivolous objections to producing documents responsive to Document List No. 1 as required by Rule 12506; the panel must also order the respondent to pay the reasonable costs and reasonable attorney's incurred in connection with the motion to compel;
  (3) The panel may issue sanctions against any party in accordance with Rule 12212(a) for failing to comply with any the discovery provisions of the Code, unless the panel finds there is substantial justification for the failure to comply;
  (4) The panel may issue sanctions against any party in accordance with Rule 12212(a) for frivolous objecting to the production of requested documents or information.

However, there is no rule that defines "frivolous" conduct or which prohibits the filing of "frivolous" pleadings. While lawyers usually understand what constitutes "frivolous" conduct, *pro se* investors and nonlawyer arbitrators may not understand this concept. Thus, FINRA should consider adopting a rule similar to Federal Rule of Civil Procedure 11 to ensure that litigants and arbitrators have a common understanding of what constitutes frivolous conduct and to deter factually frivolous pleadings and behavior designed to create delays or to increase costs.

Rule 11(b)(3) requires that factual contentions in every pleading "have evidentiary support or, if so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery." Fed. R. Civ. Pro. 11(b)(3). Similarly, Rule 11(b)(4) requires that "denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief of lack of information." Fed. R. Civ. Pro. 11(b)(4). Rule 11(b)(1) prohibits filing pleadings for "any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation." Fed. R. Civ. Pro. 11(b)(1). Thus, Rule 11 explains that litigants must have a good faith basis for their factual allegations and denials, and that they may not file pleadings to harass, cause delay, or increase costs.[11]

The Clinic believes adopting a rule that defines and prohibits frivolous conduct will enhance the fairness and efficiency of FINRA arbitrations. There are frequently significant power and knowledge disparities between member firms and their customers in FINRA arbitrations. Customers often do not understand the securities laws and FINRA rules and do not have access to the relevant documents. In contrast, member firms have substantial expertise regarding the laws and rules and they are obligated to keep documents relevant to most claims, including documents related to the customer's investment profile, risk tolerance, account, the transactions, and their supervision of the transactions. Respondents, who have 45 days to respond to any statement of claim, have more than sufficient time to review these relevant documents before filing an answer. Thus, there is no excuse for filing an answer that contains

[11] Rule 11 also forbids filing pleadings that contain claims, defenses, or legal contentions that are not "warranted by existing law or by a nonfrivolous argument for extending, modifying, or revising existing law or for establishing new law." Fed. R. Civ. Pro. 11(b)(2). The Clinic does not recommend including such a provision in any FINRA rule. Such a provision may deter *pro se* investors, who lack legal training, from initiating arbitrations or asserting claims. Further, such a provision is inconsistent with the equitable nature of arbitration. Finally, the case law on many issues is either undeveloped or out of date due to the limited judicial review of arbitration awards.

representations or denials that are inconsistent with these records. Similarly, there is no excuse for withholding these documents during discovery.

Indeed, these tactics constitute frivolous litigation conduct. They also undermine the integrity of the fact finding process and they create unnecessary delays and expenses. Further, these tactics are inconsistent with high standards of commercial honor and just and equitable principles of trade. The Clinic believes that adopting a rule which provides a clear and concrete definition of frivolous conduct will not only deter such conduct, but it will also give the arbitrators the tools necessary to deal with such conduct.

D. FINRA Should Not Limit the Availability of Punitive Damages

There is no reason to limit the availability of punitive damages at FINRA arbitration. More than thirty years ago, the Supreme Court recognized that punitive damages can be awarded in securities arbitrations. *See Mastrobuono v. Shearson Lehman Hutton, Inc.,* 514 U.S. 52 (1995). Similarly, FINRA has long prohibited pre-dispute arbitration agreements that limit the ability of any party to file any claim in arbitration or limit the ability of arbitrators to make any awards. *See* FINRA Rule 2268(d)(2)-(4). Although punitive damages have been available in FINRA arbitration for years, there is no data which indicates that excessive punitive damages awards are a problem in FINRA arbitrations. To the contrary, FINRA reports that between March 1988 and December 2025, arbitrators awarded punitive damages in only 3% in all cases. Notice 26-06 at p. 28. Moreover, this consistent with the Clinic's experience reviewing arbitrator disclosures, which reveal the vast majority of FINRA arbitrators have never awarded punitive damages. This is not surprising. Arbitrators understand that respondents, who are repeat players in FINRA arbitrations, can strike arbitrators with a history of awarding punitive damages or sanctions of any kind.

Further, eliminating the availability of punitive damages would be inconsistent with U.S. law, which allows the imposition of punitive damages to deter and punish misconduct. *See e.g., State Farm Mut. Auto Ins. Co. v. Campbell,* 538 U.S. 408, 416 (2003). Prohibiting punitive damages would also be inconsistent with FINRA's mission of investor protection and market integrity. In the typical customer case, the losses, while significant to the customer, represent a rounding error to the broker-dealer. If punitive damages were not available at FINRA arbitrations, member firms would be less likely to settle cases involving severe misconduct and

might be less rigorous in their efforts to comply with the securities laws and rules. Further, a prohibition on punitive damages, which are widely available in court, would create the perception that the FINRA forum is biased in favor of FINRA member firms.

Similarly, there is no reason for FINRA to cap punitive damages. The absence of "judicial safeguards" at FINRA arbitration do not warrant a cap on punitive damages. Indeed, it is not clear that there are any real "judicial safeguards" against punitive damages awards in court cases. Although judges instruct juries on the availability of punitive damages, juries, not judges, award punitive damages. Moreover, the Supreme Court has repeatedly refused to impose a mathematical limit on punitive damages or to identify a permissible ratio between compensatory and punitive damages. *See e.g., State Farm,* 538 U.S. at 424 (citing cases).

Finally, it is not clear that additional procedural safeguards are warranted. Punitive damage awards are extremely rare. Moreover, the Arbitrator's Guide provides appropriate guidance concerning the award of punitive damages. It explains that "punitive damages are not intended to right a wrong, but are intended to punish the wrongdoer and to deter future wrongdoing." Arbitrator Guide at p. 69. It also explains that punitive damages are available only upon a finding of intentional or malicious misconduct, reckless, or gross negligence. *Id.* This is an accurate statement of the law. To the extent that further guidance necessary, FINRA could include the Supreme Court's three-part test for analyzing the reasonableness of any punitive damages award, which requires consideration of (1) the degree of reprehensibility of the misconduct; (2) the ratio of the punitive damages award to the compensatory damages award; and (3) a comparison of the punitive damages to available civil and criminal penalties, with the degree of reprehensibility being the most important factor. *See e.g., BMW of North America, Inc. v. Gore,* 517 U.S. 559, 575 - 585 (1996). The Clinic respectfully submits that the evidence of deceitfulness, reckless or intentional disregard of the customer's investment profile, financial vulnerability, or lack of sophistication, which is relevant to the issue of reprehensibility, is also relevant to the issue of liability in most cases. Thus, procedural safeguards, such as bifurcation, seem unnecessary and might lead to duplicative hearings.

In sum, punitive damages awards are exceedingly rare in arbitrations and are likely to remain rare because respondents have the ability to strike arbitrators with a history of punitive damages awards. Thus, prohibiting punitive damages, capping punitive damages, or requiring

additional procedures as a prerequisite to awarding punitive damages, seems like a radical and unwarranted response to a problem that does not exist. Such actions would limit the relief available to investors, which is inconsistent with FINRA's mission of investor protection. It would create the perception that FINRA arbitration is not fair.

II. Conclusion

In sum, the Clinic appreciates FINRA's commitment to providing a fair and efficient dispute resolution forum. To ensure that FINRA arbitrations remain fair and efficient, the Clinic believes that FINRA should require chairperson-qualified arbitrators to be lawyers and it should provide additional mandatory training to arbitrators. The Clinic recommends changes to the Discovery Guide, Rule 12506 and Rule 12511, to ensure the prompt disclosure of documents, the early identification of witnesses, and the execution of confidentiality stipulations. The Clinic also recommends that FINRA consider adopting a rule defining frivolous conduct. Finally, the Clinic opposes any effort to limit the availability of punitive damages as unnecessary.

We appreciate the opportunity to provide feedback on these critical investor protection concerns and support FINRA's ongoing efforts to protect the interests of the investing public.

Respectfully submitted,

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