Financial Industry Regulatory Authority

September 15, 2008

Ms. Florence Harmon
Deputy Secretary
U. S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No. SR-FINRA-2007-021 – Proposed Rule Change to Amend Rules 12206 and 12504 of the Code of Arbitration Procedure for Customer Disputes and Rules 13206 and 13504 of the Code of Arbitration Procedure for Industry Disputes to Address Motions to Dismiss and to Amend the Provision of the Eligibility Rule Related to Dismissals; Response to Comments

Dear Ms. Harmon:

The Financial Industry Regulatory Authority, Inc. (FINRA) (formerly known as the National Association of Securities Dealers, Inc. (NASD)) hereby responds to the comment letters received by the Securities and Exchange Commission (SEC) with respect to the above rule filing. In this rule filing, FINRA[1] is proposing to amend NASD Rules 12206 and 12504 of the Code of Arbitration Procedure for Customer Disputes (Customer Code) and NASD Rules 13206 and 13504 of the Code of Arbitration Procedure for Industry Disputes (Industry Code).

The proposal would provide specific procedures that would govern motions to dismiss, and amend the provision of the eligibility rule related to dismissals.[2] Specifically, under the proposal, arbitrators may not grant a motion to dismiss before the conclusion of a claimant's case-in-chief, with three exceptions: (1) the claimant signed a settlement and release; (2) the respondent was not associated with the account, security, or conduct at issue; or (3) the claim is not eligible for arbitration because it does not meet the existing six-year time limit on the submission of arbitration claims (the "eligibility" rule). The proposal also would implement other procedural safeguards aimed at deterring parties from filing motions frivolously or in bad faith.

The SEC received 118 comment letters on the proposal: 62 commenters oppose the proposal, 52 support the proposal, and 4 commenters' positions are unclear.[3] Of the 52 commenters who support the proposal, two expressed unconditional support.[4] Many of the remaining supporters believe the proposal should be approved, but also believe

[1] Although some of the events referenced in this response to comments occurred prior to the formation of FINRA, this response refers to FINRA throughout for simplicity.

[2] *See* Securities Exchange Act Rel. No. 57497 (March 14, 2008), 73 FR 15019 (March 20, 2009) (File No. SR-FINRA-2008-021, Notice of Filing of Proposed Rule Change and Amendment No. 1 Relating to Amendments to the Customer and Industry Codes to Address Motions to Dismiss and to Amend the Eligibility Rule Related to Dismissals).

[3] *See* List of Commenters attached as Exhibit A.

[4] Korsak and Heiner Letters.

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that all motions to dismiss should be prohibited in FINRA's arbitration forum.[5] The commenters who oppose the proposal do so for various reasons, such as concern that the proposal is unjustified and unnecessary;[6] that it limits unnecessarily prehearing motions to dismiss;[7] or that it will increase parties costs.[8] In light of the number of comments submitted and scope of issues raised,[9] the following response summarizes the most common issues and concerns and provides FINRA's response to them.

Policy Statement on Prehearing Motions

Proposed Rules 12504(a)(1) and 13504(a)(1) state that motions to dismiss a claim prior to the conclusion of a party's case in chief are discouraged in arbitration. Many commenters addressed this statement of policy regarding motions to dismiss in FINRA's arbitration forum and, in particular, the use of the word "discouraged."

Six commenters support the rule language and believe it sets an appropriate tone for the rest of the proposal.[10] Two commenters contend that the rule language is not forceful enough and should contain language indicating that motions to dismiss are discouraged and should be granted only in extraordinary circumstances.[11] A commenter who opposes the proposal contends that, without this language, the proposal would appear to authorize and encourage motions to dismiss in the forum.[12] Seventeen commenters oppose the rule language and argue that this policy statement unfairly discourages all motions to dismiss in the forum, and creates an unnecessary bias against these motions.[13]

Generally, FINRA believes that parties have the right to a hearing in arbitration. Proposed Rules 12504(a)(1) and 13504(a)(1) reinforce this position by clarifying that prehearing motions to dismiss are discouraged in arbitration. Thus, FINRA believes that the word "discouraged" is appropriately placed in the rule language, and accurately describes its view of prehearing motions to dismiss in the forum.

FINRA also disagrees with those commenters who contend that this policy statement unfairly discourages all motions to dismiss in the forum. While the proposal limits the exceptions under which a prehearing motion to dismiss may be granted, proposed Rules 12504(b) and 13504(b) permit parties to file a motion on any ground after the conclusion of a party's case in chief. FINRA believes that it would be unfair to require parties to incur additional hearing session fees if there is a valid reason to

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[5] See, e.g., Caruso, Shewan, Lewins, St. John's, and Kruske Letters.

[6] *See, e.g.*, McDermott Letter.

[7] *See, e.g.,* SIFMA, Farley, Bingham, and Kaufman Letters.

[8] *See, e.g.,* Lampart, Wallis, Berberian, and Dulcich Letters.

[9] Some commenters chose to focus on one or two issues; while others commented on several issues. Thus, the number of commenters who support or oppose a particular issue will be less than the total number of commenters who support or oppose the proposal overall.

[10] *See, e.g.,* PIABA 2, Lawlor, and Carlson Letters.

[11] Black/Gross and Sonn Letters.

[12] Lipner Letter.

[13] *See, e.g.,* SIFMA, Wachovia, Ungar/Bravo, and Forchhiemer Letters.

dismiss after the claimant's case. In those cases, a panel may grant a motion to dismiss, under proposed subparagraph (b), if the moving party proves such action is warranted.

FINRA emphasizes that the proposed rules do not constitute an invitation to parties to file prehearing motions to dismiss. The fact that a motion may be filed under one of the exceptions in the proposal does not mean that the panel should or will grant the motion.

In a prior, withdrawn proposal, FINRA stated that motions to dismiss should be granted only in extraordinary circumstances.[14] Some commenters suggest that the absence of that language in the current proposal authorizes or encourages motions to dismiss. FINRA disagrees, and believes that the current proposal removes the ambiguity that the "extraordinary circumstances" concept created, and outlines expressly FINRA's position concerning motions to dismiss. As noted above, the current proposal would provide for three limited exceptions under which a motion to dismiss may be granted before the conclusion of a claimant's case-in-chief, thereby limiting the timing and circumstances under which such a prehearing motion may be filed. Moreover, the proposal would require a panel to impose strict sanctions against parties who file motions to dismiss frivolously or in bad faith. Taken together, FINRA believes that these provisions reinforce FINRA's position that prehearing motions to dismiss in arbitration are discouraged and should be granted only under the limited exceptions of the rule. Accordingly, FINRA declines to amend the proposal to reintroduce the term "extraordinary circumstances."

For these reasons, FINRA declines to amend the proposal at this time.

Scope of Proposed Rules 12504(a)(6)(B) and 13504(a)(6)(B) ("not associated" exception)

Proposed Rules 12504(a)(6)(B) and 13504(a)(6)(B) state that a prehearing motion to dismiss may be granted prior to the conclusion of the claimant's case, if the respondent was not associated with the account, security, or conduct at issue.

Most commenters suggested that FINRA clarify how proposed Rule 12504(a)(6)(B) will be applied. Seventeen commenters believe the exception should be interpreted broadly, so that senior executives, branch managers, and other office personnel could be excluded under this provision.[15] Conversely, eleven commenters contend that a broad interpretation of the exception could wrongly exempt persons or entities not directly associated with transactions but who are liable under applicable statutes or case law (e.g., supervisors in "selling away"[16] cases).[17]

FINRA intends this exception to apply narrowly, such as in cases involving issues of misidentification. Thus, under this exception, a prehearing motion to dismiss could be

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[14] *See* Securities Exchange Act Release No. 54360 (August 24, 2006); 71 FR 51879 (August 31, 2006) (File No. SR-NASD-2006-088).

[15] *See, e.g.,* SIFMA, Raymond James, Selden III, RBC Capital, and Shannon Letters.

[16] A "selling away" claim involves a dispute in which an associated person is alleged to have engaged in securities activities outside his or her firm.

[17] *See, e.g.,* PIABA 2, Banks, Greco, Krosschell, and Shewan Letters.

granted if, for example, a party files a claim against the wrong person or entity, or a claim names an individual who was not employed by the firm during the time of the dispute, or a claim names an individual or entity that had no control over or was not connected to an account, security or conduct at the firm during the time of the dispute. Under this interpretation, therefore, a panel would not grant a motion to dismiss filed under this exception in cases in which a respondent may be liable as a supervisor or control person under applicable statutes[18] or in "selling away" cases.[19]

One commenter seeks clarification concerning whether this exception would exclude parties in a supervisory position, or under control person liability when a broker-dealer is defunct.[20]

FINRA believes that if the claim involves a respondent who is liable as a supervisor or control person and the cause of action arose before the firm became defunct, a motion to dismiss filed under this exception would be inappropriate. Under the By-Laws, an associated person continues to be subject to FINRA's jurisdiction if the conduct occurred while the person was associated or registered with a firm.[21] Moreover, if a firm is defunct, a claimant may request default proceedings against the firm, provided certain criteria are met.[22]

Additional exceptions for permissible prehearing motions

Twenty-nine commenters, who oppose the proposal, argue that the three exceptions for prehearing motions to dismiss are too narrow and exclude certain situations in which such motions would be appropriate.[23] These commenters suggest that FINRA expand the proposed rule to include the following exceptions: clearing brokers, senior executives, statutes of limitation; and legal impossibility exceptions, such as defamation for statements made on required forms (which some courts have held are protected by an absolute privilege) and the doctrine of *res judicata*.[24] Several commenters in this group focus on the lack of an exception for clearing firms, arguing that, based on the nature of their operations, clearing firms do not owe a legal duty to claimants and, therefore, cannot be held liable for the wrongful acts of the introducing firm.[25]

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[18] See, e.g., Uniform Securities Act §509(g) (2002).

[19] FINRA reiterates its position that "selling away" claims are arbitrable under the Codes. Under the Codes, FINRA accepts cases brought by customers against associated persons in selling away cases, and cases by customers against the associated person's member firm if there is any allegation that the member was or should have been involved in the events, such as an alleged failure to supervise the associated person. *See*, *e.g.*, Multi-Financial Securities Corp. v. King, 386 F.3d 1364 (11th Cir. 2004); *see also* In the Matter of PFS Investments, Inc., 1998 SEC LEXIS 1547, (Exchange Act Rel. No. 42069) (July 28, 1998).

[20] Burke Letter.

[21] *See* FINRA By-Laws, Article V, §4(a) (Retention of Jurisdiction).

[22] Rule 12801 of Customer Code and Rule 13801 of Industry Code.

[23] For example, these commenters contend that claims involving defamation on the Form U5 or those subject to the doctrine of *res judicata* should be exceptions to the rule. *See, e.g.*, SIFMA, Thurman, Cooney, Rapp, Schrills, Kaufman, and Jacobowitz Letters.

[24] *Id*.

[25] *Id*.

Forty-three of the commenters who support the proposal contend that expanding the scope of prehearing motions to dismiss will negate the intent of the proposal and encourage unnecessary and unwarranted motions to dismiss.[26] Indeed, many of these commenters argue that the eligibility exception of the proposal should be removed because eligibility motions tend to be fact-based, and would, in most cases, require an evidentiary hearing.[27]

FINRA has considered these comments, and concluded that expanding the exceptions to the rule would negate its intent, which is to have clear, easily definable standards that do not involve fact-intensive issues. FINRA believes that the suggested additional exceptions would require fact-based determinations and, thus, would be inappropriate for dismissal before claimants have presented their case. Although these exceptions would be inappropriate for prehearing dismissal, FINRA notes that a party would be permitted to file a motion addressing these issues at the conclusion of claimant's case-in-chief. FINRA believes the proposal strikes an appropriate balance by ensuring that claimants have their claims heard in arbitration, while minimizing the parties' exposure to additional fees in the event that the claimant does not prove the claims in its case-in-chief. For these reasons, FINRA declines to amend the proposal to expand the exceptions to the rule.

FINRA also considered the concerns expressed by commenters regarding clearing firms and the impact the proposal could have on their operations. FINRA understands the benefits that clearing firms provide to the operation of the securities markets, but these benefits do not warrant an exception to the rule. Courts have found that a broker-dealer's status as a clearing firm does not immunize it from liability.[28] The courts have found that clearing firms may be liable for the misdeeds of the introducing firm, if the clearing firms become actively or directly involved in fraudulent activity.[29] Based on these findings, FINRA believes that claimants should have the opportunity to prove in an evidentiary hearing whether a clearing firm's involvement rises to the level of liability. As the issue of a clearing firm's liability in arbitration would be a fact-intensive determination, that issue would be an inappropriate exception for prehearing dismissal. Based on these findings, FINRA declines to amend the proposal to include an exception for clearing firms.

Expansion of the exception for prehearing motions under the Eligibility Rule to include applicable statutes of limitation

The proposed changes to the eligibility rules, Rules 12206(b) and 13206(b), do not include applicable statutes of limitation as an exception on which a prehearing motion would be granted.

Twenty-three commenters argue that respondents should not be forced to proceed to an evidentiary hearing against parties whose claims could be deemed stale or

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[26] *See, e.g.,* PIABA 2, Banks, St. John's, and Lageman Letters.

[27] *See, e.g.,* PIABA 2, Greco, Gross/Black, and Ledbetter Letters.

[28] *See*, *e.g.*, McDaniel v. Bear Stearns & Co., and Bear Stearns Securities Corporation, 196 F.Supp. 2d 343 (S.D.N.Y. 2002); *see also*, Koruga v. Fiserv Correspondent Services, Inc., 183 F.Supp.2d 1245 (D. Or. 2001), *aff'd*, 2002 U.S. App. LEXIS 6439 (9th Cir. 2002).

[29] *Id*.

time-barred under an applicable legal authority.[30] Conversely, several commenters contend that most statutes of limitation matters raise issues of fact which would require an evidentiary hearing.[31] Moreover, some commenters urge FINRA to remove the eligibility exception from the proposal for the same reasons.[32]

FINRA included the eligibility rule exception in the proposal because its eligibility standard is uniform for all cases (six years from the occurrence or event giving rise to the claim), and does not vary depending on a particular jurisdiction's laws or the cause of action raised by the claim. In addition, claimants whose cases are dismissed on eligibility grounds have an alternative to resolve their disputes because the current rule gives them the right to take their cases to court.[33] In light of the uniform applicability of the eligibility exception and the additional protections parties receive under the eligibility rule, FINRA declines to amend the proposal to remove the eligibility exception.

FINRA did not include applicable statutes of limitation in the eligibility exception because such issues involve fact-based determinations, depend on the law of the applicable jurisdiction, and depend on the type of claims alleged. FINRA notes that, in some jurisdictions, courts have found that statutes of limitations do not apply to arbitration proceedings. For these reasons, FINRA believes that it would be inappropriate to include an exception for prehearing motions to dismiss on statutes of limitations grounds, and thus, declines to amend the proposal to include them in the eligibility exception.

Motions permitted at the conclusion of claimant's case-in-chief

Under Proposed Rules 12504(b) and 13504(b), a motion to dismiss after the conclusion of a party's case-in-chief is not limited to the three exceptions described above.

Eighteen commenters who support the proposal argue that this provision will shift abusive motion practice to the middle of the hearing, because respondents will wait until the end of claimant's case to file their motions, and should be deleted.[34] Seven commenters who oppose the proposal argue that the ability to file a motion at the conclusion of a party's case-in-chief does not address their interests effectively, because respondents will have to prepare for and incur the costs of a full evidentiary hearing.[35]

FINRA believes that the proposal strikes a fair balance by sharply limiting prehearing motions to dismiss, but permitting motions to dismiss after the claimant's case in chief. FINRA believes it would be unfair to require the parties to continue with a hearing if claimant has not proved its case. FINRA expects such motions to be relevant to the case and based on theories that are germane to the issues raised in the case-in-chief. FINRA believes that by the close of claimant's case, the panel would have heard

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[30] *See, e.g.,* SIFMA, Krebsbach, Rapp, Babnick, Jr., Jacobowitz.

[31] Note 27.

[32] *Id*.

[33] Rule 12206(b) of the Customer Code and Rule 13206(b) of the Industry Code.

[34] *See, e.g.,* Banks, Davis, Wilcutts, Bernstein, and Caruso Letters.

[35] *See, e.g.,* Krebsbach, Farley, Walters, and Karp Letters.

enough to decide whether a motion filed at the conclusion of a claimant's case should be considered, and, if warranted, granted.

FINRA will monitor the frequency of motions filed pursuant to this provision once the proposal is implemented. If this analysis indicates potentially abusive behavior, FINRA may amend the proposal or take other appropriate action.

FINRA also will inform arbitrators that, if a party files a motion at the conclusion of a case-in-chief, the panel is not required to consider or grant the motion merely because it was filed pursuant to the rule; rather arbitrators will continue to control the hearing process. Furthermore, FINRA notes that the proposed rule would not preclude a panel from assessing respondents with sanctions, costs and attorney's fees, if the panel determines that a motion filed at this time is frivolous or in bad faith.[36]

FINRA reiterates that the purpose of the proposal is to ensure that claimants have their claims heard by a panel while permitting respondents, after completion of a claimant's case-in-chief, to challenge a claim they believe lacks merit or has not been proved. Because arbitrators currently deny most prehearing motions to dismiss, the proposal to permit motions to dismiss at this juncture, should not have a significant impact on parties' costs in preparing for a hearing. FINRA believes that respondents' exposure to attorneys' fees and forum fees should be minimized under the proposal because additional hearing sessions will not be required if the panel grants a motion to dismiss at the close of a claimant's case. Similarly, claimants will not incur additional forum costs if arbitrators believe they have not proved their case and dismiss it before respondents present their case, rather than afterwards.

For these reasons, FINRA declines to amend the proposal.

Concerns regarding the procedural safeguards in the proposal

Eight of the commenters who support the procedural safeguards in the proposal believe these provisions provide protection to investors by imposing stringent enforcement criteria.[37] However, twenty-two commenters oppose some of the proposed procedural safeguards as too stringent. Each proposed procedural rule that met with significant opposition is addressed below.

Unanimous panel decision to grant a prehearing motion.

Proposed Rules 12504(a)(7) and 13504(a)(7) require a unanimous decision by the panel to grant a prehearing motion to dismiss.[38]

The commenters who oppose this provision believe this requirement is not necessary to ensure a fair decision concerning a prehearing motion to dismiss.[39] Further, this group argues that the provision is inconsistent with other provisions of the

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[36] Rule 12212 of the Customer Code and Rule 13212 of the Industry Code.

[37] *See, e.g.*, PIABA 2, Harrison, Mougey, and St. John's Letters.

[38] *See also* Proposed Rules 12206(b)(5) and 13206(b)(5) of the Eligibility Rule.

[39] *See, e.g.,* SIFMA, Krebsbach, Wallis, Forchheimer, and Carreno Letters.

Customer and Industry Codes (collectively, Codes), in that all other decisions under the Codes require a majority decision only.[40]

FINRA believes that the type of relief requested by a prehearing motion to dismiss – the complete dismissal of a claim before an evidentiary hearing – justifies the requirement that all arbitrators agree, based on the moving party's proof, that the motion should be granted. FINRA recognizes that this standard is different from the criteria for rendering other rulings and determinations.[41] In practice, however, FINRA notes that most awards rendered in its forum are unanimous; thus, this requirement is not a significant change from current practice. For these reasons, FINRA declines to amend the proposal to change this provision.

Mandatory assessment of forum fees.

Proposed Rules 12504(a)(8) and 13504(a)(8) require that, if a panel denies a prehearing motion to dismiss, a panel must assess forum fees associated with hearings on the motion against the moving party.[42]

Commenters who oppose this provision believe it is unfair to penalize moving parties who file motions to dismiss based on the exceptions available under the proposed rule, and who rely on a claimant's pleadings being accurate and complete when filing these motions.[43]

FINRA believes that the provision on mandatory assessment of forum fees will deter parties from filing motions that fall outside the scope of the three exceptions to the rule, and will provide an incentive for parties to ensure that their prehearing motions to dismiss comply with the intent of the rules.

In response to those commenters who argue that the proposal would punish respondents when a claimant's pleading lacks specificity, FINRA reminds parties that there are no specific pleading requirements under the Codes. Rules 12302 and 13302 require a claimant to supply only "[a] statement of claim specifying the relevant facts and remedies requested" along with the required fees, copies, and signed submission agreement in order to initiate an arbitration. Similarly, the answer must include only "[an] answer specifying the relevant facts and available defenses to the statement of claim."[44] Parties may obtain further information and documents through the discovery process.[45]

For these reasons, FINRA declines to amend the proposal to change this provision.

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[40] *Id*.

[41] Rule 12414(a) of the Customer Code and Rule 13414(a) of the Industry Code state that "all rulings and determinations of the panel must be made by a majority of the arbitrators, unless the parties agree, or the Code or applicable law provides, otherwise."

[42] *See also* Proposed Rules 12206(b)(8) and 13206(b)(8) of the Eligibility Rule.

[43] *See, e.g.,* SIFMA, Karp, Amery, Shannon, and Jacobowitz Letters.

[44] Rules 12303 and 13303.

[45] See Rules 12500-12514 of the Customer Code and 13500-13512 of the Industry Code.

Mandatory assessment of costs and attorneys' fees and possible sanctions.

Proposed Rules 12504(a)(10) and 13504(a)(10) require that, if a panel deems a prehearing motion to dismiss to be frivolous, the panel must award reasonable costs and attorneys' fees to any party that opposed the motion.[46] Also, proposed Rules 12504(a)(11) and 13504(a)(11) require that, if a panel deems that a prehearing motion to dismiss was filed in bad faith, the panel may issue sanctions against the moving party.[47]

Eight commenters who oppose the proposal nevertheless support these provisions as sufficient deterrents against abusive motion practice, and believe that they eliminate the need to restrict prehearing motions to dismiss in the forum.[48] Another group of commenters who oppose the proposal argue that, as drafted, the provisions will result in an increase in the number of motions for costs, fees, and sanctions filed by claimants.[49] These commenters suggest that FINRA amend the proposal to prohibit claimants from filing such motions, and permit the panel, on its own initiative, to decide whether a motion is frivolous or in bad faith and order relief appropriately.[50]

FINRA anticipates that parties will file fewer prehearing motions to dismiss once the proposal is implemented, which should forestall any increase in the number of motions for costs, fees, and sanctions. FINRA further believes that the risk of monetary penalties and sanctions, imposed either by the panel on its own initiative, or as a result of a party's motion, should deter parties from filing such motions frivolously or in bad faith. Taken together, these enforcement mechanisms should ensure strict compliance with the rules. For these reasons, FINRA declines to amend the proposal to change these provisions.

Clarification of the in-person or telephonic prehearing conference criteria.

One commenter requests clarification concerning what would satisfy the in-person or telephonic prehearing conference requirement under proposed Rules 12504(a)(5) and 13504(a)(5).[51] The commenter is concerned that the rules imply that the panel may grant the motion solely on the basis of the submissions from the parties.[52] The proposed rule requires that a panel may not grant a motion under the rule unless an in-person or telephonic prehearing conference is held or waived by the parties. [53]

Prehearing conferences conducted under this provision will be subject to Rules 12501 and 13501 of the Codes; otherwise, the relevant rules of the Codes shall apply. Under the proposal, if the parties agree to waive the prehearing conference, as is permitted currently under the Codes,[54] the panel may grant the motion based solely on

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[46] *See also* Proposed Rules 12206(b)(9) and 13206(b)(9) of the Eligibility Rule.

[47] *See also* Proposed Rules 12206(b)(10) and 13206(b)(10) of the Eligibility Rule.

[48] *See, e.g.,* Krebsbach, Babnick, Jr., Cooney, and Kaufman Letters.

[49] *See, e.g.,* SIFMA, Deutsche Bank, Wachovia, and Lampart Letters.

[50] *Id*.

[51] St. John's Letter.

[52] *Id*.

[53] *See also* Proposed Rules 12206(b)(4) and 13206(b)(4) of the Eligibility Rule.

[54] Rule 12105(a) of the Customer Code and Rule 13105(a) of the Industry Code.

the submissions of the parties. If, however, the parties do not agree to waive the prehearing conference, then the panel must hold an evidentiary hearing on the motion at which time the parties will have an opportunity to present their arguments concerning the motion. In this instance, the panel will have received the information necessary to make an informed decision.

Effect of the proposal on the parties' costs

Seventeen commenters argue that current practice permits respondents to file numerous motions that are rarely granted, and that serve only to delay the hearings, harass claimants, and increase claimants' costs through higher forum fees and lower award amounts once expenses are paid.[55] In general, this group believes that defending these motions to dismiss is a waste of time and resources and, ultimately, will result in the denial of access to the forum for investors with small claims.[56]

Twenty-two commenters argue that the proposal prohibiting most prehearing motions to dismiss would increase all parties' costs, particularly firms', because their attorneys charge on an hourly basis, whereas claimants' attorneys charge on a contingency basis, so claimants are not incurring any costs.[57] Others in this group contend that prohibiting prehearing motions to dismiss nullifies their most important objective – to avoid the expense of preparing for and attending an evidentiary hearing.[58]

FINRA is not privy to the fee structure used by investors' attorneys or counsel for brokerage firms. However, based on internal data[59] and other statistical studies tracking motions to dismiss in our forum,[60] FINRA is aware that when motions to dismiss are filed, they serve to delay the hearings and increase all parties' costs through higher forum fees. As a result, FINRA is concerned that the current practice by some respondents of filing motions to dismiss, and sometimes multiple motions in one case, could cause investors' attorneys not to take smaller claims, because the costs incurred in defending these motions could exceed the amount in dispute. FINRA anticipates that the proposal will continue to make the forum accessible to investors, particularly those with small claims, by minimizing the number of motions to dismiss filed in the forum, and by shifting the costs and fees associated with denied motions to dismiss to the moving party. FINRA believes that the proposal's benefits, protecting investors' access to the forum and their ability to have claims heard in arbitration, outweigh the possibility of increased costs and expenses firms might incur under the rule. For these reasons, FINRA declines to amend the proposal to address this concern.

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[55] *See, e.g.,* Buchwalter, Neuman, Stoltmann, and Haigney Letters.

[56] *See, e.g.,* Forman, Estell, and St. John's Letters.

[57] *See, e.g.,* Cooney, Schrills, Hartman, and Kemnitz Letters.

[58] *See, e.g.,* Davidson, McDermott, Dulcich, and Berberian Letters.

[59] *See Additional statistical support* below for updated statistics on motions to dismiss filed in our forum.

[60] *See Securities Arbitration Commentator*, Nov. 2006 (Vol. 2006, No. 5).

Additional statistical support

Nine commenters who oppose the proposal argue that FINRA did not provide enough objective evidence to support the changes proposed.[61] This group of commenters suggests that anecdotal evidence of abuse is not sufficient proof that prehearing motions to dismiss should be prohibited.

FINRA disagrees with these commenters. A significant number of changes to FINRA's arbitration rules have begun with users of the forum submitting a concern or complaint to us. FINRA relies on its constituents to inform FINRA of concerns with its rules, arbitrator conduct, or abusive practices. Once FINRA staff becomes aware of a problem, they investigate further, and propose changes to the rules to address the concern, if necessary.

In the case of motions to dismiss, FINRA received many complaints from users of the forum documented with copies of motions to dismiss, responses, and the panels' denials of those motions. FINRA also learned through a *Securities Arbitration Commentator* study (Study) that the number of motions to dismiss filed in customer cases had begun to increase over a two year period, starting in 2004.[62] The study was conducted on motions to dismiss in customer cases and concluded that, in the universe of cases that went to award, there were motions to dismiss in 28% of the cases in 2006 as compared to 10% in 2004.[63] The results of the Study were alarming not only because of the significant increase in the motions filed in these cases, but also because the Study did not include cases that settled during that time. As a result of this analysis, FINRA became concerned that, if left unregulated, this type of motion practice would limit investors' access to the forum, which is antithetical to FINRA's goals of investor protection and market integrity.

In light of the Study and concerns raised by constituents, FINRA began tracking motions to dismiss in 2007. From January 1, 2007 to July 1, 2008, there have been 6,079 arbitration cases filed in the forum,[64] and 754 motions to dismiss filed in these cases. In 10% of these cases, parties filed one or more motions to dismiss. In 2% of the cases filed, parties filed more than one motion to dismiss. These current statistics suggest that the number of motions to dismiss filed in the forum may be declining since the Study was conducted. FINRA believes the reduction in these motions reflects its focus on this issue, through enhanced arbitrator training as well as a 2006 *Notice to Parties* to remind parties of the forum's policy and parties' responsibilities when filing motions to dismiss.[65] Even though the number of motions filed appears to be declining in the forum, FINRA believes the proposal will serve to reduce further the number of prehearing motions to dismiss filed, and, in particular, should prevent parties from filing multiple motions in a case. For these reasons, FINRA believes its statistical and

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[61] *See, e.g.,* Astarita, Farley, Davidson, and Berberian Letters.

[62] *Securities Arbitration Commentator*, Nov. 2006 (Vol. 2006, No. 5), at 3.

[63] *Id*.

[64] The data do not include cases filed in the NYSE Regulation arbitration forum.

[65] *See* Notice to Parties on Motions to Dismiss under the Code of Arbitration Procedure for Customer and Industry Disputes *available at* http://www.finra.org/ArbitrationMediation/ResourcesforParties/NoticestoParties/p037078. The *Notice* continues to be effective.

anecdotal evidence is sufficient support for the proposal, and believes the proposal should be approved as drafted.

Alternate criteria to provide specific guidance to arbitrators when deciding motions to dismiss

Ten commenters suggest that the proposal should establish a specific standard for arbitrators to use when deciding motions to dismiss.[66] Most of these commenters suggest that panels should deny prehearing motions to dismiss whenever: (1) credibility is an issue; (2) there are disputed issues of material fact; or (3) the panel believes a hearing is necessary in the interests of justice.[67]

FINRA has considered incorporating these criteria into the rule but has determined that adding these standards to the proposed rules would be inconsistent with the Codes, which do not contain such specific standards for arbitrator decision making. Because arbitration is an equitable forum, the panel may consider any evidence or use any method to achieve a fair result. FINRA did not intend to change this practice with the proposal.

Moreover, FINRA believes that establishing a specific approach for arbitrators to follow would infringe on arbitrators' discretion to decide arbitration cases. FINRA's intent in drafting the proposal was to select a very limited number of exceptions for granting prehearing motions to dismiss that would be relatively clear-cut for the panel to apply at this stage of the proceedings. FINRA believes parties should argue their positions and arbitrators should be permitted to use their discretion in determining how motions to dismiss should be decided. For these reasons, FINRA declines to amend the proposal to incorporate a specific standard for arbitrators to use when deciding motions to dismiss.

Motion to dismiss policies of other securities arbitration forums

One commenter contends that the former New York Stock Exchange (NYSE) arbitration forum did not permit prehearing motions to dismiss in its forum.[68] Another commenter states that the NYSE arbitration forum would not permit arbitrators to grant motions to dismiss before a public investor had the opportunity to present his or her claims at an evidentiary hearing on the merits.[69]

FINRA has responded to this comment previously in regard to the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc.[70] The NYSE Regulation arbitration forum had neither a rule nor a written policy on motions to dismiss, and FINRA is not aware that motions to dismiss were prohibited in the NYSE Regulation arbitration forum. Rather, FINRA understands that, in the NYSE arbitration

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[66] *See, e.g.,* Gross/Black, Van Kampen, Wachovia, Honigman Letters.

[67] *Id*.

[68] Tepper Letter.

[69] Canning Letter.

[70] *See* Supplemental Response to Comments from Linda D. Fienberg, President, Dispute Resolution, dated May 29, 2007. The SEC approved the consolidation of member firm regulatory operations of NASD and NYSE on July 26, 2007. Securities Exchange Rel. No. 56145, 72 FR 42169 (Aug. 1, 2007) (File No. SR-NASD-2007-023).

forum, the panel determined whether and if so, when, such a motion to dismiss would be heard.

Proposal's impact on the parties' negotiations

Eleven commenters argue that the proposal creates settlement value for claimants because respondents would have to conduct a cost-benefit analysis to determine whether the cost of settling the dispute is more beneficial than losing a prehearing motion to dismiss and proceeding to evidentiary hearing.[71] Generally, the commenters who support the proposal believe that it would reduce all parties' costs because the parties would no longer waste resources arguing frivolous prehearing motions to dismiss that are rarely granted.[72]

FINRA agrees with those commenters who believe the proposal would reduce all parties' costs because the number of prehearing motions to dismiss in the forum should decrease once the proposal is implemented. Moreover, FINRA believes that respondents are more likely to conduct a cost-benefit analysis concerning whether to proceed with an arbitration based on the strength or weakness of their claims or defenses, not the existence of a motion to dismiss rule. For this reason, FINRA declines to amend the proposal at this time.

Proposal's effect on parties who settle claim before hearing

Proposed Rules 12504(a)(3) and 13504(a)(3) state that, unless the parties agree or the panel determines otherwise, parties must serve motions to dismiss at least 60 days before a scheduled hearing, and parties have 45 days to respond to the motion.

The author of a February 2008 *Securities Arbitration Commentator* (SAC) article suggests that, under the proposal, parties would not be permitted to settle a claim and have it dismissed before the evidentiary hearing, if the 60-day deadline has passed and the parties have not yet filed a prehearing motion.[73]

FINRA notes that the proposal does not preclude parties from agreeing to settle at any time. Rules 12105 and 12207 of the Customer Code[74] permit the parties to agree to extend the deadlines for filing or responding to motions. The proposal would not prohibit the parties from taking these actions.

Moreover, the proposed rule is not intended to apply to motions made jointly by all parties to dismiss a case because of a settlement. Under the Codes, if all parties agree to settle a case, FINRA will close the case based on the settlement agreement.[75] This process is different from that contemplated by the proposal, in which a panel grants one party's motion to dismiss a case before an evidentiary hearing is held.

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[71] *See, e.g.,* Buckman, Gelber, Shannon, and Amery Letters.

[72] Note 55.

[73] Harry A. Jacobowitz, "Roadblocks at the Exits: FINRA's Proposed Dispositive Motions Rule," *Securities Arbitration Commentator*, February 2008 (Vol. 2007, No. 4), at 1.

[74] *See also* Rules 13105 and 13207 of the Industry Code.

[75] Rule 12902(d) of the Customer Code and Rule 13902(d) of the Industry Code.

Motions to dismiss as awards

The author of a different February 2008 SAC article argues that arbitrator decisions on motions to dismiss are awards and should be published as required under the Code.[76]

Under the Code, an award is a document stating the disposition of a case.[77] If a motion to dismiss all claims is granted and disposes of all open issues, it would be reported as an award. A decision to grant a motion to dismiss that does not dismiss all of the parties or end the dispute would not be an award; rather, it would be considered an order of the panel and would not be made publicly available.

* * *

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

Very truly yours,

Mignon McLemore
Assistant Chief Counsel
FINRA Dispute Resolution

[76] Richard P. Ryder, "Disposing of Dispositive Motions: The Process to Date," *Securities Arbitration Commentator*, February 2008 (Vol. 2007, No. 4), at 10; *see also* Jacobowitz Letter.

[77] Rule 12100(b) of the Customer Code and Rule 13100(b) of the Industry Code.

Exhibit A

Comment Letters filed on Proposed Rule Change and Amendment 1 Relating to Motions to Dismiss and the Eligibility Rule

(Release No. 34-57497, File No. SR-FINRA-2007-021)

1. Joseph C. Korsak, Esq., dated November 4, 2007 ("Korsak Letter")
2. Will Struyk, dated December 10, 2007 ("Struyk Letter")
3. Michael Thurman, Esq., Loeb & Loeb LLP, dated February 29, 2008 ("Thurman Letter")
4. Prof. Seth E. Lipner, Esq., Baruch College dated March 18, 2008 ("Lipner Letter")
5. Leonard Steiner, Esq., dated March 18, 2008 ("Steiner Letter")
6. Laurence S. Schultz, Esq., Public Investors Arbitration Bar Association, dated March 18, 2008 ("PIABA Letter")
7. Steven J. Gard, Esq., Gard Law Firm, dated March 20, 2008 ("Gard Letter")
8. Steven B. Caruso, Esq., Maddox Hargett Caruso, P.C., dated March 20, 2008 ("Caruso Letter")
9. Philip M. Aidikoff, Esq., dated March 21, 2008 ("Aidikoff Letter")
10. Charles W. Austin, Jr., Esq., dated March 21, 2008 ("Austin Letter")
11. Gail E. Boliver, dated March 22, 2008 ("Boliver Letter")
12. Steve A. Buchwalter, Esq., dated March 23, 2008 ("Buchwalter Letter")
13. Ryan K. Bakhtiari, Esq., Uhl and Bakhtiari, dated March 24, 2008 ("Bakhtiari Letter")
14. Mark E. Maddox, Esq., Maddox Hargett Caruso, P.C., dated March 24, 2008 ("Maddox Letter")
15. Robert W. Goehring, Esq., dated March 24, 2008 ("Goehring Letter")
16. John J. Miller, Esq., Swanson Midgley, LLC, dated March 24, 2008 ("Miller Letter")
17. Richard A. Lewins, dated March 24, 2008 ("Lewins Letter")
18. Howard Rosenfield, Esq., dated March 24, 2008 ("Rosenfield Letter")
19. Sam Edwards, Esq., dated March 24, 2008 ("Edwards Letter")
20. Noah H. Simpson, Esq., Simpson Woolley, LLP, dated March 24, 2008 ("Simpson Letter")
21. Robert A. Uhl, Esq., March 25, 2008 ("Uhl Letter")
22. David Harrison, Esq., dated March 26, 2008 ("Harrison Letter")
23. Jeffrey Sonn, Esq., Sonn Erez, PLC, dated March 26, 2008 ("Sonn Letter")
24. Brian N. Smiley, Esq., Smiley Bishop Porter LLP, dated March 26, 2008 ("Smiley Letter")
25. Thomas A. Hargett, Esq., dated March 27, 2008, ("Hargett Letter")
26. Jay Salamon, Esq., Hermann, Cahn and Schneider LLP, dated March 27, 2008 ("Salamon Letter")
27. J. Pat Sadler, Esq., dated March 31, 2008 ("Sadler Letter")
28. Keith L. Griffin, Esq., Maddox Hargett Caruso, P.C., dated April 1, 2008 ("Griffin Letter")
29. Scott R. Shewan, Esq., Born, Pape & Shewan LLP, dated April 1, 2008 ("Shewan Letter")

30. Alan S. Brodherson, Esq., dated April 3, 2008 (“Brodherson Letter”)
31. W. Scott Greco, Esq., Greco & Greco, P.C., dated April 3, 2008 (“Greco Letter”)
32. David P. Neuman, Esq., Stoltmann Law Offices, P.C., dated April 4, 2008 (“Neuman Letter”)
33. Edward G. Turan and Martha E. Solinger, Securities Industry and Financial Markets Association, dated April 7, 2008 (“SIFMA Letter”)
34. Curt H. Mueller, Esq., Schwab & Co., Inc., dated April 7, 2008 (“Schwab Letter”)
35. Erin Linehan, Esq., Raymond James Financial, Inc., dated April 8, 2008 (“Raymond James Letter”)
36. Barry D. Estell, Esq., dated April 8, 2008 (“Estell Letter”)
37. Robert C. Port, Esq., dated April 8, 2008 (“Port Letter”)
38. Jonathan W. Evans, Esq., dated April 8, 2008 (“Evans Letter”)
39. Kevin A. Carreno, dated April 8, 2008 (“Carreno Letter”)
40. Vincent J. Imbesi, Esq., The Avelino Law Firm, dated April 9, 2008 (“Imbesi Letter”)
41. John E. Lawlor, Esq., dated April 9, 2008 (“Lawlor Letter”)
42. Jonathan Schwartz, Esq., dated April 9, 2008 (“Schwartz Letter”)
43. Andrew Dale Ledbetter, dated April 9, 2008 (“Ledbetter Letter”)
44. Theodore A. Krebsbach, Esq., Krebsbach & Snyder, dated April 9, 2008 (“Krebsbach Letter”)
45. Raymond W. Henney, Esq., Honigman Miller Schwartz and Cohn LLP, dated April 9, 2008 (“Henney Letter”)
46. Randall R. Heiner, Esq., dated April 9, 2008 (“Heiner Letter”)
47. Inge Selden III, Esq., Maynard Cooper & Gale PC, dated April 9, 2008 (“Selden Letter”)
48. Eric G. Wallis, Esq., Reed Smith LLP, dated April 9, 2008 (“Wallis Letter”)
49. Robert H. Rex, Esq., Dickenson Murphy Rex and Sloan, dated April 9, 2008 (“Rex Letter”)
50. Bradley R. Stark, Esq., Florida International University, dated April 9, 2008 (“Stark Letter”)
51. Robert N. Rapp, Esq., Calfee, Halter Griswold LLP, dated April 9, 2008 (“Rapp Letter”)
52. Richard J. Babnick, Esq., Sichenzia Ross Friedman Ference LLP, dated April 9, 2008 (“Babnick Letter”)
53. Joseph F. Myers, Esq., dated April 9, 2008 (“Myers Letter”)
54. Anne T. Cooney, Esq., Morgan Stanley, dated April 9, 2008 (“Morgan Stanley Letter”)
55. Jonathan Kord Lagemann, Esq., dated April 9, 2008 (“Lagemann Letter”)
56. Frederick S. Schrils, Esq., GrayRobinson, dated April 9, 2008 (“Schrils Letter”)
57. Andrew Stoltmann, Esq., dated April 9, 2008 (“Stoltmann Letter”)
58. Richard M. Layne, Esq., dated April 9, 2008 (“Layne Letter”)
59. Herb Pounds, Jr., Esq., dated April 9, 2008 (“Pounds Letter”)
60. Alan F. Hartman, CLU, ChFC, dated April 9, 2008 (“Hartman Letter”)
61. Brian F. Amery, Esq., Bressler, Amery Ross, P.C., dated April 9, 2008 (“Amery Letter”)

62. Michael G. Shannon, Esq., Thelen, dated April 9, 2008 (“Shannon Letter”)
63. Carl J. Carlson, Esq., Carlson & Dennett, P.S., dated April 9, 2008 (“Carlson Letter”)
64. Matthew Farley, Esq., Drinker Biddle & Reath LLP, dated April 9, 2008 (“Farley Letter”)
65. Joel E. Davidson, Esq., Davidson & Grannum, LLP, dated April 9, 2008 (“Davidson Letter”)
66. Al Van Kampen, Esq., dated April 10, 2008 (“Van Kampen Letter”)
67. Theodore M. Davis, Esq., dated April 10, 2008 (“Davis Letter”)
68. Lawrence R. Gelber, Esq., dated April 10, 2008 (“Gelber Letter”)
69. Pearl Zuchlewski, Esq., Kraus Zuchlewski LLP, dated April 10, 2008 (“Zuchlewski Letter”)
70. Rob Bleecher, Esq., dated April 10, 2008 (“Bleecher Letter”)
71. Thomas C. Wagner, Esq., dated April 10, 2008 (“Wagner Letter”)
72. John V. McDermott, Esq., Holme Roberts Owen LLP, dated April 10, 2008 (“McDermott Letter”)
73. Peter J. Mougey, Esq., Beggs & Lane, dated April 10, 2008 (“Mougey Letter”)
74. Christopher Gibbons/Lisa A. Catalano, Securities Arbitration Clinic, St. John’s University Law School, dated April 10, 2008 (“St. John’s Letter”)
75. John W. Shaw, Esq., Berkowitz, Oliver, Williams, Shaw Eisenbrandt, dated April 10, 2008 (“Shaw Letter”)
76. Audrey Venezia, Esq., dated April 10, 2008 (“Venezia Letter”)
77. H. Nicholas Berberian, Esq., Gerber & Eisenberg LLP, dated April 10, 2008 (“Berberian Letter”)
78. Michael N. Ungar, Esq., and Kenneth A. Bravo, Esq. Ulmer & Berne LLP, dated April 10, 2008 (“Ungar Letter”)
79. Jody Forchheimer, Esq., Fidelity Investments, dated April 10, 2008 (“Fidelity Letter”)
80. Jill I. Gross, Barbara Black and Teresa Milano, dated April 10, 2008 (“Gross/Black Letter”)
81. Michael Weissmann, Esq., Bingham McCutchen LLP, dated April 10, 2008 (“Weissmann Letter”)
82. Thomas P. Willcutts, Esq., Willcutts Law Group, LLC, dated April 10, 2008 (“Willcutts Letter”)
83. Mark A. Tepper, Esq., Mark A. Tepper, P.A., dated April 10, 2008 (“Tepper Letter”)
84. Joe Soraghan, Principal, Danna McKitrick, P.C., dated April 10, 2008 (“Soraghan Letter”)
85. Bryan T. Forman, Esq., dated April 10, 2008 (“Forman Letter”)
86. Rodney Acker, Esq., Fulbright & Jaworski LLP, dated April 10, 2008 (“Acker Letter”)
87. Birgitta Siegel, Esq., Securities Arbitration & Consumer Law Clinic, Syracuse University, dated April 10, 2008 (“Syracuse Letter”)
88. Brett A. Rogers and Jill E. Steinberg, Esq., Rogers & Hardin, dated April 10, 2008 (“Rogers/Steinberg Letter”)
89. Jeffrey Kruske, Esq., dated April 10, 2008 (“Kruske Letter”)

90. John Taft, RBC Wealth Management, dated April 10, 2008 ("RBC Letter")
91. Thomas V. Dulcich, Esq., Schwabe, Williamson & Wyatt, dated April 10, 2008 ("Dulcich Letter")
92. Harry T. Walters, Esq., Citigroup, dated April 10, 2008 ("Citigroup Letter")
93. Craig Gordon, RBC Correspondent Services, dated April 10, 2008 ("Gordon Letter")
94. William A. Jacobson, Esq., Cornell Securities Law Clinic, dated April 10, 2008 ("Cornell Letter")
95. Bradford D. Kaufman, Greenberg, Taurig, P.A., dated April 10, 2008 ("Kaufman Letter")
96. Tim Canning, Esq., Law Offices of Timothy A. Canning, dated April 10, 2008 ("Canning Letter")
97. Peter R. Boutin, Esq., Keesal, Young & Logan, dated April 10, 2008 ("Boutin Letter")
98. Christian T. Kemnitz, Esq., Katten Muchin Rosenman, dated April 10, 2008 ("Kemnitz Letter")
99. Scot Bernstein, Esq, dated April 10, 2008 ("Bernstein Letter")
100. John S. Burke, Esq., Higgins Burke, P.C., dated April 10, 2008 ("Burke Letter")
101. Dayton P. Haigney, Esq., dated April 10, 2008 ("Haigney Letter")
102. Robert J. Anello, Esq., Morvillo, Abramowitz, Grand, Iason, Anello & Bohrer, P.C., dated April 10, 2008 ("Anello Letter")
103. Brad S. Karp, Esq., Paul, Weiss, Riaind, Wharton & Garrison LLP, dated April 10, 2008 ("Karp Letter")
104. Andrew L. Weinberg, Esq., Deutsche Bank Securities Inc., dated April 10, 2008 ("DBSI Letter")
105. Harry A. Jacobowitz, Esq., Securities Arbitration Commentator, dated April 10, 2008 ("Jacobowitz Letter")
106. Jenice L. Malecki, Esq., Malecki Law, dated April 10, 2008 ("Malecki Letter")
107. Stephen Krosschell, Esq., dated April 10, 2008 ("Krosschell Letter")
108. Abe Lampart, Esq., Offices of Abe Lampart, dated April 10, 2008 ("Lampart Letter")
109. Mark J. Astarita, Esq., dated April 10, 2008 ("Astarita Letter")
110. Robert S. Banks, Esq., Banks Law Offices, dated April 10, 2008 ("Banks Letter")
111. Debra G. Speyer, Esq., dated April 10, 2008 ("Speyer Letter")
112. Harry J. Buckman, Jr., dated April 11, 2008 ("Buckman Letter")
113. Jan Graham, Esq., dated April 11, 2008 ("Graham Letter")
114. Patricia Cowart, Esq., Wachovia Securities, LLC, dated April 11, 2008 ("Wachovia Letter")
115. Stuart D. Meissner, Esq., dated April 12, 2008 ("Meissner Letter")
116. Debra B. Hayes, Esq., dated April 15, 2008 ("Hayes Letter")
117. William P. Torngren, Esq., dated April 16, 2008 ("Torngren Letter")
118. Laurence S. Schultz, Public Investors Arbitration Bar Association, dated April 25, 2008 ("PIABA 2 Letter")