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Associate Chief Counsel

May 7, 2018

Mr. Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: File No. SR-FINRA-2018-003 – Proposed Rule Change Relating to Simplified Arbitration

Dear Mr. Fields:

This letter responds to comments submitted to the Securities and Exchange Commission (“Commission”) regarding the above-referenced filing. In this filing, FINRA is proposing to amend FINRA Rules 12600 and 12800 of the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and 13600 and 13800 of the Code of Arbitration Procedure for Industry Disputes (“Industry Code,” and together with the Customer Code, the “Codes”), to amend the hearing provisions to provide an additional hearing option for parties in arbitration with claims of \$50,000 or less, excluding interest and expenses (“Special Proceeding”).

The Commission received 12 comment letters in response to the proposed rule change.<sup>1</sup> Eleven commenters supported the proposed rule change, although seven commenters

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<sup>1</sup> See Letter from Steven B. Caruso, Maddox Hargett & Caruso, P.C., dated February 13, 2018 (“Caruso”); Letter from Andrew Stoltmann, President, Public Investors Arbitration Bar Association, dated March 6, 2018 (“PIABA”); Letter from Eric Duhon and Paige Foley, Student Attorneys, Investor Protection Clinic, William S. Boyd School of Law, University of Nevada, Las Vegas, dated March 6, 2018 (“UNLV”); Letter from Katherine Kokotos, Amrita Maitlall, and Sumaya Restagno, Legal Interns, and Christine Lazaro, Director of the Securities Arbitration Clinic and Professor of Clinical Legal Education, St. John’s University School of Law, dated March 6, 2018 (“SJU”); Daniel P. Guernsey, Student Intern and Teresa J. Verges, Director, University of Miami School of Law Investor Rights Clinic, dated March 6, 2018 (“MIRC”); Letter from Jill I. Gross, Professor of Law, Elisabeth Haub School of Law, Pace University, dated March 8, 2018 (“Gross”); Letter from William A. Jacobson, Clinical Professor of Law and Director, Cornell Securities Law Clinic, and Sam Wildman, Cornell University Law School, dated March 8, 2018 (“Cornell”); Letter from Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated March 8, 2018 (“SIFMA”); Letter from Barbara Black, Professor of Law, University of Cincinnati College of Law (Retired), dated March 8, 2018 (“Black”); Letter from John Ripoli, Simon Halper, and Mark Sarno, Student Interns, and Elissa Germaine, Director, Investor Rights Clinic at the Elisabeth Haub School of Law, Pace University, dated March 8, 2018 (“PIRC”); Letter from Abigail Howd, Eric Peters, and Dowdy White, Student Interns, and Nicole G. Iannarone, Assistant Clinical Professor, Investor Advocacy Clinic, Georgia State University College of Law, dated March 9, 2018 (“GSU”); and Letter from Mark D. Norych,

supported it with suggested modifications.<sup>2</sup> Commenters who supported the proposed rule change stated, among other things, that it would: (1) facilitate fairness and efficiency in the arbitration forum;<sup>3</sup> (2) provide access to justice for *pro se* claimants;<sup>4</sup> (3) provide an additional option for investors;<sup>5</sup> (4) result in lower costs, increased representation rates of claimants, and greater participant satisfaction with the arbitration process;<sup>6</sup> (5) lead to more investor trust in the process;<sup>7</sup> and (6) improve both procedural and substantive justice.<sup>8</sup> SIFMA did not expressly support or oppose the proposed rule change. However, SIFMA asserted objections to specific aspects of the proposed rule change and made recommendations for modifications.

As referenced above, several commenters suggested modifications to the proposed rule change. FINRA addresses these suggestions below.

### Cross-Examination

SIFMA stated that FINRA should permit cross-examination on fairness and due process grounds asserting, among other matters, that “members and associated persons should have the right to explore, identify, examine, and highlight errors, omissions, and misstatements that bear upon the credibility, accuracy and completeness of a claimant’s or witness’s testimony.” PIABA urged FINRA to allow limited cross-examination of one or two key witnesses stating that “cross examination is often one of the most effective means of eliciting evidence during a hearing.” Several commenters supported FINRA’s prohibition on cross-examination in a Special Proceeding.<sup>9</sup> Gross and UNLV asserted that trained and experienced FINRA arbitrators have

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President and General Counsel, Arbitration Resolution Services, Inc., dated March 9, 2018 (“ARS”).

<sup>2</sup> See ARS, PIABA, SJU, MIRC, Black, PIRC and GSU. ARS proposed the creation of a pilot whereby parties could opt in to voluntary expedited online arbitration at its forum. This comment is outside the scope of the proposed rule change.

<sup>3</sup> See Caruso, stating that “the proposed amendments . . . would be a fair, equitable and reasonable approach that would facilitate the fairness and efficiency of the investor participant experience in the FINRA arbitration forum.”

<sup>4</sup> See Gross, stating that “This simpler, lower cost and faster process provides access to justice especially for *pro se* claimants, as well as the elderly and disabled.”

<sup>5</sup> See PIABA, stating that “it is important to have additional options related to simplified arbitration.”

<sup>6</sup> See UNLV, stating that “Special Proceedings will result in lower costs, increased representation rates of claimants, and greater participant satisfaction with the arbitration process.”

<sup>7</sup> See MIRC, stating that “simplifying the hearing process and allowing investors to tell their story gives investors a sense of participation that they do not get when their case is decided on the papers . . . and therefore can lead to more investor trust in the process.”

<sup>8</sup> See Gross, stating that “[N]ot only does the proposal offer more choices to small claim claimants, but it also designs a small claims arbitration process that improves both procedural and substantive justice by providing a viable option for disputants to voice their grievances out loud to a third-party neutral.”

<sup>9</sup> See Gross, UNLV, SJU, MIRC, Black and PIRC.

the knowledge and judgment to ask questions and obtain much of the same information that would have been revealed through cross-examination. Moreover, Gross stated that “because formal rules of evidence do not apply in arbitration, cross-examination rarely yields the ‘gotcha’ moment we might see dramatized on television.”

The absence of cross-examination is one of the main features that distinguishes a Special Proceeding from the full hearing option. FINRA believes that the ability to present a case without cross-examination would benefit parties whose testimony could be intimidated by a direct confrontation. FINRA believes that the broader role of arbitrators in a Special Proceeding in asking questions of the parties would serve a similar function to cross-examination, such as gaining clarity on issues and assessing witness credibility, but within a potentially less intimidating environment. Moreover, FINRA is not eliminating the cross-examination feature in the full hearing option. A customer (under the Customer Code), or a claimant (under the Industry Code), would continue to have the option of electing a full hearing if the party believes that cross-examination would be beneficial in a particular case.

### **The Right to Request a Special Proceeding under the Codes**

SIFMA asserted that FINRA should allow firms and their associated persons to request a Special Proceeding. Currently, no hearing will be held in simplified cases unless the customer (under the Customer Code), or a claimant (under the Industry Code), requests a hearing. When FINRA developed the proposed rule change, it considered whether to expand the right of firms and associated persons under the Customer Code, and respondents under the Industry Code, to request a Special Proceeding. FINRA decided not to change the rights of the parties under the Codes relating to the ability to elect a hearing option. FINRA believes it is in the best interest of investors to continue to allow them to determine how they want to proceed in arbitration. FINRA further believes that giving the firm, generally the party with the most resources, the ability to determine the arbitration method, could create an inappropriate barrier for some investors, particularly if the firm chooses the most expensive arbitration method.

### **Additional Mechanisms for Firms and Associated Persons**

SIFMA asserted that in a Special Proceeding, FINRA should allow firms and their associated persons to file a motion to dismiss for failure to state a claim, and if granted, the case should be decided on the papers. SIFMA stated that since FINRA does not allow motions to dismiss for failure to state a claim in instances where a statement of claim lacks specificity or is drafted poorly, respondents cannot adequately prepare to defend themselves at a hearing. SIFMA also stated that in a Special Proceeding, the claimant should be precluded from raising new issues, claims or evidence not previously raised or referenced in the statement of claim. FINRA believes that motions to dismiss should be narrowly confined to the grounds outlined in Rules 12504 and 13504.<sup>10</sup> Parties can use the discovery process to explore the substance of

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<sup>10</sup> FINRA Rules 12504(a) and 13504(a) (Motions to Dismiss Prior to Conclusion of Case in Chief) provide that: “The panel cannot act upon a motion to dismiss a party or claim under paragraph (a) of this rule, unless the panel determines that:

- (A) the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release;
- (B) the moving party was not associated with the account(s), security(ies), or conduct at issue; or

their opponent's case.<sup>11</sup> Moreover, under the Codes, FINRA requires parties to provide all other parties with copies of all documents and other materials that they intend to use at the hearing that were not already produced as well as a copy of the parties' witness lists.<sup>12</sup> If the Commission approves the proposed rule change, FINRA will monitor how the process is working to determine whether it should modify the program in any way.

### **Clarify the Structure of the Special Proceedings**

GSU stated that FINRA should allow parties to give their closing statements after each party presents its case and the arbitrator concludes his or her questioning. FINRA provides arbitrators with hearing scripts to ensure that parties understand how the hearing will progress.<sup>13</sup> If the Commission approves the proposed rule change, FINRA will provide a new hearing script specific to Special Proceedings which will state that absent circumstances indicating the need to hold the hearing in a different order, parties will be allowed to give their closing statements after each party presents its case and the arbitrator concludes his or her questioning. In addition, FINRA will explain in the Regulatory Notice announcing approval of the proposed rule change,

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(C) The non-moving party previously brought a claim regarding the same dispute against the same party that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision.”

Under FINRA Rules 12504(c) and 13504(c) (Motions to Dismiss Based on Eligibility), the panel cannot act upon a motion to dismiss a claim under Rule 12206 (Time Limits), unless the panel determines that the claim is not eligible for arbitration where six years have elapsed from the occurrence or event giving rise to the claim.

<sup>11</sup> FINRA Rules 12800(d) and 13800(d) (Discovery and Additional Evidence) provide that: “The parties may request documents and other information from each other. All requests for the production of documents and other information must be served on all other parties, and filed with the Director, within 30 days from the date that the last answer is due. Any response or objection to a discovery request must be served on all other parties and filed with the Director within 10 days of the receipt of the requests. The parties receiving the request must produce the requested documents or information to all other parties by serving the requested documents or information by first-class mail, overnight mail service, overnight delivery service, hand delivery, email or facsimile. Parties must not file the documents with the Director. The arbitrator will resolve any discovery disputes.”

<sup>12</sup> FINRA Rules 12514(a) and 13514(a) (Documents and Other Materials) provide that: “At least 20 days before the first scheduled hearing date, all parties must provide all other parties with copies of all documents and other materials in their possession or control that they intend to use at the hearing that have not already been produced. The parties should not file the documents with the Director or the arbitrators before the hearing.”

FINRA Rules 12514(b) and 13514(b) (Witness Lists) provide that: “At least 20 days before the first scheduled hearing date, all parties must provide each other party with the names and business affiliations of all witnesses they intend to present at the hearing. All parties must file their witness lists with the Director.”

<sup>13</sup> See “Hearing Procedure Script – Single Arbitrator Case” for an example of a hearing script, available at <http://www.finra.org/sites/default/files/hearing-procedure-script-single-arbitrator-case.pdf>.

and in its arbitrator training materials, how the hearing will be conducted, including when parties are allowed to make closing statements.

SIFMA objected to the time allotments in the rule proposal and recommended allotments made on a percentage or other basis. The conditions outlined in the proposed rule change are intended to ensure that the parties have an opportunity to present their case to an arbitrator in a convenient and cost-effective manner. The time frames are specific and straightforward. FINRA believes that the time frames will help arbitrators and parties stay within the two session maximum for a Special Proceeding. If the Commission approves the proposed rule change, FINRA will clearly articulate the time frames in its hearing script. Moreover, through correspondence and written materials, FINRA currently reminds arbitrators to stay on schedule during the arbitration hearing and avoid reducing the allotted time by starting late or ending early. In addition, FINRA would emphasize during the arbitrator training on Special Proceedings the importance of ensuring that arbitrators are mindful of the time frames outlined in the rule text.

### **Other Methods of Appearance**

MIRC stated that FINRA should encourage the use of videoconferencing because this technology affords the arbitrator a chance to better assess the credibility of witnesses. PIRC stated that FINRA should allow customers to choose a hearing by videoconference or in person. The proposed rule change allows the parties to agree to other methods of appearance, including appearing in person or by videoconference. FINRA determined that it is in the best interest of the parties to make telephonic hearings the default hearing type because this method is the most widely available, expeditious and inexpensive format for hearings.

### **Raise the Dollar Limits on Simplified Arbitration**

SJU stated that FINRA should raise the current dollar limit on simplified arbitration from \$50,000 to \$75,000 and increase the dollar limit of the rule proposal to \$100,000. If the Commission approves the proposed rule change, FINRA will consider the feasibility of increasing the dollar limits on simplified arbitration after it has gained experience with Special Proceedings.

### **Abridged Discovery Guide**

Currently, the Customer Code provides that Document Production Lists do not apply to simplified cases. MIRC and GSU recommended that FINRA provide a Discovery Guide ("Guide") containing a shorter Document Production List for the exchange of documents in all simplified cases.<sup>14</sup> MIRC further stated that FINRA should provide parties with some additional time for discovery exchange. FINRA staff is currently studying potential enhancements to the

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<sup>14</sup> The Guide supplements the discovery rules contained in the Customer Code. It includes an introduction which describes the discovery process generally, and explains how arbitrators should apply the Guide in arbitration proceedings. The introduction is followed by two Document Production Lists, one for firms and associated persons, and one for customers, which enumerate the documents that are presumptively discoverable in customer cases. As presumptively discoverable, parties do not have to expressly request the documents. FINRA expects the parties to exchange the documents without arbitrator or staff intervention. The Guide only applies to customer arbitration proceedings, not to intra-industry cases.

discovery process in simplified arbitration generally that would not impede the expedited nature of simplified cases. FINRA would consider whether any such enhancements would also apply to the Special Proceedings.

### **Specially-Qualified Arbitrator Roster and Mandatory Training**

SJU and Cornell supported FINRA's intent to provide additional arbitrator training on Special Proceedings. Black and GSU stated that FINRA should make arbitrator training on Special Proceedings a requirement. GSU recommended in-person training and also stated that FINRA should require specialized expertise for arbitrators presiding over Special Proceedings. MIRC and Black recommended that FINRA establish a special roster of arbitrators to handle Special Proceedings. MIRC stated that the arbitrators should be chair-qualified and trained to work with *pro se* claimants.

All simplified cases are decided by a single chair-qualified public arbitrator who has fulfilled special eligibility requirements and completed chairperson training. FINRA will provide arbitrator training in Special Proceedings through a Neutral Workshop video on the FINRA website for arbitrators to view on demand, and written training materials for arbitrators including, but not limited to, discussions about the Special Proceeding in FINRA's publication for arbitrators and mediators, *The Neutral Corner*. In its training, FINRA would instruct arbitrators that the arbitrator's role in a Special Proceeding might be different than it is in a full hearing because parties would not be permitted to question opposing parties' witnesses. FINRA would emphasize that in a Special Proceeding the arbitrator might need to ask more questions than he or she would ask in a regular hearing to gain clarity on issues and to assess witness credibility. FINRA believes it needs time and experience with the new hearing option before it can consider additional qualifications and requirements for arbitrators. While FINRA will strongly encourage arbitrators to avail themselves of training resources on Special Proceedings, FINRA is concerned about the potential negative impact that additional required training could have on the availability of arbitrators to serve on Special Proceedings.

### **Change the Name of the Simplified Arbitration Process**

GSU recommended that FINRA change the name of the simplified arbitration process to "small claims" arbitration because their clients believe that their claims are not taken seriously due to the term "simplified." FINRA appreciates the comment, but believes that using the term "simplified" appropriately captures the process and helps distinguish it from the full hearing process.

### **Conclusion**

FINRA believes that the foregoing responds to the issues raised by the commenters to the rule filing and that the proposed rule change should be approved as filed. If you have any questions, please contact me at (212) 858-4481, email: [margo.hassan@finra.org](mailto:margo.hassan@finra.org).

Sincerely,

/s/ Margo A. Hassan

Margo A. Hassan  
Associate Chief Counsel