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April 9, 2008

Via E-Mail

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-7553
E-Mail: rule-comments@sec.gov

Re: File Number SR-FINRA-2007-021
Proposed NASD Customer Code Rule 12504 (Motions to Dismiss)

Dear Ms. Morris:

I write to express my concerns regarding the above referenced proposed rule (the "Proposed Rule") imposing strict limitations on pre-hearing motions to dismiss by securities industry respondents in securities arbitrations filed by investors.[1] There is no compelling empirical data evidencing that these motions are problematic or justifying the enactment of such a draconian and one-sided rule.

It is important that any rule on this subject balance the legitimate objectives of all parties. The Proposed Rule does not. Investors have a legitimate interest in not having the resolution of their claims unnecessarily delayed by frivolous pre-hearing motions to dismiss, and the securities industry has a legitimate interest in avoiding the delays, attorneys' fees and other costs that flow from not having frivolous claims resolved at an early stage of the arbitration. Early resolution of these issues also allows FINRA to devote more resources to legitimate claims. Accordingly, the best proposals are those that (1) *encourage* legitimate claims and motions to dismiss, and (2) *discourage* frivolous ones.

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[1] This letter does not address separate FINRA rule proposals with respect to dismissal of claims on eligibility grounds (Rules 12206 and 13206) or claims between industry members (Rule 13504), although the arguments made in this letter apply to those proposals as well.

The Proposed Rule is Unnecessary and Undermines the Goals of Arbitration

Unfortunately, the Proposed Rule undermines the most important attributes of the arbitration process -- the swift and cost-effective resolution of disputes -- by discouraging all pre-hearing motions to dismiss (and prohibiting many legitimate ones) instead of encouraging the early dismissal of baseless claims and defenses. It also undermines the ability of arbitrators to decide such motions based upon the unique facts of each case. Based upon my experience, the Proposed Rule will have the unintended consequence of encouraging investors to file frivolous claims, and will increase the time and expense needed to complete the average arbitration proceeding.

I have spent a good part of the past twenty-eight years representing the securities industry, including as Director of Litigation at Shearson Lehman Brothers (1987-1992) and as outside counsel, supervising thousands of securities arbitrations and personally handling hundreds of others. I argued the *Shearson v. McMahon* (1987) and *Rodriguez v. Shearson* (1989) cases where the United States Supreme Court enforced pre-dispute agreements to arbitrate claims pursuant to the federal securities laws, testified before a Congressional Subcommittee on securities arbitration, and from 2002-2004 served the second of two terms as a member of the NASD National Arbitration and Mediation Committee. As outside counsel, I have had the privilege of defending many of the largest stockbrokerage firms in securities arbitrations.

Throughout my career, I cannot recall ever filing a pre-hearing motion to dismiss that an arbitration panel determined to be frivolous, and am at a loss to understand why this subject is receiving so much attention. Legitimate pre-hearing motions to dismiss are fundamental to the arbitration process because without them respondents must incur the unnecessary time and expense of defending themselves through hearing in situations where they should be dismissed from the case at inception. At the very least, these motions narrow issues and expedite proceedings for all parties, FINRA staff and the arbitrators. Indeed, avoiding unnecessary time and expense are the primary reasons that parties agree to arbitrate rather than litigate in court.

The Proposed Rule is draconian and one-sided because it prohibits pre-hearing motions to dismiss in all but a few arbitrarily selected situations, and micromanages the process by imposing stringent procedures (i.e., unanimous opinions and written explanations) and mandatory sanctions (i.e., forum fees, costs and attorneys' fees), rather than allowing arbitrators to fashion equitable remedies each case as they do in their hearings on the merits. The Proposed Rule eliminates legitimate pre-hearing motions to dismiss in all but a few situations while doing nothing to address the fundamental problem of frivolous claims filed by investors. It also implicitly sends two harmful messages: (1) FINRA is not confident that its arbitrators are capable of resolving pre-hearing motions to dismiss on a case-by-case basis, and (2) investors are free to file frivolous claims with impunity and use them as a tool for extorting settlements. Furthermore, there is no reason to require that an arbitration award granting such a

motion be unanimous and accompanied by a written explanation when this is not required for an arbitration award that decides a case on the merits after a full hearing.

The Proposed Rule unnecessarily departs from longstanding arbitration practice at the NASD, NYSE, American Arbitration Association and other arbitral forums allowing for pre-hearing motions to dismiss. Federal and State courts confirm arbitration awards dismissing claims based upon such motions provided the investor was given an adequate opportunity to be heard, and such motions are encouraged in litigation. The maxim "justice delayed is justice denied" is fundamental to the arbitration process because the parties have contracted for a swift and cost-effective resolution of disputes, yet the Proposed Rule inexplicably labels all pre-hearing motions to dismiss as "discouraged."

The Proposed Rule Unfairly Precludes Respondents From Making Legitimate Motions Such As Those Based on Statutes of Limitation

The Proposed Rule will prohibit qualified FINRA arbitrators from deciding a wide range of important motions to dismiss at an early stage of the proceedings, including motions to dismiss based upon statutes of limitation, prior arbitration and award, and factual/ legal impossibility, among others. If the Proposed Rule is enacted, investors whose claims are unquestionably time barred as a matter of law (and whose claims would be dismissed at an early stage in court) will be allowed to present their case at hearing anyway. Investors who previously arbitrated a case through hearing and lost will be free to refile the same case and have another hearing on the same issues. Investors filing clearly irrational and factually or legally impossible claims will be entitled to a full hearing. For example, although New York's highest court recently held there is no cause of action for U-5 defamation, the Proposed Rule would allow such a claim to proceed through a hearing on the merits. All of this is bad policy in any forum -- but more so in a forum whose mandate is to resolve claims swiftly and cost-effectively.

I am currently defending a securities arbitration where an investor seeks seven-figure damages although all but one of his many trades is barred by the applicable statutes of limitation. His time-barred claims would be dismissed on motion in court. The Proposed Rule precludes pre-hearing motions based upon statutes of limitations, although they can be filed upon completion of the investor's direct case. in any case. Given how rare it is for an arbitration panel to dismiss a case mid-hearing, the likelihood is that my client will have to prepare its entire case on the merits and defend the matter through a full hearing as if its legitimate defense did not exist, and will probably have to spend more than $100,000 in legal fees for the privilege. It is easy to see how this rule will encourage frivolous claims filed primarily for the purpose of extracting a settlement.

Recently, my law firm defended a brokerage firm sued because an unaffiliated investment advisor maintained an account at the firm that it used to allegedly swindle investors. It was clear from the pleadings that the investor had no basis for a claim against the brokerage firm, and the arbitrators properly dismissed the claims after considering a pre-hearing motion to dismiss and providing the investor an opportunity to

be heard. Under the Proposed Rule, this motion would be prohibited until the investor finished his direct case, wasting the brokerage firm's time and forcing it to incur unnecessary expenses.

I also handled a case for a brokerage firm that involved a delusional *pro se* investor who believed that the eleven-digit account number imprinted on the checks issued on her cash management account represented her account balance (which was actually only about $500). She sued the firm for billions of dollars, claiming it converted her funds. Not surprisingly, our motion to dismiss was granted. If the Proposed Rule is enacted, a brokerage firm in a similar situation in arbitration will have to participate in the full discovery process and a hearing on the merits. The costs will be astronomical. The investor can also name all of the firm's senior executives and force them to participate as well, and the arbitrators will be powerless to address the situation.

The only meaningful procedural device available to brokerage firms to defend against frivolous claims is to file a pre-hearing motion to dismiss and hope that the arbitrators will address the motion in a timely fashion so that they will not be required to participate in the pleading, discovery and hearing processes, not to mention countless employee man-hours spent locating and producing documents, and preparing for and attending an arbitration hearing. These aggregate costs can reach six-figures through hearing for a medium sized arbitration. The Proposed Rule purports to address these concerns by allowing respondents to file motions to dismiss after the investor concludes his direct case at hearing; however, this does not adequately address the problem because respondents must prepare their *entire* case before the hearing begins, and incur almost all of their legal fees and other expenses by the time an investor's case is completed. On the other hand, pre-hearing motions do not require substantial additional expense for the parties, and cause investors no additional legal fee expenses in contingency fee cases.

Finally, since Code of Arbitration Procedure Rule 12212 expressly empowers arbitrators to sanction parties for violations of their orders or of the arbitration rules (sanctions that range from assessing monetary penalties, costs, expenses and attorneys fees, to dismissing claims and defenses with prejudice, to referring industry respondents to the regulators for disciplinary proceedings), it is unclear to me why sanctions must be mandatory in the case of pre-hearing motions to dismiss. Additionally, arbitrators have broad powers to fashion remedies and appropriate sanctions, even in the absence of express rules pertaining to pre-hearing motions to dismiss or other specific topics.

A Proposal for Addressing Concerns About Frivolous Motions

I believe that concerns regarding frivolous pre-hearing motions to dismiss can be adequately addressed by minor changes to current rules, rather than by enacting a rule that discourages all such motions and prohibits the filing of legitimate ones. A simple, two-pronged approach should suffice:

First, enact those subsections (and *only* those subsections) of the Proposed Rule requiring that pre-hearing motions to dismiss: (1) be in writing, (2) be filed at least sixty days prior to the hearing, (3) require an in-person hearing or telephonic conference before the entire panel of arbitrators, and (4) once denied, cannot be re-filed without permission of the arbitrators. (Sanctions should not be mandatory because arbitrators are and should be free to impose the sanctions they feel are appropriate in a given case). These changes will ensure that investors are given the same safeguards they have with respect to a determination of their substantive claims after a full hearing on the merits.

Second, FINRA should provide for earlier selection of arbitrators and *encourage* them to address the issue of frivolous claims and pre-hearing motions to dismiss on an accelerated basis, consistent with the objectives of the parties and the overall goals of the arbitration process. This policy should itself discourage the filing of frivolous motions while simultaneously removing baseless claims from the arbitration docket.

Thank you for providing this opportunity to comment on the Proposed Rule, and please feel free to contact me if you have any questions.

Very truly yours,

Theodore A. Krebsbach

TAK/rcp