PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

1285 AVENUE OF THE AMERICAS
NEW YORK, NEW YORK 10019-6064

TELEPHONE (212) 373-3000
FACSIMILE (212) 757-3990

LLOYD K. GARRISON (1946-1991)
RANDOLPH E. PAUL (1946-1956)
SIMON H. RIFKIND (1950-1995)
LOUIS S. WEISS (1927-1950)
JOHN F. WHARTON (1927-1977)

WRITER'S DIRECT DIAL NUMBER

(212) 373-3316

WRITER'S DIRECT FACSIMILE

(212) 492-0316

WRITER'S DIRECT E-MAIL ADDRESS

bkarp@paulweiss.com

1615 L STREET, NW
WASHINGTON, DC 20036-5694
TELEPHONE (202) 223-7300
FACSIMILE (202) 223-7420

FUKOKU SEIMEI BUILDING
2-2 UCHISAIWAICHO 2-CHOME
CHIYODA-KU, TOKYO 100-0011, JAPAN
TELEPHONE (81-3) 3597-8101
FACSIMILE (81-3) 3597-8120

UNIT 3601, FORTUNE PLAZA OFFICE TOWER A
NO 7 DONG SANHUAN ZHONGLU
CHAO YANG DISTRICT
BEIJING 100020
PEOPLE'S REPUBLIC OF CHINA
TELEPHONE (86-10) 5828-6300
FACSIMILE (86-10) 6530-9070/9080

12TH FLOOR, HONG KONG CLUB BUILDING
3A CHATER ROAD, CENTRAL
HONG KONG
TELEPHONE (852) 2536-9933
FACSIMILE (852) 2536-9622

ALDER CASTLE
10 NOBLE STREET
LONDON EC2V 7JU, U.K.
TELEPHONE (44 20) 7367 1600
FACSIMILE (44 20) 7367 1650

April 10, 2008

BY EMAIL TO: rule-comments@sec.gov

Ms. Nancy Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: File No. SR-FINRA-2007-021
Proposal amending NASD Rules 12206 and 12504 of the Customer Code and NASD Rules 13206 and 13504 of the Industry Code to address motions to dismiss and to amend the eligibility rule related to dismissals

Dear Ms. Morris:

Paul, Weiss, Rifkind, Wharton & Garrison LLP ("Paul Weiss") appreciates the opportunity to comment on the above-referenced proposal to amend those portions of the Financial Industry Regulatory Authority's ("FINRA") Code of Arbitration Procedure that relate to motions to dismiss in arbitration.

As counsel who regularly appear in FINRA's arbitral forum, we appreciate FINRA's continued efforts to assure the accessibility, fairness and efficiency of the forum for all prospective parties. We also commend FINRA's efforts to implement procedures to curb abusive motion practices and ensure that all potentially meritorious claims proceed to a hearing.

We share FINRA's view that procedural rules should aim to achieve an appropriate balance between affording parties the right to have their claims heard on the merits and permitting motions to dismiss in circumstances where it would be unfair, inefficient and pointless to require a party to proceed to a hearing.[1] It is our view, however, that the proposed rule change does not properly balance these competing interests because it would prohibit motions to dismiss in several circumstances where they are entirely warranted and based on well-settled principles of law. Accordingly, we respectfully offer the following comments on the proposed rule change and encourage the Commission to broaden the scope of permissible motions to dismiss.

I. The Commission Should Expand the Scope of Permissible Motions to Dismiss

Proper motions to dismiss promote fairness and efficiency. They prevent claims that have no legal basis from imposing unnecessary costs on the parties, and they free the forum from needlessly expending scarce resources. For these reasons, motions to dismiss have been considered appropriate and important procedural devices since early common law practice, the original state codes and the establishment of the Federal Rules of Civil Procedure.[2] As courts have long recognized:

> When the allegations in a complaint, however true, could not raise a claim of entitlement to relief, this basic deficiency should ... be exposed at the point of minimum expenditure of time and money by the parties and the court.[3]

Indeed, by expressly permitting motions to dismiss in limited circumstances, FINRA acknowledges that it would be unfair to require a party to proceed to a hearing in at least some circumstances where claims have no legal basis. The proposed rule change, however, would restrict pre-hearing motions to dismiss to three narrow grounds and thereby foreclose such motions in a host of circumstances where the claims lack any legal basis and, as a result, no legitimate purpose would be served by requiring the respondent to proceed through the burdensome process of discovery and hearing preparation.

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1 *See* 73 Fed. Reg. 15,022.

2 5 Wright & Miller, Federal Practice and Procedure: Civil 3d § 1355.

3 *Bell Atlantic Corp.* v. *Twombly*, 127 S.Ct. 1955, 1966 (2007) (quoting 5 Wright & Miller § 1216 and cases cited therein).

A. Claims Barred by Jurisdictional Defects, Legal Impossibility or Statutes of Limitations

There are a number of circumstances beyond the three narrow grounds enumerated in the proposed rule change in which well-established legal principles bar asserted legal claims. For instance, where a FINRA panel lacks jurisdiction, a party fails to bring a claim within the applicable statute of limitations, or where the doctrine of *res judicata* applies, a claim cannot prevail regardless of what facts may come to light during discovery or hearing.

The doctrine of *res judicata*—which protects litigants from the burden of multiple lawsuits, promotes judicial economy and prevents inconsistent decisions—bars claims that have been litigated to final resolution in a prior proceeding.[4] It is well-established that a claimant cannot properly re-assert claims that have been litigated and resolved in a prior proceeding. Under the proposed rule change, however, a respondent could be forced to defend itself against a claim multiple times, including the need to engage in discovery and a hearing, notwithstanding that the claim was barred at the outset under well-established law.

The permissible grounds for motions to dismiss should also be expanded to include expiration of applicable statutes of limitations. While the existing arbitration rules permit the filing of a dispositive motion if the claim exceeds the six-year time limit under the Code's "eligibility rule," the proposed rule change would not permit a party to file a pre-hearing motion to dismiss where the claim exceeded the applicable statute of limitations.[5]

As the "eligibility rule" makes clear, it "does not extend applicable statutes of limitations."[6] Similarly, the NASD Arbitrator's Manual provides that statutes of limitations "may preclude the awarding of damages even though the claim is eligible for submission to arbitration."[7] Parties should not be required to incur the cost of discovery or hearings where the claims at issue are demonstrably time-barred. Accordingly, filing a pre-hearing motion to dismiss based on the expiration of applicable statutes of limitations should be permitted under the rules.

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[4] *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322 (1979); *Kremer* v. *Chem. Constr. Corp.*, 456 U.S. 461 (1982).

[5] Code of Arbitration Procedure § 12206(a).

[6] Code of Arbitration Procedure § 12206(c).

[7] NASD Arbitrator's Manual, Jan. 2007 at 8.

Similarly, the rules should permit a pre-hearing motion to dismiss where the claimant lacks standing. Under the well-settled standing doctrine, a claimant must have a legally cognizable interest that was infringed by the respondent in order to obtain relief. Where it is clear from the allegations that the claimant does not have standing to assert his claims, a respondent should be permitted to file a motion to dismiss prior to discovery and hearings.

FINRA and its predecessor self-regulatory organizations have historically adhered to these well-established legal principles by dismissing claims that are barred by statutes of limitation or lack of jurisdiction. *See, e.g.*, *Max Marx Color & Chem. Co. Employees' Profit Sharing Plan* v. *Barnes,* 37 F. Supp. 2d 248, 253-54 (S.D.N.Y. 1999) (affirming NASD panel's dismissal of an employee benefit plan's ERISA claim for lack of standing because the Second Circuit—whose jurisprudence was controlling—had consistently held that only those groups explicitly named in the statute could bring such claims); *Friedman* v. *Wheat First Sec., Inc.,* 64 F. Supp. 2d 338, 341-42 (S.D.N.Y. 1999) (NASD panel dismissed claim for lack of jurisdiction); *Fortier* v. *Morgan Stanley DW, Inc.,* No. C06-3715 SC, 2006 WL 3020926, at *3-4 (N.D. Cal. Oct. 23, 2006) (affirming NASD panel's dismissal of claims as time-barred).

B. Allegations that Do Not Give Rise to a Cause of Action

Just as a number of well-settled legal doctrines bar certain claims, many types of claims do not give rise to cognizable legal theories. *See, e.g., Warren* v. *Tacher,* 114 F. Supp. 2d 600, 601 (W.D. Ky. 2000) (affirming NASD arbitration panel's pre-discovery dismissal of claims because clearing firms do not owe fiduciary duties to the customer and claimants failed "to show how any evidence that they would have obtained in discovery would overcome the panel's decision"). For example, under New York law and the laws of other states, claims for negligent misrepresentation must be based on factual representations.[8] Accordingly, when a claimant asserts a negligent misrepresentation claim based on expressions of opinion, such a claim cannot prevail as a matter of law.

Similarly, a claim that a party violated industry rules does not give rise to a private right of action.[9] And claims based on assertions that material

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[8] *Dujardin* v. *Liberty Media Corp.*, 359 F. Supp. 2d 337, 355 (S.D.N.Y. 2005); *Mehaffy, Rider, Windholz & Wilson* v. *Central Bank Denver, N.A.*, 892 P.2d 230, 237 (Co. 1995).

[9] *Lowenbraun* v. *L.F. Rothschild, Unterberg, Tobin*, 1987 U.S. Dist. WL 5806, at *2 (S.D.N.Y. Jan. 15, 1987); *Daniel Boone Area Sch. Dist.* v. *Lehman Bros., Inc.*, 187 F. Supp. 2d 400 (W.D. Pa. 2002); *WMA Sec., Inc.* v. *Wynn*, 191 F.R.D. 128, 131 (S.D. Ohio 1999); *Silverstein* v. *Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 618 F. Supp.

misrepresentations or omissions caused a claimant to retain ownership of securities—commonly known as holder claims—are not actionable under the laws of many jurisdictions.[10]

It is also well-settled law that non-discretionary account holders generally cannot state a claim against their brokers for breach of fiduciary duty because a broker who merely receives and executes a customer's orders does not exercise sufficient control to give rise to a fiduciary relationship.[11]

Like the grounds for motions to dismiss specifically permitted in the proposed rule change, the foregoing non-actionable claims are "circumstances ... [in which] it would be unfair to require a party to proceed to a hearing."[12] It is neither fair nor efficient to require a party to proceed through discovery and hearings with respect to a claim that is not cognizable or actionable under applicable law. There is no benefit or reason to allow such claims to proceed to a hearing because no amount of discovery will render them actionable or cognizable. Prohibiting motions to dismiss in circumstances such as these—where the allegations, even if true, do not give rise to a cognizable legal theory, or where well-established legal principles foreclose recovery—only serves to undermine the goals of promoting fairness and efficiency in the arbitration forum.

Accordingly, we encourage the Commission to broaden the scope of permissible motions to dismiss by permitting such motions where a claim cannot prevail

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436, 438 (S.D.N.Y. 1985); *see generally Cook* v. *NASD Regulation, Inc.*, 31 F. Supp. 2d 1245, 1248 (D. Colo. 1998).

[10] *Chanoff* v. *United States Surgical Corp.*, 857 F. Supp. 1011, 1018 (D. Conn. 1994), *aff'd*, 31 F.3d 66, 67 (2d Cir. 1994) (applying Connecticut law); *WM High Yield Fund* v. *O'Hanlon*, 2005 WL 1017811, at *13 (E.D. Pa. Apr. 29, 2005) (dismissing holder claim under Pennsylvania law); *In re WorldCom, Inc. Sec. Litig.*, 336 F. Supp. 2d 310, 323 (S.D.N.Y. 2004) (dismissing holder claim under Georgia law); *Manzo* v. *Rite Aid Corp.*, 2002 WL 31926606, at *5 (Del. Ch. Dec. 19, 2002); *Arnlund* v. *Deloitte & Touche LLP*, 199 F. Supp. 2d 461, 486-87 (E.D. Va. 2002) (applying Virginia law).

[11] *Paine Webber, Jackson & Curtis, Inc.* v. *Adams*, 718 P.2d 508, 516-17 (Colo. 1986); *see also De Kwiatkowski* v. *Bear Stearns & Co.*, 306 F.3d 1293, 1309 (2d Cir. 2002) (reversing jury verdict for plaintiff and finding that no fiduciary duty existed in connection with non-discretionary account); *Perl* v. *Smith Barney, Inc.*, 646 N.Y.S.2d 678, 680 (1st Dep't 1996); *Fekety* v. *Gruntal & Co.*, 595 N.Y.S.2d 190, 190-91 (1st Dep't 1993).

[12] 73 Fed. Reg. 15,022.

as a matter of law. We believe FINRA's laudable goal of striking the appropriate balance between ensuring that cognizable claims are heard on the merits and protecting litigants from the burden of proceeding to a hearing where it would be unfair, is best achieved by preserving appropriate pre-hearing motions to dismiss while maintaining certain of the measures set forth in the arbitration rules that curb abusive motion practices.

Several provisions of the existing Code rules and proposed rule change ensure that parties do not file motions to dismiss for improper purposes. For example, the requirement in the proposed rule change that motions to dismiss must be filed at least 90 days prior to the first hearing date ensures that such motions are not used improperly as a tactic to delay hearings. Similarly, the possibility of sanctions—several of which are severe—ensures that parties do not use motions to dismiss as a device to harass or intimidate.[13] These measures will effectively prevent abusive motion practice.

II. Decisions on Motions to Dismiss Should be Determined by a Majority of the Panel

The proposed rule change would require that decisions on motions to dismiss would have to be unanimous, citing as a basis the "ramifications of granting a motion to dismiss."[14] Given that the entry of an arbitration award—which has equally significant ramifications—does not require unanimity,[15] however, no higher standard should be applied to motions to dismiss with respect to a decision on a motion to dismiss. We believe the rule is also unnecessary to assure the appropriate disposition of motions to dismiss. Given that the proposed rule change would require a hearing before the entire

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[13] Code of Arbitration Procedure § 12504(a)(10-11). While sanctions may be appropriate for motions filed in bad faith, we believe that the provision of the proposed rule change that would *require* the panel to impose forum fees on the moving party if the motion were denied is unduly harsh and unfair. A party that moves to dismiss a claim in good faith should not be penalized for taking up its own defense. Therefore, the proposed rule, which would assess a moving party forum fees associated with a hearing on its motion to dismiss, should be stricken. Code of Arbitration Procedure § 12504(a)(9). As noted in FINRA's "statement of purpose," the proposed rule is limited in its intent to "impos[ing] stringent sanctions against parties for engaging in *abusive* practices under the rule." 73 Fed. Reg. 15,021 (Mar. 20, 2008). As the proposed rule would already secure non-moving parties all reasonable costs and fees when forced to defend a frivolous or bad faith motion, no more is required to "minimize abusive practices involving motions to dismiss." *Id.* at 15,023.

[14] Code of Arbitration Procedure § 12206(b)(5); 73 Fed. Reg. 15,022 (March 20, 2008).

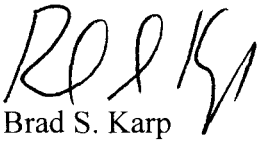
[15] Code of Arbitration Procedure § 12904(a).

panel on any motion to dismiss, sufficient procedures and safeguards exist to ensure that each panel member is hearing the parties' arguments and making an informed decision when ruling on the motion. Majority rule should govern this determination as it does all others in arbitration.

* * *

Thank you for giving Paul Weiss the opportunity to comment on the proposed rules governing motions to dismiss in arbitration.

Sincerely,



Brad S. Karp