ALBANY LAW SCHOOL

ALBANY LAW CLINIC & JUSTICE CENTER

April 3, 2009

Via Email

Elizabeth M. Murphy
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number SR-FINRA-2008-024; Release Number 34-59534
Proposed Changes to Discovery Guide in FINRA Arbitrations

Dear Ms. Murphy:

On behalf of the Albany Law School Securities Arbitration Clinic ("the SAC"), thank you for the opportunity to comment on the above-referenced proposal to modify the Discovery Guide for FINRA Arbitrations. We are a *pro bono* clinic in which students, certified to the limited practice of law by the Appellate Division, Third Judicial Department of New York and under faculty supervision, represent qualified investors of limited means in securities disputes with member firms and associated persons. Our practice generally is limited to securities arbitrations because our clients typically are contractually bound to arbitrate their disputes with their brokers and broker-dealers. Our clients are among the most vulnerable participants in the arbitration process, and typically include senior citizens living on fixed incomes, retirees, surviving spouses with no money management experience, disabled veterans and other investors of limited means.

OVERVIEW

We are aware that a number of commentators have submitted detailed objections to specific proposed revisions to the Discovery Guide and we join in those objections.[1] We are writing separately because we are gravely concerned about the impact the proposed changes to the Discovery Guide would have on our clients. Our clients already face substantial barriers when they seek to arbitrate disputes with the securities industry. In addition to the fees associated with the FINRA arbitration forum – which can be substantial and even prohibitive – the burdens associated with unearthing and producing years of personal financial information can be overwhelming. For seniors living on fixed incomes and other investors of limited means, the cost of arbitration (financial and otherwise) and the burdens associated with turning over years

[1] E.g., Letter from Scott R. Shewan, President-Elect, Public Investors Arbitration Bar Ass'n, to Elizabeth Murphy, Secretary, Sec. Exch. Comm'n (Mar. 27, 2009) (on file with author), available at http://sec.gov/comments/sr-finra-2008-024/finra2008024-10.pdf.

and years' worth of personal financial information (whether relevant or not) can be enough to dissuade them from pursuing meritorious claims.

Instead of making the arbitration process more equitable and efficient for these vulnerable investors, however, the proposed revisions to the Discovery Guide would impose additional burdens on investors already at risk. These unjustified burdens – which outweigh those placed on the industry – are intrusive, unwarranted and unwise. We urge the SEC to refrain from accepting the proposed changes until more equitable, reciprocal, and appropriate changes are proposed and considered.

THE PROPOSED REVISIONS TO THE DISCOVERY GUIDE WOULD SANCTION FISHING EXPEDITIONS INTO IRRELEVANT PERSONAL FINANCIAL INFORMATION

Under the current Discovery Guide, investors already are required to produce reams of personal financial information, whether relevant or not, whenever they decide to file statements of claim. In practical terms, this means that investors must dig through years of personal records to locate any account statement, trade confirmation, brochure, prospectus, letter, email, personal and business tax return, bank record (and more) listed in the Discovery Guide, copy it (often at great expense) and produce it to respondent firms and associated persons whether or not this material has anything to do with the dispute at issue. While this task is onerous for everyone, it is particularly difficult for the elderly, disabled and economically stressed clients that we typically serve. To be clear, we have seen investors walk away from meritorious claims because they cannot afford the costs (financial and otherwise) associated with FINRA arbitrations.

Instead of reducing the burdens on these vulnerable investors, however, the proposed revisions to the Discovery Guide will only make things worse by unjustifiably expanding the list of presumptively discoverable documents. For example, under the revised Discovery Guide, customers would be required to identify all loans applied for from five years prior to the first transaction complained of through the filing of the statement of claim. This could include car loans, home mortgage loans, home equity loans, credit card applications, personal loans and other loans that the drafters of the revisions never contemplated. Once these loans are identified, the revised Discovery Guide would require the customer to provide the opposing party with authorization directed to the third party lender for all loan applications. This intrusive and burdensome requirement has no place in arbitration. In every case that the SAC has handled (and in the vast majority of cases), loan information is completely irrelevant. A private citizen should not have to divulge irrelevant personal financial information in order to initiate an arbitration action.

The revisions also would unjustifiably expand the time period for presumptively discoverable documents. Under the revised Discovery Guide, tax returns and brokerage statements would be presumptively discoverable for five years prior to the first transaction at issue. This means, for example, that in a suitability case filed six years after the first transaction at issue, customers could be required to dig up and produce twelve years' worth of financial information, even if the respondent firm and/or associated person did not ask a single question or look at a single piece of paper (let alone the long list of presumptively discoverable documents

set forth in the revised Discovery Guide) before recommending the products at issue. This is simply an unacceptable burden. The task of gathering over a decade of financial information would be onerous for anyone, let alone elderly customers and others who may be especially susceptible to investment abuse. Considering only copying costs, these proposed additions would prevent investors living on fixed incomes, investors of limited means and others who are facing financial pressures from pursuing their claims.

The proposed revisions also are contrary to the industry's "know your customer" rule. In a suitability case, for example, the relevant question is what the broker did or did not learn about the customer and his/her circumstances and objectives before making an investment recommendation. The proposed changes would enable brokers who initially fail to gather the necessary information from their customers to learn and use as ammunition during the hearing everything about the customer after the fact, through discovery. Instead of leveling the playing field, the proposed changes unduly favor member firms' and associated persons' *post hoc* interpretations of a client's financial sophistication, contrary to SEC cases holding that the customer's wealth is not a determinant issue.[2] Put simply, if respondent lied to an investor, and/or did not bother to review an investor's financial situation, goals and objectives before recommending securities, the respondent should not be able to dig through the investor's entire financial history to argue that transactions were suitable after the fact.

THE PROPOSED REVISIONS TO THE DISCOVERY GUIDE UNFAIRLY EXEMPT FIRMS AND ASSOCIATED PERSONS FROM DISCOVERY OBLIGATIONS

In contrast to the additional burdens placed on investors, the proposed revisions to the Discovery Guide are markedly more favorable towards member firms and associated persons. For example, while the revised Discovery Guide requires investors to produce account-related documents (including statements and confirmations), firms and associated persons would no longer presumptively be required to produce this information. This makes no sense. Unlike customers, firms are required to maintain account-related information for a period of years under SEC rules, including Securities Exchange Act Rule 17a-3(a)(17). In many cases, getting a full and complete set of account statements from the firm is critical. For example, in several recent cases, respondent brokers provided our clients with fictitious account statements. Getting account statements from the respondent firm was the only way that we could demonstrate what actually happened in the clients' accounts. Especially in cases like this, allowing firms to argue that account statements are not presumptively discoverable would not be an equitable result.[3]

---

[2] See e.g., Arthur Joseph Lewis, 50 S.E.C. 747, 749 (1991) ("the fact that a customer . . . may be wealthy does not provide a basis for recommending risky investments."); see also David Joseph Dambro, 51 S.E.C. 513, 517 (1993) (stating that the determination of suitability should be based on the "appropriateness of the investment for the investor" and not whether the investor can "afford to lose the money.").

[3] It is worth noting that when customers request account-related records, firms often tell them that it will cost thousands of dollars and/or take many months to provide this information. In at least one case, when a client pushed back on the cost, she was told that she would have to file an arbitration action to get her statements. Our clients simply cannot afford to initiate arbitration and/or pay thousands of dollars merely to obtain account records necessary to evaluate and prosecute claims. This sort of behavior further

The revised Discovery Guide's treatment of telephone records is similarly objectionable. Under the proposed amendments, investors must produce recordings of conversions or telephone calls. By contrast, the revisions would exempt firms and associated persons from this requirement. This one-sided burden is baffling. Firms regularly record conversations between brokers and customers. Allowing the industry to suppress this important evidence, while requiring customers to turn it over, is unfair in the extreme.

We also note that while investors are required to produce their entire financial life history under the revised Discovery Guide, firms and associated persons face no such burden. If, as FINRA maintains, the new information called for in this Discovery Guide is necessary for a "broader understanding of a customer's financial status," why doesn't the revised Guide require firms and associated persons presumptively to produce a comparably wide range of personal and business financial information, including full commission runs? Full runs often show whether a respondent broker was trading a suspect security in multiple accounts, and may also indicate whether the broker traded the security on a solicited basis in multiple accounts. More broadly, commission runs can demonstrate whether the conduct at issue was the result of the client's particular desires, or whether the associated person traded in securities at issue across accounts/investors and/or as part of his standard practice.

THE PROPOSED CHANGES TO THE DISCOVERY GUIDE WILL REINFORCE INVESTORS' PERCEPTION THAT FINRA ARBITRATIONS ARE UNFAIR AND ABUSIVE

The proposed revisions to the Discovery Guide are particularly inappropriate given widespread reports of discovery abuse by member firms and associated persons, troublingly low customer win rates in the forum and investors' overall negative perception of the FINRA arbitration forum. For example, in Notice to Members 03-70 FINRA noted that complaints about member firms' abuse of the discovery process were on the rise:

> Despite the guidance provided in the Code and the Discovery Guide, NASD continues to receive complaints regarding possible abuses of the discovery process . . . . The increasing frequency with which arbitration panels are awarding monetary sanctions for discovery abuse, as well as increasing complaints from the parties, leads NASD to conclude that discovery abuse is on the rise.[4]

Among other abusive practices, the Notice to Members highlighted reports that member firms have intentionally concealed documents, failed to cooperate in the discovery process, and failed to provide discoverable material.[5] The NTM cautioned that "discovery abuses hinders the

---

suggests that firms, not investors of limited means, should be required presumptively to produce account statements and confirmations.

[4] NASD, Notice to Members 03-07, 762-63, November 2003, *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003073.pdf (emphasis added).

[5] Id. at 762.

efficient and cost-effective resolution of disputes in this forum, and undermines the integrity and fairness of the NASD forum."[6]

We have seen examples of such behavior in our clinic. In one recent case, for example, all three respondents failed to produce any of the presumptively discoverable documents listed in the Discovery Guide, even though the deadline set forth in Rule 12506(b) of the Code of Arbitration Procedure has passed. In the likely event that we are required to engage in motion practice to obtain these documents, Respondents will have succeeded in making arbitration a slower and more expensive forum for our clients. It is hard to understand why our clients should be forced to locate and produce an even longer list of documents when in our experience, it is respondent firms and associated persons who regularly flout discovery rules.

Imposing additional discovery requirements on investors also seems unwise in the face of already-low customer win rates.[7] In our experience, respondent firms and associated persons try to use these low win rates to bully investors (especially *pro se* investor-claimants) into dropping claims or accepting pennies on the dollar even in cases involving egregious investment abuse. Expanding investors' discovery obligations in the face of these tactics and statistics is not sound policy, and should not be permitted here.

More generally, investors' negative perception of the arbitration forum makes it even harder to understand why investors (and not firms and associated persons) should be subject to dramatically expanded discovery requirements. In their recently-conducted study, Professors Jill Gross and Barbara Black found that a significant percentage of customers believe that the arbitration proceedings are unfair and biased.[8] According to the study, "[t]he question that generated the most negative customer reaction asked about perception of arbitrator impartiality, based on their most recent experience in arbitration."[9] 41% of customers surveyed did not feel that the arbitration panel was impartial.[10] Astoundingly, 71% of customers were dissatisfied with the arbitration outcome, while only 36% of all other participants were dissatisfied.[11] The Commission should not add to these negative perceptions by approving discovery rules which once again favor industry at investors' expense.

CONCLUSION

The proposed revisions to the Discovery Guide impose substantial and unjustified burdens on all investors, but especially the vulnerable investors that we typically represent. In the interest of ensuring a prompt, cost-effective and fair forum for the resolution of disputes, and to restore

---

[6] Id. at 763.
[7] This information can be found at http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm.
[8] Jill I. Gross & Barbara Black, When Perception Changes Reality: An Empirical Study of Investor's Views of the Fairness of Securities Arbitration, 2008 J. DISP. RESOL. 349 (2008).
[9] Id. at 385.
[10] Id.
[11] Id. at 386.

investor confidence in the FINRA arbitration forum, the SAC respectfully requests that the Commission reject the proposed revisions to the Discovery Guide.

Thank you for your consideration.

Respectfully Submitted,

Peter McCormack
Law Intern

Yumi Frost
Law Intern

Albany Law School
Securities Arbitration Clinic
Albany Law School Clinic & Justice Center