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April 15, 2009

VIE E-MAIL TO RULE-COMMENTS@SEC.GOV

Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SR-FINRA-2008-024

Dear Ms. Morris:

On April 2, 2009, I provided you with comments concerning Lists 1 and 2 of Discovery Guide proposals submitted by FINRA. Set forth below are my comments with respect to the remaining lists of the Discovery Guide proposal.

1. <u>List 5, Item 2</u>

The current List 5, Item 2, presumptively requires the production of all exception reports and supervisory activity reviews relating to the broker and the customer's account, generated not earlier than one year before or not later than one year after the transaction at issue, as well as all other documents reflecting supervision of the associated person and the customer's account at issue. FINRA proposes to amend this rule to apply the minimal two-year document production period to all documents produced under the rule. It is noted that in contrast to the two-year production period for documents produced by the industry, customers under the existing rules are required to provide tax returns and financial information for a period beginning three years prior to the first transaction at issue through the date the statement of claim is filed. Furthermore, FINRA has proposed to extend this customer three-year production period to five years requiring the customer to produce such documents from five years prior to the first transaction through the date of filing the statement of claim in the case of financial statements, and from five years prior to the first transaction through the year in which the claim is filed in the case of tax returns. These extended production periods for the customer could well exceed a period of 11 years as has been noted in my List 2 comments.

The contrast between the two-year brokerage industry production period to provide supervisory documents with FINRA's potential 11-year production period for investors is striking. There is no material additional burden on a brokerage firm in producing documents for a more lengthy period than the two years. Fairness would dictate that the customer/brokerage firm production periods should at the very least be comparable. Accordingly, the production period for the brokerage firm should be extended to be consistent with the production period applicable to investors for tax returns and financial documents. Furthermore, the production of brokerage firm supervisory information beyond the existing two-year period may well be expected to yield material evidence for the investor's case. The production period for these supervisory documents should be extended.

It is also important to note that the current List 5, Item 2, provides a general obligation for the brokerage firm to produce "all other documents reflecting supervision of the associated person(s) and the customer's account(s)" without any time limitation. FINRA has proposed elimination of this general discovery obligation and instead categorizes only certain types of documents that must be produced. In addition, FINRA has eliminated the existing open-ended time period for documents to be produced and instead capped the discovery period at just two years. In doing so, FINRA has not only set a short cutoff period, it also has narrowed the scope of the supervisory documents that must be produced. It is not feasible for FINRA to identify all of the types of supervisory documents that may be relevant to the case. The general obligation to produce supervisory documents should be maintained for those documents relating to the associated person(s) or the customer's account(s), and the discovery period should be left open and not be capped at just two years.

2. <u>List 5, Item 3</u>

FINRA proposes to retain a similar shortened production period of one year prior to and subsequent to the first transaction at issue concerning the production of internal audit reports. See comment to List 5, Item 2, concerning extending this period to be consistent with the extended production period imposed upon the customer.

3. <u>List 13, Item 3</u>

FINRA proposes to presumptively require the production of all documents "between the firm/associated person and the customer" which relate to asset allocation, diversification, trading strategies, and market conditions. These documents certainly may prove essential to a customer seeking to establish that transactions were unsuitable, particularly in equity concentration cases which are common. However, they should not be limited to production of documents that are "*between* the firm/associated person and the customer." The firm documentation relating to these issues normally would not have been *between* the firm/associated person and the customer. In fact, they would be buried in the firm's files and never have been produced to the customer. The fact that such documents were not disclosed to the customer may be even more important in establishing a firm's liability than if the documents had been disclosed, for it could provide evidence that these expected strategies were concealed from the customer. List 13, Item 3, should require the production of these documents from the firm regardless of whether they were previously provided to or discussed with the customer.

4. <u>New List 12</u>

FINRA proposes to presumptively require production of information about trading activities in customer accounts of the associated person with respect to up to five securities/products selected by the customer. FINRA's argument is that limiting the number to five securities minimizes delays in the discovery process. This makes little sense. If the trading in a customer's account involves multiple products, this information should have to be provided with respect to all such products. If a full production of relevant documents imposes some delay in the discovery process, so be it. FINRA should not limit the production of relevant evidence just because a case involves issues concerning more than five products.

FINRA also proposes to limit the discovery period to six months before and six months after the transactions at issue. Again, FINRA has arbitrarily decided to place a minimal burden on the brokerage firm even though it requires customers to produce documents for periods of up to 11 years. This period should not be capped at six months before and after, but rather should be for a period of at least three years before and after the transactions at issue in order to assure an opportunity to fully evaluate the relevance of trading in other customers' accounts.

<u>The Pattern of Discovery Abuse by the Brokerage Industry Requires Mandatory Rules and Substantial Sanctions</u>

Discovery in arbitration has been repeatedly abused by the brokerage industry. There have been numerous fines and sanctions imposed upon the major firms. The industry's approach has been simple. They pay the fines and then continue with new abuses. Perhaps the most significant action taken by the NASD was in July 2004 when three of the most prominent brokerage firms were fined a total of $750,000 for repeatedly failing to comply with their basic discovery obligations in arbitration. CitiGroup, Merrill Lynch, and Morgan Stanley each paid $250,000. There could be no clearer demonstration of why the discovery obligations of the brokerage industry must be strengthened and not weakened, and must be enforced with sanctions which provide true deterrents.

The SEC is well aware of how extreme the industry abuses can be and how major firms pay large sanctions and then continue to undermine the integrity of investor arbitration. In 2007, just three years after being sanctioned $250,000 by the NASD, Morgan Stanley agreed to a $15 million sanction for e-mail destruction relating to arbitration discovery. Notwithstanding the 2004 NASD sanctions, Morgan Stanley repeatedly made false statements to both claimants and regulators denying the fraudulent destruction of documents. If there is to be any assurance of compliance with the rules, the brokerage industry must be subject to explicit mandatory obligations with respect to document production, and discovery rules should direct arbitrators to impose very substantial sanctions whenever firms violate these rules.

Failure to adopt such rules and instead easing the industry's discovery burdens and allowing shortened broker-friendly presumptive production obligations can only further encourage discovery abuse by the industry. With this track record, the SEC cannot follow FINRA's lead in assuming brokerage firm compliance. The SEC should not approve FINRA's proposed discovery rules which allow the industry to exercise judgment or any discretion whatsoever as to what documents must be produced. Brokerage firm discovery obligations must be expanded and basic document production made mandatory. The rules must be explicit and direct. Production periods should be extended, not shortened. Firms cannot be rewarded for their wrongdoing. Their repeated abuse of the arbitration process which has resulted in the failure of the arbitration system for so many investors cannot be allowed to continue.

Thank you for the opportunity to provide comments with respect to this proposal.

Very truly yours,

Laurence S. Schultz

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