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Re: File No. SR-FINRA-2010-0036 – Proposed Rule Change to Amend the Arbitration Codes to Permit Arbitrators to Make Referrals During an Arbitration Proceeding.

I object to the proposed amendment as an unjustified additional burden on public investors. It appears to be a solution without a problem, the implementation of which would pose potentially devastating penalties on customers already unfairly treated in an industry dominated forum. FINRA's regulatory structure should not be given an "additional tool" that will further prejudice investors. It is another example of why customers should not be subjected to mandatory arbitration in a forum hostile to their best interest. I object for the following reasons:

There Is No Demonstrated Problem for This Solution

FINRA states no reason to impose an additional, potentially draconian burden on already defrauded customers. It provides only a vague reference to "recent well publicized frauds that resulted in harm to investors" as a justification.1 It fails to identify those frauds or to state how a mid-arbitration referral by an arbitrator might have protected investors. FINRA should be required to provide substantial justification, not vague generalizations to place substantial new burdens on customers.

FINRA's assessment that mid-case referrals would "strengthen FINRA's regulatory structure" is an added insult to defrauded customers. In neither the mandatory arbitration agreement nor the uniform submission agreement are investors told they will be required to assist FINRA Enforcement at great prejudice to themselves. If improved enforcement is the goal, customers should be freed from forced arbitration and allowed to seek relief in the state courts where, at less cost, they could receive real discovery and full recovery of damages from a jury or their peers that would be publicly available to FINRA Regulation in real time. The very secrecy of arbitration prevents the public from learning of widespread fraud. It is a major impediment to protecting the investing public and a major tool of damage control for FINRA members engaged in the fraud. The proposed rule will not change that.

The Rule Will Only Apply to Cases Near Completion

I can come up with no rational scenario where an arbitrator would be presented with information or evidence that "poses a serious, ongoing, imminent threat to investors" during the discovery phase of the arbitration. The arbitrators generally do not see information or evidence during discovery. A Claimant's lawyer who currently attaches especially incriminating information in a discovery motion certainly won't in the future if the consequences include starting over with a new panel. The rule will therefore apply exclusively to arbitrations where the hearing has already begun. FINRA admits that the impact would be greatest on those customers whose hearings were almost completed yet provides no rationale why an arbitrator would do so in order to give FINRA Regulation a three day head start at great prejudice to Claimant.

1 Bernie Madoff wasn't involved in arbitration.

Starting Over Will Cause Customers Substantial Harm

The most rational explanation of the proposal from the customer view is that an industry-friendly arbitrator could give a Respondent firm a heads up that the two remaining arbitrators appear to be offended by the conduct and the firm is about to be hit with a substantial award. The member-friendly arbitrator stops a big award in its tracks in a manner that FINRA could not only approve, but congratulate. The member firm is put on notice that it needs to start its document shredders and prepare for another lackluster FINRA investigative inquiry and the customer gets to start over. When starting over, the customer has already shown most or all of his evidence and strategy to Respondents who are then free to come back with new facts, evidence, and strategy based on what was disclosed at the first hearing. It's another unfair industry advantage.

FINRA prevaricates that the Respondent subject to the referral "would attempt to settle, rather than risk continuing the case." A more likely scenario is that a worn out customers would agree to mediate only to learn from a FINRA mediator that the odds of receiving a second FINRA panel that would give a full award, maybe even attorneys fees, interest, and punitive damages are so small as to be infinitesimal.2 Better to take whatever small percentage offered than to fight on in an inherently biased system which has already cut off their hearing. Thrown in would be the member firm's threat of just going out of business and moving the brokers to another FINRA bucket shop in the interim period. That would likely leave any potential award uncollectible. The heads-up by the arbitrator would also give the firm additional time to disperse assets prior to the second hearing.

This Proposal Benefits Only the Crooked Broker

FINRA's provision that "any party" may request the removal of an entire panel after one member shows some modest concern for the welfare of customers is disingenuous to the extent of being insulting. Which party might object to an arbitrator showing concern over investor's being abused? The only party is the one engaging in the abuse. The Claimants are already part way to making their case, but under the proposed change FINRA could squash this nascent concern about customer protection in its embryonic stage and the member firm gets to start over with the benefit of having seen the customers' case. It is absurd to even suggest that a member firm would agree to keep a panel that has referred it to the enforcement division. It is another example of FINRA pretending that its forum is neutral by offering all parties a choice that only benefits member firms.

The Proposed Rule Won't Work

Even if one thinks the idea of arbitrators as enforcement officers at the expense of customers is good, the proposed rule is unworkable.3 What happens if the second panel comes upon the same information and makes the same referral? Does Claimant have to start over yet a third time? Is there any limit? If one arbitrator making a referral is so prejudicial as to question the neutrality of the other two arbitrators, wouldn't the fact that the second panel will know also be too prejudicial to continue? They may not see the referral, but they will know it had to be something really major or they wouldn't be there. What will FINRA tell the new panel? Does FINRA seriously believe that the new panel is not going to know what happened to the old panel? Will the new panel think their job is to exonerate the member as well as minimize damages? Who decides if a referral meets the criteria?

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2 FINRA mediators routinely advise customers of their less than 50% chance of winning and that even if they do they are unlikely to receive more than 30% of damages.

3 The alleged benefits of fast and inexpensive, while doubtful in any case, are gone.

Customer Costs Will Be Substantial

FINRA states that a customer "could" incur additional costs if required to start over. It seeks to partially mitigate those costs by not double charging them. The truth is that a customer will invariably incur additional costs and they could be substantial. Arbitration is not cheap. The entry cost is high and there are few savings to make it up. Most of the savings accrue to one side, the member firm. Arbitration has become a spending contest. Customers are subjected to endless discovery motions and hearings to obtain basic Discovery Guide documents which are supposed to be produced automatically early in the arbitration. They aren't and the customers are charged every time they ask the panel to order compliance. That can be multiple times for the same documents. The proposed rule stating that prior panel decisions would remain in force is disingenuous. Respondents will file a motion to reconsider every disputed ruling on the basis that the prior panel was removed for bias. It's true, how does Claimant respond; that it's the good kind of bias? The customer will be required to argue each issue a second time and be charged for each hearing. Since FINRA arbitrators are trained to give the member firm something in every motion in order to appear "fair" the result will be the chipping away at the already partial compliance under the prior panel.

What if the customers have to fly their expert in for a second hearing date? What if the expert is not available for the next hearing date? Will the customer be expected to bear the cost of hiring a new expert who will have to review the previous record? Who is going to pay to transcribe the "record" of the hearings of the prior panel? They will be needed for the new motion practice and the actual new hearing. In short, the additional costs in both time and money would be substantial and always accrue to the benefit of the member firm to the detriment of the customers who have already lost a substantial portion of their net worth. Spending contests almost always benefit members. Claimant lawyers are currently reluctant to accept smaller cases because panels refuse to award costs and attorney fees as required by state blue sky laws. The amount of losses that lawyers require to accept a case can only go up with the risk that the case may have to be tried twice with a full motion practice preceding each hearing. That does not benefit investors who already struggle to find competent counsel for smaller claims.

There Is An Obvious Alternative

The obvious solution to any perceived need to enlist arbitrators as enforcement militia is that they be allowed to make anonymous referrals. A concern that information or a particular document needs immediate investigation is not a sign of inherent bias. It is simply that, a concern which the Respondent firm may well be able to overcome. To stop the proceeding immediately and remove the entire panel is not justified. It would serve only to discourage the referrals the proposed rule allegedly is meant to encourage. At the completion of the hearing, Respondents will have either satisfied the arbitrators that the information or evidence is not what it seems or they won't, but they don't get a do-over where they can change their evidence and testimony at a later hearing date based on the evidence and strategy revealed in the abandoned hearing. FINRA Enforcement can investigate the arbitrator referral or not and determine that violations are occurring or not. They can even contact the Claimant if they are not working in partnership with Dispute Resolution. There are two separate functions that should not be combined to the benefit of the member firm and the detriment of the customer. Anonymous referrals would provide the benefit wanted without the unacceptable collateral damage.

Summary

Few investors participate in FINRA arbitration voluntarily. They are forced into a biased

industry forum by contracts of adhesion. They do not agree to become adjunct enforcement officials. Nor should FINRA enforcement need them. The only thing lacking is the will. They have the initial filings and are free to begin an investigation at any time. No compelling need for the proposed rule has been demonstrated. Considering FINRA's glacial enforcement pace a few days delay could not have any real effect while substantially increasing cost to the affected customer. If FINRA is not capable of separating its "neutral" dispute resolution from its enforcement function, perhaps it is time to remove dispute resolution from FINRA authority. The purpose of dispute resolution is the fair and timely resolution of disputes. It doesn't do that very well and this terrible proposed rule would only make it worse.