January 17, 2008

Nancy M. Morris
Secretary
U. S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No. SR-NASD-2007-021 – Proposed Rule Change Amends the Definition of Public Arbitrator under the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes; Response to Comments

Dear Ms. Morris:

The Financial Industry Regulatory Authority, Inc. (FINRA) (formerly known as the National Association of Securities Dealers, Inc. (NASD)) hereby responds to the comment letters received by the Securities and Exchange Commission (SEC) with respect to the above rule filing. In this rule filing, FINRA is proposing to amend the definition of public arbitrator under the Code of Arbitration Procedure for Customer Disputes (Customer Code) and the Code of Arbitration Procedure for Industry Disputes (Industry Code) (collectively, the Codes) by excluding from classification as public arbitrator individuals whose employers derive significant revenue from representing securities industry clients.[1]

Specifically, FINRA proposes to add a provision to the definition of public arbitrator in Rule 12100(u) of the Customer Code and Rule 13100(u) of the Industry Code that would prevent an attorney, accountant, or other professional from being classified as a public arbitrator, if the person's firm derived $50,000 or more in annual revenue in the past two years from professional services rendered to any persons or entities listed in Rules 12100(p)(1) or 13100(p)(1) relating to any customer disputes concerning an investment account or transaction, including but not limited to, law firm fees, accounting firm fees, and consulting fees.

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[1] *See* Securities Exchange Act Rel. No. 56039 (July 10, 2007), 72 FR 39110 (July 17, 2007) (File No. SR-NASD-2007-021, Notice of Filing of Proposed Rule Change to Amend Definition of Public Arbitrator).

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The SEC received 64 letters.[2] Thirty-nine commenters support the amendment,[3]

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[2] Comment letters were submitted by Comment letters were submitted by Philip M. Aidikoff, Esq., Attorney, dated July 17, 2007 ("Aidikoff Letter"); Professor Seth E. Lipner, Zicklin School of Business, Baruch College, dated July 23, 2007 ("Lipner Letter"); Steven B. Caruso, Esq., President, Public Investors Arbitration Bar Association, dated July 23, 2007 ("PIABA Letter"), William S. Shepherd, Esq., Founder, Shepherd, Smith & Edwards, LLP, dated July 24, 2007 ("Shepherd Letter"); Richard Layne, dated July 25, 2007 ("Layne Letter"); Dale Ledbetter, Ledbetter Associates, dated July 25, 2007 ("Ledbetter Letter"); Jeffrey B. Kaplan, Esq., Dimond Kaplan Rothstein, P.A., dated July 25, 2007 ("Kaplan Letter"); Charles C. Mihalek, Esq., dated July 25, 2007 ("Mihalek Letter"); Daniel A. Ball, Esq., Ball Law Offices, dated July 25, 2007 ("Ball Letter"); Stuart D. Meissner, Esq., Law Offices of Stuart D. Meissner LLC, dated July 25, 2007 ("Meissner Letter"); Adam S. Doner, Esq., dated July 25, 2007 ("Doner Letter"); Jay H. Salamon, Esq., Hermann Cahn & Schneider LLP, dated July 25, 2007 ("Salamon Letter"); Robert W. Goehring, Esq., dated July 25, 2007 ("Goehring Letter"); Barry D. Estell, dated July 25, 2007 ("Estell Letter"); Steve A. Buchwalter, Esq., Law Offices of Steve A. Buchwalter, P.C., dated July 25, 2007 ("Buchwalter Letter"); Charles W. Austin, Jr., dated July 25, 2007 ("Austin Letter"); Les Greenberg, Esq., Law Offices of Les Greenberg, dated July 27, 2007 ("Greenberg Letter"); Jeffrey A. Feldman, Esq., Law Offices of Jeffrey A. Feldman, dated July 27, 2007 ("Feldman Letter"); Frederick W. Rosenberg, Esq., dated July 30, 2007 ("Rosenberg Letter"); W. Scott Greco, Esq., Greco & Greco, P.C., dated July 31, 2007 ("Greco Letter"); Bryan J. Lantagne, Esq., Director, Massachusetts Securities Division and Chair, NASAA Arbitration Working Group, dated August 2, 2007 ("Lantagne Letter"); Peter J. Mougey, Esq., Beggs & Lane, dated August 3, 2007 ("Mougey Letter"); Andrew Stoltmann, Esq., Stoltman Law Offices, P.C., dated August 6, 2007 ("Stoltman Letter"); Robert C. Port, Esq., Cohen Goldstein Port & Gottlieb, LLP, dated August 6, 2007 ("Port Letter"); James D. Keeney, Esq., James D. Keeney, P.A., dated August 6, 2007 ("Keeney Letter"); Herb Pounds, Esq., Herbert E. Pounds, Jr., P.C., dated August 6, 2007 ("Pounds Letter"); John Miller, Esq., Swanson Midgley LLC, dated August 6, 2007 ("Miller Letter"); Janet K. DeCosta, Esq., dated August 6, 2007 ("DeCosta Letter"); Milton H. Fried, Jr., Esq., dated August 6, 2007 ("Fried Letter"); Laurence S. Schultz, Esq., Driggers, Schultz & Herbst, dated August 6, 2007 ("Schultz Letter"); Mark A. Tepper, Esq., President, Mark A. Tepper, P.A., dated August 6, 2007 ("Tepper Letter"); Leonard Steiner, dated August 6, 2007 ("Steiner Letter"); William P. Torngren, Esq., dated August 6, 2007 ("Torngren Letter"); Richard A. Lewins, Esq., Special Counsel, Burg Simpson Eldredge Hersh & Jardine P.C., dated August 7, 2007 ("Lewins Letter"); Jonathan W. Evans, Esq., Jonathan W. Evans & Associates, dated August 7, 2007 ("Evans Letter"); Kathleen H. Gorr, Esq., dated August 7, 2007 ("Gorr Letter"); Martin L. Feinberg, Esq., dated August 8, 2007 ("Feinberg Letter"); Dave Liebrader, Esq., dated August 8, 2007 ("Liebrader Letter"); Steven M. McCauley, Esq., dated August 8, 2007 ("McCauley Letter"); David Harrison, dated August 8, 2007 ("Harrison Letter"); Rob Bleecher, Esq., dated August 8, 2007 ("Bleecher Letter"); Thomas C. Wagner, Esq., Van Deusen & Wagner L.L.C., dated August 8, 2007 ("Wagner Letter"); Carl J. Carlson, Esq., Carlson & Dennett, P.S., dated August 8, 2007 ("Carlson Letter"); Robert S. Banks, Jr., Esq., The Banks Law Office, P.C., dated August 8, 2007 ("Banks Letter"); Jeffrey S. Kruske, Esq., Law Office of Jeffrey S. Kruske, P.A., dated August 8, 2007 ("Kruske Letter"); Mitchell S. Ostwald, Esq., The Law Offices of Mitchell S. Ostwald, dated August 8, 2007 (("Ostwald Letter") (letter submitted twice)); Debra G. Speyer, Esq., Law Offices of Debra G. Speyer, dated August 8, 2007 ("Speyer Letter"); Dawn R. Meade, Esq., The Spencer Law Firm, dated August 9, 2007 (("Meade Letter") (letter submitted twice)); Scott C. Ilgenfritz, Esq., dated August 8, 2007 ("Ilgenfritz Letter"); Eliot Goldstein, Esq., Partner, Law Offices of Eliot Goldstein, LLP, dated August 9, 2007 ("Goldstein Letter"); Howard Rosenfield, Esq., Law Offices of Howard Rosenfield, dated August 10, 2007 ("Rosenfield Letter"); Scott R. Shewan, Esq., Born, Pape & Shewan LLP, dated August 13, 2007 ("Shewan Letter"); Joseph Fogel, Esq., Fogel & Associates, dated August 14, 2007 ("Fogel Letter"); Donald M. Feferman, Esq., Donald M. Feferman, P.C., dated August 16, 2007 ("Feferman Letter"); Gail E. Boliver, Esq., Boliver Law Firm, dated August 19, 2007 ("Boliver Letter"); Stephen P. Meyer, Esq., Meyer & Ford, dated August 20, 2007 ("Meyer Letter"); Jan

twenty-one oppose it,[4] and four comment letters were excluded.[5] Many of the commenters raise several common issues, which will be discussed in this response. These commenters share the same views on these issues, regardless of whether they support or oppose the proposal overall. Thus, the number of commenters who support a particular issue will include some commenters who support the proposal, as well as some who do not.

Forty-one commenters contend that the proposal does not go far enough.[6] All of these commenters argue that, if arbitrators or their firms receive any compensation or revenue from the securities industry, the arbitrators should not be classified as public arbitrators under the rule.

FINRA believes that the proposed $50,000 annual revenue limitation reasonably narrows the definition of public arbitrator, while simultaneously maintaining the integrity of the public arbitrator roster. The proposed annual revenue limitation will remove from the public arbitrator pool those arbitrators whose firms derive substantial revenue from providing professional services to members of the securities industry involving customer disputes. FINRA believes that reducing the proposed annual revenue limitation to zero would remove experienced, competent public arbitrators from our roster based on only minimal work done by their firms for the industry. This would lead to delays in arbitration proceedings and, ultimately, could increase the cost of arbitration proceedings for parties, if it became necessary to increase honoraria to attract individuals who could meet a lower annual revenue limitation. Moreover, FINRA notes that no dollar amount can ever precisely define public arbitrators. However, FINRA believes that the proposed annual revenue limitation will help eliminate the perception of bias that exists among users of the forum and help protect the integrity of the forum. For these reasons, FINRA believes the proposed annual revenue limitation is reasonable, and declines to amend the proposal at this time.

Twenty-six commenters[7] argue that the definition of "professional services" is too narrowly defined.[8] These commenters suggest that, at a minimum, the proposed

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Graham, Esq., Graham Law Offices, dated August 20, 2007 ("Graham Letter"); John E. Sutherland, Esq., dated August 20, 2007 ("Sutherland Letter"); Ronald M. Amato, Esq., Shaheen, Novoselsky, Staat, Filipowski & Eccleston, P.C, dated August 21, 2007 ("Amato Letter"); James J. Eccleston, Esq., Shaheen, Novoselsky, Staat, Filipowski & Eccleston, P.C, dated August 21, 2007 ("Eccleston Letter"); J. L. Spray, Esq., Mattson, Ricketts, Davies, Stewart & Calkins, dated August 21, 2007 ("Spray Letter"); Randall R. Heiner, Esq., Heiner Law Offices, dated August 23, 2007 ("Heiner Letter").

[3] *See, e.g.*, Salamon, Feldman, Keeney, and Bleecher Letters.

[4] *See, e.g.*, Ledbetter, Doner, Pounds, and Liebrader Letters.

[5] FINRA notes that two commenters submitted the same letter twice. *See supra* n.2. And two other commenters were unclear on whether they supported or opposed the proposal; thus, their letters are not included in the number of those who support or oppose the proposal.

[6] *See*, *e.g.*, Meissner, Steiner, Schultz, Tepper, Shewan and Fogel Letters.

[7] *See*, *e.g.*, PIABA, Shepherd, Gorr, and Kruske Letters.

[8] The proposal defines "professional services" as relating to customer disputes with broker-dealers or associated persons concerning an investment account or transaction.

$50,000 annual revenue limitation should be expanded to include all services rendered by a public arbitrator to a firm or associated person.

In drafting the proposal, FINRA received significant input from constituent groups comprised of public investor and securities industry representatives. These groups agreed that the annual revenue limitation should apply only to those services, such as defense work in a customer dispute, that are closely related to matters that arbitrators would be deciding in an arbitration proceeding. FINRA believes that restricting the annual revenue limitation to the provision of such professional services targets public arbitrators whose work, or whose firm's work, might affect the arbitrator's impartiality. Moreover, FINRA believes that expanding the proposed annual revenue limitation to include all services could result in the removal of experienced, competent public arbitrators from our roster. For these reasons, FINRA declines to amend the definition of professional services at this time.

Nineteen commenters express concern that the proposal does not indicate how FINRA will monitor and enforce the $50,000 annual revenue limitation.[9] Some commenters suggest that every arbitrator classified as public be required to file an annual certification under oath.[10] Other commenters suggest the FINRA implement a mandatory annual arbitrator fee reporting requirement.[11]

If the proposal is approved, FINRA will notify all public arbitrators of the rule and how it will be applied. The notification will remind them of their obligation to update their Arbitrator Disclosure Reports with relevant information. Because arbitrators must continually update their disclosure reports, regardless of their classification or whether they have been selected for a panel, FINRA believes that a mandatory annual arbitrator fee reporting requirement could delay the disclosure of relevant information. FINRA also believes that an annual certification under oath would be a redundant requirement. When an arbitrator is selected to serve on a case, the arbitrator is required to complete a checklist and take an oath confirming that the arbitrator's disclosures are true and complete. For these reasons, FINRA believes its enforcement procedures are more than sufficient and declines to amend the proposal as suggested.

One commenter[12] suggested that FINRA implement a "cooling off" period after the annual revenue limitation no longer applies and before a person can serve as a public arbitrator. The commenter argues that "anyone identified closely enough with the securities industry to be disqualified from serving as a public arbitrator because of disqualifying annual revenue should be disqualified for a substantial period after his annual revenues again qualify him to be a public arbitrator."[13] The commenter notes that FINRA applies this concept to individuals who have been out of the securities industry for fewer than five years by assigning them to the non-public arbitrator pool.[14] The

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[9] *See*, *e.g.*, Lipner, PIABA, Feldman, and Speyer Letters.

[10] *See*, *e.g.*, PIABA, Shepherd, and Torngren Letters.

[11] *See*, *e.g.*, Schultz, Evans, Liebrader, Ilgenfritz and Heiner Letters.

[12] *See* Feinberg Letter.

[13] *Id.* at pp. 3-4.

[14] *Id.*

commenter recommends that that the proposal be amended so that anyone who is disqualified from serving as a public arbitrator because of disqualifying annual revenue should be disqualified from serving as a public arbitrator until at least five consecutive years have passed without his receiving any disqualifying annual revenue.[15]

FINRA believes there is a distinction between individuals who work in the industry and individuals who receive revenue for providing services to members of the securities industry. In the case of individuals who worked for the industry, FINRA believes that a five-year "cooling off" period[16] is appropriate, as such individuals might maintain close relationships with staff at their former firms. FINRA does not believe that a similar "cooling off" period is required for individuals who receive (or whose firms receive) revenue for providing services to members of the securities industry. The current proposal, however, is simply an additional narrowing of an already quite narrow definition of "public arbitrator," in that it further restricts the arbitrator pool after application of the current 10% test that excludes from the definition of public arbitrator, attorneys, attorneys, accountants, and other professionals whose firms have derived 10 percent or more of their annual revenue, in the last two years, from clients involved in the activities defined in the definition of non-public arbitrator.[17] FINRA does not believe that such a *de minimis* amount of annual revenue creates an inherent bias in favor of the securities industry on the part of public arbitrators. Rather, FINRA believes that the proposed annual revenue limitation will increase investor confidence in the arbitration process by removing from the public arbitrator pool those arbitrators whose ties to the securities industry might raise concerns by investors about their impartiality. For these reasons, FINRA declines to amend the proposal to add a "cooling off" period at this time.

Finally, most commenters argue that the requirement that a non-public arbitrator be a member of a three-person panel involving a customer dispute should be eliminated.[18] FINRA is not amending the provisions that address this issue in the Codes; therefore these comments are outside the scope of the rule filing.

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[15] *Id.*

[16] Rule 12100(p) of the Customer Code and Rule 13100(p) of the Industry Code.

[17] Rule 12100(u)(4) of the Customer Code and Rule 13100(u)(4) of the Industry Code.

[18] *See, e.g.*, Lantagne, Banks, and Stoltman Letters.

If you have any questions, please contact me on (202) 728-8151 or at mignon.mclemore@finra.org.

Very truly yours,

Mignon McLemore
Assistant Chief Counsel
FINRA Dispute Resolution