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To: FINRA
From: Richard A. Stephens
Re: Comment on Proposed New *In re* Expungement Procedures for Persons Not Named in a Customer-Initiated Arbitration
Date: May 18, 2012

In response to FINRA's Regulatory Notice 12-18, these are my comments, which are best understood from my dual perspective as an active FINRA arbitrator, on the Chairman roster, and as a practitioner representing primarily claimants (usually senior citizens) in customer cases in FINRA arbitration. I am a member, in good standing, of the Bars of New York, California, Florida, the District of Columbia, and numerous federal courts. I formerly served as an attorney with the U.S. Securities and Exchange Commission in Washington D.C. in both the Enforcement Division, and the Division of Investment Management.

As a summary, the proposed rule is seriously misguided, and will cause disastrous consequences. It should be discarded, since not needed. If FINRA nevertheless desires an efficient type of procedure, I have constructed an alternate proposal.

Genesis of Proposed Rule

As I understand the origins of this proposed rule, its genesis emanates from the decision a few years ago by FINRA and the SEC to inform the public about arbitrations involving alleged misconduct by registered representatives, where the public was being seriously misled. Previously, if a customer wrote a complaint letter, it would appear on the agent's CRD. However, if a customer brought a written arbitration statement of claim against the agent's employer, based upon the misconduct of the agent, that written complaint was given a lesser status and not deemed a "written complaint" at all, therefore allowing rogue agents to be the subject of written statements of claim, without those *de facto* complaints appearing on the agent's CRD, unless the agent was specifically named as a respondent. Thus, in the multitude of cases with the agent is not named as a respondent, for good reasons reflected below, the public was seriously misled by the lack of customer complaints on that rogue agent's CRD. After serious criticism of this discrepancy, FINRA and the SEC came to their senses and decided to treat arbitration claims based upon an agents alleged misconduct *the same* as a written complaint from a

customer, and *both equally reportable* because both are truly "written complaints" about an agent's sales practices. In essence, FINRA and the SEC properly chose to treat a customer complaint identically, regardless of whether it was a letter written to the firm, or a statement of claim, in both cases reflecting the customer's allegations of wrongdoing. As I have noted from viewing CRDs, agents routinely state their belief that the customer was wrong, or similar comments that appear publicly, so the agent does have his or her say in response.

Now, in a "tail wagging the dog" situation, agents whose alleged misconduct is reflected on their CRD, because their employer was named in an arbitration where the agent was not specifically named as a party, want to have an opportunity for "expungement" from their CRD, which opportunity does not exist for customer letters of complaint. This would once again result in complaint letters being treated differently than statements of claim, which makes no sense and will cause disastrous results.

Essentially, FINRA says it is sympathetic to associates who assert that they have *no formal remedy*, under the existing FINRA Codes of Arbitration Procedure to have an opportunity for expungement of allegations involving their conduct, but where merely the employer firm is sued in an arbitration. FINRA states its purpose:

> FINRA believes the proposed *In re* expungement rules and accompanying forms provide unnamed persons with a remedy to seek redress concerning allegations that could impact their livelihoods, yet maintain the protections of FINRA's expungement rules to ensure the integrity of the CRD records, on which the investing public relies."

Since there is no expungement procedure for customer written complaints *by letters*, enacting an expungement process for written customer *statements of claim* would again create a disparity between customer written complaint *by letters*, and customer written complaints *by statements of claim*, which elimination of this disparity several years ago was applauded by the public.

The Proposal Will Have Disastrous Consequences

When I reviewed this FINRA proposal for expungement procedures, I was appalled. It is a combination of : (1) elder abuse, (2) an anti-customer bias, (3) losing the efficiency of arbitrations compared to court litigations, and (4) could cause further intimidation of customers so that more broker abuses go unreported and unremedied, thereby impeding information needed by FINRA Enforcement and the SEC to clean up the markets so we do not have another Great Recession. These adverse effects are caused primarily by the "discovery" and "document subpoena" and "witness subpoena" potential *harassments* of customers (including the elderly) who are ordinary Americans already put through the emotional wringer and have no taste to be bothered again. They will not cooperate because they do not care once their cases are

over. They want to move on with their lives. **Under the procedures proposed by FINRA, Chairmen will issue subpoenas that are unopposed upon request by the non-party associate in a subsequent proceeding, so the customers will ignore them, allowing the brokers to bring law suits *in court* for contempt against that customer and harass them to death.**

Whether FINRA realizes it or not, this proposal appears to be a connivance by the brokerage industry to force claimants to name all of the associates in the customer's arbitration, in order to evade the harassment of discovery and subpoenas and more testimony and more grief, and more worry and more lost sleep, so better to get it over with by naming every individual broker.

The brokerage industry, and the "Defense Bar" do not like claimants naming only the firm, which entity is responsible for every act by its registered agents under state laws and respondeat superior. The brokerage industry wants to force claimants to name multiple parties resulting in tremendous extra costs and strategic disadvantages that are very prejudicial. For example, for every respondent named, there is potentially a different law firm (because of conflicts of interest); and for each respondent, there are a specified number of "strikes" and procedures for ranking arbitrators, where conspiring and cooperating respondents can mathematically force more pro-respondent arbitrators onto the panel. And then, the claimant is confronted with multiple answers, document requests, motions of every type, multiple opening statements, multiple questioning of witnesses and posing objections, and multiple closing arguments. The added costs and confusion can cause an enormous burden and strategic disadvantage upon the claimant. Moreover, just as importantly, by naming the individual brokers, the arbitrators are invited to possibly assess much or all of the damages against the individual broker, rather than the firm, with the individual broker jumping into bankruptcy or choosing to give up his or her registration rather than pay, preventing any recovery by a deserving claimant, the ultimate prejudice.

For those reasons, I and many other claimant practitioners do *not* name individual brokers, who routinely testify anyway because their firms want them as witnesses. For years, these registered representatives had nothing on their CRD about their misconduct found to be responsible for liability by their employer firms. The public was not informed of even repeater violators even though arbitrators were issuing awards against firms based on the agent's misconduct. FINRA wisely chose to start having those claims reported so that a statement claim is treated the same as a written letter of complaint letter, with both communicating customer allegations.

As I understand the CRD system, if the customer sends in a written complaint, it goes on the CRD of that individual agent, and there is no procedure to remove it, except that the agent usually expresses a denial of the public to see, thereby already given an opportunity to be heard. There is no FINRA expungement procedure for such a written complaint, so there is no need for a FINRA expungement procedure for a written statement of claim, which is a "written complaint". The filing of a statement of claim complaining about an associate's misconduct should be treated just like any other written

complaint, with the broker injecting his or her position with a denial on the CRD. That is the "procedure". That is the associate's "remedy". Thus, there is no need for FINRA to adopt an expungement procedure for a statement of claim, another form of written complaint. After wisely choosing to treat the statement of claim as a written complaint (forcing such filings to be on the CRD of an associate the same as any other type of written complaint), FINRA appears to now retreat from its previous position by singling out a statement of claim as a type of written complaint warranting expungement.

The supplemental arbitrations will expand the workload of FINRA staff enormously. There are probably thousands of cases brought each year where the individual associates are not named. **Therefore, FINRA must be prepared to handle potentially hundreds or thousands of new arbitrations, with new discovery motions, with subpoenas, with objections, with arbitrator hearings, requiring an entire new bureaucracy.**

The damage to the customers can be enormous. Lawyers who have worked with senior citizens know that conflicts, such as arbitrations or litigations, are very draining, particularly for such senior citizens. It is hard enough to get a defrauded customer to come forward, and willing to spend part of the remaining precious months or years of their lives in battling with the brokerage firm. **After final hearings, when the citizens want to move on with their lives, they will get reminded, harassed, and threatened, by a supplemental procedure from the associate who abused them, seeking to cause their lives misery, and maybe even resulting in their demise.**

Any type of bothering customers after their final hearings is an abuse. The proposed FINRA procedures are such an abuse. There should be no discovery or subpoenas or any requirement to be witnesses, in anything subsequent to the final hearings of their case. For example, look at the Discovery procedures and how customers can be abused:

(l) Discovery

(1) Arbitrators shall determine whether an unnamed person may receive documents on a case-by-case basis as follows:

(A) Additional document requests by an unnamed person, including requests for orders of production, are limited to only **those documents which the unnamed person has demonstrated are substantially and directly related to establishing the grounds for expungement under Rule 2080.**

i. An unnamed person shall request additional documents at least 45 days before the first hearing session. For purposes of this rule, documents shall include tapes, digital or other recordings or transcripts. FINRA shall provide the documents upon an unnamed person's request, if the arbitrator rules in favor of production, after considering any objections under Rule 13807(l)(1)(A)(iii).

ii. **The party from the underlying investment-related customer-initiated arbitration proceeding that is the subject of the request shall provide the documents or object to the request within 10 days from the date of the unnamed person's request.**

iii. **If the party from the underlying investment-related customer-initiated arbitration proceeding objects to the additional document request, the party must specifically identify which document or requested information it is objecting to and why.** Objections must be in writing, and must be served on the unnamed person and arbitrator at the same time and in the same manner. **The party from the underlying proceeding must produce all applicable listed documents, or other requested documents or information not specified in the objection.** Any objection not made within the required time is waived unless the arbitrator determines that the party from the underlying proceeding had good cause for failing to object within the required time. The arbitrator shall make any rulings on objections to **additional document requests.**

(B) Subpoena requests by an unnamed person, **including orders of appearance,** shall be made at least 45 days before the first hearing session and are limited to only **those witnesses which the unnamed person has demonstrated are substantially and directly related to establishing the grounds for expungement under Rule 2080.**

i. An unnamed person may make a written motion requesting that the arbitrator issue a subpoena to any respondent in the underlying investment-related customer-initiated arbitration proceeding. The motion shall include a draft subpoena and shall be filed with the Director, with an additional copy for the arbitrator.

ii. **The unnamed person shall not subpoena a customer in the underlying investment-related customer-initiated arbitration proceeding, unless the unnamed person demonstrates that the customer's testimony is not available from tape, digital or other recording or transcript, and that no other approach or method exists to obtain documents or information that substantially and directly relate to establishing grounds for expungement under Rule 2080.**

So, under these discovery procedures, we have senior citizens who want to forget about their bad FINRA experience now getting harassed for "documents" and possibly their testimony in another subsequent proceeding on the same subject matter. **These customers no longer have attorneys, who have either earned their contingent fee or moved on, so these senior citizens must cope on their own with these new demands from FINRA. They don't know what to object to, or how to object, or have the energy or inclination to fight any more. They will be subject to an enormous and ambiguous demand for "documents which the unnamed person has demonstrated are substantially and directly related to establishing the grounds for expungement", and cause them to waste time, energy, and money, which is harassing. What happens if the customer refuses to abide by the order, or document demand, or the arbitrator's compelling documents ?? Can he be held in contempt, and sanctioned?? And the associate can go to court to enforce sanctions against the same customer**

previously abused by that agent?? <u>What kind of a Pandora's box is FINRA opening??</u>

From An Arbitrator's Perspective

Putting on my "Chairman's hat" as a member of FINRA's Chairman roster, and actively serving, I believe that this proposal dissuades arbitrators from serving. I have always regarded being a FINRA arbitrator as an honor, with the small honorarium insignificant compared to the self-satisfaction of seeing remedies for abused customers or resolving serious employment disputes. I do not care to waste my time holding a *subsequent* evidentiary hearing, with new discovery, solely on whether a complaint involving a non-party associate's conduct was merited to be filed in written form by a statement of claim, with the same CRD effect as a letter of complaint. It is a waste of my time. Many FINRA arbitrators have much more important things to do, but regard their FINRA service as special. FINRA should not degrade that service.

Proposed Solutions

BEST SOLUTION: The simple answer is to continue treating the statement of claim as a written customer complaint, as FINRA has already decreed years ago to eliminate the unwarranted and highly-criticized discrepancy, with the broker continuing to have an opportunity to respond to the public on his or her CRD.

NEXT BEST SOLUTION: To the extent that FINRA feels compelled to adopt some "formal" procedure enabling an expungement, the procedure can be woven into the existing customer arbitration without supplemental arbitrations that increase the duration of the matter well beyond the normal lengthier times in courts, and without causing harassment to customers, or unopposed expungement procedures that do not include the customers *de facto* because they have no further interest in the process after their hearing is over or their case settled.

To the extent that FINRA feels that an associate needs a "formal" remedy for expunging a written allegation in a statement of claim, as one type of customer complaint, overkill is not required since **<u>less drastic measures are available</u>** to efficiently use existing resources rather than commencing hundreds *or thousands* of new arbitrations *needlessly*. A simple procedure can be derived by looking at possible scenarios after the statement of claim is filed naming solely the firm:

<u>Procedure No. 1:</u> Upon a filing of a statement claim against a firm but not naming an associate as a respondent, FINRA should determine the identity of the agent and send a <u>notice</u> to the associate that such a claim has been filed not naming the associate, along with a simple form that has a <u>box to be checked</u>, and the form returned timely *if* the associate wants the Panel to consider an expungement for that associate. No narrative, brief, answer, or other writing should be permitted from that agent, and instead solely the

box checking a request for expungement, so that it "officially" and "formally" becomes an item for the panel to rule upon. [Note: under existing practice, firms frequently request in their Answer the expungement of the matter off the associate's CRD, but this new procedure would ensure that the Panel has received a *formal* request from the associate in any event].

Procedure No. 2:

1. If the case settles, the CRD says that the case settled, etc., and whether the associate paid any money in settlement, and that the associate denies any wrongdoing (or else the associate can give his or her own words of denial).

To instead employ new procedures for a new evidentiary hearing is really ridiculous, since the purpose of settlement is to avoid an evidentiary hearing; so the result of forcing new evidentiary hearings solely for expungement purposes, and costs of evidence etc., would deter settlement from ever occurring, and cause extra expense, certainly not a desired goal for FINRA.

2. If the case goes to final hearing, the arbitrators would already have received the associate's formal request for expungement, and will rule on that request at the same time as all other matters in the arbitration. Firms always call their associates as witnesses to deny the misconduct, so the associate will be heard by arbitrators and be properly cross-examined by claimant's counsel so that the arbitrators get a fair and balanced observation.

As a note, there is no presumption stated in the proposed procedures. **Obviously, someone wanting to have an item expunged from their CRD should have the burden of proof, with a presumption therefore against expungement. That presumption should be expressly stated in the procedures for the arbitrator to use as a benchmark.**

3. If the case is dismissed other than from settlement or award, for example as a discovery sanction, or of voluntary dismissal for no consideration, then the CRD reference should automatically be expunged in some manner.

It's that simple. No new thousands of cases. No Hobson's Choice. No elder abuse. No anti-customer bias. No forced naming of associates. No enormous waste of FINRA staff. No impairment to Enforcement.

Conclusion

The proposed Rule will create a nightmare for customers through a Hobson's Choice, and will create an entire avenue for a new large bulk of FINRA arbitrations, and turn FINRA into an arbitration forum more expensive, longer in duration, and burdensome than litigation in courts. The proposal should be discarded in its entirely

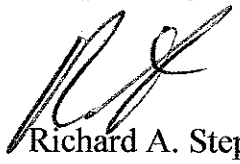
since there is no need for any expungement of a statement of claim for a non-party any more than an expungement proceeding to eliminate a customer letter of complaint against an associate. They should be treated the same. The broker gets his chance to respond on his CRD.

This Proposal is a nightmare and a Pandora's Box. Any "closing" of a file will trigger a new arbitration with document requests, subpoenas, enforcement dilemmas and an embarrassment for FINRA, whether the "closing" was voluntary, through settlement, or through final hearings.

There is no need to do anything since FINRA has already determined that statements of claim are equal to other types of written complaints for going on an associate's CRD. There is no good reason to elevate it to special status. These is no expungement of written customer complaints, and no need to start one for any type of written complaint.

If, however, FINRA wants a procedure so that it is removed for statements of claim, I have proposed a practical alternative that will save all these headaches, avoid multiple hearings, and not adversely affect Enforcement.

Respectfully,



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