

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59189; File No. SR-FINRA-2007-021)

December 31, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Relating to Amendments to the Code of Arbitration Procedure for Customer Disputes and the Code of Arbitration Procedure for Industry Disputes to Address Motions to Dismiss and to Amend the Eligibility Rule Related to Dismissals

I. Introduction

The Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“SEC” or “Commission”) on November 2, 2007, and amended on February 13, 2008 (Amendment No. 1), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change relating to amendments to the Code of Arbitration Procedure for Customer Disputes (“Customer Code”) and the Code of Arbitration Procedure for Industry Disputes (“Industry Code,” and together with the Customer Code, the “Codes”) to address motions to dismiss and to amend the eligibility rule related to dismissals. The proposed rule change was published for comment in the Federal Register on March 20, 2008.³ The Commission received 119 comments in response to the proposed rule change.⁴ This order approves the proposed rule change, as modified by Amendment No. 1.

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 57497 (March 14, 2008), 73 FR 15019 (March 20, 2008) (SR-FINRA-2007-021) (notice).

4 See Joseph C. Korsak, Esq., dated November 4, 2007 (“Korsak Letter”); Will Struyk, dated December 10, 2007 (“Struyk Letter”); Michael Thurman, Esq., Loeb & Loeb

LLP, dated February 29, 2008 (“Thurman Letter”); Prof. Seth E. Lipner, Esq., Baruch College dated March 18, 2008 (“Lipner Letter”); Leonard Steiner, Esq., dated March 18, 2008 (“Steiner Letter”); Laurence S. Schultz, Esq., Public Investors Arbitration Bar Association, dated March 18, 2008 (“PIABA Letter”); Steven J. Gard, Esq., Gard Law Firm, dated March 20, 2008 (“Gard Letter”); Steven B. Caruso, Esq., Maddox Hargett Caruso, P.C., dated March 20, 2008 (“Caruso Letter”); Philip M. Aidikoff, Esq., dated March 21, 2008 (“Aidikoff Letter”); Charles W. Austin, Jr., Esq., dated March 21, 2008 (“Austin Letter”); Gail E. Boliver, dated March 22, 2008 (“Boliver Letter”); Steve A. Buchwalter, Esq., dated March 23, 2008 (“Buchwalter Letter”); Ryan K. Bakhtiari, Esq., Uhl and Bakhtiari, dated March 24, 2008 (“Bakhtiari Letter”); Mark E. Maddox, Esq., Maddox Hargett Caruso, P.C., dated March 24, 2008 (“Maddox Letter”); Robert W. Goehring, Esq., dated March 24, 2008 (“Goehring Letter”); John J. Miller, Esq., Swanson Midgley, LLC, dated March 24, 2008 (“Miller Letter”); Richard A. Lewins, dated March 24, 2008 (“Lewins Letter”); Howard Rosenfield, Esq., dated March 24, 2008 (“Rosenfield Letter”); Sam Edwards, Esq., dated March 24, 2008 (“Edwards Letter”); Noah H. Simpson, Esq., Simpson Woolley, LLP, dated March 24, 2008 (“Simpson Letter”); Robert A. Uhl, Esq., March 25, 2008 (“Uhl Letter”); David Harrison, Esq., dated March 26, 2008 (“Harrison Letter”); Jeffrey Sonn, Esq., Sonn Erez, PLC, dated March 26, 2008 (“Sonn Letter”); Brian N. Smiley, Esq., Smiley Bishop Porter LLP, dated March 26, 2008 (“Smiley Letter”); Thomas A. Hargett, Esq., dated March 27, 2008, (“Hargett Letter”); Jay Salamon, Esq., Hermann, Cahn and Schneider LLP, dated March 27, 2008 (“Salamon Letter”); J. Pat Sadler, Esq., dated March 31, 2008 (“Sadler Letter”); Keith L. Griffin, Esq., Maddox Hargett Caruso, P.C., dated April 1, 2008 (“Griffin Letter”); Scott R. Shewan, Esq., Born, Pape & Shewan LLP, dated April 1, 2008 (“Shewan Letter”); Alan S. Brodherson, Esq., dated April 3, 2008 (“Brodherson Letter”); W. Scott Greco, Esq., Greco & Greco, P.C., dated April 3, 2008 (“Greco Letter”); David P. Neuman, Esq., Stoltmann Law Offices, P.C., dated April 4, 2008 (“Neuman Letter”); Edward G. Turan and Martha E. Solinger, Securities Industry and Financial Markets Association, dated April 7, 2008 (“SIFMA Letter”); Curt H. Mueller, Esq., Schwab & Co., Inc., dated April 7, 2008 (“Schwab Letter”); Erin Linehan, Esq., Raymond James Financial, Inc., dated April 8, 2008 (“Raymond James Letter”); Barry D. Estell, Esq., dated April 8, 2008 (“Estell Letter”); Robert C. Port, Esq., dated April 8, 2008 (“Port Letter”); Jonathan W. Evans, Esq., dated April 8, 2008 (“Evans Letter”); Kevin A. Carreno, dated April 8, 2008 (“Carreno Letter”); Vincent J. Imbesi, Esq., The Avelino Law Firm, dated April 9, 2008 (“Imbesi Letter”); John E. Lawlor, Esq., dated April 9, 2008 (“Lawlor Letter”); Jonathan Schwartz, Esq., dated April 9, 2008 (“Schwartz Letter”); Andrew Dale Ledbetter, dated April 9, 2008 (“Ledbetter Letter”); Theodore A. Krebsbach, Esq., Krebsbach & Snyder, dated April 9, 2008 (“Krebsbach Letter”); Raymond W. Henney, Esq., Honigman Miller Schwartz and Cohn LLP, dated April 9, 2008 (“Henney Letter”); Randall R. Heiner, Esq., dated April 9, 2008 (“Heiner Letter”); Inge Selden III, Esq., Maynard Cooper & Gale PC, dated April 9, 2008 (“Selden Letter”); Eric G. Wallis, Esq., Reed Smith LLP, dated April 9, 2008 (“Wallis Letter”); Robert H. Rex, Esq., Dickenson Murphy Rex and Sloan, dated April 9, 2008 (“Rex Letter”); Bradley R.

Stark, Esq., Florida International University, dated April 9, 2008 (“Stark Letter”); Robert N. Rapp, Esq., Calfee, Halter Griswold LLP, dated April 9, 2008 (“Rapp Letter”); Richard J. Babnick, Esq., Sichenzia Ross Friedman Ference LLP, dated April 9, 2008 (“Babnick Letter”); Joseph F. Myers, Esq., dated April 9, 2008 (“Myers Letter”); Anne T. Cooney, Esq., Morgan Stanley, dated April 9, 2008 (“Morgan Stanley Letter”); Jonathan Kord Lagemann, Esq., dated April 9, 2008 (“Lagemann Letter”); Frederick S. Schriels, Esq., GrayRobinson, dated April 9, 2008 (“Schriels Letter”); Andrew Stoltmann, Esq., dated April 9, 2008 (“Stoltmann Letter”); Richard M. Layne, Esq., dated April 9, 2008 (“Layne Letter”); Herb Pounds, Jr., Esq., dated April 9, 2008 (“Pounds Letter”); Alan F. Hartman, CLU, ChFC, dated April 9, 2008 (“Hartman Letter”); Brian F. Amery, Esq., Bressler, Amery Ross, P.C., dated April 9, 2008 (“Amery Letter”); Michael G. Shannon, Esq., Thelen Reid Brown Raysman & Steiner LLP, dated April 9, 2008 (“Shannon Letter”); Carl J. Carlson, Esq., Carlson & Dennett, P.S., dated April 9, 2008 (“Carlson Letter”); Matthew Farley, Esq., Drinker Biddle & Reath LLP, dated April 9, 2008 (“Farley Letter”); Joel E. Davidson, Esq., Davidson & Grannum, LLP, dated April 9, 2008 (“Davidson Letter”); Al Van Kampen, Esq., dated April 10, 2008 (“Van Kampen Letter”); Theodore M. Davis, Esq., dated April 10, 2008 (“Davis Letter”); Lawrence R. Gelber, Esq., dated April 10, 2008 (“Gelber Letter”); Pearl Zuchlewski, Esq., Kraus Zuchlewski LLP, dated April 10, 2008 (“Zuchlewski Letter”); Rob Bleecher, Esq., dated April 10, 2008 (“Bleecher Letter”); Thomas C. Wagner, Esq., dated April 10, 2008 (“Wagner Letter”); John V. McDermott, Esq., Holme Roberts Owen LLP, dated April 10, 2008 (“McDermott Letter”); Peter J. Mougey, Esq., Beggs & Lane, dated April 10, 2008 (“Mougey Letter”); Christopher Gibbons/Lisa A. Catalano, Securities Arbitration Clinic, St. John’s University Law School, dated April 10, 2008 (“St. John’s Letter”); John W. Shaw, Esq., Berkowitz, Oliver, Williams, Shaw Eisenbrandt, dated April 10, 2008 (“Shaw Letter”); Audrey Venezia, Esq., dated April 10, 2008 (“Venezia Letter”); H. Nicholas Berberian, Esq., Gerber & Eisenberg LLP, dated April 10, 2008 (“Berberian Letter”); Michael N. Ungar, Esq., and Kenneth A. Bravo, Esq. Ulmer & Berne LLP, dated April 10, 2008 (“Ungar/Bravo Letter”); Jody Forchheimer, Esq., Fidelity Investments, dated April 10, 2008 (“Forchheimer Letter”); Jill I. Gross, Barbara Black and Teresa Milano, dated April 10, 2008 (“Gross/Black Letter”); Michael Weissmann, Esq., Bingham McCutchen LLP, dated April 10, 2008 (“Weissmann Letter”); Thomas P. Willcutts, Esq., Willcutts Law Group, LLC, dated April 10, 2008 (“Willcutts Letter”); Mark A. Tepper, Esq., Mark A. Tepper, P.A., dated April 10, 2008 (“Tepper Letter”); Joe Soraghan, Principal, Danna McKitrick, P.C., dated April 10, 2008 (“Soraghan Letter”); Bryan T. Forman, Esq., dated April 10, 2008 (“Forman Letter”); Rodney Acker, Esq., Fulbright & Jaworski LLP, dated April 10, 2008 (“Acker Letter”); Birgitta Siegel, Esq., Securities Arbitration & Consumer Law Clinic, Syracuse University, dated April 10, 2008 (“Syracuse Letter”); Brett A. Rogers and Jill E. Steinberg, Esq., Rogers & Hardin, dated April 10, 2008 (“Rogers/Steinberg Letter”); Jeffrey Kruske, Esq., dated April 10, 2008 (“Kruske Letter”); John Taft, RBC Wealth Management, dated April 10, 2008 (“RBC Letter”); Thomas V. Dulcich, Esq., Schwabe, Williamson & Wyatt, dated April 10, 2008 (“Dulcich Letter”); Harry T. Walters, Esq., Citigroup, dated April 10, 2008

II. Description of the Proposed Rule Change

FINRA⁵ proposed to provide specific procedures to govern motions to dismiss, and to amend the provision of the eligibility rule related to dismissals. The proposal is designed to ensure that parties would have their claims heard in arbitration, by significantly limiting the grounds for filing motions to dismiss prior to the conclusion of a party's case in chief and by imposing stringent sanctions against parties for engaging in abusive practices under the rule.

("Citigroup Letter"); Craig Gordon, RBC Correspondent Services, dated April 10, 2008 ("Gordon Letter"); William A. Jacobson, Esq., Cornell Securities Law Clinic, dated April 10, 2008 ("Cornell Letter"); Bradford D. Kaufman, Greenberg, Taurig, P.A., dated April 10, 2008 ("Kaufman Letter"); Tim Canning, Esq., Law Offices of Timothy A. Canning, dated April 10, 2008 ("Canning Letter"); Peter R. Boutin, Esq., Keesal, Young & Logan, dated April 10, 2008 ("Boutin Letter"); Christian T. Kemnitz, Esq., Katten Muchin Rosenman, dated April 10, 2008 ("Kemnitz Letter"); Scot Bernstein, Esq., dated April 10, 2008 ("Bernstein Letter"); John S. Burke, Esq., Higgins Burke, P.C., dated April 10, 2008 ("Burke Letter"); Dayton P. Haigney, Esq., dated April 10, 2008 ("Haigney Letter"); Robert J. Anello, Esq., Morvillo, Abramowitz, Grand, Iason, Anello & Bohrer, P.C., dated April 10, 2008 ("Anello Letter"); Brad S. Karp, Esq., Paul, Weiss, Rifkind, Wharton & Garrison LLP, dated April 10, 2008 ("Karp Letter"); Andrew L. Weinberg, Esq., Deutsche Bank Securities Inc., dated April 10, 2008 ("DBSI Letter"); Harry A. Jacobowitz, Esq., Securities Arbitration Commentator, dated April 10, 2008 ("Jacobowitz Letter"); Jenice L. Malecki, Esq., Malecki Law, dated April 10, 2008 ("Malecki Letter"); Stephen Krosschell, Esq., dated April 10, 2008 ("Krosschell Letter"); Abe Lampart, Esq., Offices of Abe Lampart, dated April 10, 2008 ("Lampart Letter"); Mark J. Astarita, Esq., dated April 10, 2008 ("Astarita Letter"); Robert S. Banks, Esq., Banks Law Offices, dated April 10, 2008 ("Banks Letter"); Debra G. Speyer, Esq., dated April 10, 2008 ("Speyer Letter"); Joseph Fogel, Sherman Oaks, CA ("Fogel Letter"); Harry J. Buckman, Jr., dated April 11, 2008 ("Buckman Letter"); Jan Graham, Esq., dated April 11, 2008 ("Graham Letter"); Patricia Cowart, Esq., Wachovia Securities, LLC, dated April 11, 2008 ("Wachovia Letter"); Stuart D. Meissner, Esq., dated April 12, 2008 ("Meissner Letter"); Debra B. Hayes, Esq., dated April 15, 2008 ("Hayes Letter"); William P. Torngren, Esq., dated April 16, 2008 ("Torngren Letter"); Laurence S. Schultz, Public Investors Arbitration Bar Association, dated April 25, 2008 ("PIABA 2 Letter").

5 Although some of the events referenced in this rule filing occurred prior to the formation of FINRA through consolidation of NASD and the member regulatory functions of NYSE Regulation, the rule filing refers to FINRA throughout for simplicity.

BACKGROUND

The Code of Arbitration Procedure that was in use prior to April 16, 2007, did not address motions practice.⁶ Because motions were becoming increasingly common in arbitration, FINRA proposed to include in its revision of the entire Code of Arbitration Procedure (“Code Revision”) some guidance for parties and arbitrators with respect to motions practice.

The Code Revision, as initially filed with the SEC in 2003, contained a rule that would have permitted a panel to grant a motion to decide claims before a hearing on the merits (a “dispositive motion”) only under extraordinary circumstances. FINRA proposed this rule in an attempt to address concerns raised by investors’ counsel, SEC staff and other constituent groups about abusive and duplicative filing of dispositive motions. Specifically, FINRA received complaints that parties (typically respondent⁷ firms) were filing dispositive motions routinely and repetitively in an apparent effort to delay scheduled hearing sessions on the merits, increase investors’ costs (typically claimants⁸), and intimidate less sophisticated parties.⁹ In some cases, if a party did not receive a favorable ruling on a dispositive motion filed at a particular stage in an arbitration proceeding, that party would re-

6 The Codes became effective on April 16, 2007, for claims filed on or after that date; the old Code continues to apply to pending cases until their conclusion.

7 A respondent is a party against whom a statement of claim or third party claim has been filed.

8 A claimant is a party that files the statement of claim and other documents that initiate an arbitration.

9 For example, the Securities Arbitration Commentator published a study in Fall 2006 on motions to dismiss in customer cases, which concludes that, in the universe of cases that went to award, there were motions to dismiss in 28% of the cases in 2006 as compared to 10% in 2004. *Securities Arbitration Commentator*, Nov. 2006 (Vol. 2006, No. 5), at 3.

file the same or a similar dispositive motion at a later time, which often served only to increase investors' costs and delay the hearing and the issuance of any award. Moreover, FINRA learned through various constituent and focus groups that some respondents' attorneys were being counseled by their law firms that an acceptable and useful tactic was to file multiple dispositive motions at various stages of an arbitration proceeding.

When the Code Revision was published for comment in the Federal Register, commenters opposed the dispositive motions rule for a variety of reasons. Therefore, FINRA removed the rule from the Code Revision and re-filed it separately.¹⁰ The SEC then approved the Code Revision without the dispositive motions rule.¹¹

PRIOR DISPOSITIVE MOTIONS PROPOSAL

As re-filed with the SEC, the dispositive motions proposal would have permitted a panel to grant a dispositive motion prior to an evidentiary hearing only under extraordinary circumstances.¹² The SEC published the proposal for public comment on August 31, 2006, and received over 60 comment letters,¹³ the majority of which opposed the proposal.

Based on the comments, FINRA recognized that the proposal did not provide effective guidance on how dispositive motions would be handled in the forum. Because the comments indicated that various issues involving dispositive motions required more

10 See Securities Exchange Act Release No. 54360 (August 24, 2006), 71 FR 51879 (August 31, 2006) (SR-NASD-2006-088) (notice).

11 See Securities Exchange Act Release No. 55158 (January 24, 2007), 72 FR 4574 (January 31, 2007) (SR-NASD-2003-158 and SR-NASD-2004-011) (approval order).

12 See note 10, supra.

13 See Comments on File No. SR-NASD-2006-088, Notice of Filing of Proposed Rule Change Relating to Motions to Decide Claims Before a Hearing on the Merits, available at <http://www.sec.gov/comments/sr-nasd-2006-088/nasd2006088.shtml> (last visited December 5, 2008).

guidance, FINRA withdrew the dispositive motions proposal, and filed a new proposed rule change to provide specific procedures that would govern motions to dismiss. In its new proposed rule change, FINRA also proposed to amend the separate rule governing dismissals made on eligibility grounds.

MOTIONS TO DISMISS ON OTHER THAN ELIGIBILITY GROUNDS

FINRA filed the proposed rule change to provide specific procedures that would govern motions to dismiss. Generally, FINRA stated that it believes that parties have the right to a hearing in arbitration. In certain very limited circumstances, however, FINRA indicated that it would be unfair to require a party to proceed to a hearing. The proposal is designed to balance these competing interests. In FINRA's view, the proposal should ensure that parties¹⁴ have their claims heard in arbitration, by significantly limiting the grounds for filing motions to dismiss prior to conclusion of a party's case in chief and by imposing stringent sanctions against parties for engaging in abusive practices under the rule. The proposal would permit parties to file a motion to dismiss at the conclusion of a party's case in chief, based on any theory of law.

The proposed rule change would govern motions to dismiss filed prior to the conclusion of a party's case in chief (under the Customer Code or Industry Code, as applicable), as discussed in further detail below.

14 For purposes of the proposal, a party could be an initial claimant, respondent, counterclaimant, cross claimant, or third party claimant and his or her motion to dismiss would be subject to Rules 12206 and 12504 of the Customer Code or Rules 13206 and 13504 of the Industry Code.

Discourage Motions to Dismiss a Claim Prior to Conclusion of a Party's Case in Chief

The proposal would clarify that motions to dismiss a claim prior to the conclusion of a party's case in chief are discouraged in arbitration. FINRA stated that it believes that parties have the right to a hearing in arbitration, and only in certain very limited circumstances should that right be challenged. This policy statement would not apply to motions filed on the basis of eligibility grounds, as discussed below.

Require that Motions to Dismiss Be Filed in Writing, Separately from the Answer, and After the Answer Is Filed

FINRA stated that it believes that requiring a party to file a motion to dismiss in writing separately from the answer and only after the answer is filed would deter parties from filing these motions routinely in lieu of an answer, and would prevent parties from combining a motion to dismiss with an answer. This provision should ensure that parties receive an answer that responds directly to the statement of claim.

Filing Deadlines

The proposed rule change would require parties to serve motions under this provision at least 60 days before a scheduled hearing and would provide 45 days to respond to a motion unless the parties agree or the panel determines otherwise. FINRA stated that it believes that requiring a motion to dismiss to be served at least 60 days before a scheduled hearing and providing 45 days for a party to respond to such a motion would prevent the moving party from filing a motion shortly before a hearing as a surprise tactic to force a delay in the arbitration process.

Require the Full Panel to Decide Motions to Dismiss

The proposal would require the full panel to decide motions to dismiss. Given the ramifications of granting a motion to dismiss, FINRA stated that it believes that each member of the panel should be required to hear the parties' arguments, so that each panel member may make an informed decision when ruling on the motion.

Require an Evidentiary Hearing

Under the proposal, the panel would not be permitted to grant a motion to dismiss prior to the conclusion of a party's case in chief unless the panel holds an in-person or telephonic prehearing conference on the motion that is recorded in accordance with Rule 12606 of the Customer Code or Rule 13206 of the Industry Code, unless such conference is waived by the parties. FINRA stated that it believes this requirement would ensure that the panel holds a hearing on the motion and that the panel has sufficient information to make a ruling.

Limited Grounds on which a Motion May Be Granted

FINRA proposed to limit the grounds on which a panel may act upon a motion to dismiss prior to the conclusion of the party's case in chief. The proposal states that a panel may act upon a motion to dismiss only after the party rests its case in chief unless the panel determines that:

- the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release; or

- the moving party was not associated with the account(s), security(ies), or conduct at issue.¹⁵

FINRA stated that it believes that limiting the grounds on which a motion to dismiss may be granted prior to the conclusion of the party's case in chief would minimize the potential for abusive practices and ensure that most parties' claims would be heard in the forum.

Require a Unanimous, Explained, Written Decision to Grant a Motion to Dismiss

The proposal would require a unanimous decision by the panel to grant a motion to dismiss as well as a written explanation of the decision in the award. Under the proposal, each member of the panel must agree to grant a motion to dismiss. FINRA stated that it believes that because these decisions are an integral part of the arbitration process, all panel members should agree to dismiss a claim; otherwise the case should continue. Moreover, the provision that requires the panel to provide a written explanation of its decision would help parties understand the panel's rationale for its decision.

Require Permission from the Arbitrators to Re-File a Denied Motion to Dismiss

Under the proposal, a party would be prohibited from re-filing a denied motion to dismiss, unless specifically permitted by a panel order. FINRA stated that it believes this limitation would serve to expedite the arbitration process and minimize parties' costs.

Require Arbitrators to Award Fees Associated with Denied Motions to Dismiss and to Award

Fees and Costs Associated with Frivolously Filed Motions to Dismiss

15 A motion to dismiss on eligibility grounds would be governed by Rules 12206 and 13206 of the Customer and Industry Code, respectively; the amendments to those rules are discussed below.

The proposal would also require that the panel assess forum fees associated with hearings on the motion to dismiss against the party filing the motion to dismiss, if the panel denies the motion. Further, if the panel deems frivolous a motion filed under this rule, the panel must award reasonable costs and attorneys' fees to a party that opposed the motion. FINRA stated that it believes that imposing monetary penalties would minimize abusive practices involving motions to dismiss and would deter parties from filing such motions frivolously.

Permit Sanctions for Motion to Dismiss Filed in Bad Faith

If the panel determines that a party filed a motion under this rule in bad faith, the panel also may issue sanctions under Rule 12212 of the Customer Code or Rule 13212 of the Industry Code. FINRA stated that it believes that these stringent sanction requirements would provide panels with additional enforcement mechanisms to address abusive practices involving motions to dismiss if other deterrents prove ineffective.

When a moving party (governed by the Customer Code or Industry Code, as applicable) files a motion to dismiss at the conclusion of a party's case in chief, the provisions governing motions to dismiss filed prior to the conclusion of a party's case in chief discussed above would not apply. Thus, a moving party could file a motion to dismiss at the conclusion of a party's case in chief, based on any theory of law. The rule, however, would not preclude the panel under this scenario from issuing an explanation of its decision if it grants the motion, or awarding costs or fees to the party that opposed the motion if it denies the motion.

FINRA stated that it believes that permitting a moving party to file a motion to dismiss at the conclusion of a party's case in chief should balance the goal of ensuring that non-moving parties have their claims heard by a panel against the rights of moving parties to challenge a claim they believe lacks merit or has not been proved. Moreover, FINRA stated that it believes that arbitrators should be permitted to entertain and act upon a motion to dismiss at this stage of a hearing to minimize the moving parties' incurring unnecessary additional attorneys' fees and forum fees. If a claimant has presented its case in chief and clearly failed to present sufficient evidence to support a claim, then the moving party should not be forced to incur the additional expenses and costs associated with unnecessary hearings.

The proposal provides that motions to dismiss based on failure to comply with the code or an order of the panel under Rule 12212 of the Customer Code or 13212 of the Industry Code, as applicable, would be governed by that rule. Further, the proposal provides that motions to dismiss based on discovery abuse filed under Rule 12511 of the Customer Code or Rule 13511 of the Industry Code, as applicable, would be governed by that rule.

AMENDMENTS TO THE DISMISSAL PROVISION OF THE ELIGIBILITY RULE

FINRA proposed to amend Rules 12206(b) and 13206(b) of the Customer and Industry Codes, respectively, to address motions to dismiss made on eligibility grounds. Under this proposal, a party would be permitted to file a motion to dismiss on eligibility grounds at any stage of the proceeding (after the answer is filed), except that a party would not be permitted to file this motion any later than 90 days before the scheduled hearing on the merits. FINRA also proposed to amend the rule to address the res judicata defense claimants

could encounter when they attempt to pursue in court a claim dismissed in arbitration, when the grounds for the dismissal are unclear.

First, FINRA proposed to amend Rules 12206(b) of the Customer Code and Rule 13206(b) of the Industry Code to establish procedures for motions to dismiss made on eligibility grounds. In light of the new motions to dismiss proposal, FINRA stated that it believes that similar changes should be incorporated into the existing eligibility rule to provide procedures and guidance for dealing with motions to dismiss made on eligibility grounds. The proposed changes to the eligibility rule contain most of the same provisions as those contained in the proposed motions to dismiss rule (discussed above), except for those criteria that are not applicable to eligibility motions, that is, the two other grounds on which a panel may grant a motion to dismiss before a party has presented its case in chief (i.e., signed settlement and written release and factual impossibility).

In addition, the filing deadlines would be different from those in the motions to dismiss proposal. Under the proposed rule, a party would be permitted to file a motion to dismiss on eligibility grounds at any stage of the proceeding (after the answer is filed), except that a party would not be permitted to file this motion any later than 90 days before the scheduled hearing on the merits. FINRA stated that it believes that this requirement would encourage moving parties to determine in the early stages of the case whether to pursue their claims in court or to proceed with the arbitration. Further, FINRA stated that this requirement would prevent the moving party from filing this motion shortly before a hearing as a surprise tactic to force a delay in the arbitration process.

The proposal also would provide parties with 30 days to respond to an eligibility motion. If a panel grants a motion to dismiss a party's claim based on eligibility grounds,

that party must re-file the claim in court to pursue its remedies, which could further delay resolution of the dispute. Therefore, FINRA proposed the 30-day timeframe to respond to eligibility motions to expedite the process, so that the time between filing a claim and resolution of the dispute is shortened.

Second, FINRA addressed potential problems in the implementation of the eligibility rule since it was last amended in 2005. Currently, the eligibility rule makes clear that dismissal of a claim on eligibility grounds in arbitration does not preclude a party from pursuing the claim in court; it provides that, by requesting dismissal of a claim under the rule, the requesting party is agreeing that the non-moving party may withdraw any remaining related claims without prejudice and may pursue all of the claims in court.¹⁶

In certain situations, when a claim is dismissed under the eligibility rule, FINRA understands that claimants have had difficulty proceeding with their claims in court, because respondents have asserted a res judicata defense when the panel's grounds for dismissing the arbitration claim were unclear. For example, if a respondent files a motion to dismiss based on several grounds, including eligibility, and the panel issues an order dismissing a claim, but without citing reasons, the claimants would not know whether or not they are afforded the right to pursue the claim in court, as provided by the rule. If the claimants proceed to file the dismissed claim in court, the respondents may argue that the panel's decision on the claim is the final decision, and that claimants are barred from having the court decide the same claim again. In such a case, claimants would be required to prove that the dismissal was based on

16 Rule 12206(b) of the Customer Code and Rule 13206(b) of the Industry Code.

eligibility, not the other grounds for dismissal that the respondents raised. This would be difficult or impossible if the arbitrator or panel did not explain the reasons for the dismissal.

FINRA proposed to amend the eligibility rule to address this issue. As amended, the rule would provide that when a party files a motion to dismiss on multiple grounds, including eligibility, the panel must consider the threshold issue of eligibility first. First, the rule would be amended to require that if the panel grants the motion to dismiss on eligibility grounds on all claims, it shall not rule on any other grounds for the motion to dismiss. Second, the rule would be amended to require that if the panel grants the motion to dismiss on eligibility grounds, on some, but not all claims, and the non-moving party elects to move the case to court, the panel shall not rule on any other ground for dismissal for 15 days from the date of service of the panel's decision to grant the motion to dismiss on eligibility grounds. Third, the rule would be amended to require that, when arbitrators dismiss any claim on eligibility grounds, that fact must be stated on the face of their order and any subsequent award the panel may issue. And fourth, the rule would provide that if the panel denies the motion to dismiss on the basis of eligibility, it shall rule on the other bases for the motion to dismiss the remaining claims in accordance with the motions to dismiss rule. FINRA stated that it believes that the proposed amendments will close a loophole that has resulted from implementing the rule by eliminating the res judicata defense that claimants could face when they attempt to pursue claims in court that were dismissed in arbitration on eligibility grounds.

III. Comment Letters

The Commission received 119 comments relating to FINRA-2007-021 concerning amendments to arbitration procedures for pre-hearing motions to dismiss and dismissals on eligibility grounds. The Commission also received FINRA's response to comments, which is discussed below.¹⁷ Of the 119 letters: (i) sixteen commenters¹⁸ (consisting of professors and attorneys representing investors) opposed the proposed rule change on the basis that it does not go far enough to end the abuse in motions to dismiss, (ii) forty-four commenters¹⁹ (consisting of SIFMA, broker-dealers and attorneys representing the financial industry) opposed the rule principally because of the narrow scope of the grounds for filing pre-hearing motions to dismiss; (iii) two commenters²⁰ (an attorney representing investors and a professor of finance) opposed the proposed rule for other reasons; (iv) fifty-four commenters²¹ (including PIABA,²² attorneys

17 Letter from Mignon McLemore, FINRA, dated September 15, 2008 ("FINRA Letter").

18 Burke, Canning, Estell, Fogel, Gard, Krosschell, Lipner, Meissner, Port, Pounds, Rex, Simpson, Speyer, Steiner, Tepper and Willcutts Letters.

19 Acker, Amery, Anello, Astarita, Babnick, Berberian, Brodherson, Boutin, Buckman, Carreno, Citigroup, Davidson, DBSI, Dulcich, Farley, Forchheimer, Gelber, Gordon, Hartman, Henney, Karp, Kaufman, Kemnitz, Krebsbach, Lampart, McDermott, Morgan Stanley, Rapp, Raymond James, RBC, Rogers/Steinberg, Schriels, Schwab, Selden, Shannon, Shaw, SIFMA, Soraghan, Thurman, Ungar/Bravo, Venezia, Wachovia, Wallis, and Weissman Letters.

20 Schwartz and Stark Letters.

21 Aidikoff, Austin, Banks, Bakhtiari, Bernstein, Bleacher, Boliver, Buchwalter, Carlson, Caruso, Cornell, Davis, Edwards, Evans, Forman, Graham, Griffin, Goehring, Greco, Gross/Black, Haigney, Hargett, Harrison, Hayes, Heiner, Korsak, Kruske, Imbesi, Lagemann, Lawlor, Layne, Ledbetter, Lewins, Maddox, Malecki, Miller, Mougey, Myers, Neuman, PIABA, PIABA 2, Sadler, Salamon, Shewan, Smiley, Sonn, St. John's, Stoltmann, Syracuse, Torngren, Uhl, Van Kampen, Wagner and Zuchlewski Letters.

22 PIABA wrote two letters in support of the proposed rule.

representing investors, law school clinics and professors) supported the proposed rule; and (vi) three²³ commenters did not express a definitive view.

Of the 44 commenters that opposed the rule on the basis of the narrow scope of grounds for filing pre-hearing motions to dismiss, 15 commenters²⁴ expressed concern regarding many of the procedural rules in the proposal, 11 commenters²⁵ noted that they would support the procedural rules in the proposal, while the remaining 18 commenters did not state their views regarding the procedural rules. Of the 54 commenters who supported the proposal, two expressed unconditional support.²⁶ Many of the remaining supporters indicated that the proposal should be approved, but also that all motions to dismiss should be prohibited in FINRA's arbitration forum.²⁷

DETAILED DISCUSSION OF COMMENTS AND FINRA RESPONSE

Policy Statement on Prehearing Motions

Proposed Rules 12504(a)(1) of the Customer Code and 13504(a)(1) of the Industry Code would provide that motions to dismiss a claim prior to the conclusion of a party's case in chief are discouraged in arbitration. Many commenters addressed this statement of policy regarding motions to dismiss in FINRA's arbitration forum and, in particular, the use of the word "discouraged."

23 Jacobowitz, Rosenfield and Struyk Letters.

24 Astarita, Berberian, Berne, Carreno, DBSI, Forchheimer, Gordon, Lampart, RBC, Selden, Shaw, SIFMA, Ungar/Bravo, Venezia and Wachovia Letters.

25 Babnick, Berberian, Citigroup, Kaufman, Kemnitz, McDermott, Morgan Stanley, Raymond James, Rogers, Schriels, and Thurman Letters.

26 Heiner and Korsak Letters.

27 See, e.g., Caruso, Kruske, Lewins, Shewan and St. John's Letters.

Several commenters supported the statement of policy, indicating that it sets an appropriate tone for the rest of the proposal.²⁸ One commenter contended that the rule language does not sufficiently discourage motions to dismiss and should indicate that motions to dismiss should be granted only in extraordinary circumstances.²⁹ One commenter who opposed the proposal contended that, without this language, the proposal would appear to authorize and encourage motions to dismiss in the forum.³⁰ A number of commenters opposed the policy statement, arguing that it unfairly discourages motions to dismiss prior to the conclusion of a party's case in chief in the forum, and creates an unnecessary bias against these motions.³¹

FINRA responded to these comments by stating that, generally, FINRA believes that parties have the right to a hearing in arbitration and that proposed Rules 12504(a)(1) of the Customer Code and 13504(a)(1) of the Industry Code would reinforce this position by clarifying that prehearing motions to dismiss are discouraged in arbitration. FINRA stated its belief that the word "discouraged" is appropriately placed in the rule language, and accurately describes its view of prehearing motions to dismiss in the forum.

FINRA also disagreed with those commenters who contended that this policy statement unfairly discourages all motions to dismiss in the forum. FINRA pointed out that, while the proposal limits the exceptions under which a prehearing motion to dismiss may be granted, proposed Rules 12504(b) of the Customer Code and 13504(b) of the Industry Code

28 See, e.g., Carlson Letters, Lawlor and PIABA 2.

29 Black/Gross Letter.

30 Lipner Letter.

31 See, e.g., Forchheimer, SIFMA, Ungar/Bravo, and Wachovia Letters.

would permit parties to file a motion on any ground after the conclusion of a party's case in chief. FINRA indicated its belief that it would be unfair to require parties to incur additional hearing session fees if there is a valid reason to dismiss after the claimant's case. In those cases, FINRA suggested that a panel may grant a motion to dismiss, under proposed subparagraph (b), if the moving party proves such action is warranted.

FINRA emphasized that the proposed rules do not constitute an invitation to parties to file prehearing motions to dismiss. Further, FINRA noted that the fact that a motion may be filed under one of the exceptions in the proposal does not mean that the panel should or will grant the motion.

In a prior, withdrawn proposal, FINRA stated that motions to dismiss should be granted only in extraordinary circumstances.³² Some commenters suggested that the absence of that language in the current proposal effectively authorizes or encourages motions to dismiss. FINRA indicated that it disagrees, and believes that the current proposal removes the ambiguity that the "extraordinary circumstances" concept created, and expressly outlines FINRA's position concerning motions to dismiss. FINRA reiterated that the current proposal would provide for three limited exceptions under which a motion to dismiss may be granted before the conclusion of a claimant's case-in-chief, thereby limiting the timing and circumstances under which such a prehearing motion may be filed. Moreover, FINRA pointed out that the proposal would require a panel to impose strict sanctions against parties who file motions to dismiss frivolously or in bad faith. Taken together, FINRA stated that these provisions reinforce its position that prehearing motions to dismiss in arbitration are

32 See note 10, supra.

discouraged and should be granted only under the limited exceptions of the rule.

Accordingly, FINRA declined to amend the proposal to reintroduce the reference to “extraordinary circumstances.”

Scope of Proposed Rules 12504(a)(6)(B) of the Customer Code and 13504(a)(6)(B) of the Industry Code (“not associated” exception)

Proposed Rules 12504(a)(6)(B) of the Customer Code and 13504(a)(6)(B) of the Industry Code would provide that a prehearing motion to dismiss may be granted prior to the conclusion of the claimant’s case, if the respondent was not associated with the account, security, or conduct at issue.

Most commenters suggested that FINRA should clarify how proposed Rule 12504(a)(6)(B) of the Customer Code would be applied. Many commenters indicated their belief that the exception should be interpreted broadly, so that senior executives, branch managers, and other office personnel could be excluded under this provision.³³ Conversely, a number of commenters contended that a broad interpretation of the exception could wrongly exempt persons or entities not directly associated with transactions but who are liable under applicable statutes or case law (e.g., supervisors in “selling away”³⁴ cases).³⁵

FINRA responded to these comments by indicating that it intends this exception to apply narrowly, such as in cases involving issues of misidentification. Thus, under this exception, a prehearing motion to dismiss could be granted if, for example, a party files a

33 See, e.g., Raymond James, Selden, Shannon and SIFMA Letters.

34 A “selling away” claim involves a dispute in which an associated person is alleged to have engaged in securities activities outside his or her firm.

35 See, e.g., Banks, Greco, Krosschell, PIABA 2 and Shewan Letters.

claim against the wrong person or entity, or a claim names an individual who was not employed by the firm during the time of the dispute, or a claim names an individual or entity that had no control over or was not connected to an account, security or conduct at the firm during the time of the dispute. Under this interpretation, therefore, a panel would not grant a motion to dismiss filed under this exception in cases in which a respondent may be liable as a supervisor or control person under applicable statutes³⁶ or in “selling away” cases.³⁷

One commenter sought clarification concerning whether this exception would exclude parties in a supervisory position, or under control person liability when a broker-dealer is defunct.³⁸

FINRA stated that if the claim involves a respondent who is liable as a supervisor or control person and the cause of action arose before the firm became defunct, a motion to dismiss filed under this exception would be inappropriate. FINRA noted that under its By-Laws, an associated person continues to be subject to FINRA’s jurisdiction if the conduct occurred while the person was associated or registered with a firm.³⁹ Moreover, FINRA

36 See, e.g., Uniform Securities Act §509(g) (2002).

37 FINRA reiterated its position that “selling away” claims are arbitrable under the Codes. Under the Codes, FINRA accepts cases brought by customers against associated persons in selling away cases, and cases by customers against the associated person’s member firm if there is any allegation that the member was or should have been involved in the events, such as an alleged failure to supervise the associated person. See, e.g., Multi-Financial Securities Corp. v. King, 386 F.3d 1364 (11th Cir. 2004); see also In the Matter of PFS Investments, Inc., 1998 SEC LEXIS 1547, (Exchange Act Rel. No. 42069) (July 28, 1998).

38 Burke Letter.

39 See FINRA By-Laws, Article V, §4(a) (Retention of Jurisdiction).

pointed out that if a firm is defunct, a claimant may request default proceedings against the firm, provided certain criteria are met.⁴⁰

Additional exceptions for permissible prehearing motions

Numerous commenters, who opposed the proposal, argued that the three exceptions to the general prohibition on prehearing motions to dismiss⁴¹ are too narrow and fail to include certain situations in which such motions would be appropriate.⁴² These commenters suggested that FINRA expand the proposed rule to include the following exceptions: clearing brokers, senior executives, statutes of limitation, and legal impossibility exceptions, such as defamation for statements made on required forms (which some courts have held are protected by an absolute privilege) and the doctrine of *res judicata*.⁴³ Several of these commenters focused on the lack of an exception for clearing firms, arguing that, based on the nature of their operations, clearing firms do not owe a legal duty to claimants and, therefore, cannot be held liable for the wrongful acts of the introducing firm.⁴⁴

40 Rule 12801 of Customer Code and Rule 13801 of Industry Code.

41 The three exceptions, as described above under II. Description of the Proposed Rule Change, are: (1) the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release; (2) the moving party was not associated with the account(s), security(ies), or conduct at issue; or (3) the claim is not eligible for arbitration in FINRA's forum, under Rule 12206 of the Customer Code or 13206 of the Industry Code, as applicable.

42 For example, these commenters contend that claims involving defamation on the Form U5 or those subject to the doctrine of *res judicata* should be exceptions to the rule. See, e.g., SIFMA, Thurman, Morgan Stanley, Rapp, Schriels, Kaufman, and Jacobowitz Letters.

43 Id.

44 Id.

A large portion of the commenters who supported the proposal contended that expanding the scope of prehearing motions to dismiss would negate the intent of the proposal and encourage unnecessary and unwarranted motions to dismiss.⁴⁵ Indeed, many of these commenters argued that the eligibility exception to the general prohibition on prehearing motions to dismiss should be removed because eligibility motions tend to be fact-based, and would, in most cases, require an evidentiary hearing.⁴⁶

FINRA responded by stating that it had considered these comments, and concluded that expanding the exceptions to the rule would negate its intent, which is to have clear, easily definable standards that do not involve fact-intensive issues. FINRA stated that the suggested additional exceptions would require fact-based determinations and, thus, would be inappropriate for dismissal before claimants have presented their cases. Although these exceptions would be inappropriate for prehearing dismissal, FINRA noted that a party would be permitted to file a motion addressing these issues at the conclusion of a claimant's case-in-chief. FINRA stated that the proposal strikes an appropriate balance by ensuring that claimants have their claims heard in arbitration, while minimizing the parties' exposure to additional fees in the event that the claimant does not prove the claims in its case-in-chief. For these reasons, FINRA declined to amend the proposal to expand the exceptions to the rule.

FINRA also specifically stated that it had considered the concerns expressed by commenters regarding clearing firms and the impact the proposal could have on their operations. FINRA indicated that it understands the benefits that clearing firms provide to

45 See, e.g., Banks, Lagemann, PIABA 2 and St. John's Letters.

46 See, e.g., Greco, Gross/Black, Ledbetter and PIABA 2 Letters.

the operation of the securities markets, but these benefits do not warrant an exception to the rule. FINRA noted that courts have found that a broker-dealer's status as a clearing firm does not immunize it from liability.⁴⁷ Further, FINRA stated that the courts have found that clearing firms may be liable for the misdeeds of the introducing firm, if the clearing firms become actively or directly involved in fraudulent activity.⁴⁸ Based on these findings, FINRA stated its belief that claimants should have the opportunity to prove in an evidentiary hearing whether a clearing firm's involvement rises to the level of liability. As the issue of a clearing firm's liability in arbitration would be a fact-intensive determination, FINRA stated that issue would be inappropriate for prehearing dismissal. Based on these findings, FINRA declined to amend the proposal to include an exception for clearing firms.

Expansion of the exception for prehearing motions under the Eligibility Rule to include applicable statutes of limitation

The proposed changes to the eligibility rules, Rules 12206(b) of the Customer Code and 13206(b) of the Industry Code, would not include applicable statutes of limitation as an exception on which a prehearing motion would be granted.

Many commenters argued that respondents should not be forced to proceed to an evidentiary hearing against parties whose claims could be deemed stale or time-barred under an applicable legal authority.⁴⁹ Conversely, several other commenters contended that most

47 See, e.g., *McDaniel v. Bear Stearns & Co., and Bear Stearns Securities Corporation*, 196 F.Supp. 2d 343 (S.D.N.Y. 2002); see also, *Koruga v. Fiserv Correspondent Services, Inc.*, 183 F.Supp.2d 1245 (D. Or. 2001), *aff'd*, 40 Fed.Appx. 364, 2002 WL 530548 (9th Cir. 2002).

48 Id.

49 See, e.g., Babnick, Jacobowitz, Krebsbach, Rapp and SIFMA Letters.

statutes of limitation matters raise issues of fact which would require an evidentiary hearing.⁵⁰ Some commenters urged FINRA to remove the eligibility exception from the proposal for the same reasons.⁵¹

FINRA responded by stating that it included the eligibility rule exception in the proposal because its eligibility standard is uniform for all cases (six years from the occurrence or event giving rise to the claim), and does not vary depending on a particular jurisdiction's laws or the cause of action raised by the claim. In addition, FINRA noted that claimants whose cases are dismissed on eligibility grounds have an alternative to resolve their disputes because the current rule gives them the right to take their cases to court.⁵² In light of the uniform applicability of the eligibility exception and the additional protections parties receive under the eligibility rule, FINRA declined to amend the proposal to remove the eligibility exception.

Further, FINRA responded that it did not include applicable statutes of limitation in the eligibility exception because such issues involve fact-based determinations, depend on the law of the applicable jurisdiction, and depend on the type of claims alleged. FINRA noted that, in some jurisdictions, courts have found that statutes of limitations do not apply to arbitration proceedings. For these reasons, FINRA stated that it would be inappropriate to include an exception for prehearing motions to dismiss on statute of limitations grounds, and thus, declined to amend the proposal to include them in the eligibility exception.

50 See, e.g., Greco, Gross/Black, Ledbetter and PIABA 2 Letters.

51 Id.

52 Rule 12206(b) of the Customer Code and Rule 13206(b) of the Industry Code.

Motions permitted at the conclusion of claimant's case-in-chief

Under Proposed Rules 12504(b) of the Customer Code and 13504(b) of the Industry Code, a motion to dismiss after the conclusion of a party's case-in-chief would not be limited to the three exceptions described above.⁵³

Many commenters who supported the proposal argued that this provision would shift abusive motions practice to the middle of the hearing, because respondents would wait until the end of claimant's case to file their motions, and thus, this provision should be deleted.⁵⁴ Several commenters who opposed the proposal argued that the ability to file a motion at the conclusion of a party's case-in-chief does not address their interests effectively, because respondents would have to prepare for and incur the costs of a full evidentiary hearing.⁵⁵

FINRA responded by stating that the proposal strikes a fair balance by sharply limiting prehearing motions to dismiss, but permitting motions to dismiss after the claimant's case in chief. FINRA stated that it would be unfair to require the parties to continue with a hearing if the claimant has not proved its case. FINRA indicated that it expects such motions to be relevant to the case and based on theories that are germane to the issues raised in the case-in-chief. FINRA further stated that by the close of claimant's case, the panel would have heard enough to decide whether a motion filed at the conclusion of a claimant's case should be considered, and, if warranted, granted.

53 See note 41, supra.

54 See, e.g., Banks, Bernstein, Caruso, Davis and Wilcutts Letters.

55 See, e.g., Farley, Karp, Krebsbach and Walters Letters.

FINRA stated that it will monitor the frequency of motions filed pursuant to this provision once the proposal is implemented. If this analysis indicates potentially abusive behavior, FINRA stated that it may amend the rule or take other appropriate action.

FINRA also stated it will inform arbitrators that, if a party files a motion at the conclusion of a case-in-chief, the panel is not required to consider or grant the motion merely because it was filed pursuant to the rule; rather arbitrators will continue to control the hearing process. Furthermore, FINRA noted that the proposed rule would not preclude a panel from assessing respondents with sanctions, costs and attorney's fees, if the panel determines that a motion filed at this time is frivolous or in bad faith.⁵⁶

FINRA reiterated that the purpose of the proposal is to ensure that claimants have their claims heard by a panel while permitting respondents, after completion of a claimant's case-in-chief, to challenge a claim they believe lacks merit or has not been proved. FINRA suggested that because arbitrators currently deny most prehearing motions to dismiss, the proposal to permit motions to dismiss at this juncture should not have a significant impact on parties' costs in preparing for a hearing. FINRA stated its belief that respondents' exposure to attorneys' fees and forum fees should be minimized under the proposal because additional hearing sessions will not be required if the panel grants a motion to dismiss at the close of a claimant's case. Further, FINRA stated that, similarly, claimants will not incur additional forum costs if arbitrators believe they have not proved their case and dismiss it before respondents present their case, rather than at the conclusion of respondents' case.

For these reasons, FINRA declined to amend the proposal.

56 Rule 12212 of the Customer Code and Rule 13212 of the Industry Code.

Concerns regarding the procedural safeguards in the proposal

Several of the commenters who supported the procedural safeguards in the proposal indicated that these provisions provide protection to investors by creating an effective deterrent to abusive practices.⁵⁷ However, multiple commenters opposed some of the proposed procedural safeguards as too stringent. Each proposed procedural rule that generated significant comment is addressed below.

- Unanimous panel decision to grant a prehearing motion.

Proposed Rules 12504(a)(7) of the Customer Code and 13504(a)(7) of the Industry Code would require a unanimous decision by the panel to grant a prehearing motion to dismiss.⁵⁸

The commenters who opposed this provision stated that this requirement is not necessary to ensure a fair decision concerning a prehearing motion to dismiss.⁵⁹ Further, these commenters argued that the provision is inconsistent with other provisions of the Codes, which only require a majority decision.⁶⁰

FINRA responded that the type of relief requested by a prehearing motion to dismiss – the complete dismissal of a claim before an evidentiary hearing – justifies the requirement that all arbitrators agree, based on the moving party’s proof, that the motion should be granted. FINRA indicated that it recognizes that this standard is different from the criteria

57 See, e.g., Harrison, Mougey, PIABA 2 and St. John’s Letters.

58 See also Proposed Rules 12206(b)(5) and 13206(b)(5) of the eligibility rule.

59 See, e.g., Carreno, Forchheimer, Krebsbach, SIFMA and Wallis Letters.

60 Id.

for rendering other rulings and determinations.⁶¹ In practice, however, FINRA noted that most awards rendered in its forum are unanimous; thus, FINRA stated that this requirement is not a significant change from current practice. For these reasons, FINRA declined to amend the proposal to change this provision.

- Mandatory assessment of forum fees.

Proposed Rules 12504(a)(8) of the Customer Code and 13504(a)(8) of the Industry Code would require that, if a panel denies a prehearing motion to dismiss, it must assess forum fees associated with hearings on the motion against the moving party.⁶²

Commenters who opposed this provision stated that it is unfair to penalize moving parties who file motions to dismiss based on the exceptions available under the proposed rule, and who rely on a claimant's pleadings being accurate and complete when filing these motions.⁶³

FINRA responded by stating that this provision on mandatory assessment of forum fees will deter parties from filing motions that fall outside the scope of the three exceptions⁶⁴ to the rule, and will provide an incentive for parties to ensure that their prehearing motions to dismiss comply with the intent of the rule.

In response to those commenters who argued that the proposal would punish respondents when a claimant's pleading lacks specificity, FINRA reminded parties that there

61 Rule 12414(a) of the Customer Code and Rule 13414(a) of the Industry Code provide that "all rulings and determinations of the panel must be made by a majority of the arbitrators, unless the parties agree, or the Code or applicable law provides, otherwise."

62 See also Proposed Rules 12206(b)(8) and 13206(b)(8).

63 See, e.g., Amery, Jacobowitz, Karp, Shannon and SIFMA and Letters.

64 See note 41, supra.

are no specific pleading requirements under the Codes. FINRA noted that Rules 12302 of the Customer Code and 13302 of the Industry Code require a claimant to supply only “[a] statement of claim specifying the relevant facts and remedies requested” along with the required fees, copies, and signed submission agreement in order to initiate an arbitration. Similarly, FINRA pointed out that the answer must include only “[an] answer specifying the relevant facts and available defenses to the statement of claim.”⁶⁵ Further, FINRA stated that parties may obtain further information and documents through the discovery process.⁶⁶

For these reasons, FINRA declined to amend the proposal to change this provision.

Mandatory assessment of costs and attorneys’ fees and possible sanctions

Proposed Rules 12504(a)(10) of the Customer Code and 13504(a)(10) of the Industry Code would require that, if a panel deems a prehearing motion to dismiss to be frivolous, it must award reasonable costs and attorneys’ fees to any party that opposed the motion.⁶⁷

Also, proposed Rules 12504(a)(11) of the Customer Code and 13504(a)(11) of the Industry Code would require that, if a panel deems that a prehearing motion to dismiss was filed in bad faith, it may issue sanctions against the moving party.⁶⁸

Several commenters who opposed the proposal nevertheless supported these provisions as sufficient deterrents against abusive motions practice, and suggested that they would eliminate the need to restrict prehearing motions to dismiss in the forum.⁶⁹ Other

65 Rules 12303 and 13303.

66 See Rules 12500-12514 of the Customer Code and 13500-13512 of the Industry Code.

67 See also Proposed Rules 12206(b)(9) and 13206(b)(9) of the eligibility rule.

68 See also Proposed Rules 12206(b)(10) and 13206(b)(10) of the eligibility rule.

69 See, e.g., Babnick, Kaufman, Krebsbach and Morgan Stanley Letters.

commenters who opposed the proposal argued that, as drafted, the provisions would result in an increase in the number of motions for costs, fees, and sanctions filed by claimants.⁷⁰

These commenters suggested that FINRA should amend the proposal to prohibit claimants from filing such motions, and permit the panel, on its own initiative, to decide whether a motion is frivolous or in bad faith and order relief appropriately.⁷¹

FINRA responded by stating that it “anticipates that parties will file fewer prehearing motions to dismiss once the proposal is implemented, which should forestall any increase in the number of motions for costs, fees, and sanctions.”⁷² FINRA further stated its belief that the risk of monetary penalties and sanctions, imposed either by the panel on its own initiative, or as a result of a party’s motion, should deter parties from filing such motions frivolously or in bad faith. FINRA suggested that, taken together, these enforcement mechanisms should ensure strict compliance with the rules. For these reasons, FINRA declined to amend the proposal to change these provisions.

Clarification of the in-person or telephonic prehearing conference criteria

The proposed rule requires that a panel may not grant a motion under the rule unless an in-person or telephonic prehearing conference is held or waived by the parties.⁷³ One commenter requested clarification concerning what would satisfy the in-person or telephonic

70 See, e.g., Deutsche Bank, Lampart, SIFMA and Wachovia Letters.

71 Id.

72 FINRA Letter.

73 Proposed Rules 12504(a)(5) of the Customer Code and 13504(a)(5) of the Industry Code. See also Proposed Rules 12206(b)(4) and 13206(b)(4) of the eligibility rule.

prehearing conference requirement.⁷⁴ The commenter was concerned that the rules imply that the panel may grant the motion solely on the basis of the submissions from the parties.⁷⁵

FINRA responded by explaining that prehearing conferences conducted under this provision would be subject to Rules 12501 of the Customer Code and 13501 of the Industry Code. Further, FINRA explained that, under the proposal, if the parties agree to waive the prehearing conference, as is permitted currently under the Codes,⁷⁶ the panel may grant the motion based solely on the submissions of the parties. FINRA also stated that, if, however, the parties do not agree to waive the prehearing conference, then the panel must hold an evidentiary hearing on the motion at which time the parties will have an opportunity to present their arguments concerning the motion. In this situation, FINRA explained that the panel will have received the information necessary to make an informed decision.

Effect of the proposal on the parties' costs

Many commenters argued that current practice permits respondents to file numerous motions that are rarely granted, and that serve only to delay the hearings, harass claimants, and increase claimants' costs through higher forum fees and lower award amounts once expenses are paid.⁷⁷ In general, these commenters indicated that defending these motions to dismiss is a waste of time and resources and, ultimately, will result in the denial of access to the forum for investors with small claims.⁷⁸

74 St. John's Letter.

75 Id.

76 Rule 12105(a) of the Customer Code and Rule 13105(a) of the Industry Code.

77 See, e.g., Buchwalter, Haigney, Neuman and Stoltmann Letters.

78 Id. See also, e.g., Estell, Forman and St. John's Letters.

A number of commenters argued that the proposal prohibiting most prehearing motions to dismiss would increase all parties' costs, particularly firms', because their attorneys charge on an hourly basis, whereas claimants' attorneys charge on a contingency basis, so claimants are not incurring any costs.⁷⁹ Others contended that prohibiting prehearing motions to dismiss nullifies their most important objective – to avoid the expense of preparing for and attending an evidentiary hearing.⁸⁰

FINRA responded by stating that it is not privy to the fee structure used by investors' attorneys or counsel for brokerage firms. However, based on internal data⁸¹ and other statistical studies tracking motions to dismiss in FINRA's forum,⁸² FINRA noted that it is aware that when motions to dismiss are filed, they serve to delay the hearings and increase all parties' costs through higher forum fees. As a result, FINRA stated its concern that the current practice by some respondents of filing motions to dismiss, and sometimes multiple motions in one case, could cause investors' attorneys not to take smaller claims, because the costs incurred in defending these motions could exceed the amount in dispute. FINRA stated that it anticipates that the proposal will continue to make the forum accessible to investors, particularly those with small claims, by minimizing the number of motions to dismiss filed in the forum, and by shifting the costs and fees associated with denied motions to dismiss to the moving party. FINRA stated that the proposal's benefits protecting investors' access to the forum and their ability to have claims heard in arbitration outweigh the possibility of

79 See, e.g., Hartman, Kemnitz, Morgan Stanley and Schriels Letters.

80 See, e.g., Berberian, Davidson, Dulcich and McDermott Letters.

81 See Additional statistical support section below for updated statistics on motions to dismiss filed in FINRA's forum.

82 See Securities Arbitration Commentator, Nov. 2006 (Vol. 2006, No. 5) ("Study").

increased costs and expenses firms might incur under the rule. For these reasons, FINRA declined to amend the proposal to address this concern.

Additional statistical support

Several commenters who opposed the proposal argued that FINRA did not provide enough objective evidence to support the changes proposed.⁸³ These commenters suggested that anecdotal evidence of abuse is not sufficient proof that prehearing motions to dismiss should be prohibited.

FINRA responded that it disagrees with these commenters. FINRA stated that a significant number of changes to FINRA's arbitration rules have begun with users of the forum expressing a concern or complaint to FINRA. FINRA further stated that it relies on its constituents to inform it of concerns with its rules, arbitrator conduct, or abusive practices. Moreover, FINRA noted that once FINRA staff member become aware of a problem, they investigate further, and propose changes to the rules to address the concern, if necessary.

FINRA stated that, in the case of motions to dismiss, it received many complaints from users of the forum documented with copies of motions to dismiss, responses, and the panels' denials of those motions. FINRA stated that it also learned through a Securities Arbitration Commentator study that the number of motions to dismiss filed in customer cases had begun to increase over a two year period, starting in 2004.⁸⁴ The Study was conducted on motions to dismiss in customer cases and concluded that, of the cases that went to award in 2006, 28% had motions to dismiss as compared to 10% of cases that went to award in

83 See, e.g., Astarita, Berberian, Davidson and Farley Letters.

84 See, note 82, supra, at 3.

2004.⁸⁵ FINRA found the results of the Study “alarming” not only because of the significant increase in the motions filed in these cases, but also because the Study did not include cases that settled during that time. As a result of this analysis, FINRA indicated that it became concerned that, if left unregulated, this type of motions practice would limit investors’ access to the forum, which is antithetical to FINRA’s goals of investor protection and market integrity.

In light of the Study and concerns raised by constituents, FINRA began tracking motions to dismiss in 2007. FINRA noted that from January 1, 2007 to July 1, 2008, there have been 6,079 arbitration cases filed in the forum,⁸⁶ and a total of 754 motions to dismiss filed in these cases. Further, FINRA noted that in 10% of the 6,079 cases, parties filed one or more motions to dismiss, and in 2% of the 6,079 cases, parties filed two or more motions to dismiss. FINRA stated that these current statistics suggest that the number of motions to dismiss filed in the forum may be declining since the Study was conducted. FINRA opined that the reduction in these motions reflects its focus on this issue, through enhanced arbitrator training as well as a 2006 Notice to Parties to remind parties of the forum’s policy and parties’ responsibilities when filing motions to dismiss.⁸⁷ FINRA indicated that even though the number of motions filed appears to be declining in the forum, the proposal will serve to reduce further the number of prehearing motions to dismiss filed, and, in particular, should

85 Id.

86 The data do not include cases filed in the NYSE Regulation arbitration forum.

87 See Notice to Parties on Motions to Dismiss under the Code of Arbitration Procedure for Customer and Industry Disputes available at <http://www.finra.org/ArbitrationMediation/ResourcesforParties/NoticestoParties/p037078>. The Notice continues to be effective.

prevent parties from filing multiple motions in a case. For these reasons, FINRA stated that its statistical and anecdotal evidence is sufficient support for the proposal, and that the proposal should be approved as drafted.

Alternate criteria to provide specific guidance to arbitrators when deciding motions to dismiss

Several commenters suggested that the proposal should establish a specific standard for arbitrators to use when deciding motions to dismiss.⁸⁸ Most of these commenters suggested that panels should deny prehearing motions to dismiss whenever: (1) credibility is an issue; (2) there are disputed issues of material fact; or (3) the panel believes a hearing is necessary in the interests of justice.⁸⁹

FINRA responded by stating that it considered incorporating these criteria into the rule but determined that this would be inconsistent with the Codes, which do not contain such specific standards for arbitrator decision making. FINRA further stated that because arbitration is an equitable forum, the panel may consider any evidence or use any method to achieve a fair result. FINRA indicated that it did not intend for the proposal to change this practice.

Moreover, FINRA stated that establishing a specific approach for arbitrators to follow would infringe on arbitrators' discretion to decide arbitration cases. FINRA stated that the intent of the proposal was to select a very limited number of exceptions for granting prehearing motions to dismiss that would be relatively clear-cut for the panel to apply at this stage of the proceedings. FINRA stated that parties should argue their positions and

88 See, e.g., Gross/Black, Honigman, Van Kampen and Wachovia Letters.

89 Id.

arbitrators should be permitted to use their discretion in determining how motions to dismiss should be decided. For these reasons, FINRA declined to amend the proposal to incorporate a specific standard for arbitrators to use when deciding motions to dismiss.

Motion to dismiss policies of other securities arbitration forums

One commenter contended that the former New York Stock Exchange (“NYSE”) arbitration forum did not permit prehearing motions to dismiss.⁹⁰ Another commenter stated that the NYSE Regulation arbitration forum would not permit arbitrators to grant motions to dismiss before an investor had the opportunity to present his or her claims at an evidentiary hearing on the merits.⁹¹

FINRA stated that it responded to this comment previously in regard to the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc.⁹² FINRA noted that the NYSE Regulation arbitration forum had neither a rule nor a written policy on motions to dismiss, and FINRA was not aware that motions to dismiss were prohibited in the NYSE Regulation arbitration forum. Rather, FINRA stated its understanding that, in the NYSE forum, the panel determined whether and if so, when, a motion to dismiss would be heard.

90 Tepper Letter.

91 Canning Letter.

92 See Supplemental Response to Comments from Linda D. Fienberg, President, Dispute Resolution, dated May 29, 2007. The SEC approved the consolidation of member firm regulatory operations of NASD and NYSE on July 26, 2007. Securities Exchange Act Rel. No. 56145, 72 FR 42169 (Aug. 1, 2007) (SR-NASD-2007-023) (approval order).

Proposal's impact on the parties' negotiations

A number of commenters argued that the proposal would create settlement value for claimants because respondents would have to conduct a cost-benefit analysis to determine whether the cost of settling the dispute is more beneficial than losing a prehearing motion to dismiss and proceeding to evidentiary hearing.⁹³ Generally, the commenters who supported the proposal stated that it would reduce all parties' costs because the parties would no longer waste resources arguing frivolous prehearing motions to dismiss that are rarely granted.⁹⁴

FINRA responded that it agrees with those commenters who believe the proposal would reduce all parties' costs because the number of prehearing motions to dismiss in the forum should decrease once the proposal is implemented. Moreover, FINRA stated that it believes that respondents are more likely to conduct a cost-benefit analysis concerning whether to proceed with an arbitration based on the strength or weakness of their claims or defenses, not the existence of a motion to dismiss rule. For this reason, FINRA declined to amend the proposal at this time.

Proposal's effect on parties who settle claim before hearing

Proposed Rules 12504(a)(3) of the Customer Code and 13504(a)(3) of the Industry Code provide that, unless the parties agree or the panel determines otherwise, parties must serve motions to dismiss at least 60 days before a scheduled hearing, and parties have 45 days to respond to the motion.

The author of a February 2008 Securities Arbitration Commentator ("SAC") article suggested that, under the proposal, parties would not be permitted to settle a claim and have

93 See, e.g., Amery, Buckman, Gelber and Shannon Letters.

94 See, e.g., Buchwalter, Haigney, Neuman and Stoltmann Letters.

it dismissed before the evidentiary hearing, if the 60-day deadline has passed and the parties have not yet filed a prehearing motion.⁹⁵

FINRA responded to the suggestion in the article by noting that the proposal does not preclude parties from agreeing to settle at any time. FINRA pointed out that Rules 12105 and 12207 of the Customer Code⁹⁶ permit the parties to agree to extend the deadlines for filing or responding to motions. FINRA stated that the proposal would not prohibit the parties from taking these actions.

Moreover, FINRA stated that the proposed rule is not intended to apply to motions made jointly by all parties to dismiss a case because of a settlement. FINRA pointed out that, under the Codes, if all parties agree to settle a case, FINRA will close the case based on the settlement agreement.⁹⁷ FINRA stated that this process is different from that contemplated by the proposal, in which a panel grants one party's motion to dismiss a case before an evidentiary hearing is held.

Motions to dismiss as awards

The author of a different February 2008 SAC article argued that arbitrator decisions on motions to dismiss are awards and should be published as required under the Code.⁹⁸

95 Harry A. Jacobowitz, "Roadblocks at the Exits: FINRA's Proposed Dispositive Motions Rule," Securities Arbitration Commentator, February 2008 (Vol. 2007, No. 4), at 1.

96 See also Rules 13105 and 13207 of the Industry Code.

97 Rule 12902(d) of the Customer Code and Rule 13902(d) of the Industry Code.

98 Richard P. Ryder, "Disposing of Dispositive Motions: The Process to Date," Securities Arbitration Commentator, February 2008 (Vol. 2007, No. 4), at 10; see also Jacobowitz Letter.

FINRA responded to the comments in this article by stating that, under the Code, an award is a document stating the disposition of a case.⁹⁹ FINRA explained that, if a motion to dismiss all claims is granted and disposes of all open issues, it would be reported as an award. FINRA further explained that a decision to grant a motion to dismiss that does not dismiss all of the parties or end the dispute would not be an award; rather, it would be considered an order of the panel and would not be made publicly available.

IV. Discussion and Findings

After careful review of the proposed rule change, the comments and FINRA's response to the comments, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association.¹⁰⁰ In particular, the Commission believes the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁰¹ which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The Commission believes that the proposed rule change would enhance investor confidence in the fairness and neutrality of FINRA's arbitration forum by ensuring that non-moving parties have their claims heard in arbitration, while preserving the moving parties' rights to challenge the necessity of a hearing in certain limited circumstances. Further, the Commission believes the proposed changes to

99 Rule 12100(b) of the Customer Code and Rule 13100(b) of the Industry Code.

100 In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. See 15 U.S.C. 78c(f).

101 15 U.S.C. 78o-3(b)(6).

the eligibility rule would help prevent manipulative practices by closing a loophole in the existing rule, so that parties may pursue their claims in court without facing an unintended legal impediment, in the event their claims are dismissed in arbitration on eligibility grounds.¹⁰²

Policy Statement on Prehearing Motions

The Commission believes that FINRA has adequately responded to the comments regarding FINRA's proposed policy statement on prehearing motions. The Commission agrees that parties have the right to a hearing in arbitration, and that prehearing motions to dismiss should be limited. The Commission also agrees with FINRA that proposed Rules 12504(a)(1) of the Customer Code and 13504(a)(1) of the Industry Code reinforce this position by clarifying that prehearing motions to dismiss are discouraged in arbitration.

Further, the Commission believes that FINRA adequately responded to the commenters who contend that this policy statement unfairly discourages all motions to dismiss in the forum, by pointing out that the proposal permits parties to file a motion to dismiss on any ground after the conclusion of a party's case in chief.

Finally, given the comments that were received in response to the original proposal, which stated that motions to dismiss should be granted only in extraordinary circumstances, the Commission believes that FINRA has appropriately refined the statement to reflect

102 As described above, under the existing rule, if a respondent files a motion to dismiss based on several grounds, including eligibility, and the panel issues an order dismissing a claim, but without citing reasons, the claimants would not know whether or not they are afforded the right to pursue the claim in court. If the claimants proceed to file the dismissed claim in court, the respondents may argue that the panel's decision on the claim is the final decision, and that claimants are barred from having the court decide the same claim again.

FINRA's policy while eliminating any ambiguity created by the words "extraordinary circumstances."

The Commission's oversight of the securities arbitration process is directed at ensuring that it is fair and efficient. As noted above, FINRA had received complaints that parties were filing dispositive motions routinely and repetitively in an apparent effort to delay scheduled hearing sessions on the merits, increase investors' costs, and intimidate less sophisticated parties. This type of abusive motions practice undermines the fairness and efficiency of the securities arbitration process. The proposed rules, which strictly limit the grounds for filing pre-hearing motions to dismiss, and impose sanctions on parties that engage in abusive practices, are designed to enhance the fairness and efficiency of the process. The Commission believes that FINRA's policy statement sets a clear tone that commands a narrow reading of the provisions setting forth the grounds on which parties may bring a motion to dismiss prior to the conclusion of a party's case in chief. A narrow reading of those provisions is essential to help achieve FINRA's overarching goal of the proposal: to enhance investor confidence in the fairness and neutrality of FINRA's arbitration forum by ensuring that non-moving parties have their claims heard in arbitration, while preserving the moving parties' rights to challenge the necessity of a hearing in certain limited circumstances. Furthermore, this policy statement is consistent with other parts of the Codes, where FINRA sets forth procedures that are only permitted to be used in limited circumstances.¹⁰³

103 See, e.g., NASD Rules 12507(a)(1), which states that "interrogatories are generally not permitted in arbitration," while setting forth limited types of written discovery requests and 12510 (Depositions), which states that "depositions are strongly

Scope of Proposed Rules 12504(a)(6) of the Customer Code and 13504(a)(6) of the Industry Code with respect to Clearing Firms

The Commission carefully considered a commenter's arguments that when a statement of claim does not make factual allegations of direct misconduct by a clearing firm, the clearing firm should be dismissed from the case.¹⁰⁴ Under applicable rules of self-regulatory organizations, all clearing agreements must identify the division of duties between the introducing and clearing brokers.¹⁰⁵ Typically, an introducing or correspondent broker deals directly with the public and originates customer accounts¹⁰⁶ while the clearing broker handles functions related to the clearance and settlement of trades in the accounts of its introducing broker.¹⁰⁷ The clearing broker usually has no direct contact with the customers of its introducing broker, except for the periodic mailing of reports and other records relating to their accounts.¹⁰⁸ However, a clearing broker may expose itself to liability with respect to the introducing broker's misdeeds "where a clearing firm moves beyond performing mere ministerial or routine clearing functions [with actual knowledge] and becomes actively and directly involved in the introducing broker's [fraudulent] actions. . . ."¹⁰⁹ Although findings of liability against clearing brokers are unusual, courts have upheld arbitration awards against

discouraged in arbitration," while setting forth a list of the limited circumstances in which depositions are permitted.

104 See SIFMA Letter.

105 See, e.g., NYSE Rule 382, NASD Rule 3230, Amex Rule 400.

106 See *Katz v. Fin. Clearing & Serv. Corp.*, 794 F. Supp. 88, 90 (S.D.N.Y. 1992).

107 Dillon v. Militano, 731 F. Supp. 634, 636 (S.D.N.Y. 1990).

108 Stander v. Fin. Clearing & Serv. Corp., 730 F. Supp. 1282, 1285 (S.D.N.Y. 1990).

109 McDaniel v. Bear Stearns & Co., 196 F. Supp. at 353.

clearing brokers, finding that the arbitrators did not act with “manifest disregard of the law.”¹¹⁰

Because claimants generally need to be able to develop the facts to argue the liability of a clearing firm in a particular dispute, the Commission agrees with FINRA’s analysis that it would be inappropriate for clearing firms to be eligible for prehearing dismissal based solely on their status as clearing brokers. Under the proposed rule, however, clearing firms will continue to be permitted to file motions to dismiss for any reason after the conclusion of the claimant’s case in chief. The Commission believes that this strikes an appropriate balance between providing claimants an opportunity to resolve factual disputes and limiting clearing firms’ needless involvement in disputes. The Commission staff has asked FINRA to request that SIFMA provide it with available statistics regarding all motions to dismiss filed by clearing firms in the past and until the effective date of the proposed rule change.¹¹¹ Further, the Commission has asked FINRA to maintain statistics on motions to dismiss filed by clearing firms for a period of six months from the effective date of this proposed rule change, to shed greater light on any burdens imposed on clearing firms. The Commission has also asked FINRA to consider additional steps it could take to inform parties of the distinction between introducing brokers and clearing brokers.

Scope of Proposed Rules 12504(a)(6)(B) of the Customer Code and 13504(a)(6)(B) of the Industry Code (“not associated” exception)

110 See, e.g., *id.*; see also, *Koruga*, 183 F.Supp.2d at 1247.

111 To the extent that firms and other interested parties have access to information or statistics that would be relevant, such firms and parties are invited to send such information to the attention of the staff of FINRA Dispute Resolution.

With respect to the comments regarding the “not associated” exception, the Commission believes that FINRA responded appropriately. Specifically, FINRA indicated that it intends this exception to apply narrowly, such as in cases involving issues of misidentification. FINRA further clarified the meaning of “not associated” by providing examples of ways in which the exception could be invoked. The Commission agrees with FINRA that the “not associated” exception would be inappropriate in cases in which a respondent may be liable as a supervisor or control person under applicable statutes or in “selling away” cases.

The Commission recognizes that certain situations, such as cases involving mistaken identity, would merit a prehearing dismissal, which is why the Commission supports the existence of a “not associated” exception within the rules. However, as stated above, the Commission believes that a narrow interpretation of the exceptions is appropriate.

Additional exceptions for permissible prehearing motions

With respect to the comments requesting that FINRA incorporate additional exceptions for prehearing motions to dismiss, the Commission believes that FINRA responded appropriately. Specifically, the Commission agrees with FINRA’s conclusion that expanding the exceptions to the rule would negate its intent, which is to have clear, easily definable standards for permissible prehearing motions to dismiss that do not involve fact-intensive issues. Moreover, the Commission agrees that the suggested additional exceptions would require fact-based determinations and, thus, would be inappropriate for dismissal before a claimant has presented its case. As FINRA pointed out, a party is permitted to file a motion to dismiss on any basis after the conclusion of a party’s case in chief.

The Commission believes that, particularly with respect to the limited exceptions to prehearing motions, the proposal strikes an appropriate balance by ensuring that claimants have their claims heard in arbitration, while minimizing the parties' exposure to additional fees in the event that the claimant does not prove the claims in its case-in-chief.

Expansion of the exception for prehearing motions under the Eligibility Rule to include applicable statutes of limitation

With respect to the comments regarding statutes of limitations, the Commission believes that eligibility is an appropriate ground for a prehearing motion to dismiss because of its uniform application in all cases, and because of the additional protections parties receive under the eligibility rule. As FINRA explained, statutes of limitations involve fact-based determinations, depend on the law of the applicable jurisdiction, and depend on the type of claims alleged. Moreover, FINRA noted that, in some jurisdictions, courts have found that statutes of limitations do not apply to arbitration proceedings. For these reasons, the Commission agrees with FINRA's conclusion that it would be inappropriate to include an exception for prehearing motions to dismiss on statute of limitations grounds.

Motions permitted at the conclusion of claimant's case-in-chief

With respect to the argument that this provision will shift abusive motions practice to the middle of the hearing, because respondents will wait until the end of claimant's case to file their motions, the Commission believes FINRA responded appropriately. In particular, the Commission agrees with FINRA's assertion that it would be unfair to require the parties to continue with a hearing if the claimant has not proved its case.

The Commission staff has requested that FINRA gather statistics on a going-forward basis, to determine whether abusive motions practice becomes apparent in the post-hearing

phase of arbitration. In response, FINRA stated that it will monitor the frequency of motions filed pursuant to this provision once the proposal is implemented. FINRA has agreed to analyze the information to determine whether potentially abusive behavior develops, and FINRA stated that it may propose further amendments to the rules that are subject to this proposal or take other appropriate action.

In addition, further to discussions with the Commission staff, FINRA noted in its response that the proposed rule would not preclude a panel from assessing respondents with sanctions, costs and attorney's fees, if the panel determines that a motion filed at this time is frivolous or in bad faith.

Concerns regarding the procedural safeguards and mandatory assessment of costs and attorneys' fees and possible sanctions

With respect to the comments regarding the procedural safeguards and mandatory assessment of costs and fees and possible sanctions, the Commission believes FINRA responded appropriately. The Commission believes that the proposal's procedural safeguards are carefully designed to enhance the fairness and neutrality of FINRA's arbitration forum. The Commission further believes that the mandatory assessment of costs and attorneys' fees and possible sanctions serves the necessary function of deterring parties from filing such motions frivolously or in bad faith, and should ensure strict compliance with the rules.

Effect of the proposal on the parties' costs

With respect to the comments suggesting that the proposal prohibiting prehearing motions to dismiss except on limited grounds would increase all parties' costs, particularly firms', because their attorneys charge on an hourly basis (whereas claimants' attorneys

charge on a contingency basis, so claimants are not incurring any costs),¹¹² the Commission is unconvinced. The Commission believes FINRA responded appropriately by highlighting the effect of motions to dismiss on all parties' costs and the potential for claimants' attorneys to be reluctant to take on small cases due to costs associated with motions to dismiss.

Furthermore, the Commission agrees with FINRA's ultimate determination that the proposal's benefits of protecting investors' access to the forum and their ability to have claims heard in arbitration, outweigh the possibility of increased costs and expenses firms might incur under the rule.

General

In general, the Commission believes that FINRA has responded to the comments adequately and appropriately, and has explained how the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder that are applicable to a national securities association. As noted above, the Commission believes that the proposal would help achieve the overarching goal of ensuring that parties would have their claims heard in arbitration, by significantly limiting the grounds for filing motions to dismiss prior to the conclusion of a party's case in chief and by imposing stringent sanctions against parties for engaging in abusive practices under the rule. At the same time, the Commission believes that the proposal would not unduly limit the rights of parties to seek dismissal, because it would allow prehearing motions to dismiss in certain limited circumstances, and it would not affect the ability of parties to seek dismissal after the conclusion of the claimant's

112 See, e.g., Hartman, Kemnitz, Morgan Stanley and Schriels Letters.

case in chief. As such, the Commission finds that the proposal would contribute to the fairness and efficiency of the securities arbitration process.

V. Conclusions

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹¹³ that the proposed rule change (SR-FINRA-2007-021), as modified by Amendment No. 1, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹¹⁴

Florence E. Harmon
Acting Secretary

113 15 U.S.C. 78s(b)(2).

114 17 CFR 200.30-3(a)(12).