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FINRA Dispute Resolution Task Force
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RE: Suggestions for Improvements to FINRA Arbitration Process for Small Claims and Other Issues Impacting Access to FINRA forum

Dear Task Force Members:

The University of Miami School of Law Investor Rights Clinic ("the IRC")[1] appreciates the opportunity to provide suggestions to the FINRA Dispute Resolution Task Force ("Task Force") that FINRA should consider to improve the arbitration process, particularly for small claim investors. Because the IRC only handles claims that fall below $100,000, the vast majority of which are under $50,000 and qualify for Simplified Arbitration, we routinely deal with a number of specific issues that impact smaller claims. Moreover, our clients and other callers who contact us for assistance regularly share information about the particular difficulties they face in understanding whether they have a claim in the first place and, if so, how to navigate FINRA's Dispute Resolution process.

Therefore, we have set forth below several suggestions to improve the simplified arbitration process, including: 1) establishing a simplified guide with filing forms for *pro se* claimants (in English and Spanish), with published timelines and short form "Discovery Guide" for small claims; 2) telephonic hearings for all small claims at the customer's option; and 3) establishing a neutral roster of "small claims" arbitrators who have been specially trained in handling *pro se* cases and holding telephonic hearings. In addition, we have also provided comments and suggestions about two specific issues that directly impact an investor's access to FINRA's arbitration forum, specifically, the hearing location (Rule 12213) and the eligibility rule (Rule 12206). Finally, we urge the Task Force to strongly recommend to FINRA that it provide continued funding support to the existing law school clinics given the critical assistance these clinics provide to an underserved population: low and modest income investors with potential claims too small for them to obtain legal representation.

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[1] Launched in January 2012, the IRC was initially funded with a $250,000 grant from the FINRA Investor Education Foundation ("FINRA Foundation"). Like other law school securities arbitration clinics, the IRC provides pro-bono representation to investors of modest means who have suffered investment losses as a result of broker misconduct but, due to the size of their claim, cannot find legal representation. Under faculty supervision, law students provide legal assistance and advice to investors who have potential claims involving misrepresentation, unsuitability, unauthorized trading, excessive trading, and failure to supervise, among other claims. For more information, please see http://investorrights.law.miami.edu.

I. SPECIFIC RECOMMENDATIONS FOR SIMPLIFIED ARBITRATION UNDER RULE 12800

A. "Simplifying" the Simplified Arbitration Process

The simplified arbitration process for claims under $50,000 is anything but simple. With about 16 law school securities arbitration clinics across the country (8 of which are in New York), most claimants with small claims cannot find legal representation and must either abandon their claims or proceed *pro se* in the complicated and unfamiliar forum of FINRA arbitration.

FINRA Dispute Resolution's Party Reference Guide for Simplified Cases ("Guide"), for example, is over 70 pages long and yet provides no guidance on how to prepare a Statement of Claim. The Guide does not explain or provide examples on whether or how to conduct discovery beyond quoting Rule 12800(d)(2); it does not discuss the reasons why a claimant should consider making "additional submission" in a simplified claim and, if so, what kind of information may be helpful to the claimant's case. The Uniform Forms Guide does not fill the gap, as it only provides only the barest description of what a claimant should include in a statement of claim,[2] and the only forms it provides are a "Claim Information Sheet" and "Submission Agreement."

To assist *pro se* claimants desiring to utilize FINRA's simplified arbitration process, we recommend that FINRA publish a short, truly simplified guide for *pro se* claimants in customer cases, limited to no more than 7-10 pages, which should include:

- **Standardized (and optional) "Statement of Claim" form** on which a *pro se* claimant can include all relevant information, including the claimant's biographical information (age, residence, education, employment background), the name of the broker-dealer and registered representative(s) involved, date(s) of the transaction(s) at issue, a description of the investment(s) at issue, estimated losses, and a space for the claimant to "tell his or her story." The form (and any of the entries on the form) would be entirely optional; importantly, it would provide *pro se* claimants with a template, if nothing more, with respect to what information is relevant in the FINRA arbitration process.

- **Concise Key Timelines Sheet** setting forth the key events that will occur during the simplified arbitration process. The timeline will allow pro se claimants to have a better

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[2] The Uniform Forms Guide – which applies to all FINRA arbitration claims generally – explains that a Statement of Claim "is a written narrative that sets forth the facts of the dispute . . . [which] should set forth the details of the dispute, including all relevant dates and names, in a clear, concise and chronological fashion, and should conclude by indicating what relief (e.g., the amount of money damages, specific performance, interest, etc.) is requested." Uniform Forms Guide, at 4, *available at*: http://www.finra.org/sites/default/files/UniformsFormsGuide-March-2015.pdf.

sense of the entire arbitration process and a sense for what steps or actions will take place in the process and when. Once the Statement of Claim is served on Respondent, moreover, FINRA should set specific dates corresponding to each deadline and notify the parties in writing.

- **Create a Simplified Discovery Guide** that provides parties with a short list of documents and information each side should automatically exchange. Ironically, engaging in discovery in simplified cases is actually far more difficult for *pro se* parties than in regular arbitration proceedings. In regular proceedings, Rule 12506(a) provides for the parties to automatically exchange documents listed in the Discovery Guide, which are presumptively discoverable. In a simplified proceeding, however, the parties must identify what, if any, documents they will need. For the *pro se* claimant, this can be extremely challenging. A simplified discovery guide can set forth a narrow set of documents that the parties should presumptively exchange within 30 days after the Statement of Answer is served. This would allow *pro se* claimants the opportunity to participate in the important discovery process.[3]

B. <u>Telephonic Hearings</u>

As Professors Jill Gross and Barbara Black noted in their February 2008 Report to the Securities Industry Conference on Arbitration, "participants' perceptions of fairness, particularly procedural fairness, are critical to the integrity of the dispute resolution process."[4] Providing small claim investors with an opportunity to explain their position before an arbitrator is an integral component to increased transparency and perception of fairness in the process.[5]

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[3] We understand the concern the Task Force may have with further complicating the simplified arbitration process, which currently presumes that parties will *not* engage in discovery. However, our experience demonstrates that customers often do not possess basic documentation necessary to support their claims (i.e., account opening application, correspondence, documentation evidencing the recommendation at issue), thus requiring some basic discovery exchange. Moreover, FINRA can provide for a presumption *against* additional discovery beyond the categories listed in a Simplified Discovery Guide.

[4] *See,* Barbara Black and Jill Gross, *Perceptions of Fairness of Securities Arbitration: An Empirical Study*, Univ. of Cincinnati Public Law Research Paper No. 08-01, at 59 (February 6, 2008), *available at:* http://ssrn.com/abstract=1090969. The authors' study documented the results of a mailed survey to customer participants of FINRA's arbitration process.

[5] *See, e.g.*, Barbara Black and Jill Gross, *When Perception Changes Reality: An Empirical Study Of Investors' Views Of The Fairness Of Securities Arbitration*, 2008 J. Disp. Resol. 349 (2008) ("[F]our key elements 'reliably lead people to conclude that a dispute resolution process is procedurally fair': (1) the process provides an opportunity for disputants to voice their concerns to a third party; (2) the disputants perceive that the third party actually considered these concerns; (3) the disputants perceive that the third party treated them in an 'even-handed' way; and (4) the disputants feel that they were treated in a dignified and respectful manner.")(*citing*

Although a customer can request a hearing in an otherwise "paper" case under Rule 12800(c)(1), this is simply not a viable option for most customers in a simplified proceeding, particularly those persons proceeding *pro se* because, should the customer request a hearing, the matter is no longer considered "simplified" and "the regular provisions of the Code relating to prehearings and hearings, including fee provisions, will apply." Rule 12800 (c)(2). This choice is really no choice at all, given the additional costs associated with regular arbitrations, including a prehearing conference, extensive discovery, and the expenses and possible difficulties of travel for many claimants. This leaves claimants with only one real option, presenting their case on the papers, something that most *pro se* claimants will be unable to do effectively.

The Task Force should consider and recommend a process providing for (at the customer's option) a half-day, telephonic hearing in all simplified arbitration cases. By amending Rule 12800 to allow the customer the right to elect a telephonic hearing, FINRA could substantially simplify the small claims process and, importantly, greatly enhance customer's perception of fairness by providing them with an opportunity to discuss their claim without imposing unnecessary burdens and costs. All parties would find telephonic hearings less time consuming than in-person hearings because there is no travel required. Also, to the extent many customer claims depend upon an assessment of credibility, a hearing – even telephonically – will assist the arbitrator in making a more informed, reasoned judgment. Finally, the perception of fairness of the process will improve for investors.

C. Dedicated Roster of Simplified Arbitration Neutrals

We recommend that FINRA establish a neutral roster of public arbitrators who have completed additional training in handling simplified arbitration matters and cases involving *pro se* claimants. Arbitrators that frequently work with *pro se* litigants would be more understanding of their need to provide some guidance of the process to claimants while maintaining neutrality. They can further be trained to implement a streamlined hearing process to conduct telephonic hearings in simplified proceedings.

II. RECOMMENDATIONS APPLICABLE TO ARBITRATIONS GENERALLY

A. Presumption of Customer Residence As "Hearing Location"

Currently, FINRA Rule 12213 provides that the Director "will select the hearing location closest to the customer's residence at the time of the events giving rise to the dispute unless the hearing location closest to the customer's residence is in a different state, in which case the customer may request a hearing location in the customer's state of residence at the time of the events giving rise to the dispute." The rule's language strongly suggests that FINRA meant to provide customers with a presumption of a hearing forum located closest to where they live.

Nancy A. Welsh, *Remembering the Role of Justice in Resolution: Insights from Procedural and Social Justice Theories,* 54 J. Legal Ed. 49, 52 (2004)).

However, in many cases, the customer may have relocated to another state since the date of the transaction(s) at issue. We see this scenario frequently at the IRC, since many investors re-locate to Florida (and other warmer locales) upon retirement. In such cases, the Director will still presumptively set the hearing location nearest to where the investor *used to live*, requiring the claimant to file a motion to change the hearing location.[6] Although Rule 12213 allows a claimant to file a motion to change the hearing location with the Director, or the Panel once appointed, our experience has demonstrated that changing the hearing location can be difficult for customers. In the cases we have filed to date where this issue has arisen, the Director has refrained from ruling on the motion to change hearing location and, instead, referred the motion to the Arbitrator. This immediately presents an initial obstacle to the motion, because an Arbitrator is unlikely to rule for a venue change when it will likely result in his or her removal from the panel.

By way of example, in the case where the IRC succeeded in having the hearing location transferred to Florida from Puerto Rico (since the claimant had retired and relocated with her elderly mother to Ocala, Florida), removal was not an issue because the Arbitrator was qualified for hearings in both locations. However, the Arbitrator did not rule on the motion for nearly a year – approximately two weeks before the date of the hearing. This delay caused substantial anguish to our client, who thought she and her elderly mother (suffering from Alzheimer's) would have to travel back to Puerto Rico for a hearing. The ruling prompted a favorable

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[6] The language in Rule 12213 that provides a customer with the opportunity to choose a hearing location in a different state only applies if the customer was in fact living in that state "at the time of the events giving rise to the dispute" and, as explained by Regulatory Notice 10-17, was meant to provide a customer with options if he has hearing locations in his own state but a closer one in a neighboring state:

> For example, if a customer in an arbitration proceeding lives in Hoboken, New Jersey, the Director will select the New York City hearing location, because this hearing location is closer to the customer's residence than the FINRA hearing location in Newark, New Jersey . . . . FINRA amended Rule 12213(a) to expand the criteria for selecting a hearing location. Specifically, the rule now states that the Director will select the hearing location closest to the customer's residence at the time of the events giving rise to the dispute, unless the hearing location closest to the customer's residence is in a different state. In that case, the customer may request a hearing location in the state where the customer resided at the time of the events giving rise to the dispute. Applying the amended rule to the example above, if the customer requests the Newark, New Jersey, hearing location, the Director generally will grant the request, even though the closest hearing location to the customer's residence is the New York City location.

Because this amendment only applies to the hearing location options that existed at the time of the events giving rise to the dispute, it does not apply to situations where the customer has moved to another state since the events giving rise to the dispute.

settlement on behalf of our client less than a week before the hearing, but not after substantial litigation had occurred.

Establishing a presumption that a customer can request a hearing in a location *either* nearest to where the customer resided at the time of the events giving rise to the dispute *or* where he or she resides when the arbitration claim is filed would greatly assist customers and provide better access to the arbitration forum. Many customers who have relocated – usually because of retirement or health concerns – face physical, mental, and financial challenges that make travel to another state difficult. Respondent firms do not face similar burdens, since many typically do business throughout the country, are represented by counsel, and all relevant documents are produced during the course of discovery in any event.[7]

FINRA should amend Rule 12213 to provide that in customer cases, the Director will select the hearing location closest to the customer's residence either at the time of the events in question, or where the customer resides at the time of the claim, at the customer's option. This will greatly alleviate the anxiety, costs, and burdens (both physical and financial) to customers who have relocated since the transactions at issue, and greatly expand customers' access to the FINRA forum.

B. Providing Guidance On The "Occurrence Or Event" Language Of The Eligibility Rule

Rule 12206(a) provides that "[n]o claim shall be eligible for submission to arbitration under the Code where six years have elapsed from the *occurrence or event* giving rise to the claim." Commonly referred to as the "eligibility rule," we agree that it is a necessary limitation to ensure fairness and efficiency of the arbitral process, encourage due diligence on the part of claimants and prevent unjust prejudice that may arise from the filing of stale claims. However, FINRA does not provide much guidance on the application of the rule beyond explaining in the Arbitrator's Guide that:

> The arbitrators may find that there is a continuing occurrence or event giving rise to the dispute. For example, although a customer purchased stock 10 years ago, there are allegations of ongoing fraud starting with the purchase, but continuing to a date within six years of the date the claim was filed.[8]

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[7] The Arbitrator's Guide's does not currently include any guidance on how to handle a customer's request to change the hearing location. However, it does state that considerations such as location of witnesses and documents, where the agreement was signed, and who initiated the transaction at issue, are relevant in "cases involving firms only." Arbitrator's Guide, at 41, *available at:* http://www.finra.org/sites/default/files/Arbitrator's-Guide.pdf. This language implicitly suggests that such considerations should not have any bearing on customers' requests to change the hearing location.

[8] Arbitrator's Guide, at 45.

This language strongly suggests that an arbitration panel should not just consider the purchase date of a security, but also whether there is continuing conduct (such as active concealment, additional misrepresentations, churning or other continuing misconduct) that falls within the six-year period. The more difficult question is whether the eligibility rule is subject to equitable tolling. We submit that the eligibility rule should be subject to equitable tolling, both as a matter of law under Supreme Court precedent, and as a matter of equity.

The Supreme Court in *Howsam v. Dean Witter Reynolds, Inc.*,[9] resolved a conflict among the circuits and held that the eligibility rule under then NASD Rule 10304 (now FINRA Rule 12206) was a procedural "gateway" issue for the arbitrator to decide. Importantly, the Court distinguished "substantive" gateway issues, such as whether the parties are bound by an arbitration provision in the first place or whether an arbitration clause applies to a particular dispute, from "procedural" gateway issues that include waiver, delay and like defenses.[10] *Howsam* provides compelling support for the argument that the eligibility rule, like statutes of limitation, is subject to equitable tolling.[11]

Allowing for equitable tolling of the eligibility rule is also appropriate given that many investors are not aware that they were placed in an unsuitable investment, among other misconduct, until long after the "purchase date." At the IRC, we have repeatedly dealt with cases where senior investors (many with limited or no prior investment experience) were placed in highly risky or complex products, and were wholly unaware of the risks until it was too late – often years later. Equitable tolling is entirely appropriate in such instances, particularly in the case of small claim investors who may encounter difficulties in finding representation.

The Task Force should recommend that FINRA provide some clarity and, consistent with *Howsam* and equity, expressly amend the eligibility rule (or issue a Regulatory Notice) stating that the purchase date is *not* necessarily the trigger date of an action under Rule 12206, and that the rule is procedural in nature and subject to equitable tolling. Express guidance is necessary because panels have dismissed actions on the grounds that the eligibility rule cannot be tolled,[12] and they will continue to do so unless FINRA states otherwise. FINRA should do so.

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[9] 537 U.S. 79, 123 S.Ct. 588, 154 L.Ed.2d 491 (2002).

[10] 123 S. Ct. at 592-93.

[11] *See, e.g., Mid-Ohio Sec. Corp. v. Estate of Burns*, 790 F. Supp. 1263, 1271 (D. Nev. 2011) (*Howsam* "eviscerated" the premise that the eligibility was a substantive limit on the ability to arbitrate and, therefore, not subject to tolling).

[12] *See, e.g., Raifman v. Wachovia Secs., LLC*, FINRA Case No. 10-02474 (Feb. 23, 2011) (granting motion to dismiss on ground that eligibility rule is not a statute of limitation and therefore not subject to equitable tolling, even where there were allegations of fraudulent statements); *Trotter v. Park Avenue Secs.*, FINRA Case No. 09-04458 (August 31, 2010) (applying law of Eleventh Circuit to hold that eligibility rule is not subject to equitable tolling).

III. PROVIDING SUSTAINED FUNDING TO LAW SCHOOL CLINICS

For nearly two decades, law school securities clinics have played a critical role in providing assistance to low and moderate income investors who could not obtain legal representation to recover damages due to broker misconduct because of the size of their claims.[13] The FINRA Foundation recognized the important role the clinics served in filling the gap in legal representation for investors with small claims and provided "seed" funding in the form of $250,000 grants to eight additional law school clinics, including the University of Miami School of Law, which opened the IRC.[14] The FINRA Foundation has not issued any new grants to law schools since 2012, and has provided no additional funding to any of the eight law schools it originally funded.[15]

When the FINRA Foundation issued its grants, it obtained commitments from the respective law schools that they would continue to fund and operate the investor advocacy clinics. However, most of these grants were issued prior to 2010, when law schools around the country were experiencing historically high levels of JD student enrollment. Since 2010, law schools have experienced significant decreases in enrollments. According to the American Bar Association (ABA) Section of Legal Education, in 2014 the total enrollment in JD programs (including both full-time and part-time students) at the nation's 204 ABA-approved law schools fell nearly 7 percent from 2013 and about 18.5 percent from 2010.[16] These decreases in enrollment have had a profound impact on law schools as most have had to reposition themselves to operate at far lower levels of tuition income. Law schools have found themselves

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[13] In 1997, then SEC Chairman, Arthur Levitt, recognized that small claim investors could not obtain cost-effective representation, leaving them with the Hobson's choice of pursuing their claims *pro se* in an unknown and complicated forum, or not pursuing their claims at all. Chairman Levitt looked to law schools for the solution and, two years later, four securities clinics opened and paved the way for additional clinics due to the success of this pro bono model. Jill Gross, *The Improbable Birth and Conceivable Death of the Securities Arbitration Clinic*, 15 CARDOZO J. CONFLICT RESOL. 597, 601-602 (2014). Chairman Levitt described the ideas as "a win-win proposition: small investors get much-needed legal assistance and students gain valuable learning experience." *See* SEC Press Release, "SEC Announces Pilot Securities Arbitration Clinic to Help Small Investors" on November 12, 1997, *available at:* https://www.sec.gov/news/press/pressarchive/1997/97-101.txt.

[14] See FINRA Investor Education Foundation's Investor Advocacy Clinic Program, *available at:* http://www.finrafoundation.org/grants/awarded/advocacy/.

[15] Jill Gross, *supra* note 13, at 619-20 (the FINRA Foundation has established a policy that it will not provide continuing funding to the securities arbitration clinics).

[16] Mark Hanson, *As Law School Enrollment Drops, Experts Disagree on Whether the Bottom is in Sight*, ABA Journal (March 1, 2015), *available at:* http://www.americanbar.org/news/abanews/aba-news-archives/2014/12/aba_section_of_legal.html

cutting non-essential programs and specialty clinics, such as the securities arbitration clinics, and a number of these clinics have in fact closed in the last few years.[17]

The loss (and potential additional losses) of these law school clinics represents a significant blow to FINRA's mission of investor education and protection. These clinics provide an essential service to an otherwise underserved population. In addition to providing legal representation, the clinics provide information and other assistance to investors, and engage in financial outreach in their respective communities.

By way of example, since it opened in January 2012, the IRC has handled more than 220 intakes, which are calls or requests for assistance. In cases where the caller did not qualify for representation (or the matter did not involve a registered broker or associated member), the IRC has provided information, resources, and referrals to the caller and, in some cases, prepared referral letters reporting misconduct to federal and state regulators. The IRC has opened 50 matters under formal retainer agreements and filed 11 arbitrations. It has recovered over $600,000 for investors. Importantly, in cases where the IRC has concluded, after conducting a full review and analysis of the client's account statements and relevant facts, that the client did not have a viable claim, the IRC has counseled its client accordingly. This provides an invaluable service to investors (who are grateful to have had careful review of their potential claims) and their brokerage firms alike.

In addition to assisting small claim investors, law school securities clinics embody the heart of the FINRA Foundation's mission of providing "underserved Americans with the knowledge, skills and tools necessary for financial success throughout life."[18] The IRC requires its student interns to participate in a financial literacy or outreach project during their semester at the clinic. Since it has opened, the IRC has conducted financial education programs at senior centers, rotary clubs, church organizations, the Goodwill center for vocational training, at colleges and high schools, and other organizations.

As Professor Gross observed in her recent article, *The Improbable Birth and Conceivable Death of the Securities Arbitration Clinic*, there are few other resources that are available to fund securities arbitration clinics. The only "funder awash in tens of millions of dollars slated for investor education and protection" is the FINRA Foundation, and without a shift in its policy, it is highly likely that many of the existing clinics will close, despite the increasing need for investor protection and advocacy.[19] We urge the Task Force to strongly recommend that FINRA reconsider its funding position and provide sustaining financial assistance through the FINRA Foundation.

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[17] Jill Gross, *supra* note 13, at 620-21.

[18] See FINRA Investor Education Foundation's mission and vision. http://www.finrafoundation.org/about/index.htm

[19] Jill Gross, *supra* note 13, at 621.

In conclusion, the IRC would like to again thank the Task Force for the opportunity and privilege to participate in the Task Force's important work and to provide suggestions to improve access to FINRA's process on behalf of investors.

Respectfully submitted,

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