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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79285; File No. SR-FINRA-2016-030)

November 10, 2016

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change to Amend Rule 12504 of the Code of Arbitration Procedure for Customer Disputes and Rule 13504 of the Code of Arbitration Procedure for Industry Disputes Relating to Motions to Dismiss in Arbitration

I. Introduction

On August 3, 2016, Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend Rules 12504 of the Code of Arbitration Procedure for Customer Disputes ("Customer Code") and Rule 13504 of the Code of Arbitration Procedure for Industry Disputes ("Industry Code" and, together with the Customer Code, "Codes").[3] The proposed rule change would allow arbitrators to act upon a motion to dismiss a party or claim prior to the conclusion of a party's case in chief if the arbitrators determine that the non-moving party previously brought a claim regarding the same dispute against the same party, and the dispute was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision.

The proposed rule change was published for comment in the Federal Register on August 17, 2016.[4] The public comment period closed on September 7, 2016. The Commission received

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

2 17 CFR 240.19b-4.

3 See File No. SR–FINRA–2016–030.

4 See Exchange Act Release No. 78553 (Aug. 11, 2016); 81 FR at 54888 (Aug. 17, 2016) ("Notice").

four (4) comment letters on the proposed amendments.[5] On September 19, 2016, FINRA extended the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to November 15, 2016.[6] On October 31, 2016, FINRA responded to the comment letters received in response to the Notice.[7] This order approves the proposed rule change.

II. Description of the Proposed Rule Change[8]

Background

In 2009, FINRA amended the Codes to adopt FINRA Rules 12504 and 13504 (Motions to Dismiss), and to amend FINRA Rules 12206 and 13206 (Time Limits), to establish procedures limiting motions to dismiss in arbitration.[9] A motion to dismiss is a request made to the

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[5] See Letters from Steven B. Caruso, Maddox Hargett Caruso, P.C. (Aug. 11, 2016) ("Caruso Letter"); David T. Bellaire, Esq., Executive Vice President & General Counsel, Financial Services Institute (Sept. 7, 2016) ("FSI Letter"); Hugh Berkson, President, Public Investors Arbitration Bar Association (Sept. 7, 2016) ("PIABA Letter"); and William A. Jacobson, Esq., Clinical Professor of Law, Cornell Law School, Director, Cornell Securities Law Clinic, and Arjun A. Ajjegowda, Student, Cornell Law School (Sept. 7, 2016) ("Cornell Letter"). The comment letters are available on FINRA's website at http://www.finra.org, at the principal office of FINRA, at the Commission's website at https://www.sec.gov/comments/sr-finra-2016-029/finra2016029.shtml, and at the Commission's Public Reference Room.

[6] See Letter from Margo A. Hassan, Associate Chief Counsel, FINRA, to Lourdes Gonzalez, Assistant Chief Counsel – Sales Practices, Division of Trading and Markets, Securities and Exchange Commission, dated September 19, 2016.

[7] See Letter from Margo A. Hassan, Associate Chief Counsel, FINRA, to Brent J. Fields, Secretary, Securities and Exchange the Commission, dated October 31, 2016 ("FINRA Letter"). The FINRA Letter is available on FINRA's website at http://www.finra.org, at the principal office of FINRA, at the Commission's website at https://www.sec.gov/comments/sr-finra-2016-029/finra2016029.shtml, and at the Commission's Public Reference Room.

[8] The subsequent description of the proposed rule change is substantially excerpted from FINRA's description in the Notice. See Notice, 81 FR at 54889-54889.

[9] See Exchange Act Release No. 59189 (Dec. 31, 2008), 74 FR 731 (Jan. 7, 2009) (Order Approving Proposed Rule Change, As Modified by Amendment No. 1 Thereto, Relating to

arbitrators to remove a party or some or all claims raised by a party filing a claim. If the arbitrators grant a motion to dismiss before a hearing is held (a prehearing motion), the party bringing the claim loses the opportunity to have his or her arbitration case heard in whole or in part by the arbitrators. The procedures set forth in the Codes significantly limit the use of motions to dismiss because FINRA believed that respondents were filing prehearing motions routinely and repetitively in an effort to delay scheduled hearing sessions on the merits, increase investors' costs, and intimidate less sophisticated investors.

Among other requirements, the Codes require parties to file prehearing motions to dismiss in writing, separately from the answer, and only after they file the answer.[10] The full panel of arbitrators must decide a motion to dismiss,[11] and the panel must hold a hearing on the motion unless the parties waive the hearing.[12] If a panel grants a motion to dismiss, the decision must be unanimous, and must be accompanied by a written explanation.[13]

Under the Codes, arbitrators cannot act upon a motion prior to the conclusion of the non-moving party's case in chief unless the arbitrators determine that: (1) the non-moving party previously released the claim in dispute by a signed settlement or written release,[14] (2) the moving party was not associated with the account, security, or conduct at issue,[15] or (3) a claim

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Amendment 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) (File No. SR-FINRA-2007-021) ("2009 Order").

10 See FINRA Rules 12504(a)(2) and 13504(a)(2).

11 See FINRA Rules 12504(a)(4) and 13504(a)(4).

12 See FINRA Rules 12504(a)(5) and 13504(a)(5).

13 See FINRA Rules 12504(a)(7) and 13504(a)(7).

14 See FINRA Rules 12504(a)(6)(A) and 13504(a)(6)(A).

15 See FINRA Rules 12504(a)(6)(B) and 13504(a)(6)(B).

is not eligible for arbitration because it does not meet the six-year time limit for submitting a claim.[16]

Furthermore, the Codes impose sanctions against parties for engaging in abusive practices. For instance, if the arbitrators deny a motion to dismiss prior to the conclusion of the non-moving party's case in chief, the arbitrators must assess forum fees associated with hearing the motion against the moving party.[17] Moreover, if they find the motion to be frivolous, they must award reasonable costs and attorneys' fees to a party that opposed the motion.[18] In addition, the arbitrators may issue sanctions under the Codes if they determine that a party filed a motion under the rule in bad faith.[19]

Proposed Rule Change

FINRA is proposing to amend the Codes to add an additional ground for arbitrators to act on motions to dismiss prior to the conclusion of the claimant's case in chief in both customer and industry cases. Currently, FINRA's Director of Arbitration ("Director") can deny use of the forum for customer and industry claims if it is clear that a party is bringing exactly the same claims against the same parties that were already heard at the forum.[20] FINRA states, however, that if there are questions about whether the matter concerns a different claim, the Director is

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[16] See FINRA Rules 12206 and 13206 (Time Limits), which provide that no claim shall be eligible for submission to arbitration where six years have elapsed from the occurrence or event giving rise to the claim.

[17] See FINRA Rules 12504(a)(9) and 13504(a)(9).

[18] See FINRA Rules 12504(a)(10) and 13504(a)(10).

[19] See FINRA Rules 12504(a)(11) and 13504(a)(11); see also FINRA Rules 12212 and 13212 (Sanctions) relating to available sanctions.

[20] See FINRA Rules 12203 and 13303 (Denial of the Forum), which provide that the Director may decline to permit the use of the FINRA arbitration forum if the Director determines that, given the purposes of FINRA and the intent of the Codes, the subject matter of the dispute is inappropriate. FINRA states that the Director rarely invokes this authority.

likely to deny the motion and allow the arbitration to proceed so that the arbitrators can decide the merits of the parties' assertions. FINRA believes that adding the additional ground for arbitrators to act on motions to dismiss is appropriate because parties should not be subject to the legal fees associated with arbitrating claims that have been fully adjudicated in a prior proceeding. FINRA also believes that the proposed rule change would deter parties' use of repeated filings as a means of leverage during settlement negotiations.

Specifically, FINRA is proposing to amend FINRA Rules 12504(a)(6) and 13504(a)(6) to add new paragraph (C) which would specify that arbitrators can also act upon a motion to dismiss a party or claim if they determine that the non-moving party previously brought a claim regarding the same dispute[21] against the same party that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision. For example, FINRA states that the proposed rule change would allow the arbitrators to grant a motion to dismiss relating to a particular controversy if they believe the matter was adjudicated fully even in instances where a claimant adds a new cause of action, or adds additional facts.

III. Summary of Comments and FINRA's Response

As noted above, the Commission received four (4) comment letters on the proposed rule change,[22] and a response letter from FINRA.[23] As discussed in more detail below, two

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[21] FINRA Rules 12100 and 13100 provide that "dispute" means a dispute, claim or controversy, and that it may consist of one or more claims.

[22] See supra note 5.

[23] See supra note 7.

commenters supported the proposal,[24] one generally supported the proposal but recommended modifications,[25] and one opposed the proposal.[26]

Of the two commenters who supported the proposal, one commenter stated that the proposed amendments "would be a fair, equitable and reasonable approach and should be approved by the SEC on an expedited basis."[27] The other commenter stated that the proposal would "appropriately enhance the arbitration process by eliminating claims that have already been heard and decided on the merits in another forum" and would consequently "promote both the integrity and fairness of arbitration proceedings."[28]

Scope of the Proposal

A third commenter generally supported the proposal, stating that "a current ground for dismissal under the present rule, that 'the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release,' and the proposed additional language are in line with the same reasoning: that a final, enforceable resolution has already been reached."[29] This commenter suggested, however, that FINRA should continue to discourage motions to dismiss prior to the conclusion of a party's case in chief. Accordingly, the commenter recommended that FINRA should: (1) clarify that the proposal should be narrowly construed such that it applies to "adjudications on the merits where the non-moving parties have had a full and fair opportunity to argue their claims;" (2) narrowly define the term "same party"

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24 See Caruso Letter and FSI Letter.

25 See PIABA Letter.

26 See Cornell Letter.

27 See Caruso Letter.

28 See FSI Letter.

29 See PIABA Letter (citing FINRA Rules 12504(a)(6)(A) and 13504(a)(6)(A)).

to mean "the specific party named in the previous arbitration;"[30] and (3) stress "the importance of continuing to permit the non-moving party to have a full opportunity to oppose such motion to dismiss, and to present evidence and testimony to the arbitrators on the merits of the motion prior to their decision."[31]

In its response, FINRA stated that it drafted the proposed amendments narrowly, in continued adherence "to the principle 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 would not reject a claim initiated against a related, but previously unnamed party, and that it would be a moving party's responsibility to demonstrate to the arbitrators that such a party is the "same party" for purposes of the proposed rule change. FINRA also expressed its intention to train its arbitrators on the rule change, emphasizing that the moving party must demonstrate that the non-moving party brought the same dispute against the same party and that the non-moving party had a full opportunity to present its claims in the earlier proceeding.[32]

Summary Judgment

One supportive commenter noted that the Codes do not permit a claimant to file a motion for summary judgment, and suggested that this "disparity" be corrected "so that the playing field in the securities arbitration arena is level and equal for all of the participants in the forum."[33]

In its response, FINRA stated that it limited the grounds on which motions to dismiss could be filed based on the belief that some respondents were filing prehearing motions

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[30] The commenter argues that "without clarification, a claimant might be improperly precluded from pursuing claims against respondents not originally named in an adjudicated case." See PIABA Letter.

[31] See id.

[32] See FINRA Letter.

[33] See Caruso Letter.

"routinely and repetitively in an effort to delay scheduled hearing sessions on the merits, increase investors' costs, and intimidate less sophisticated investors." FINRA asserted that the rules were "designed to deter the inappropriate use of dispositive motions, not to provide respondents with a new vehicle to seek early dismissal of a claimant's claims." Accordingly, FINRA declined to amend the Codes to permit parties to bring motions for summary judgment, as it believes that such an amendment would conflict with its goal of limiting dispositive motions that curtail the opportunity for parties to fully present their cases.[34]

Demonstrated Need for the Proposal

One commenter opposed the proposed rule change, stating that FINRA has not demonstrated a need to broaden the scope of the rule, and that "FINRA has not provided any statistical evidence as to the frequency of repeat claims being brought under circumstances that the Proposed Rule Change would remedy."[35] In addition, the commenter asserted that courts already provide remedies for the alleged problem of repeat filing of claims by enjoining or staying the arbitration proceedings and FINRA has failed to demonstrate that the court remedy is less effective and fair to all parties.[36]

In its response, FINRA asserted that it had demonstrated a need for the proposed rule change. According to FINRA, statistics suggest that the proposed rule change would impact a small number of cases.[37] However, FINRA believes that the proposed rule change would reduce both parties' costs where these motions are granted at an earlier stage in the proceeding, and that

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[34] See FINRA Letter.

[35] See Cornell Letter (expressing no position with respect to the proposed change to FINRA Rule 13504 of the Industry Code).

[36] See id.

[37] See SR-FINRA-2016-030 at page 9. FINRA staff provided the Task Force with statistics for 2013 and 2014.

the rule change would nevertheless allow the non-moving party to present evidence and testimony to the arbitrators concerning the merits of the motion prior to the decision on the motion – thus limiting the risk that arbitrators might act on incomplete or insufficient information. FINRA therefore believes that the benefit of the cost savings to the impacted parties outweighs the commenter's concern regarding the demonstrated need for the proposal.

With regard to the same commenter's suggestion that parties use the courts to address the issue of repeat filings, FINRA stated that parties "would be better served by having issues relating to the earlier adjudication of a dispute resolved in the forum where the claimant chose to initiate the arbitration proceeding." According to FINRA, "[t]he moving party should not have to seek a remedy in a separate court proceeding, and the non-moving party should not be subject to additional litigation costs outside of the arbitration forum." FINRA stated that "this is especially important for *pro se* investors," who might be unable to argue the law in court without counsel. Accordingly, FINRA believes that "forcing [*pro se* investors] into a court proceeding might preclude them from pursuing their claims."[38]

IV. Discussion and Commission Findings

The Commission has carefully considered the proposal, the comments received, and FINRA's response to the comments. Based on its review of the record, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities association.[39] In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the

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[38] See FINRA Letter.

[39] In approving the proposed rule change, the Commission has also considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

Exchange Act,[40] which requires, among other things, that FINRA's rules 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.

As discussed above, the proposal would amend Rules 12504(a)(6) and 13504(a)(6) to add new paragraph (C), allowing arbitrators to also act upon a motion to dismiss a party or claim if they determine that the non-moving party previously brought a claim regarding the same dispute against the same party that was fully and finally adjudicated on the merits and memorialized in an order, judgment, award, or decision. The proposed rule change would allow the arbitrators to grant a motion to dismiss relating to a particular controversy if they believe the matter was adjudicated fully even in instances where a claimant adds a new cause of action, or adds additional facts.

The Commission has considered the four (4) comment letters received on the proposed rule change,[41] along with FINRA's response to the comments.[42] The Commission acknowledges commenters' beliefs that the proposed rule change "would be a fair, equitable and reasonable approach,"[43] that it would promote the "integrity and fairness of arbitration proceedings" by "eliminating claims that have already been heard and decided on the merits in another forum,"[44] and that the proposal was in line with the reasoning of the current rule – "that a final, enforceable

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40 15 U.S.C. 78o-3(b)(6).

41 See supra note 5.

42 See supra note 7.

43 See Caruso Letter.

44 See FSI Letter.

resolution has already been reached."[45] However, the Commission also recognizes commenters' concerns and opposition to the proposal.[46]

Scope of the Proposal

The Commission agrees with a commenter's concern that the proposed rule change should be applied narrowly, where a claim has previously been adjudicated on the merits against the same party, and the non-moving party has had a full and fair opportunity to argue their claims in opposition to the motion to dismiss.[47] However, the Commission believes that FINRA has drafted the proposed rule change narrowly, so as to discourage the filing of motions to dismiss except in these limited circumstances. The Commission also recognizes FINRA's stated effort to help ensure that claims initiated against related, but previously unnamed parties will not be rejected, as well as its stated effort to train arbitrators on the rule change. The Commission believes that FINRA's response should address the commenter's concerns.[48]

Summary Judgment

The Commission also recognizes a commenter's suggestion that the FINRA Codes should permit parties to file motions for summary judgment.[49] The Commission preliminarily believes that such an amendment would conflict with FINRA's goal of limiting dispositive motions that curtail the opportunity for parties to fully present their cases.[50] The Commission

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45 See PIABA Letter.

46 See supra notes 25-26.

47 See PIABA Letter.

48 See FINRA Letter.

49 See Caruso Letter.

50 See FINRA Letter.

therefore supports FINRA's decision not to expand the scope of the rule change to permit motions for summary judgment.

Demonstrated Need for the Proposal

The Commission further recognizes a commenter's assertion that FINRA has not demonstrated a need for the rule change.[51] However, although few cases might be impacted by the rule change, according to FINRA, the Commission agrees with FINRA's belief that, if implemented properly, the rule change can benefit those parties by reducing their arbitration costs while still allowing the non-moving party to present evidence and testimony concerning the merits of the motion.[52]

With regard to the same commenter's suggestion that parties use the courts to address the issue of repeat filings,[53] the Commission generally supports FINRA's view that the parties should not be required to file a separate court proceeding to seek dismissal of repeat filings, and that such matters would be better resolved in the original arbitration forum.[54]

To note, the Commission additionally recognizes that the FINRA Dispute Resolution Task Force ("Task Force") reviewed the topic of motions to dismiss and recommended that FINRA amend the motions to dismiss rule in customer cases to include one additional category for which motions to dismiss may be made before the conclusion of the case in chief – situations where the dispute was previously concluded through adjudication or arbitration and

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51 See Cornell Letter.

52 See FINRA Letter.

53 See Cornell Letter.

54 See FINRA Letter.

memorialized in an order, judgment, award, or decision.[55] This amendment is consistent with the Task Force's recommendation.

Taking into consideration the comments and FINRA's responses, the Commission believes that the proposal is consistent with the Exchange Act. The Commission believes that the proposal will help protect investors and the public interest by, among other things, providing an additional ground for arbitrators to act on motions to dismiss prior to the conclusion of the claimant's case in chief in both customer and industry cases, while preserving the ability of a non-moving party to present evidence and testimony to the arbitrators concerning the merits of the motion. In addition, the Commission believes that the reasoning for the proposed new ground for dismissal is consistent with the reasoning for an existing ground for dismissal – that "the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release."[56] Furthermore, the Commission believes that FINRA's responses, as discussed in more detail above, appropriately addressed commenters' concerns and adequately explained FINRA's reasons for declining to modify its proposal. Accordingly, the Commission believes that the approach proposed by FINRA is appropriate and designed to

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[55] In July 2014, FINRA formed the Task Force to "suggest strategies to enhance the transparency, impartiality, and efficiency of FINRA's securities dispute resolution forum for all participants." See FINRA News Release, FINRA Announces Arbitration Task Force, dated July 17, 2014, available at http://www.finra.org/newsroom/2014/finra-announces-arbitration-task-force; see also Notice, 81 FR at 54889.

The Task Force ultimately found that FINRA Rules 12504 and 13504 appeared to be working as intended to prevent the filing of frivolous motions to dismiss, but recommended that, in instances where arbitrations involve claims previously adjudicated by a court or arbitrated by an arbitration panel, respondents should be able to seek early dismissal. See FINRA Dispute Resolution Task Force, Final Report and Recommendations of the FINRA Dispute Resolution Task Force, dated December 16, 2015, available at http://www.finra.org/sites/default/files/Final-DR-task-force-report.pdf; see also Notice, 81 FR at 54889.

[56] See FINRA Rule 12504(a)(6)(A); FINRA Rule 13504(a)(6)(A).

protect investors and the public interest, consistent with Section 15A(b)(6) of the Exchange Act and the rules and regulations thereunder.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,[57] that the proposed rule change (SR-FINRA-2016-030) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[58]

Brent J. Fields
Secretary

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[57] 15 U.S.C. 78s(b)(2).

[58] 17 CFR 200.30-3(a)(12).

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