Approved June 23, 2005

Minutes of the March 15, 2005 Meeting of the
Securities Industry Conference on Arbitration
New York, New York

Members Present
Theodore Eppenstein, Public Member
George Friedman, NASD
Constantine Katsoris, Public Member and Chair
George Kramer, SIA
Karen Kupersmith, NYSE
Pat Sadler, Public Member
Steven Sneeringer, A. G. Edwards & Sons, Inc.
Jim Yong, National Stock Exchange

Members Participating by Phone
Linda Fienberg, NASD
Jim Flynn, CBOE
Matt Mennes, Pacific Exchange

Invitees Participating in Person or by Phone
David Blass, SEC
Heather Cook, National Futures Association
Lourdes Gonzalez, SEC
Paula Jenson, SEC
Gena Lai, SEC
Helene McGee, SEC
Kenneth Meister, Prudential Equity Group

SIA Invitees Present
Michael Alford, Raymond James
Clay Grumke, A. G. Edwards & Sons, Inc.
Edward Turan, Citigroup
Andrew Weinberg, CSFB

Guests
Richard Berry, NASD
Barbara Brady, NASD
Rose Seeman, NASD

The Securities Industry Conference on Arbitration ("Conference" or "SICA") convened on March 15, 2005 at 9:30 a.m., Professor Constantine Katsoris, Chair, presiding. We were joined by the SIA Arbitration Committee delegation at noon.

Approval of Minutes of January 12, 2005 Meeting [Tab 1]

Mr. Friedman pointed out technical amendments. Further amendments by Mr. Eppenstein were proposed and unanimously approved. Mr. Friedman agreed to finalize and distribute the minutes.

Changes to SICA's Arbitrators' Manual on Witness Attendance [Tab 2]

The Conference considered a proposal by Mr. Eppenstein and supported by the Subcommittee to amend the SICA Arbitrators' Manual to permit an investor to have an additional fact witness or family member present at their hearing.

The Conference members discussed how to best design this amendment in such a way that would allow an investor the added support of bringing a fact witness or family member to their hearing, without placing an undue burden upon the respondent, or limiting the scope of the arbitrators' authority to make the ultimate decision on a case-by-case basis. After a full discussion, the Conference unanimously agreed upon the following change:

Attendance of Witnesses at the Hearing

Arbitrators will always have the authority under the Uniform Code to determine who may attend the hearing. Parties must be allowed to attend the hearing. A corporate party may designate a representative as it may choose, whether or not that representative is going to be a fact witness.

Sometimes there is disagreement among the parties as to whether an expert witness should be permitted to attend. Arbitrators should consider that expert witnesses often serve an important role in assisting parties and their counsel in the presentation of their cases, and may also be asked to testify about what has been said at the hearing, in addition to facts known to them prior to the hearing. Absent persuasive reasons to the contrary, there is a presumption that expert witnesses, as opposed to fact witnesses, should be permitted to attend the entire proceedings.

Absent persuasive reasons to the contrary, and subject to the discretion of the arbitrators, the investor party should be permitted to designate one individual to attend the hearing, as there are many instances where an investor wishes to have a spouse, son or daughter, accountant, or other fact witness attend. These people can provide added support to the investor party, and can also provide valuable assistance when hearing the testimony of fact witnesses.

Designations should be made before the hearings start.

Result: Mr. Friedman said that NASD would take responsibility for updating the print and Web versions of the Arbitrators' Manual.

Peremptory Challenges for Arbitrator Appointments [Tab 3]

Mr. Eppenstein proposed a change to the Uniform Code that would allow each party one peremptory challenge per case for any arbitrator "administratively appointed" by the SRO. Mr. Friedman informed the Conference that NASD had, as part of its Code of Arbitration simplification rule filing with SEC, proposed to expand the list of arbitrators presented to parties from 5 to 7 names per category (public, non-public, and chair-public), with a limited number of strikes. He said this amendment was intended to reduce the number of "administrative appointments" of arbitrators.

Chairman Katsoris stated that he supported Mr. Eppenstein's proposal. The Conference also discussed how much time a party should have to exercise its peremptory challenge, and the effect of a peremptory challenge on a scheduled hearing date). These issues were not resolved.

Result: Mr. Eppenstein's proposal passed 5- 0, with three abstentions. Mr. Friedman said that he would make the change to the Uniform Code, and distribute the revised version to the members. Chairman Katsoris appointed a Subcommittee to be headed by Mr. Sadler, and consisting of Ms. Brady, Mr. Eppenstein, Mr. Flynn, Ms. Kupersmith, Mr. Mennes, and Mr. Meister to review the arbitrator roster and removal issues outlined above. Chairman Katsoris requested that Item 4 and Item 10 be tabled until the June SICA meeting so that the Subcommittee can share their recommendations with the Conference.

Review of Temporary and Permanent Arbitrator Removal Criteria [Tab 4]

Mr. Eppenstein proposed that the Uniform Code be revised to provide for arbitrator removal criteria for non-disclosure and alleged misconduct. but Professor Katsoris was very concerned that Mr. Eppenstein's proposals regarding the Review of Temporary and Permanent Arbitrator Removal Criteria (Tab 4) and Removal of Sitting Arbitrators (Tab 10) would create an unfair standard for arbitrators that could potentially reduce the number of neutrals willing to serve on SRO panels. This issue was tabled until the June meeting, pending review by the Subcommittee.

SIA Proposal on Responsible Pleading Practices [Tab 5]

Mr. Kramer said that the Subcommittee was unable to come to a consensus on the issue of whether to require claimants to provide a signed attestation that he or she had made reasonable efforts to properly name respondents, and withdrew this proposal. He reported that the Subcommittee agreed that it would be a positive step to prepare and distribute educational materials to investors concerning expungements and responsible pleadings.

Result: Mr. Kramer will work with the Subcommittee on drafting the educational materials cited above and will present them to the Conference at its June meeting.

Expedited Suspension Proceeding [Tab 6]

Mr. Friedman said that NASD has been working with the SEC to develop a rule that would have NASD assume the role of "SRO of last resort" meaning NASD would take on the additional responsibility of handling expedited suspension procedures for non-payment of awards in cases where an industry party was no longer subject to the jurisdiction of the SRO that issued the award, but was still subject to NASD's jurisdiction. He said, however, that a comprehensive solution would require that all SROs with arbitration programs have expedited suspension

procedures for non-payment of their awards. SICA ultimately approved a resolution encouraging SROs to adopt expedited suspension procedures for non-payment of awards issued by their forum.

Result: By a unanimous vote, SICA adopted a resolution encouraging all SROs with arbitration programs to adopt expedited suspension procedures for non-payment of that SRO's arbitration awards.

NASD Update on Out of State Attorneys [Tab 7]

Mr. Friedman reported that the NASD Dispute Resolution Board, at its November 17, 2004 meeting, approved a rule amendment to the NASD Code of Arbitration Procedure providing in essence that, if a party elects to have a paid representative, that person must be admitted to practice law somewhere in the United States. Mr. Friedman noted that this rule was not intended to preempt state law.

Conference members discussed whether further action from SICA was necessary in light of recent court rulings in Florida and Ohio which effectively bar multi-jurisdictional practice of law with respect to arbitration. Mr. Sadler requested that the issue of non-attorney representation in arbitration also be addressed.

Result: Chairman Katsoris appointed Mr. Friedman to chair a Subcommittee consisting of Mr. Eppenstein, Mr. Kramer, Ms. Kupersmith, and Mr. Mennes, to look into the issue of multi-jurisdictional practice and non-attorney representation in arbitration and report back at the June meeting.

Arbitration of Employment Disputes, Effect of U-4, Subsequent Agreement and Recent New York Court of Appeals Case [Tab 8]

Mr. Eppenstein discussed the recent decision of the New York Court of Appeals, which held that brokerage firms are free to establish ADR procedures that supersede the arbitration language contained in the standard securities self-regulatory registration agreement, Form U-4.

Chairman Katsoris appointed a Subcommittee to be chaired by Mr. Eppenstein and consisting of Mr. Friedman, Mr. Kramer, Ms. Kupersmith, and Mr. Sneeringer to look at this issue further. The Subcommittee will also explore the issue of whether an employee should be able to require arbitration of statutory employment disputes where there is no underlying arbitration agreement.

Result: The Subcommittee will report on their findings at the June meeting.

Update on Independent Survey [Tab 9]

Mr. Friedman updated the Conference on the work of the Subcommittee, consisting of himself, Kenneth Andrichik (Senior Vice President and Director of Mediation - NASD), Chairman Katsoris, and Ms. Kupersmith.

Mr. Friedman informed the Conference that the Subcommittee has chosen Professors Barbara Black and Jill Gross of Pace University School of Law Investor Rights Project to administer the survey on the perceptions of fairness between SRO arbitration and litigation. They hope to have

this survey completed by the end of the year. He said that the Subcommittee is currently working on designing the questionnaire for the study.

Result: The Subcommittee will report progress on this initiative at the June meeting.

Removal of Sitting Arbitrators – Section 19-D of the SICA Code [Tab 10]

This issue was tabled until the June meeting, pending review by the Subcommittee (see discussion of Item 3, above).

Explained Arbitration Awards [Tab 11]

Ms. Fienberg discussed amendments to Rule 12904 of the Customer Code and Rule 13904 of the Industry Code (pending Code revision), which were filed with the SEC earlier this morning, that would allow customers (whether as claimant or respondent) or associated persons (in an industry claim, whether as claimant or respondent) to require arbitrators to provide explained decisions. She told the Conference that this rule would add transparency to the process and would address a common criticism of SRO arbitration.

Several industry members expressed their concern that this rule would result in more motions to vacate arbitration awards. Chairman Katsoris distributed an article he wrote in the current issue of the Securities Arbitration Commentator, which outlines his opposition to the rule. Ms. Fienberg pointed out that after the SEC publishes the rule filing, there would be a comment period in which he and others could air their concerns.

Update/Statistics on NASD Pilot Procedures for Elderly/Infirm/Terminally Ill Parties [Tab 12]

Mr. Berry reported on the status of the pilot program to expedite arbitration proceedings for elderly, infirm, and terminally ill parties. He said that anecdotal evidence suggested that it is going well, but there was not enough meaningful data available to present to the Conference at this time.

Result: Mr. Berry will update the Conference on this program again at the June meeting.

NASD Update on Direct Communication Rule [Tab 13]

Mr. Berry reported on the status of the Direct Communication Rule. He said that at this time it appears that about 20% of all parties have opted to participate in the program. He added that NASD now has a better tracking mechanism for parties who choose to participate and he will be able to furnish the Conference with more accurate statistics at the June meeting. Ms. Kupersmith said that, providing the arbitrator agrees to it, the NYSE allows direct communication, It doesn't have a formal pilot program, however.

Result: Mr. Berry will update the Conference again at the June meeting.

Report on Law School Securities Clinics [Tab 14]

Chairman Katsoris reported that Fordham hosted a meeting for representatives of Law School Securities Clinics last February. Mr. Friedman added that Northwestern Law School had recently started a program, using seed money from NASD's Investor Education Fund.

Update on 13th SICA Report [Tab 15]

Chairman Katsoris reported that he is working on preparing SICA's 13th Report. He expects to have it published by the end of the year.

SRO Case Filing Statistics for 2003 and 2004 [Tab 16]

Ms. Kupersmith reported that she is in the process of collecting this data and she would distribute it shortly.

California Arbitration Ethics Standards Update [Tab 17]

Mr. Friedman informed the Conference that NASD and NYSE won the 9th Circuit *Grunwald* case pertaining to the issue of arbitrator disclosure standards. He said that a similar case, *Jenve*, was currently being heard before the California Supreme Court and that a decision was expected before June 6, 2005.

Cases and Articles of Interest [Tab 18]

No discussion.

New Business [Tab 19]

There was no new business reported.

Schedule of Future Meetings [Tab 20]

- June 23, 2005 at Fordham Law School in New York.
- October 11, 2005 at CBOE in Chicago

There being no further business, the meeting adjourned at 2:10 p.m.

Respectfully submitted by:
Rose Seeman

Memorandum

To: SICA

From: NASD Dispute Resolution

Date: February 27, 2005

DISCUSSION ITEM

Issue: Independent Research on Fairness of SRO Arbitration

Background

In July 2002, the SEC retained Professor Michael Perino to assess the adequacy of NASD and NYSE arbitrator disclosure requirements, and to evaluate the impact of the recently adopted California Ethics Standards on the SRO's current conflict disclosure rules.

The Perino Report, released on November 4, 2002, recommended several amendments to SRO disclosure and related rules that, according to the Report, might "provide additional assurance to investors that arbitrations are in fact neutral and fair."

SICA and the SROs have already acted on the Perino Report's recommendations to improve the rules as to arbitrator classification and disclosure requirements. However, the Report also recommended that the SROs sponsor a survey to gauge user perceptions of the arbitration process. Specifically, the Report stated:

> **Sponsor Independent Research to Evaluate Fairness of SRO Arbitrations.** Given the unquestioned significance of securities arbitrations, it is crucial that the SROs resolve any lingering concerns about pro-industry bias. To date, available empirical evidence, particularly with respect to investor perceptions of the arbitration process, is fairly limited and only suggests that there are no substantial systemic problems in SRO arbitrations. As a result, this Report recommends that the SROs sponsor additional independent studies to further evaluate the impartiality of the SRO arbitration process.

SICA formed a Task Group (consisting of George Friedman, Tom Stipanowich, Constantine Katsoris, Karen Kupersmith, and Kenneth Andrichik) to define the scope of the study and to select a vendor to perform the research. The Task Group determined that the survey should be conducted under SICA's auspices and should have two major parts:

1) Perceptions of parties and attorneys who have used the SRO arbitration process; and

2) A quantitative analysis of outcomes in arbitration as compared to litigation.

In May 2004, the Task Group reviewed the proposals submitted by three vendors to conduct this survey and decided to revise the bid notice to add a request to attempt a

comparison of **perceptions** of fairness between SRO arbitration and litigation. Each vendor responded to the revised bid notice and the Task Group. Two vendors proposed similar approaches that met the requirements but one of the bids was substantially lower in cost.

Update

At its December 2004 meeting, SICA approved the Task Group recommendation to select the proposal submitted by Professors Barbara Black and Jill I. Gross of Pace University School of Law.

The proposal from Pace University School of Law includes three parts:

1) A survey of individuals who have previously participated in arbitration arising out of a customer dispute before the NASD or NYSE;

2) Interviews of parties and/or their representatives to elicit responses as to their experiences with, perceptions of, and critiques of the SRO arbitration forums; and

3) Research of print material on the fairness of SRO arbitration.

The professors have agreed to strive to complete their research and deliver a report of their findings within the 2005 calendar year.

The cost of the Fairness Study of SRO Arbitrations will be $52,000, to be split equally by NASD and the NYSE. NASD is developing a contract to define the responsibilities of the vendor and to outline the intended use of the survey results.

The first assignment for the vendor will be to design the survey instrument. Toward that end, Chairman Katsoris added to the Task Group Pat Sadler, Steve Sneeringer, and Romaine Gardner. SICA, guided by the Task Group, will exercise editorial control over the final survey questions to ensure that the results are perceived to be truly independent. The Task Group will continue to report progress on this initiative.