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Minutes of the January 12, 2006 Meeting of the
Securities Industry Conference on Arbitration
New York, New York

Members Present
Peter Cella, Public Member
Theodore Eppenstein, Public Member
Jim Flynn, CBOE
Linda D. Fienberg, NASD
George Friedman, NASD
George Kramer, SIA
Constantine Katsoris, Public Member and Chair
Karen Kupersmith, NYSE
Kenneth Meister, Prudential Securities

Members Participating by Phone
Matthew Mennes, Pacific Exchange

Invitees Participating in Person or by Phone
Mary Ann Gadziala, SEC
Lourdes Gonzalez, SEC
Paula Jenson, SEC
Gena Lyia, SEC
Helene McGee, SEC
Elizabeth Sheridan, National Futures Association
Patricia Struck, NASAA

Guests:
Kenneth Andrichik, NASD
David Blass, SEC
Richard Berry, NASD
Barbara Brady, NASD
Joe Borg, NASAA
Jean Feeney, NASD
Jill Gross, Pace Law Securities Clinic
Bryan Lantagne, NASAA
Rose Seeman, NASD

The Securities Industry Conference on Arbitration ("Conference" or "SICA") convened on January 12, 2006 at 8:30 a.m., Professor Constantine Katsoris, Chair, presiding.

Approval of Minutes of October 11, 2005 Meeting [Tab 1]

With the addition of some technical amendments submitted by Mr. Eppenstein, the minutes were approved unanimously by the Conference. Mr. Flynn to finalize and distribute.

Changes to SICA Temporary and Permanent Removal Criteria [Tab 2]

Mr. Eppenstein requested that this item should be encompassed into the larger issues addressed in Petition for SEC Rulemaking [Tab 5].

Independent Survey Subgroup [Tab 3]

Professor Jill Gross joined the meeting as a guest to discuss the survey that she and Professor Barbara Black, of Pace Law School, have been commissioned by SICA to administer on the perception of fairness in securities arbitration.

Professor Gross discussed in detail the methodology used in determining the content of the questions. Some Conference members were concerned that the data mined from the survey would be more substantive if the participants were asked to look at a broader range of arbitrations, as opposed to only their last experience in the forum. The Conference reviewed the draft of the survey, and after a lengthy discussion there were some technical amendments made to the draft. The survey appears to be on track to be released by summer 2006.

Result: Professors Black and Gross will incorporate SICA's suggestions and present a new draft of the survey to the Conference before its March meeting. The survey will be presented as a SICA survey, administered by Pace Law School. The Subcommittee will meet before the meeting to resolve any remaining issues.

DISCUSSION ITEMS

Single Securities Arbitration Forum [Tab 4]

Mr. Mennes discussed the issue of multiple SRO securities arbitration forums and whether such a structure was still necessary in light of the fact that NASD administers the vast majority of securities arbitrations.

Chairman Katsoris cited a Coopers & Lybrand study from the early 1990s, which found that multiple SROs encouraged competition that in turn leads to better case administration. He acknowledged that the look of securities arbitration had changed substantially since the time of that study and that the issue merited further consideration.

Result: Chairman Katsoris appointed a Subcommittee consisting of Mr. Friedman and Mr. Eppenstein as co-chairs, along with Mr. Andrichik, Mr. Flynn, Mr. Kramer, Ms. Kupersmith, Mr. Meister, Mr. Mennes, and Ms. Struck. They will meet before the March SICA meeting to discuss their findings.

Petition for SEC Rulemaking [Tab 5]

SICA reviewed the two petitions for rulemaking received by the SEC from Les Greenberg and Avery Goodman, and the subsequent letter dated August 19, 2005 from SEC's Catherine McGuire asking that SICA evaluate the proposals. The proposals fall into two broad categories: arbitrator training and an appeal process for reviewing SRO decisions on arbitrator classification or challenges. Mr. Eppenstein informed the Conference that the Subcommittee (described below) had met before the meeting; they evaluated the issues and had recommendations.

Mr. Greenberg's petition and the determinations of the Conference are as follows:

Arbitrators should be allowed to conduct independent legal research and that SROs should not restrict same: SROs were opposed to this proposal on the grounds that the role of the arbitrator is not the same as a judge in a litigation and SROs would be limited in their ability to regulate such research. However, some Conference members were concerned that we not appear to be restricting the arbitrators' ability to use whatever resources they deem necessary to make the best decision in the case before them. The Conference agreed that the Subcommittee should review the existing SICA Arbitrators' Manual and the Guide to Arbitration to clarify when such research would be permitted (for example, looking up cases cited in briefs).

The elimination of the industry arbitrator or that, in the alternative, the industry arbitrator be required to disclose to the parties any information he or she presents to the other arbitrators in deliberations: These issues will be taken up by the task force reviewing classification. They will be reviewing a proposal to eliminate classification; PIABA's proposals on arbitrator classification and definitions; and the work of NASD's Neutral Roster Task Force.

SROs with arbitration programs should conduct party evaluations and peer evaluation (on a mandatory basis): The SROs all reported that they have existing party and peer evaluation programs. Conference members agreed that mandatory peer evaluation was unnecessary, but suggested that the Subcommittee could discuss ways of improving the response rate

Arbitrators would be required to disclose their arbitrator evaluation process: For the reasons cited above, this proposal was determined to be unnecessary.

SROs be required to train arbitrators in applicable substantive law: The Conference determined that it is inappropriate for SROs to provide substantive training for the following reasons: it is up to the parties to bring the case to the arbitrators; training in the substantive law of 50 states would be very difficult and hard to maintain; it would likely be difficult to get a consensus on content; and strict application of the law could be harmful to investors.

SROs include in their predispute arbitration agreements whether their arbitrators are trained in the law and required to follow it. For the reasons cited above, this proposal was determined to be inappropriate.

The SEC specifically oversee whether SROs are following the first 5 proposals: In light of the fact that his proposals have not yet been approved, the Conference determined that any discussion of this proposal would be premature. The SEC currently oversees SRO conduct under approved rules.

Mr. Goodman's petition is as follows:

Claimants be permitted to appeal to an SEC administrative law judge SRO decisions on arbitrator removal or reclassification: Some Conference members supported this proposal for the sake of further transparency of SRO securities arbitration. Mr. Eppenstein asserted that an additional level of appeal was necessary to protect the investing public from arbitrators who fail to disclose pertinent information. Mr. Friedman responded that as Director he is currently permitted by the Code of Arbitration Procedure (the Code) to remove arbitrators for failure to

disclose and that this measure would run counter to the SROs goals for expedient administration of claims. The classification task force will take up this topic.

Result: The Subcommittee, consisting of Mr. Eppenstein and Mr. Friedman (co-chairs), Mr. Flynn, Mr. Kramer, and Ms. Kupersmith will meet to evaluate the remaining proposals, which will be presented as a discussion item at SICA's March 21st meeting. Mr. Berry and Ms. Brady of NASD may serve as alternates for Mr. Friedman.

PIABA Proposals Following October SICA Meeting [Tab 6]

Mr. Sadler discussed the proposals on arbitrator classification received from PIABA following the joint SICA-PIABA meeting last October. The proposals, as embodied by a December 28th letter to Chairman Katsoris from PIABA president Robert Banks, are:

1) Allow the customer the option of having or not having an industry arbitrator on the panel (Uniform Code Rule 16(b)).

2) Require that public arbitrators have no ties to the industry.

3) Increase the single arbitrator threshold to $200,000, with the customer having a choice of opting for three arbitrators in smaller cases.

The Conference engaged in a lengthy discussion on the role of the non-public arbitrator. Messrs. Eppenstein and Sadler said that they had misgivings about the neutrality of the non-public arbitrator and the perception of bias in requiring a non-public arbitrator to serve on three-arbitrator panels. They also questioned the perceived neutrality of the public pool of arbitrators, which they feel allows too much room for ties to the industry. Mr. Eppenstein discussed his reiteration of Chairman Katsoris' 2003 proposal to eliminate classification, so that parties would choose from a "neutral" pool, as opposed to a public and non-public pool of arbitrators.

Ms. Fienberg and Mr. Friedman said that NASD had recently taken measures to further assure the neutrality of their public roster, citing amendments to Rules 10308 and 10312 of NASD Code of Arbitration Procedure, which were intended to ensure that NASD's public roster would be free of significant ties to the securities industry. Ms. Fienberg said that while NASD has taken many positive steps to recruit arbitrators, they were concerned that further narrowing the criteria could result in many otherwise qualified people being removed from their roster. Chairman Katsoris stated that he shared that concern.

Ms. Fienberg also discussed the recent rule proposal by NASD to raise the single-arbitrator threshold to $100,000. She said that the SEC would put out this proposal for comment shortly and that NASD was open to suggestions on refining the rule.

Result: The Chairman formed a subcommittee to review the proposals, consisting of Mr. Eppenstein and Mr. Meister, co-chairs, Ms. Brady and Ms. Feeney from NASD, Ms. Jenson, Ms. Kupersmith, and Ms. Struck (NASAA).

Arbitration of Employment Disputes Subgroup [Tab 7]

Mr. Eppenstein discussed a recent decision of the New York State Court of Appeals, *CIBC v. Pitofsky*, in which the court held that a privately negotiated employment agreement between a broker-dealer and its employee, requiring that employment disputes be administered by a non-SRO arbitration forum, superseded an earlier U-4 Agreement requiring SRO arbitration.

Mr. Eppenstein is concerned that this ruling and other recent rulings of a similar ilk can be detrimental to employees who wish to have SRO arbitration for all of their employment disputes. He proposed that SICA adopt a resolution urging the SROs to issue a Notice to Members precluding this practice (similar to NASD Rule 3110 for customer disputes), and that SROs adopt rules similar to SICA Uniform Code of Arbitration Rule 1, allowing an employee to require an arbitration at an SRO irrespective of whether there is an arbitration agreement (i.e., a rule similar to NASD Rule 10301 for customers).

Result: By a vote of 3 in favor 0 opposed, and 4 abstentions (from the SROs), SICA approved a resolution urging the SROs to issue a Notice to Members precluding firms from denying, via a private arbitration agreement, an employee's right to seek arbitration at an SRO; and 2) urging SROs to adopt a rule similar to SICA Rule 1 as described above.

Proposal on Arbitrator Classification [Tab 8]

This topic was encompassed into PIABA Proposals Following October SICA Meeting [Tab 6] and will be reviewed by the Subcommittee convened to review issues of classification.

Electronic Discovery [Tab 9]

The issue was tabled until the March SICA Meeting.

INFORMATION ITEMS

Update/Statistics on NASD Pilot Procedures for Elderly/Infirm Parties [Tab 10]

Mr. Berry updated the Conference on the progress of this program. He said that it has been very effective in expediting the hearings of elderly/infirm parties, with the average processing time for such cases being 12.4 months as opposed to 16.8 months for all hearing-based decisions closed in 2005.

Update/Statistics on Direct Communication Rule [Tab 11]

Mr. Berry reported on the Direct Communication Rule. He said that anecdotal reports were positive but at this time there was no hard data to submit to the Conference. He reminded SICA that NASD intended to do a survey after about a year of experience, and that he will report again at the March SICA meeting.

SRO Reports on Activities and Rule Filings [Tab 12]

NASD and the NYSE reviewed their recent rule filings. Ms. Fienberg announced that Mary Schapiro had been chosen to replace Robert Glauber as President and CEO of NASD when Mr. Glauber's term ends.

Cases and Articles of Interest [Tab 13]

Mr. Meister called SICA's attention to the case of *Episcopal Diocese of Central Florida v. Prudential Securities*, a recent decision of the Florida Court of Appeal. The court ordered bifurcation of an

arbitration, holding that tort claims were not subject to the arbitration clause. Mr. Meister said Prudential might appeal the decision, which he described as very troubling.

Schedule of Future Meetings [Tab 14]

The schedule for the remaining 2006 SICA meetings is as follows:

- March 21, 2006 at SIA Compliance & Legal Annual Meeting (Hollywood, FL)
- June 13, 2006 at NYSE (New York)
- October 25, 2006 at PIABA (Tucson, AZ)

With respect to the March 21st meeting at the SIA meeting, Mr. Kramer suggested we might switch to March 20th, so SICA members could attend the arbitration related panels on March 21st. In the end, this proved to be problematic. However, the group agreed that the already scheduled March 21st meeting will start at noon (instead of at 8:30) and run until 4 or 5 in the afternoon. The meeting will start with a joint lunch with the SIA delegation.

New Business [Tab 15]

No discussion.

There being no other business, the meeting adjourned at 2:42 p.m.

Respectfully submitted by:
Rose E. Seeman

REPORT ON SICA FAIRNESS SURVEY

By: J. Pat Sadler
January, 2006

On December 13, 2005, I met with Jill Gross and Barbara Black at Pace University Law School in White Plains, NY to discuss (1) the NASD's proposed changes to the first draft of the Securities Arbitration Fairness Survey, and (2) the proposed changes upon which SICA members reached a consensus at our October, 2005 meeting.

There were a number of the proposed changes with which Professors Black and Gross did not agree. This report will summarize the December 13 meeting. Professor Gross will attend a portion of the January 12, 2006 SICA meeting to further discuss the issues regarding survey questions.

Preamble: Professors Black and Gross feel strongly that the Pace Investor Rights Project should be identified as jointly conducting the survey with SICA. They pointed out that when the survey was first proposed to them, it was not mentioned that SICA would be involved in the project. Also, the Request for Proposal sought a "vendor" to conduct the study, and mentioned only that SICA would "retain editorial responsibility to approve the final version of any survey questions," not that SICA would conduct the study itself.

Procedural and Formatting Issues: The professors pointed out that the survey has not yet been formatted, and that formatting will accomplish many of the procedural (non-substantive) comments, particularly those in the NASD comments.

Preamble: SICA questioned whether repeat counsel could answer the survey on the basis of only their most recent case. Professors Black and Gross believe that this instruction is important as they are not trying to get general impressions, and they believe recent experience is best recalled. Survey science teaches that studies should endeavor to eliminate memory bias

generated by "impressions," and focus the survey respondent instead of the most recent experience. Statistically, the law of averages shows that a "terrible" recent experience will smooth out against a "great" recent experience.

Question 2. SICA suggested adding choice "F." "No, I was represented by a law school legal clinic." Professors Black and Gross think that this is unnecessary since representation by a law school clinic equals representation by a lawyer.

Question 5. NASD suggests that answer 5(a) may be unnecessary. Professors Black and Gross believe that it is needed as Question 5 feeds from Question 2 and can be answered by parties, as well as by party representatives/attorneys.

Questions 6 & 7. SICA suggested omitting these questions as arbitrations are almost always mandated by arbitration clauses. Professors Black and Gross would like to leave these in, as mandatory arbitration clauses are sometimes not present or are waived.

Questions 7 & 8. NASD suggested inviting a free writing section if answer "F" is selected for Question 7 or "G" is selected for Question 8. Professors Black and Gross indicated that the survey is not designed for free writing and that additional detail will come from telephone follow up.

Questions 10 & 12(b). SICA suggested adding "including punitive damages, excluding attorneys fees, interest, and costs" to these sections. Professors Black and Gross agreed with the suggestion to define more clearly the term "damages," but will define it to exclude punitive damages, attorneys fees, interest and costs.

Questions 11(a) & (b). NASD suggested wording changes (i.e., a single arbitrator as opposed to one arbitrator). Professors Black and Gross believe the original wording is more clear and better utilizes plain English.

Question 14(a). NASD questioned whether the survey should ask whether the award

was unanimous. Professors Black and Gross believe this information isn't helpful to the issue of perception of fairness.

Question 14(b). NASD and some SICA members suggested using the term "non-public arbitrator" instead of "industry arbitrator." Professors Black and Gross say that testing indicates that customers are confused by the term "non-public" and that "industry" is more clear to potential survey respondents. However, they agreed to add a definition of that term earlier in the survey to make it clearer.

Question 15. SICA suggested adding the words "at any time during the dispute" so that the question would be worded the same as 14(d). Professors Black and Gross agreed with this suggestion.

Question 15. NASD suggested changing the question to apply to "any" of the public arbitrators. Professors Black and Gross agreed with the suggestion.

Preamble to Questions 16-34. SICA suggested substituting the word "were" for the word "appeared." Professors Black and Gross believe that the suggested change could discourage participation as potential respondents might feel incompetent to answer.

Questions 24-27. SICA inquired as to the use of negative language in these questions. Professors Black and Gross respond that some questions contain positive language, and some contain negative language so as to discourage respondents from answering mindlessly.

Questions 35, 35a, 35b. SICA suggested broadening the comparison from securities disputes to all civil non-matrimonial, non-custodial civil court cases. Professors Black and Gross note that the original request for proposal did not request any comparison of arbitration vs. court experiences. They believe these questions seek to compare apples to oranges and are unlikely to yield any useful data.