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December 18, 2007

VIA FACSIMILE: (202) 225-0182

The Honorable Barney Frank
House Committee on Financial Services
2252 Rayburn House Office Building
Washington, D.C. 20515-2104

Re: What the SEC's Division of Market Regulation Does to Keep Securities Arbitration Rules Unfriendly to the Investing Public

Dear Congressman Frank:

Since early 2005, I have made several Freedom of Information Act ("FOIA") requests to the SECURITIES AND EXCHANGE COMMISSION ("SEC") to learn why the SEC has not promulgated arbitration rule changes to make securities arbitration equitable. I have obtained most of the documents described herein from the SEC in response to those FOIA requests. I am currently engaged in litigation with the SEC based upon allegations that the SEC Staff unreasonably delayed acting upon my Petition for Rulemaking # 4-502, which seeks various improvements to the securities arbitration process. The following information summarizes the results of my investigation.

Overview

The Staff of the SEC has essentially established what one could consider "underground" regulations that were not vetted with the public and essentially nullify SEC General Rule 192(a).¹ Rule 192(a) requires the SEC Staff to make recommendations on Petitions for Rulemaking ("Petitions") to the SEC Commissioners, without unreasonable delay. The SEC Staff (Division of Market Regulation ["MR"]) has, in practice, rewritten Rule 192(a) to require that it first send all Petitions proposed by the investing public ("public Petitions") to self-regulatory organizations ("SROs") for

¹ SEC Rule 192(a) states, "Any person desiring the issuance, amendment or repeal of a rule of general application may file a petition with the Secretary. ... The Secretary shall ... refer it to the appropriate division or office for consideration and recommendation. Such recommendations shall be transmitted ... to the Commission for such action as the Commission deems appropriate." (Emphasis added.)

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recommendations, but does not set a return deadline. If the SROs fail to take up the public Petitions, the SEC Staff takes no action and feels that it is not bound by the provisions of Rule 192(a). Prior to referring the public Petitions to the SROs, SEC Staff knows that the proposals are anathema to the SROs. In the interim, no investor friendly securities arbitration rule change of major importance comes before the SEC Commissioners and the investing public continues to receive mediocre justice in securities disputes resolved before forums sponsored by SROs.

SEC Staff, In Practice, Has Abrogated SEC Rule 192(a) and Delegated Its Securities Arbitration Rulemaking Duties to the SROs

The SEC receives proposals concerning securities arbitration rules from two sources --- (1) SROs, *e.g.*, NEW YORK STOCK EXCHANGE ("NYSE"), NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. ("NASD"), and (2) the public. Public Petitions seek rule changes beneficial to public investors, *e.g.*, prohibit securities broker-dealers from requiring investors to accept pre-dispute arbitration agreements as a condition of opening an account.² Generally, public Petitions are based upon allegations of improper conduct by SROs during the securities arbitration process and/or seek rules that run counter to the financial interests and/or preferences of SROs and the securities industry. Rule 192(a) requires the SEC Staff (Division of Market Regulation) to make recommendations to the SEC Commissioners concerning public Petitions. SEC Staff should make recommendations in a timely manner. Congress has not specified an exact timeframe, but action should not be unreasonably delayed. However, the actions of SEC Staff described herein constitute a pattern of bad faith, which constitutes *per se* unreasonable delay.

Prior to 1998, the SEC Staff, in practice, abolished Rule 192(a) by delegating its securities arbitration rulemaking duties to the SROs. SEC Staff forwards public Petitions to the SROs (acting under the guise of the Securities Industry Conference on Arbitration ["SICA"]) for its advice and recommendations and takes no further action unless and until SROs file proposed rule changes that are supposedly based upon the proposals contained in public Petitions.³ SEC Staff does not impose a time within which the SROs

² "In 1988, MR (SEC Division of Market Regulation) forwarded a legislative proposal to the Commission that would have prohibited broker-dealers from requiring customers to sign predispute arbitration agreements as a condition of opening brokerage accounts. ... MR withdrew its legislative proposal...." (SEC Oversight of Self-Regulatory Organization Arbitration [Audit 289] August 24, 1999.)

³ "Under the Commission's rules of practice, when any person submits a petition to the Commission for issuance, amendment or repeal of a Commission rule, it is referred to the Division ... having general responsibility for or oversight of the particular subject matter implicated by the rule. The staff of that Division considers the petition, collects relevant information, and makes a recommendation to the Commission on the action that the Commission should take regarding the petition. ... The Commission has

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are required to render recommendations and/or to seek related rule changes. The SEC Staff makes no recommendation to the Commissioners while awaiting action by the SROs. Obviously, the SROs do not hasten to endorse recommendations or seek rule changes that would impair their financial best interests or contradict their existing rules.

The practical result is that SEC Staff has never made any recommendation concerning securities arbitration to the Commissioners in response to a public Petition. SEC Staff has used referrals to SICA and the SROs as a method to avoid its obligations under SEC General Rule 192.

SICA Is Controlled by the Securities Industry, and SEC Staff Is Aware of and Supports SICA's Members' Conflicts of Interest

SICA is a securities industry dominated group. The NYSE and NASD formed SICA in 1978, in response to and at the prompting/behest of the SEC in lieu of an advisory committee on securities arbitration, which the SEC initially contemplated forming for itself. The vast majority of SICA's members are SROs and the SECURITIES INDUSTRY ASSOCIATION ("SIA"), which brings together the shared interests of nearly 600 securities firms to accomplish common goals. SICA has had three or four "public members." Replacement "public members" may be nominated by other "public members," but only with the "concurrence" of the SROs, and may be removed by a 2/3 vote of the SROs and SIA members.

The SROs financially control SICA. The NYSE and NASD finance SICA's activities, including associated expenses of the "public members."⁴ The NASD and NYSE selected the vendor of and financed a "Securities Arbitration Fairness Survey" on behalf of SICA.⁵ NASD threatened to withdraw its financial support if the survey

not sought, except in rare circumstances, to require specific SRO rules to be implemented by adopting a Commission rule under Section 19(c) mandating that SROs adopt rules as the Commission directs. Rather, SROs are generally first given the opportunity to review their rules and propose amendments as they deem necessary. ... In accordance with these procedures, we have reviewed PIABA's petition. We have concluded that PIABA's proposed rule amendments should first be considered by the SROs for possible SRO rulemaking. For this reason, we have referred this petition to the Securities Industry Conference on Arbitration (SICA) for consideration and recommendation." (Emphasis in original.) (Letter dated April 28, 1998 from Catherine McGuire, Director, SEC Division of Market Regulation to the PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION.)

⁴ "The public member expense reimbursement policy was discussed. It was determined that the NASD will distribute its travel expense guidelines to public members as a guide to reasonable expenses." (SICA Meeting Minutes 2/6/98.)

⁵ "[N]ASD has one proposal from an outside vendor that has done previous work for NASD. ... [T]he survey should be paid for by NASD and NYSE.... The SROs will narrow down the field of vendors."

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contained "inflammatory" questions, *i.e.*, whether "securities industry" arbitrators should be removed from arbitration hearing panels, whether securities arbitration should be mandatory.⁶ SICA members were not aware of the contractual terms that the NASD had negotiated with the vendor of the survey.⁷

SEC Staff has known that the expressed positions and/or financial interests of the controlling members of SICA conflict with the proposals in public Petitions. SEC Staff has known that the public Petitions allege improper conduct by the controlling members of SICA. SEC Staff has ignored those conflicting interests when referring public Petitions to SICA.⁸

In a letter dated October 9, 1987 to the SEC, from the then "public members" of SICA, the "public members" candidly complained that the SEC Staff ignores issues that the "public members" support. They stated, "For the past ten years ... Staff members of the SEC have been regularly present at SICA meetings, but very little, if any support, (sic) has in the past been given by the SEC to the positions urged by the PMs."⁹

SEC Staff works with SICA to cause the withdrawal of public Petitions. On October 1, 1997, the PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

(SICA Minutes 4/9/03.) "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." (Memorandum from NASD Dispute Resolution to SICA 2/27/05.)

⁶ "Linda Fienberg (President, NASD Dispute Resolution) observed that some of PIABA's suggested questions (e.g., eliminating mandatory arbitration and getting rid of the industry arbitrator) were somewhat inflammatory... She reserved the right to reconsider NASD's participation if the final survey contained such questions." (SICA Meeting Minutes 10/11/05.)

⁷ "Linda Fienberg called participants' attention to an open contractual issue.... Linda Fienberg agreed to provide copies of the contract to interested SICA members." (SICA Meeting Minutes 3/21/06.)

⁸ Petition for Rulemaking # 4-506 seeks to change arbitration rules regarding who would have final authority to disqualify arbitrators hearing disputes between public investors and securities brokerage firms by allowing appeals of disqualification decisions rendered by Directors of Arbitration to an independent SEC Administrative Law Judge. SEC Staff referred the Petition to SICA for recommendations. SICA recognized that the underlying allegation of the Petition is that Directors of Arbitration at SROs are not independent. A Director of Arbitration promptly determined, "[T]his measure would run counter to the SROs goals...." SICA, then, appointed him to co-chair a subcommittee that it assigned to make recommendations. A majority of the members of the subcommittee consisted of Directors of Arbitration of SROs. (SICA Meeting Minutes 10/11/05, 1/12/06, 6/13/06; SEC handwritten notes, 1/12/06.) SEC Staff has not issued a recommendation to the Commissioners pertaining to Petition # 4-506.

⁹ Public Members of SICA letter dated 10/9/87 to SEC (Richard G. Ketchum, Director, MR).

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("PIABA") filed Petition for Rulemaking # 4-403 with the SEC.¹⁰ SEC Staff advised SICA that it would act upon the Petition if SICA did not intervene.¹¹ SICA intervened.¹² SEC Staff requested PIABA to withdraw its Petition, but PIABA refused.¹³ On April 28, 1998, SEC Staff forwarded PIABA's Petition to SICA to seek its recommendations. At the non-public SICA meeting on January 18, 2000, with three (3) SEC Staff members present, "SICA further determined to renew its request that PIABA withdraw its SEC Rule 19(c) rulemaking petition."¹⁴ In December 2007, in response to a FOIA request to produce documents, the SEC was not able to produce any document evidencing the current status of PIABA's Petition.

SEC Staff and the SICA have effectively concealed their intimate relationship from public view. Access to SICA's meetings and minutes of those meetings are not available to the public. Several members of SEC Staff have attended and participated in each SICA meeting and serve on some SICA subcommittees or task forces.¹⁵ SEC Staff advised SROs on how best to portray SICA's Report on Non-SRO Arbitration Pilot Program to conceal that the program was a failure.¹⁶

¹⁰ PIABA Petition # 4-403 proposes that investors be permitted to arbitrate disputes before the AMERICAN ARBITRATION ASSOCIATION and that "securities industry" arbitrators be eliminated from some hearing panels.

¹¹ "Mr. Beckley asked the SEC Staff what their procedure would be in the absence of any intervention by SICA. Ms. McGuire stated that the Staff would review the Petition in due course and determine what to recommend to the Commission. Mr. Dubow moved that the SEC be asked to defer consideration of PIABA 19c Petition...." (SICA Meeting Minutes 10/16/97.)

¹² "[A]t the recent quarterly SICA meeting ... October 16 ... SICA members unanimously voted to request postponement of PIABA's petition (now styled Rulemaking Petition, File No. 4-403)." (SICA Letter dated 11/5/97 to MR [Catherine McGuire].)

¹³ "PIABA has now had an opportunity to discuss your request that it withdraw from consideration its three proposed rule changes." (PIABA letter dated 3/2/98 to MR [Catherine McGuire].)

¹⁴ SICA Meeting Minutes 1/18/00.

¹⁵ Memorandum on SICA Governance dated 8/2/06, 3/21/07; SICA Meeting Minutes 10/25/06.

¹⁶ "In the months since the program was instituted not one case has thus far proceeded to arbitration at a non-SRO forum under the pilot program. ... In an effort to determine why eligible parties elected not to participate in the pilot program ... Constantine Katsoris ... was charged with obtaining confidential information from those parties or their counsel. He furnished counsel with a survey form...." (Draft letter and email dated 12/08/00 from SICA to Robert Love, Special Counsel, MR.) "Case filings under the pilot are negligible." (SICA Minutes 1/19/01.) "Here's a summary of the significant SICA items.... SICA Pilot: SICA's questionnaire to counsel/parties asking why they determined not to use the pilot asserts that it is confidential. ... After tedious debate on how to characterize the replies (with the SROs wanting them to be a proxy for widespread joy with the process, and public member Ted Eppenstein asserting that he was privy

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Conclusion

SEC Staff and the SROs have enjoyed a cozy and well-concealed relationship to the detriment of the investing public. For all practical purposes, the SEC Staff has abolished SEC General Rule 192(a) and delegated its securities arbitration rulemaking duties --- on behalf of the investing public --- to the SROs. SEC Staff has totally ignored the conflicts of interest of SICA, an organization controlled by SROs and the securities industry. SROs negatively comment upon and/or fail to seek rules based upon proposals in public Petitions. SEC Staff has never made a recommendation to the SEC Commissioners in response to public Petitions. The reality is that SEC Staff has quietly abrogated SEC General Rule 192(a). SEC Staff operates in bad faith, and, thus, with unreasonable delay in dealing with public Petitions.

I respectfully request a Congressional investigation of the above-described egregious conduct of the SEC Staff, which stifles the legitimate rights of the investing public.

Very truly yours,

LES GREENBERG

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to secret information indicating great woe with the process), I suggested that someone draft a short, flat report that doesn't say too much.... As for the pilot itself, there are rumoured (sic) citings (sic) of a couple of cases, with unclear status or case stage. There may also be a glitch in the statistics...." (SEC Email dated 1/25/01 from Robert Love, Special Counsel, MR, to Catherine McGuire, Director, MR.)