Re: Has NASD Dispute Resolution, which is **NOT** a sponsor of this email, informed you that….? (Part VI)

> "Nobody makes a greater mistake than he who did nothing because he could only do a little."
>
> --- Edmund Burke (1727 – 1797)

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The following are some of the email comments received from arbitrators (**A**) and some of my replies (**LG**). Both have been edited. From time to time, I had some afterthoughts on the subject (**LG [Supplement]**). On other occasions, ideas, which are not in direct response to an arbitrator's comment, are presented for your consideration (**LG [Idea]**) and reply.

## I. Arbitrator Competence and the Selection Process

**A:** I just read #6--comments re: "random" "rotational" and "career arbitrator" issues. Bravo! My first reaction is, all the noise about changes to the arbitrator selection system is just re-arranging the deck chairs on the Titanic--when what's needed is more lifeboats. Nobody can be sure of getting a just result in an arbitration until the arbitrator selection system is brought out into the sunlight and arbitrator competence, as well as the standards for determining competence, are made public and demonstrable. It seems to me that the reaction you got to your comments about career arbitrators missed the point. Arbitrators who serve on numerous cases would not be a problem if they were known to be competent and unbiased. In fact, that would be a good thing--put the best arbitrators to work. Unless the whole idea behind a "random/rotational/neutral" system is just to rotate in the incompetent, easily swayed or reliably biased arbitrators?

**LG:** You hit the nail on the head. The issue is how best to assure that the arbitrators are "competent and unbiased." There were various situations in 1992-1993, which resulted in a call for a change in arbitrator selection process. It was a time when the NASD provided many free seminars dealing with substantive law. Those seminars also provided a means for arbitrators to gather and exchange views. Individual panels were then handpicked by Staff. One major factor to Staff was how available the arbitrator was --- the more available arbitrators made the Staff's job much less time consuming. The panel of arbitrators was much smaller. There was much lobbying of Staff and others to be selected to serve. The NASD indicated that there was no problem for an arbitrator to indicate his/her availability, but not to solicit assignment. A few law firms dominated the

defense business. Thus, the defense attorneys became very familiar with the arbitrators. The word got around that if an arbitrator ruled big-time in favor of a claimant, those law firms would forever challenge the arbitrator's selection. Staff, not wanting to go through the challenge process, would not select the arbitrators or readily suggest that they recuse themselves rather than fight the challenge.

**A:** I don't think that things have changed much re: staff just trying to avoid the process of actually making sure the panel is unbiased. Although my impression (which is all based on the last … years) is that the staff is not really cozying up to their "favorite" arbitrators--they just truly do not know what they are doing, i.e. running a dispute resolution forum that is becoming more and more like a court system. I find it hard to remember that most of the staff are truly young and inexperienced (and probably not paid much), or experienced only in that organization and its unexplained ways. What they do know, perhaps, is that when they put someone on the panel who has done many, many arbitrations, then that person won't be asking them for help. The first couple of times I served on a panel, the staff made a big point of telling me that the other arbitrators were "experienced, excellent" arbitrators. I now realize that they were the worst I have ever served with--but I don't recall that they wanted to award any money to claimants. So it's the same situation you are describing, but nobody can prove that staff is deliberately giving cases to arbitrators who won't rule in favor of claimants. Because the staff wouldn't know how to do that even if they tried--and they have the neutral/random/whatever system to talk about if anyone asks.

## II. Should An Arbitrator Just Follow Orders?

**A:** I have not been assigned a case since I was told to come into the NASD office a few days after a hearing ended to sign a decision prepared by NASD. I insisted on it not containing a "required" paragraph about certain NASD procedures which did not belong in an arbitrator decision. Also, I refused to sign the portions about how much money had been paid to the NASD because I had no way of verifying it and an arbitration award I had previously signed had a mistake in this portion of the award and had to be redone. The office was under tremendous pressure at the time to get awards out soon, so a mistake was not a surprise. I guess my refusals made me a "trouble-maker" since I am concerned about adversely affecting my reputation by signing something below my standards. I was a … arbitrator and used to writing my own decisions completely. Do you think that we could cause NASD to value higher legal standards than they do now? Quality over quantity?

**LG:** That is the goal. The Perino Report, in a thinly veiled attempt to justify the abolition of legal standards, states, "Arbitrators are not bound by precise legal standards, which may benefit investors, particularly as federal securities remedies have become more restrictive." My comment, in part, was "Of course, 'not bound by precise legal standards' 'may benefit investors.' Also, it 'may benefit' non-investors. 'Federal securities remedies' may 'have become more restrictive,' but any decent investor's attorney will allege a claim for breach of fiduciary duty under state law --- a non-'federal securities remedy.'" In another area, the Perino Report states, "NASD-DR staff reviews the list and excludes arbitrators for conflicts that are not coded into the NLSS. Staff members are required to document why arbitrators are removed from an NLSS-generated

list. NASD-DR Regional Directors and the Director of Neutral Management review those reports monthly." My comments were, "Why was the information not coded into the system? How does the Staff become aware of non-coded conflicts? If aware, why is the coding not immediately corrected? How much access to the coding does a Staffer have? What if a Staffer changes the coding, but fails to 'document' it? Are the arbitrators informed that they have been bounced? Are they offered an opportunity to dispute the existence of an alleged non-coded conflict? How fair is the procedure to dispute a Staffer's finding?"

**LG (Supplement):** Another arbitrator informed me that she was asked to sign an award that was based upon a stipulation by the parties, which included a statement of facts to expunge information from a salesperson's CRD. She was very reluctant to sign as she did not know (and had no way of knowing) whether the supposed facts stated in the stipulation were true. She did not appreciate the NASD for asking her to place her reputation on the line.

## III. What's the Plan, Coach?

**A:** I am an arbitrator. I am not sure I get the drift of your comments. Are you against the entire system, from which, it would appear, you make a living, or do you just feel the NASD does a poor job and the SEC does a poor job of supervision?

**LG:** Thanks for your comments. Many arbitrators are concerned about what appears to be a precipitous decline in the quality of NASD arbitration and are trying to make an effort to cause the NASD and SEC to improve the arbitration process. I feel that the NASD and SEC could do a much better job in improving the quality of the arbitration process. All parties are required to arbitrate before SROs without competition from non-SROs, e.g., AAA, or the courts. All parties to a fair and effective arbitration system are entitled some assurance of competence of arbitrators and predictability of results. The NASD, at the operational level, discourages use of the law as even a starting point in the decision making process. Use of decision making standards would cause fewer bad cases to be brought or settled much quicker. Further, the NASD, at the operational level, confuses competence with bias and, currently, has no effective means to evaluate arbitrator competence. Since, the forum is a monopoly; there is very little incentive to improve. Let me know you thoughts on the above and other subjects covered in the emails.

**A:** I generally agree that the training is more on how to look fair and do not talk to the parties in the rest room, than how to approach decision making, balance conflicting stories, apply the law, which law to apply, authority of SEC, NASD, Exchange Rules and state law, etc. I also do not like the increasing "legalization", by increasing use of Motions, now having to write opinions which will, in my view, assure every large case is appealed to some court on the grounds that the decision did not follow the law, squabbling on discovery issues, etc. But I, like probably most, do not have the time to take this on as a cause. Good luck,

**LG (Supplement):** My suggestions are mild compared to others. "The term 'arbitration' as it is used in these proceedings is a misnomer. Most often, this process is not about two evenly matched parties to a dispute seeking the middle ground and a resolution to their conflict from knowledge, independence and unbiased fact finders, rather what we have in

America today is an industry sponsored damage containment and control program masquerading as a juridical proceeding. …Given that investors, by law today, have no choice but arbitration, we need to make the system more fair. The best way to do that is to take it out of the hands of the industry — put someone besides the NASD in charge. … [W]e need to increase oversight of the arbitration process." (Testimony Of William Francis Galvin, Secretary of the Commonwealth of Massachusetts, Before the U.S. House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises A Review of the Securities Arbitration System Thursday, March 17, 2005)

## IV. Congressional Testimony – Quotable Quotes

**LG (Idea):** On March 17, 2005, the Capital Markets Subcommittee of the House Committee on Financial Services took testimony concerning "A Review of the Securities Arbitration System." The Subcommittee is Chaired by Congressman Richard H. Baker, 341 Cannon House Office Building, Washington, D.C. 20515. Phone: 202-225-3901; Fax: 202-225-7313. The complete written statements of the usual suspects can be found at: http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=362 .

**Witness Statement:** "Fairness: Arbitration is based on principles of equity – doing what is most fair and just in light of the facts and circumstances of the particular case. Public investors receive a direct benefit from these equitable principles. Should a panel of arbitrators find that the facts of particular case merit an award because it is equitable, an award can be made without the need to cite case precedents or any other justification." (Karen Kupersmith Director of Arbitration New York Stock Exchange, Inc.)

**LG (Idea):** Would industry respondents not also "receive a direct benefit"? The question is: What is "fair and just" and how is it determined? What's "fair and just" and "equitable" to one person may not be "fair and just" and "equitable" to another. Should parties be required to subject themselves to the luck of the draw? Would you want that for yourself? And, think of it, the award can be made "without need … (of) any … justification"!

**Witness Statement:** "[T]he system works. But it will continue to be superior to court-based litigation only if we guard against what I call the 'creeping litigiousness' that is at the gates. … the NASD's recently proposed rule change that would require arbitration panels, upon request of a customer, to provide written explanations of their awards would be counterproductive and contrary to the spirit of arbitration. By turning arbitrators into pseudo-judges, forced to write opinions that are subject to review, this rule would inevitably lead to more appeals from arbitration awards. Any explanation provided by an arbitration panel would be closely parsed by the losing party, in an effort to identify possible grounds for undermining the finality of the award. Although no doubt well-intended by people who believe written explanations will be helpful to customers, this new requirement will be anything but customer-friendly: it will undermine the chief benefit of arbitration by adding the opportunity for an additional layer of costs and legal maneuvering. The relative finality of arbitration decisions that exists today could be

destroyed, which would be a detriment to investors and industry members alike." (Marc E. Lackritz, President, Securities Industry Association)

**LG (Idea):** His reasoning is not applicable in California, where there is presently little to no chance to overturn an arbitration award. Otherwise, he presents a factually unsupported classic "beware of unintended consequences" argument to maintain the status quo.

**Witness Statement:** "NASD believes that transparency should be a hallmark of securities arbitration… An important step that NASD has taken involves the issuing of expanded written explanations in arbitration awards. The NASD Board of Governors recently proposed a rule change that will enable investors to require arbitration panels to explain the basis of their awards. NASD filed this rule proposal with the SEC for comment and approval on March 15. … We are currently working on two additional initiatives to improve the discovery process. The first is the creation of a voluntary pilot program for the use of a special roster of trained Discovery Arbitrators, who would review and resolve discovery issues expeditiously." (Linda D. Fienberg, President, NASD Dispute Resolution)

**LG (Idea):** The NASD has posted a copy of its proposed rule at: http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013542&ssSourceNodeId=1186 . (Please see next section.) Does the fact that the NASD may resort to "trained Discovery Arbitrators" constitute an admission that many current arbitrators are not able to deal with discovery issues and training would not help? If one cannot deal effectively with discovery issues, how about the entire decision making process and writing a statement of reasons.

## V. Opportunity to Comment to the SEC on "Explained Decision" Proposal

**LG (Idea):** The NASD believes in "transparency." Hmmm. Just remember where you learned of the opportunity to comment on the proposed rule! The NASD has posted a copy of its proposed rule at: http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013542&ssSourceNodeId=1186 . One may submit email comments to the SEC at: rule-comment@sec.gov . The subject line must state "SR-NASD-2005-032." Time is of the essence. You may review the proposed rule, when the SEC is ready to receive comments, at: http://www.sec.gov/rules/sro/nasd.shtml . Instructions to submit comments located are at: http://www.sec.gov/rules/submitcomments.htm . My comments are located at: http://www.LGEsquire.com/LG_SEC_SR-NASD-2005-032.pdf and will be filed with the SEC.

## VI. Non-Arbitrator Bias and Full Disclosure in Perino Report?

**LG (Idea):** One of the numerous issues raised in my annotated comments to the Perino Report on arbitrator bias was whether the securities industry buttered his bread. I recently found that following: "EXPERT ENGAGEMENTS AND CONSULTANCIES: U.S. Securities and Exchange Commission; New York Stock Exchange; Morgan Stanley Dean Witter; UBS PaineWebber, Inc.; U.S. Bancorp Piper Jaffray; National Union Fire

Insurance Company … New York Life Insurance Co. … BankAmerica Corporation" (Is Securities Arbitration Fair for Investors? Written Testimony of Professor Michael A. Perino St. John's University School of Law Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the Committee on Financial Services United States House of Representatives March 17, 2005) If he did any such work for the securities industry before writing his Perino Report for the SEC, the information should have been, but was not, disclosed in the Perino Report. If he did the work after writing the Perino Report, someone must have been very pleased with the dubious pro-securities industry conclusions that he reached. An annotated Perino Report is available on my website. You can be the judge, you decide.

My thanks to those who have contributed to Parts I, II, III, IV and/or V and/or shared their ideas/information with me.

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