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

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

The following are some of the email comments received from arbitrators (**A**) and some of my replies (**LG**). Both may 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, use and/or comment (**LG [Idea]**).

I. Discovery

A: What's this about setting up a separate process for discovery motions? What a horrible idea; that cannot possibly speed things up and will require big expenditures if the NASD actually proposes to pay arbitrators/discovery masters for the time required to read the material in dispute. I recently served on a case where emails became an issue. The NASD set it up the standard way, i.e., the parties were encouraged to stipulate to keep costs down by having the chair alone resolve discovery issues. That got overwhelming, so the entire panel was brought in to hear motions ... and review several thousand pages of documents. The staff realized that the standard telephone hearing fee was grossly inadequate, so we got an extra fee. I think it was 50 bucks. Requests for emails and cell phone records have become common. Good luck getting competent people to put in the time truly required to resolve these issues. That's why the courts pay judges a salary, and why judges require the parties to pay for discovery masters to handle the overflow in big cases.

LG (Supplement): It might be beneficial to the NASD if it informed arbitrators, who labor in the trenches, of proposed changes and seek comment. At a minimum, it would be good PR.

II. Follow the Law? --- Three Very Divergent Views

A. Deference

A #1: My most recent experiences serving on panels raised no cause for alarm: I served with other lawyers who cared about the law and with industry arbitrators who showed deference to the law as presented by counsel. Nevertheless, I concur with Wm. Galvin's characterization of the arbitration process ("an industry-sponsored damage containment system masquerading as a judicial process"). The arbitration system takes the place of the courts, and we can't leave protection of rights to the luck of the draw.

LG (Supplement): They "showed deference to the law as presented by counsel." One concerned is that there is no NASD guideline with respect to use of the law that is known to a member of the panel, but not presented by counsel. Further, there is no guideline as to whether a panel member may do any "research" on the law (vis-à-vis the facts).

B. "Contributory Negligence"

A #2: Thanks … for your informative and provocative communications--

This last one gives me some heartburn because my overall impression is that it comes down quite heavily on the theme that NASD arbitrations do not result in fair and equitable awards, and that somehow everyone serving as arbitrators should be more technically trained.

Of course there is some bias in that heartburn because I, like probably most other arbitrators, feel strongly that the cases I've served on have resulted in fair and equitable awards with no bias toward either side. Just the facts, the evidence, and judgments/evaluations of the testimony determined the outcome. No weeping hearts, no hard hearts, just the facts and a desire to reach a fair and equitable common sense decision. Of course individual arbitrators often see things in different ways and discussions in deliberations are often "interesting", but with give and take and a willingness to listen and consider others' views the outcomes have been good as far as I'm concerned. Is the system really broken or in need of major revision?

Now, the service you are providing is excellent and very helpful --- and is something NASD would be well advised to sponsor. I wish I had more confidence that they would do as well as you. The exchange of views is at least as educational as the teleconferences NASD has sponsored and the format is probably better and less burdensome for all concerned than formal training sessions. Are any of the senior people at NASD DR aware of your work?

LG: Sorry for the heartburn. There is no doubt that arbitration results, depending on the arbitrators hearing the matter, can provide "fair," "just" and "equitable" results to the parties. For me, it is question of predictability of results and use of the guidelines in substantive law to provide that predictability. My primary focus is not on the issue of "bias toward either side," but improving competence, i.e., training in substantive law, effective evaluation system. You stated, "Just the facts, the evidence, and judgments/evaluations of the testimony determined the outcome." Where does substantive law come into the picture? If it does, how do you learn what it is? What instructions, if any, have you received from the NASD as to the application of the law in the decision-making process?

I have no knowledge as to whether "senior people at NASD DR" are aware of my efforts to encourage NASD arbitrators to share information and/or opinions concerning the arbitration process.

A: We're in full agreement that improving competence of arbitrators is important, and the means used by NASD to accomplish that, and their diligence in weeding out those who are not competent, can be definitely questioned. However, you'll need to educate me further when it comes to the importance of knowing and rigidly applying substantive law to arrive at the desired fair and equitable result. I've always thought the laws including case law have that same objective. In saying that I do not mean to say that the inclusion of legal cites and briefs by both counsel in cases is not important and does not deserves consideration, insofar as it aids arriving at that hallowed ground of "fair and equitable". …

By the way, the competence of counsel, especially for the claimants, could often be improved, but that's a different issue. If there's anything I've learned as an arbitrator it's that if one gets into a situation requiring legal help it is extremely wise to hire the best for the matter at issue regardless of hourly rate. Same for expert witnesses.

LG: "Substantive law" is short hand for differentiating law applicable to resolving the matter, e.g., law dealing with breach of fiduciary duty, from law applicable to procedure, e.g., law dealing with whether hearsay evidence is admissible. There may not be a "rigid" approach to law as many cases can be interpreted by legal counsel in different ways. It is for arbitrators to understand the ways and take them into consideration before rendering a decision. However, there are strong indicators that the NASD does not wish its arbitrators to know the law, e.g., no training in law, or to consider the law, e.g., inadequate policy guidelines, in their decision making process. …

You raise an interesting question as to the competence of legal counsel appearing before arbitration panels. It has been my observation that practice before a court, with its strict rules and penalties, sharpens one's skills. .... The more an attorney practices before arbitration panels and not in court, the more he/she becomes sloppy --- really sloppy. It happens to attorneys, regardless of which side they represent. There are claimants, who have obvious breach of contract claims, but not a claim for fraud, where their attorneys ignore the easy-to-win breach of contract claim and insist that the claim is based only on grounds of fraud (where, possibly, the attorney feels that there is a shot at punitive damages). If an arbitrator accepted claimant's counsel's position, a deserving claimant would walk and a wrongdoer would benefit. There are respondents who are harmed when their counsel fail to use back up defenses, e.g. calculations and expert testimony to show that a perfectly suitable portfolio would have declined a high percentage of the amount that the high-tech stock portfolio declined. There are situations when legal counsel for both the claimant and the respondent are not aware of relevant case law on the subject under consideration.

A properly written explanation of an award could alert clients to potential claims for malpractice by their counsel, e.g. "A claim based upon allegations of fraud requires evidence that the representation was false at the time it was made. Claimant presented no such evidence. Therefore, we rule for respondent." At present, parties have no real idea of whether their award was the result of the facts/law applied to their situation, malpractice of legal counsel or….

Expert witnesses, as long as they point out important facts that could be overlooked, summarize documents, explain non-obvious factual situations and do not assume the role of quasi co-counsel, can be helpful. However, I have found that much of their "testimony" is really a substitute for what should be counsel's closing argument.

A: Many thanks. Back in the old days when law schools were scarce it is my understanding that many future lawyers obtained their legal training through the equivalent of an apprentice system which enabled them to get their licenses to practice law. If we keep this up, I'll be ready for the bar exam in no time, thanks to you.

In many (most?) cases the concept of contributory negligence is in the picture, even though I don't immediately recall hearing that phrase in the cases I've been on. From your comments I gather that doesn't make you very comfortable. It kind of works for me in arriving at "fair and equitable". Knowing that, would you cross me off the panel list if you were representing one of the parties?

Your final paragraph suggests that the written explanation of an award could be phrased to invite a malpractice claim when counsel doesn't represent the party adequately. My reaction to that suggestion is that the panel didn't do its job if it didn't ask questions to clarify the situation during the hearing. It seems to me that the panel should not punish a party because that party is not well represented, but rather should actively seek the truth/facts in the hearing in a neutral way if the panel has questions. Do you think I should be immediately sent to Remedial Training Camp for Arbitrators for having such thoughts?

LG: Before you take the bar, we need to look at *Black's Law Dictionary* on the concept of "contributory negligence," i.e., "The act or omission amounting to want of ordinary care on part of complaining party, which, concurring with defendant's negligence, is proximate cause of injury." A translation might be, "The respondent was negligent, but the law allows the amount of damage he/she/it caused to be reduced if the claimant was also negligent." Generally, it might also be referred to as "comparative fault." It is a principle used to distribute fault and reduce damages awarded. However, the operative word is "negligence." The concept of "contributory negligence" does not allow damages to be reduced when the claimant asserts other causes of action. (There are other concepts to reduce damages, e.g., failure to mitigate damages --- one must act reasonably once one knows or should know that one has been harmed by the acts of another. Failure to act reasonably may, also, diminish a party's credibility that they supposedly first learned information after the harmful event occurred.) In cases of breach of contract or torts other than negligence, e.g., fraud, breach of fiduciary duty, the concept of contributory negligence does not apply. In those situations, "contributory negligence" is a bogus defense.

Let's look at this defense another way. In a claim of fraud by affirmative statement, the claimant must prove that he/she reasonably relied upon respondent's statement. A respondent, when defending against a fraud claim, may assert that a claimant did not reasonably rely upon any statement and, therefore, the claim should be completely denied. That is proper. The parties are only entitled to an all-or-nothing result. Otherwise, one might hear the legally improper defense argument, "The customer was contributorily negligent (and damages should be reduced) as he/she trusted that the broker was telling the truth when a minimal investigation by the customer would have shown that the respondent's statement was false and, thus, should not have been relied upon."

It seems that the concept of contributory negligence might be limited to situations where both the customer and the broker make errors, e.g. where a customer gives a sell order, the broker executes the order, both should have known that the number of shares

was incorrect and damages resulted from a buy-in. These are issues that you might raise with counsel when a "contributory negligence" defense is considered.

I agree that an arbitrator, in his/her quest for truth and justice, should make inquiries. However, other arbitrators and judges feel that it's the client's problem if the client's attorney does not cover necessary material. Those arbitrators and judges do not want to appear to be helping a party. There is a corollary problem. What if the arbitrator waits until after the hearing is closed to first raise the questions with his/her co-panelists? I feel that the witnesses (expert and otherwise) and legal counsel should be given a chance to answer as they may have valuable information to correct an arbitrator's preliminary suspicions and the co-panelists should hear others' points of view. The questions that an arbitrator might raise could apply to issues of law and/or questions of fact.

LG (Supplement): The last statement leads to the issue of whether an arbitrator may use case law of which he/she is aware, but was not presented by counsel for the parties and/or conduct independent legal research. Personally, I have no problem with such efforts as long as the parties are given an opportunity to comment to the entire panel of what the arbitrator feels is applicable law. Again, sorry for the heartburn.

C. <u>"Does one plus one equal two?"</u>

A #3: You sure like to let everyone know that you're an Esquire. I want to thank you for all the information you sent me regarding NASD and arbitration. I must be living on another planet because most of what you state is happening at a hearing, never has occurred in any of the cases I have served on, including a couple of cases for NYSE. I have been a Panelist (public).… Since 1996 I have been selected to serve on 65 cases (15 are still active). 19 have gone to hearing. In addition I have been Chairman of 28 of these cases. Other than a couple of single arbitrator cases all of the cases have been with 3 Panelists. The majority of the people have been Public arbitrators which included many Attorneys, also many are Industry people. Although we receive from both parties, reams of papers with case law, not once in any case during a hearing or during any deliberations has any one referred to them. In every case I have been selected to serve on, ALL the Panelists approach the matter totally neutral. All we look for are the facts. What we try to determine is what was laid out in the statement of claim real. (sic) … Please note that we look at each case for specific information relating to that case. We do not need case law. Simply, <u>does one plus one equal two</u>. That's what we try to determine.

Now let me try to describe what really bugs me. And that is most Claimant attorneys forget who they are talking. Their approach is the same to the Panel as it is to a jury of 12 who don't know a stock from a bond, use redundancy to an excess and try to play on emotion. To me it is an insult to our experience and knowledge. I could write a book on the subject, but everyone would think I was writing a script for television. I just finished 2 cases, one went 5 days and one went 4 days, both could have been wrapped up to two to two and a half days if it weren't for long winded and repetitious presentations. Panelists do everything they can to get to the crux of the matter, but it isn't easy.

In 2003, NASD handled over 9000 cases. Can you imagine what would have happened to the court system if there was no arbitration? I recently read "Jury trials are in sharp decline. More accused criminals are opting for plea deals, and companies are

finding it cheaper to settle disputes through arbitration or other means". It goes on to say, "Lawyers ponder whether they could - or should - do anything about a drastic decline in jury trials". Isn't this why many attorneys are fighting against arbitration? $$$$ As a friend of my mine recently said, "all civil cases should go the arbitration".

LG: Thank you for your candid comments, e.g., "[N]ot once in any case during a hearing or during any deliberations has any one referred to them (reams of paper with case law received from the parties)… All we look for are the facts. … We do not need case law. Simply, does one plus one equal two. That's what we try to determine." Once you have determined the facts, what, other than using the "does one plus one equal two" approach, determines the significance of those facts? Most would agree that the subject matter of arbitration is becoming more and more complicated. It seems that, without referring to case law, each arbitration panel would attempt to reinvent the wheel.

There's a lot of blame to go around with respect to redundancy of materials presented at hearings and the length of hearings. First, look to the Chairpersons, who have the power to control the presentations. A simple, but firm "Counsel, you have asked that same question many times and received the same or similar answers. We are very well versed in the subject matter. You have made your point. Now, move on to another area." might solve the problem. Next, look to opposing counsel, who could object by stating, "Objection, asked and answered." and insist that the Chairperson rule on the objection. Next, look to the NASD, with its "civility" training, which instills a general fear of offending a party. So, if you are suffering through hearings, it is because you are not using the legitimate tools available to you to cure the problem.

My questions about arbitration deal with quality of case resolutions not quantity. I have no idea of the source of your quotes. I have no information about "many attorneys are fighting against arbitration" or the basis of your friend's opinion. Some might argue that, if the results in arbitration were more predictable, fewer cases would be filed and more would be settled without hearing. Using the "does one plus one equal two" standard would not achieve that result.

Please be good enough to inform me from what source(s) you learned to use the "does one plus one equal two" approach to resolving arbitration claims. Do you feel that attorneys should be informed not to waste their time, their client's money and our forests by filing briefs containing case law? Do you feel that using the applicable law in the decision making process would not assist in reaching a fair and equitable result? If it would not assist, why not?

LG (Supplement): I inquired of a college professor, who has studied the arbitration process, concerning the last arbitrator's comments. He stated, "[A]mong other things, this reflects a common layperson misunderstanding. Many of my business school students (including not only undergraduates, but also a fair number of graduate students) fail to appreciate the distinction between law and fact. That seems to be the case with the writer of this e-mail. Of course, there are some cases where the law is not in dispute, and therefore the case turns completely on resolution of the factual issues. Nonetheless, as you observe, (even when the law is not disputed) the decider of the case in an orderly legal system must apply law to the facts. … [A]rbitration is not a system that is obligated to law. That is why I object to the eagerness of our judiciary to so readily embrace the substitution of arbitration for the right to a trial in a court of law, when the parties have not 'genuinely agreed' to this."

There is still the issue of how arbitrators learn what the law (even if it is not in dispute) is in order to apply to the facts.

NASD Rule 3110(f)(1) sets forth certain written disclosures that are required to be contained in predispute arbitration agreements with customers, e.g., "(D) The arbitrators' award is not required to include factual findings or legal reasoning…" One might wonder whether the negative implication of that statement is that awards are based upon "legal reasoning," but arbitrators are not required to explicitly state their legal reasoning process. "The Arbitrator's Manual" states, "Arbitrators should realize that they are viewed by parties in an arbitration proceeding much as a judge would be viewed in a court of law." One might reasonably assume that parties believe that "a judge … in a court of law" bases his/her decisions on the law. The ultimate question might be whether arbitration agreements sufficiently inform customers that arbitrators are not required to base awards upon the law, but may utilize only the "does one plus one equal two" principle.

III. "NASD Needs Arbitrators"?

A: I thought this (the following ABA listserv exchange) may be of interest.

Sent: 3/25/2005 …
Subject: NASD Needs Arbitrators

NASD Dispute Resolution is seeking to recruit qualified arbitrators to meet the demands of its rapidly expanding caseload and to help maintain the efficiency of its dispute resolution system. Interested individuals should contact Neil McCoy, Recruitment Supervisor, Department of Neutral Management to request application materials. Mr. McCoy can be reached by email at neil.mccoy@nasd.com or by telephone at 212-858-4283. Please direct inquiries to him by email or telephone. Paul (Dubow)

Subject: Re: NASD Needs Arbitrators

Mr. McCoy - I have been on the list for over 25 years and not received any appointments in the last 10 years. Please advise...

LG: Mr. Dubow once served as General Counsel for Dean Witter & Co. Website comments state, "He was a member of the Securities Industry Conference on Arbitration (the organization which develops the rules for SRO securities arbitration) and served two terms on the NASD National Arbitration and Mediation Committee."

In her recent statement to Congress, Ms. Fienberg, President of NASD Dispute Resolution, stated, "In 2004 alone, NASD administered over 9,000 arbitrations and 2,000 mediations throughout 56 hearing locations. … Approximately 60 percent of all claims are settled directly between the parties or through mediation. Arbitrators decide only about 30 percent of the claims. … NASD maintains a roster of approximately 7,000 arbitrators and 1,000 mediators…." *The Neutral Corner* (2/05) states, "NASD Dispute Resolution experienced a decrease in case filings from 8,945 in 2003 to 8,201 in 2004. In a major effort to reduce the existing caseload, NASD Dispute Resolution increased by

27% the number of cases closed between January 1, 2004 and December 31, 2004 compared to the same period in 2003."

Let's do some rough number crunching. Of the 8,201 claims filed in 2004, 30% will get to a hearing, i.e., 2,460. If one assumes that each requires a 3-person panel, 7,380 arbitrators would be needed. Without differentiating between industry and non-industry arbitrators, each arbitrator would serve on about one hearing per year. If the NASD has designated a "Recruitment Director" to secure more arbitrators and the NASD's case load continues to drop, some arbitrators may never serve on a matter that goes to hearing.

It appears that the bottom-line result is that the NASD will dilute the quality of its arbitrators. On-the-job training will be almost non-existent. Economic incentive to invest time/money in one's own training will vanish.

Do you have any theories … on why the NASD wishes to add to the arbitrator pool?

IV. Reading Material

LG (Supplement): An arbitrator recommended reading Professor's Murray S. Levin's "The Role of Substantive Law in Business Arbitration and the Importance of Volition." *American Business Law Journal*, Fall, 1997. 35 Am. Bus. L.J. 105. If you have access to LexisNexis, it's available at: http://www.lexis.com/research/xlink?app=00075&view=full&searchtype=get&search=35+Am.+Bus.+L.J.+105. A preview of the article, published on the internet, states, "Most arbitration statutes do not address the role that substantive law is to play in decision-making by arbitrators. Commonly referenced arbitration rules and most agreements to arbitrate also are silent on this issue. Arbitration statutes do provide for appellate review by the courts on limited grounds, but not including error of law. In this environment, arbitral practice consists of a discretionary combination of law and common sense. The notion that arbitration awards may significantly deviate from the law does not sit well with some members of the judiciary. Nevertheless, arbitration is ..."

My thanks to those who have contributed to Parts I through VI and/or shared their ideas/information with me.

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