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

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

I. Arbitrators and the Law
II. Industry Arbitrators and Discovery Motion Compensation
III. Comments on Petition for Rulemaking (SEC File No. 4-502)

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]**).

NASD Dispute Resolution has requested that I inform you that my Email Newsletters "are not authorized to speak on behalf of NASD or NASD Dispute Resolution."

A summary of prior publications, others materials and associated links are located at: http://www.LGEsquire.com/LG_Links.html .

I. Arbitrators and the Law

A: It's not just that the NASD doesn't train arbitrators in the law, they actively encourage them to ignore the law as in the current issue of The Neutral Corner copied below. (Emphasis mine.)

Question and Answer: Understanding and Applying the Law in a Case

Question: What should an arbitrator do when additional information is needed to understand the law presented in a case?

Answer: Although most arbitration claims present questions of fact that the panel will be able to decide on the proffered evidence, some parties may rely on a specific law or statute. Generally, the party who raised a legal issue will offer the panel a brief that sets forth the law or statute along with an explanation of how it applies to the facts of the case. However, arbitrators may also encourage the party to present the issue orally. In addition, arbitrators may request that parties submit a brief on any issue if the arbitrators believe it would assist them in deciding the case. In any of these situations, the opposing party or parties should be allowed to respond.

Arbitrators are reminded that they are not to engage in any outside legal research, nor should they ask NASD staff to conduct legal research for the arbitrators.

The panel must rely on the parties to provide the research in support of their respective positions.

Arbitrators are not bound by case precedent or statutory law. Rather, they are guided in their analysis by the underlying policies of the law, and are given wide latitude in their interpretation of legal concepts. If, however, an arbitrator manifestly disregards the law, a court may….

LG: The vague and ambiguous purported "answer" creates many more questions.

What does the vague phrase "outside legal research mean"? Does it mean that attorneys and others familiar with the law (securities and otherwise) will be required to wipe their memory banks clean before entering the hearing room or ruling upon any pre-hearing motions? Have they not been doing "outside legal research" throughout their careers to reach their current state of knowledge of the law?

The NASD informs arbitrators that they are viewed by the parties "much as a judge would be viewed in a court of law." (The Arbitrator's Manual, p. 3.) Does the NASD inform the parties that, inconsistent with the parties' reasonable expectations, the NASD instructs its arbitrators that they "are not bound by case precedent or statutory law"? Does that mean that arbitrators should ignore the law in their decision-making process?

Has the NASD abandoned all standards in the decision-making process? How does an arbitrator learn what "the underlying policies of the law" are to do an "analysis"? How does an arbitrator learn what the "legal concepts" are? How is an arbitrator supposed to "interpret" the law? How wide is the "latitude in their interpretation"? Are arbitrators asked to "encourage the party to present the issue (of law) orally" so that there will be no easily accessible record? Are arbitrators required to read any brief that is submitted by the parties?

If arbitrators are informed that they can ignore the law and, further, are not even taught what the law is, how does an arbitrator know whether or not he/she "manifestly disregards the law"?

On February 20, 2005, I wrote to the NASD to seek clarification of its policy concerning the law. No clarification has been provided. The questions were and are the following:

> 1. What is the NASD's policy on the subject of arbitrators learning and employing the law in deciding cases? Are NASD arbitrators forbidden from independently researching the law and/or employing one's own knowledge of specific applicable cases? Does the NASD policy forbid arbitrators to employ any knowledge of the law not presented by the parties? Must the arbitrator accept the law as stated by legal counsel?
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> 2. What should the arbitrator do if he/she is aware that the attorneys are incorrectly stating the law or, simply, not aware that it exists? Are NASD arbitrators forbidden from informing legal counsel of the parties and fellow panelists of apparently applicable law of which the arbitrator is aware and asking for counsels' versions of whether the law is applicable and, if so, how the law applies to the facts presented at the hearing?
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> 3. If an arbitrator knows of specific applicable law, does the NASD forbid the arbitrator from employing it in the decision making

process? Are NASD arbitrators who are aware of applicable law, which the arbitrator believes counsel are not aware, required to provide the parties with an opportunity to remove the arbitrator from the panel based upon grounds of bias?

In disputes among NASD members or NASD members and their employees, arbitrators are required to have "substantial familiarity with employment law," "ten or more years legal experience" or "experience litigating" and apply a "legal standard." (NASD Rule 10355.) However, those arbitrators should be disqualified as they are required to already have done "outside legal research" to qualify. Is this a Catch-22, or what?

Securities industry arbitrators are treated much differently than persons familiar with the law with respect to knowledge obtained outside the hearing room. A person's knowledge of the law is treated as "outside legal research" and is *verboten*. However, in recent testimony before Congress, the Securities Industry Association attempted to justify the existence of securities industry arbitrators assigned to customer cases by stating: "[I]n light of the ever-growing complexity of the financial products that are often the subject of arbitrations … and the technical issues that sometimes arise … SIA believes that the presence of one arbitrator who is more familiar with these products and their appropriate and/or inappropriate use greatly increases the chances for the fairest resolution of claims. … An arbitrator with experience in the business is in the best position to evaluate, and to help co-arbitrators evaluate, that testimony. In addition, arbitrators who have had some experience in the securities industry are more likely to be well-versed in the supervisory and compliance structure of brokerage firms, the duties and obligations of brokers and other financial professionals, and the regulatory framework under which these individuals and firms are required to operate." (Testimony of Marc E. Lackritz President, Securities Industry Association before the Committee on Financial Services U.S. House of Representatives March 17, 2005, p. 6-7.)

Are arbitrators expected to treat a statement in *Neutral Corner* as official NASD policy? The NASD is discretely attempting to promulgate a very substantial policy of informing arbitrators to ignore the law, which is inconsistent with the purposes of the federal securities law and its publicly available literature. One wonders whether the SEC would grant such authorization if the NASD sought permission.

One should note that the NASD does not specify the ramifications to attorneys and others familiar with the law who decline to leave their knowledge of the law outside the hearing room.

LG (Supplement): The arbitrator's reference is to the April 2005 issue of the *Neutral Corner*, which is available on the NASD's website.

The *Neutral Corner* (April 2005) mentioned this email newsletter under "Unsolicited Mass Emails to Arbitrators." (Comment on the content is reserved.) In "Arbitrator Disclosure Tips … Tip#2," it reminded "inactive" attorneys to keep their disclosures current. We covered the subject in Parts I and II, mentioning potential criminal penalties under California law to other than "active" attorneys designating themselves with "Esquire."

II. Industry Arbitrators and Discovery Motion Compensation

A: Just read through your latest efforts and wanted to say thank you for attempting to serve up some sense to the SEC/NASD. Even with all my legal and industry experience, I find it daunting to follow, let alone participate in, this process. So I think you are doing a huge public service here. I'd like to add my two cents' worth on the issues of (1) requiring that at least one arbitrator be an industry person, and (2) paying arbitrators for discovery motions and other pre-hearing work.

(1) Industry Arbitrators: Be careful what you wish for here. I must disclose that I am a lawyer, and classified as an industry arbitrator when I serve. It seems to me that when there is confusion among arbitrators about some securities-industry-specific issue, they usually ask the lawyer representing the industry party for help. Sometimes that lawyer isn't much help, or makes an argument about vague things like "industry standard" that really need an educated, independent ear to evaluate. My fear is that a public arbitrator who had no litigation experience would be more likely to be swayed by that kind of thing.

(2) Discovery Motions: I agree that the proposal to pay a flat $200 for discovery motion work is not a good answer. My fear is that if that proposal is rejected, the current problem (attorneys filing huge court-like discovery motions to be decided by one or more uncompensated arbitrators with no experience in handling them) will only get worse. The attorneys filing the motions have nothing to lose; the arbitrator(s) deciding them have nothing to gain, and by the way, whatever happened to the idea that "motion practice is disfavored in arbitration"?

As long as we are dealing with a mandatory arbitration system, I don't think that there is any way to stop the lawyers representing parties from using all the tools they would use in court. My experience is that motions are filed more often, and are more complicated, in the disputes between industry members than they are in disputes involving individual investors. When there is an investor involved, the industry lawyer (and there is always a lawyer for the industry member) is usually willing to just stick with the proscribed list of discoverable documents, and work it out at hearing if there is a problem getting those documents. In other words, no uncompensated work for the arbitrator(s), and no extra costs for the investor.

This is decidedly NOT the case for disputes among industry members. In those cases, I routinely find myself asked to decide complicated discovery motions or motions to dismiss prior to hearing. They usually just arrive in the mail with a cover letter from the NASD staff person … stating that I should contact the other arbitrators and let the NASD know my decision.

It is often all but impossible to reach the assigned staff attorney even for assistance with things like setting up a conference call among arbitrators or scheduling a telephone hearing on the motion. When my blood pressure starts to boil over I realize that a big part of the problem is that the NASD (for reasons that surpass understanding) is trying to run this system without anyone qualified to make the decisions demanded by the work. The staff attorneys I have asked about procedures for setting hearings don't know how to do it, or tell me that it can't be done unless a party requests it. One time I got through … to an actual staff attorney and set up a phone hearing on a motion to dismiss, but a telephone clerk later cancelled it (without informing the arbitrators) because one party had told the clerk that they did not require the hearing. Long story short, the clerk

didn't understand what he was doing--and the party who didn't want to pay for a hearing had almost succeeded in getting the hearing cancelled. Even after it was finally sorted out, the arbitrators came out inconvenienced, frustrated with NASD, and not compensated for all the time and work involved. The law firms representing these industry members know better than to act like this. They wouldn't get away with it in court. Since they seem to forget that they are not dealing with a court that has full-time, salaried hearing officers to devote to their cases, it seems to me that the only way to deal with them is to act like a court. If you have a problem you can't work out, you file a motion. If you want someone to decide your motion, then you need to set some time on that person's calendar. You need to pay that person for their time. There is a way to do this within the current set up....but not if there is no identifiable person setting up hearings, or keeping one side from canceling them. In other words, I think that a HUGE part of the problem here is with the NASD setting up a system that leaves no one accountable for individual cases, or employs people who, with all good intentions, simply do not understanding their jobs.

LG: My concern is that the NASD encourages securities industry arbitrators, in effect, to provide evidence without the parties knowing or having the right to cross-examine. Any panelist should ask for clarification from the parties or their counsel when they feel that testimony or explanations are vague. They can push beyond "industry standard." (One could ask, "Counsel, how does one determine that it is the 'industry standard'?") In that manner, the parties would be able to present their best shot to all panelists.

A: I think that we are on the same page on this, but I've never seen an industry arbitrator providing what I would call evidence. I have seen arbitrators--public and industry--essentially give weight to argument that is not supported by evidence. I'm thinking of counsel simply arguing, without offering case law or statutes, that industry standard allow whatever his client did. I, of course, always ask for citations and copies of cases and statutes. I think it helps, rather than hurts, to have someone who knows the territory on the panel when this kind of non-evidence is coming from the industry side, because it comes in so fast and is usually wrapped up in several layers of industry jargon. It really gets tricky with expert witnesses called by industry parties. They often attempt to testify as to facts as well as present opinions on the ultimate issues in the case. (In court, we call that invading the province of the jury, right?) I think that it helps to have an arbitrator with industry experience to translate the jargon and evaluate the expert's credentials and opinions.

But we are in agreement that any decision needs to be based on disclosed law and standards, and supported by evidence presented by the parties. I will try to get my thoughts organized for official presentation.

LG: Where are the claimants' counsels when it comes time to object to the improper arguments? Do they assume that arbitrators are so sophisticated that they will recognize improper arguments and, thus, do not bother to object? Shouldn't all of the arbitrators "know the territory … when this kind of non-evidence is coming" from any party or counsel? What evaluations, if any, is the NASD doing to learn whether arbitrators "know the territory"? If an arbitrator does not "know the territory," how is he/she going to learn? Who pays, in terms of money or otherwise, for his/her learning cure?

Some "experts" are very valuable in summarizing loads of documents, demonstrating patterns and/or pointing arbitrators to a smoking gun. On the other hand, I

have heard some define "expert witness" as "someone with a white shirt, from out of town." Some "experts" go so far to argue the client's case that they can be classified as "quasi co-counsel." If they need translation, why don't they ask the parties or counsel to provide it?

Is there not some arbitrator training to allow each arbitrator to "translate the jargon and evaluate the expert's credentials and opinions" on his/her own? The NASD supposedly offers the securities industry and the public a panel of savvy arbitrators who can expeditiously reach fair and equitable results. Of what value are arbitrators who lack sufficient knowledge to be able "to translate the jargon and evaluate the expert's credentials and opinions"? Are the decisions actually made by those with the knowledge, while the other arbitrators are there only for the ride?

III. Comments on Petition for Rulemaking (SEC File No. 4-502)

LG (Idea): Some have already submitted written comments concerning Petition for Rulemaking (SEC File No. 4-502). They may be viewed at: http://www.sec.gov/rules/petitions/4-502.shtml. Hopefully, more will express their views. Commenting on the Petition will allow those who labor in the arbitration trenches to have a real opportunity to inform the SEC of: (1) how arbitration functions in the real world; (2) whether changes should be made; and, if so, (3) what those changes should be.

My continuing thanks to those who have contributed to Parts I through XIII and/or shared their ideas/information. Please continue to forward these emails to your colleagues and associates and share your arbitration ideas and experiences with your fellow readers.

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