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

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

I. "Explained Decisions" – Comment and Rebuttal
II. The Ruder Task Force Report (1996)
III. Arbitrator Selection Process
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VI. Arbitrator Superstars?

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 have 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, other materials, e.g., annotated "studies" or "reports," and associated links are located at: http://www.LGEsquire.com/LG_Links.html.

I. "Explained Decisions" – Comment and Rebuttal

The NASD filed its proposed rule SR-NASD-2005-032 ("explained decisions") with the SEC. The comment period ended on August 5, 2005, but the SEC has previously posted "late" comment letters. Comment letters may be viewed at: http://www.sec.gov/rules/sro/nasd/nasd2005032.shtml and clicking through the various links.

A: Although many of your comments about how the "fairness and equitableness" of NASD hearings are very worthy of consideration by NASD and SEC, I believe they are offered in the inappropriate context of the proposed "explained decision" rule. I love the quote from Burke copied above (as well as Huff's little book about how to lie with stats) and I apply it here.

Proper usage of the decision rule can provide participants with what they minimally deserve -- an explanation or rationale for the decision rendered! I do not believe such a rule "masks" inequities in the process or the inappropriateness of the arbitrator training and selection. Au contraire, explanations unmask the process, make it more transparent, and easier to criticize and improve. Many present awards state little more than the amount. While I certainly agree that an explanation cannot solve the several problems and critiques you raise, it can expose and target them better than no information at all. Transcripts are also valuable to peer behind the closed doors, but additionally it is important to know how the arbitrators evaluated and weighed evidence to determine an award.

Here the NASD has proposed something that only does a little, but a la Burke it is not nothing. Also, this minor step is in a good direction to encourage additional dialog about the larger problems you raise.

LG: Thanks for the comments. I filed two sets of comments, i.e., a comment on the proposed rule, a rebuttal to the Edwards' comment. I assume that you are referring to the latter with respect to the "fairness and equitableness." Edwards' position was essentially that reports and studies show that NASD arbitration is perceived by participants as "fair and equitable," thus, it is "fair and equitable" and, therefore, it does not need to be changed with the proposed "explained decision" rule. My rebuttal dealt with the reports and studies, which are the bases for Edwards' position. Unfortunately, as time passes, the reports and studies are accepted for the truth of their general conclusions and the details are lost. I could not stand-by when such reports and studies are cited for what they do <u>not</u> say or without disclosure of their flaws, e.g. inadequate samples, bias. I know that I am very critical of the authors, but, sometimes, those who push trash get trashed.

My initial comment set forth specific deficiencies of the proposed "explained decisions" rule, e.g., unwarranted exclusion of legal authorities and damage calculations, additional costs, no enforcement mechanism, no quality control, and I suggested a jury-instruction-check-the-box alternative.

Sometimes, a legislative problem arises when ineffective legislation is passed. The problem is that the legislation does not come near solving the problem, but causes the underlying issues not be revisited for years, if ever. If adopted, in its present form, the NASD would claim that all the prior problems have been solved and use that argument against those who still desire change.

I believe that Burke's quote deals with outsiders attempting to change the government as opposed to the powers-that-be providing very little real change, but masking it as something more. (A la, let them eat cake.) In the latter context, a little is worse than nothing.

You mention, "[T]his minor step is in a good direction to encourage <u>additional</u> dialog about the larger problems you raise." (Emphasis added.) To what "dialog" is reference made?

A: Indeed I missed the other set of comments you offered, and indeed I support your efforts to increase fairness and to critique the reports. Nonetheless, I still believe that it is not effective to attach such comments to a proposal that can be seen by many as relatively unrelated. This practice reminds me of one of the means that Members of Congress use to achieve their specific ends i.e. by attaching unrelated pork to major appropriation bills (ok, ok, that isn't exactly the same).

Sorry, I missed these specific criticisms of the "explained decision" rule. For some arbitration, I would love the luxury of employing a legal clerk to augment partisan briefs. I support the most transparent kind of decision disclosure including damage calculations. The more that is written, the more that can be evaluated by the participants and by NASD. Of course this is based on my belief that most arbitrators and even most NASD officials truly want to develop a system that results in fair decisions that are perceived fairly. That is where my commitment is and that is what 100% of the arbitrators I have worked with have given lip service and energy to. Even if my lack of cynicism about motives is largely on target, your concerns about arbitrator competence, knowledge and training are valid.

This a popular argument. The extreme version is all or nothing. Governors and Presidents sometimes veto imperfect bills so that they can be sent back for reconsideration. In the instant case, I believe that ANY explained decisions will lead to some "unmasking" of the basis and process of arbitration decisions. This is turn lead to MORE public criticism based on actual case data, and this will lead to exposure rather than suppression. Hopefully exposure will lead to change.

We really differ here (Burke's quote). For me a little is often better than nothing especially when the "little" is a catalyst or the initial push down a slippery slope. Advocates for change like you and me don't have to show extreme gratefulness for little changes. Instead it is possible to say "thanks, now let's really move ahead with the following additional suggestions". A quantitative question that varies greatly with the situation: "How much of a loaf is better than none?"

It looks like you are implying that there is no real head-to-head dialog or debate. I was referring to the differing SEC comments. Despite the mild stylistic criticisms that I have offered, I certainly don't want to and probably can't inhibit your zeal for reform or even revolution. For one person, you are doing a hell of a lot to raise consciousness about some important issues that affect fairness. Keep going!!

LG (Idea): Part of a securities industry representative's formal comment to the SEC stated, "It is a truism that many arbitration awards represent an exercise of discretion by the panel to afford a client some relief, even when no legal basis exists for an award. While brokerage firms complain about such awards, we also recognize the usefulness of a process that allows arbitrators to provide some measure of relief to customers who feel themselves to be seriously aggrieved."

What are the facts upon which the comment is based? Upon what facts, if any, substantiate implication that "exercise of discretion" flows in favor of customers? If the award in favor of a customer is for 1/100 of the amount claimed, does that imply that the arbitrators took pity on a case that should not have been brought or that the arbitrators found liability, but refused to render a just award? The key admission is that arbitrators are permitted to and encouraged to utilize unrestricted "discretion." The SEC should be committed to the enforcement of federal securities law and arbitration awards employing that standard and not unrestricted discretion exercised by persons selected in a non-transparent process who, for the most part, are not trained in law and whose performance is not effectively evaluated.

II. The Ruder Task Force Report (1996)

LG (Idea): A reader of this email newsletter forwarded a copy of a 1996 article by Ms. Linda Fienberg that dealt with the then recent Ruder Task Force Report. (The Report is available at the NASD's website book store for $15.) The NASD has known of serious problems for about 10 years, but has not dealt with them. Would you, as a business owner committed to providing your customers with a top of the line quality product, continue to employ a management employee, who for 9 years knew of a major problem in your product, but failed to cure the problem? The article states, in part:

> The NASD Securities Arbitration Report: A View from the Inside By Linda D. Fienberg and Matthew S. Yeo; Linda D. Fienberg is a partner, and Matthew S. Yeo is an associate, at Covington & Burling in Washington, D.C. Ms. Fienberg was a member of the NASD Arbitration Policy Task Force and served as the Task Force Reporter. Mr. Yeo helped research and write the Task Force report. … [T]he NASD Board of Governors commissioned the Task Force to review the entire securities arbitration process. … [T]he Task Force identified many areas in which improvements to the process could be made. … Arbitrator-Related Issues. Among the most important recommendations made by the Task Force are those relating to arbitrators, particularly their training, quality, and selection. Overall, the Task Force found that, while there are many qualified arbitrators in the NASD arbitrator pool, arbitrator quality is inconsistent. The Task Force therefore recommended increased training for all arbitrators, including a continuing education requiremet (sic), and recommended that panel chairs receive more specialized training. As envisioned by the Task Force, panel chairs -- most of whom are lawyers -- will play a much greater role in managing the arbitration process. … Implementation and Beyond. … While the Task Force Report established the broad contours of a revised securities arbitration process, the implementation of its recommendations will require an extensive revision of the NASD Code of Arbitration Procedure and other pertinent rules, all of which must be approved by the SEC. (Insights, April 1996)

III. Arbitrator Selection Process

LG (Idea): Several months ago, an arbitrator mentioned that the same person was repeatedly selected by NASD staff for appointments in the writer's geographic area.

If a sufficient number of proposed arbitrators are rejected by the parties, the NASD selects, in its discretion, replacements to fill hearing panel assignments. NASD Arbitration Manual, Section 10308(c)(4)(B). Also, Staffers may exercise discretion to fill panel positions, which are vacated near a hearing date.

The NASD Staff is probably overworked and underpaid. If Staff knew that an assignment could be filled with one telephone call, as the prospective panelist would

most likely be available and had not been previously challenged, it would be reasonable to make one call rather than more.

How effective is the "random" selection process? Has the NASD publicly stated whether the Staff has been instructed to follow any procedure in exercising its discretion? If so, what is it? How many times has it been used? Does the NASD prepare any publicly available statistics on the issue? Years ago, I suggested to the NASD that it publish (and/or make available on its website) a yearly list of the amounts of compensation paid to each arbitrator in the prior year. Such would provide a little transparency.

IV. NASD Discovery Arbitrators

LG (Idea): On August 1, 2005, the NASD launched "a voluntary, two-year discovery arbitrator pilot to address concerns about the discovery process in arbitration. A single Discovery Arbitrator will be appointed to resolve all discovery disputes prior to the hearing. These Discovery Arbitrators will not be a part of the panel to hear the merits of the case; they are appointed solely to resolve the parties' discovery disputes. … The Discovery Arbitrators are pre-selected public arbitrators currently on Dispute Resolution's roster who are lawyers with experience in resolving discovery-related disputes. … The Director of Arbitration will appoint an arbitrator from the roster of Discovery Arbitrators… Once the hearing commences … the panel appointed to hear the merits of the case will decide any new discovery issues. … [T]he panel may only review the Discovery Arbitrator's prior rulings on the basis of new facts or circumstances that arose after the commencement of the hearings."

The existence of such a project appears to be an admission by the NASD that its arbitrator selection process is in need of serious repair. Why would a Chairperson, who is required to make evidentiary decisions and discovery decisions during the hearing, not be capable of competently making pre-hearing discovery decisions? Won't parties be reluctant to involve the services of a Discovery Arbitrator out of fear of offending the assigned Chairperson? Why would anyone opt for a pig-in-a-poke Discovery Arbitrator? How could an attorney justify such a decision to his/her client if subsequent discovery rulings were off-the-wall and seriously detrimental to the client's case?

How were arbitrators' names placed on the "roster of Discovery Arbitrators"? How is one selected for service, e.g. "random," "rotational," arbitrator lobbying of NASD personnel? What is the scheduled compensation? Who pays?

How difficult would it be for panels to reverse prior discovery orders by determining that the discovery issue is "new" or "new facts or circumstances … arose after the commencement of the hearing"? By what authority is the NASD restricting an arbitrator from correcting/reversing an incorrect pre-hearing discovery ruling?

Will Discovery Arbitrators have too much power? Some discovery orders, e.g., bars to evidence, issue determination, can effectively decide cases.

After the two-year test period, when few participants opt to use Discovery Arbitrators, will the NASD declare the project a success as it would have demonstrated that participants feel that Chairpersons are very knowledgeable in discovery matters? It

might also demonstrate other matters, e.g., parties could not agree to employ a Discovery Arbitrator.

One wonders whether the NASD has the legal authority to implement such a program without specific authorization from the SEC. But, outside legal research on that subject may be *verboten*.

V. Arbitrators and the Law

A: I have followed your commentaries with interest, and I think you have provided a great deal of useful information. Most importantly, you have created an independent forum where arbitrators can discuss things without censorship from NASD staffers.

You have often mentioned that there have been instances where NASD staffers told arbitrators that they are not allowed to do legal research, and have claimed that arbitrators who have done legal research are biased, and must recuse themselves. … I serve as a public in cases where my actions as a lawyer don't disqualify me. To date, no one has ever told me not to do legal research. But, then, I have never had to do legal research. Most of the cases simply involved application of basic legal principles I learned in law school, as applied to the facts.

That having been said, I think that the NASD arbitration forum can be arbitrary and capricious. As an arbitrator, I have always followed the law, no matter where it led me. I have never allowed sympathy or a desire to curry favor with one party or another to cloud my decisions. I have also never allowed my personal feelings to cloud a decision. Following the law may lead to a decision for someone I don't care for, whether it is a claimant or a respondent, but that doesn't matter, so long as the law, or a reasoned interpretation of it, is followed. I find it astonishing that NASD would prevent a lawyer from researching the law, in order to make a sound decision.

…

Obviously, federal judges have clerks who research the law. Many judges, at the state level, yearn for this privilege, because it would allow them to make better decisions when swamped with cases, and lacking time to do the research themselves. The idea that NASD is preventing arbitrators, who are willing to put in the extra time and effort to research the applicable law, from doing so, is astounding.

…

LG: In *Neutral Corner* (April 2005), the NASD specifically stated, "Arbitrators are reminded that they are not to engage in any outside legal research…" Please see Part XIII (http://www.lgesquire.com/NASDArbEmail_Part_XIII.pdf) for a lengthy analysis of those comments. Employing "basic legal principles," under the NASD's broad admonition, may qualify as doing "outside legal research." What may be "basic" to you may not be to others.

A: I want you to know that I, for one, as an NASD arbitrator, refuse to ignore the law. I read the cases cited by counsel for the parties and their pre-hearing briefs. … I find it helpful to have an industry person on the panel. …

LG: … Part of the Petition relates a situation where a NASD Regional Director instructed an arbitrator (with extensive securities litigation experience) to promise to

ignore the law or invite and grant a motion for recusal based upon grounds of bias. The arbitrator was aware of case law, specifically on point, which was not cited by the parties or known to her fellow panelists. She wanted to provide a copy of the case to fellow arbitrators and counsel and request counsel to comment upon its applicability. The NASD equated legal competence with bias. …

A: Your raising of important questions provides a valuable service. As far as what goes into reaching a decision no one is going to tell me what I put over my signature or how I reach the decision. If the NASD wants to kick me off the panel for being a contentious lawyer/arbitrator, it is welcome to do so. …

LG: … Parties suffer when the best and the brightest walk. Hang in there.

VI. Arbitrator Superstars?

A: The group exists. One has only to go to the NASD-DR website and look up guidelines for expense reimbursement. These uber-arbitrators are Category 4. That means the NASD selects them (you can not volunteer) and you are give expense account travel opportunities all over the country. The only question is the selection criteria for this exalted status. Selected by the SIA, perhaps?

LG: The Guidelines for Arbitrator Reimbursement can be found at: http://www.nasd.com/web/groups/med_arb/documents/mediation_arbitration/nasdw_009518.pdf. It states, in part, "Category Four: Arbitrators who are asked by NASD Dispute Resolution to serve in a hearing location in which they did not previously volunteer to serve." (Emphasis in original.)

A: I would be interested in knowing why the A-team arbitrators program was started and who is chosen for membership. XXX has a long list of arbitrators, so I don't understand bringing someone in from YYY or ZZZ. If it's because the A-team is particularly good, then that contradicts the NASD's comment … that they're proud of the community-based program of arbitrators drawn from all walks of life with little knowledge or experience in securities or securities law.

LG (Supplement): To some, it might interesting that one would be "proud (to select) … arbitrators … with little knowledge or experience in securities or securities law" to resolve matters dealing with those subjects. To others, it might be shocking.

A: More great things to ponder. After a quick read, I have one comment re: "Superstar Arbitrators," arbitrators who are reimbursed for travel expenses. My limited experience with this issue tells me that it isn't about NASD selecting specific people who they think are good--it's about filling a panel on a case that is set for hearing in a weird location, or for such an extended time, that they cannot get anyone local to be on the panel. This situation gets set up when (as often happens) the original panel members don't know until after the IPHC where the case will be heard, or how many hearing dates will be set. So everybody just waits to see if the hearing will actually go, and then--surprise--one or more arbitrators drop out. Getting people who have to travel to fill in is a last-ditch-thing. They only pay people who haven't previously agreed to serve in that location.

LG: In about 1990, I was asked to serve as an arbitrator in Las Vegas for several sessions. An arbitratrix was called in from San Diego. There may have been many arbitrators in Las Vegas, but, perhaps, they all knew the parties.

A: I like the word "arbitratrix." Re: NASD bringing in out-of-town arbitrators...I had to fight like mad to get paid as agreed for a XXX case. NASD called me only after the entire original panel …withdrew….. Of course there was no "expense account" or direct billing. Then NASD lost my expense report, then paid only some of it...my credit card has yet to recover. That was almost pleasant compared to my experience working on a case in one of the smaller … venues. ... [T]he NASD very begrudgingly paid only a part of my hotel expenses, plus some limited mileage allowance, only because they erroneously believed I had volunteered to serve in AAA. … In our last conversation about that expense reimbursement, the NASD staff person wound up shrieking at me…. So nice to be appreciated.

My continuing thanks to those who have contributed to Parts I through XVII 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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