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

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

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.

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]**).

I. NASD Proposed Arbitration Code/Rule Changes

The SEC recently sought comment on NASD proposal SR-NASD-2004-011, which deals with several changes to its arbitration code. (All NASD proposals and requests for comment may be found at: **http://www.sec.gov/rules/sro/nasd.shtml**.) The text of the proposal can be found at: http://www.sec.gov/rules/sro/nasd/34-51857.pdf. The proposal has been lingering at the SEC for a few years. Numerous comments may be found at: http://www.sec.gov/rules/sro/nasd/nasd2003158.shtml. Some of the proposals are as follows:

> **Ex Parte Communications (Proposed Rule 13210)**
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> The current Code does not address ex parte communications. … [T]he revised Code would include Proposed Rule 13210 explicitly to … state that participants in NASD arbitrations "should not engage in conversation with arbitrators in the absence of the other party(ies)." …

Materials provided to parties also advise parties to avoid ex parte communications with arbitrators.

…

Neutral List Selection System and Arbitrator Rosters (Proposed Rule 13400)

[T]he proposed Industry Code would require that NASD create and maintain a third roster of arbitrators who are qualified to serve as chairpersons. The parties would select the chairperson from the chair-qualified list in the same manner and at the same time that they select the other members of the panel. In single-arbitrator cases, the arbitrator would be selected from a list of chair-qualified arbitrators, unless the parties agreed otherwise.

…

Under proposed Rule 13400, arbitrators would be eligible for the chairperson roster if they have completed chairperson training provided by NASD, or have substantially equivalent training or experience, and either: • Have a law degree and are a member of a bar of at least one jurisdiction and have served as an arbitrator through award on at least two arbitrations administered by a SRO in which hearings were held; or • Have served as an arbitrator through award on at least three arbitrations administered by an SRO in which hearings were held.

...

Generating and Sending Lists to the Parties (Proposed Rule 13403)

…

[P]roposed Rules 13403 and 13404 would expand the number of names of proposed arbitrators provided to the parties to seven names for each arbitrator on the panel, but would limit the number of arbitrators that each party may strike from each list to five. NASD believes that expanding the lists, but limiting the number of strikes each party may exercise, will expedite panel appointment and minimize the likelihood that the Director will have to appoint an arbitrator who was not on the original lists sent to parties. Currently, parties are allowed unlimited strikes, which often results in no arbitrators being left on the consolidated list. In such cases, the administration of the arbitration is delayed, and the Director must appoint arbitrators to fill the panel.

II. <u>"Explained Decisions" – Comment and Rebuttal</u>

LG (Idea): The following quote is from a recent comment letter to the SEC on proposed SR-NASD-2005-032 might qualify for both the "Admission of the Year" and the "Let's Continue the Sham" awards:

> <u>1</u>/ The principal focus of my practice is the defense of individual reps and firms in customer initiated NASD and NYSE arbitrations.
>
> …..

> Moreover, customers, whom the NASD believes views arbitrators as comparable to judges in a court of law, will come to recognize that there are arbitrators that lack sufficient knowledge, skill and training to serve in that capacity. It is difficult enough for a judge with years of legal education and training staffed with law clerks to draft a reasoned opinion much less a non-attorney with no legal background or knowledge of training and no experience in the securities industry. (Emphasis added.)

III. Arbitrators and the Law

A: I too am an attorney (retired) who serves on NASD panels, often as Chair. I believe that you may be ignoring the influence of an attorney on a panel when it comes to considering "the law" with respect to the parties positions at arbitration proceedings. Generally the industry member is not a lawyer. Most often the remaining panel member is not a lawyer. I have found that these panel members feel they should defer to the understanding of the "Law" as the lawyer panel member expounds on it. Lay persons generally do not realize that "law" is subject to interpretation. That particular fact situation may change the application of the law. Lay persons often do not realize that decisions by trial courts are subject to appeal and may not establish precedent. Most lay people are not aware that even decisions of the individual U.S. Circuit courts differ from one another. Which "law" to be applied is often decided by split decisions of the higher courts at all levels.

When a lawyer panel member does independent research and then adopts a course of action which he believes is warranted, he brings a strong influence upon his fellow members. If the position of the lawyer panel member was known to the parties, during the hearing, it is possible that the parties would address the issue and might persuade the panel to one course or another.

The question of knowledge of the law is a thorny one. Judges, Professors and indeed individual lawyers see the same case law differently.

I am not suggesting that lawyer panel members should ignore their knowledge of legal thinking and precedent, but that knowledge must be used judiciously, something most of us are not accustomed to. Many lawyers take positions as if it is the "only" answer and set in stone. That the law is full of nuance escapes the thinking of many. Particularly lay persons often fail to realize that case law is difficult to apply.

I believe that panel members should certainly read the cases cited by the parties, if they have some question about the applicability of those cases they should ask questions of the counsel for the respective parties, carefully, so as not to indicate a conclusion they have formed, so that the counsel will have an opportunity to address any issue during the hearing. If Attorney panel members perform their own individual research, adopt a position they believe is indicated by the research, and then expound their conclusion forcefully, there is a risk that the other non-lawyer panel members will defer to what they believe is the superior knowledge of the "professional".

As I said earlier, it is not an easy issue, and I do not believe you have addressed this matter in your discussion. (Emphasis added.)

LG: There is a problem with “deferring” whether it is to the attorney or the securities industry member of the panel. There have been writings that deal with those issues. The

suggestion has been that both the attorney and the securities industry panelists reveal their ideas to the parties, who can then present their views through additional legal research, argument and/or additional witnesses. In that manner, the other two panelists might hear contradicting views rather than blindly "defer" to the third panelist. At this time, the NASD welcomes information to co-panelists, which need not be disclosed to the parties, from securities industry panelists, but forbids attorneys from using vaguely defined "legal research," which includes information gained from years of experience.

My Petition for Rulemaking (SEC File No. 4-502) covered the issues you mentioned. It contained the following description of true-to- life incident:

> The NASD policy requires that an arbitrator's extensive knowledge of securities law and requests for full disclosure to co-panelists and the parties be considered as bias, when it should be considered as a demonstration of competence. An NASD Regional Director recently attempted to dissuade an arbitrator, who is well-versed in securities law and experienced in securities litigation/arbitration, from informing co-panelists and attorneys for the parties of applicable case law. (The relevant legal opinion describes the decision making process/criteria without specifying whether the ultimate decision was in favor of the plaintiffs or defendants.) The arbitrator desired to learn the attorneys' opinions as to whether the case law was applicable to the matter and, if so, how it was applicable. The co-panelists refused to consider the law (as they believed that such would be a violation of some unspecified rule as the parties did not supply the legal authority) and/or allow its disclosure to the parties. The NASD Regional Director solicited a promise from the arbitrator not to employ that law in the decision-making process. When the arbitrator refused to disregard the law, the NASD Regional Director suggested that the arbitrator invite and grant a party's motion for recusal based on grounds of bias. After the motion was granted, the two remaining arbitrators granted a motion to strike from the record all questions asked by the recused arbitrator and all answers thereto.

My Supplement the Petition states:

> In its April 2005 publication of the *Neutral Corner*, the NASD set forth its policy as to whether arbitrators are permitted to employ their knowledge of the law in the decision-making process. It stated,
>
> **Question and Answer: Understanding and Applying the Law in a Case**
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> **Question:** What should an arbitrator do when additional information is needed to understand the law presented in a case?
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> **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 vacate an award. (See The Arbitrator's Manual). (Emphasis in original.)

The purported "Answer" demonstrates that NASD's disdain for use of the law in the decision-making process.

In essence, the NASD has informed arbitrators to ignore the law in their decision-making process. Attorneys and others familiar with the law been doing "outside legal research" throughout their careers to reach their current state of knowledge of the law. The vague phrase "outside legal research" dictates that attorneys and others familiar with the law (securities and otherwise) would be required to wipe their memory banks clean before entering the hearing room or ruling upon any pre-hearing motions.

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.) The NASD does not 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."

Essentially, the NASD has abandoned all standards in the decision-making process. The NASD does not state how an arbitrator is to learn what "the underlying policies of the law" are in order to do an "analysis." Nor, does it state how an arbitrator is to learn: (1) what the "legal concepts" are; (2) how an arbitrator supposed to "interpret" the law; or (3) how wide is the "latitude in their interpretation." One might reasonably conclude that the NASD informs arbitrators to "encourage the party to present the issue (of law) orally" so that there will be no easily accessible record on appeal. Further, arbitrators are not required to read any brief that is submitted by the parties.

The NASD informs arbitrators that they can ignore the law and, further, are not even taught what the law is, but they are not informed how, with that total lack of knowledge, how an arbitrator would know whether or not he/she "manifestly disregards the law."

This latest NASD pronouncement constitutes a Catch-22. 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.) Thus, those arbitrators should be disqualified as they are required to already have done "outside legal research" to qualify.

The *Neutral Corner* 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. An example in the Petition shows that it is the NASD's policy to instruct such persons to invite and grant a motion for recusal on the grounds of bias.

The NASD expects arbitrators to treat a statement in the *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 the NASD's publicly available literature. The SEC has not granted such authorization to the NASD. It is inconceivable that the NASD would formally/publicly seek approval, in substance, to require arbitrators to ignore the law in the decision-making process or that the SEC would grant such permission.

IV. "Random" Selection of Arbitrators

A: Someone had complained about the scratching and ranking of potential arbitrators as a waste of time. … But the NASD did not explain what happens … under either the rotational or random system. … This is another example of how secretive the process is.

LG: "NASD reviews its arbitration program continuously to identify ways to promote transparency to investors, improve the quality of arbitration, and ensure the integrity of the arbitration process. … NASD strives continually to improve the transparency of the arbitration process for investors. … Transparency is a cardinal value of the federal securities laws. … NASD believes that transparency should be a hallmark of securities arbitration as well." (Testimony of Linda D. Fienberg President NASD Dispute Resolution Before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises Committee on Financial Services United States House of Representatives March 17, 2005)

LG (Supplement): In its proposed rule change NASD-SR-2004-011, the NASD stated, **"**Currently, parties are allowed unlimited strikes, which often results in no arbitrators being left on the consolidated list. In such cases, the administration of the arbitration is delayed, and the Director must appoint arbitrators to fill the panel." However, there was no disclosure as to how and in what manner the "Director" acts to "appoint arbitrators to fill the panel." Further, one might wonder how often is "often." If "often" approaches 100%, then "rotational" or "random" selection of panels by the parties became a meaningless act.

V. Comments on the *Neutral Corner* (August 2005)

LG (Idea): A recent issue of the *Neutral Corner* (August 2005) stated, in part:

Selection of Discovery Arbitrators

Discovery arbitrators are pre-selected public arbitrators currently on NASD DR's roster who are lawyers with experience in resolving discovery-related disputes. After parties sign the stipulation agreeing to participate in this program, the Director of Arbitration will appoint an arbitrator from the roster of discovery arbitrators.

As part of the appointment process, NASD DR staff will pre-screen the roster of discovery arbitrators for current conflicts. Once NASD DR assigns the discovery arbitrator to a particular case, the parties may only challenge the appointment of the discovery arbitrator by filing a causal challenge or a Director's

However, there was no information as to who is on the "roster," how they are "pre-selected," the manner, e.g., "random," "rotational," favoritism, by which they are "appointed" or whether the "Director of Arbitration" may delegate his/her authority and, if so, to whom. (The issue was covered in detail in Part XVII.) This is another example of NASD transparency or lack thereof.

Case Filings

Arbitration case filings from January 1 through July 31, 2005 reflect a 29 percent decrease compared to cases filed during the same time in 2004. NASD DR experienced a decrease in case filings during this seven-month period from 5,083 in 2004 to 3,602 in 2005. At the same time, NASD DR staff increased by six percent the number of cases closed from January 1 through July 31, 2005 compared to the same period in 2004.

Is the NASD still recruiting more and more arbitrators? If so, why?

How to Conduct a Deliberation

…

Applying the Law to the Facts

Arbitrators are not strictly bound by case precedent or by 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.

However, if the panel manifestly disregards the law, a court may vacate an award. If the parties provide the panel with the law, the law is clear, and it applies to the facts of the case, then the law should be followed.

…

Arbitrators should not engage in any outside legal research, nor should they ask NASD DR staff to conduct legal research on their behalf. If the panel feels that it needs additional information in order to make a decision, it must rely on the parties to provide research in support of their respective positions before reaching final determinations.

Why must NASD arbitrators be informed of this elementary decision-making process information in the *Neutral Corner*? Were they not selected as arbitrators based upon their prior decision-making experiences? Were they not taught this decision-making process (vis-à-vis 2 hours of civility training) in their initial arbitrator training?

How is one to be "guided by the underlying policies of the law" without an explanation of what those "underlying policies of the law" are? How "wide" is the "latitude" that is "given"?

What are the "legal concepts" to which reference is made. How does one determine whether the law is "clear"? Are arbitrators supposed to ignore applicable law with which they are familiar if the parties did not provide it?

How does an arbitrator know that he/she is about to "manifestly disregards the law" in order not to do it?

Repeating NASD platitudes will not cure the basic problems of lack of proper recruiting, inadequate training and effective evaluation methods.

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