Public Investors Arbitration Bar Association

April 16, 2008

Nancy M. Morris,
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SR-FINRA-2008-009
Proposed FINRA Amendment to Customer Code Rule 12400(c)
Chairperson Eligibility Requirements

Dear Ms. Morris:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA") to comment in opposition to FINRA's proposed change to Rule 12400(c) (eligibility for chairperson roster). PIABA is a national bar association dedicated to the protection of the rights and interests of public investors in securities and commodities arbitration. Our members and the investors we represent have a strong interest in the rules that govern the arbitration process at FINRA. Our concern as to FINRA rule proposals is even greater now that FINRA has combined with the New York Stock Exchange to establish a monopoly over the investor arbitration process.

Rule 12400(c) currently requires that a FINRA arbitration chairperson must either have completed FINRA's chairperson training or "have substantially equivalent training or experience." FINRA now proposes to delete the "substantially equivalent training or experience" language of the Rule, thereby extending its monopoly over arbitrator training to include mandatory training of the arbitrators whom it will deem to be "chair-qualified." The proposed change will have the effect of extending FINRA's influence over case outcomes and actually will increase the unfair packing of FINRA arbitration panels with repeat arbitrators who have an established tendency to favor securities industry respondents. Allowing FINRA to tighten its control over its dispute resolution monopoly will increase the investing public's distrust in the process – a distrust that is well-documented in a recent independent survey commissioned by the Securities Industry Conference on Arbitration.[1]

In order to understand our strong opposition to this seemingly minor rule change, it is important to reconsider PIABA's longstanding opposition to the existence of a separate, chair-qualified list.

The chairperson roster is the list of arbitrators eligible to chair a FINRA arbitration panel. Three lists of potential arbitrators are provided for striking and ranking by the parties: (1) a list of eight potential chairpersons, all of whom must meet FINRA's definition of "chair-qualified" arbitrators; (2) a separate list of eight potential public non-chair arbitrators; and (3) a list of eight potential industry arbitrators. Under the list selection rule that the SEC approved, the non-chair public arbitrator list contains names drawn from both the roster of non-chair-qualified public arbitrators *and* the roster of chair-qualified arbitrators. Thus, the "chair-qualified" arbitrators' names are put into the hat twice for list-selection purposes rather

[1] Jill I. Gross and Barbara Black, "Perceptions of Fairness in Securities Arbitration: An Empirical Study—Report to the Securities Industry Conference on Arbitration" (February 6, 2008). The report is available online at http://www.law.pace.edu/files/finalreporttosica.pdf.

than just once like all of the other arbitrators, with the result that the deck is stacked in their favor.[2]

Segregating the chair-qualified public arbitrators from the rest of the public arbitrators runs contrary to FINRA's purported principle that "all arbitrators on the lists will have the same chance of being selected for any case."[3] Creating a system where chair-qualified arbitrators are favored in the list-selection process compounds the imbalance dramatically. As FINRA and the SEC are aware, it is possible to demonstrate mathematically, without any need for statistical or empirical data, that: (1) the current deck-stacking rule will increase chair-qualified arbitrators' odds of having their names sent to the parties for striking and ranking and will decrease non-chair-qualified arbitrators' odds of having their names sent out on those lists; and (2) the increases and decreases for the two groups of arbitrators are quantifiable and predictable.[4]

Giving some potential arbitrators preferential treatment in the selection process creates an arbitration forum that utilizes a small group of "repeat" arbitrators who will hear a disproportionately large number of cases. Independent studies have established that "repeat arbitrators" are more likely to produce rulings that favor defendants or respondents[5] who frequently are repeat players in the process.

The pool of "repeat arbitrators" – now called "chair-qualified arbitrators" – is not dominated by active practicing attorneys who serve on FINRA panels as a public service. More often, these "repeat arbitrators" are retired or semi-retired attorneys who hope to be appointed to FINRA arbitration panels as often as they can get assigned. It therefore is in the self-interest of the "repeat arbitrators" to refrain from rendering awards that might offend the securities industry members that are "repeat players" in the forum and thereby jeopardize the arbitrators' chances of being appointed in the future. Given that self-interest, it should surprise no one that "repeat arbitrators" are more likely to render decisions that favor "repeat players" who have disproportionate ability to control the arbitrator's future assignments. In FINRA arbitrations, this means that "chair-qualified arbitrators" are more likely to render decisions that favor FINRA's members.

---

[2] Rule 12403(a)(3) provides as follows: "If the panel consists of three arbitrators, the Neutral List Selection System will generate the chairperson list first. Chair-qualified arbitrators who were not selected for the chairperson list will be eligible for selection on the public list. An individual arbitrator cannot appear on both the chairperson list and the public list for the same case."

[3] NASD argument in support of its original amendment proposing the three-list arbitrator selection process currently utilized by FINRA. Response to comments and Partial Amendment 5, dated August 15, 2006. File SR-NASD-2003-158 at page 22.

[4] See Scot Bernstein, "Stacking the Deck in Arbitrator List Selection: A Study in Regulatory Failure and a Practical Look at the Consequences," *PLI Securities Arbitration 2007* (August 2007), copies of which are available through Westlaw and at www.sbernsteinlaw.com. An earlier version of Appendix B to that PLI chapter, containing the algebraic proof that quantified the problem that would arise as a result of the NASD's proposed deck-stacking rule, was submitted to the SEC by Mr. Bernstein in May 2006 as a public comment in response to the NASD's May 4, 2006, Partial Amendment Number 5, Amendments to the NASD Code of Arbitration Procedure for Customer Disputes, File Number SR-NASD-2003-158. The same proof appeared as an attachment to a public comment letter submitted to the SEC by Mr. Bernstein and C. Thomas Mason III in October 2006 in response to the NASD's Partial Amendment No. 7, Amendments to the NASD Code of Arbitration Procedure for Customer Disputes, File Number SR-NASD-2003-158.

[5] See, *e.g.*, MARCUS NIETO & MARGARET HOSEL, ARBITRATION IN CALIFORNIA MANAGED HEALTH CARE SYSTEMS (California Research Bureau, Dec. 2000) (finding that where a small group of repeat arbitrators handled many of Kaiser Permanente's arbitration claims, 75% of those arbitrators ruled in favor of the defense in 80% of the cases; overall, after surmounting other systemic disadvantages, plaintiffs' chances of winning an award were 15%-25% better with an infrequent arbitrator than with a repeat player arbitrator); Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 McGeorge L. Rev. 223 (1998); Marc Galanter's classic study, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Changes*, 9 Law and Society Rev. 95 (1974).

Thus, repeat arbitrators are the opposite of Article III judges, who cannot be fired and whose pay cannot be reduced during their lifetimes. We point this out only to show that we as a nation have understood, since at least 1789, the undesirable consequences of allowing adjudicators of disputes to be subject to political or monetary incentives and pressures. There is no reason to pretend that those long-understood principles of human nature have somehow changed.

One of the obvious solutions to having too many "repeat arbitrators" hearing cases is to have newer, perhaps less jaded, arbitrators assigned to sit on panels. Unfortunately, with the current rule's dramatic increase in the likelihood that "chair-qualified" arbitrators will dominate arbitration panels, it becomes correspondingly more difficult for those newer arbitrators to be seated on panels.

Moreover, as Rule 12400(c) also requires a non-lawyer arbitrator to have served on three cases through award as a prerequisite to achieving "chair-qualified" status,[6] it will become more and more difficult for newer arbitrators to get to the point where they have an equal likelihood of being included on lists sent to the parties for striking and ranking. This results in an entrenchment of repeat arbitrators on panels, rather than the opposite. And it is in direct conflict with FINRA's policy that all arbitrators should have an equal chance to serve.

FINRA's proposed change to the eligibility standard for the roster of chair-qualified arbitrators will further reduce the potential size of FINRA's pool of favored arbitrators. And a smaller, more exclusive list of "repeat arbitrators" will increase the likelihood that each member of that roster will serve on even more panels and will render more decisions favorable to securities industry members. This will work to the detriment of public customer claimants, whose chances of achieving a favorable award are decreased by the presence of "repeat arbitrators." It also will give further support to the public perception that the FINRA arbitration monopoly is a playing field tilted in favor of FINRA's member firms, a place where investors cannot get a fair shake.

If the goal is to provide an "equal chance" arbitrator selection process and a forum through which public customers can have an opportunity for a fair adjudication of their claims, the proposed rule change is counterproductive and must be rejected. Further, the SEC should seize this opportunity to do away with the deck-stacking rule and revisit its original decision to allow FINRA to maintain a separate list of "chair-qualified" repeat arbitrators. Such a change would clearly be in the public interest.

Thank you for allowing us to comment on this proposed rule change.

Respectfully,

PUBLIC INVESTORS ARBITRATION
BAR ASSOCIATION

Laurence S. Schultz
President, 2007-2008

Contact Information:
Laurence S. Schultz, Esq.
Driggers, Schultz & Herbst, P.C.
2600 West Big Beaver Road, Suite 550
Troy, Michigan 48084
Phone: (248) 649-6000
Fax: (248) 649-6442
E-mail: LSSARB@AOL.COM

[6] Arbitrators who are attorneys must sit on two cases through award.