MARTIN L. FEINBERG
ATTORNEY AT LAW
365 SOUTH END AVENUE
NEW YORK, NEW YORK 10280-1043
(212) 432-0873

August 8, 2007

BY E-MAIL

Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549–1090
rule-comments@SEC.gov

Re: Comment: File No. SR-NASD-2007-021
Amendments to NASD Arbitration Code 12100(u) - Definition of Public Arbitrator

Dear Ms. Morris:

I write to comment on SR-NASD-2007-021, a revision to Rule 12100(u) of the NASD[1] Code of Arbitration Procedure concerning the definition of "public arbitrator."

I write as one who is a former member of the enforcement division staff of the Securities and Exchange Commission ("SEC"), as a current arbitrator in NASD arbitrations, and as an advocate for investors in NASD securities arbitrations.

We commend NASD for recognizing that individuals or firms that earn $50,000 from the securities industry may be biased or appear to be biased in favor of the securities industry. The addition of this provision to NASD's Code of Arbitration Procedure will improve the code.

Nevertheless, we have comments. Our comments fall into three categories: (1) comments relating to improving the wording of the proposed rule to achieve the result currently contemplated by the rule, (2) comments to change the proposed rule to improve the likelihood that NASD's goals in promulgating this rule will be achieved, and (3) comments relating to the non-public arbitrator.

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[1] On July 30, 2007, NASD Dispute Resolution became part of the Financial Industry Regulatory Authority ("FINRA"), and this rule change will be incorporated into FINRA's Code of Arbitration. However, to maintain consistency and to avoid confusion, we use the term NASD throughout this comment.

1. NASD can improve the wording of the proposed rule

The rule provides that public arbitrator does not include someone whose firm "derived $50,000 or more in annual revenue in the past two years . . . ." The rule would be clearer if it said "derived $50,000 or more in annual revenue in **each of** the past two years . . . . " or "$50,000 or more in annual revenue in **one of** the past two years . . . ." depending upon the drafters' intent.[2]

2. NASD can improve the rule

The purpose of the rule is apparently to remove from the public arbitrator pool those who are biased or appear to be biased in favor of the securities industry. To achieve this goal, NASD can improve the rule.

a. Proposed Rule 12100(u)(5) should be consistent with Rule 12100(u)(4)

Rule 12100(u)(4) and Proposed Rule 12100(u)(5) differ in at least two ways regarding the sources of revenues that will disqualify an arbitrator from the public arbitrator classification. These differences should be reconciled.

First, Rule 12100(u)(4) provides that a public arbitrator "is not an attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past two years from any persons or entities listed in **paragraphs [12100](p)(1)-(4)**" (emphasis added)

Proposed Rule 12100(u)(5) limits the source of income to "persons of entities listed in **paragraph [12100](p)(1).**" (emphasis added)

If for the purposes of Rule 12100(u)(4) there is an appearance of bias if revenue is derived from one of the sources listed in paragraphs 12100(p)(1)-(4), the same appearance of bias exists for the purposes of Proposed Rule 12100(u)(5). Proposed Rule 12100(u)(5) should include all sources of revenue cited in Rule 12100(u)(4).

Second, Rule 12100(u)(4) does not limit the source of securities industry revenues "to any customer disputes concerning an investment account or transaction." Proposed Rule 12100(u)(5) does.

If for the purposes of Rule 12100(u)(4) there is an appearance of bias when an arbitrator derives revenues from the securities industry for any reason and not just as a result of"any customer disputes concerning an investment account or transaction," the appearance of bias also exists for the purposes of Proposed Rule 12100(u)(5). Proposed Rule 12100(u)(5) should not

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[2] Similar changes would improve existing rule 12100(u)(4).

include the words "relating to any customer disputes concerning an investment account or transaction, including but not limited to, law firm fees, accounting firm fees, and consulting fees."

NASD's justifies its inconsistent treatment of the two rules by describing discussions it had with "some users of the [NASD arbitration] forum" who "voice[d] concerns about individuals serving as public arbitrators when they have business relationships with entities that derive income from broker-dealers."[3] The so-called "some users of the [NASD arbitration] forum" said their concerns

> focused primarily on the law firm's defense of action (in arbitration or litigation) by customers of broker-dealers, and not on representing broker-dealers in underwriting or other activities. Therefore, those concerned with the amount of annual revenue recommended that there be an annual dollar limitation of $50,000 on revenue from broker-dealers relating to customer disputes with a brokerage firm or associated person concerning an investment account.

Because the so-called "some users of the [NASD arbitration] forum" agreed among themselves that the rule should disregard certain forms of revenue, we now have a proposed rule that ignores the very factors that create an appearance of bias that Rule 12100(u)(4) correctly recognized.

Transcription of a rule does not justify it. A self regulatory organization should regulate, not transcribe.

The sources of revenue recognized in Rule 12100(u)(4) should be recognized in Proposed Rule 12100(u)(5).

b. The Proposed Rule should require a "cooling-off period" after the annual revenue disqualification no longer applies and before a person can serve as a public arbitrator

Under the proposed rule, a person is disqualified from serving as a public arbitrator if "his firm derived $50,000 or more in annual revenue in the past two years" from, for example, representing broker-dealers in securities arbitrations against customers ("disqualifying annual revenue").

Thus, if in years 1 and 2 a person's disqualifying annual revenue was $55,000, the person cannot be a public arbitrator in year 3. But he can be a public arbitrator in year 4. Similarly, if in years 1-15 the person's disqualifying annual revenue was $55,000, he cannot be a public arbitrator in year 16, but he can be a public arbitrator in year 17.

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[3] Proposed Rule Change Filing SR-2007-21 (Mar. 12, 2007) at 9.

This should not be the case. Anyone identified closely enough with the securities industry to be disqualified from serving as a public arbitrator because of disqualifying annual revenue should be disqualified for a substantial period after his annual revenues again qualify him to be a public arbitrator.

NASD recognizes this concept when it assigns to the non-public arbitrator pool people who have been out of the securities industry for fewer than 5 years.[4]

Similarly, anyone who is disqualified from serving as a public arbitrator because of disqualifying annual revenue should be disqualified from serving as a public arbitrator until he does not receive disqualifying annual revenue for at least 5 consecutive years.

c. The Proposed Rule needs more stringent enforcement provisions

The entirety of NASD's proposed system of enforcement is "NASD will survey its public arbitrators to determine which arbitrators will be removed from the roster for appointment to new cases upon the effective date of the proposed rule."[5]

It does not instill confidence that NASD lacks the ability to assure independently that its arbitrators are properly classified, and it must rely solely on the arbitrators. Yet this is the consequence of the proposed rule. It contains no enforcement procedure.

Even if NASD requires that every time an arbitrator is selected to serve on an arbitration he must file a representation that he qualifies under the rules to be a public arbitrator, nothing prevents the arbitrator from filing a false statement.[6]

Moreover, even if a party to the arbitration expressly asks the arbitrator whether he qualifies to be a public arbitrator, the arbitrator is not required to answer the question.

Without a reasonable method of enforcing the rule, the rule's benefits are illusory.

d. The amount of annual revenues that disqualify someone from serving as a public arbitrator should be any amount more than $0.00

NASD apparently concedes there is nothing special about the number $50,000. Apparently, it's only reason for using $50,000 is because the so-called "some users of the [NASD

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[4] *See* NASD Code of Arbitration Procedure 12100(p)(1)(A).

[5] Proposed Rule Change Filing SR-2007-21 (Mar. 12, 2007) at 10 n.9.

[6] As discussed below, it would be easier to know that an arbitrator earns more than $0 than to know he earns more than $50,000. *See infra* p.6.

arbitration] forum" recommended it. *See supra* p.3. Apparently, the number could just as easily be $10,000 or $90,000.

Nevertheless, $50,000 is a substantial amount of money. For example, according to the United States Bureau of Labor Statistics the median income of lawyers and accountants as of May 2006 was $102,470 and $54,630 respectively. (See attached.) To the average lawyer or accountant $50,000 is a substantial sum.

Perhaps instead of selecting an arbitrary number like $50,000, we should use a number more closely associated with attorney and accountant incomes. The average investor earns no more than lawyers or accountants, and if NASD's goal is to enhance investor credibility in the arbitration process, the threshold number that disqualifies a person from serving as a public arbitrator should be a number that investors from all over the United States can relate to, not just what the so-called "some users of the [NASD arbitration] forum" can relate to.

Thus, for example, we can use as a guide Rule 12100(u)(4), which sets the threshold for disqualification at 10% of revenues. Perhaps the monetary threshold should be 10% of the median income of lawyers or accountants, that is, somewhere between $5,000–$11,000.

The advantage this number has over the $50,000 number suggested by the so-called "some users of the [NASD arbitration] forum" is that it at least correlates with something, i.e., the approximate median income of the every-day lawyer or accountant in this country.

As is easily seen from the above, the threshold number is not easily quantified or justified, and the definition of public arbitrator is necessarily imprecise. NASD recognized this problem when it responded to comments to the proposed 10% rule:

> Given the inherently imprecise nature of such definitions, NASD believes that, to protect both the integrity of the NASD forum, and investors' confidence in the integrity of the forum, it is preferable that the definition of public arbitrator be overly restrictive rather than overly permissive.[7]

We agree, and we submit that to "protect the integrity of the NASD forum" and to "protect investors' confidence in the integrity of the forum," the threshold number for public arbitrators should be one that instills the greatest confidence. The threshold number should be $0. As NASD properly recognized, "it is preferable that the definition of public arbitrator be overly restrictive rather than overly permissive."

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[7] Letter from Laura Gansler, NASD Counsel, to Florence Harmon,Senior Special Counsel, SEC Division of Market Regulation (Sept. 30, 2003) at 2. Available at http://www.finra.org/RulesRegulation/RuleFilings/2003RuleFilings/P009379

As a practical matter, whatever number NASD selects will not satisfy everyone. Even so, the number that instills the most confidence in the arbitration forum should be the number NASD selects. That number should be $0 for a number of reasons.

First, it is almost impossible to police the amount of money someone earns. Nevertheless, it is easier to determine that someone has earned more than $0 from the securities industry than it is to determine whether he has earned more $50,000 (or $5,000). Once a person is seen to have any business relationship with the securities industry (for example, he represents someone in an arbitration against a customer), it is easy to infer that his revenues have exceeded the $0 threshold.

Second, because of the entrepreneurial environment lawyers, accountants, and other professionals inhabit these days, a professional who earns any amount of money from the securities industry – no matter how little – can easily be perceived as someone who wants to earn more from the securities industry. So the professional who earns only $30,000 (a number below NASD's proposed threshold) from the securities industry in one year can easily be perceived by the investor to be someone who wants to earn $75,000 from the securities industry next year. Such perceptions do not instill confidence.

Moreover, under the Proposed Rule 121009(u)(5) and rule 12100(u)(4), a professional or his firm can earn millions of dollars from the securities industry in January of year 1, the millions of dollars can be 95% of the arbitrator's or his firms anticipated earnings for the year, and the arbitrator would still qualify as a public arbitrator for nearly two years. This does not instill confidence.

To instill confidence, NASD should set the threshold number at $0. As soon as the professional earns any money from the securities industry for services rendered, he should remove himself from the public arbitrator list.

3. The time has come to eliminate the non-public arbitrator

NASD's continued use of a non-public arbitrator undermines its goal to field a roster of arbitrators of integrity and neutrality. Accordingly, the non-public arbitrator should be eliminated.

NASD contends that its classification of arbitrators into public and non-public arbitrators assures the "integrity and neutrality of its arbitration roster." For example, by way of background to the purpose of its current filing, NASD says "NASD has taken numerous steps in recent years to ensure the **integrity and neutrality of its arbitrator roster** by addressing classification of arbitrators."[8]

[8] Proposed Rule Change Filing SR-2007-21 (Mar. 12, 2007) at 6 (emphasis added).

To support its position that it seeks arbitrator rosters of "integrity and neutrality," NASD cites a 2004 amendment to the rules that narrows the definition of public arbitrator to exclude "attorneys, accountants, or other professionals whose firms have derived 10 percent or more of their annual revenue in the previous two years from clients involved in securities related activities."[9] Thus, under NASD's current interpretation, the 10% rule's purpose was "to ensure the integrity and neutrality of its arbitrator roster."

Yet, in a 2003 response to public comments made to the proposed 10% rule, NASD was silent regarding the neutrality and integrity of the arbitrator roster. Instead, NASD acknowledged that the purpose of the 10% rule was to ensure that there be no appearance of bias in favor of the securities industry among public arbitrators:

> "While some persons who have no actual bias in favor of the securities industry or against investors may be disqualified from serving as public arbitrators under the proposed rule change, the new provision is not intended to eliminate only persons with actual bias, but also persons who could reasonably perceive [sic] to be biased. NASD believes that the "ten percent of annual revenues" threshold will help eliminate the potential perception of bias, despite the fact that any given individual who falls within that category may not in fact be biased"[10]

Thus, the purpose of these arbitrator classification rules is not – as NASD currently suggests – to "ensure the **integrity and neutrality of its arbitrator roster** by addressing classification of arbitrators." The purpose of these arbitration classification rules is to ensure that if there is to be an actual bias or an appearance of bias in favor of the securities industry, the actual bias or appearance of bias in favor of the securities industry be limited to those arbitrators classified as non-public arbitrators.

Otherwise, the qualifications relating to bias required to be a non-public arbitrator would be the same as the qualifications relating to bias required to be a public arbitrator, that is, all arbitrators with actual biases or the **appearance** of bias in favor of the securities industry would be removed from the arbitration roster. Of course, if this were the case, no one could qualify for membership on the non-public roster – if for no other reason than the appearance of bias. If the appearance of bias undermines the concept of neutrality, then the non-public arbitrator should be eliminated.

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[9] *Id.* at 7.

[10] Letter from Laura Gansler, NASD Counsel, to Florence Harmon,Senior Special Counsel, SEC Division of Market Regulation (Sept. 30, 2003) at 2. Available at http://www.finra.org/RulesRegulation/RuleFilings/2003RuleFilings/P009379

Defining an arbitration panel to be "neutral" because actual bias or the appearance of bias in favor of the securities industry does not exist in 2/3 of the arbitration panel (the public members) does not make the panel "neutral."[11]

It is true that some contend that this failure of neutrality is outweighed by the non-public arbitrator's expertise in the securities industry. According to some, the expertise contributes to the arbitration panel's understanding of the issues. However, in my experience as an arbitrator, I have found that the non-public arbitrator's unique expertise rarely coincides with the expertise needed to resolve issues in the case. Moreover, because investment products have become more complicated, more litigants choose to offer expert testimony at the hearings rather than rely on the non-public arbitrator's expertise. Thus, including a non-public arbitrator on the panel at the expense of the appearance of neutrality is unwarranted.

NASD recognizes that it has a statutory obligation "to protect investors and the public interest."[12] Yet, NASD continues to think that it satisfies its statutory obligations as long as 2/3 of the arbitration panel appears to be neutral. As NASD proclaims, "NASD believes that **the proposed rule change will enhance investor confidence in the fairness and neutrality of NASD's arbitration forum**, by providing further assurance to parties that persons who receive a significant amount of compensation from the securities industry are not able to serve as **public arbitrators** in NASD arbitrations."[13]

It is inconceivable that NASD fulfills its statutory obligations to protect investors and the public interest by striving for fairness and neutrality in 2/3 of the members of its arbitration panels. Investor confidence is not enhanced when NASD and the SEC allow **"persons who receive a significant amount of compensation from the securities industry"** (see previous paragraph) to serve as arbitrators.

It is time for NASD and the SEC to recognize that the goal of neutrality and the appearance of neutrality of an arbitration panel cannot be achieved if the arbitrator classification system is such that only 2/3 of the arbitration panel is vetted for bias or the appearance of bias in favor of the securities industry. It is time to recognize that only those who qualify as public arbitrators qualify as NASD arbitrators. It is time to define "neutral" to mean "neutral."

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[11] "'When I use a word,' Humpty Dumpty said, in rather a scornful tone, 'it means just what I choose it to mean – neither more nor less.'" L. Carroll, *Through the Looking-Glass* , published with *Alice's Adventures in Wonderland*, (New York: New American Library, 1960) at 188.

[12] Proposed Rule Change Filing SR-2007-21 (Mar. 12, 2007) at 10-11.

[13] *Id.* at 11 (emphasis added).

Thank you for the opportunity to comment. If you have any questions, please contact me.

Very truly yours,

Occupational Employment and Wages, May 2006

23-1011 Lawyers

Represent clients in criminal and civil litigation and other legal proceedings, draw up legal documents, and manage or advise clients on legal transactions. May specialize in a single area or may practice broadly in many areas of law.

National estimates for this occupation
Industry profile for this occupation
State profile for this occupation
Metropolitan area profile for this occupation

National estimates for this occupation: Top

Employment estimate and mean wage estimates for this occupation:

Employment (1)	Employment RSE (3)	Mean hourly wage	Mean annual wage (2)	Wage RSE (3)
547,710	0.9 %	$54.65	$113,660	0.9 %

Percentile wage estimates for this occupation:

Percentile	10%	25%	50% (Median)	75%	90%
Hourly Wage	$24.32	$33.61	$49.26	(5)	(5)
Annual Wage (2)	$50,580	$69,910	$102,470	(5)	(5)

Industry profile for this occupation: Top

Industries with the highest published employment and wages for this occupation are provided. For a list of all industries with employment in this occupation, see the Create Customized Tables function.

Industries with the highest levels of employment in this occupation:

Industry	Employment	Hourly mean wage	Annual mean wage

Occupational Employment and Wages, May 2006

13-2011 Accountants and Auditors

Examine, analyze, and interpret accounting records for the purpose of giving advice or preparing statements. Install or advise on systems of recording costs or other financial and budgetary data.

National estimates for this occupation
Industry profile for this occupation
State profile for this occupation
Metropolitan area profile for this occupation

National estimates for this occupation: Top

Employment estimate and mean wage estimates for this occupation:

Employment (1)	Employment RSE (3)	Mean hourly wage	Mean annual wage (2)	Wage RSE (3)
1,092,960	0.6 %	$29.17	$60,670	0.3 %

Percentile wage estimates for this occupation:

Percentile	10%	25%	50% (Median)	75%	90%
Hourly Wage	$16.57	$20.44	$26.26	$34.59	$45.22
Annual Wage (2)	$34,470	$42,520	$54,630	$71,960	$94,050

Industry profile for this occupation: Top

Industries with the highest published employment and wages for this occupation are provided. For a list of all industries with employment in this occupation, see the Create Customized Tables function.

Industries with the highest levels of employment in this occupation:

Industry	Employment	Hourly mean wage	Annual mean wage