

PUBLIC MEMBERS OF SICA

SECURITIES

INDUSTRY

CONFERENCE

ON ARBITRATION

PUBLIC MEMBERS

THEODORE G. EPPENSTEIN
CONSTANTINE N. KATSORIS
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EMERITUS PUBLIC MEMBERS

PETER R. CELLA
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January 12, 2007

The Honorable Christopher Cox
Chairman
The U.S. Securities and Exchange Commission
100 F. Street NE
Washington, DC 20549

**Re: The Public's Concerns about the Newly Combined
NASD/NYSE Arbitration Forum and SICA's Mandate**

Dear Chairman Cox:

The Public Members of the Securities Industry Conference on Arbitration are independently appointed, unaffiliated with the securities industry and serve to help protect the interests of public investors in securities arbitration. It is in this capacity that we communicate our concern regarding the recently announced proposed merger of the arbitration departments of the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers ("NASD") (collectively "the Consolidated SRO"), which will effectively create the only forum available for the resolution of disputes between public customers and the securities industry. All the Public Members (and the retired Emeritus Public Members) wish to address certain questions raised by the consolidation with respect to the future of securities arbitration. We suggest several measures that we believe would assist the investing public's perception of fairness as well as the process of arbitration.

SICA was established in April 1977 with the support of the Securities and Exchange Commission. It was tasked to create a comprehensive Uniform Code of Arbitration ("Uniform Code") to cover all claims by investors, in all self-regulatory organizations ("SRO's"). The Uniform Code that was developed harmonized the rules of the various SROs and codified procedures that previously had been informally utilized. The original Uniform Code was developed by SICA in the late 1970's, and since that time SICA has met on a regular basis to review and amend it as necessary.

When in 1987 the U.S. Supreme Court decided that arbitration clauses would be enforced in 1934 Exchange Act securities cases,¹ investors became generally obligated to arbitrate their disputes with the industry, pursuant to predispute arbitration agreements. Two years later, the Supreme Court similarly upheld the arbitrability of claims under the Securities Act of 1933 pursuant to predispute arbitration agreements.² These two decisions transformed SRO arbitration from a voluntary process to a mandatory procedure for the resolution of most public investor disputes.

After 1987, brokerage firms utilized arbitration clauses in their customer agreements that required that all customer claims and controversies were to be tried in an arbitration forum operated by the various self-regulatory organizations. At the time there were multiple arbitration forums, including the NASD, NYSE, American Stock Exchange, Pacific Stock Exchange and Boston Stock Exchange, to name a few. Over the past decade, securities arbitration was principally administered by the NASD and the NYSE, the two major forums with the majority of the case filings. The remaining SRO's substantially reduced their caseload, while other exchanges were absorbed or gave up their arbitration programs entirely. According to a recent SICA subcommittee report, aside from the NASD and NYSE there were a bare handful of cases filed at all the other SRO forums in 2005. With the consolidation of the NASD and the NYSE arbitration departments there will be only one securities industry funded arbitration forum to which all investors must bring their claims and controversies.

The prospect of a single securities arbitration forum maintained and funded by the securities industry will only heighten the suspicion long held by many public investors that the system they are compelled to use is less than independent and hence less than fair. In the past SICA and particularly its Public Members have been able to exert some effect upon the uniform arbitration rules and their administration. The consolidation potentially creates a securities industry dispute resolution structure that will inherit all the present problems in the arbitration process in addition to a heightened degree of doubt as to its fairness. This is particularly so given the recent securities market abuses in which public investors were severely damaged while many, as the public observed, in the industry reaped substantial profits at the expense of their customers. The real issue is whether the Consolidated SRO should have the responsibility for providing the only arbitration forum to resolve investors' disputes, as opposed to having this critical function given to, or shared with, another forum totally independent of the securities industry?

We recall that the Commission had recommended in 1987 that an alternative to SRO arbitration should be made available for customers, and had asked SICA to encourage broker-dealers to include the option of a non-industry forum in future predispute arbitration clauses: "We recommend that SICA encourage broker-dealers to

¹*Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

²*Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477 (1989).

include in their arbitration clauses the option of using AAA arbitration as well as SRO arbitration forums.”³ At that time, SICA advised the SEC that the SIA’s standard customer agreement included non-SRO alternative forums,⁴ which is no longer the case. In fact, the SEC mandated in 1989 that the securities industry could no longer preclude access of investors to their choice of SRO forums. The SEC was clear that the SRO “rules are intended to effectuate an underlying policy of allowing the customer to choose the most appropriate forum for resolution of his or her particular claim.”⁵

It has been reported by the NASD that the customers’ chances of winning an award had substantially dwindled to around forty-three percent by 2006.⁶ Yet historically, after McMahon (1989-90) the win rate at the NASD/NYSE was about sixty percent, as reported by the GAO,⁷ and when investor awards are granted, they are frequently only for a small percentage of the loss suffered by the investor, sometimes not even enough to pay their costs to arbitrate. Indeed, the public has been warned by a well-respected journalist that: “If you’re an investor who has filed an arbitration case against your stockbroker, you would be wise to steel yourself for an irrational and unjust outcome.”⁸

³ Letter of Richard G. Ketchum, Director, SEC Division of Market Regulation, September 10, 1987 at p. 11.

⁴ See SICA Letter to Richard G. Ketchum, Director, SEC Division of Market Regulation, December 14, 1987 at p. 9.

⁵ Litigation Release No. 12198, 44 S.E.C. Docket 461, 1989 WL 992090 (S.E.C. Release No.). See also SEC Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the New York Stock Exchange, Inc., National Association of Securities Dealers, Inc., and the American Stock Exchange, Inc., Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses, Release No. 34-26805, 43 S.E.C. Docket 1250, 54 FR21144, 1989 WL 991624(S.E.C. Release No.).

⁶ See NASD Dispute Resolution Statistics-Results of Customer Complaint Arbitration Award Cases at www.nasd.com/ArbitrationMediation/NASDDisputeResolution/Statistics/index.htm NASD’s statistics also show a drop of around 20% in the customer’s chances from 2000 levels to 2005 levels. *Id.*

⁷ General Accounting [Government Accountability] Office, GAO/GGD-92-74, Securities Arbitration-How Investors Fare (May 11, 1992). See also Sec. Arb. Commentator, Public Customer Award Survey-The First 10,000 Awards (May 1996)(“A steady downward trend in the ‘customer win’ rate is revealed. . .”), commenting on Awards in the 1989-1995 time period.

⁸ Gretchen Morgenson, “FAIR GAME; When Winning Feels A Lot Like Losing,” New York Times Business Section, December 10, 2006, p.1.

A single, independent securities arbitration forum, with SEC oversight and public investor and securities industry participation, would serve to contribute to the reduction of this negative perception.

Another alternative to compulsory SRO arbitration would be to again provide the public investor with the right to choose to bring grievances to court or to arbitration. While not all cases would be susceptible to resolution in court (for example, claims under \$25,000), it would permit the public investor the choice as was their right prior to 1987.

The creation of the Consolidated SRO underscores the continuing importance of maintaining SICA and the Public Members' role in attempting to ensure an arbitration process that protects public investors' rights in securities arbitration. The Public Members voice their concerns and make recommendations for reform. SICA's three voting Public Members are augmented by the experience of the Emeritus Public Members. No Public Member is affiliated with the securities industry. While the Emeritus Public Members do not have a vote, as the current Public Members do, they can also attend meetings, receive agenda books, submit agenda items, invite guests and participate in the discussions, all of which benefits public investors and aids the perception of integrity and fairness in monitoring the SRO arbitration system.

In light of the fact that there will now realistically be only one SRO arbitration forum, we must strengthen SICA's role as a watchdog over the arbitration process and, in addition, ensure that at least one-half of the future voting members of SICA be Public Members, for only then will public investors be persuaded that they have a real voice in a process they are being forced to participate in.

The continuation of the role of SICA and that of its independent Public Members is necessary in order to secure and maintain balance and fairness in securities arbitration.

Securities industry considerations have been the focus of the present consolidation, particularly the great savings achieved for the Consolidated SRO. It is not unreasonable to suggest that the public investors' interests be considered in order to ensure a truly level playing field for their claims in arbitration.

Respectfully,

The Public Members of SICA*

Current Public Members
Theodore G. Eppenstein
Constantine N. Katsoris
J. Pat Sadler

Emeritus Public Members
Peter R. Cella
Thomas R. Grady
Thomas J. Stipanowich

* *The Public Members and Emeritus over the long history of SICA have developed innovative ideas, vigorously represented the public investors' interests, and worked with industry and SRO representatives in order to revise and reform the securities arbitration system. Each of the current Public Members and Emeritus have extensive experience in preserving the rights of the investing public.*

The three public members are Theodore G. Eppenstein, Esq., Professor Constantine Katsoris, and J. Pat Sadler, Esq.

Theodore G. Eppenstein is a partner in the New York law firm Eppenstein & Eppenstein. He and his firm represented the investors in the McMahon case. He has testified before two Congressional subcommittees, assisted in drafting securities arbitration reform legislation, and has been a successful practitioner in this field, including winning a historic arbitration case against Refco, Inc. and succeeding in a precedent-setting case before the New York State Court of Appeals. Mr. Eppenstein has been a Public Member of SICA since 1998. He has worked on many subcommittees and has been chair of several subcommittees including Electronic Discovery, Special Procedures for the Elderly and Infirm Parties and Employment Disputes. Mr. Eppenstein and his partner Madelaine Eppenstein have co-authored many articles on securities arbitration and litigation, and he has regularly commented on matters that concern public investors, including before the Ruder Commission and the NYSE. Mr. Eppenstein was part of the NYSE's "Dream Team" which gave presentations on U.S. securities arbitration at the NYSE/MICEX Symposium in Moscow in 2000 along with Peter Cella, Esq., Professor Katsoris and Professor Thomas J. Stipanowich. He was also part of another NYSE delegation and was a principal speaker on arbitration at the Cairo and Alexandria Stock Exchanges in 2003 along with Professor Katsoris.

Professor Katsoris is Wilkinson Professor of Law at the Fordham University School of Law in New York where he has taught courses in taxation and other business related courses. He was one of the original Public Members when SICA was formed in 1977 and returned as a Public Member and Chair of SICA in January 2003. His service to the public has been well documented and includes co-chairing the NYSE Symposium on Arbitration, testifying before Congress on securities arbitration issues and speaking at various industry and arbitration related seminars. He is a well known commentator and has written numerous articles, some of which have been noted by the U.S. Supreme Court and the SEC. He is also a public arbitrator for the NASD and NYSE for over 35 years and an active mediator in securities disputes. At the suggestion of past SEC Chairman Arthur Levitt nearly ten years ago he was instrumental in establishing the securities arbitration clinic at Fordham and elsewhere.

J. Pat Sadler is a partner in Sadler & Houdesvan in Atlanta, Georgia, and represents the public's interest as a major part of his professional activity. Mr. Sadler is a former president of the Public Investor Arbitration Bar Association ("PIABA") and serves as a director of that organization. He is an experienced and active litigator and arbitrates before the various SRO's on behalf of claimants. He joined SICA as a Public

Member in 2005 and has assisted in many of SICA's subcommittees and projects, including as Chair of the subcommittee planning the survey on arbitration which will be shortly disseminated. Mr. Sadler also was a member of the NASD's NAMC.

The Emeritus Public Members are Peter R. Cella, Esq., Thomas R. Grady, Esq. and Professor Thomas J. Stipanowich. Mr. Cella was one of the original public members when SICA was formed in 1977. He served for about 18 years before taking Emeritus status. He is a renowned securities litigator representing public customers who have constituted a significant portion of his practice. He was part of the NYSE's "Dream Team" that went to Moscow in 2000. In 1984 Governor Mario Cuomo appointed Mr. Cella to the Citizen's Planning Committee Against Crime, an advisory group to the Governor of New York. Mr. Cella represents investors in his practice and is an arbitrator at the NASD and NYSE.

Thomas R. Grady is another Emeritus Public Member. Mr. Grady is Of Counsel to the firm of Ackerman, Link & Sartory and practices securities arbitration and litigation throughout the country from his offices in Naples and West Palm Beach, Florida. As a Public Member, Mr. Grady co-authored revisions to eligibility rules, helped to draft the Uniform Code into plain English with the coordination of representatives from the industry and fought against discovery and motion practice abuses in arbitration. Mr. Grady's insights over the years have been invaluable to the public.

Thomas J. Stipanowich, Emeritus Member, is Professor of Law at Pepperdine University School of Law and Academic Director of the Straus Institute for Dispute Resolution. He is the co-author of a five-volume treatise on the Federal Arbitration Act and many other works on arbitration and conflict resolution including a new law school book and materials Resolving Disputes: Theory, Practice and Law (Aspen 2005). From 2001-2006 he was President and CEO of the International Institute for Conflict Prevention and Resolution (CPR), a prominent international think tank based in New York City. He was also Academic Advisor for the revision of the Uniform Arbitration Act and was the Academic Reporter and primary drafter of the Consumer Due Process Protocol for arbitration. During his tenure as a SICA Public Member and Chair of SICA he was William L. Matthews Professor at the University of Kentucky.

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cc: The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Kathleen L. Casey
The Honorable Annette L. Nazareth

The Honorable Max Baucus
The Honorable Christopher J. Dodd
The Honorable Daniel K. Inouye
The Honorable Chuck Grassley
The Honorable Richard C. Shelby
The Honorable Ted Stevens

The Honorable Rick C. Boucher
The Honorable John Conyers, Jr.
The Honorable John David Dingell, Jr.
The Honorable Barney Frank
The Honorable Edward John Markey
The Honorable Spencer Bachus
The Honorable Lamar S. Smith
The Honorable Joe Barton
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Amal Amy, Ass't Gen. Counsel, SIA

SICA Members and Invitees