Law Offices of
LES GREENBERG
10732 Farragut Drive
Culver City, California 90230-4105
Tele. & Fax. (310) 838-8105
E-Mail: LGreenberg@LGEsquire.com
www.LGEsquire.com

April 8, 2007

VIA EMAIL: rule-comments@sec.gov

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

Re: Consolidation of the Member Firm Regulatory Functions
SR-NASD-2007-023

Dear Ms. Morris:

This letter comments upon the prior comments submitted by the "Public Members" of the Securities Industry Conference on Arbitration ("SICA") dated January 12, 2007 and the NASD Dispute Resolution ("NASD") dated January 26. 2007. They discuss the issue of whether mandatory securities arbitration offered by the consolidated regulatory forum would be "fair" to customers of the securities industry.

I. My Background

From 1971 to 1973, I served as the Associate General Counsel and/or Compliance Director of Mitchum, Jones & Templeton, Inc., a regional New York Stock Exchange ("NYSE") Member Firm.

From 1973, I have been engaged in the private practice of law as a sole practitioner where substantially all representation dealt with financial/investment litigation. I have represented many individual investors and more than twenty (20) regional securities brokerage firms before arbitration panels and in various state and federal courts in hundreds of securities industry related disputes. I no longer represent securities brokerage firms.

I was admitted to the NASD panel of arbitrators in 1976. I have served on the panels of arbitrators of the American Arbitration Association, Pacific Stock Exchange,

NYSE and Municipal Securities Rule Making Board. Further, I serve the Los Angeles civil courts and the Los Angeles County Bar Association as an arbitrator.

In May 2005, I filed Petition for Rulemaking (SEC File No. 4-502)[1] with the Securities and Exchange Commission ("SEC"), which requests the creation of arbitration rules designed to:

(1) Specifically permit arbitration panel members, should they elect to do so, to conduct legal research, or, in the alternative, forbid Self-Regulatory Organizations ("SROs"), e.g., NASD, sponsored arbitration forums from restricting arbitrators from conducting legal research;

(2) Abolish the requirement that a securities industry arbitrator be assigned to each three person panel hearing customer disputes or, in the alternative, require that information presented to a panel of arbitrators by a securities industry arbitrator be revealed to the parties during open hearing;

(3) Require SROs to conduct continuing evaluations of ability of every arbitrator on their panels to perform his/her duties, including, but not limited to mandatory peer evaluations;

(4) Require SROs to train arbitrators in applicable law;

(5) Require SROs to reveal in pre-dispute arbitration agreements whether their arbitrators are required to follow the law in their decision-making process, the training of their arbitrators in the law, their process, if any, to evaluate their arbitrators on a continuing basis; and,

(6) Require the SEC's Division of Market Regulation to specifically oversee SROs to determine whether they are in compliance with rules adopted pursuant to items (1) through (5), inclusive.

Essentially, the Petition seeks to correct many aspects of the arbitration process, which make the process unfair to the investing public.

II. SICA and NASD Comments

The "Public Members" of SICA contend that the proposed consolidation of the arbitration departments of the NASD and NYSE will negatively affect the fairness of the mandatory securities arbitration process. They state, "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.'"

[1] A copy of the Petition is available at: http://www.sec.gov/rules/petitions/petn4-502.pdf. A copy of Supplemental Information is available at: http://www.sec.gov/rules/petitions/4-502/lgreenberg062205.pdf.

In its letter dated January 26, 2007, the NASD responds by challenging "any notion that the NASD's arbitration program is unfair" by citing various studies, reports and surveys and claiming the existence of effective oversight by the SEC.

There are material aspects of those studies, reports, surveys and oversight that need further discussion.

III. The Tidwell Report

The NASD states that, in 1999, it "engaged the United States Military Academy at West Point to conduct an independent analysis of surveys submitted by our forum's constituents." The NASD cites, "G. Tidwell, K. Foster, and M. Hummel, Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations, at 3 (Aug. 5, 1999)" ("Tidwell Report").

The results of the Tidwell Report and the alleged "independent analysis" are suspect for several reasons:

(1) The Tidwell Report was prepared by a person employed by the NASD, who was, in reality, performing a self-critical analysis;

(2) The sample was not representative, as 90% of the possible evaluators declined to respond;

(3) Those who did respond were biased, as they knew the results of the respective arbitration hearing in which they participated;

(4) The Tidwell Report erroneously assumed that only two parties were involved in each hearing, which enhanced the evaluator response rate; and,

(5) There was no survey of parties who settled before hearing, which is the situation in the vast majority of cases.

The degree of bias/independence of the Tidwell Report and the so-called "independent analysis of surveys" was raised by the fact that Gary Tidwell taught at the United States Military Academy and/or he was employed or prospectively employed by the NASD. A NASD Press Release dated January 19, 2000 states, "The National Association of Securities Dealers, Inc. (NASD®) announced that it has launched the NASD Institute for Professional Development (NIPD). Gary L. Tidwell, who was recently elected Vice President, NASD Regulation, Inc., has been named Executive Director of the Institute. … Tidwell was named Vice President of NASD Regulation in December 1999. He joined the self-regulatory organization in 1998 as Director of Neutral Management in the Office of Dispute Resolution. Tidwell maintains a tenured

professorship at the College of Charleston and also teaches at the United States Military Academy at West Point."

The NASD claims that "93.49% of those responding" indicated of how their cases were handled. However, only 10% of those surveyed responded. Thus, only 7% of those surveyed felt the process was "fair." Another report, upon which the NASD relies, considers the number statistically insignificant. (See, Section IV, below.)

IV. The Perino Report

The NASD cites," M. Perino, Report to the SEC Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations, at 51 (Nov. 4, 2002)" (Perino Report"). The NASD states that the Perino Report "touched on user perceptions of fairness, finding that '[a]vailable empirical evidence suggests that SRO arbitrations are fair and that investors perceive them to be fair.'"

The Perino Report states, "Given the unquestioned significance of securities arbitrations, it is crucial that the SROs resolve any lingering concerns about pro-industry bias. To date, available empirical evidence, particularly with respect to investor perceptions of the arbitration process, is fairly limited.... As a result, this Report recommends that the SROs sponsor additional independent studies to further evaluate the impartiality of the SRO arbitration process. ... In 2000, the GAO could not reach a conclusion on the fairness of the process...." (Emphasis added.)

A few years after issuing the Perino Report, Perino revealed his securities industry clients by stating, "EXPERT ENGAGEMENTS AND CONSULTANCIES: U.S. Securities and Exchange Commission; New York Stock Exchange; Morgan Stanley Dean Witter; UBS PaineWebber, Inc.; U.S. Bancorp Piper Jaffray; National Union Fire Insurance Company … New York Life Insurance Co. … BankAmerica Corporation." (Is Securities Arbitration Fair for Investors? Written Testimony of Professor Michael A. Perino St. John's University School of Law Before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises of the Committee on Financial Services United States House of Representatives March 17, 2005)

Perino criticizes the Tidwell Report by stating, "Two limitations of the study suggest that its findings must be interpreted with caution. First, few arbitration participants completed the surveys; the authors concluded that the evaluations response rate was only between 10%-20%. Second, these responses may reflect selection bias problems. ... [I]t is still possible that individuals that were more satisfied with the fairness of the process or that achieved favorable outcomes were more likely to complete the surveys." Id.

V. Securities Arbitration Fairness "Survey"

The NASD adopted the Perino Report's suggestion of another "survey" by stating, "This survey is about to be conducted under SICA's auspices by the Pace Investor Rights Project (affiliated with the Pace University School of Law)."

In response to a Freedom of Information Act ("FOIA") request directed to the SEC, I obtained copies of SICA Meeting Minutes, which described SICA's efforts with respect to its anticipated "independent research." It appears obvious that the securities industry exercised a heavy hand in designing the "survey," selecting the persons who are to "administer the survey" and who are not engaged full time in the "survey" business, and financing the "survey." The "survey" lacks credence even before the public is informed of its purported results. Excerpts of SICA Meeting Minutes dated January 16, 2004 to March 21, 2006 are as follows:

> Independent Research on Fairness of SRO Arbitrations ...
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> George Friedman (NASD) stated that it would not be appropriate for SROs to drive the process of collecting information on the fairness of SRO arbitrations.
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> ...
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> Mr. Friedman updated the Conference on the work of the subcommittee, consisting of Mr. Friedman (NASD), Chairman Katsoris, Ms. Kupersmith (NYSE), and Kenneth Andrichik (NASD). They are currently working on picking a vendor to administer the survey on the perceptions of fairness between SRO arbitration and litigation.
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> ...
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> [T]he Subcommittee has chosen Professors Barbara Black and Jill Gross of Pace University School of Law to administer the survey. The Subcommittee will meet again shortly to design the questionnaire. ... Professors Black and Gross have sent him a first draft of the survey. He will distribute the draft to the Conference members to return to him with their comments.
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> ...
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> Pat Sadler distributed various proposed changes (from NASD, SIA, PIABA, Chairman Katsoris) to the draft survey prepared by the outside vendor (Professors Black and Gross of the Pace Law School Investor Rights Clinic). There was a prolonged discussion, with several suggested amendments. ... ● Linda Fienberg (NASD) observed that some of PIABA's suggested questions (e.g., eliminating mandatory arbitration and getting rid of the industry arbitrator) were somewhat inflammatory, and beyond the scope of the original suggestions in the "Perino Report"

> that gave rise to the survey project. She reserved the right to reconsider NASD's participation if the final survey contained such questions.
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> ...
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> Professors Black and Gross will incorporate SICA's suggestions and present a new draft of the survey to the Conference before its March meeting. The survey will be presented as a SICA survey, administered by Pace Law School.
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> ...
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> Linda Fienberg (NASD) called participants' attention to an open contractual issue, i.e., a lack of clarity as to who owns the data. Pace desires to publish an article based on the results of the survey. While this is not necessarily problematic, several Committee members expressed concerns about maintaining confidentiality of the data. Linda Fienberg agreed provide copies of the contract to interested SICA members.

The SROs drove the process of collecting information on the fairness of SRO arbitrations in spit of SICA's clear acknowledgement that "it would not be appropriate for SROs to drive the process of collecting information on the fairness of SRO arbitrations."

While anticipating the results of the Securities Arbitration Fairness Survey, one might observe SICA's prior experience with "surveys." From January 2000 until January 2002, pursuant to SICA's recommendation and guidance, the NASD and NYSE arbitration forums provided claimants with alternative forums before which their claims could be heard. Of 277 eligible cases, eight claimants elected to participate (to some degree). In response to my FOIA request, the SEC produced a copy of various documents relating to that pilot program.

SICA informed the SEC, "At the time of implementation of the program, we were aware of the possibility that the program might not see a lot of cases. ... Thus far, only four responses have been received, all from attorneys."[2] SICA debated how the results of the "survey" would be portrayed to the public. A SEC representative described the internal debate by stating, "After tedious debate on how to characterize the replies (with the SROs wanting them to be a proxy for widespread joy with the process, and public member Ted Eppenstein asserting that he was privy to secret information indicating great woe with the process), I suggested that someone draft a short, flat report that doesn't say too much...."[3]

One should wonder whether there will be a "tedious debate on how to characterize the replies" to the Securities Arbitration Fairness Survey and whether the SEC will advise

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[2] Email dated December 8, 2000 from Thomas Stipanowich, Chairman of SICA, to Robert Love, SEC.
[3] Email dated January 24, 2001 from Robert Love, SEC, to Catherine McGuire, SEC.

another "short, flat report that doesn't say too much." If the past is prologue, one would expect the NASD and NYSE to push for a proclamation of "widespread joy with the process," and they have been driving and financing the "survey."

VI. SEC Oversight

The NASD states, "[W]e are subject to extensive regulatory oversight.... NASD's dispute resolution program is subjected to extensive regulatory oversight. The SEC must approve all arbitration and mediation rules. ... SEC's Office of Compliance Inspections and Examinations conducts periodic inspections of our dispute resolution program. The GAO also conducts reviews of our program from time to time."

The NASD claims that SICA presented "conclusory statements that have no evidentiary basis." However, the NASD presented no evidence as to what the SEC does or does not do with respect to the "periodic inspections" or what the GAO does or does not do with respect to its "reviews."

The Petition, at page 21, deals with lack of SEC oversight. One wonders how so many problems exist in the securities arbitration process, as described fully in the Petition, if there is adequate SEC oversight. In March 2005, via a FOIA request, I sought records from the SEC concerning its alleged "inspections" of the NASD's arbitration program by requesting:

> Please send to me a copy of all writings, e.g., reports of findings of inspections, letters, emails, audits, reports, notes of oral communications and/or interviews, notices, that evidence that the Securities and Exchange Commission, including its staff, (collectively "SEC") from January 1, 1996 to the date hereof has exercised oversight over NASD Dispute Regulation (and/or any predecessor organization)(collectively "NASD") arbitration with respect to:
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> (a) The degree of fairness to the respective parties of arbitrator awards rendered in NASD arbitration proceedings;
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> (b) The adequacy of training, other than with respect to procedural matters, provided by the NASD to its arbitrators;
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> (c) The adequacy of the process by which the NASD evaluates the competence of NASD arbitrators after the respective arbitrators have first been assigned to their first case; and,
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> (d) The NASD's implementation of recommendations contained in the Report of the Arbitration Policy Task Force To The Board of Governors National Association of Securities Dealers, Inc. (January

> 1996) with respect to arbitrator training in the substantive law and methods for arbitrator evaluations.

The SEC refused to provide any such information. The NASD will only provide conclusory statements. Thus, in essence, one is asked to trust, but denied all ability to verify.

We have previously seen how the SEC exercises some "oversight" by advising SICA, which primarily consists of securities industry members, to "draft a short, flat report that doesn't say too much...." The NASD states, "Customers already have the right to take their claims against defunct firms directly to court." On that subject, in its email dated January 24, 2001, the SEC representative stated:

> NASD gave only the briefest of presentations of its rule that would allow investors access to court in cases against a defunct broker-dealer. I expanded in order to advised (sic) the exchanges of the need to protect themselves. After the meeting, I asked Nancy Nielson, the secretary, to please make certain she looked at and understood the rule and possible implications for the exchanges so that the minutes reflect this, and help them protect themselves with similar filings if they feel exposed.

It is obvious that the SEC interprets "oversight" to mean protection of the securities industry from the investing public.

VII. The Securities Arbitration Process Will Remain Unfair As It Lacks Decision Making Standards, Arbitrator Training In the Law and Mandatory Arbitrator Evaluation

One of the main topics of the Petition, at pages 5 through 20, is that the arbitration before securities industry sponsored forums cannot be "fair" when the NASD discourages use of the applicable law in the decision making process, has no effective arbitrator evaluation procedure and has discontinued training arbitrators in the applicable law.

In 2006, I conducted a multi-month internet based study of NASD arbitration, which involved communications with more than 1,000 NASD arbitrators. The study showed that the NASD impliedly informs arbitrators to, in effect, "do justice," but does not provide the tools to accomplish that goal. One very active and candid NASD arbitrator informed me, in part:

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> Although we receive from both parties, reams of papers with case law, not once in any case during a hearing or during any deliberations has any one referred to them. … We do not need case law. Simply, does one plus one equal two. That's what we try to determine.

An arbitrator's knowledge of the law applicable to disputes is especially important. In order to determine the facts that are relevant and their significance, an arbitrator must understand the applicable law. He/she has no standard upon which to base a decision. Thus, justice is not served. Current ambiguous NASD guidelines to arbitrators to "do justice" or render "fair and equitable" decisions are, effectively, no guidelines and an excuse to foster and enable incompetence.

A. 1987 SEC Correspondence

"In his 1987 letter, Mr. Ketchum was blunt. The self-regulatory organizations, he said, 'have administered virtually no formal training for arbitrators on matters relating to either arbitration law, relevant state law or securities law. The current level of training should be addressed promptly.'" ("When Naiveté Meets Wall Street," New York Times, 12/3/89.)

On September 10, 1987, Mr. Richard G. Ketchum, Director, Division of Market Regulation, SEC wrote to all members of SICA, including the NASD, stating:

> The Commission staff has been examining self-regulatory organization-sponsored arbitration over the past 18 months. The focus of the review was broad and was designed to test both the fairness and efficiency of self-regulatory organization ("SRO") arbitration programs. This review reflects the Commission's belief in the need for thorough oversight of SRO arbitration systems.... The staff has presented its findings to the Commission, which has endorsed recommendations set out in this letter.

With respect to "Arbitrator Training," the letter states:

> Our review found that the SROs have administered virtually no formal training for arbitrators on matters relating to either arbitration law, including the scope of arbitrators' authority, relevant state law, or securities law. The current level of training should be addressed promptly. (Emphasis added.)

B. GAO Report (1992) Recommended Arbitrator Training

Congress requested that the GAO study the arbitrator education process. ["In response to the concerns of industry members and individual investors, the Chairmen of the House Committee on Energy and Commerce and its Subcommittee on Telecommunications and Finance, and the Chairman and four members of the Senate Committee on Banking, Housing, and Urban Affairs requested that we examine arbitration practices in the securities industry. As agreed with the Committees and Subcommittee, we examined issues related to … the selection and training of arbitrators." Securities Arbitration --- How Investors Fare, United States General Accounting Office, Report to Congressional Requestors, May 1992, GAO/GGD-92-74 ("GAO Report"), p. 21.]

The GAO Report partially responded to the Congressional request, which dealt with "training." ["Recommendations to SEC. GAO recommends that the Chairman, SEC, require SROS that administer arbitration forums to … establish a system to ensure these arbitrators are adequately trained…." GAO Report, p. 61.]

By 1992, the GAO, SEC and NASD were able to examine years of arbitration experience with respect to thousands of arbitration hearings. Yet, they suggested an additional study as to providing "better" arbitrator training. ["Finally, with respect to our recommendation concerning arbitrator training, SEC stated that 'it would be appropriate to study whether there are cost-effective means to assess arbitrators' training needs and provide better training.' This action is consistent with the intent of our recommendation, and the SROS told us they plan to begin such a study." GAO Report, p. 63.]

The SEC commented to the GAO that the NASD needed to expand arbitrator training and evaluation efforts. ["Nevertheless, while the SROs should expand their training efforts, the Staff does not believe that a prescription of specified courses should, or could, become an acceptable substitute for careful, varied evaluation by the arbitration departments to assure the independence and capability of arbitrators." GAO Report, p. 102.] Subsequently, the NASD eliminated its training program related to applicable law and informally advised panelists to ignore applicable securities under threat of being recused from serving as an arbitrator on the ground of bias. (Details are set forth in the Petition.)

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C. Ruder Task Force Report (1996) Recommended that the NASD Implement a Program to Train Arbitrators in Substantive Law

The "Securities Arbitration Reform --- Report of the Arbitration Policy Task Force to the Board of Governors National Association of Securities Dealers, Inc." (January 1996) ("Ruder Task Force Report") recommended that the NASD improve arbitrator training as to applicable law and implement an effective evaluation procedure concerning arbitrator competence. The Ruder Task Force Report stated, in part:

> Many securities arbitration participants expressed concerns about the selection, quality, and training of arbitrators. .... Commentators also complained about the quality and training of the arbitrators. They felt that the arbitrators lacked sufficient expertise in the relevant substantive law…
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> ….
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> The two characteristics for which arbitrators received the lowest ratings in both the 1993 and 1994 surveys were "ability to cope with complex material" and "ability to analyze problems and identify key issues."
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> ….
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> We recommend that the scope and frequency of arbitrator training be expanded even further. In particular, we believe that there should be a continuing education requirement beyond the introductory session presently required of new arbitrators. Appropriate programs should be available for all levels of experience, emphasizing … relevant areas of substantive law.
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> ….
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> The training requirements should be applied flexibly based upon an arbitrator's demonstrated knowledge of relevant substantive law.... The requirements should be structured, however, to ensure that arbitrators remain current with important new developments in … and relevant law.
> (Emphasis added.)

Ms. Linda D. Fienberg, Esquire, served as the "Task Force Reporter" of Ruder Task Force Report. She is President of NASD Dispute Resolution. The NASD has not implemented the previously mentioned recommendations.

Since, 1993, the NASD has ceased offering training in applicable law. However, in 2004, the NASD sought authority from the SEC to charge arbitrators additional training fees to provide a "two-hour … session… on … videotaped training on civility." (SR-NASD-2004-001)

VIII. Conclusion

Comments by the "Public Members" of SICA reveal the public's perception that the mandatory securities arbitration process in unfair. The response by the NASD does nothing to dispel that perception. The NASD's flawed use of reports, studies and surveys is disingenuous, at best. Reform of the securities arbitration process is badly needed. Until that reform occurs, the arbitration process will remain unfair.

Please communicate with me in the event that further information is desired.

Very truly yours,

Les Greenberg

Digitally signed by Les Greenberg
DN: cn=Les Greenberg, c=US, o=Law Offices of Les Greenberg, ou=Attorney at Law, email=LGreenberg@LGEsquire.com
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LES GREENBERG

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