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July 14, 2005

Jonathan G. Katz, Secretary **Via Email**
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303
rule-comments@SEC.gov

Re: Comment: File No. SR-NASD-2003-158
Amendments to NASD Arbitration Rules for Customer Disputes

Dear Mr. Katz:

Thank you for the opportunity to comment on NASD's proposed changes to its arbitration code. The amended NASD Code of Arbitration is an enormous improvement over what we have now. It is well organized, generally well written, and much more user friendly than the current code. NASD should be commended for recognizing the need to reorganize the code and for undertaking so difficult a task. My additional comments follow.

1) Rule12607: Order of Presentation of Evidence and Arguments

This is a new rule that codifies standard practice. However the rule is ambiguous in two respects: first, it does not mention rebuttal testimony. Second, despite its title, it says nothing about opening statements or closing arguments.

A. The rule should expressly discuss rebuttal testimony

In its current form, the rule gives the impression that rebuttal testimony is not part of the typical procedure. Yet, Rule 10321(c) of the current code and its analog in the proposed code (Rule 12514(c)) correctly assume rebuttal by providing that documents to be used in rebuttal need not be exchanged pursuant to the twenty-day exchange requirement.

In the current code, it is unnecessary to mention rebuttal in any rule other than Rule 10321(c), because no other rule in the code addresses the order of the presentation of evidence. But once the proposed code raises the issue, the entire order of presentation of evidence should be provided. Otherwise, unnecessary

debate will ensue about whether rebuttal is allowed, and in some cases investors, who constitute the vast majority of claimants, will lose the rights to rebuttal that the code envisions.

B. The rule should expressly discuss opening statements and closing arguments

Given its current title, the rule gives the impression that it governs opening statements and closing arguments. Someone may infer from this that in closing arguments claimant goes first and respondent second. But it is common practice that the party with the burden of proof always has the option of having the last word.

The current practice at the NASD is provided by IM-10317, which is included among the current rules. It says, "In response to recent questions concerning the order of closing argument in arbitration proceedings conducted under the auspices of the National Association of Securities Dealers, Inc., it is the practice in these proceedings to allow claimants to proceed first in closing argument, with rebuttal argument being permitted. Claimants may reserve their entire closing for rebuttal. The hearing procedures may, however, be varied in the discretion of the arbitrators, provided all parties are allowed a full and fair opportunity to present their respective cases. We recommend that to prevent any ambiguity about the intent of this rule, that the rule discuss opening statements (that is, that claimants go first and respondents second) and closing arguments. **With respect to closing arguments, the rule should track the intent and the language of IM-10317.**

2) Rule 12406-Chair Qualified Arbitrators

There should be no qualified Chair List. Such requirement basically would mandate that every single panel have someone who is either a lawyer or an arbitrator who has heard numerous arbitrations. Such is hardly a jury of one's peers and provides the appearance of attempting to maintain the "old boys network" by having one industry person on every panel and add to that someone who makes their living on not being stricken by the major wirehouses in arbitrator selection process. The Chair Qualified Arbitrator rule is an investor unfriendly change that must be rejected.

3) Rule 12403 – Non-public (Industry) arbitrator

Although it is not an issue in the changes to the Code, I would like to express my continuing opposition to the mandatory inclusion of an industry arbitrator on all panels. Through mandatory arbitration, individual investors are required to give up

their right to a jury of their peers, and the replacement is a panel which includes a member of the industry opposing the individual investor's claim. The built-in bias with such an industry arbitrator is fundamentally unfair to the individual investor. While the alleged purpose of the industry arbitrator is to include an "expert" on the panel, this can also result in an individual with a built-in bias unduly influencing the other public arbitrators who defer to the industry arbitrator on issues of standards in the industry. Furthermore, an "expert" on the panel is unnecessary in most cases where each side calls an expert witness to explain their position.

4) Rule 12512: Subpoenas

I question the intent of this rule and find its ambiguity inconsistent with the clarity of most of the other proposed rules. Indeed the current rule is clearer, albeit no less an invitation to mischief. Neither the current rule nor the proposed rule should permit attorneys to issue subpoenas. **The rule should state clearly and unambiguously that arbitrators and only arbitrators may issue subpoenas**.

A. The Rule Should State That Only Arbitrators May Issue Subpoenas

Under the current state of the law, only arbitrators may issue subpoenas when the Federal Arbitration Act ("FAA") applies to an arbitration. The FAA applies to virtually all securities arbitrations. Therefore, only arbitrators may issue subpoenas in virtually all securities arbitrations. Nevertheless, attorneys for parties – especially parties in the securities industry – issue phoney subpoenas seeking private financial information (sometimes even directed to claimants' employers) about customers from, among others, financial institutions that are not ordinarily permitted to disclose such information. When served with these phoney subpoenas, these institutions disclose the information in violation of federal law. As we demonstrate below, only arbitrators are permitted to issue subpoenas and any suggestion by the NASD rule that others may, is an invitation for mischief.

B. Only arbitrators may issue subpoenas in securities arbitrations

Every single securities arbitration filed with the NASD is governed by the FAA. *See The Citizens Bank v. Alafabco, Inc., 123 S. Ct. 2037 (2003)*.
The FAA permits only arbitrators to issue subpoenas. Section 7 of the FAA provides in relevant part "The arbitrators selected . . . or a majority of them, may summon in writing any person to attend before them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case. . . . **Said summons shall issue in the name of the arbitrator or arbitrators, or a majority of them, and shall be**

signed by the arbitrators, or a majority of them, . . . 9 U.S.C.A. § 7 (emphasis added).

Thus, only arbitrators may issue subpoenas in arbitrations governed by the FAA. Federal appeals courts that have addressed the issue agree. The United States Court of Appeals for the Second Circuit has expressly stated that Section 7 of the FAA "explicitly confers authority only upon arbitrators; by necessary implication, the parties to an arbitration may not employ this provision to subpoena documents or witnesses." *National Broadcasting Co. v. Bear Stearns & Co.*, 165 F.3d 184, 187 (2d Cir. 1999) (citing cases); *Burton v. Bush*, 614 F.2d 389, 390 (4th Cir. 1980) ("While an arbitration panel may subpoena documents or witnesses, the litigating parties have no comparable privilege.") (citing cases); *see also St. Mary's Med. Ctr. Of Evansville, Inc. v. Disco Aluminum Prods. Co.*, 969 F.2d 585, 591 (7th Cir. 1992) (citing *Burton* with approval). Accordingly, only the arbitrators can issue subpoenas where the Federal Arbitration Act applies. Indeed, in the unlikely event that state arbitration law applies, only arbitrators would be authorized to issue subpoenas, because nearly every state arbitration law authorizes only arbitrators to issue subpoenas. *See, e.*6 *.g., DeSapio v. Kohlmeyer*, 35 N.Y.2d 402, 406; 321 N.E.2d 770; 362 N.Y.S.2d 843 (1974) ("Under the CPLR, arbiters do not have the power to direct the parties to engage in disclosure proceedings. While a court may order disclosure 'to aid in arbitration' pursuant to *CPLR 3102* (subd. [c]), it is a measure of the different place occupied by discovery in arbitration that courts will not order disclosure 'except under extraordinary circumstances.'"); *Integrity Ins. Co. v. American Centennial Ins. Co.*. 885 F. Supp. 69, 71 n.3 (S.D.N.Y. 1995) ("The arbitrators are sitting in New York, which grants arbitrators authority to issue subpoenas. See N.Y. Civ. Prac. L. & R. ("CPLR") §§ 2302(a), 7505 (McKinney 1991). Professor Siegel notes that this authority extends only to the hearing before the arbitrators, "and not, by implication, for the steps preparatory to the hearing," i.e. discovery. David D. Siegel, Practice Commentaries, CPLR 2302:1. However, in an action brought in federal court, the provisions of the FAA prevail over any inconsistent state arbitration statutes. *Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 18 L. Ed. 2d 1270, 87 S. Ct.1801 (1967).*"); Alexander, Practice Commentaries to Section 7505 (McKinney 1998) ("The subpoena power conferred by CPLR 7505 is limited to the procuring of evidence for the hearing or trial of the dispute. Depositions or other forms of pretrial discovery are not ordinarily contemplated in arbitration proceedings. CPLR 3102(c) authorizes discovery in aid of arbitration only by court order.")

C. Allowing anyone other than the arbitrators to issue subpoenas is an invitation to engage in the same mischief in which some parties currently engage

Retaining the current rule or the proposed rule invites mischief. Parties – especially (but not exclusively) those representing the securities industry – have applied the NASD rule as though it were a license to issue subpoenas under all circumstances. In fact, the rule only permits subpoenas to be issued if the law allows it. As discussed above, the law does not allow it. This has not deterred parties' attorneys from issuing subpoenas and arguing that if they were doing anything wrong, the arbitrators should stop them. Often, the subpoenas are issued long before the arbitrators have been appointed and the recipients of the subpoenas have responded. As we demonstrate below, this harms the arbitration process in at least three ways.

i. The proposed rule limits the authority of arbitrators to control discovery
First, the FAA authorizes the arbitrators, in effect, to control discovery. If the arbitrators decide whether a subpoena should be issued, the arbitrators also decide the scope of the subpoena. If the lawyer issues the subpoena, the arbitrators' power to control discovery is limited thus undermining one of the goals and policies of the FAA.

ii. The proposed rule places parties who appear *pro se* at a disadvantage
Third, under the current rule and the apparent intent of the proposed rule, a party appearing *pro se* does not have the same access to the subpoena process as a party with counsel. A party with counsel can issue the subpoena before the arbitrators are appointed and get the documents he wants without the intervention of the arbitrators. A party appearing *pro se* must both wait for the arbitrators to be empanelled and hope that the arbitrators agree with him that the documents he wants subpoenaed are worthy of subpoena. Thus, permitting lawyers to issue subpoenas, even when it is legal to issue them, places the *pro se* party at a disadvantage. Even the appearance of such a disadvantage is inappropriate in a forum that is identified with the securities industry. For the foregoing reasons, we submit the proposed rule should be changed to permit only arbitrators to issue subpoenas.

5. Support For PIABA's Position

Finally, please note I support and adopt those views expressed by PIABA President Rosemary J. Shockman in her letter dated July 13, 2005.

Thank you for the opportunity to express my views on the crucially important topics outlined above.

Sincerely,

Andrew Stoltmann