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June 8, 2005

Office of Chief Counsel
JUN 29 2005
Division of Market Regulation

Catherine McGuire
Associate Director and Chief Counsel
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: NASD *De Facto* Rule Concerning Motions to Dismiss

Dear Ms. McGuire:

I was disappointed in both the tenor and the substance of your March 9, 2005, letter in which you endorsed NASD-DR's practice of allowing motions to dismiss in arbitration in violation of NASD Rule 10303 which mandates a hearing unless waived by the parties.

You state that NASD-DR has advised the SEC that arbitrators may entertain motions to dismiss as a function of the arbitrators' inherent power to control the arbitration proceedings, codified in Rule 10324. You also suggest that this NASD rule interpretation allowing motions to dismiss is supported by federal case law which holds that a "hearing" may consist of simply an opportunity for each side for argument, citing *Warren v. Tacher*, 114 F. Supp. 2d, 600 (W.D. Ky. 2000).

First, let me re-emphasize that the question of motions to dismiss presents a fundamental issue of investor protection. Motions to dismiss are an important tool for the brokerage industry to defeat investor claims without allowing investors the evidentiary hearing required by Rule 10303. The NASD, while advertising itself as supporting investor protection, has simply ignored Rule 10303 and instead supported the industry on this issue.

As an SRO, the NASD is subject to conflicts of interest and must balance investor protection with the interests of its broker-dealer members. Even so, it is surprising that the NASD would contend that Rule 10324, which allows arbitrators to interpret the Code, authorizes an arbitration panel to absolutely ignore the explicit hearing requirements guaranteed investors under Rule 10303. Arbitrators should never be led to believe that their power to "interpret" the Code allows them to ignore its explicit provisions.

But it is even more troubling that the SEC should support the NASD in this anti-investor position. A government agency charged with investor protection and responsible for overseeing the NASD should not endorse subversion of arbitration rules designed to protect investors.

Your citation of *Warren v. Tacher* as authority that the "hearing" required under Rule 10303 can merely consist of a proceeding in which each side has an opportunity to present argument is equally disturbing. A cursory review of the Code of Arbitration Procedure confirms that the Code distinguishes between the hearing requirement provided in Rule 10303 and the opportunity to present argument without testimony as provided in Rules 10315 and 10321(d).

Adopting a strained, anti-investor interpretation by ignoring the explicit language of the Code of Arbitration Procedure and instead relying on an isolated district court decision is inappropriate for a federal agency charged with SRO oversight and responsible for investor protection. I would hope the SEC would conduct an independent, objective review of the issues involved rather than parrot the self-serving arguments of the agency it regulates.

You suggest that the best solution in this matter is to merely await action on the NASD's proposed Code revision. Interestingly, the NASD included language in proposed Rule 12504 that motions to dismiss (other than those relating to time frames) are discouraged by the NASD and may only be granted in extraordinary circumstances. The proposed rewrite was made public in 2004, and yet the NASD has failed to alert arbitrators to this important policy position.

In the meantime, the NASD continues to encourage arbitrators to ignore Rule 10303 and grant industry motions to dismiss. In my letter to you dated December 13, 2004, I pointed out these positions in NASD arbitrator training materials. Even more recently, the current arbitrator expungement examination, which is required to be taken by all arbitrators, encourages arbitrators to believe that they have an unfettered right to grant motions to dismiss in violation of Rule 10303. See my letter dated March 10, 2005, to Linda Fienberg, a copy of which is enclosed.

In the interest of investor protection, I again ask that you reconsider your position and instruct the NASD that Rule 10303 should be enforced in accordance with its terms. At the very least, the NASD should promptly advise arbitrators of its position as set forth in the Code rewrite that motions to dismiss are discouraged and should only be granted in extraordinary circumstances.

Very truly yours,

Laurence S. Schultz

LSS/ch
Enclosure

cc: Linda D. Fienberg (w/o enc.)
PIABA Board of Directors (w/o enc.)