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Richard P. Ryder, President

July 21, 2005

Jonathan G. Katz, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

RE: **SR-NASD-2003-158**
NASD Customer Code

Dear Secretary Katz:

The opportunity to comment on SRO rule proposals promotes a salutary process, one that allows the public at large to participate in and potentially assist in the rulemaking process. It is unfortunate that so many proposals regarding material changes in the arbitration process have been released at once by the Commission, as it forces haste in composing comments and a more narrow selection of items on which to comment. With that said, I submit this comment letter, somewhat tardily, to address the proposed Code overhaul in the instant Rule filing on a broad plane and with a specific emphasis. I also wish to address the Commission's special questions, as posed in the comment Release.

Attached to this e-mail message are two files, each one containing one-half of a two-part analysis in which our newsletter engaged in early 2004, shortly after the Rule filing was made. These two PDF files, which I wrote as SAC's Editor, review the entire Customer Code with an eye to spotlighting, and sometimes commenting upon, substantive changes that the Code changes will effectuate. In the articles, I refer to a proposal to allow arbitrators to sanction party representatives; that proposal has been withdrawn by NASD and the article's reference to that provision should be ignored.

We found, in reviewing the "Code Re-Write," that there are clearly many more substantive changes being proposed than the NASD considers substantive in its summary of substantive changes. We hope that the attached articles will provide an easy guide to those substantive changes, but we limit our comment on those changes to that which appears in the articles. Our purpose here is to focus upon the single Rule 10330, relating to "Awards."

NASD has proposed very few changes to this Rule (other than re-numbering it), but it has interpreted the Rule in practice in two specific ways that we believe require the Commission's attention. We understand that substantive Rule Interpretations by a self-regulatory organization must undergo the same public inspection and SEC approval process as Rule changes themselves must. This has not been the case regarding these two interpretive stances. If NASD is going to continue to interpret Rule 10330 as it has in the past, this is a most opportune time to incorporate those "informal" but persistent Interpretations into its Code overhaul.

Once an arbitral decision is identified by NASD as an "Award," it becomes subject to the requirements of Rule 10330. It must contain the signatures and names of the Arbitrators, a summary of the issues, damage figures, and other specific elements itemized in Rule 10330. Moreover, the Rule requires in subparagraph (f) that "[a]ll awards and their content must be made publicly available." The NASD does not offer a definition of the term "Award" in this Code overhaul, but upon that term swivels the important requirements of public availability of an informative "Award."

NASD Interpretation: Only one "Award" may issue in an arbitration proceeding, even if the Arbitrators make multiple dispositive determinations regarding individual Respondents or Claimants in a multi-party case. Conversely, no "Award" will issue if the matter is finally disposed of by settlement, even though dispositive determinations regarding individual Respondents or Claimants have earlier been rendered.

That NASD does not offer a definition of an "Award" in this Rule filing or its current Code does not mean that NASD has not interpreted Rule 10330 by substantively defining what constitutes a Rule 10330 "Award." It takes the position, we understand, that a maximum of one "Award" may issue in an arbitration proceeding. This stance caused a serious problem in a case recently decided by the Seventh Circuit, Olson v. Wexford Clearing Services, No. 03-1223 (2005).

In Olson, a public investor's claims against a single Respondent, WCS, were dismissed in their entirety, leaving other Respondents in the matter to continue the arbitration proceeding. NASD did not issue a Rule 10330 "Award," but issued instead something called a "PreHearing Conference Order." Plaintiff followed other avenues within the proceeding to bring the dismissed Respondent back into the case and by the time he turned to the courts for relief, it was too late. The investor's petition was untimely, the courts ruled, because more than three months had passed since the final disposition regarding Wexford.

The Seventh Circuit ruled that the "PreHearing Conference Order" was an "Award," that triggered the time to move for vacatur under Section 10 of the Federal Arbitration Act. The lower court's view was the same; it defined the "Order" as an "Award," because "it unambiguously resolves the arbitration in favor of Wexford." In this instance, a Claimant failed to timely challenge a post-Award dismissal, because the ruling was not issued in a form that would have given proper notice that an "Award" was issuing.

NASD did not view any of the rulings in connection with this dismissal as an "Award," even though it finally disposed of the claims against a named party. Thus, this "Award" was not made publicly available and the information elements required by Rule 10330 were not disclosed to the public via an "Award." The Wexford Order did not have a majority of the Arbitrator's signatures on it, nor did it list the names of the Arbitrators. The arbitration (NASD ID #98-02762, Chicago) appears to have settled or been abandoned, because no subsequent "final" Award in the case has been made publicly available.

Thus, the Wexford "Order" not only caused confusion within this arbitration proceeding, but it also has not been recorded as a final ruling by this Panel of Arbitrators in any subsequent public document. It is likely that the three Arbitrators who made this ruling will have, on their Award disclosure sheets, a listing indicating service on this case, but parties will not be able to access a public "Award" that will tell them that this Panel ordered a pre-hearing dismissal. We have no view on whether this was a good decision or a bad decision. Nevertheless, a pre-hearing dismissal, as the NASD posits in this Rule filing, is an extraordinary event; this is information that a party in a future case might consider material.

There is more than one instance of this failure to make public an "Award" that issued during an arbitration. NASD only makes public that "Award" which closes the proceeding through a "final" arbitral determination. Given a federal circuit ruling disagreeing with this policy, NASD should explain why its Interpretation of what constitutes a Rule 10330 "Award" remains as it does and why that Interpretation has not been aired for public debate.

NASD Interpretation: The required elements of Rule 10330, although they disclose information of material importance about parties, party representatives, and arbitrators, are subject to omission by mutual agreement of the parties.

We may state this NASD Interpretation more broadly than NASD staff apply it in practice, but, if so, it is because NASD has not publicly defined its contours. We do know that the staff has permitted parties to agree that one Arbitrator may sign a Stipulated Award on behalf of the entire Panel, when Rule 10330's terms require (absent a legal exception) signatures "by a majority of the arbitrators" and, more importantly, that the names of all serving Arbitrators appear in the Award.

Take two examples, which can be found online (NASD ID Nos. 03-05589 (Koach) & 02-05812 (Hinderliter)). Each Award explicitly states that "[t]he parties have agreed that the Stipulated Award in this matter may be signed by a single arbitrator for the entire panel." Because these Awards only disclose the names of the sole signing Arbitrators, the names of the other two Panel members were not made publicly available. This is disturbing, to the extent that it indicates a staff view that the requirements of Rule 10330 may be waived whenever the parties so agree.

If parties are able to agree that the "name" and "signature" requirements of Rule 10330 can be waived by mutual agreement of the parties, why will parties not also agree that other information elements may be omitted from the public "Award"? May the "public availability" requirement of Rule 10330 be waived? That seems ridiculous, but it is not logically inconsistent with the staff's actions. Given these cited Awards and the apparent view among NASD staff that information elements may be omitted at the parties' behest, NASD should be willing to air its views on this issue for public debate.

Our view, of course, is that the provisions of Rule 10330 are non-waivable. They have been developed not to benefit the parties in the arbitration matter, but to ease public perceptions about arbitration's "back-room" nature and its alleged "industry-tilt" by making itemized information about each Award readily available and easily accessible to people. Parties today are able to learn much more about their Panel nominees from public Awards. They are able to network to party representatives and others who have appeared before named Arbitrators. From the information they cull from Awards, they can launch further investigation, ask more informed questions of their candidates, and ultimately make better decisions about who will decide their case. Neither NASD Dispute Resolution, nor the parties in a particular case, have the right to block information that is required to be in an Award from becoming publicly available.

SEC's Special Questions:
(A) To the general question, which is preferable, SICA's Uniform Code or the NASD's provisions, we answer SICA's Uniform Code. NASD participates in SICA meetings, as it has since I was Director of Arbitration in the 1970's, but its practices have changed over the past decade. In recent years, it has proceeded to offer rule changes without regard to the uniformity that has characterized SRO efforts in earlier years. Often without consulting SICA in any serious way, NASD has acted alone. The premise has been that it so dominates the arbitration process that it should not hesitate while SICA debates a rule that NASD needs to adopt.

To NASD's credit, many of its rule changes have been excellent rule revisions and it has been very responsive to public calls for process changes. On the other hand, its internal rule-proposing organs are not as independent and open as that which SICA provides. NASD's "go-it-alone" approach negatively affects public perceptions and it has led to some serious missteps that SICA debate might have prevented or treated. NASD has also been able (not that anybody else was trying hard) to increase and secure its dominance of the arbitration field, because it has abandoned the uniformity premise under which SICA operates.

Further comment on this point seems premature, given that the SEC has not only let this happen, but has participated actively in reducing SICA's role. It has ignored SICA's potential contribution and allowed NASD to disregard SICA's place in the arbitration rulemaking process. If the Commission is truly serious about creating a different environment, in which the public will have a true choice among viable SRO forums with uniform rules and procedures, it must define its purpose and stage real debate on the issue.

(B) See our two PDF attachments for a highlighting of substantive changes proposed in the new Customer Code.

(C) I think NASD should define which rules are subject to modification by mutual agreement of the parties. Procedural modifications that affect only the arbitration at hand should be encouraged, so that experimentation and customizing processes may take place. On the other hand, provisions that serve a wider or more public purpose, such as the Rule 10330 requirements discussed above, should be exempt from party modification.

(D) Chair-qualified Panelists will be the best trained and most experienced of the neutrals in NASD's Arbitrator pool. They should be nominated for service both as Chairpersons and as Public Arbitrators. To do less underutilizes them and may discourage some from becoming Chair-qualified.

(E) through (H): No comment

The Commission has a daunting task of review before it. It must recognize that many will forego comment because the job is too great and the likelihood of an impact may seem remote. We have focused our comments on an area that we find important to the integrity and perception of SRO arbitration and hope the Commission will have the time and inclination to pursue the issues raised with NASD. Thank you.

Sincerely,

Richard P. Ryder

Encls.

Covering Significant Issues & Events in Securities/Commodities Arbitration *Vol. 2004, No. 2*

SECURITIES ARBITRATION COMMENTATOR

Publishing Since 1988 (Feb. '04) ISSN: 1041-3057

IN THIS ISSUE

THE ARB CODE RE-WRITE

An Overview and Analysis of the Coming Changes in NASD's Proposed Customer Code

(Part 1 of 2)

Introduction

On October 15, 2003, the NASD commenced the rule approval process on the largest overhaul of its Code of Arbitration Procedure since May 1989. In that month, fourteen years earlier, the NASD, NYSE and other regional self-regulatory organizations implemented sweeping changes to the arbitration process, as recommended by the SEC staff and by the Securities Industry Conference of Arbitration (SICA), in the aftermath of the U.S. Supreme Court's *McMahon* decision and the October 1987 Market Crash. The Supreme Court's *Rodriguez* decision issued in May 1989 as well, another victory for brokerage firms, won by their in-house counsel, and an emphatic reinforcement of the Court's message with respect to federal arbitration policy.

SAC covered the *Rodriguez* decision and the new NYSE and NASD Code changes in the same issue, 2 SAC 5 (May 1989). That edition of the newsletter also reported on a recent meeting of SICA, the progenitor of the Uniform Code of Arbitration, and the finalization by that body of industry, SRO and public representatives of the new guide called *The Arbitrator's Manual*. The lead article in 2 SAC 5 covered the Code changes, which were designed to be substantive and aimed at enhancing perceptions of fairness with the investing public at a time of upheaval in arbitration law and securities disputes.

Our task in this article will be to review the filed Code changes, but in a much-changed setting and time. First, the current sweeping changes are, by NASD's account, mostly a codification of current practices, with a few substantive modifications, and were occasioned by a need to re-organize the Code chronologically and to present it in "Plain English." Secondly, this Code re-write is being done by NASD itself, not in cooperation with SICA, not in anticipation that other SRO forums will follow with similar changes, and not, at least publicly, at the instance of the Commission staff.[1]

Thirdly, this Code change is not directed towards taking many arbitration codes and making them one, but, instead, it divides the existing NASD Code of Arbitration Procedure into three separate units: The Customer Code ("NASD Code of Arbitration Procedure for Customer Disputes"), which is the body of revisions filed in October 2003; and two other Codes (Industry and Mediation), both filed in January 2004. The Customer Code filing is formidable enough for the review we undertake in this article – almost 300 pages. The Mediation Code is virtually unchanged in substance and the Industry Code tracks, wherever feasible, the Customer Code.

The Rule Filing

File No. SR-NASD-2003-158 achieves its bulk, not because the Code is any longer, but because the filing is structured in five sections to assist review. Section 1 sets forth an overview of the proposed changes and describes many of the substantive amendments contained in the filing. As "Exhibit 2,"

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NASD attaches a copy of the proposed Customer Code, renumbered in the Rule 12000 Series, as opposed to the current Rule 10000 Series. A comparison chart follows as "Exhibit 3," which proceeds by subject matter to place the text of the "Current Rule" next to the text of the "Proposed Rule," and to comment on the differences. Then, "Exhibit 4" helps with the Rule number changes by supplying an old-to-new conversion guide.

For our purposes, we found the Comparison Chart, "Exhibit 3," to be the most helpful. However, textual changes are not the only modifications to structure and that often makes direct comparisons difficult when using the Chart. For instance, a new "Definitions" section has been added as Rule 12100 and that has no counterpart in the Current Rules. Similarly, much of the Discovery Guide, which, as party guidelines, had been kept separate from the Code provisions, will now be drafted into the Code (Proposed Rules 12505-12511). The Document Production Lists and other explanatory or non-substantive text have been separated from the material that has been added to the Customer Code and will become a new Discovery Guide. The text of the Proposed Discovery Guide comprises "Exhibit 5."

A direct comparison of rules from the Current Code to the Proposed Code is also complicated by the dictates of the "Plain English" protocols. For instance, "Plain English" calls for simplified language and breaking longer rules into shorter one. Lists are boiled down to "bullet points" and sentences are restructured to make use of active verbs. These textual and structural revisions, though designed to eliminate confusion and to effectuate non-substantive change, do, at the very least, frustrate easy identification of intended differences between the Current Code and the Proposed Code.[2]

General Overview

As we indicated, NASD identifies the substantive changes that it intends in the first Section of the Rule filing and it also explains some codifications of current practice that are proposed. Truth be told, the mind needs little sharpening to spot many more substantive changes in the Proposed Code than mentioned in Section 1 or at least many more changes that represent alterations with a potential substantive impact. A number of these revisions could take pages to explore and debate,[3] but our approach will be to highlight changes, as we see them, with a view to identifying matters for deeper reader consideration or comment.

Perhaps, because the changes were not developed for a larger confederation of forums and do arise from internal organs at NASD, the proposals for revision tend generally to be forum-centric, i.e., designed to relieve administrative burdens and make things easier on the arbitration staff. While that no doubt advances the legitimate aim to be more efficient and speedier in case administration, it also

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SUBSCRIPTION INFORMATION: The Securities Arbitration Commentator is published 8 times per year and sells by annual subscription. Back issues of SAC are available to subscribers only at $20 per issue. An attractive SAC-imprinted "D-Ring" binder is also available to store back-issues. The 1.5" blue binder, with grey print on its face and backing, costs $15.

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fosters in the case of this Code a favoring staff prerogatives over those of the arbitrators. To the extent that the Proposed Code aims to resolve some of the problems that have been encountered with the Current Code, the resolutions are directed more towards solving the staff's problems than those of the arbitrators or the parties.

Generally speaking, we think the following observations, summarized in "bullet points" below, are valid reflections of the changes in the Proposed Code and may be tested against the specific line items we describe throughout the remainder of this article:

- The Director of Arbitration will enjoy greater independence from the National Arbitration and Mediation Committee.
- The Director of Arbitration will have greater powers to take discretionary action promptly, whenever the process requires intervention.
- Arbitrators will realize a perceptible pullback of their powers, as the staff becomes the chief protector of the integrity of the process and trumps the arbitrators on matters that affect administrative prerogatives.
- NASD will broaden its openness as a forum that is self-sustaining, as opposed to subsidized, and ready to handle whatever disputes are consonant with its primary mission as a regulatory services provider.
- NASD will utilize its status as a SRO to guide and adjust registrants' conduct as parties in arbitration disputes.
- The Code changes are comprehensive and reflect not only the staff's deep understanding of the process and the Current Code, but also the importance of tracking and reacting to court decisions on arbitration-related issues.

Observations re Specific Rules

In this Part 1, we review the Proposed Rules in numerical order from Rule 12100 to the end of the Rule 12300 Series. According to Section 1 of the filing, that will cover definitions of terms, rules relating to the organization and authority of the forum; general arbitration rules, including the jurisdictional or scope-of-coverage provisions; and the rules explaining how to initiate and respond to a claim, how to amend claims, and when claims may be combined and separated. The other six "Parts" of the Customer Code will be reviewed in Part 2 of this article.

Rule 12100: Definitions (No Current Rule)

"Non-Public Arbitrator" and "Public Arbitrator" are designations preserved in the Proposed Code and the definitions adopt the new classification criteria contained in separate rule proposals that have been before the SEC for some time (See Katsoris article, "The Composition of SRO Panels?" SAC, Vol. 2003, No. 6 (Oct. '03), p. 3).

"Director" is defined as the Director of NASD Dispute Resolution, but the definition makes clear that, absent a clear reservation of authority, use of the word "Director" in the Code means staff delegates as well.

Some terms that continue to be used in the Code and have engendered a great deal of controversy, uncertainty or litigation are not defined, yet clarification might have served us well. Two examples are the words "Award" and "Customer(s)."

The single public instrument available to the public is the "Award" and the lessons of the May 1989 changes have proved the wisdom of promoting public trust in the process through the distribution of Public Awards. Sunlight sanitizes and transparency promotes confidence. With the growing complexity of arbitration, however, there is often more than one "Award" issuing in an arbitration proceeding. Interim Awards that provide emergency or other critical relief, partial Awards that dispose of one of multiple parties, and complete pre-hearing dispositions that arrive as letter rulings are several examples. How "Award" is defined determines whether these dispositions by arbitrators will reach the public eye or, indeed, be considered as part of an Arbitrator's public record.

"Customers" have the power, without a bilateral or specific agreement with their brokerage firms, to compel arbitration as third-party beneficiaries of the contractual relationships extant between SRO and registrant. Today, however, it is clear from "selling away" and "analyst conflict" cases, among others, that brokerage firms and associated persons are sometimes forced to arbitrate disputes with "investors" with whom they may have no direct business relationship. There are policy decisions here that are being made by the courts instead of the policymakers – or by staff members on an *ad hoc* basis without debate or notice.

On the other hand, some terms that have engendered considerable litigation are not defined in the Proposed Code, because they have been written out of existence. The term "or others" in Current Rule 10101, "Matters Eligible for Submission," has teased courts with its inferential inclusion of parties who might arbitrate, but who are not "customers," "members" or "associated persons" (*see, e.g.*, "*McMahan Secs. v. Forum Captl Mkts.*, 6 SAC 8(15) (2nd Cir, 1994) and *Farrand v. Lutheran Brotherhood*, 5 SAC 9(8) (7th Cir. 1993)). Yet, the term is so broad as to be amorphous. In the Proposed Code, Rule 12201, "Elective Arbitration," uses the more restrictive phrase, "…or other related party."

Rule 12102: NAMC (nka Rule 10102)

NASD Dispute Resolution's Board of Directors has set the size and composition of the NAMC, i.e., that its members shall number no more than 25 and no fewer than 10 and at least 50% will be non-industry members.

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These criteria are not part of the Current Code.

Rule 12103: Director of Dispute Resolution (nka Rule 10103)

The Proposed Code changes the designation from Director of Arbitration, a term adopted by SICA for use in the UCA, and makes it clear that the President of NASD Dispute Resolution may substitute for the DODR or, if necessary, appoint an interim Director. This provision also de-links the DODR from the NAMC, making the DODR answerable to the NAMC "at the NAMC's request," as opposed to being, under the Current Code, "directly responsible to the [NAMC.]"

Rule 12104: Effect of Arbitration on NASD Regulatory Activities (nka Rule 10105)

We were looking here for some language that would seek to authorize the increasing willingness of the NASD to employ the grinding wheels of regulatory sanctions for breaches of the procedural requirements of the arbitration Rules. We found the Rule unchanged, however, except that its disciplinary referral provision is broadened to include "other applicable rules or laws," in addition to the federal securities laws and the NASD rules.

Rule 12200: Arbitration Under an Arbitration Agreement or the Rules of NASD (nka Rule 10301)

We described in a footnote above the collapsing of the two phrases "business" and "activities" in relation to members and associated persons, respectively, into one phrase, "business activities," applicable to both classes. The "insurance company" exception in this jurisdictional substitute for Rule 10301 ("Required Submissions") also refers in the Proposed Code to "activities," excepting from required arbitration disputes the "insurance business activities" of an insurance company member, rather than the "insurance business" of such members.

Rule 12201: Elective Arbitration (nka Rule 10101)

We see in this Rule the same reference to "business activities" and "insurance business activities" of members, associated persons, and insurance company members as we see in Rule 12200. In our estimation, that consistency of construction argues forcefully that better drafting was intended, rather than a narrowing of the scope of arbitrable disputes. At the same time, we think adding "business" to the "activities" of an associated person denotes a substantive change in the kinds of disputes that can be arbitrated and one that may imply a "scope of employment" construction. Finally, we do not readily understand the reason for including the "insurance company" exception in the "elective arbitration" rule, since that implies that NASD cannot entertain the arbitration of such disputes, even if the parties all agree. That intent seems at odds with the apparent willingness of NASD to open its forum to the non-securities disputes of other members and even, where consent permits, to the securities disputes of non-members or "other related parties" who are non-members.

Rule 12203: Denial of NASD Forum and Referral to Other Forums (nka Rule 10301)

In Rule 10301, the Director, with the NAMC's permission, was authorized to reject disputes submitted for arbitration as "not a proper subject matter for arbitration." Now, the Director may independently decline to permit the use of the forum, but will do so only if it is "inappropriate" to allow it. NASD has also adopted a new rule, Rule 12205, that, like NYSE Rule 600(e) and consistent with the classwide arbitration prohibition (Rule 12204), declines to entertain arbitrations that are "shareholder derivative actions."

Rule 12206: Time Limits (nka Rule 10304 & 10307)

The new eligibility rule, Rule 12206, tracks the language of a Rule proposal that is presently awaiting approval at the SEC (SR-NASD 2003-101, filed 6/19/03). Reviewing that proposed rule in SAA 03-31, we noted that NASD had deleted without comment the important statement that "[t]he Rule does not extend applicable statutes of limitations." We were pleased to see its return in the proposed rule.

Rule 12207: Extension of Deadlines (nka Rule 10314)

By enumerating those deadlines that the parties can jointly agree should be extended, NASD seeks, in this replacement to Rule 10314(a)(5), "to give parties maximum control over extensions of deadlines set by the Code." As the NASD comment states, though, it also seeks to "ensure that the panel retains control over deadlines established by the panel." The anomaly arises where the Director is granted authority to override a panel deadline. While that authority is saved for "extraordinary circumstances," the perceived need for the power – and a delegable power at that – to override a Panel on a case-specific ruling is philosophically troubling .

Rule 12210: Ex Parte Communications (No Current Rule)

A new rule establishes an explicit bar upon parties communicating with arbitrators without all parties present. However, in Rule 12210(b), provision is made, by stating "unless… the arbitrators and the parties agree…," for an expected pilot, currently before the SEC, that will permit voluntary direct communications with arbitrators about written submissions (SR-NASD-2003-163, filed 10/31/03).

Rule 12211: Sanctions (nka Rule 10305)

Arbitrators have had the power to issue sanctions, through provisions dispersed throughout the Code, such as NASD Rule 10305, which permits dismissal as a sanction "for willful and intentional material failure to comply with an order of the arbitrator(s)" and Rule 10324, in which arbitrators are empowered "to take appropriate action to obtain compliance with any ruling by the arbitrators." The new Code

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centralizes the sanctioning power in two forceful provisions, one dealing with discovery (Rule 12511) and this one, which addresses broader "failure to comply with any provision in the Code, or any order of the panel…." Rule 12211 also enumerates various types of sanctions that a panel might impose. The big change in this provision, one that is likely to draw a great deal of comment, lies in its express application to a party's representative, as well as a party. *(ed: Wry humor in the numbering?! NASD's sanctions rule for counsel is 12211 and FRCP Rule 11 provides for sanctioning counsel in federal court.)*

Rule 12212: Hearing Locations (No Current Rule, but see Rule 10315)

While the practical implications of the particular revisions in this "New Rule" are not earth-shaking, they illustrate the philosophical shifts that we addressed above. The determination of "time and place" has always resided initially with the Director, and, once the case was underway, the Panel traditionally manages the case and the parties address all requests to the Panel. Under Rule 10315, which disappears in the Proposed Code, the Arbitrators are currently empowered to set the "time and place" of all meetings, except the "first meeting." Under Rule 12212, NASD empowers the Director to select which of its designated hearing locations will be used, without reference to the stage of the proceeding or any right by the panel to intervene or effectuate a change of the location. Moreover, if one of the parties wants a change of location, they need to make a "motion" to the Director, not the Panel. According to the NASD Comment, this provision has no Current Code counterpart; as its purpose, it "codifies current practice and provides guidance to parties regarding the selection of hearing locations."

Rule 12213: Payment of Arbitrators (nka IM-10104)

The chairperson will only get the additional $75 stipend for a day's hearings on the merits, not for prehearing conferences. This has been the NASD's consistent position, but now the language of the Code will support that stance.

Rules 12302 & 12303: Filing an Initial Statement of Claim; Answering the Statement of Claim (nka Rule 10314)

Rule 12302 requires that the Statement of Claim "specify the relevant facts and the remedies sought" and adds that claimant "**may** include any additional documents supporting the statement of claim" (emphasis added). Rule 12303 requires that the Statement of Answer specify "the relevant facts and available defenses to the statement of claim" and adds that the Respondent "**must** include any additional documents supporting the answer…" (emphasis added). What is the purpose of the "may" on the one hand and the "must" on the other? The NASD Comment does not say.

Rule 12304: Answering Counterclaims (nka Rule 10314)

The Proposed Code changes the time frames for answering various pleadings to a uniform 20 calendar days and, with one exception that we saw, changed all time deadlines to calendar days instead of business days. Whereas replies were due within 10 days before and responses to cross-claims 45 days, now both are permitted a 20-day period (e.g., amended pleadings, Rule 12310). On the other hand, where the responding party is new to the case, as with the initial response and third-party respondents (Rule 12306), the time frame for response is 45 days (note that, in Rule 12306, the third-party respondent is instructed that s/he "may" include additional documents with the third-party answer.)

Rule 12307: Deficient Claims (No Current Rule)

Putting into writing a policy that arose, as we recall, from comments by the Claimants' Bar during the eligibility battles, NASD confines staff review of claim deficiencies to non-substantive matters and itemizes in "bullet points" the reasons why a claim may not pass muster. The Rule states that "[t]he Director will not serve any claim that is deficient." "Claim" is a defined term, which means "an allegation or request for relief," but it must also be observed that only Statements of Claim are served by the "Director," not Statements of Answer. In any case, the sufficiency of the pleading is not at issue, but rather the information and other requirements that the staff needs to administer the case properly.

Rule 12308: Loss of Defenses Due to Untimely or Incomplete Answer (nka Rule 10314)

The ability of arbitrators to bar defenses for inadequate or untimely answers appears in the Current Code, but the Proposed Code makes some changes. Because arbitrators are not appointed until months after the answer is due, by which time even less diligent respondents will have filed responses, pleas for sanctions often appear to the newly empanelled arbitrators as more tactically driven than deserved. The new Code provision may be reacting to this circumstance in two ways that require attention. First, the provision may well be making applicable to all non-answering respondents the streamlined default procedures established for defunct firms that fail to participate in the arbitration process. Rule 12308 states that a failing party "may also be subject to default proceedings under Rule 12801" and Rule 12801(b)(1) is revised to indicate that a default proceeding may be initiated "against one or more respondents that fail to file a timely answer…." A second potential cause for concern lies in a provision for a bar of "defenses or facts at the hearing" that would deem incomplete an answer that "fails to include defenses or relevant facts … that were known to [respondent] at the time the answer was filed" (emphasis added). Must all known and relevant facts be pled, even if they are not responsive to the Statement of Claim? Current Rule 10314's requirement only mandates that the Statement of Answer

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specify "the relevant facts and available defenses to the statement of claim."

Rule 12309: Amending Pleadings (nka Rule 10328)

It is clear throughout this Re-Write that NASD responds to situations that arise, to complaints that staff receive, and to case law construing the Code. A change in this proposed Rule reflects staff attention to lessons supplied by case law. In *Zabawa v. FAS Wealth Mgmt.,* 12 SAC 11&12(32), an Award was vacated because certain Respondents, added to the arbitration after the NLSS process was underway, were deprived of an opportunity to participate in the selection of the arbitration panel. In Rule 12309(c), NASD focuses on the time period between the date rankings are due and the date the NLSS process is complete and provides that no parties may be added by amended pleading during that period. Once the panel is appointed, parties can, with approval by the panel, be added, but they will hereafter be given an opportunity to object to being added. If added, the new parties will have the opportunity, not to begin the Neutral List Selection System process anew, but to challenge any seated arbitrator for cause. This acts to balance the objective of freely allowing amended pleadings with the need to avoid prejudice to newly added parties.

Rule 12314: Combining Claims (nka Rule 10314)

The provisions regarding joinder and consolidation that appear in NASD Rule 10314(d) are broken into three Proposed Rules (12312, 12313 and 12314). While the Director has been empowered to make preliminary rulings in this area, the panel has always had plenary authority once seated to deal with managing cases involving multiple parties. Rule 12314 provides more order to that procedural process by allowing the Panel to "reconsider the Director's decision upon motion of a party." The Director has the authority to sever or consolidate and the Panel cannot, it seems, reconsider his/her ruling *sua sponte*.

<u>Conclusion-Part 1</u>

It is the music, not just the notes, that one has the opportunity to contemplate when a comprehensive review is underway and this one resonates with themes that warrant readers' attention and discussion. There are, of course, flash points for debate, such as the notion of attorney sanctions, that will perforce be part of the dialogue, but those are short refrains in a symphony of change. Today, there are uncertainties about the future of the NYSE's arbitration program and, even if it continues, its dedication and appeal. Whether or not it is good to have a single SRO arbitration forum, we are quietly moving in that direction. The strategic views and concerns of NASD management pervade this Code re-write and we, as users of this predominant service, have an opportunity to apprehend those philosophical attitudes at a pivotal time and, perhaps, through comment to influence them.

Even within the rules we cover, this review by no means identifies each change that the Proposed Code intends to or will effectuate, nor are our brief remarks about important revisions meant to be thorough. We are critical of some of the changes, but we think the first step in a healthy debate is to outline the issues and fathom their significance. Here, the issues are manifold, because of the magnitude of the Proposed Code revisions, and a prominent few could easily dominate the rule comment process. If we accomplish nothing else by this rule-by-rule comparison, and even if we occasionally err about or misjudge the actual nature of a particular proposal, we can still hope to persuade readers that much of a significant nature lies within the Proposed Code changes and that review and comment should not be squandered on the "red herrings" and the obvious.

As we went to print, the Proposed Codes had not been released by the Commission for publication in the Federal Register, so the formal period for comment had not yet commenced. Our effort will be to conclude and publish Part 2 of this review within the period allowed for public comment by the SEC. We welcome reader comment as this process moves forward.

<u>Endnotes</u>

[1] The 1989 omnibus revisions to the SRO Codes were performed in tandem by the SICA-participating forums and tracked the Uniform Code of Arbitration closely. At the time, NASD was the dominant forum, but it only had about two-thirds of the annual case volume. Today, NASD's market share approaches 90% and the forums participating in SICA have dwindled to few that are active. NASD has been moving in this direction of "going it alone" for some time (see Katsoris article, "SICA: Does the Bell Toll for Thee?" 1/94 excerpt: "If the recent NASD 'lone-ranger' approach is heralding a new era of go-it-alone changes in which SICA is by-passed, then the very integrity of SICA is at stake." 6 SAC 1(2)).
Of course, SICA remains an important sounding board and fulcrum for change, and, while its loss of status is regrettable for a variety of reasons, it may also be necessary and inevitable. The real changes in securities arbitration will, as they have increasingly, emanate from NASD and SEC. While many of the concepts and contributions of the Uniform Code of Arbitration will remain, an arbitration structure built on standardized rules shared among competing arbitration forums is dead!

[2] While no doubt a salutary contribution, the conversion of the Code to "Plain English" must by itself be viewed as fostering change that may potentially be substantive. Litigation disputes that lead courts to construe the Code of Arbitration Procedure number in the hundreds every year and a good deal of judicial gloss has built around the terms and phrases that appear in the Code. It may well be that "Plain English" alterations designed to make rules easier to read and understand, will also have unintended consequences from an interpretative standpoint.

[3] By way of example, there are textual changes to the jurisdictional sections of the Code, Rules 12200 and 12201, which potentially alter the scope of arbitrable disputes. For instance, the Code's coverage of disputes involving the "business" of a member or the "activities" of an associated person will, in the Proposed Code, combine the phrase and cover disputes involving the "business activities" of the member or the associated person. The "Definitions" section of the Proposed Code does not offer a definition of "business activities," but arguably the term is less broad than "business" and far narrower indeed than the unrestricted term, "activities." That courts may read into the new language an intent to alter the scope of disputes that members must arbitrate with customers seems to us a distinct possibility.

Letter to the Editor

(Re Expungement)

Jonathan Schwartz, Esq.
Attorney at Law
Marina del Rey, CA

Dear Editor:

I read with interest your description of the new expungement options proposed by the NASD. I was particularly interested in your comment that "…we can expect, more and more, that settlements will be affected, as will the ease of joint representation. A broker who wants to clear her record will have a conflicting interest with her employer. She may need to opt out of a firm's settlement with a customer and press for an adjudication or some form of mini-hearing to obtain the necessary expungement findings."

As an attorney who finds himself representing individual brokers in customer disputes, this has been a particularly troublesome area. In particular, I have found counsel for more than one brokerage firm taking the position that they have the unilateral power to settle a customer claim on behalf of the broker-dealer, its officers, employees, etc., a group that includes my client, regardless of our wishes.

In one instance where I discussed with opposing counsel the possibility of my stockbroker client opting out of a proposed settlement, I learned that the compliance department for the respondent broker-dealer intended to report the settlement on my client's U-4, whether my client opted out or not. This is a situation in which the parties were willing to enter into a settlement without my client's participation, where my expectation was that I would later be able to arrange a resolution of the claim against my client in such a way as to allow the answer to Item 7E 1(c) or 2 to be changed from a "Yes" to a "No."

Compliance personnel for the major brokerage firms are not responsive to these procedural niceties and, in fact, the language of Items 7E 1(c) and 7E 2 make reference to a claim that "was settled for an amount of $10,000 or more," without speaking to a situation in which a case "was settled" by one respondent but not another. Indeed, the tenor of the language seems to dictate the response that is usually taken; that a settlement with the firm is the event that should be reported on Form U-4 whether the broker participated in it or not. What, exactly, is your next move when the customer has settled with the firm and filed a request to dismiss the claim?

(ed: These are good observations. We appreciate the insights. Mr. Schwartz's reference to a SAC expungement article speaks to a piece that appeared in a recent Arb Alert. It also appears in this issue's "In Brief" section.)

In Brief

"NASD SPEAKS" AT EVENING FORUM: ***Repeating an undertaking that she has met for the past five years, NASD-DR Vice President Elizabeth R. Clancy spoke to a group of arbitration practitioners and neutrals about developments and plans for improvement at NASD Dispute Resolution.*** The February 2 gathering ("NASD Listens … And Speaks") was moderated by Martin Feinberg, former Chair and current member of the Committee on Arbitration and ADR of the New York County Lawyers Association, and held at NYCLA's Vesey Street building. Ms. Clancy, who is Regional Director of the Northeast Office, reviewed case statistics and recent rule changes. She reported as well that **Ken Andrichik**, who developed the NASD's successful mediation program, has been promoted to Senior Vice President status, and that **Judith Norris**, head of the West Coast Region, is now a Vice President. We also heard that the recent opening of a Newark, NJ hearing location and the planned opening of a Hartford, CT location (SAA 03-33) are part of a corporate objective to open at least one NASD hearing situs in every state over the next two years. Look for new Northeast situses in Rhode Island, Vermont and New Hampshire. According to Ms. Clancy, visitors to the NASD WebSite are now able to review the new procedures for filing a case online and track through how the filing procedures will work. The new Web-based Case Filing System is part of the Matrix computerization effort and, while voluntary for all filers at this point, online claim filing will soon be mandatory for some parties (*e.g.,* claimants with analyst claims and attorney representation are scheduled for May 2004). The Code overhaul, new expungement rules, online Chair training, staff additions, and Arbitrator-related developments were all covered. Of interest, we thought, was a discussion about the new Code proposal for arbitral sanctioning powers against representatives, as well as parties, in NASD arbitration. Ms. Clancy urged interested parties to review carefully the new Code proposals and to participate when the SEC publishes the changes for comment. She also outlined the NASD's procedures for tracking payment of Awards to customers and offered some statistics on the incidence of vacatur attempts. (See deatails on page 12, "Vacatur Statistics").

INDUSTRY CODE PROPOSED BY NASD: ***NASD Dispute Resolution has commenced a rulemaking process that will end with three dispute resolution codes instead of one; all three installments have now been filed with the SEC.*** We reported on the filing of the Customer Code in October 2003 (SAA 03-42), which is likely to be the most controversial; the new Industry Code for intra-industry matters followed on January 16, 2004 (SR-NASD-2004-011). We expect the SEC staff has awaited the filing of all three Codes and will publish them in the Federal Register for comment all at once. While that will mean a great deal of reading for commenters, it will maintain consistency among the three Codes and allow any revisions that arise to be made uniformly. NASD's stated purpose in launching this overhaul, which it is pursuing independently of SICA and the Uniform Code of Arbitration, is to reorganize the rules in "a more logical, user-friendly way," to "[s]implify the language and structure of the rules," and to "[i]mplement several substantive rule changes to the Industry and Customer Codes.…" The current Code, which is numbered under the Rule 10000 series, will be split in three parts: the Customer Code will be re-numbered as a Rule 12000 set, while the Industry Code will use the Rule 13000 series and the Mediation Code the Rule 14000 series. The Customer and Industry Codes are, with few exceptions, numbered so that the last three digits in the Rule series deal with the same subject matter and, for the most part, the procedures that guide the two processes are the same in both Codes. Rules 10210 and 10211, governing statutory employment discrimination claims, deal with industry matters only, so they appear only in the Industry Code. These industry-specific provisions contain no substantive changes from the current Code, NASD states, nor does Rule 10335, governing injunctive relief in industry matters. Those changes which NASD lists in its filing as substantive would: (1) allow procedures to be modified when all <u>active</u> participants agree; (2) permit the Director to decline jurisdiction on his/her own and in a wider array of cases; (3) make shareholder derivative actions non-arbitrable at NASD; (4) allow greater flexibility in extending deadlines; (5) expressly prohibit *ex parte* communication between parties and arbitrators; (6) provide for sanctions against a party representative in "extraordinary circumstances;" (7) codify the factors that are considered in determining hearing location and allow the Director to alter the hearing location, prior to the commencement of list selection; (8) extend the time for answering counterclaims to 20 days and reduce the time for answering cross-claims to 20 days; (9) codify the practices related to treating and/or closing cases reflecting deficiencies in the pleading of claims; (10) adopt new procedures for amending claims that would add parties to the case and extend the time for answering amended pleadings; (11) make a number of changes to the arbitrator selection procedures, including establishing a separate roster for chairpersons with specific qualifications, making NLSS random (vs. rotational), and expanding the number of candidates in each selection slot, while limiting the number of strikes; (12) require IPHCs, absent party agreement to the contrary, and allow the Panel to tape-record any pre-hearing conference; (13) issue guidance on motion practice, in particular, dispositive motions; (14) revamp discovery procedures, by, among other things, extending the time to respond from 30 to 60 days and strengthening sanction powers; (15) define procedures for withdrawals and discouraging last-minute postponements by requiring a "good cause" determination; (16) revise the simplified arbitration procedures; and (17) last but not least, change the fee schedule to, among other things, eliminate "repetitive high-end brackets and align the brackets in the filing fee schedule with the brackets in the member filing fee and surcharge

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schedules. Most of the proposed changes are quite consistent with the substantive changes proposed in the Customer Code. *(ed: The Mediation Code has now been filed with the SEC as well.)*

NASD EXPUNGEMENT RULE APPROVED: ***NASD Rule 2130, entitled "Obtaining an Order of Expungement of Customer Dispute Information from the Central Registration Depository (CRD System)," was approved by the Securities and Exchange Commission in mid-December.*** The announcement that SR-NASD-2002-168 (filed 11/19/02) gained SEC approval was published in the Federal Register in late December (SEC. Rel. No. 34-48933, dtd 12/16/03; 68 Fed. Reg. 247, p. 74667, 12/24/03). During the 13 months that this controversial rule change was before the Commission, some 28 comment letters were submitted and NASD, in response to these and earlier comments, reacted with substantive amendments to the proposed Rule. As late as September 2003, NASD filed rule changes that overhauled the criteria by which it will judge the appropriateness of expungement orders from arbitral or judicial forums. (SAA 03-43). The new Rule establishes a procedure for the post-Award effectuation of expungement orders through a judicial confirmation process and formal removal from CRD of the offending information. The procedure refers to customer disputes, not intra-industry cases, and requires that NASD be named in all such confirmation proceedings, unless it waives participation. NASD waiver of participation promises the least expensive and protracted route for expungement, but waiver requires, for the most part, that NASD be presented with "affirmative judicial or arbitral findings" that meet one of three criteria (see below). Without the requisite arbitral findings, NASD will, except in extraordinary circumstances, oppose the expungement before the court. Use of the word "affirmative" is intended to convey to arbitrators the need to base the requisite finding upon solid ground. This probably means that arbitrators will need to hear sufficient evidence to allow such findings, a complication that will thwart the fairly active practice of settling upon condition that a stipulated expungement Award will issue. On the other hand, NASD assures the Commission that its regard for the integrity of arbitral findings and the arbitration process will lead it to waive involvement in the post-Award process whenever the requisite findings are properly included in the arbitrators' Award. To assure waiver of NASD participation, arbitrators will, after appropriate factfinding, affirmatively determine that: "(A) the claim, allegation or information is factually impossible or clearly erroneous; (B) the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds; or (C) the claim, allegation, or information is false." *(ed: Alert readers can find previous articles on this rule in past Arb Alerts, SAA 02-03, 02-04, 02-40, 02-48, 02-49, 03-11 and 03-43. The new Rule will apply to cases filed on or after the effective date and that date will be set in an upcoming Notice to Members. That leaves a considerable lag time during which the current Moratorium procedures will continue to apply. In a related development, NASD has announced its intention to enhance access to CRD records via the Public Disclosure Program (nka NASD BrokerCheck) with online reports and other improvements, see NASD NTM 03-76.)* (SAC Ref. No. 04-01-01)

NASD RULE RE UNPAID AWARDS APPROVED: ***A Rule proposal regulating the membership application process will make it more difficult for brokerage firms and associated persons to avoid paying arbitration Awards through the camouflage of reorganization.*** The transfer of assets from one brokerage firm to another or to a new entity is a legitimate means of transferring control and ownership, but it is also a means by which some brokerage firms and their principals cover their tracks and seek to avoid future liabilities or current debts to customers. By moving their assets under a new corporate roof, such people can often make collection more difficult and avoid the crushing impact of NASD enforcement efforts. We reported on this proposal when it was first published by NASD for comment (SAA 02-32), but not since. It was filed with the SEC in January 2003 under File No. SR-NASD-2003-07 and published for comment in October 2003, after a single amendment. A second amendment followed and, without comment, the Rule changes were approved on December 22, 2003 (Rel No. 34-48969, published 68 Fed. Reg. 250, p. 75681, 12/31/03). NASD Rule 1014, which lists certain factors, such as pending or past regulatory actions, that will be considered in the membership process, now includes "pending arbitrations or civil actions against the applicant, as well as unpaid arbitration awards, or other adjudicated customer awards against the applicant" or designated persons in control relationships with the member. There will also be a "presumption" that "negative events" relating to Rule 1014 will block membership approval, absent adequate rebuttal. NASD Rule 1017 broadens and clarifies the categories of asset dispositions that will trigger the approval process. Any transfer of assets in bulk will require NASD approval, whether it is fashioned as an acquisition or otherwise, and the amount involved will be objectively fixed, using a 25% threshold test, instead of the more subjective "substantially all" in the previous rule. Finally, Rule 1011 has been altered to include, for membership approval purposes, "persons" associated with the firm in control-type relationships, whether natural or corporate. With these changes, NASD believes the new Rules will "strengthen its ability to protect investors with pending claims, awards or judgments against NASD members, and to otherwise detect and prevent misconduct." The SEC states that the broadening of transactions subject to the approval process and the extension to any form of asset transfer "should enhance the NASD's ability to ensure that such transactions do not result in a member or its owners insulating itself or themselves from the responsibility to pay existing or potential customer claims." *(ed: NASD has since published NTM 04-10, entitled "Membership Application and Continuation Rules," which describes the new Rules in detail .)* (SAC Ref. No. 2004-05-02)

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NASD PROPOSES DIRECT PARTY-ARBITRATOR COMMUNICATIONS: ***NASD submits an innovative plan for SEC approval that would, with mutual agreement among all parties and arbitrators, allow direct communications on matters that will expedite the process and reduce miscommunications.*** In June 2001, NASD commenced a one-year pilot in the Chicago Regional Office which tested the concept of taking the staff out of the middle of communications between the parties and the arbitrators. Currently, any orders or rulings from the arbitrators must pass through the staff to the parties and party requests for arbitral intervention or determinations also must be relayed by the staff to the Panel. This helps to assure that the information which reaches the arbitrators is properly screened and it guards against *ex parte* communications which might create suspicion of bias or corruption. On the other hand, with sophisticated counsel and experienced arbitrators, direct communications with appropriate ground rules can often streamline the process. NASD found, among those whom it surveyed and received responses, that "73% of party representatives and 69% of the arbitrators… favored continuing direct communication" as an alternative after the Chicago pilot ended. The current proposal, filed with the SEC on October 31, 2003 under SR-NASD-2003-163, establishes a new Rule 10334, that permits unanimous agreement among the parties and arbitrators to communicate directly. The parties all need to be represented by counsel and written instructions must be set forth in an arbitral order that lists the items of direct communication and a means of communication that is available to all. Moreover, the staff must be copied on all orders or decisions and receive all materials sent to the Panel. Verbal *ex parte* communications are still prohibited and any party may opt out and terminate the direct communications at any time. (SAC Ref. No. 03-43-02)

NASD RAISES ARB TRAINING RATES: ***NASD Dispute Resolution submitted a proposed rule change to the SEC on January 7, which increases the fee for arbitrator panel training and initiates a fee for taking its online training courses.*** The NASD Board approved a proposal in July 2003 delegating authority to the President of NASD Dispute Resolution to alter all fees administered by the forum and, pursuant to that authority, she has acted to raise the fee for arbitrator panel training from \$100 to \$125 and to charge a \$25 fee for arbitrators who take online training. NASD explains that the hike in panel training charges was driven by increased room rental and staff travel costs. Moreover, arbitrators who serve as co-trainers can be paid a higher honorarium and the training sessions can be lengthened to include additional subject matter. Charging a fee for online training will facilitate NASD-DR's plan to develop short training modules, handling matters such as expungement requests and discovery abuses. It is to these mini-modules that the \$25 charge will apply. The new fees became effective within 30 days of Commission approval.

DISCOVERY ABUSES: NEW NOTICE TO PARTIES: ***NASD Dispute Resolution has published on its WebSite (<u>www.nasdadr.com</u>) a further reminder to parties that cooperation in the document exchange and compliance with discovery rules and procedures is a duty, the abuse of which can lead to sanctions.*** NASD published a Notice to Members, NTM 03-70, on this subject in November 2003, reminding members of the disciplinary consequences of not obeying arbitral discovery orders (see SAA 03-44). This new Notice, which appeared in early January, is addressed to all parties and focuses more on the sanctions that can be levied by arbitrators on <u>any</u> party who does not abide by the rules. In addition to highlighting some of the sanctions that arbitrators may impose, at the top of the Notice, the Notice also describes some sanctions actually imposed by Panels. These "real-life" examples have considerable effect, as they not only inform parties that the "possible" has really occurred, but it also describes some weighty penalties aimed at both member and non-member parties. During the past year, for example, arbitrators have dismissed several claims with prejudice for failure to comply with discovery orders and have, in several other cases, referred noncompliance by registered individuals for disciplinary review. Monetary sanctions have been imposed for as much as \$10,000 per day for continued withholding of discoverable documents and more than a couple four-figure monetary sanctions are also reported. The procedures and applicable rules are reviewed in the Notice and parties are informed that NASD staff will be "reminding arbitrators about what they can do to manage the discovery process effectively, including what sanctions are available when parties violate either NASD rules or arbitrator orders." (*ed: See the previous edition of SAC, Vol. 2004, No. 1 for a feature article by NASD's Laura Gansler that covers this area with thoroughness.)*

ANALYST CONFLICT CASES SET FOR ONLINE FILING: ***NASD has submitted a rule revision to the SEC which would amend its claim filing rules to employ online filing procedures for claims attributing losses "due to reliance on a recommendation from an analyst."*** SR-NASD-2003-151, sent to the Commission under date of October 6, 2003 proposes to amend the "Statement of Claim" section of NASD Rule 10314 to accommodate the expected flood of analyst-conflict cases that could be filed in the near future. NASD has been planning conversion to a totally new MATRICS computer regime, with roll-out in six phases or releases between the second quarter of 2003 and the fourth quarter of 2005. It will accelerate one aspect of that conversion, planned for the final implementation phase, to implement an "online claim notification procedure" for analyst-conflict cases. The accelerated implementation, NASD explains, is necessitated by an anticipated "influx of arbitration cases arising out of the Global Settlement of conflicts of Interest Between Research analysts and Investment Banking ("Global Settlement"), executed earlier this year." Under the plan, attorneys representing clients with "analyst-related" claims must complete a Claim Information Sheet, as is currently required, but s/he must do so on the NASD Dispute Resolution WebSite.

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Online submission will generate a Tracking Form which counsel will then file by mail, along with the Statement of Claim, the Uniform Submission Agreement, and the usual fees. The new procedure will be available to all filers, but will be required for the analyst-related claims. Counsel who are tech-challenged may request assistance from the staff and, for the first 90 days of the two-year pilot, grace will be accorded those who cannot or do not comply. NASD asserts that the new procedure will offer "tools" and online enhancements that will actively assist claimants and that the changes are needed to "expedite the case intake process, provide better data recovery, reduce manual data entry, and provide for more efficient claims intake and administration." *(ed: The current "intake" process and how it will be altered by the online changes are described in detail in the filing. NASD recently announced the commencement of voluntary online filing on its WebSite.)* (SAC Ref. No. 03-39-01)

NASD STATS, 12/03 & 2003 YEAR-END: ***As it turned out, 2003 ended with NASD failing to make even its lowest projection for case filings, but still reporting enough new submissions to shatter past annual volume records.*** NASD Dispute Resolution posted its case statistics for the last month in 2003, giving us a full year's picture on a record year, but it failed to break the 9,000 mark. Because of the Global Research Settlement and the thousands of cases that certain Claimants' attorneys were claiming to be preparing for filing, NASD Dispute Resolution ratcheted up hiring and space preparations for filings that they were, at one time, led to announce could hit 14,000. Instead, the monthly submission tallies for 2003 show the year getting off to a quick start, with a 24% jump over 2002, which held steady until about July. After that, the filings continued at a quick pace, relative to the year before, but by December 2003, reached only a 16% increase over 2002. In December, 685 additional cases were added to the arbitration docket, compared to 620 in 2002, but that number was the third lowest for monthly showings during 2003. Despite the slowdown at year-end, NASD Dispute Resolution recorded 8,945 cases, a level more than 1,200 cases higher than in any year past. NASD also closed 7,278 cases, a 22% increase over the 5,957 cases processed to conclusion in 2002. Moreover, the gap between cases entering the pipeline and exiting it also decreased a bit, in spite of the high volume. In 2002, NASD opened approximately 1,750 cases more than it closed, a difference that gets added to the docket backlog and can, over time, affect turnaround averages. In 2003, the gap was still large, but was less than 1,700 and improving. Still, over two years, that shortfall has added a net of almost 3,500 cases to the pending docket. Average turnaround time ended the year 7% higher than 2002, for all concluded cases, and those that went to decision after a merits hearing took an average of 17.4 months to conclude, 5% higher than the average of 16.5 months in 2002. The overall turnaround rate is being helped by mediated settlements and, to some extent, by simplified decisions, those small claims cases that are decided "on the papers," i.e., without a formal hearing. On the mediation side, average turnaround time actually decreased 5% from 2002, at the same time as the cases entering mediation agreements surged 19% to 1,114 from 936. Mediation also closed a record number of cases and, because many of those were already awaiting arbitration, mediated settlements assisted the closed case tally significantly. In 2003, approximately 16% of the cases closed due to mediated settlements, a higher percentage than mediation has achieved in at least the last four years and probably ever. Direct settlements between the parties, as a percentage of the closed case tally for 2003, declined to a low point of 36% compared to averages over a high the last five years of 37-44%. Together, then, all settlements constituted about 52% of the total closed cases in 2003, as compared to 50% in 2002, 56% in 2001, 55% in 2000, and 52% in 1999. Approximately 2,100 cases were decided by NASD arbitrators during the year past. Most of these decided cases were initiated by customers, of course, and about 54% of those customers won some monetary award. The total amount awarded to customers by NASD Panels hit $162 million in 2003, $30 million of which constituted punitive damages. The remaining $132 million is the highest compensatory figure on record, although, on a case-by-case basis, it is probably comparable to customer results in 2002. The "bad broker" allegations, such as churning and unauthorized trading, decreased in frequency, both on an absolute and a relative basis in 2003, while the more elusive "omission of facts" claims surged 65% higher and "negligence" claims (apart from "suitability" allegations) were up 39%, as compared to 2002. The investment vehicles involved in the new filings were mostly common stocks and mutual funds. Cases involving mutual funds were up 36% from 2002 (and in 2002 doubled as the identified vehicle for disputed losses), while common stock cases increased 23% from the year earlier. These statistical weightings in both the "controversy" and "product" categories seem consistent to us with a surge in claims related to the tech-stock bubble and that, of course, explains the upward bounce in new filings for 2003 (and 2002). The impact, though, was not as great as those who were predicting 10,000 or more NASD filings. Ultimately, that may be attributable to the review of disputes by a more sophisticated Claimants' bar, to effective early dispute resolution procedures within brokerage firms, or to a host of other factors, both salutary and accidental, that caused investors with tech-stock losses not to opt for arbitration. What is important, relative to arbitration's integrity and its value as a practical and visible remedy, is that the major SRO forums had prepared to react, if the demand arose.

NASD STATS: SMALL CLAIMS COMPONENT: ***We suspect that the settlement rate for larger cases may have dropped even more than the 2003 statistics suggest and that small claims settlements are acting as a counter-balance.*** The NASD figures do not allow us to reach a firm conclusion on that proposition, so we have to extrapolate a little. Here's our reasoning. The number of "arbitration customer paper cases," i.e., those small claims disputes decided by arbitrators on the papers without a formal hearing, reached a low of 237 cases in 2003 (vs., e.g., 485 in 2000). All such decided "document" cases, whether brought

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by employees or customers, totaled 313 in 2003 and comprised only 4% of the closed cases, about half of the historic norm. Since we have no reason to believe that small claims filings in 2003 did not keep pace with the whole, the number of small claims entered on the NASD docket in 2003 must be up as well, perhaps 16% or thereabouts. Where are these cases going? These are sensitive cases from an oversight standpoint, so we do not believe they are being pushed to the back burner while large cases go forward. It must be that customers with small claims are either opting for a formal hearing more than ever before or these smaller items are being settled quickly by the brokerage firms as a matter of docket control. Take your pick, but we theorize that, with all of the case volume and the screws still tight on hiring, inside counsel are opting to resolve the small matters with minimal review, in order to focus sufficient attention on the cases that represent the greatest financial threat. If, turning the coin the other way, customers with small claims are opting for a formal hearing with greater frequency than in past years, a tactical decision we have always encouraged, the statistics indicate that it is time for a fresh look at the "on the papers" alternative. These decisions are being resolved 20% faster than in prior years and the "win" rate for customers is at a long-term high of 60%, according to NASD-DR statistics. In contrast, investors who chose to forego a hearing in 2001 waited 9.2 months for a decision and prevailed on their claims only 44% of the time. Since we generally believe that higher "win" rates for Claimants who choose to "roll the dice" with the arbitrators are directly proportional with higher settlement rates, we would also cite the 60% "win" rate as a further indication that a greater percentage of the small claims matters are getting resolved quickly by the respondent broker-dealers.

VACATUR STATISTICS REVEAL SURPRISES: ***As a consequence of NASD's efforts to track payment of the arbitration Awards it issues, statistics are now available that indicate the incidence with which Awards favoring customers are challenged and how often those challenges meet with success.*** NASD Rules require broker-dealers to report whether they have paid amounts awarded to customers in NASD Arbitrations and, when they have not, they must indicate a satisfactory reason for non-payment. As a consequence of this tracking procedure, NASD has the means to evaluate just how often Awards get challenged in the courts through post-Award petitions for vacatur. Now, the Awards that NASD tracks, and the vacatur proceedings it follows, are just those in which the customer won money from a registered person or broker-dealer. Thus, challenges by customers who lost in arbitration are not part of the statistical sample and could add significantly to the statistical incidence of vacatur attempts. On the other hand, court challenges by customers who won something, but claim they should have won more, are part of the sample. The sample covers the 2003 period and catalogs 119 vacatur filings, during a time when 2,077 Awards issued. If one excludes Small Claims Awards from the total, on the assumption (probably only half-true) that they are not generally the subject of formal court challenges, then 1,764 Awards were decided during the survey period. This would indicate that broker-dealers (and disgruntled "winning" customers) go to court to overturn Arbitration Awards about 6-7% of the time. Just counting the Awards that contained some monetary amount to challenge (54% in 2003), that challenge rate would climb to 12-14% of the time. How often are such vacatur efforts successful? Well, deduct those that are still pending and others that settled and only 54 of the 119 concluded with a denial or grant of vacatur. Of that 54, there were 39 Awards (or 72%) that survived the vacatur attempts and 15 (or 28%) in which vacatur was granted. That is a high incidence of vacaturs, viewed in that perspective, and it surprised us. We were surprised, too, to hear that about half of the 15 successful vacatur attempts were initiated by the customer side. Of course, viewed in terms of the overall, it is still quite true that 98% of all arbitration Awards are final. It is helpful, though, to see that one reason for that is not necessarily judicial restraint, but, perhaps, party restraint (dare we say satisfaction with the process). For brokerage firms, at least, it appears that the Arbitrators' decision is accepted in 90-95% of the cases they lose. *(ed: We wish to thank NASD's Liz Clancy and Staff Attorney Avi Rosenfeld for taking the trouble to compile and to make available the figures we cite above; the conclusions and extrapolations are ours alone, not theirs.)* (SAC Ref. No. 2004-05-01)

SAWTELLE AWARD VACATED 2X: ***$25 million in punitive damages is warranted, the Arbitration Panel has twice ruled and, twice, the New York state courts have vacated the amount as "grossly excessive."*** On January 22, a New York state trial court considered a new Award (*Sawtelle v. Waddell & Reed,* NASD ID #97-03642, 9/4/03) rendered by a NASD Panel that had been instructed via judicial remand to review its earlier award of $25 million in punitive damages, in light of the guidance offered by the New York Appellate Division (NYAD) in a February 2003 vacatur decision. Judge Stallman of the New York State Supreme Court, New York County, explains in vacating the Panel's decision this second time around, that the three NASD Arbitrators failed to provide any showing that they had considered the proportionality of the punitive award to the compensatory damages (around $1 million) awarded, which is what concerned the Appellate Division. Instead, the new Award embellishes upon the reprehensibility of W&R's conduct, calling it "horrible" and explaining in greater detail why. The NYAD considered that the conduct was outrageous, Judge Stallman states, and still held that "an award of punitive damages must be proportional to the damage caused by that conduct, as measured by the compensatory damages that are awarded." The absence of any evidence that the Panel considered proportionality restrictions in reaching its award "conflicts with the Appellate Division's holding to the contrary. The panel thus acted contrary to law and beyond the scope and purpose of the remand." As a consequence, the Court refers the case back to arbitration, solely on the punitive damages issue, but remands to a different panel. *(ed: Readers of the Arb Alert can track this matter through all of its incarnations since the August 2001 initial Award (SAA 01-32). This Court*

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only modified the Award the first time around (covered in the Lit Alert, SLA 2002-24), but that's when the Appellate Division stepped in and used the Supreme Court's BMW v. Gore *factors to criticize the $25 million in punitives (SAA 03-06) as "grossly excessive." This latest vacatur (also summarized in SLA 2004-05) followed the remand ruling, reported in SAA 03-36. For the record, we led the SAA 03-06 piece with this exclamation: "Incredibly, the three Arbitrators who were directed to reconsider an excessive award of punitive damages have done so and have decided that they were right after all!" Unfortunately, the Arbitrators, who are experienced Panelists (more than 150 arbitrations among them) and who are no doubt sincere in their steadfastness, have left the parties the arduous and expensive task of presenting the punitive damages issue anew to a fresh Panel.)* (SAC Ref. No. 2004-05-03)

COL PROVISIONS UNDER REGULATORY ATTACK: ***The Utah Securities Director issued a letter to all Utah-registered broker-dealers in mid-December that declares unlawful the litigator's practice of asserting choice-of-law provisions as a defense to rights and remedies available under Utah law.*** Of course, it is the lawyers who make these arguments, but the letter from Director S. Anthony Taggart advises brokerage firms to inform all attorneys representing the firm in arbitration proceedings that asserting such defenses will subject the client to disciplinary sanctions. According to the letter, the Utah Uniform Securities Act provides significant rights and remedies to Utah investors and the Utah Legislature has stressed that these provisions are not waivable by contract. "Based upon this statute," Director Taggart writes, "the Division considers the choice of law provisions in new account documentation to be void to the extent that the provisions may be interpreted to eliminate any protections or remedies that Utah citizens have under the Act." This position is supported by court decisions and policies articulated by the SEC and the NASD, some of which are cited or described in the remaining paragraphs. The letter concludes by warning of potential sanctions if the Division learns of a "broker-dealer attempting to limit the rights and remedies of a Utah citizen with a choice of law provision" and admonishes that it "will not accept as a defense in a proceeding before the Division, that the attorney representing the firm was not aware of the Division's position." *(ed: SAC thanks to Michael Shannon, Brown Raysman, New York City, for alerting us to this development. The letter and a release that specifically mentions New York COL provisions appears on the WebSite of the Utah Division of Securities, www.securities.utah.gov.)* (SAC Ref. No. 04-01-02)

ILLINOIS & OUT-OF-STATE ATTORNEYS: ***Attorneys, especially in-house counsel, who participate in Illinois-based arbitration proceedings should pay heed to this ruling regarding the licensure of out-of-state attorneys representing out-of-state clients.*** In Colmar, Ltd. v. Fremantlemedia North America Inc., No. 02 CH 15805 (Ill. App., 4Div., 12/4/03), the state Appellate Court considered an Award challenge in a commercial dispute. The parties had arbitrated their contractual dispute twice in Illinois and FMNA chose to be represented by a California attorney named Peter J. Anderson. Mr. Anderson disclosed that he was not licensed in Illinois, but AAA rules did not require that he be and the Arbitrators did not rule otherwise. Colmar claimed, in its vacatur action below, that the Award was void because Mr. Anderson engaged in the unauthorized practice of law by appearing as an attorney in Illinois. Had this been a court action, the Court agrees, case law would void the judgment, in the event of an unauthorized practice (UPL) problem. In parsing the distinctions between that situation and this arbitration-based circumstance, the Court provides an excellent analysis of the developing legal authority, in the form of Restatements, Model Rules, and case law, that signal a shift in outlook concerning the multi-jurisdictional practice of law. This was a vacatur petition, signifying that the lower court had only limited authority to review the Arbitrators' rulings and the applicable appellate standard required an abuse of discretion to overturn the lower court's confirmation. From that standpoint, reliance on this decision must be guarded, when assuming that out-of-state attorneys are free to represent parties in securities arbitration; nevertheless, the reasoning is broad and mindful of both policy considerations and the case law in other jurisdictions. A UPL Committee determination in New Jersey (1994 WL 719208) is cited as finding that an out-of-state attorney could represent a party in AAA arbitration in New Jersey. A New York federal court permitted a New Jersey law firm's collection suit to proceed for fees incurred in the representation of a party in a New York-based commercial arbitration (*Williamson v. Quinn Constr. Corp.*, 537 F. Supp. 613 (SDNY 1982)). On the other hand, the Court confronts the California precedent in *Birbrower v. Sup. Ct.*, 17 Cal.4th 119 (1998), which held to the opposite effect, but states: "…both the Restatement and ABA Commission have criticized *Birbrower* as creating too harsh a result. We agree and, therefore, decline to follow it." The Court does not rely upon FMNA being an out-of-state client, but focuses more upon the differences between arbitration and litigation and upon the fact that Mr. Anderson had an ongoing relationship with FMNA. Its stated holding reflects these influences: "In this case, the relevant factors weigh in favor of our finding that Anderson's activities were authorized primarily because they related to his regular representation of FMNA in California and involved issues that were not specific to Illinois law…. Accordingly, we decline to extend the general rule [voiding legal judgments upon a finding of unauthorized practice] to apply to situations where an out-of-state attorney represents a client in arbitration in Illinois." (SAA Ref. No. 04-03-01)

RAPOPORT **& FLORIDA PRACTICE:** ***On February 9, 2004, the Florida Bar filed a Petition with the Florida Supreme Court to amend the Rules Regulating the Florida Bar and the Florida Rules of Judicial Administration to allow for the multijurisdictional practice of law. The new rules would resolve the uncertainty engendered by the Court's*** **Rapoport**

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decision concerning the ability of non-Florida licensed attorneys to represent parties in Florida arbitrations. Of course, approval by the Court is required to make the rules effective, but the current proposals have been vetted by a number of committees of the Florida Bar and were fashioned to comport with national standards promoted by the American Bar Association. The Petition submits a new "Rule 1-3.11, Appearances by Non-Florida Lawyers in an Arbitration Proceeding in Florida," that would permit such appearances when the appearance: (1) is for a client who resides in or has an office in the lawyer's home state; or (2) arises out of or is reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice; and (3) it is not one that requires *pro hac vice* admission. *(ed: We understand this construction to mean that (3) applies when either (1) or (2) applies.)* Also required is provision of a notice to The Florida Bar and payment of a filing fee. Of course, this is not a license to engage in a "general practice" in Florida and "general practice," within the context of arbitration practice, would include presumptively a non-Florida lawyer who files more than three demands for arbitration or responses to arbitration in separate arbitration proceedings in a 365-day period. *(ed: The* Rapoport *decision, see Securities Litigation Alert 03-09 or SAA 03-08, declared as unauthorized an arbitration practice by a non-Florida attorney who lived in, advertised in, and maintained an office in Florida. The new Rule excludes from exemptive coverage, among others, any non-Florida attorney who is a Florida resident. Most of our information about these new developments came from a memo to clients, produced by Fowler White Boggs Banker, PA, Tampa, FL, and dated February 16, 2004. Of course, the uncertainty created by Rapoport will persist until these amendments are approved and, in that regard, the Fowler White memo observes that "… no complaints have been submitted to the Florida Bar based on actions violating the Rapoport decision. As the Florida Bar disciplinary process is driven by complaints, no actions have been taken based on the Rapoport decision." The full text of the Petition can be accessed by visiting this URL: http://www.flabar.org. SAC thanks to Brian Okay and Burt Wiand of Fowler White for this Rapoport update.)*

Articles & Case Law

As a regular feature, SAC summarizes articles and case decisions of interest in the field of securities/commodities arbitration law. If you find one we missed or are involved in a case that produces an interesting decision, please write and send us a copy. *As it is our objective to cover all relevant decisions, we will sometimes include decisions in the current "Articles & Case Law" section that issued a year or more ago. We also summarize unpublished decisions and orders. For these reasons, readers are cautioned to cite-check cases to assure they have not been overruled and may be cited in accordance with local court rules.* We thank our readers who have contributed court opinions and who, by their efforts, help us all to keep informed. Credit is given to contributors at the end of the relevant case summaries.

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A.G. Edwards, Merrill Lose Millions In Arbitrations, by Lynn Cowan, WALL ST. JNL. (online ed., 1/13/04)(both firms were ordered to pay millions in compensatory and punitive damages to investors by two separate arbitration panels which found both firms were "grossly negligent" in their supervision of brokers).

Arbitrating and Mediating NASD Suitability Claims in the Digital Age, by Ernest E. Badway, METROPOLITAN CORPORATE COUNSEL (8/03), p. 21.

Bank of America Faces Allegations: Former Executive Charges Use of "Creative" Accounts, Pressure for Contributions, by Carrick Mollenkamp, THE WALL ST. JNL. (online ed., 11/12/03).

Beware High-Yield Exuberance: With the Public Focused on Recovering Equity Markets, Fixed-Income Problems May Be Brewing, by James Eccleston, ON WALL STREET (2/04), p. 68 (reps normally should not recommend diversifying an equities portfolio with junk bonds).

Clemente Hints That Possible Grasso Meddling in Arbitration Drove Him From NYSE, by David Serchuk, SECURITIES WEEK (3/1/04), p. 1.

Court Vacates Punitive Award That Set a Record for Wall Street, by Susanne Craig, WALL ST. JNL. (online ed., 1/29/04)(finding a $25 million punitive damage award excessive, a New York state court vacated the largest punitive damage award ever levied against a Wall Street firm and sent the case back to another arbitration panel to be heard).

First Montauk Financial Announces Settlement of Arbitration, by Dan Lowrey, WALL ST. JNL. (online ed., 7/24/03) (FMFK disclosed settlement of high-yield corporate bond complaints in Form 8-K by issuing FMFK stock and warrants to customers).

Former BofA Exec's Claim Tossed Out by NASD Panel, by Lynn Cowan, WALL ST. JNL. (online ed., 11/4/03) (NASD ID #02-02669 (New York, 10/24/03: pre-hearing motion released Bank of America on jurisdictional grounds and Bank of America Securities won dismissal of $29 million claim by C. Edward Carter, former head of investment banking).

Getting Personal: Reviewing Broker Forms Can Save Hassle, by Kaja Whitehouse, WALL ST. JNL. (online ed., 10/23/03) (reviewing new account form, transaction confirmations, and account statements will save hassles and money).

How Hazards for Investors Get Tolerated Year After Year, by Susan Pulliam, Susanne Craig and Randall Smith, WALL ST. JNL. (online ed., 2/6/04)(cites a failure to pay arbitration awards as one of the "open secrets" raising eyebrows but persisting on Wall Street).

Merrill Is Told to Pay $6 Million In Tech-Stock Arbitration Case, WALL ST. JNL. (online ed., 2/8/04)(Four telecom industry workers won $6 million in arbitration against Merrill on allegations that their broker used a risky exercise-and-hold strategy for their employee stock options. The case, as reported, "is one of may outgrowths of the tech-stock meltdown of 2000, and also another cautionary tale about borrowing money to invest in the stock market.")

Merrill Still in the Market for Temp Attorneys to Handle Arbitration Caseload, by David Serchuk, SECURITIES WEEK (10/20/03), p. 1 (reports that Merrill is using temporary attorneys for assignments lasting 1 to 1.5 years).

Morgan Stanley Moves to Vacate Two Arbitrations Decisions Against the Firm, by David Serchuk, SECURITIES WEEK (2/9/04), p. 1 (one Florida panel awarded a respondent/counter-claim claimant $1.75 million based on, *inter alia*, his termination without reasonable cause and the other panel, also in Florida, awarded a claimant $1.649 million in part for deferred compensation violations and wrongful termination).

NASD Drafts New Streamlined Code for Industry Arbitrations, by Staff Reporters, ADRWORLD.COM (1/28/04) (NASD submitted to the SEC for approval its newly drafted guidelines for industry arbitrations).

NASD Sparks Controvery As it Seeks to Address Discovery Abuse During Arbitrations, by David Serchuk, SECURITIES WEEK (11/17/03), p. 1.

School of Arb: University Programs Aid Small Investors, by David Serchuk, SECURITIES WEEK (10/20/03), p. 10.

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ARTICLES & CASE LAW *cont'd from page 15*

SEC Approves Tighter CRD Expungement Rule, by Rosalyn Retkwa, ON WALL STREET (2/04), p. 20 (in December, the SEC approved a new NASDR rule that severely limits the ability of brokers to get customer complaints expunged from their CRDs).

Signing Away Your Right to Sue, by Jane Spencer, WALL ST. JNL. (online ed., 10/1/03) (discusses the spread of arbitration clauses to other industries and consumer-based services. *Arbitrate More, Give In to Greed Less* presents a responsive Letter to Editor from an arbitration advocate (10/13/03)).

You Can Recover from Unfit Advice, by Kathy Kristof, THE STAR LEDGER (1/27/04), p. 33 (reports a $239,670 arbitration award for a couple of retirees whose loss was $158,000 [the award, as reported, included 100% of the damages claimed, plus 10% interest and repayment of incurred expenses]).

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Defendants' Standing to Oppose Lead Plaintiff Appointment Under the Private Securities Litigation Reform Act of 1995, by Tiffany M. Wong, THE UNIV.OF CHICAGO LEGAL FORUM, Vol. 2003, p. 833.

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Impact of Investor Meetings/Presentations on Share Prices, Insider Trading and Securities Regulation, by Caspar Rose, INTNL. REV. OF LAW & ECON., Vol. 23, No. 3 (Sept. 2003), p. 227.

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Reciprocal Ethical Duties: The Arbitrator and Practicing Attorneys, by Robert M. Shafton, ALTERNATIVES TO THE HIGH COST OF LITIGATION (11/03 & 12/03, vol. 21, no. 10), p. 197.

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Timelines for Sarbanes-Oxley Whisleblower Enforcement: Does the Administrative Procedure Arithmetic Work?, *by Allen B. Roberts, THE METROPOLITAN CORPORATE COUNSEL (11/03), p. 26.*

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U.S. Regulation of Public Securities Offerings and Development of Standards for Internet Offerings, by Natalie L. Regoli, UMLA L. REV., Vol. 35 (2003), p. 151.

ARTICLE SUMMARIES

Arbitrating and Mediating Suitability Claims in the Digital Age, Ernest E. Badway, THE METROPOLITAN CORPORATE COUNSEL (Aug. '03), p. 21.

Mr. Badway is a former SEC attorney who represents broker-dealers and brokers in securities regulation and white collar criminal defense relating to trading and underwriting matters and also represents parties in arbitration. This article focuses upon the "ever-increasing interplay between various broker-dealer online services and customer suitability for clients and lawyers, who are either arbitrating or mediating a case before" the SRO arbitration forums. The author explains the rise in popularity and sophistication connected with online trading, but cautions that "[t]hese technological advancements, however, have not relieved broker-dealers of one of their paramount responsibilities: broker-dealers must only recommend suitable securities to their customers." Research reports provided online, e-mail transmissions directed to clients, and other interactions with the online customer have been alleged as recommendations in claims subject to arbitration or mediation.

By way of analyzing the different issues presented in suitability cases, the author labels suitability as "customer-specific" suitability, "reasonable basis" suitability, and suitability involving questions of excessive trading. The first brand of suitability relates to the "know your customer" dictum and holds that a customer's investment objectives must be evaluated and recommendations tailored thereto. The second invokes the "due diligence" obligations of broker-dealers to investigate the stocks that they recommend. The third, which can arise even if the securities in play are well-researched and lie within the customer's suitability

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ARTICLES & CASE LAW *cont'd from page 17*

tolerance, relates to account factors such as trading frequency, use of leverage and overconcentration.

NASD's NTM 01-23 provides guidance to members about the factors that describe the parameters of a securities recommendation in an online environment. These indicia of recommendations included directed "pop-up" or e-mail communications encouraging a specific securities purchase or purchases within a market sector. Using portfolio analysis tools that provide stock lists based upon financial or other information supplied by a customer and employing data mining technologies to gather information and "push" specific investment suggestions were examples of a "call to action."

Such calls were distinguished from other more objective or passive research and analytic activities to illustrate the boundaries that form a "recommendation" for suitability purposes. Mr. Badway adds that, "in typical bureaucratic fashion, the NASD staff stated that broker-dealers and the public should not construe its suggestions or advice in this policy statement as a bright line test. Additionally, the NASD staff specifically warned broker-dealers that disclaimers would not discharge their suitability obligations if the customer communications were reasonably viewed as recommendations through their content, context and presentation."

With these factors in mind, the article's remaining paragraphs concentrate on advising broker-dealers how to avoid the land mines and traps that are triggered by careless communications with customers. The author sounds a final practical note regarding related securities fraud and breach of contract claims in arbitrations. "[O]ne should not lose focus on the entirety of the arbitration or mediation process by solely focusing on one particular issue between a broker-dealer and its customer. Remember: an arbitration panel (and, to a lesser extent, a mediator) only needs to find one good claim to determine that a customer is entitled to recovery." ■

Cases

SUMMARY OF DECISIONS

(ed: The court decisions summarized below are arranged by major subject heading first and digested in a single sentence. This enables readers to quickly refer to the courts or topics that are of key interest. The decisions are then arranged in alphabetical order by Plaintiff and summarized more fully. The single summary sentences are repeated and bold-type headnotes are added to facilitate quick scanning for topics of interest or for sorting decisions by major issues. Generally speaking, these case synopses were prepared for SAC's other newsletter service, the Securities Litigation Commentator/Alert (SLC) *and have been previously published in that organ's weekly e-mail alert service ("Lit Alert"). Where the synopsis has been written by one of SLC's Contributing Editors, the author's first initial and last name appear at the end of the summary. We thank the SLC Contributing Editors for their assistance in creating these case summaries.)*

AGREEMENT TO ARBITRATE: *Successor in interest liability may be predicated upon a number of grounds, which seek either subterfuge or a common identity between the predecessor and successor firms.* RYAN BECK & CO., INC. v. CAMPBELL **(N.D. IL)**

AGREEMENT TO ARBITRATE: *Agreement to submit one's dispute to an ADR process that involves binding arbitration bars further proceedings on the claim in court.* TAYLOR v. PRUDENTIAL INS. CO. **(3rd Cir.)**

ARBITRATION AGREEMENT: *A customer who continues to do business with an acquiring broker-dealer will be subject to the broker-dealer's contractual stipulations.* UBS PWI v. BROWN **(AL Sup. Ct.)**

ARBITRABILITY: *Employment discrimination claims under Title VII may be arbitrated under NASD Rule 10201(b) where the parties have entered into an arbitration agreement separate and apart from the Form U-4.* ZOURAS v. GOLDMAN SACHS **(S.D. NY)**

AWARD CHALLENGE: *The amount in controversy in a suit challenging an arbitration award includes the matter at stake in the arbitration, provided the plaintiff is seeking to reopen arbitration.* SIROTZKY v. NYSE **(7th Cir.)**

BREADTH OF AGREEMENT: *A court may order a non-signatory's case to be joined with an ongoing arbitration, but the two disputes must be based upon the same operative facts or be otherwise inherently inseparable.* MERRILL LYNCH TRUST CO., FSB, IN RE **(TX App., 4Dist.)**

BREADTH OF AGREEMENT: *Non-signatories to an arbitration agreement can be required to arbitrate as "certain othersÓ under Rule 10201 of the NASD Code of Arbitration Procedure.* PRUCO SECS. CORP. v. MONTGOMERY **(D. ND)**

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ARTICLES & CASE LAW *cont'd from page 18*

COMPETING AGREEMENTS: The regulatory requirement to arbitrate before one of the SRO forums cannot be superseded by a bilateral agreement between a member and its employee. CS FIRST BOSTON CORP. v. PITOFSKY **(NY App. 1Dept.)**

DAMAGES CALCULATIONS: *Liability for failure to execute a sale of restricted stock commences from the date the selling broker misadvises the stockholder.* ROSS COMMUNICATION INTELLIGENCE CORP., IN RE **(S.D. NY)**

FORUM OF CHOICE: *Where it is apparent that the relief requested by a litigant is impossible of performance, the Court will not commit itself to the issuance of futile orders or to the granting of relief that cannot be implemented.* INSTINET CORP, IN RE **(NY Sup. Ct. NY Cty.)**

PARALLEL PROCEEDINGS: *Intervention in an enforcement action by the SEC is rarely granted, especially to investor-intervenors, and one primary reason is that the Court becomes logic-bound to allow intervention by other investors who have a different viewpoint.* SEC v. BEAR STEARNS & CO., INC. **(S.D. NY)**

RES JUDICATA: *Res judicata issues must be decided by a court of law as they are outside the scope of an arbitration agreement; it is beyond the arbitrator's competence to decide the preclusive effect of a prior court decision.* MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. v. BENJAMIN **(NY App., 1Dept.)**

SCOPE OF REVIEW, JUDICIAL: *The court must override the jury's verdict when the verdict is against the manifest weight of the evidence or has no rational predicate in the evidence.* RUSKIN v. RYAN **(FL App., 4DCA)**

SELLING AWAY: *Even if events occurred prior to employment, the claim meets the test of arbitrability under NASD Rule 10301(a) as long as the dispute relates to a NASD member and a customer or is in connection with the business activities of an associated person.* USALLIANZ SECS. v. So. MICHIGAN BANCORP **(W.D. MI)**

TIMELINESS ISSUES: *A respondent whose arbitration cross-complaint against other respondents is dismissed must file a motion to vacate that decision within ninety days and cannot wait until the entire arbitration proceeding is completed.* NORTHEAST SECS. v. QUEST CAPTL. STRATEGIES **(S.D. NY)**

WAIVER: *The party asserting waiver of arbitration has a heavy burden, and courts are not to infer waiver without a firm basis to do so.* BURNS v. HAMILTON **(S.D. IN)**

WAIVER: *Under Pennsylvania law, waiver of an arbitration agreement may not be had when the moving party relies exclusively upon testimonial affidavits.* STERN v. PRUDENTIAL FINL., INC. **(PA Super. Ct.)**

WAIVER: *A brokerage firm and its employees waived arbitration because they waited more than two months to file a motion to compel arbitration, during which period they engaged in extensive discovery.* THE RETIREMENT GROUP v. LINSCO/PRIVATE LEDGER CORP. **(CA App., 4Dist.)**

Cases

Burns v. Hamilton, 2003 U.S. Dist. LEXIS 20837, No. 1:02-cv-1388-SEB (S.D. Ind., 11/7/03). **Arbitration Agreement * Waiver * Stay of Litigation * Fraudulent Inducement.** Plaintiff succumbed to greed and high-pressure tactics and deposited $30,000 that was never seen again. He filed suit in state court (which the clearing firm, National Commodities Corp., Inc., removed because of diversity) and sought to avoid arbitration on the basis of waiver and judicial economy. There is little new or surprising in this decision, except a twist in NCCI's Arbitration Agreement, which was separate from the Customer Agreement: It specifically stated that it "need not be executed in order to open a customer account." The plaintiff signed both agreements. The Court finds, consistent with *Prima Paint*, "There is no dispute that Burns entered into the Arbitration Agreement freely and without fraud in its inducement." Plaintiff objected that one of the representatives had told him to "go to hell" when he demanded arbitration, and therefore the clearing firm had waived arbitration. This went nowhere. Plaintiff also objected to having his case "piece-mealed" in different fora. The Court agreeably obliges: "it will stay the entirety of this action until the arbitration is complete and any award is ripe for entry as a judgment. Consequently, Burns will have the single venue he requests." Stay was facilitated by the fact that none of the other defendants had been served and the introducing BD, Calvary Financial Corp., was apparently defunct. (*C. T. Mason. The decision will not be published. This case reinforces the wisdom that an attorney who represents himself has a foolish client. The individual who invested his money in the alleged fraudulent scheme was also the attorney seeking to avoid*

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arbitration. Neither effort was successful.) (SLC Ref. No. 2003-48-01)

Credit Suisse First Boston Corp. v. Pitofsky, No. 1580 (N.Y. App. Div., 1Dept., 11/25/03). **Forum Selection * Forum of Choice * Form U-4 * Competing Agreements * SRO Rules (NYSE Rule 347) * Arbitration Agreement * Enforceability (Public Policy).** *The regulatory requirement to arbitrate before one of the SRO forums cannot be superseded by a bilateral agreement between a member and its employee.*

CSFB instituted an Early Dispute Resolution Program in January 1998, which offered a three-step mechanism for addressing employee grievances that ended in binding arbitration. Arbitration under the EDRP was to take place before one of three specified forums, including JAMS. Mr. Pitofsky chose the NYSE, which was not listed among the three forums, and CSFB sought to enjoin arbitration. The trial court agreed, finding that NYSE Rule 347 does not specify a forum; it only requires arbitration of disputes between registered personnel and members. Similarly, the Form U-4 signed by Mr. Pitofsky requires arbitration before the SROs, but not specifically before the NYSE. Thus, the trial court reasoned, the Form U-4 could be superseded by subsequent agreement, to wit, the EDRP. This Court reverses, pointing out that the EDRP specifically excepted registered representatives subject to a "legal requirement" that they arbitrate before "a particular forum…. The facts before us clearly delineate the very circumstances this exception sets forth," the Appellate Division holds. First of all, "Respondent CSFB's contention that Form U-4 and NYSE Rule 347 simply require that the parties arbitrate employment disputes, but do not require that they do so in any particular forum, is erroneous." Secondly, New York case law holds that the Form U-4 cannot be superseded by a subsequent employment agreement. "Essentially, the obligation here to arbitrate in the NYSE forum is imposed on each party due to its affiliation with and assent to the rules of the NYSE." *(ed: While the decision seems sound, it may well cause bifurcation problems where employment discrimination claims are involved. This dispute appears to be solely a compensation dispute, which is NYSE-arbitrable. If there were also Title VII claims, though, they would be arbitrable under the EDRP but not under the NYSE Rules (except by post-dispute agreement).)* (SLC Ref. No. 2003-49-01)

Instinet Corp., In Re, No. 108720/03 (N.Y. Sup., NY Cty., 11/14/03). **Agreement to Arbitrate * FAA (§ 1) * Arbitrability * SRO Rules (NYSE §600(a)) * Forum Selection * Jurisdiction Issues (Arbitral) * Antitrust Issues.** *Where it is apparent that the relief requested by a litigant is impossible of performance because of a fundamental impediment such as lack of jurisdiction of the arbitral body to which the Court is urged to send the matter, the Court will not commit itself to the issuance of futile orders or to the granting of relief that cannot be implemented.*

This dispute arises out of a series of agreements between Archipelago Securities, LLC ("Archipelago") with both petitioner Instinet Corporation ("Instinet") and The Island ECN, Inc. ("Island"). All of the agreements provide that if the parties failed to resolve a dispute within thirty days, the dispute could be submitted to arbitration before the New York Stock Exchange, Inc. ("NYSE") or the National Association of Securities Dealers, Inc. ("NASD"). Archipelago agreed that Instinet had the unilateral right to select between the NYSE and NASD arbitration facilities to resolve any dispute. Archipelago, a registered broker-dealer, executed trades for its customers from its own order book and also looked to other venues, such as Island and Instinet, to obtain the best prices for its customers. Both Instinet and Island charged Archipelago entities certain fees for each transaction. Originally, the fees paid by Archipelago were the same as those charged by Instinet and Island to all regular subscribers to their liquidity. In late 2000, however, both Instinet and Island began to selectively revise their pricing and both reclassified the Archipelago entities in a new "hit or take" customer category where the fees were substantially higher than those paid by regular broker-dealer subscribers. Archipelago complained that the "hit or take" fees were excessive, discriminatory and in violation of the securities laws and antitrust laws. Archipelago further demanded that Instinet refund the overcharges resulting from these fees. On September 20, 2002, Island officially merged with Instinet Group Incorporated, the parent company of Instinet (hereinafter referred to collectively as "Instinet"). On the same day, Island filed a demand for arbitration by means of a Statement of Claim against Archipelago with the NASD alleging, *inter alia*, breach of contract, quantum meruit and unjust enrichment. On December 3, 2002, Archipelago served its Answer and asserted counterclaims for breach of contract, breach of the obligation of good faith, attempted monopolization under Section 2 of the Sherman Act (15 U.S.C. § 2) and conspiracy to restrain trade under Section 1 of the Sherman Act. On January 3, 2003, Archipelago filed a Statement of Claim against Instinet before the NASD asserting essentially the same claims that it had asserted in its counterclaims against Island. Instinet then commenced a special proceeding pursuant to Article 75 of the CPLR and the Federal Arbitration Act, 9 U.S.C. § 1 et seq. ("FAA") seeking to stay arbitration before the NASD on the ground that Archipelago violated the parties' arbitration agreement, and to compel arbitration before the NYSE. Archipelago opposed Instinet's application and cross-moved for, *inter alia*, dismissal of the Petition. In denying Instinet's application and Petition and ordering the parties to proceed to arbitration before the NASD, the Court holds that the NYSE lacks jurisdiction over the instant dispute noting that neither of the parties is a NYSE member and that the matters in dispute are unconnected to the NYSE-related activities of either of the associated persons. The Court explains that, although NYSE Rule 600(a) operates as a "default provision" and provides for arbitration of a customer's or a non-member's claim against an associated person, the claim must be in connection with the associated person's NYSE activities. In addition, Instinet's failure to

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make a timely forum selection violated its obligation of good faith and fair dealing. *(P. Michaels)* (SLC Ref. No. 2003-48-03)

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Benjamin, No. 1467N (N.Y. App. Div., 1Dept., 10/23/03). **Agreement to Arbitrate * Collateral Estoppel/Res Judicata * Arbitrability.** *Res judicata issues must be decided by a court of law as they are outside the scope of an arbitration agreement; it is beyond the arbitrator's competence to decide the preclusive effect of a prior court decision.*

Following a divorce decree and equitable distribution of marital assets under New York law, Benjamin, the husband of Merrill Lynch broker Clayton, brought a NASD arbitration against Clayton and Merrill Lynch. His claim was based on her allegedly improper handling of the couple's joint Merrill Lynch account and the siphoning of assets belonging to Benjamin. Strong public policy considerations favor finality of judgments and the matters sought to be arbitrated are barred by the doctrine of *res judicata*, writes the Appellate Court. It rejects Benjamin's contention that NY's Civil Practice Law & Rules ("C.P.L.R.") limits the court's role to determining whether a valid agreement to arbitrate was entered into or was complied with and whether the claim sought to be arbitrated is barred by the applicable statute of limitations. He maintains that the issue of the preclusive effect of a prior judgment is one for the arbitrator. Although not expressly stated in the C.P.L.R., the Court responds, public policy is part of the court's "gatekeeping role." The preclusive effect of prior litigation is one area that is beyond the reach of an arbitrator's discretion and must be considered by the court in the first instance. Equitable distribution of assets has already determined the same issues that Benjamin seeks to have decided in arbitration. Although he claims he "deliberately reserved these claims for arbitration," the claims "arose out of the same 'factual grouping' as the claims" in the prior court action. Benjamin's claims against Merrill Lynch are similarly barred in that they are derivative of the claims against Clayton. *(S. Anderson)* (SLA 2003-44-02)

Merrill Lynch Trust Co., FSB, In Re, No. 04-03-00424-CV, 2003 Tex. App. LEXIS 9142 (Tex. App., 4Dist., 10/29/03). **Arbitration Agreement * Breadth of Agreement (Non-Signatories) * Stay of Litigation * Equitable Defenses (Estoppel).** *A court may order a non-signatory's case to be joined with an ongoing arbitration, but the two disputes must be based upon the same operative facts or be otherwise inherently inseparable.*

In 1994, Chris Pereyra opened an account with Merrill Lynch and signed a Cash Management Account Agreement ("CMAA") that contained an arbitration clause. Her broker, Henry Medina, advised her to establish a trust account with Merrill Lynch Trust Co. ('the Trust Company") as trustee. An insurance policy issued by Merrill Lynch Life was the sole asset of the trust. In 2002, Pereyra commenced an NASD arbitration proceeding against Merrill Lynch, Medina, and the Trust Company. At the same time she filed suit in state court against the Trust Company and Medina. The two lawsuit defendants moved to compel arbitration. Neither Medina nor the Trust Company were signatories to the CMAA but they asserted that they were entitled to arbitration under the doctrine of equitable estoppel and because they were agents of Merrill Lynch. They also moved to stay the court proceedings. Both motions were denied and the defendants appeal. The decision is affirmed. The doctrine of equitable estoppel applies when the signatory to an agreement containing an arbitration clause: 1) must rely on the terms of the agreement in asserting its claims against the non-signatory; or 2) raises claims "of substantially interdependent and concerted misconduct" by the non-signatory. Here, the creation of the trust was not conditioned upon Pereyra being a brokerage customer of Merrill Lynch or conditioned upon her having a CMAA with Merrill Lynch. Nor are the claims interdependent because the NASD action involves the mishandling of Pereyra's investments while the lawsuit pertains to the insurance policy. The defendants' agency argument fails because Merrill Lynch is not a defendant in the lawsuit and the defendants did not present any evidence to establish that they were working on behalf of Merrill Lynch on matters covered by the CMAA. The Court also refuses to stay the lawsuit pending completion of the NASD action because Medina and the Trust Company did not establish that the claims asserted against them in the lawsuit were based on the same operative facts and were inherently inseparable from the claims asserted in the NASD action. Nor did they establish how litigation of the lawsuit would impair an arbitrator's consideration of the claims against them in the NASD action. *(P. Dubow)* (SLA 2003-44-03)

Northeast Securities, Inc. v. Quest Capital Strategies, Inc., 2003 U.S. Dist. LEXIS 20025 (S.D. N.Y., 11/7/03). **Timeliness Issues (Statute of Limitations) * FAA (§§ 10 & 12) * Evidentiary Standards * Manifest Disregard of Law * Confirmation of Award * Rationale of Award * Forum Costs * Simultaneous Proceedings * Statutory Definitions ("Award" "Partial Final Award").** *A respondent whose arbitration cross-complaint against other respondents is dismissed must file a motion to vacate that decision within ninety days and cannot wait until the entire arbitration proceeding is completed.*

In January 1998, Northeast filed a claim in arbitration against Quest and several of its employees, to wit, David and Carolyne Yu, Richard Skinner, and Joyce Lubbers. Lubbers filed a cross complaint against Quest and the Yus, but it was dismissed in January 1999. The arbitration continued and an Award in favor of Northeast against all respondents was issued in March 2003. Northeast immediately moved to confirm the Award and Lubbers filed a cross-motion to vacate both the Award obtained by Northeast and the dismissal of the cross complaint. The Court denies the cross motion. The cross motion to vacate the dismissal of the cross-complaint is time-barred because Lubbers waited until the entire arbitration was completed before filing it. She had to file the motion to vacate the dismissal of the cross com-

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plaint within 90 days, e.g., by April 1999. The challenge to the main Award is timely, but it fails on its merits. Failure of the panel to state the grounds for the Award does not require vacatur. Lubbers' claim to vacate the award for manifest disregard of the law fails. The Arbitrators did not follow the Federal Rules of Civil Procedure, but arbitrators are not constrained by formal rules of evidence and procedure. Finally, Lubbers' claim that the Award in favor of Northeast should be vacated because it allegedly failed to pay her travel expenses as promised fails because breach of an agreement to pay travel expenses is not one of the limited grounds for vacatur set forth in the Federal Arbitration Act. *(P. Dubow) (EIC: That the Court regards the Arbitrator's cross-claim dismissal as an "Award," for purposes of the FAA's vacatur provisions, should mean that a separate "Award" would issue under the NASD Rules governing public availability of Awards. The difficulty with waiting to include the ruling in an Award at the end of the entire proceeding is, as happened here, that it will get overlooked. See NASD ID #98-00090 (NYC, 3/10/03)).* (SLC Ref. No. 2003-46-03)

Pruco Securities Corp. v. Montgomery, No. A1-03-55 (D. N.D., 10/15/03). **Breadth of Agreement (Non-Signatories) * Raiding Disputes * SRO Rules (NAC, NASD Rules 10101 & 10201) * Statutory Definitions ("Certain Others") * Employment Agreements * Restrictive Covenants * Agreement to Arbitrate * Arbitrability * Arbitrator Authority, Scope of.** *Non-signatories to an arbitration agreement can be required to arbitrate as "certain others" under Rule 10201 of the NASD Code of Arbitration Procedure.*

When Pruco and Prudential Insurance sued Robert Montgomery for breach of covenant not to compete and other common law claims, Montgomery's present employers, Minnesota Life Insurance and Securian Financial Services, intervened. Under agreements that Montgomery signed at the time of his resignation, he agreed not to recruit present Prudential/Pruco employees or sales assistants and to arbitrate all claims. When three additional agents followed Montgomery, allegedly recruited by him, Prudential/Pruco filed for a TRO, citing an attempt to gain access to their client lists. After intervening, Minnesota Life and Securian asserted counterclaims for abuse of process, tortious interference with business relations and a request for judgment declaring the covenants null and void. After a hearing, the Court dissolved the TRO, denied a preliminary injunction and referred the matter to arbitration, directing the arbitration panel to decide: (1) whether Prudential, a non-NASD member, can require Minnesota Life, another non-member, to arbitrate; and, (2) whether Securian, a NASD member, can be compelled to arbitrate with a non-member, Prudential. After the arbitration panel answered both questions in the affirmative, Prudential filed a motion for a stay and to compel arbitration, to stay the action on a discretionary basis, or in the alternative to dismiss the counterclaims pursuant to Rule 12(b)(6). The arbitration panel referred the decision concerning whether to compel arbitration back to the court. Minnesota and Securian assert that they cannot be compelled to arbitrate under the FAA or the NASD Code of Arbitration because they have not agreed to arbitrate. Howsam v. Dean Witter holds that the court has the power to decide whether non-parties to a contract may be required to arbitrate against their will; "the question of arbitrability is clearly an issue for judicial determination." The Court relies on Rule 10101 of the NASD Code of Arbitration Procedure, as setting the scope for permissive arbitration of disputes "arising out of or in connection with the business" of any NASD member or the employment activities of any associated person. Rule 10201 limits the scope of mandatory arbitration to disputes initiated by members or associated persons against certain classes, between or among "members and/or associated persons, and/or certain others." As defined in McMahan v. Forum Capital Markets, 35 F.3d 82, 88 (2d Cir. 1994), "certain others" refers to persons or entities that (1) play an active role in the securities industry, (2) are either signatories to a securities industry arbitration agreement or to an instrument of another signatory; and, (3) "voluntarily participated in the particular events giving rise to the controversy underlying the arbitration." Holding as a matter of law that all three requirements are met both as to Minnesota Life and Securian and that they are required to arbitrate the counterclaims under the plain meaning of Rule 10201, the Court grants a discretionary stay in favor of arbitration. *(S. Anderson)* (SLA Ref. No. 2003-43-01)

Ross v. Communication Intelligence Corp., No. 02 Civ. 6197 (VM) (S.D. N.Y., 7/9/03). **Jurisdiction Issues (Diversity, "Amount in Controversy") * SEC Rule 144 ("Restricted Stock") * Damages Calculations * Parallel Proceedings.** *Liability for failure to execute a sale of restricted stock commences from the date the selling broker misadvises the stockholder.*

Plaintiff acquired restricted shares of CIC, which were supposed to be sold under Rule 144. The shares were delivered to Charles Schwab & Co. for sale, but, due to delays, sale of the stock did not occur until the price had declined. Plaintiffs filed an arbitration against Schwab for negligence and also filed this action against CIC for wrongfully advising Schwab as to resale rights. CIC claims that potential losses do not meet federal requirements ($75,000), requiring dismissal of the complaint. Since determination of the amount in controversy turns on when there was a failure to act, the Court finds that damages run from the time CIC misadvised Plaintiff, March 30, 2000 (to April 3, 2000, when the misadvice was corrected) and not from the date of delivery, March 6, 2000. This leaves Plaintiffs below the jurisdictional requirement with only $13, 586.81 in damages. "Plaintiffs have not persuaded the Court that CIC should or even could have better instructed Mrs. Ross" on the sale or the forms needed. *(P. Hoblin: This case points out the wisdom of having competent people getting involved with complicated securities transactions. This Court dismissed the Complaint for lack of jurisdiction; the action against Schwab in arbitration may still proceed.)* (SLA 2003-44-16)

Ruskin v. Ryan, No. 4D02-2122 (Fla. App., 4Dist., 11/05/03). **Appeal-**

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ability * Award Challenge * Scope of Review, Judicial ("Manifest Weight of the Evidence") * Parallel Proceedings * Malicious Prosecution * Perjury * Damage Calculations. *The court must override the jury's verdict when the verdict is against the manifest weight of the evidence or has no rational predicate in the evidence.*

On the heels of a securities arbitration Award (NASD ID #93-01575 (Ft. Lauderdale, 1/8/96)), in which the Ruskins unsuccessfully sought $100,000 lost in a Ponzi scheme, broker Ryan filed suit against the arbitration Claimants and their attorney, alleging malicious prosecution, solicitation of perjury and perjury. The lawsuit resulted in a decision in favor of Ryan on all counts and an award of $750,000. Following denial of their motion for directed verdict and new trial, the Ruskins appealed. Although the Court finds no merit to their appeal, it also finds that the jury's verdict is not supported by competent substantial evidence and reverses and remands for a new trial on damages only. Evidence showed that Ryan had hired attorneys to represent her in 14 lawsuits, including the Ruskins', a SEC investigation and a class action, resulting in attorneys' fees of $360,000 and lost income of over $1 million due to termination of Ryan's employment. No evidence was presented to show the amount of fees attributable to the Ruskins' case or that Ryan lost her job as a result of the Ruskins' case, as opposed to the other litigation and regulatory proceedings. With no interrogatory verdict, the court is unable to determine the amount of compensatory damages erroneously awarded but holds that, "absent the unsupported damages, the award could not have reached $750,000." A dissenting opinion would hold that the jury, in its fact-finding capacity, is entitled to weigh the evidence presented and render its verdict, which should not be disturbed as being "against the manifest weight of the evidence" unless it is "clear, obvious, and indisputable that the jury was wrong." *(S. Anderson) (EIC: The dangers of accepting representation where the claim lacks merit are increasing. The attorney in this matter settled, but more malicious prosecution claims will flow from the magnified consequences of a "bad" CRD and the difficulties of winning expungement. In addition, attorneys will also be vulnerable to sanctions for frivolous claims under the NASD's new Arbitration Code.)* (SLC Ref. No. 2003-46-07)

Ryan Beck & Co., Inc. v. Campbell, No. 02 C 7016 (N.D. Ill., 10/2/03). **Agreement to Arbitrate * Liability Issues ("Successor in Interest") * Injunctive Relief (Permanent Injunction) * Choice of Law * State Statutes Interpreted (NY Debtors & Creditors Law, §276).** *Successor in interest liability may be predicated upon a number of grounds, which seek to establish either subterfuge or a common identity between the predecessor and successor firms.*

Out of its opposition to one arbitration has come a court ruling that will assist Ryan Beck greatly in fending off the claims of former Gruntal clients. Ryan Beck purchased most of the assets of Gruntal in April 2002, just two months after Wilson Campbell closed an account with Gruntal that had $4 million in losses. Mr. Campbell sought arbitration against Gruntal, his former broker and Ryan Beck in August 2002. Ryan Beck sought injunctive and declaratory relief in October 2002 that it was not bound to arbitrate and, shortly thereafter, Gruntal filed for bankruptcy protection. The Court initially denied a TRO, but later issued an opinion and order granting Ryan Beck's motion for a preliminary injunction (See prior summaries, SLA 2003-01 & 2003-17). The likely success predicted by the Court becomes actual success in this Opinion with the issuance of a permanent injunction. It is clear that Mr. Campbell and Ryan Beck had no direct agreement to arbitrate disputes, but "Ryan Beck nonetheless may be compelled to arbitrate Campbell's claim if it is found to be liable as a successor in interest to Gruntal." A purchaser may be liable for the obligations of the seller under a number of theories (implied assumption of liability; *de facto* merger; mere continuation or "new hat"; and fraudulent evasion of liability). Mr. Campbell presses the *de facto* merger and fraudulent transaction arguments. *De facto* merger may be found where continuity of ownership occurs, the predecessor business ceases quickly, the successor assumes the liabilities needed to do business as before, and the management, personnel, physical location, and general business operation continue relatively unchanged. New York law, which applies here, places great emphasis on continuity of ownership, but its absence is not an absolute bar. Defendant concedes that continuity of ownership is not present and, while Gruntal ceased business quickly and even filed for bankruptcy, Ryan Beck's Board remained as before and "there was no continuity of management or major decisionmakers…. [N]o Gruntal officer, director or employee became a member of the executive management of Ryan Beck." The allegations that the transaction was effected to fraudulently escape liability is similarly rejected by the Court. While Ryan Beck clearly sought to avoid assuming Gruntal's liability for customer complaints and arbitrations, no evidence of subterfuge or material misrepresentations has been provided. The Court examines the record for evidence of six "badges of fraud" and, finding none, concludes that there was no intent to defraud Gruntal creditors. Accordingly, "we conclude that Campbell has failed to demonstrate that any of the exceptions to the general rule against successor liability apply here" and "hold that Ryan Beck is entitled to a declaratory judgment that it is not a successor in interest to Gruntal." *(ed: The outcome on the arbitration issue might change for customers who transferred to Ryan Beck after the purchase of assets (e.g.,* Ryan Beck v. Fakih, *SLA 2003-27), but the Court's determination of successor non-liability for the Gruntal period has applicability to both the arbitrability question and the ultimate merits question.)* (SLC Ref. No. 2003-46-02)

SEC v. Bear Stearns & Co., Inc., 03 Civ. 2937 (WHP) (S.D. N.Y., 8/25/03). **Research Fraud * Conflicts of Interest (Analyst) * FRCP (Rule 24 "Permissive Intervention") * Enforcement Practice/Procedure.** *Intervention in an enforcement action by the SEC is rarely granted, especially to investor-intervenors, and one primary reason is that the Court becomes logic-bound to*

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allow intervention by other investors who have a different viewpoint.

The instant actions seek to redress violations of the 1933 Act and the rules of the SROs against ten separate investment banks (Bear Stearns, J.P. Morgan Securities, Lehman Brothers, Merrill Lynch, U.S. Bancorp Piper Jaffray, UBS Warburg, Goldman Sachs, Citigroup Global Markets, CS First Boston, and Morgan Stanley) for allowing undisclosed conflicts of interest between their investment banking and research activities that compromised the objectivity of their research reports. Two research analysts, Jack Grubman and Henry Blodgett, are the subject of civil actions as well for issuing allegedly conflicted advice. There are then 12 proposed consent judgments filed with the Court, which provide for both injunctive and monetary relief. Some of the monetary relief relates to the funding of (1) proposed Distribution Funds under an Administrator whose plans will be approved by the SEC and the Court; and, (2) an Investor Education Fund under a separate Administrator pursuant to a plan to be approved by the SEC and the Court. Hooper & Weiss, a Jericho, NY law firm, has moved to intervene in the enforcement action on behalf of two Iowans who are customers of Salomon (Citigroup) and Merrill Lynch and, purportedly, more than 12,000 other "aggrieved investors." The movants propose making Defendants include undertakings in their consent judgments that would defray arbitration costs and arbitrators' fees, would assure public access to documents discovered in the course of the regulatory investigations, and would prohibit admissibility objections to certain documents in individual arbitrations. The Court is not sympathetic: "Intervention is not an avenue for advancing the competing agendas of non-parties to a settlement…." Permissive intervention under FRCP 24(b) is discretionary and will not be permitted where it will unduly delay or prejudice the main action. Such concerns are especially "acute where the Government, and particularly the SEC, is a party to the underlying action," because of the Commission's limited resources and the importance of consent decrees to its regulatory efforts. Were other investor-intervenors to follow, chaos would reign. "[S]uch large-scale intervention would cause incalculable confusion, add unmanageable complexity, and bring this Court's review and administration of the underlying actions to a halt." Movants seek *amici* status in the alternative, but the Court rejects this approach, too. "The customary role of an amicus is 'to aid the court and offer insights not available from the parties.'" These investors do not have a "unique point of view that is not available to the Court from the parties…." The SEC represents the public and can adequately inform the Court of that perspective. Moreover, the two Iowans, "Hughes and Kehn… [do not appear] 'as an objective, neutral, dispassionate 'friend of the court.' …Rather, the movants seek to advance a narrow vision of what the proposed consent judgments should look like to further their potential arbitration claims." In any case, the Court now has their views and "will consider them in its continuing review." *(ed: The Weiss firm's claim of 12,000 investors who are waiting to file arbitrations has caught media attention. It has contributed to officials making estimates that NASD filings could rocket into the 12-14,000 area and to expressed concern in the press about the ability of the arbitration forums to handle the volume. The Court expresses some skepticism about the claim and, as time proceeds without the appearance of the promised filings, they would seem less likely to come.)* (SLA 2003-44-13)

Sirotzky v. NYSE & Sanford C. Bernstein & Co., Inc., No. 02-3240 (7th Cir., 10/29/03). **Award Challenge * Representation Issues * Agreement to Arbitrate * U.S. Statutes Interpreted (28 U.S.C. § 1441) * Jurisdiction Issues (Remand; Removal) * SRO Rules (NYSE Arbitration Rule 614) * Sanctions (Judicial).** *The amount in controversy in a suit challenging an arbitration award includes the matter at stake in the arbitration, provided the plaintiff is seeking to reopen arbitration.*

Sara Sirotzky ("Plaintiff") hired Defendant Sanford C. Bernstein & Co., Inc. ("Bernstein") to give her investment advice, pursuant to a contract that provided for arbitration under the arbitration rules of the New York Stock Exchange ("NYSE") of any dispute arising out of the contract. A dispute arose and Plaintiff invoked arbitration seeking $242,000 in damages. The arbitrators, after a hearing in Chicago, ruled in Bernstein's favor and ordered Plaintiff to pay the NYSE $4,800, the fee for providing the parties with an arbitral forum. Rather than comply, Plaintiff sued both Bernstein and the NYSE (collectively referred to as "Defendants") in an Illinois state court, seeking to vacate the arbitrators' decision on the ground that Bernstein had been represented by a lawyer not admitted to practice in Illinois. After the state judge determined the amount in controversy included the damages that Plaintiff had sought from Bernstein in the arbitration proceeding, Bernstein and the NYSE removed the case to federal district court pursuant to 28 U.S.C. § 1441. The district court ruled that the amount in controversy was the $4,800 fee, far less than the minimum amount required for a diversity suit in federal court, and remanded the case to state court. When Plaintiff asked the lower court to award her attorney's fees, the court refused on the ground that the theory on which the Defendants had based their removal of the case was not frivolous. Plaintiff followed with this appeal. Affirming the decision below, the Court holds that the district judge did not abuse his discretion in refusing to award Plaintiff the attorney's fees that she incurred in getting her case remanded to the state court. The Court explains that the natural assumption was that Plaintiff was seeking to set aside the arbitrators' decision so she could get another shot at the $242,000 she claimed were the damages caused by Bernstein's alleged breach of contract. As for the issue regarding Bernstein's legal representation, the procedures and evidentiary rules in an arbitration proceeding are matters for the arbitrators and the arbitration contract to determine, rather than for a court to impose. The Court also notes that the NYSE Constitution and Arbitration Rules do not even require parties to be represented by a lawyer, let alone a licensed one. *(P. Michaels) (EIC: The lower court's decision remanding to state court was summarized in SLA 2002-25 and the NYSE Award number is #2000-*

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008548, Chicago, 6/23/01). (SLA 2003-44-01)

Stern v. Prudential Financial, Inc., No. 6 EDA 2003, 2003 Pa. Super. Lexis 4019 (Pa. Super. Ct., 11/12/03). **Arbitration Agreement (Command Client Agreement) * Waiver * Appealability.** *Under Pennsylvania law, waiver of an arbitration agreement may not be had when the moving party relies exclusively upon testimonial affidavits.*

David E. Stern filed a complaint, alleging Prudential and its broker engaged in negligent and improper dealing in managing his account. Applying the rule applicable to summary judgment motions, this Appellate Court holds that the trial court erred in ordering arbitration and ruling that Prudential had not waived the arbitration clause in the Command Client Agreement. Instead, the Court finds that, while each of the three affidavits were clear, each person told a different version of what happened. As a result, there were no undisputed facts or language to warrant summary judgment. The Court remands with instructions that the parties present additional evidence by "depositions, written interrogatories, or other discovery." *(W. Nelson: The order does not specifically limit the scope of discovery after remand. Conceivably, if the parties availed themselves of the full scope of discovery available under the civil procedure rules, an argument could certainly be made that the parties have waived the right to arbitrate by conduct.)* (SLC Ref. No. 2003-47-01)

Taylor v. Prudential Ins. Co. of America, No. 03-1260 (3rd Cir., 11/6/03). **Representation Issues * Agreement to Arbitrate * Employment Discrimination * Enforceability (Unconscionability) * Waiver * Appealability.** *Agreement to submit one's dispute to an ADR process that involves binding arbitration bars further proceedings on the claim in court.*

Along with other Prudential employees with employment discrimination claims, Plaintiff retained the law firm of Leeds & Morelli to represent them. She later agreed to resolve her claim exclusively through an ADR process that offered mediation and binding arbitration. The process began, but, apparently dissatisfied, Ms. Taylor retained different counsel and commenced litigation of her claims. Citing the ADR agreement, Prudential moved to dismiss the complaint. The District Court concluded that the agreement must be enforced, that Plaintiff was fully advised of the ADR process and actively participated for a time. The Third Circuit affirms, relying upon the lower court's opinion. *(ed: The Appellate Court treats this order compelling arbitration as final, even though it arose in an "embedded" proceeding. It does not describe the precise disposition of the case below, except to note that "[t]he court then directed that the case proceed to arbitration," but it does determine that jurisdiction exists under* Green Tree v. Randolph, *531 U.S. 79 (2000).)* (SLC Ref. No. 2003-48-04)

The Retirement Group v. Linsco/Private Ledger Corp., 2003 Cal. App. Unpub. LEXIS 9606 (Cal. App., 4Dist., 10/8/03). **Discovery Issues * Waiver * Raiding * Injunctive Relief * Prejudice.** *A brokerage firm and its employees waived arbitration because they waited more than two months to file a motion to compel arbitration, during which period they engaged in extensive discovery.*

On April 21, 2002 The Retirement Group ("TRG") filed suit in California state court against three former employees ('the brokers") and their new employer, Linsco/Private Ledger ("LPL"), alleging misappropriation of trade secrets and seeking a preliminary injunction. Three days later, it noticed *ex parte* proceedings for a temporary restraining order. The TRO was issued against the brokers, but the court decided not to issue a TRO against LPL because it was concerned that any injunction issued against LPL would be overbroad and difficult to enforce against a nationwide firm with many offices. Shortly after the injunction was issued, LPL reminded TRG of its obligation to arbitrate the dispute pursuant to NASD rules. TRG in essence did not respond. During the next two months, LPL took the depositions of three TRG witnesses and requested extensive document production from TRG and a non-party affiliate that, among other things, required the production of the records of 3000 TRG customers. The brokers took six depositions of present and former TRG employees and TRG took seven depositions of defense parties and witnesses. On June 26, the defendants moved to compel arbitration. The motion was denied on the ground of waiver. Defendants appeal, arguing that their discovery efforts were aimed at defeating the injunction, which allegedly was non-arbitrable. The decision is affirmed. In making a waiver determination, a court may consider whether the litigation machinery has been substantially invoked and whether the parties were well into the preparation of a lawsuit before the motion to compel arbitration is filed. Here, all sides had invested significant time, effort and money in the discovery concerning the preliminary injunction by the time the motion to compel was filed. Because of the broad nature of the substantive claims, the trial court undertook an extensive review of the documents at the preliminary injunction stage to assess the merits of the claim that this was protected material in the form of customer lists and sales materials. Immediate action to move the matter to arbitration could have prevented such an expenditure of effort by the court and counsel. *(P. Dubow: The defendants could have moved to compel arbitration as soon as the TRO was granted, as permitted by NASD Rule 10335, and the court stated that it would have granted the motion. TRG's failure to respond to the "reminder" was not an excuse. A peripheral issue in this case was whether arbitration was available during the summer of 2002 because of the NASD's initial reaction to the Judicial Council rules. One might think that this would work in the defendants' favor, but it had the opposite effect. The NASD's stance did not prevent the defendants from at least moving to compel arbitration. Their failure to do so could have led TRG to believe that the defendants intended to litigate, not arbitrate, and its expenditure of $70,000 in legal fees established its claim that it was prejudiced by defendants' actions. (Please note that this is an un-*

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published decision which cannot be cited in other court matters pursuant to California Rules of Court 977(a).) (SLC Ref. No. 2003-42-03)

UBS PaineWebber, Inc. v. Brown, No. 1020524 (Ala. Sup. Ct., 10/10/03). **Breadth of Agreement * Arbitration Agreement * Equitable Estoppel.** *A customer who continues to do business with an acquiring broker-dealer will be subject to the broker-dealer's contractual stipulations.*

Brown had an existing stock brokerage account with J. C. Bradford and had signed an arbitration agreement with Bradford. Bradford merged with Appellant and UBS sent negative consent letters accepting account transfers regarding Bradford's customers. Brown denies receiving the UBS letter and, therefore, denies any contractual relationship with UBS. However, this position is inconsistent with Brown's complaint, where he alleges UBS owed him a duty. The Court holds that Brown's continuing relationship with UBS after executing trades "precludes his denial of acceptance of the terms of the PaineWebber arbitration clause, …which unambiguously covers pre-existing disputes." *(P. Hoblin: Negative consent letters may prove difficult to enforce. In this case, the Court depended on subsequent trading to establish a contractual relationship.)* (SLC Ref. No. 2003-42-02)

USAllianz Securities v. Southern Michigan Bancorp, Inc., No. 1:03-CV-369, 1:03-CV-370 (W.D. Mich. 10/20/03). **Arbitrability * Selling Away * Stay of Arbitration * Statutory Definitions ("Customer") * Supervisory Issues.** *Even if events occurred prior to employment, the claim meets the test of arbitrability under NASD Rule 10301(a) as long as the dispute relates to a NASD member and a customer or is in connection with the business activities of an associated person.*

The Court grants motions of So. Michigan Bancorp and Conrad, a corporate and individual defendant, to compel arbitration of claims against petitioning broker-dealer USAllianz regarding the activities of James Morrison, a former registered representative. Morrison conducted business from the same location, while a registered agent of Jefferson Pilot and, later, USAllianz. Morrison sold So. Mich. and Conrad viatical contracts issued by Future First Financial Group. Viaticals are investment contracts through which an investor acquires an interest in an insurance policy of a terminally ill person at a 20-40% discount to receive the benefit of the policy when the insured dies. Morrison claimed the contracts were safe and secure and promised an overall profit of $87,500. After the Florida Department of Insurance revoked Futures First's license and informed defendants that their contacts were worthless, they filed for arbitration with the NASD, alleging violations of federal securities law and state law for failure to supervise. Plaintiff then filed for a permanent injunction and declaratory judgment. As a NASD member, USAllianz agrees to arbitrate all disputes contemplated under Rule 10301 of the NASD Code of Arbitration Procedure. Rule 10301(a) provides that members must arbitrate disputes with "customers" if they "arise in connection with the business of a member or activities of a member's associated persons." Two conditions trigger this requirement: (1) a dispute between either an NASD member and a customer; and (2) a dispute arising in connection with the business activities of the associated person. A claim alleging the firm's lack of supervision arises in connection with the member's business under Rule 10301(a), even though neither investor had an account with USAllianz. Because both have a relationship with Morrison, who is a USAllianz registered representative and an "associated person" of USAllianz, both are customers of USAllianz within the meaning of Rule 10301(a). Even though the purchases took place prior to Morrison's association with USAllianz, it had a "continuing duty to supervise and to act to lessen the losses resulting from the purchase of viaticals." For purposes of the decision as to arbitrability, it is irrelevant whether these "customers" have alleged meritorious claims. *(S. Anderson)* (SLC Ref. No. 2003-48-02)

Zouras v. Goldman Sachs, No. 02 Civ. 9249, 2003 WL 21997745 (S.D. N.Y., 8/22/03). **Arbitrability * Arbitration Agreement (Employment Contract) * Employment Discrimination * FAA (§3) * Federal Employment Statutes (ADA; Title VII) * SRO Rules (NASD Rule 10201(b)).** *Employment discrimination claims under Title VII may be arbitrated under NASD Rule 10201(b) where the parties have entered into an arbitration agreement separate and apart from the Form U-4.*

Plaintiff signed an employment application with Spear Leeds containing an arbitration provision. Spear was acquired by Goldman in 2001 and Plaintiff and other employees were terminated. Plaintiff filed a complaint under Title VII and the ADA. Defendants filed a motion to compel arbitration and stay. The only issue contested by Plaintiff on the motion was whether her claims of sex discrimination under Title VII were arbitrable. In granting the motion, the Court rejects Plaintiff's arguments that Title VII claims are not subject to arbitration and that the NASD does not provide a forum for arbitration of such claims pursuant to Rule 10201(b). With respect to the former, the Second Circuit's decision in <u>Desiderio v. NASD</u> makes clear that Title VII claims are "squarely" subject to arbitration. With respect to the latter, NASD Rule 10201(b) does not prevent parties from reaching an arbitration agreement separate and apart from the Form U-4, as was the case here. *(W. Nelson)* (SLC Ref. No. 2003-45-02)

INFORMATION REQUESTS: SAC aims to concentrate in one publication all significant news and views regarding securities/commodities arbitration. To provide subscribers with current, useful information from varying perspectives, the editor invites your comments/criticism and your assistance in bringing items of interest to the attention of our readers. Please submit letters/articles/case decisions/etc. to: Richard P. Ryder, Editor/ Securities Arbitration Commentator/ P. O. Box 112/ Maplewood, N.J. 07040.

SAC's Bulletin Board

The *Bulletin Board* is open to all subscribers who wish to post a message related to arbitration practice or process, free of charge. When insufficient room is available, you may not see your message until the next issue. Please check with us if you are uncertain about when we will be able to publish your announcement.

People

Bingham McCutchen is proud to welcome **W. Hardy Callcott** (as of December 8, 2003) and **Herbert F. Janick III** (as of May 1, 2004) as partners in its Broker-Dealer Group. Mr. Callcott can be congratulated at Three Embarcadero Center, San Francisco, CA 94111, Tel. 415-393-2310, E-Mail: hardy.callcott@bingham.com. Mr. Janick can be congratulated at 150 Federal Street, Boston, MA 02110, Tel. 617-951-8000, E-mail: herb.janick@bingham.com.

Scott Carfello has been appointed by **NASD Dispute Resolution** to head its MidWest Regional Office, effective March 15, 2004.. Mr. Carfello assumes the Regional Director's position after long-standing employment with the American Arbitration Association. At AAA, he served most recently as District Vice President for the Midwest Region and in other positions since 1986. As Divisional VP, the Chicago regional office and the business development activities of the Kansas City, Minneapolis and St. Louis offices were primary responsibilities. Mr. Carfello is admitted to practice in Illinois and serves as an adjunct professor of law at John Marshall Law School. E-mail: scott.carfello@nasd.com.

Positions Open/Wanted

Seasoned attorney, admitted to practice in New York and New Jersey, with extremely diverse litigation and transactional experience, seeks securities litigation/arbitration attorney position. Please contact Steven P. Krasner (917-763-2574; spkrasner@aol.com) for more information regarding backgound and qualifications.

SCHEDULE OF COMING EVENTS

If you know of an arbitration event scheduled in the coming quarter, please tell us and we'll post it here.

Mar. 21-24: "SIA Compliance & Legal 35th Annual Seminar," sponsored by the C&L Division of the Securities Industry Association, will be held at the JW Marriott Desert Ridge Resort & Spa, **Phoenix, AZ.** Seminar Chair **Beth Dorfman** (Quick & Reilly) and Co-Chair **Harris I. Safian** (First New York Securities) have put together a program that includes some 40 state and federal regulators as speakers and 52 topical workshops. Arbitration is featured on Monday and Tuesday's workshop program and Mediation has its own spot on Wednesday's agenda. Regis. Fees: $1000/$600. For info., visit www.siacl.com/events.html.

Mar. 29: "The 2004 NSCP Canadian Regional Membership Meeting," hosted by Manulife and sponsored by Ashland Partners & Co., LLP, Deloitte & Touche LLP, TD Asset Management Inc. and Tory's LLP, will be held at Manulife Financial, 200 Bloor Street East, South Tower, Main Floor, **Toronto, Ontario, Canada** M4W 1E5. Regis. Fee: $250/ $200/$175. For info., call 860-672-0843.

April 13-16: "National Regulatory Services' 19th Annual Spring Compliance Conference," sponsored by NRS, a division of Thomson Media, will be held in **Bonita Springs, FL**. The two and a half-day conference is aimed to assist investment advisors and broker/dealers in navigating the new and updated rules and regulations. For more info. and to register, call NRS at 860-435-0200.

April 15-17: "The ABA Section of Dispute Resolution – Sixth Annual Conference," co-sponsored by the NYCLA, will be held at the Sheraton New York Hotel & Towers, 811 Seventh Avenue, **New York, NY.** For info., visit www.abanet.org/dispute.

May 6-7: "International Securities Markets 2004: Emerging Best Practices for a Rapidly Evolving Regulatory Scheme," sponsored by the Practicing Law Institute, will be held at the PLI New York Center, **New York, NY.** (The PLI California Center, **San Francisco, CA**, will be the conference location on May 17-18). Regis. Fee: $1,495. For info., contact PLI, 800/260-4PLI or register online at www.pli.edu.

May 11-13: "Spring Securities Conference," sponsored by the NASD, will be held at the Baltimore Marriott Waterfront Hotel, **Baltimore, MD**. Attendees will have the opportunity to hear directly from NASD officials and other industry experts about the latest securities regulatory issues, share best practices with colleagues, and learn about pragmatic strategies and tools to help with firm compliance. Keynote Speakers — SEC Chairman William Donaldson & U.S. Senator Paul Sarbanes. For more info. regarding conference agendas and registration information, visit www.nasd.com/conference/ssc04_home.asp. Or call NASD — Tel: 212/858-4119.

May 20-21: "Securities Laws Update 2004," sponsored by the Practicing Law Institute, will be held at Vanderbilt University Law School, **Nashville, TN**. Regis. Fee: $1,195. For info., contact PLI, 800/260-4PLI or register online at www.pli.edu.

June 2: "HOT TOPICS: Securities Arbitration and Mediation 2004," sponsored by the Association of the Bar of the City of New York, will be held at the ABCNY City Bar Center, **New York, NY,** from 6PM-8:30PM. Speakers will include representatives from the SRO arbitration forums and members of the arbitration defense and claimants' bar. Mediator-Arbitrator Roger Deitz will moderate the forum and lead discussion on the latest rule changes, decisions and proposals, as well as practice tips and techniques . Details will follow as the event draws near. For info., go to the Bar's WebSite (CLE Programs) at URL: http://www.abcny.org/homepg.html.

June 14-15: "Litigating Employment Discrimination & Sexual Harassment Claims 2004," sponsored by the Practicing Law Institute, will be held at the PLI New York Center, **New York, NY.** Regis. Fee: $1,295. For info., contact PLI, 800/260-4PLI or register online at www.pli.edu.

Covering Significant Issues & Events in Securities/Commodities Arbitration *Vol. 2004, No. 3*

SECURITIES ARBITRATION

COMMENTATOR

Publishing Since 1988 (April '04) ISSN: 1041-3057

IN THIS ISSUE

THE ARB CODE RE-WRITE

An Overview and Analysis of the Coming Changes in NASD's Proposed Customer Code

(Part 2 of 2)

Introduction

In Part 1 of this article, we began the process of reviewing the individual provisions of the NASD's Proposed Customer Code with an eye to identifying substantive changes that await users of the forum upon SEC approval of the rules. Since Part 1 was written, SEC has not released the proposed rule changes for comment, meaning that our attempt to be timely in providing this review may end with our being premature.

Nevertheless, our aim to raise readers' consciousness to the changes that the new Code will bring and to encourage debate on the sometimes controversial revisions will still be served. Part 2 picks up where Part 1 ended, with the 12400 Series of the Proposed Customer Code. In the first segment of this article, we covered Rules 12100 to 12314, which include definitional provisions regarding key terms in the new Code; rules relating to the organization and authority of the forum; general arbitration rules, including the jurisdictional or scope-of-coverage provisions; and the rules explaining how to initiate and respond to a claim, how to amend claims, and when claims may be combined and separated.

Highlights from Part 1

Among the more controversial changes we highlighted in that review, or those most worthy of consideration and study, were:

- A new "Definitions" section at the front of the Code, which neglects to define some critical terms, such as "Award," "Customer," and "Professional," but defines other terms that may assist first-time users.
- Changes to Rules 12200 and 12201 appear aimed at aligning the jurisdictional scope of arbitrable disputes, whether the claimant's focus is upon an industry member, an associated person, or an insurance company member, by dint of a uniform phrase, "business activities" (another important, undefined term).
- The Director of Dispute Resolution will be generally more independent of the NAMC and, in particular, will have broader powers to accept or reject disputes that are submitted for NASD arbitration, based upon a broader, policy-based standard of what is appropriate or "inappropriate."
- NASD has re-inserted an essential phrase in its six-year eligibility rule, clarifying that the six-year time period is not intended to affect applicable statutes of limitations. That qualifying provision assures that arbitration will not become a haven for claims that would be stale in court.
- The arbitration staff will have the residual authority to override a Panel's determination on appropriate deadlines, albeit in "extraordinary circumstances,"
- Sanction powers are magnified and underscored and party representatives become expressly subject to the Panel's sanctioning authority. In tandem with the emphasis on sanctions for discovery abuses, the NASD will move the Discovery "Guidelines" into the Code, effectively making them "rules."
- As currently worded, the pleading requirements seem to compel a Respondent to file any supporting documents with the filing of its Answer. Yet, the provisions for including

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supporting documents with the Claim or in answer to a Third-Party Claim are (appropriately) permissive.

- Respondents who fail to file a timely Answer may be subject to default proceedings. The default procedures were developed to streamline the path for Claimants with claims against defunct firms, but the new Code appears to open the default procedures to non-responsive Respondents, whether active or defunct.

Part 2 - Observations by Rule

In this second segment, the rules under review, Proposed Rules 12400 to 12904, move chronologically through the arbitration process, providing new rules on the appointment of arbitrators and chairpersons; rules on motions and specific discovery procedures to govern the pre-hearing process; rules relating to the hearing, dismissal, withdrawal or settlement of claims; simplified arbitration rules and default procedures; and rules regarding fees and Awards. A true, chronological rendering is, of course, impracticable. Fees, for example, attach at the front of the proceeding, during the case, and at the end. Similarly, Arbitrators under NASD procedures are generally appointed well after discovery has commenced and, often, after discovery has hopelessly stalled.[1] Nevertheless, the new structure supplies a sense of order and place for the newcomer and makes regular reference ultimately easier for the veteran user.

Rules 12400-409: Neutral List Selection System/Arbitrator Composition

Rule 10308, regarding the Neutral List Selection System, has been broken into ten rules, which, as a group, effect numerous changes to the current operation of the NLSS. The process of computerized selection of nominees will be changed from a rotational system, which assures that all arbitrators in the NASD pool will have the opportunity to be nominated, to a random system (Rule 12400). While random, there will be a first cut before the drum is spun of arbitrators with obvious conflicts that NLSS can identify (Rule 12403(a)(3)). We cover the changes appearing in this group by subject matter, since the topical changes are interwoven among the ten provisions.

Chairperson Roster

A pool of chair-qualified arbitrators will be established, which will be the source for nominations either to the sole-arbitrator panel or to the Chair of a three-person panel (Rule 12400). To become Chair-qualified will require that an arbitrator have participated in three SRO arbitrations that have proceeded through Award, if s/he is not an attorney; for attorneys, the requirement is reduced to two SRO arbitrations. The opportunity for parties to request expertise as a criterion for narrowing NLSS' selection of an arbitrator candidate will be eliminated.[2] Gone as well will be the option parties now have under Rule 10308(c)(5) of mutually agreeing upon a Chairperson, but replacing that option will be a routine that will encourage party choice with regard to a Chairperson, while also

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SUBSCRIPTION INFORMATION: The Securities Arbitration Commentator is published 8 times per year and sells by annual subscription. Regular Subscription: $290; Preferred Subscription (with weekly e-mail Alerts): $590. Back issues of SAC are available to subscribers only at $20 per issue. An attractive SAC-imprinted "D-Ring" binder is also available to store back-issues. The 1.5" blue binder, with grey print on its face and backing, costs $15.

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assuring that the candidates for Chair have some training and experience.

Smaller Claims Changes

All of the Small Claims parties under Rule 12800 will find their sole arbitrator in the Chair-qualified pool (Rule 12402). Small Claims Arbitrators will be more restricted in their powers, as the Chair's ability to ask for three panelists or to dismiss a counterclaim from the proceeding will be removed. The parties will not have the express right to agree to a non-public arbitrator being appointed (Rule 12401). Small Claimants previously had an opt-out if the broker-dealer brought a counterclaim that exceeded the amount claimed by the customer. That right appears to be gone which, for customers who do not have PDAAs with their brokerage firms, represents a trap for the unwary.

The Small Claims procedures were the first product of SICA's efforts to develop uniform arbitration procedures applicable to all SRO forums and then in the early 1980s SICA's Uniform Code of Arbitration was launched and then periodically amended. That collaborative work among the various SROs and industry and public representatives is largely unwound by this overhaul and, particularly in the Small Claims area, the differences among SRO forums will be important for investors to know about, when deciding where to file their claims.

For matters between $25,000 and $50,000, Rule 12401 provides that three arbitrators may be "requested" by any party, where before, the right was assured. On the other hand, the right had to be exercised in the initial filing, whereas Rule 12401 does not indicate a time frame by which the request must be made. While either a Claimant or Respondent may make this request, the sole arbitrator no longer may. The idea that the parties might agree to a single non-public arbitrator or to more than one non-public arbitrator in a three-person Panel are no longer options expressed in the new Rules.

Three-Person Panels

The NLSS system will produce three lists in the usual case, one from the public arbitrator roster, one from the non-public arbitrator roster, and one from the NASD's chairperson roster (Rule 12403). Each list will have seven candidates and each party will have five strikes as to those seven candidates. That two candidates will remain on each party's list increases the likelihood that a panel can be formed from among the available party choices. NASD reportedly makes at least one arbitrator appointment in about a third of the cases, so this improvement will provide more choices to the parties while decreasing the necessity for staff appointments.

Party choices are that much more important, as their selections are more likely to register in the final appointments that are made. Those who have previously exercised a wholesale strike of all candidates, rather than do their due diligence, will not have fate to blame any longer. Those who have rationalized that investigating one's arbitrators was a waste of time, if the other side was going to strike the lot, will now have the assurance that their due diligence efforts will have a greater chance of having their choices appointed.

Rankings will be performed as before, but the language has been adjusted in Rule 12404(c) to deal with another situation that blossomed into litigation. A circumstance arose in *National Planning Corp. v. Achatz*, 12 SAC 11&12(27-28), wherein counsel sent its rankings to NASD, but the rankings were mis-directed and not received in time to be considered. Counsel faxed its selection list to NASD, but used an incorrect phone number. NPC's quest for judicial relief was unsuccessful, but the episode may have sparked a textual change in the Rule. Where Rule 10308(c)(2) provides that a party must "timely return" its lists, if they are to be considered, the new language in Rule 12404(c) speaks in terms of the Director not "receiv[ing] a party's ranked lists within that time."

Staff Appointments

Practice is codified in more than one area by the omnibus changes; the staff appointment procedure serves as one example. When the Director needs to make a "staff appointment," Rule 12406(c) proposes that he will "complete the panel from names generated randomly" by the NLSS. Choosing from NLSS was the practice, as we understand it, but Rule 10308 (c)(4) only stated that "the Director shall appoint one or more arbitrators to complete the arbitration panel." It must be that the staff's experience with the size of its arbitrator pool has made it sufficiently confident that it can commit to rules that assure seven candidates for each list in each hearing location and that tie the Director's appointment to the next available NLSS selection.

Rules 12409 & 12410: Arbitrator Recusal and Removal

Rule 12409 is a brand new provision that answers the question "who decides," when a party challenges an arbitrator and requests recusal. The "arbitrator who is the subject of the request" is the correct answer, NASD believes, "because the weight of case law on the subject prohibits removal of an arbitrator by other arbitrators." The Director's authority to remove a seated arbitrator is preserved in Rule 12410(b), in situations where the information regarding a conflict or bias was required to be disclosed <u>and</u> "was not previously known by the parties." This text replaces the "not previously disclosed" language in Rule 10308(d)(2) and focuses on the party's inability to consider the information during the selection process.

Rule 12411: Replacement of Arbitrators

Previously, there existed a clear distinction between the Director's replacing an arbitrator before the hearing process commenced (Rule 10308(d)) and his replacing an arbitrator after the first hearing session (Rule 10313). It was relatively automatic in the first instance, whereas, in the second instance, the parties had the right to notice of a vacancy and to elect to proceed with the remaining arbitrators. Under Rule 12411, whenever an arbitrator becomes unwilling or unable to serve, "the Director will appoint a replace-

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ment arbitrator, …unless the parties agree in writing to proceed with only the remaining arbitrators." While NASD comments that parties now have the right to opt for a "remaining arbitrator" panel at "all stages of the proceeding," we see no requirement that the Director will notice the vacancy before filling it. NASD makes clear that the parties' option is only valid "up until the time the appointment of the replacement arbitrator occurs." Knowledge is a precursor to action, so removing the notice requirement encourages a circumstance where the Director will proceed with replacement before the parties become aware of a vacancy.

Rule 12500: Initial Prehearing Conference

NASD's practice of scheduling an initial prehearing conference in virtually every case is now codified in a new rule, in which the panel's appointment will trigger a conference before the full panel. The parties will receive notice of the time and place at least 20 calendar days beforehand. The Director, not the arbitrators, will schedule the conference and the parties, not the arbitrators, may agree that it will not be telephonic. The parties may also follow a written waiver, should they wish to forego the prehearing conference, that is aimed at assuring party agreement concerning important dates and details. Under Rule 12501, any additional conferences will be scheduled by the panel and a new Rule 12502 establishes that, generally, prehearing conferences will not be tape-recorded. If the conference is called to hear a dispositive motion, (Rule 12504), then it will be tape-recorded.

Rule 12503 & 12504: Motion Practice & Motions to Decide Claims Pre-Hearing

Motion practice is legitimatized by the new Code, in recognition of current practice and in the belief that guidance is needed "regarding how and when motions may be made, the time for responding to motions, and who decides motions." Procedures for making a motion, serving it on the parties, and getting a response are items covered in Rule 12503. Regarding "who decides," the Director determines motions relating to the "use of the forum" and removal of an arbitrator. Recusal motions are decided by the challenged arbitrator, discovery motions by one arbitrator, unless it relates to privilege (Rule 12503(c)(3)), and the full panel decides "all other motions."

Contrary to the distinct impression given by Rule 12212 (see Part 1) that the Director makes the final determination on hearing location and that parties must submit motions to the Director to change the hearing location (Rule 12212(c)), Rule 12503 states that, once the panel is appointed, it may change the hearing location. Similarly, the panel is given plenary authority to decide motions "relating to combining or separating claims or arbitrations," once it is appointed, while Rule 12314 indicates that the panel may only "reconsider" determinations previously made by the Director on those issues. These are presumably timing issues, but the seeming inconsistencies among these Rules should be reconciled with clarifying language. Our own view is that NASD takes the better approach in Rule 12503.

Dispositive Motions

Dispositive motions are those that determine the outcome regarding a particular claim or the arbitration proceeding itself. A pre-hearing determination on such motions is permitted under new Rule 12504, but the Rule makes clear that such determinations, outside the area of six-year eligibility, are "discouraged, and may only be granted in extraordinary circumstances." "May" means "shall" in this context, not "should," and the "shall" is aimed, not at the parties, but at the arbitrators. The mandatory phrasing concerns us, first, because we think, conceptually, that discretion is best left with the arbitrators and NASD as a forum displays increasing hubris on this delicate point. More practically, such contractual imperatives in arbitration rules subject arbitrators to judicial second-guessing about exceeding their powers.

When a dispositive motion is submitted to the Panel, the Code prescribes the procedures that will apply. The motion must be served at least 60 days before a scheduled hearing, with 45 days given for a response. The full panel must deliberate and a prehearing conference, presumably for oral argument, is required, unless waived by the parties. This prehearing conference will be tape-recorded and specific provision is made for sanctions, if the panel "determines that a party filed a motion under this Rule in bad faith."

The focus of public comment is likely to concentrate on whether dispositive motions should be allowed at all and whether "extraordinary circumstances" provides the appropriate criterion. There are additional points of uncertainty, we believe. For instance, the Proposed Rule does not expressly state that the Panel can <u>deny</u> leave to make such a motion. By setting forth time frames for briefing and consideration, the Rule implies that the motion once made will receive consideration. That could mean a 2-month delay, when the moving party is the only one that sees delay as justified. The Panel should have the right to manage the proceeding.

Given the nature of a dispositive motion, the movant might justifiably request a stay of discovery while the motion is under consideration. What purpose will be served, the movant could argue, by engaging in discovery when a dismissal of the case is at hand? Particularly, if the motion is made before a Panel is even appointed, as could easily be the case, the cooperative exchange of documents could be disrupted.

Having embraced this limited motion practice and set forth procedures for motion submission and consideration, NASD should address in this Rule the potential distraction motion practice represents to smooth, cooperative discovery. How will discovery be kept on track before the Panel is appointed? How will a moving party

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with a just cause get timely consideration?

Finally, Rule 12504 also does not address whether a ruling that grants a dispositive motion will result in the issuance of an Award under Rule 12904. If it does not, and the entire proceeding is dismissed as to one Respondent or all, there will be no public record of that determination and the arbitrators who decided it will not list the case on their Award Disclosure Sheet for the benefit of future disputants choosing panelists.

What about a Claimant who wants to challenge a partial Award, dismissing some Respondents but not all, The new Rules should make clear when the 3-month "window" for vacatur commences, at the time of the dispositive ruling or, later, when the whole case closes. Having begun the journey, NASD should visit all the points of attraction. That issues it raises through rule changes are difficult does not mean that they should be left for future rulemaking.

Rule 12505-12511: Discovery Guidelines Codified

Concerned about reports that the NASD Discovery Guidelines "are routinely ignored," Dispute Resolution has drafted the discovery procedures in the Guidelines into the new Code. Parties will be given 60 days now, instead of 30 days, to respond to the Document Production Lists that the Director provides at the time the Statement of Claim is served (Rule 12506). Parties will not have the option to ignore the Lists. They will need to either produce all of the requested documents, explain what has not been produced and when it will be, or file an objection to production, as provided in Rule 12508. Similar time frames and response requirements will attach to discovery requests that parties make, over and above the Document Production Lists (Rule 12507).

As to the Document Production Lists, "produce or object" is the operative regime and Rule 12508(b) makes plain that "[a]ny objection not made within the required time is waived," absent "substantial justification" for the omission. Other discovery requests that concern documents or information not described in the Document Production Lists should be "specific, and relate to the matter in controversy." Motions to compel discovery and the responses thereto are subject to the time frames and other requirements of the "Motions" Rule, Rule 12503. Rule 12509 requires that the document request, any objections, and a description of the moving party's efforts "to resolve the issue" must accompany the motion.

Rule 12510: Depositions

"Depositions are strongly discouraged," this new Rule begins, but under circumstances specified in the rule, may be permitted by the Panel. These are the usual suspects, but missing is the provision for depositions by mutual agreement of the parties. As we have noted, mutual agreement is simply viewed as unlikely in the new Code and its encouragement is replaced by a more pessimistic and inflexible regime.

Rule 12511: Discovery Sanctions

Much discussion has been circulating lately about arbitral sanctions to address non-compliance with discovery orders by certain broker-dealers. NASD has even threatened to engage its disciplinary machinery to deal with problems of perceived discovery abuse in arbitration. The new Code establishes a general sanctions rule (Rule 12211), which sets forth the many ways in which a panel can formulate sanctions, and this Rule, which sets forth circumstances specifically related to discovery that may trigger 12211 sanctions. Readers should compare the language of these two rules carefully to determine if they are concurrent in their coverage. Arguably, the imposition of sanctions for discovery failures and abuses is limited to parties and not their representatives, because this specific Rule indicates that the "panel may issue [Rule 12211] sanctions against any party…," without mentioning party representatives.

Rule 12512: Subpoenas

Rule 10322 provides for subpoenas and orders of appearance, whereas the Proposed Code treats the two separately in Rules 121512 and 12513. The provisions do not change much, but Rule 12512 adds a new service requirement. Copies of subpoenas must not only be given to all parties, but they must also be provided by the issuing party "at the same time and in the same manner in which the subpoena was issued." While this proviso is appropriate in other service contexts, it seems wasteful and a bit impractical to require that all parties be simultaneously given subpoena copies by personal service, if personal service must be used to serve the subpoenaed witness.

Rule 12514: 20-Day Exchange

A number of changes have been made to this Rule to buttress its effectiveness. First, unlike Rule 10321, this provision makes clear that documents previously produced in discovery need not be exchanged *(ed: While the new Rule does not require it, we think it is still good practice to list such documents, so that an affirmative representation can be made that an adversary has the document in his/her possession. Where multiple parties are involved, in particular, production to one party may not have been the same as production to another party.).* The witness lists not only must be exchanged among the parties, but the Director must receive the witness lists, "with enough copies for each arbitrator." Witnesses must now be identified by both name and business affiliation.

The Rule does not explain what the Director will do with the witness list copies, but we presume the staff will promptly distribute the lists to the arbitrators, so that final conflict checks can be performed. Finally, Subparagraph (c) takes on the "cross-examination or rebuttal" exception to production before hearing and reverses the presumption that formerly protected such material from production. Any failure to produce a document or to identify a witness later offered at hearing will have to be supported by a

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"good cause" explanation to excuse the omission. In this way, the Proposed Rule creates considerable uncertainty that a panel will accept documents or witnesses not produced or identified during the 20-day exchange.

Rule 12601: Postponement of Hearings

Postponements directly before hearing have been, for years, a nuisance for staff and arbitrators and costly for the parties (See Katsoris article, "Arbitration Virus," 2 SAC 1 (1)). Rule 12601 describes the bases upon which hearing dates may be postponed and, for motions to postpone that are made within 10 days of hearing, it establishes a "good cause" requirement. *(ed: Does that mean, by negative inference that a party's motion for postponement, made outside the 10-day timeframe, does not require "good cause"?)* The Proposed Rule also describes circumstances under which a postponement will not result in a hearing postponement fee being charged. It drops the SICA "double-fee" provision for the second postponement (See Rule 10319), but it preserves in subparagraph (c) the prospect that the panel could dismiss the arbitration without prejudice "[i]f all parties jointly request, or agree to, more than two postponements…."

Rule 12606: Record of Proceedings

Rule 10326 on this subject has been expanded and re-worked to provide a far better explanation of the ways in which a stenographic record can become the official record of the proceeding, who gets a copy and who pays for the copies. With the larger-dollar disputes and more complex cases, stenographic records and tape transcriptions are likely to be more common. This clarification is, therefore, welcome.

Rule 12700: Dismissal of Proceedings Prior to Award

The parties control their own case and the parties can settle the claims in dispute, withdraw the claims upon mutual agreement, or dismiss the case with or without prejudice. Proposed Rule 12700(a) makes this clear, inserting mandatory language regarding the obligation of the panel to dismiss a claim or arbitration "at the joint request of the parties to that arbitration or claim." In such case, with no need for an arbitral determination, the matter will be resolved "prior to Award."

Rule 12700(b) indicates further that "the panel may dismiss a claim or an arbitration" on eligibility grounds (Rule 12206), on a motion to dismiss prior to a merits hearing (Rule 12504), as a sanction (Rule 12211), or as a consequence of too many postponements (Rule 12601). These dismissals, unlike dismissals by mutual consent, require a dispositive determination of the arbitrators, i.e., an "Award." Yet, NASD implies by the title of this provision ("dismissal… <u>prior to</u> Award) that there will be no public Award under Rule 12904 and, therefore, no public record to reflect the incidence of or the circumstances precipitating these kinds of dispositive, arbitral determinations.

In effect, these determinations are being treated as settlements are treated – confidentially – but they are not settlements. Since these final decisions of the panel will be subject to vacatur challenges in the courts, they are clearly "Awards" in the eyes of the law.

Rule 12900: Fees Due When A Claim is Filed

The omnibus revisions to the NASD Code will not dramatically change the fees charged a Claimant filing an arbitration, but the laddered fee schedule, which charges higher filing fees and hearing session deposits for larger claims, will be telescoped to a degree and fewer levels will exist in the fee grid. Moreover, the initial filing fee and separate hearing deposit will be combined into one filing fee figure to reduce confusion among filing claimants. As a consequence of these adjustments, Claimants with a $1 million dollar claim will be charged $1800, only three times more than Claimants with a $30-$50,000 claim ($600). Under the new fee grid, Claimants with multi-million dollar claims will not be charged any more than Claimants with a $1 million claim.

Perhaps, this fairly "flat" fee structure can be cost-justified with the observation that arbitration administration does not cost much more per session for large-dollar cases than it does for smaller matters, but courts looking at the cost of arbitration today are concerned with a Claimant's ability to pay. Their concern is with the average employee or customer and her ability to get a fair adjudication. Federal courts, from the U.S. Supreme Court (in *Green Tree Finl. v. Randolph*) on down are concerned that fees for the little guy are not so high as to become a barrier to the vindication of his/her statutory rights. State courts have declared arbitration agreements unconscionable and unenforceable where the costs are deemed excessive by a court. Concentrating the cost load on the smaller dollar end of the dispute range and establishing a no-increase policy for claims above $1 million seems to favor the richer (or once-richer) Claimant. This change simply invites judicial skepticism.

Encouraging Claimants with large-dollar claims to exaggerate their damage requests by charging the same rate for a $1 million claim or a $1 billion claim leaves the perception that the richer (or once-richer) Claimant is not shouldering a fair share and the mid-level Claimant is shouldering a disproportionate percentage (in fairness terms) of the forum fees.

Inviting exaggerated claims on the high-end of the scale will also feed those who want to discredit securities arbitration's ability to recover losses. Recovery rates are as important as win rates in any quantitative assessment of a forum's effectiveness, as victories can be Pyrrhic for Claimants who receive meager awards. Of course, the best measurement of a good award is how the awarded amount compares to the amount in contention. Because, f necessity, recovery rates compare amounts awarded to the losses claimed by the initiating parties, inflated claims can distort recovery measurements. One practical damper encouraging Claimants to estimate reasonably their claimed compensatory losses has been the graduated fee schedule. Untethering the Claimant from this anchor with respect to claims over the $1 million mark will frustrate attempts to estimate

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average recoveries on larger claims at NASD.

NASD's desire to create a fee schedule that is simple and uncomplicated makes sense, but collapsing its schedule as it proposes would hurt arbitration and feed perceptions of unfairness. Charging the middle tier for the bulk of the forum's expenses does not benefit broker-dealers as a group and it impacts most the middle-class investor. A schedule which equitably places the cost burden on those who stand to benefit most and those most likely to have the resources seems preferable. Simplicity could be achieved, simply by charging a fixed percentage as an additional fee for any amounts claimed over $1 million. This would provide the most revenues from those who chose to assert the biggest claims and it would also encourage more deliberate damage calculations.

Rule 12904: Awards

The changes in the Code provision that describe the contents and delivery of the panel's decision remains very similar to the text of Rule 10330. NASD requires two new, but unsurprising, elements to be expressly stated in the Award: (1) the arbitrators will acknowledge having read the pleadings and other materials filed by the parties; and (2) the fees will be allocated as permitted by the Code. Beyond these salutary changes, the only difference we noted was the addition of "first class" mail as a method of delivering the Award. No explanation for the change is offered in the "Comments" section of the Comparison Chart or in the rule filing.

"Awards" must be in writing and they must be made publicly available, but Rule 12904 does not say what constitutes an "Award." We end where we began in Part I, noting that this most basic of definitions is left open to question in the Code. Awards are the dispositive decisions of the arbitrators and the ultimate products of their deliberations. Awards adjudicate disputes and, in arbitration, are the sole public records of the arbitrated disputes. They are, in effect, the only unobstructed view the public, the media, and future arbitrating parties get by which to judge the forum and the forum's arbitrators. The Award is the public's "window" into arbitration's workings and effectiveness.

When the General Accounting Office (GAO) examines the SRO arbitration forums for fairness, as it has done at Congressional instance, three and more times since 1990, the GAO;s primary analytical tool for quantifying results and performing forum comparisons, is the Public Award. NASD should be taking opportunities at times like this to work with SICA to add more substance about disputes and arbitral decision-making to its Awards. At the very least, what dispositive decisions of arbitration will be made public and which will be kept secret should be made clear in these Proposed Rules through an "Award" definition.

Conclusion

When we began this analysis, it was with the wind at our back. There is a great deal of information to review and comparisons to be made and we wanted very much to publish our observations before the SEC published the Proposed Customer Code (and the companion Industry and Mediation Codes) for comment in the Federal Register. As we go to print with this second and final installment of our analysis, we now worry that this commentary will be lost by the time the SEC engages in formal rule review.

Even so, we hope readers will find in our coverage the elements of the Proposed Customer Code that most interest or concern them and focus their own examination (and, when the time comes, public comment) on those elements. As we stated at the start of this article, we see these proposed changes as the biggest overhaul of securities arbitration since the SEC and SICA launched a thoroughgoing review of the state of SRO arbitration from 1987 to 1989. Comment on the proposed changes will likely be even more important now that it was then.

Today, there is a strong cadre of Claimants' attorneys who are involved daily in the securities arbitration process. That perspective was represented perhaps by consumer groups in 1989, but not by the sophisticated force of an organized and coordinated plaintiffs' bar. The Proposed Code changes today were not developed, at least publicly, by the SEC staff or by SICA, but by the forum itself and one can expect, quite naturally, differences in perspective that result from the difference in source. Proposals, for instance, may be designed to serve administrative concerns as much as they serve user needs.

Finally, every change of substance in its new Customer Code moves the NASD further away from the (very few) other available forums and makes the SRO arbitration forums less alike and uniform. While this may be appropriate, given NASD's huge presence in the arena, it still represents a fundamental philosophical change from the collective cooperation that drove the 1989 rule revisions. Even though that change has been evolving for some time, this formal campaign justifies the process and will, with the SEC's imprimatur, cement the underpinnings of further change to a new foundation.

Endnotes

1 *See* "Pre-Panel Discovery," by Prof. Jill Gross, SAC, Vol. 2003, No. 3, p. 1, which discusses the lack of arbitral oversight during the lengthening period between discovery's commencement and the empanelling of the arbitrators. *But see*, "Discovery at NASD," by Barbara Brady, SAC, Vol. 2003, No. 5, p. 1, a responsive article by the NASD-DR's Director of Neutral Management, which disagrees with Prof. Gross' observations.

2 See "NLSS & Expertise," by S. Lipner, 11 SAC 8(1)). To many in the industry, expertise in one's arbitrators is the *sine qua non* of arbitration. To supply an expertise ingredient to the selection process, NASD added an "expertise function" overlay to its Neutral List Selection System. The Lipner article argued that the expertise factor was not needed. Besides, the way it was being implemented left too many unanswered questions and too much opportunity for mischief.

SEMINAR HIGHLIGHTS: SIA C&L CONFERENCE

(Arbitration & Mediation)

Heightened interest in arbitration was evident at the Annual meeting of the membership of the Compliance & Legal Division, Securities Industry Association, which took place March 21-24, 2004 in Scottsdale, AZ. The level of interest was apparent, first, in the number of workshops that dealt with dispute resolution. There were two dedicated to arbitration and one on mediation at this Conference, more than we can recollect in past conferences. At a time when compliance and legal personnel are being inundated with new rule requirements and pulled from pillar to post, this kind of attention to resolving disputes is impressive and telling. The level of interest was further apparent in the large size of the audiences at each session. Both of the Arbitration Panels featured representatives from the SRO forums (NASD & NYSE) and many fine litigators and litigation managers. Here is the roster of speakers:

Arbitration I – William McC. Montgomery, UBS Financial Services, Inc., **Moderator**
Panelists: Harry Albirt, NYSE Arbitration; George M. Garvey, Munger Tolles & Olson, LLP; Daniel A. Greenstone, CIBC; and James A. Tricarico, Jr., Kirkpatrick & Lockhart, LLP.

Arbitration II – Ellen Slipp, Citigroup Global Markets, Inc., **Moderator**
Panelists: I. Scott Bieler, Merrill Lynch, Pierce, Fenner & Smith, Inc.; Peter R. Boutin, Keesal Young & Logan; Linda D. Fienberg, NASD Dispute Resolution; Richard L. Martens, Boose Casey, et al.

Mediation – Kenneth E. Meister, Prudential Equity Group, LLC, **Moderator**
Panelists: Brian F. Amery, Bressler Amery & Ross, PC; Mark A. Buckstein, Professional Dispute Resolutions, Inc; Matthew Farley, Drinker Biddle & Reath, LLP; and Harry T. Walters, Citigroup Global Markets, Inc.

Of interest, on the statistical side, was the coincidental presentation by both NASD and NYSE of their busy dockets in terms of **open caseload**. Current docket figures are not among the usual statistical information released by either forum; on the other hand, it does indicate what each has on its plate. NYSE reported that activity is up 30%, in terms of the size of the forum's docket. Last year, NYSE had about 1,420 cases in process (prior to the 2003 SIA conference) and this year the number at the time of this conference was 1,820. NASD disclosed that just under 11,000 cases are listed on its active docket. Both forums indicated that they have staffed up to deal with the new challenges. NYSE has added four attorneys, as well as additional assistants and secretaries. NASD now has 220 employees and 30 temps processing cases.

The open docket figures for both forums suggest that the current caseloads equate to well more than a year's work, meaning that **average turnaround time** will likely remain in excess of a year for some time to come. NYSE confirmed that average time from filing to Award, in cases that are tried to decision, is running at 13.5 to 14 months. NASD has long been over a year on average, both in overall time to termination and as to hearing decisions only. As a consequence, NASD is perceived as placing more pressure on parties to agree to near-term hearing dates and one speaker projected that this might be causing busier Claimants' counsel to choose NYSE, where the process is generally more "party-driven" and parties' agreements regarding hearing dates will be given deference.

Expungement of CRD records was a topical issue at each of the three sessions. NASD's new rule restricting the process and the criteria for expungement narrows the channel of availability for this remedy and will have a dynamic impact on the arbitration and mediation processes. NYSE is currently concerned about Arbitrators being asked to "rubber-stamp" Consent Awards that contain expungement orders and will encourage arbitrators to make inquiry and even hold a brief hearing before assenting to the stipulated Order. Of course, the need for "affirmative findings" under the new NASD Rules will complicate the use of Consent Awards further. Discussion also centered on naming the broker as a Respondent, which is becoming an act of considerable tactical complexity. One of NASD's planned "mini-modules" for online training of arbitrators will be dedicated to expungement.

The proposal came more than once that NASD consider having a "4th arbitrator" on hand for discovery disputes, to weigh expungement requests in settlement situations, or to deal with motions *in limine*. The new provisions in the Customer Code for **motion practice** will create even more need for the presence, early in the pre-hearing process, of a procedural decisionmaker, as delays in Panel appointment logjam the process. Delays actually caused by individual arbitrators are being dealt with through an "aggressive program" NASD has underway to remove arbitrators from the pool, if their conduct is dilatory or inimical to the process. Staff delays have been reduced in the Award issuance process and in the NLSS-nominating process, but, ultimately, Ms. Fienberg reminded the audience that 80% of the time, control of the case is out of the hands of the staff and within the control of the parties and the arbitrators.

The speakers discussed various types of cases prominent in arbitration today and their special characteristics. **Mutual fund-related disputes** have risen dramatically, Ms. Fienberg reported, but the claims are not focused upon the much-publicized market tim-

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SEMINAR HIGHLIGHTS *cont'd from page 8*

ing and late-trading abuses that are current regulatory targets. The claims have more to do with risk issues and compensation motivations, the common grist of arbitration, where the vehicle happens to be the mutual fund product.

Both forums reported that "**analyst-banking conflict" (ABC) cases** are evident among the mix of new disputes in arbitration. NASD received about 800 new filings that it can identify as Global Research Settlement - related, far fewer than some estimates suggested, but a substantial component of the docket, nevertheless. Discovery in these cases is particularly problematical, because Claimants seek broad disclosure of the interrelationships among departments of the brokerage firm, while defense counsel, sensitized by regulatory actions, are primed to resist expansive requests.

Reliance on research reports is a key factor in establishing liability in ABC cases, but reliance should also be alleged by the Claimant, some speakers argued, to justify production of research-related documentation. Demonstrating to Arbitrators with WebSite "hit" data that Claimants have not shown interest in research can be helpful in defining the appropriate scope of discovery. When specific research reports are identified as relevant, identifying the report's alleged misrepresentations or omissions helps to describe the extent to which analyst-banking relationships are truly implicated.

Other case-types were discussed and considerable focus fell upon the Discovery Guidelines and the NASD's warnings with respect to **discovery abuse**. There is an informed recognition that curt objections to production and unexplained refusals to discuss overbroad requests are unwise tactics. Brokerage and law firm representatives described increased efforts to make arbitrators aware of the efforts that they take to recover and produce relevant documents and of the cost burdens involved in meeting requests they oppose. Written objections to production provide one place where the Respondent can make a record of its reasons for believing that production is unwarranted, in terms of the facts and defenses in the particular case.

Electronic discovery constituted a particular area of discussion, where costs of production can be great and the need to educate the Panel critical. *Zubulake v. UBS Warburg*, an employment case ongoing in New York federal court, produced an excellent decision describing the complexities of e-mail production and the considerations that can lead to cost-sharing (SLA 2003-22). NYSE's Albirt advised of a case in which Arbitrators had ordered e-mail production conditioned upon cost-sharing.

Finally, **mediation** was both the subject of discussion at the Arbitration workshops and at the separate workshop dedicated to this popular dispute resolution mechanism. It was clear at the mediation session that some lawyers become used to a small group of mediators and are reluctant to dedicate the time to acquainting themselves with others. Ms. Fienberg mentioned this as one bottleneck in the mediation process at NASD. Parties should consider mediation before entering the arbitration process and should consider using a mediator who will be available to the parties on a convenient and timely basis.

The use of mediation has exploded and it is being used both inside and outside the arbitration process. One speaker estimated that some 2,000 disputes are being mediated in the securities arena each year. Does the process merely substitute for the traditional "banter" and "give-and-take" between counsel that lead to **bilateral settlements**, instead of supplementing such negotiations? Most agreed that there was truth to this observation. One veteran defense lawyer estimated that only 10% of the time does he know opposing counsel today, where, in the past, he estimated an acquaintance with the lawyer 50% of the time. Another speaker reported that mediation is often suggested by Claimants' counsel at a very early stage, even, at times, before the Statement of Claim is served, so that mediation becomes the vehicle for settlement discussions before the "banter" would even begin.

Members of the audience worried about entering into mediation discussions prior to the commencement of formal arbitration proceedings. The reporting requirements seem to provide very little incentive for such **pre-arbitration efforts to settle**, but cost and other factors, others argued, do make the prospect worth considering, especially if Claimants' counsel suggests it. Ground rules must be negotiated, though. Counsel should decide, for example, what documents will be produced and whether a side agreement on tolling is needed. One lawyer requires account statements and tax returns at a minimum.

Among the other changes evolving as familiarity with the mediation process has grown have been: (1) **Preparation**, which today is considerable, both in terms of preparing the mediator and in terms of presenting one's case at the mediation. Use of graphics and PowerPoint presentations are not unusual and damages calculations are far more sophisticated than in the past. These efforts help advance settlement and they also demonstrate readiness for hearing if negotiations fail. (2) **Differences in mediator styles**, which are far more varied. Mediators in the beginning were primarily facilitative. As the practice grew, mediators entered the field with securities backgrounds, instead of process backgrounds, and were able to offer more evaluative judgments. Mediators also experiment with the usual routines within the process. One mediator prepares very well before the start and kicks off the mediation with his observations and comments. That kind of diversity gives greater flexibility to practitioners in choosing their neutrals. To obtain these benefits, though, requires attention to the mediation process, independently of the arbitration process. ■

In Brief

(ed: "In Brief" is a regular feature of this newsleter, in which short pieces about important and timely developments are spotlighted for our busy readers. The articles that appear in this space may have been published within the past month or so in our companion weekly e-mail service on securities arbitration,* SAC's Arbitration Alert. *Where this is the case, those earlier articles will generally have been edited and updated in order to reflect our current knowledge on the topic. The SAC Reference Numbers that appear at the end of some "In Brief" articles identify the Arb Alert in which the original news item on the topic was published and it also indicates that backup materials on the matter are available to requesting subscribers from SAC. When calling to acquire those materials, please use the SAC Ref. No. and ask for the copying and delivery charges before ordering.)

NASD STATS., 2/04: ***Continuing a reversal evident in January's statistics (SAA 04-08), close-outs convincingly exceeded new filings at NASD in the second month of 2004.*** NASD Dispute Resolution has been in a deficit-type mode for the past several years, as new cases coming in numbered several thousand more in total than cases being closed. A trend of that nature will ultimately put strains on turnaround time, staff resources, and service in general. For a few months in 2003 and with some vigor in 2004, the "deficit" has turned to a "surplus," as NASD has begun to achieve higher close-out figures. True, some of the difference (17%) between the 1,234 new case submissions through February 2004 and the 1,443 close-outs during that same period is due to a 16% drop in new filings, but there is more termination activity, too. Close-outs are up 27%, compared to last year at the same time. There were 726 case terminations recorded in February, a near-record number of close-outs reached only once previously (Oct. '03 - 843). It is too early to make much of this welcome shift, because the increase, at least relative to 2003, does not derive from more cases moving through Award. Settlements are up, as are stipulated Awards and other administrative and party withdrawals. Average turnaround time continues to inch upwards, to the extent that all three categories of turnaround time (overall, hearing decisions, and simplified decisions) are on the rise, to one degree or another. If the "surplus" trend continues, pressure on turnaround time will be naturally relieved. Reflective of the lower filing numbers are the lower numbers on controversy types; not one category reflects increased numbers over last year's allocations. The character of the disputes seem to be generally as they were in 2003, as the categories that trailed most during the spurt in cases during 2003 (e.g., churning, unauthorized trading, and online trading) continue to trail by the greatest percentage in 2004 (-37%, -22% and –59%, respectively). On the money side, the aggregate damages awarded to customers on their compensatory claims in 2003 set a record at $132 million and a near-record for total damages awarded ($162 million) and this year is on a track that will exceed those amounts. $29 million in compensatory awards have been made to customers and, with punitive awards included, the total soars to $36 million. At this rate, damages awarded could easily exceed $200 million by the end of 2004 and that does not account for the 60-70% of the outcomes due to settlements. The $36 million was assessed against industry parties by 164 separate arbitration Panels, 164 "winners" among the 289 customer cases that closed (both hearings & paper) during these past two months. In addition to a historically high average award of almost $220,000, customers are experiencing a "win" rate (57%) that is also on the high side. This is not the late 90's either, when many of the big Awards sanctioned defunct broker-dealers and schlock houses – easy wins with little likelihood of recovery. From our quick SCAN of these Awards, we think big wirehouses, regionals, independents and bank affiliates are the primary respondents. *(ed: Are complaints to the SEC a leading indicator of how many securities arbitration claims will be filed? The industry newsletter* Securities Week *recently reported that the SEC closed FY2003 (thru 9/03) with a 14% drop in investor complaints (Vol. 31, no. 10, p. 1, 3/8/04). Investors filed 70,574 complaints with SEC in FY2003 and are routinely advised about arbitration as a way in which to seek a monetary recovery.)* (SAC Ref. No. 04-11-01)

NEUTRAL CORNER, 2/04: The February 2004 issue of NASD's newsletter for neutrals, *The Neutral Corner (TNC)*, leads with a short article on its initiatives to curb discovery abuses. A longer, more detailed description of these efforts and the events that triggered them was authored by NASD Attorney Laura Gansler and appeared in the January 2004 (Vol. 2004, No. 1) issue of *SAC*. Promotions of Kenneth Andrichik to Senior Vice President and of Judith Norris to Vice President are reported. Ms. Norris heads the West Coast Regional Office and Mr. Andrichik is in charge of mediation, new business ventures and international expansion. Peer Evaluations, the New Code overhaul, the new Expungement rule, and online Chairperson Training are also covered. The feature article in *TNC* is written by Philip S. Cottone, a well-known Mediator and Arbitrator, who describes in "Thoughts on Managing a Multiparty Mediation" how an actual mediation proceeded. Written from the perspective of the mediator, the article succinctly portrays the mediator's role in dealing with a dispute that was clearly complex and involved numerous claimants. Mediators have to consider the dynamics of negotiations, as well as the best approach for inducing the parties to explore alternatives to trial. Because all mediations are unique in some ways, this kind of inductive approach – treatment of a specific case study to convey general lessons – informs the reader of some tactical possibilities, while making clear that one size cannot fit all. Mr. Cottone's piece follows the matter from the initial discussions with counsel before retention, through the first sessions, to a parsing of the issues and a gathering of momentum to a final settlement. He emphasizes the need

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for "getting the lawyers to work together cooperatively to build a settlement" and praises counsel in this particular case as serving "their clients' best interests, not in posturing or positioning themselves for the arbitration."

CHICAGO REGIONAL DIRECTOR DEPARTS: ***John Barlow, the Regional Director of the Chicago Office of NASD Dispute Resolution, has left his post after more than a decade of service. Scott Carfello, formerly of the AAA, is named as Mr. Barlow's successor.*** John Barlow joined NASD in 1986 as a staff attorney after serving as an enforcement attorney in the Illinois Securities Department. He has managed the Midwest Regional Office since January 1990. Mr. Barlow participated in various Dispute Resolution initiatives over the years, including staff liaison to the NAMC on Rule 10335, the expedited arbitration rule for industry disputes, and, more recently, the pilot on voluntary direct communications between parties and arbitrators (now a rule proposal, SR-NASD-2003-163). As of March 15, 2004, Scott Carfello has been the new director of the Midwest Region. NASD reportedly conducted a thorough search that included qualified internal and external candidates. Mr. Carfello comes to his new post from the American Arbitration Association, where he served most recently as District Vice President for the AAA's Midwest Region and in other positions since 1986. As Divisional VP, the Chicago regional office and the business development activities of the Kansas City, Minneapolis and St. Louis offices were his primary responsibilities. While at AAA, Mr. Carfello served as liaison to the ABA and was recording secretary to a joint ABA-AMA-AAA Commission on Health Care Dispute Resolution. A graduate of John Marshall Law School (JD) and Illinois State University (BS), Mr. Carfello is admitted to practice in Illinois and is an adjunct professor of law at John Marshall Law School.

MEDIATION CODE FILED BY NASD-DR: ***The last of the three segments of the Code overhaul by NASD Dispute Resolution was submitted for approval to the SEC on January 23, 2004 (SR-NASD-2004-13); this third segment, the "Mediation Code," utilizes the Rule 14000 Series to set forth the rules for NASD mediation.*** This rule filing is part of a comprehensive plan to overhaul the NASD Code of Arbitration Procedure by splitting it into its three basic elements: a Customer Code, an Industry Code, and this Mediation Code. The first two have been previously filed with the Commission and all three segments will likely be published for comment in the Federal Register at once. NASD's stated purpose in undertaking this project is to simplify the Codes by putting them into a more logical order, one that follows the process, and "to rewrite the three Codes using plain English, in accordance with the Commission's plain English guidelines." In addition, NASD has included some significant, substantive changes in the Customer and Industry Codes, but states in this filing that it "is not proposing substantive changes to the current rules governing mediations." Of course, one reason for reorganizing the current mediation provisions into a separate Code relates to ease of use, but it is also true that today parties enter mediation directly. Parties remain free to access mediation while pursuing the arbitration process, but, where both sides are sufficiently familiar with dispute resolution mechanisms, going directly to mediation can actually save time and expense. According to NASD-DR, the new Code differs from the current mediation rule provisions only in that: (1) the rules are now written in the plain English format; and (2) there is a new Definitions Rule that defines the terms used throughout the Code. (SAC Ref. No. 04-06-01)

NASD RELEASE ON EXPUNGEMENT RULES: ***A March 4, 2004 "News Release" from NASD announced approval of "a rule that will limit the expungement of customer dispute information from the Central Registration Depository (CRD);" an accompanying Notice to Members (NTM 04-16) set an effective date of April 12, 2004.*** Until the adoption of new Rule 2130 (SAA 04-01), NASD operated under a moratorium procedure (see NTM 99-09) that required confirmation of arbitration Awards ordering expungement of customer dispute information from the CRD. This new Rule maintains much of that regime, but tightens the standards under which arbitrators should order expungement and requires that NASD be named in any confirmation or other judicial proceeding in which expungement is under consideration. NASD will forego opposition to the petition for expungement where one of three stringent criteria is met. If the arbitrators determine that expungement should be granted, they must "state in the award the basis on which the expungement relief was granted. [Where a stipulated Award is involved] [t]he arbitrators may require the submission of documents or a brief evidentiary hearing to gather the information necessary to make such findings." The requisite "affirmative findings" rely upon evidentiary determinations that the broker was not involved in the bad acts, that the allegations are factually impossible or clearly erroneous, or that the allegations are false. A waiver procedure will save parties in arbitration some time, by notifying NASD before filing for confirmation that the criteria are met; if NASD agrees, it will waive being named. "Persons who have been sued in court may seek expungement relief from the court; however, they will not be able to avail themselves of the rule's waiver provision and will be required to name NASD as a party." *(ed: The April 12 effective date does not apply to all expungement orders issued after that date. The new procedures only apply to expungement orders in cases filed on or after April 12, meaning that this new procedure will be implemented very slowly and will not even start to have an impact until six to twelve months from now.)* (SAC Ref. No. 04-11-04)

ONLINE CLAIM FILING PROPOSED BY NASD-DR: ***On January 28, 2004, NASD Dispute Resolution filed a rule change to amend NASD Rule 10314(a) to allow voluntary use of the Internet to file claims and to require certain claims be filed that way (SR-NASD-2004-16).*** Only part of the claim submission process will be completed online in this pilot program,

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while the remainder of the process will continue to be performed through the mails. When a Claimant initiates an online claim, s/he will complete a Claim Information Sheet similar to the one in current use, after obtaining a User ID and password on the NASD WebSite. Repeat users may use the same User ID and password in subsequent cases. While the procedure will be voluntary during the pilot period for most Claimants, those with "analyst related arbitrations, who are represented by counsel," will be required to use the online mechanism. That requirement is not limited to customer-claimants, but to any associated person, member or customer with a claimed loss "due to reliance on a recommendation from an analyst." After completing the CIS form, the user will be prompted to print the "NASD Dispute Resolution Tracking Form." This Tracking Form will then be sent by mail to NASD, along with the Statement of Claim, the executed Uniform Submission Agreement, and the required fees. The Tracking Form will alert the NASD staff to the existence of the online CIS form, which they can then access for data entry purposes. Claimants should find the online CIS form helpful in that a "look up" tool will be used to provide the exact name of the member or associated person for automatic insertion" into the form. There will also be a "Tool Tips" corner with "Help" guidance and a "fee calculator" that will assist in ascertaining the appropriate fee amount to be remitted to NASD. NASD believes that people will save time using this new facility and the availability of a digitized CIS form will automate internal docket recording tasks that accompany the receipt of new Claims. The initial procedures followed by staff in the Regional Offices, when they receive the case materials, will also be expedited by the uploading of information relating to party names and contact data, type of dispute, fees and relief requested. "[T]he staff will be able to analyze the case without having to input data into CRAFTIS." Why are the analyst cases lined up for mandatory on-line filing? NASD answers that it has been "upgrading its computer technology platform, in what is known as the MATRICS Computer Project, which will replace its two legacy case management systems: CRAFTIS and NLSS." Online claim filing was originally planned for deployment in 2005, but the online claim notification procedure aspect of the online filing process was accelerated to meet a perceived "influx of arbitration cases arising out of the Global Settlement of Conflicts of Interest Between Research Analysts and Investment Banking."

FORUM COSTS & UNCONSCIONABILITY: ***An Ohio Appellate Court tossed out an arbitration clause that provided for forum costs it deemed excessive and a no-class action provision that it deemed unfair.*** Our focus lies with the Court's determination that the Plaintiff consumer in *Lisa Eagle v. Fred Martin Motor Co.*, No. 21522 (Ohio App., 9Dist., 2/25/04) would be charged forum fees that are excessive if the arbitration agreement were enforced. According to an article about the decision by ADRWorld.com reporters (www.adrworld.com, 3/4/04), "the appeals court observed that Fred Martin's arbitration clause provides for arbitration before and according to the rules of the National Arbitration Forum. NAF rules require payment of upfront filing fees that in Eagle's case would be $750 for a case valued in excess of $75,000, and proceeding fees could total an additional $6,000." We simply note that NASD fees for a Claimant filing a claim of that size, under its new Consumer Code, would be $975 (filing fee of $225 and the initial hearing deposit), with hearing costs of $1,500 per day and an average 3.2 hearing days for a claim in that dollar-range. *(ed: We see this as a developing area of the law after the U.S. Supreme Court's* Randolph *decision. This is just a single appellate decision, so we draw no general conclusions. We do think that heed must be paid to what courts perceive as unreasonable costs.)* (SAC Ref. No. 03-09-03)

WAIVER-OF-STANDARDS RULE EXTENDED: ***NASD submitted a rule proposal on March 5, 2004, seeking immediate approval of an extension on its pilot rule on the California Standards. The rule proposal appeared in the Federal Register on March 31, 2004 (69 Fed. Reg. 62, p. 17010).*** Securities arbitration in California continues to operate under a unique structure that requires arbitrating parties to waive state law in exchange for SRO arbitration services. State appellate and federal district courts have supported the SROs' position that the so-called California Standards, which impose disclosure standards on California arbitrators, conflict with the arbitration scheme approved by the SEC, but that has not yet led the SRO forums to ignore the Standards. Instead, the NASD has required parties, since September 26, 2002, to waive the Standards as part of the situs selection process and the SEC has approved that procedure, as set forth in a pilot rule in IM-10100(f) of the NASD Code of Arbitration Procedure. In this most recent filing (SR-NASD-2004-040), NASD has requested that the current pilot expiration date of March 31, 2004 be extended for six months to September 30, 2004, while it awaits a definitive outcome of litigation that will resolve the status of the disputed Standards. The Federal Register announcement published SEC Rel. No. 34-49452, dtd. 3/19/04, and notices both the filing and the immediate effectiveness of the 6-month extension requested by NASD. *(ed: Neither the California Supreme Court, nor the Ninth Circuit, has ruled on the preemption issue. The Ninth Circuit has an appeal before it of the NASD-NYSE lawsuit against the California Judicial Council. The California Supreme Court recently granted a petition for review of the decision in* Jevne v. Superior Ct. *(SAA 03-46) and NASD and NYSE have been permitted to intervene in that appeal as real parties-in-interest.*). (SAC Ref. No. 04-11-02).

NTM 04-11, UNIFORM SUBMISSION AGREEMENTS (USAs): ***NASD reminds members and associated persons of their duty to file Uniform Submission Agreements when named in NASD arbitrations.*** According to a Notice to Members issued in February, "NASD has learned that some members and associated persons named as respondents in arbitration proceedings are neglecting or refusing to submit a signed USA in a timely manner." Claimants generally do execute and submit a USA at

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the commencement of the process, in part because the failure to do so will delay the acceptance and service of the Statement of Claim. Characteristically, when Respondents do not submit a USA by the time the hearing takes place, the Arbitrators will include a ruling in the Award that asserts their jurisdiction over the dispute and the parties nevertheless. Issuance of this Notice is warranted, NASD states, because "[f]ailing to sign and submit the USA may cause confusion, lead to ancillary litigation, and undermine the enforceability of arbitration awards." Arbitrators are empowered to sanction parties who fail to comply timely with the requirement to submit a signed USA "and, in certain circumstances, [the failure] may be considered a violation of just and equitable principle [sic] of trade and NASD Rule 2110." Besides threatening the use of disciplinary measures, NASD will also adjust its arbitration procedures to notify all parties of unsigned USAs, so that the Panel at the initial pre-hearing conference (IPHC) may receive requests for enforcement. In addition, the IPHC script will be amended to "include a statement by the arbitrators that any party that has not yet filed a USA must do so, or object in writing to NASD jurisdiction … within 30 days, and that failure to do so may result in sanctions, as provided by the Code, as well as possible disciplinary action." *(ed: NASD has taken to drawing the "regulatory" gun out of its holster whenever the arbitration "rules of the road" are not observed. The USA has a strong theoretical place in the arbitration process, but too much can be made of its significance; in fact, SICA has discussed on a number of occasions whether it is a redundant instrument. We favor keeping the USA and believe it has value, but its value relates to contractual concepts and obligations. A contractual response might be more appropriate. Instead of burdening the disciplinary process with traffic tickets and making the arbitrators "administrative" cops, consider this: Where the USA is not signed, an agreement to arbitrate will not be conclusively presumed as to that Respondent until the Arbitrators so rule. In the meantime, the Answer will be deemed deficient and the Respondent risks waiver. Claimant can elect to withdraw its claim or to revise and add to it without leave to amend. This could work for both sides, whether or not the non-complying party is registered. The tactical disadvantages will assure self-enforcement in most instances and, when it does not, the Arbitrators will rule in the Award, as they do in every such case now, as to whether the NASD Arbitration Code or another instrument contractually obliges the non-signing party to arbitrate.)* (SAC Ref. No. 03-09-01)

CHAIRPERSON SELECTION TIME CURTAILED: ***Under a proposal submitted to the SEC on March 3, NASD will allow only 5 days for parties to agree on the selection of a chairperson, as opposed to the 15-day period in Rule 10308(c)(5).*** The change is necessitated, the NASD states in its filing of SR-NASD-2004-039, in order to speed up the selection process and allow the IPHC to be scheduled more expeditiously. 80% of the time, NASD argues, the 15-day period is wasted, because the parties cannot or do not make a mutual selection and the Director must make the appointment. Under the proposed rule, NASD would only have to wait 5 days before making the selection and, where the parties "notify staff that they are negotiating to select a chairperson" and need an extension of time, staff will grant additional time. *(ed: We might quarrel with the stated premise for the change, in that the arbitrator selection process is already complete when the chair selection option kicks in, plus (at least in the Northeast Region) the IPHC is also scheduled at the time the arbitrator appointments are announced to the parties. Arguably, the staff could schedule the IPHC ten days sooner than they have in the past, but that is currently a matter within administrative discretion. This change may not produce the desired reduction in case turnaround time. Ultimately, though, it all matters little, as the option to select the chairperson will be taken out of the parties' hands altogether under the new Customer Code (see Proposed Rule 12406). This filing does not mention the Proposed Code filing, but it would substitute a qualified chairperson's list for part of the Public Arbitrator list of nominees that parties now receive and allow the Director to select the Chair from the unstricken candidates. That NASD-DR has filed the proposal at this juncture may signify that a long wait is now anticipated before the SEC will act on the Proposed Customer Code.)* (SAC Ref. No. 04-10-01)

ARBITRATOR PHONE-IN, DISCOVERY ISSUES: ***Some 1,500 arbitrators participated in an hour-long session hosted by Linda Fienberg, President of NASD Dispute Resolution on March 17, 2004; an audio of that session is now available on the NASD Dispute Resolution WebSite (www.nasdadr.com).*** The phone-in itself was a neat technological event, whereby arbitrators were prompted to phone an 888 number and enter a pass code to enter the Workshop. Ms. Fienberg spoke to the participants on a listen-only basis, but individuals were able to submit questions to standby staff by pressing a button on his/her phone. Thus, after her presentation, Ms. Fienberg was able to cover specific questions on a real-time basis. During the session, she imparted information about new hearing locations; cases statistics; staff efforts to reduce processing time; arbitrator and mediator rolls (8,000 and 900 in number, respectively); honoraria adjustments; and the use and abuse of the Discovery Guide. Regarding honoraria, she indicated that a $100 payment for cancellations has been proposed and some payment for consideration of motions is under consideration. The new Customer Code, approval of which is expected in 2005, will incorporate the substantive provisions of the current Discovery Guide, provide for stronger sanctions and greater sanctioning power, and delineate procedures for the handling of motions. Ms. Fienberg described the staff's recent efforts to focus on discovery abuses and discussed at length the available tools to deal with discovery failures and egregious conduct at hearing. Besides the phone-in questions from arbitrators, participants were invited to submit pre-conference questions and Ms. Fienberg dealt with a score of those. Discovery delays and battles have become a major deterrent to expeditious processing and this theme resounded in the responses to questions. One such question dealt with sanctioning attorneys who represent parties in arbitration; case law,

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she said, supports such authority. In answer to a question regarding the NAMC and the Discovery Guide, she reported that a new subcommittee will review the current Guide and the sanction options available to arbitrators. Besides the sword, there is also the pen, as one sanction option that has been used to effect by arbitrators is the mention of inappropriate conduct in the Award. One arbitrator worried that imposing sanctions could invite bias challenges, but Ms. Fienberg answered that the panel must control the hearings and, if sanctioning was employed with temperance and even-handedness, the risk of a challenge would be acceptable. She ended by answering four or five phone-in questions and advised arbitrators that their questions and her answers would be available for viewing online at the Dispute Resolution WebSite. (SAC Ref. No. 2004-14-02)

NEW ETHICS CODE FOR COMMERCIAL ARBS: ***The last piece of the puzzle fell into place when, on February 9, 2004, the House of Delegates of the American Bar Association approved a revised code of ethics for arbitrators in commercial disputes that took effect March 1.*** ABA was the last of three sponsoring organizations to approve the new Code. This is the first time this AAA/ABA Ethics Code has been amended since its adoption in 1977 and the effort to do so has taken about seven years. The impact on securities arbitration will likely be muted, as the primary changes deal with a presumption of neutrality for arbitrators in party-appointed or tri-partite arbitration. Changes to the Code have also been made to accommodate the growth and changes in international arbitration over the years. There is an increased emphasis on arbitrator disclosures, but it stresses that the Code "does not establish new or additional grounds for judicial review of arbitration awards." A copy of the new Code of Ethics may be viewed on the AAA's WebSite (Search for "Code of Ethics") and on the NASD-DR WebSite. AAA and CPR co-sponsored this effort with the ABA.

NASD SEEKS MORE ARBITRATORS: ***NASD Dispute Resolution has posted a Member Alert on its WebSite with this explanatory title: "To Help Maintain Its Fair, Efficient Dispute Resolution System NASD Needs Additional Qualified Arbitrators To Meet The Demands Of Its Increasing Caseload And Expanded Geographical Scope."*** The Alert describes the duties of an arbitrator, how to apply and the nature of arbitration at NASD, adding that the purpose of this specific Alert to its members relates to the need to recruit arbitrator candidates "who are *active* securities professionals in order to maintain a diverse balance of participants." Other qualified candidates are also welcome from the public sector, but the particular need at the moment lies with Industry Arbitrators. With a pending docket that is running at about 11,000 cases today, the availability of 8,000 NASD-qualified arbitrators operating in 51 hearing locations must be strained in some areas of the country. The announcement states that each year the number of new arbitrations filed has dramatically increased and that now "NASD intends to establish additional hearing locations in 2004-5 in the following states: Alabama, Iowa, Kansas, South Carolina, Delaware, Rhode Island, Idaho, Maine, Mississippi, Montana, North Dakota, South Dakota, New Hampshire, Vermont, West Virginia and Wyoming. Faced with this challenge, NASD needs to recruit and train qualified persons – from a variety of backgrounds, professions, and cultures – to serve as neutral arbitrators." Interested parties should call 212-858-4283 to obtain an Arbitrator Application Kit or visit the NASD WebSite at www.nasdadr.com. *(ed: The NASD-DR WebSite provides a chart which shows, by Arbitrator classification (Public; Non-Public) and by hearing location, where it is experiencing shortages. The matrix chart, when we recently visited, showed a "yes" for shortages in every location and classification box, so recruiting assistance is needed in all sectors.)* (SAC Ref. No. 2004-08-03)

ARB CLINICS CONVENE ROUNDTABLE: ***An annual Roundtable Conference was recently convened of twelve law schools to discuss both planned and functioning Securities Arbitration Clinics.*** Originated by an idea promoted by then-SEC Chair Arthur Levitt, securities arbitration clinics were established to provide legal assistance to small investors who are not able to secure legal assistance on their own. The number of securities arbitration clinics with active, healthy programs amounted to a handful, though, before NYAG Elliot Spitzer arranged for grants to support additional clinics at a number of New York State-based law schools (see e.g., SAA 03-39). Currently, at least eight law schools have received grants of $200,000 each, as the beneficiaries of "spinning" settlements with discredited corporate executives. At this conference, which was held on February 27, 2004 at the Fordham Law School, representatives from law schools with planned clinics learned from those with accomplished programs how to obtain assistance from the SEC and the Office of the Attorney General. Fordham hosted the meeting and invited, in addition to law school representatives, staff from the SEC, the NYAG's Office, NASD and SICA. Among the topics discussed were: (1) the criteria Clinics use in deciding whether or not to accept a prospect as a client; (2) the payment and recovery of arbitration fees and other costs associated with arbitration; (3) the analysis of brokerage account statements and other documentation; and (4) reports on the opening of each Clinic and other interests common to the group. Pace Law was the first to establish a Clinic in 1997. Fordham Law, Brooklyn Law and U. Buffalo Law also started Clinics thereafter. Today, the largest, Fordham Law, has a score of law students assisting investors in arbitration and its Clinic is headed by Romaine L. Gardner and Marcella Silverman. Barbara Black and Jill Gross attended the Roundtable for Pace, Deborah Masucci and Karen van Ingen for Brooklyn, and Cheryl Nichols for Buffalo. (SAC Ref. No. 03-09-02)

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PROPOSED FOREIGN HEARING LOCATION RULE: ***We previously reported that NASD had established a London hearing location in cooperation with a British confederation of arbitrators; this rule deals with the money side of administering disputes in foreign hearing locations.*** In SAA 03-47, a collaboration between NASD and the Chartered Institute of Arbitrators was discussed that permitted NASD to schedule cases in London under its auspices, while "CIArb" provided the neutrals to hear the dispute. A new NASD rule will permit the use of foreign hearing locations "[i]f the Director and all parties agree." In that case, the parties will pay an additional surcharge for each day of hearings and IM-10104 will allow the Director to set "a higher or additional honorarium" in such "special circumstances." The rule filing (SR-NASD-2004-042, filed 3/8/04) also explains the voluntary process by which parties will choose to have their hearing in London before CIArb arbitrators. One condition on the choice would be the payment of the surcharge. Additionally, "CIArb neutrals have agreed to serve in NASD cases at daily rates that are lower than their normal charges." Those rates are still "significantly higher" than the usual NASD rates, so the surcharge is designed to cover the difference. NASD also holds out the prospect of developing similar arrangements in other foreign hearing locations. NASD-DR's Business Development staff will administer the London cases, along with CIArb staff, and CIArb neutrals will add their biographical information to the Neutral List Selection System. Thus, the arbitrator disclosure and selection procedures will be "the same as in other hearings locations." The Code will be the governing instrument, but the parties will, through these local arrangements, have the "option of holding their arbitration hearings closer to home, using local arbitrators, and saving the expenses of traveling to the U.S. to resolve their disputes." (SAC Ref. No. 04-11-03)

NASD-DR ENTERS CONNECTICUT: ***As part of its plan to establish a hearing location in each state within a year's time, NASD Dispute Resolution announced the recent opening of a Hartford, CT situs to service arbitration and mediation claims.*** The announcement, which appears in a "News Release" on the NASD Dispute Resolution WebSite (www.nasdadr.com), indicates that 89 arbitration claims were filed by Connecticut residents in 2002. Most of these cases will be or already have been heard in Boston or New York City, but future cases, while still administered by a staff in New York, will be tried before a Panel formed from an available pool of arbitrators that currently numbers 190. "The addition of hearing locations has proven to have a positive impact," said Linda Fienberg, President of NASD-DR. "By the end of the first quarter of 2005, NASD Dispute Resolution will have a hearing location in every state." (SAC Ref. No. 2004-13-02)

NEW AT NASD-DR:
SICA Report: The Twelfth Report to SEC of the Securities Industry Conference on Arbitration (see SAA 03-47 for a summary of the Report) is now available on the NASD Dispute Resolution WebSite. We used this URL to find the new "Web" version of the Report: http://www.nasdadr.com/pub_parties.asp#other. ■

Articles & Case Law

As a regular feature, SAC summarizes articles and case decisions of interest in the field of securities/commodities arbitration law. If you find one we missed or are involved in a case that produces an interesting decision, please write and send us a copy. *As it is our objective to cover all relevant decisions, we will sometimes include decisions in the current "Articles & Case Law" section that issued a year or more ago. We also summarize unpublished decisions and orders. For these reasons, readers are cautioned to cite-check cases to assure they have not been overruled and may be cited in accordance with local court rules.* We thank our readers who have contributed court opinions and who, by their efforts, help us all to keep informed. Credit is given to contributors at the end of the relevant case summaries.

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What Caused Enron? A Capsule Social and Economic History of the 1990s, by John C. Coffee, Jr., CORNELL L. REV., Vol. 89, No. 2, Jan. 2004, p. 269.

Cases

SUMMARY OF DECISIONS

(ed: The court decisions summarized below are arranged by major subject heading first and digested in a single sentence. This enables readers to quickly refer to the courts or topics that are of key interest. The decisions are then arranged in alphabetical order by Plaintiff and summarized more fully. The single summary sentences are repeated and bold-type headnotes are added to facilitate quick scanning for topics of interest or for sorting decisions by major issues. Generally speaking, these case synopses were prepared for SAC's other newsletter service, the Securities Litigation Commentator/Alert (SLC) *and have been previously published in that organ's weekly e-mail alert service ("Lit Alert"). Where the synopsis has been written by one of SLC's Contributing Editors, the author's first initial and last name appear at the end of the summary. We thank the SLC Contributing Editors for their assistance in creating these case summaries.)*

AGREEMENT TO ARBITRATE: *A finding by a lower court of the non-existence of an agreement to arbitrate is binding on the appeals court.* SLAUGHTER v. SWICEGOOD & RAYMOND JAMES & ASSOCS., INC. **(NC App.)**

ARBITRATOR AUTHORITY, SCOPE OF: *The policy of judicial noninterference with the arbitral process requires that the courts accord wide discretion to arbitrators in procedural matters.* GLEN RAUCH SECURITIES, INC. v. WEINRAUB **(NY App., 1Dept.)**

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ARBITRARY & CAPRICIOUS: *Arbitration award was vacated as "arbitrary and capricious" because the arbitrators did not show that they drew their decision from the evidence.* BRABHAM v. A.G. EDWARDS & SONS, INC. **(S.D. MS)**

AWARD CHALLENGE: *Refusing to hear testimony on significant liability issues, such as the central suitability question, can deprive a party of the fundamental fairness assurance implicit in every agreement to arbitrate.* BORDONARO v. MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. **(OH App., 8Dist.)**

AWARD CHALLENGE: *A reviewing court may not overturn an arbitration award based on the arbitrator's determination of the relevancy or persuasiveness of the evidence submitted by the parties.* SKINNER v. DONALDSON, LUFKIN & JENRETTE SECURITIES CORPORATION **(N.D. CA)**

BANKRUPTCY ISSUES: *Receiver of corporation used as part of Ponzi scheme lacks standing to sue third parties on behalf of defrauded investors; victims have no claims against broker dealer for its banking activities, which simply create a debtor-creditor relationship.* FREEMAN v. DEAN WITTER REYNOLDS, INC. **(FL App., 2DCA.)**

BREADTH OF AGREEMENT: *Arbitration clause purporting to cover "all controversies" is limited by the authority of the signatory and does not provide for arbitration of controversies beyond his actual or apparent authority.* BANK OF NEW YORK v. UBS WARBURG, LLC, IN RE **(NY App. Div., 1Dept.)**

BREADTH OF AGREEMENT: *A party cannot be required to submit to arbitration any dispute which he has not agreed to submit.* COOTS v. WACHOVIA SECURITIES, INC. (**D. MD)CALIFORNIA STANDARDS:** *California's ethical standards for arbitrators are preempted by federal law with respect to arbitrations before the NYSE and NASD.* CHEN v. MORGAN STANLEY DW, INC. **(CA App., 2Dist.)**

CALIFORNIA STANDARDS: *The California Standards cannot be applied to SRO arbitration, without conflict with the federal regulatory scheme, and, thus, a waiver provision in the SRO rules cannot render arbitration agreements selecting the SROs unenforceable.* WINBERG v. SALOMON SMITH BARNEY **(CA App., 5Dist.)**

COLLECTION ISSUES: *Post-Award assistance in collecting an arbitration Award is not available among the provisional remedies that New York law allows in aid of arbitration.* WOODLEY v. WARBURG DILLON READ, IN RE **(NY Sup. Ct., NY Cty.)**

CONSTITUTIONAL ISSUES: *Although the Arbitrators clearly addressed Respondent's conduct as outrageous, they failed, in granting a punitive damages award of $25 million, to consider proportionality concerns.* SAWTELLE v. WADDELL & REED, INC. **(NY Sup. Ct., NY Cty.)**

EVIDENTIARY STANDARDS: C*ourts may preliminarily enjoin out-of-state parties from using at SRO industry arbitrations transcripts of taped conversations upon a proper showing of privacy objections.* MICHELSEN v. GREENWICH PRIME TRADING GROUP, LLC **(S.D. CA)**

FIDUCIARY STANDARDS: *In the absence of a previous fiduciary relationship, no fiduciary obligation to explain an arbitration agreement arises at the time of its execution.* RODRIQUEZ v. MORGAN STANLEY DW, INC. **(CA App., 4Dist.)**

FORUM COSTS: *Arbitration provision in Form U-4 is procedurally unconscionable, but not substantively unconscionable except for assessing forum fees to the employee; the fee part is severed.* WINOKUR v. GREAT WESTERN FINANCIAL SECURITIES CORP. **(CA App., 2Dist.)**

IRRATIONALITY: *Holding a brokerage firm liable for improper actions by its broker, but absolving that broker of any liability in the same Award, reflects irrationality in the Arbitrators' decision.* MORGAN STANLEY DW INC. v. AFRIDI **(NY Sup. Ct., NY Cty.)**

JURISDICTION ISSUES: *Broker-dealer cannot utilize the expanded jurisdiction of §27 of the 1934 Act to confer personal jurisdiction and venue on federal court in action to dismiss investor's arbitration alleging only state law claims in a selling away case.* WASHINGTON SQUARE SECURITIES, INC. v. WALDEN **(D. MN)**

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MANIFEST DISREGARD: *The doctrine of Manifest Disregard requires that the parties have been directed to violate the law.* AOT USA v. MERRILL LYNCH PROFESSIONAL CLEARING CORP. **(N. D. IL)**

MANIFEST DISREGARD: *An arbitration award shall be vacated where the arbitrators refused to heed a clearly defined legal principle.* STIFEL, NICOLAUS & CO., INC. v. MAY **(W.D. KY)**

PREJUDICE TO PARTY: *Although three circuits have held that a failure to promptly appeal a denial of arbitration may, by estoppel, foreclose the demanding party's right to arbitration, this is not automatic and depends on a showing of prejudice to the other side.* COLON v. R.K. GRACE & COMPANY **(1st Cir.)**

SELLING AWAY: *A former employer's liability for a broker's actions may be stemmed by termination, but only if the victim is made aware of the termination.* FIRST MONTAUK SECURITIES CORP. v. AGARWAL **(E.D. PA)**

STATUTORY DEFINITION ("CUSTOMER") *The "activities" of an "associated person," as that term is used in NASD Rule 10301, is not necessarily limited to his conduct as an "associated person "* SMITH v. BARTOLINI **(N.D. IL)**

WAIVER: *The presence of an arbitration staff member in the Panel's deliberation session must be objected to by counsel, if a challenge based upon fraud, corruption or misbehavior is to be preserved.* NAHAS v. WEDBUSH MORGAN SECURITIES **(9th Cir.)**

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AOT USA v. Merrill Lynch Professional Clearing Corp., No. 03 C 1513 (N.D. Ill., 1/28/04). **Award Challenge * Confirmation of Award * FAA (§10) * Manifest Disregard.** *The doctrine of Manifest Disregard requires that the parties have been directed to violate the law.*

AOT seeks to set aside an arbitration Award (CBOE ID #01M001 (Chicago, 1/29/03)), but does not allege the statutory grounds under Section 10 of the FAA. Instead, it asserts the theory of "manifest disregard." AOT had commenced arbitration on allegations that Merrill Lynch improperly executed "buy-ins" in October 2000 of a position in Terra Networks at a "commercially unreasonable price." According to the Court, a finding of "manifest disregard" requires that the parties be directed to violate the law or that an arbitration order "does not adhere to the legal principles specified by contract." This is not the case at hand; here, the Panel considered and rejected AOT's assertions. In addition, the Court point out that "AOT fails to plead an explicit public policy that has been violated." *(P. Hoblin: Again, a court has agreed to review the doctrine of Manifest Disregard and rejected its application, leaving the deeper consideration: does this doctrine legally exist?)* (SLC Ref. No. 2004-08-03)

Bank of New York v. UBS Warburg, LLC, In Re, No. 2381N (N.Y. App. Div., 1Dept., 2/3/04). **Arbitration Agreement * Enforceability (Actual; Apparent) * Breadth of Agreement.** *Arbitration clause purporting to cover "all controversies" is limited by the authority of the signatory and does not provide for arbitration of controversies beyond his actual or apparent authority.*

Court reverses an order in UBS' favor compelling arbitration of a dispute with BONY, concerning execution of two program trades in the amount of $46 million. The alleged arbitration agreement is contained in forms that UBS's credit manager requested BONY to sign — a General Option Approval Form and Customer Agreement — so UBS could update its records. He also requested a Corporate Resolution and Trading Authorization. The authority of the AVP in the Options Department, who signed the documents, was limited to duties within his particular division or function, which did not include program trading. The Court holds that he lacked general authority to bind the entire bank. Corporate agents can bind their principal only by the acts and contracts done within the scope of their authority. Nor was there implied consent, since no senior officer with actual authority to bind the entire bank took any action to subject the bank to arbitration of every dispute that might arise. UBS did not present proof that it reasonably believed that the AVP-Options had implied or apparent authority to bind the entire bank. The fact that the arbitration clause contains broad "all controversies" language does not alter the fact that the bank did not agree to arbitrate every action taken by any department of the bank with UBS. (*S. Anderson. The author of this summary is a former member of the PaineWebber Legal Department, which is now a part of UBS.)* (SLC Ref. No. 2004-07-03)

Bordonaro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 2004 WL 308099 (Ohio App., 8Dist., 2/19/04). **Award Challenge * Expert Testimony/Opinions * Vacatur of Award * Arbitrator Misconduct (Pertinent & Material Evidence) * Fundamental Fairness * Arbitrator Remand.** *Refusing to hear testimony on significant liability issues, such as the central suitability question, can deprive a party of the fundamental fairness assurance implicit in every agreement to arbitrate.*

The NASD Award in this matter (NASD ID #01-02610 (Cleveland, 10/4/02)) reflects expeditious handling by an experienced Panel of two lawyers and a broker who collectively had some 25-30 Arbitration Awards to their credit. Yet, arbitral rulings regarding the shape and course of the hearing were interpreted by this Court as striking at the essential fairness of the process. In particular, the Court refers to Plaintiff-investor Bordonaro's plan to submit expert testimony concerning the suitability of the investments in dispute. The testimony had been proffered by Claimant as to damages and the Panel had acceded to that request over objections from Respondent. However, the Panel also rejected expert testimony "on industry customs and practices and the applicable standard of care in this case." The trial court confirmed the Award, but, on appeal, this Court deems the exclusion of testimony by the expert as a "gross procedural impropriety." The Court's analysis begins with the observation that opinion testimony on ultimate factual issues is now expressly allowed in federal court and that custom and usage testimony is commonly permitted in securities arbitrations and in court. Under Ohio law, expert testimony in medical malpractice suits is not only permitted, but required. The Court stops short of requiring expert testimony in suitability cases, but adds (citing a federal district court decision and two arbitration Awards(!)) that "there is authority supporting expert testimony as a requirement." In this case, the Appellate Panel pinpoints suitability and the appropriate standard of care to be exercised by a stockbroker as the essential issues in the arbitration, yet, with the exclusion of the expert, "plaintiff could not and did not present any evidence about such matters." While Merrill Lynch was not permitted to offer expert testimony on the liability issue either, it did present fact testimony, the Court observes, by "experienced securities professionals with more than 80 years experience between them in the industry. The hearing transcript shows that each of the witnesses' testimony touched on practices at Merrill Lynch and within the securities industry, generally." The exclusion of the expert testimony "eviscerated plaintiff's case and thus amounts to a gross procedural impropriety" that challenged the fundamental fairness of the proceeding. *(ed: Regardless of the merits of the ruling in this particular case, the proposition is troubling that arbitrators must accept expert testimony that they may deem unnecessary*

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or superfluous. Our concern is with the impact of a decision like this on the arbitrators' ability to control the process. Oftentimes, Panels have more collective experience and knowledge than the proffered experts – must they accept expert assistance anyway? The issue here was not the competence of the experts in this matter or the reliability of their testimony; rather, that the Arbitrators opted to judge for themselves. "We are of a like mind as a panel," the Chair stated at hearing, "and the liability aspect of this matter really rests with the panel. We are the experts. We are going to decide what's going to be the appropriate standard to apply and whether the standard has been met in this case... We're going to decide the issue of liability based on the facts of those who are preeminently present and are involved in these transactions." Hey, not anymore!) (SLC Ref. No. 2004-08-06)

Brabham v. A.G. Edwards & Sons, Inc., No. 2:987-CV-280PG, 265 F.Supp.2d 720 (S.D. Miss., 5/30/03). **Award Challenge * Vacatur of Award * Rationale of Award * Arbitrary & Capricious * Irrationality/ Rational Basis * Manifest Disregard of Law.** *Arbitration award was vacated as "arbitrary and capricious" because the arbitrators did not show that they drew their decision from the evidence.*

Court decisions vacating an arbitration award on non-statutory grounds are as scarce as hens' teeth. This case is particularly extraordinary because the claimant was awarded some 15-24% of his claimed damages but convinced this Court to vacate because the arbitrators failed to explain why they did not award more. Federal courts have created judicial grounds for vacatur to supplement the criteria in 9 U.S.C. §10: (1) manifest disregard for the law; (2) arbitrary and capricious award; (3) failure to draw its essence from the underlying contract; and (4) contrary to public policy. In this case, an investor brought a claim against his former brokerage firm for having caused his investments to severely underperform market benchmarks during a favorable period in the stock market. Claimant's expert witness testified that Brabham's damages ranged from $529,711 to $867,009. The Defendants' expert testified that Defendants did nothing wrong and that Brabham suffered no damages. The panel awarded damages in the amount of $124,809.64. On Claimant's motion to vacate, the Court finds it is unable to reconcile the amount of damages awarded with the evidence at the hearing. It rejects claimant's argument that the arbitrators' failure to apply market index benchmarks was manifest disregard of the law. *Miley v. Oppenheimer & Co.*, 637 F.2d 318 (5th Cir. 1981), is controlling authority in the 5th Circuit, but "[t]here is no indication that the calculation method used in *Miley* and urged by Brabham is by any means required as a matter of law." Claimant's contention that the award resulted from arbitrary and capricious conduct was, however, successful. According to the Court, "the Fifth Circuit has recognized 'manifest disregard' and 'arbitrary and capricious' standards of review for review of any and all arbitration awards, not just statutory claims." The arbitrary and capricious standard applies here because "a ground for the arbitrator's decision cannot be inferred from the facts of the case." (Quoting *Ainsworth v. Skurnick*, 960 F.2d 939 (11th Cir. 1992).) The Court reasons thusly: "The arbitrators did not explain the basis for their award. The Defendants have offered no explanation for how the award was calculated. This Court has found none. …[T]here are no facts in the record as to which one can draw a reasonable inference as to how the panel reached its conclusion as to a specific damage award. Hence there is no reasonable factual basis in the record to support the award of the arbitrators and the award must be vacated." (*C. T. Mason. This vacatur decision shows once again that when arbitrators cloak their reasoning in silence, they hurt the parties and the ADR process that they are supposed to serve. See Richard P. Ryder, Making A Better Award—An Essential Arbitrator Function, The Neutral Corner, Oct. 2002 (http://www.nasdadr.com/neutral_corner/1002_award.asp); Seth E. Lipner, Ideas Whose Time Has Come: The Single Arbitrator And Reasoned Awards, Securities Arbitration 2000 659 (1196 PLI/Corp 659); Brooke A. Masters, Investors v. Brokers: Meting Out Quick Justice in Murky World of Arbitration, Wash. Post, July 15, 2003, at E01 (http://www.washingtonpost.com/wp-dyn/articles/A56096-2003Jul14.html); Calvin W. Sharpe, Integrity Review Of Statutory Arbitration Awards, 54 Hastings L.J. 311 (2003); Josef Rohlik, Arbitrators Should Write Opinions For Parties And For Courts, 44 St. Louis U. L.J. 933 (2000); Christopher B. Kaczmarek, Public Law Deserves Public Justice: Why Public Law Arbitrators Should Be Required To Issue Written, Publishable Opinions, 4 Employee Rts. & Emp. Pol'y J. 285 (2000); Stephen L. Hayford, A New Paradigm For Commercial Arbitration: Rethinking The Relationship Between Reasoned Awards And The Judicial Standards For Vacatur, 66 Geo. Wash. L. Rev. 443 (1998); Alan Scott Rau, Integrity in Private Judging, 38 S. Tex. L. Rev. 485 (1997); C. Thomas Mason III, Irreducible Disagreements: The Six-Year Rule Revisited, 1 Securities Arbitration 1997 557 (998 PLI/Corp 557); Lynn Katzler, Should Mandatory Written Opinions Be Required In All Securities Arbitrations?: The Practical And Legal Implications To The Securities Industry, 45 Am. U. L. Rev. 151 (1995).*) *(EIC: This case is currently on appeal to the Fifth Circuit. Dkt. No. 03-60679)* (SLC Ref. No. 2004-04-02)

Chen v. Morgan Stanley DW, Inc., No. B167545, (Cal.App., 2Dist., 1/7/04). **Arbitration Agreement (Motion to Compel) * Preemption, Federal * 1934 Act * State Statutes Interpreted (California Standards).** *California's ethical standards for arbitrators are preempted by federal law with respect to arbitrations before the NYSE and NASD.*

The issue before the Court is whether an arbitration provision in a customer agreement is unenforceable because the NYSE and NASD have refused to appoint arbitrators absent a

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waiver of California's ethical standards for arbitrators. Citing Jevne v. Superior Court (SLA 2003-46) and Mayo v. Dean Witter Reynolds, Inc. (SLA 2003-17), the Court finds that there is an irreconcilable conflict in the procedures for the disqualification of arbitrators under the California ethics standards and the rules of the NASD and NYSE and concludes that the California ethics standards are preempted under the Securities Exchange Act. The Court declines to follow Alan v. Superior Court (SLA 2003-32), noting that the Alan court expressly declined to resolve the preemption issue. *(W. Nelson)* (SLC Ref. No. 2004-03-02)

Colon v. R.K. Grace & Company, No. 03-1206 (1st Cir., 12/22/03). **Appealability * Arbitration Agreement * Form U-4 * Arbitrability * FAA (§§ 4, 16) * Equitable Defenses (Estoppel; Waiver) * Prejudice to Party * Breadth of Agreement.** *Although three circuits have held that a failure to promptly appeal a denial of arbitration may, by estoppel, foreclose the demanding party's right to arbitration, this is not automatic and depends on a showing of prejudice to the other side.*

This appeal arises out of a complex commercial dispute resulting in a jury verdict for Plaintiffs, Thomas E. Colon ("Colon") and R.K. Grace & Company of Puerto Rico ("Grace Puerto Rico") (collectively referred to as "Plaintiffs") against Defendants R.K. Grace & Company U.S.A., a Florida company operating as an investment advisor and broker-dealer in securities ("Grace U.S.A.") and John Kaweske, President and Chief Executive of Grace U.S.A. ("Kaweske") (collectively referred to as "Defendants"). In January 1995, Grace U.S.A. entered into a written agreement with Colon which provided that Colon, acting as an independent contractor, would handle securities purchases and sales for his customers through Grace U.S.A. and receive a portion of the commissions on such transactions (the "1995 Agreement"). The 1995 Agreement contained an arbitration clause in which Colon and Grace U.S.A. agreed to arbitrate any dispute between them under the agreement. In June 1995, Colon also signed a U-4 form, agreeing to arbitrate any dispute between him and his firm (Grace U.S.A.), a customer, or any other person for which arbitration is required under the rules of the National Association of Securities Dealers ("NASD"). In January 1997, Kaweske and Colon formed Grace Puerto Rico and each owned 50% of the shares. Colon claimed that there was an oral understanding between Kaweske and him that this new company would provide administrative services for Colon and a number of new Grace U.S.A. representatives in Puerto Rico, that 100% of the commissions would be returned by Grace U.S.A.; and that a small portion of the commissions would be divided between Colon and Kaweske (the "1997 Agreement"). According to Colon, by 1998, Grace U.S.A. was in arrears in its promised payments because Kaweske was withholding amounts due to cover imprudent investments he had made. Colon also alleged that Grace Puerto Rico was being harmed by this retention because it could not pay its own bills. In February 2001 Colon and Grace Puerto Rico brought suit against Kaweske and Grace U.S.A. in federal district court in Puerto Rico alleging, *inter alia*, a breach of contract and breach of fiduciary duty. The Defendants alleged the claims were covered by the arbitration agreements in the 1995 Agreement and the U-4. The district court rejected this argument, ruling that the claims did not involve the 1995 Agreement and that Defendants never sought to offer a signed 1997 Agreement as an authenticated contract. The Defendants appeal post-verdict, arguing primarily that arbitration of the dispute was required. Plaintiffs argue that this claim was waived because Defendants failed to take an interlocutory appeal. In affirming the district court ruling, the Court reiterates that the 1995 Agreement does not apply to the present claims and that the 1997 Agreement was never authenticated. However, in response to Plaintiffs' argument, the Court explains that, although three circuits have held that a failure to promptly appeal a denial of arbitration may, by estoppel, foreclose the demanding party's right to arbitration, this is not automatic and depends on a showing of prejudice to the other side. The Court also explains that the district judge did not definitively deny the arbitration request until well after trial began—indeed, until all the evidence was taken, and that any holding that Defendants had to appeal the denial immediately so as to avoid unnecessary trial would be ridiculous. *(P. Michaels) (EIC: The Court acknowledges that the Form U-4 "was surely a possible basis for arbitration…, [but] [n]othing in the defendants' brief discusses or cites to the internal NASD rules, court precedents or any other materials that would illuminate the issue of just how far the clause extends….")* (SLC Ref. No. 2004-01-01)

Coots v. Wachovia Securities, Inc., No. PJM 03-705 (D. Md., 12/15/03). **Arbitration Agreement * Equitable Defenses (Estoppel) * Contractual Issues (Non-Signatories) * Breadth of Agreement.** *A party cannot be required to submit to arbitration any dispute which he has not agreed to submit.*

Jacquelyn A. Coots ("Coots"), as guardian of the property of four minor children (individually and collectively, the "Children"), brought suit against Wachovia Securities, Inc. and Wachovia Bank, N.A. (collectively, "Wachovia"), alleging that they converted life insurance proceeds disbursed to the Children upon the death of their father. Wachovia seeks to compel arbitration of the dispute pursuant to a Customer Agreement that the Children's mother, Cassandra Wallace ("Wallace"), signed (the "Agreement"), and the Court denies Wachovia's motion. In June 2000 (after the death of their father), Wallace took four equal checks (totaling in excess of $300,000) each payable to "Cassandra Wallace, as Trustee FBO [each named child], a minor" to First Union National Bank and First Union Brokerage Services, Inc., Wachovia's predecessor in interest, where, instead of opening custodial accounts as trustee for the benefit

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of each child, she opened two accounts in her own name. By August 2001, the insurance proceeds were entirely dissipated without benefit to the Children, and Coots alleges that Wachovia converted the Children's funds when it took from Wallace the checks naming them as beneficiaries and permitted Wallace to open and use the funds in her personal accounts. Wachovia, however, seeks to bind the Children to the Agreement (containing an arbitration provision) despite their non-signatory status, contending that (1) the Children have directly benefited from the Agreement, and (2) their claim is "inextricably intertwined" or "inherently inseparable" from the Agreement. As such, Wachovia contends the Children are equitably estopped from challenging the Agreement, including its terms requiring arbitration. Although conceding that a non-signatory may sometimes be bound by an arbitration provision executed by other parties pursuant to, among other theories, an equitable estoppel theory, the Court rejects each of Wachovia's equitable estoppel arguments in turn noting, at the crux, that while federal policy favors arbitration, "a party cannot be required to submit to arbitration any dispute upon which he has not agreed to so submit." As for the direct benefit theory, the Court holds that the Children, at most, indirectly benefited from Wallace's accounts and that the Children did not receive benefits flowing directly from the Agreement. In respect of Wachovia's second theory, the Court explains that, outside of a corporate parent-subsidiary relationship, "the Fourth Circuit has expressly declined to rule upon whether a non-signatory may be bound to arbitrate when claims are 'inherently inseparable' from the remainder of a contract." The Court, therefore, refuses to extend the "inextricably intertwined" or "inherently inseparable" non-signatory exceptions beyond the parent-subsidiary setting. *(Securities Attorney and Editor-At-Large Steven P. Krasner).* (SLC Ref. No. 2004-07-01)

First Montauk Securities Corp. v. Agarwal, No. 03-186 (E.D. Pa., 12/16/03). **Selling Away * Award Challenge * Liability Issues (Respondeat Superior) * Confirmation of Award * Manifest Disregard of Law.** *A former employer's liability for a broker's actions may be stemmed by termination, but only if the victim is made aware of the termination.*

The underlying Award in this case grants both compensatory damages and punitive damages, totaling approximately $1.3 million, to a group of about seven investors who were former clients of a First Montauk broker (NASD ID #01-04742, Philadelphia, 8/22/03). In this action, First Montauk, separate and apart from the broker, challenges the award against it of $616,236 in compensatory damages. It argues that the "Tech-Vest" investments that led to the clients' losses were sold away from the firm by the broker and that the broker had resigned and was not even working for First Montauk during much of the relevant period. First Montauk claims that a stipulation of counsel establishes that the clients received actual notice of the broker's termination and, yet, that stipulation was ignored by the Arbitrators. The Court stresses its narrow review function, stating that "an arbitration award which has some support in the record cannot be vacated." Here, the Court finds evidentiary support "for the proposition that none of the claimants acted unreasonably in assuming that D'Alfonso was authorized by Montauk to sell the Tech-Vest investments." The stipulation between counsel merely addresses First Montauk's usual practice of contacting clients upon a broker's departure, but it is "a far cry from a stipulation that any of the claimants actually received notice of D'Alfonso's termination." On these facts, the Court cannot find that the Panel disregarded the law in imposing liability upon First Montauk. *(ed: "Selling away" liability can be significant and may even spell financial disaster for an independent brokerage firm. Even if the firm intends doing no further business with the clients, notice should still be given to each customer serviced by a broker. Here, the Court suggests that First Montauk should have kept company records reflecting the names and addresses of clients to whom the notification letters were sent and the date upon which each letter was sent.)* (SLC Ref. No. 2004-02-01)

Freeman v. Dean Witter Reynolds, Inc., No. 2D01-4195, consol. 2D01-4202 (Fla. App., 2DCA, 12/19/03). **Bankruptcy/Insolvency Issues (Receiver's Standing) * Fiduciary Standards (Duty to Third Parties) * Standing Issues * Representation Issues * Disclosure Issues.** *Receiver of corporation used as part of Ponzi scheme lacks standing to sue third parties on behalf of defrauded investors; victims have no claims against broker-dealer for its banking activities, which simply create a debtor-creditor relationship.*

Receiver for NorthAmerican Financial Services, Inc. brings action on behalf of company and individual customers of the company, who were victims of a Ponzi scheme by Peter Graziano and his wife. NorthAmerican supposedly held funds from investors in mortgage finance operations, but, instead, the funds were deposited in a DWR money market account, which the Grazianos used for their own purposes, netting over $2 million from 50 customers. Defendants, who are alleged to be liable for providing legal or financial advice where they should have known of the Ponzi scheme, include DWR, its registered representative and the Grazianos' law firm, all alleged to have aided and abetted the fraud by failing to take steps to prevent the losses. The eight causes of action include: (1) aiding and abetting fraud; (2) aiding and abetting breach of fiduciary duty; (3) aiding and abetting tortious interference with NorthAmerican's business relationships with its customers; (4) breach of fiduciary duty by DWR; (5) civil conspiracy to commit fraudulent transfers and aiding and abetting fraudulent transfers; (6) civil conspiracy; (7) negligent hiring and training of its registered representative by DWR; and, (8) legal malpractice against

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the law firm. Plaintiffs concede that counts 3 and 6 do not state a cause of action. The Court refuses to imply a duty on the part of DWR to make certain that funds deposited in a money market account were properly used, distinguishing DWR's banking activities, which create a debtor-creditor relationship, from its brokerage activities, which would create a fiduciary relationship. The Receiver lacks standing to sue on behalf of corporate creditors although he may sue the recipients of fraudulent transfers of corporate funds. The Receiver is barred from recovering damages from third parties for fraud perpetrated by corporate insiders where the corporation lacks even one honest board member or innocent shareholder in that the Receiver cannot establish that the corporation is separate and distinct from the Grazianos. As to defendants other than DWR, Plaintiff failed to establish that they had a duty to disclose misconduct of the Grazianos to NorthAmerican as a separate corporate entity and not just a "robot or zombie of the Grazianos." As pled, the Receiver's claims would require a report by defendants to the individual customers as third parties and these claims could not have been assigned to the Receiver by NorthAmerican in its receivership. Nor is any basis alleged to conclude that the law firm had a legal obligation to notify any regulatory or law enforcement agency. *(S. Anderson)* (SLC Ref. No. 2004-01-03)

Glen Rauch Securities, Inc. v. Weinraub, No. 2553 (N.Y. App. Div., 1Dept., 12/23/03). **Award Challenge * Discovery Issues * Confirmation of Award * Sanctions (Arbitral) * Arbitrator Authority, Scope of * Arbitrator Misconduct (Material & Pertinent Evidence).** *The policy of judicial noninterference with the arbitral process requires that the courts accord wide discretion to arbitrators in procedural matters.*

The underlying Award, NASD ID #00-02468 (New York, 4/9/02), does not mention the sanction that Appellant Mark Weinraub challenges, but, evidently, during the arbitration hearing, the Panel ordered the exclusion of evidence that Mr. Weinraub offered. The Court finds that the Arbitrators "properly sanctioned [Weinraub] for his failure to comply with their order directing the production of documents by precluding the testimony of a witness and the introduction of evidence to which the undisclosed documents related." Arbitrators must have the latitude to exercise control and "not be restricted without a compelling reason…. Respondent has not shown that relevant public policy considerations bar imposition of the sanction of preclusion, or that the award is facially unenforceable." *(ed: Although Mr. Weinraub initiated the arbitration against GRS, he ended up on the wrong side of a $100,000+ counterclaim award for an account deficit, plus expungement was ordered for the named broker when Claimant's claims were denied.)* (SLC Ref. No. 2004-03-03)

Michelsen v. Greenwich Prime Trading Group, LLC, No. 03CV2414 J (LSP) (S.D. Cal., 1/21/04, 1/27/04, 2/4/04). **State Statutes Interpreted (Cal. Penal Code §§ 631, 632, 637.2) * Evidentiary Standards (Tape Recordings; Industry Practice) * Simultaneous Proceedings * Jurisdiction Issues (Cal. Civ. Proc. § 410.10) * Stay of Litigation * SRO Rules (NASD Rules 10101, 10201, 10335) * Arbitrability * Injunctive Relief * FRCP (Rule 65) * Statutory Definitions ("Confidential Communications").** *Courts may preliminarily enjoin out-of-state parties from using at SRO industry arbitrations transcripts of taped conversations upon a proper showing of privacy objections.*

Defendants, a group of Connecticut-based registered representatives (and their company, Greenwich Prime Trading), brought an NASD arbitration to recover $800,000 in trading losses from a California-based broker-dealer (Embarcadero Securities). Defendants had entered into an affiliation and understanding with Embarcadero pursuant to which defendants conducted a trading execution business as Embarcadero's registered representatives. Plaintiffs (all former principals of Embarcadero) commenced this action for violation of the California Invasion of Privacy Act, Cal. Penal Code ◊631, et seq., which prohibits a party to a "confidential communication" from recording the communication without the consent of the other party. Plaintiffs moved for a preliminary injunction to prevent defendants from using at the arbitration tapes and other records of certain telephone calls between the parties and to require that these documents be turned over to plaintiffs. Defendants moved to dismiss the action for lack of personal jurisdiction or, in the alternative, to stay the action in favor of the arbitration. The Court denies the motion to dismiss, finding that (i) defendants had "purposefully availed" themselves of the privilege of conducting activities in California; (ii) their claim arose out of or resulted from defendants' forum-related activities; and (iii) the Court's exercise of personal jurisdiction is reasonable. Regarding defendants' stay motion, the Court determines that plaintiffs' claim should be brought before the arbitration panel because it "arises out" of the parties' business relationship and thus is subject to arbitration under Rule 10101, and plaintiffs had each signed a submission agreement with NASD. The Court thus stays the action to the extent that plaintiffs sought monetary damages. But, because Rule 10335(a)(1) allows a party in industry disputes to seek a preliminary injunction, coupled with the district court's power to issue a preliminary injunction to preserve the status quo in these circumstances, the Court refuses to stay the request for injunctive relief. In subsequent orders, the Court grants plaintiff's motion enjoining defendants from using the "tapes, transcripts and/or other records or information obtained from the recording..., as evidence or part of their allegations" in the arbitration. Finding no need therefor, the Court refuses plaintiffs' request that the tapes be turned over to them. The preliminary injunction is conditioned on plaintiffs' compliance with

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Rule 10335's requirement that they file a statement of claim with NASD for permanent injunctive relief involving violations of the same invasion of privacy statute. In the Court's view, plaintiffs' declarations regarding industry practice and their specific denial of knowledge of any recording demonstrates that they have "a fair chance of success on the merits." *(C. Asher: *Both California and Connecticut are among a significant minority of States that have enacted "all party" statutes that prohibit the taping or recording of telephone calls without the consent of all parties to the conversation. Market participants who consider recording telephone conversations must take into account the laws of the individual States in which their customers or broker-dealers are located and whether the circumstances or protocol of the recording (e.g., beep tones; recorded message) constitutes a sufficient predicate to establish express or implied consent by the other parties to the call. These concerns are reinforced by the Michelsen Court's observation that long-arm jurisdiction exists under Constitutional due process principles even if the defendants had never been physically present in the state. *The practice of using preliminary injunction motions to preclude use in arbitration of evidence illegally obtained or subject to legal privilege may be essential given the parties' penchant to insert the "evidence" in the initial pleadings, thus tending to defeat the desired effect of a later motion* in limine*. The dilemma for the California respondents in Michelsen concerns how they will be able, if required, to prosecute their monetary and injunctive claims for invasion of privacy before the same panel from which they seek to exclude evidence of the recorded calls. Watch out what you ask for.)* (SLC Ref. No. 2004-08-02)

Morgan Stanley DW Inc. v. Afridi, N.Y.L. Jnl. (N.Y. Sup. Ct., NY Cty., 10/30/03). **Award Challenge * Vacatur of Award * Irrationality * Manifest Disregard of Law * Remand to Arbitrators.** *Holding a brokerage firm liable for improper actions by its broker, but absolving that broker of any liability in the same Award, reflects irrationality in the Arbitrators' decision.*

Tagged with sole liability for a damage award that totaled $220,000, MSDW moved to vacate, arguing irrationality in the Arbitration Panel's decision (NASD ID #01-03013 (NY, 3/24/03)). The arbitration claims were lodged against three Respondents: MSDW, the branch manager, and the broker, who also happened to be the son of the Claimant. Nevertheless, the Arbitration Panel found only MSDW liable, even though "[t]he essential claims made by [Mr. Afridi] related to alleged improper handling of his account by his son. [Claimant] claimed that he was unaware of how his account was being handled, contending that his son, who resided with him, intercepted all confirmation notices and periodic brokerage statements sent to him by [MSDW]." That the claims of wrongful conduct by MSDW are predicated upon the actions of its broker means that, for MSDW to be liable, broker Afridi must also be liable. Regarding a claim for supervisory liability, the Court rules, "[t]he claim of improper supervision … is not an independent ground on which to sustain the Award" and cannot support the finding of liability on the part of the employer only. The Second Circuit upheld an Award in *Perpetual Secs. v. Tang* (SLA 2002-20) in similar circumstances and opined that the finding of sole liability against an employer may have been justified, because "there was negligent supervision of the employee…," but the Court rejects this precedent. "[T]he court did not state what independent basis would support such a conclusion, and if it meant that the claim of improper supervision was such independent basis, such conclusion would be contrary to … New York law." Given the finding of irrationality, the Award must be vacated. A new arbitration must be convened "before a different panel." *(ed: We can accept the Court's reading of the law without agreeing with its vacatur ruling. The decision overlooks the point that, while the Second Circuit's interpretation in* Perpetual *may not be binding on a state court, the existence of the precedent belies a finding of irrationality against arbitrators who adhere to it. Query, when does an error of law graduate to an irrational action, justifying vacatur? Irrationality appears to be an easier vacatur ground to establish than "manifest disregard." Irrationality presumes knowledge by the Arbitrators of the correct law, while "manifest disregard" requires that they be instructed on the law and ignore it.)* (SLC Ref. No. 2004-05-02)

Nahas v. Wedbush Morgan Securities, No. 02-17537 (9th Cir., 8/18/03). **Award Challenge * Confirmation of Award * Evident Partiality * Manifest Disregard of Law * Arbitrator Misconduct * Arbitrator Bias * Waiver.** *The presence of an arbitration staff member in the Panel's deliberation session must be objected to by counsel, if a challenge based upon fraud, corruption or misbehavior is to be preserved.*

In a short Opinion made without oral argument, this Ninth Circuit Panel easily affirms dismissal of an investor's Award challenge. Appellant had entered NYSE Arbitration with claims, among other things, of breach of fiduciary duty, unsuitability and misrepresentations. He argues to the Court that the governing law of fiduciary duty was disregarded by the Arbitrators, but the Court sees no "persuasive evidence" of this. Mr. Nahas also alleges evident partiality, in part, based upon an evidentiary ruling regarding the acceptance into evidence of medical records. Evidentiary rulings are not a likely source to justify vacatur and claiming partiality, as well as misconduct, regarding the admissibility of evidence, does not bootstrap a potential evidentiary error into a cause for vacatur. Finally, Claimant-Appellant argues that the presence of a NYSE representative during the Panel's deliberation demonstrated "fraud, corruption and misbehavior," but that argument is waived, "because Nahas did not object during the arbitration." *(ed: Mr. Nahas was represented in the arbitration below,*

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NYSE ID #2001-009304, (Honolulu, 5/21/02), but appears to have gone the post-Award route on his own.) (SLC Ref. No. 2003-50-01)

Rodriquez v. Morgan Stanley DW, Inc., No. D040868 (Cal. App., 4Dist., 9/10/03). **Arbitration Agreement * Enforceability (Fraud in the Execution; Impermissible Waiver) * California Standards * Arbitrator Disclosures * Preemption, Federal * Fiduciary Standards.** *In the absence of a previous fiduciary relationship, no fiduciary obligation to explain an arbitration agreement arises at the time of its execution.*

After seeing their account drop in value between June 2000 and May 2002 from a starting value of $800,000 to a low of $12,000, Plaintiff alleged mismanagement by Defendants and sought a declaration of invalidity regarding the arbitration agreement they signed. The trial court granted the application, but is reversed on appeal. Plaintiffs claim fraud in the execution of the arbitration agreement, which requires active concealment or an affirmative misrepresentation under California law and reasonable reliance, given the opportunities for learning the truth prior to execution. A failure to explain the agreement and its significance is not sufficient as a matter of law, even where some language impairment is apparent, without an affirmative misrepresentation or concealment. That showing is absent here; further, the clients had the opportunity to take the agreement home before they signed it, so fraud or coercion are not evident. Plaintiffs cite the California Standards, which they might be denied, if compelled to arbitrate before the NYSE or NASD, as the agreement provides. Inclusion of a waiver of statutory protections does not necessarily render a contract illegal, the Court responds. "Because Clients agreed to arbitrate only before the NYSE or NASD, and those organizations have adopted rules (which may not be challenged here, see 15 U.S.C. §78y) for arbitration conducted before them that permit appointment of an arbitration panel to obviate conflicts with California's standards, we decline to relieve Clients of their contractual obligation to arbitrate their dispute with Brokers." *(ed: The Court indicates in a footnote that it does not reach the preemption issue because to do so "would effectively adjudicate the obligations of parties not before the court…. [I]t is inappropriate to adjudicate the federal preemption issue in a case in which neither NASD or NYSE are parties."* (SLC Ref. No. 2004-01-02)

Sawtelle v. Waddell & Reed, Inc., Index No. 115056/01 (N.Y. Sup. Ct., NY Cty., 1/22/04). **Award Challenge * Vacatur of Award * Remand to Arbitrators * Punitive Damages * Constitutional Issues (Due Process – Proportionality) * Rationale of Award * FAA (§10).** *Although the Arbitrators clearly addressed Respondent's conduct as outrageous, they failed, in granting a punitive damages award of $25 million, to consider proportionality concerns.*

In an employment dispute, which was first decided in August 2001, Mr. Sawtelle won punitive damages of $25 million (NASD ID #97-03642, NY). The trial court modified the compensatory award a bit, but upheld the rest of the Award (SLA 2002-24). On appeal, though, the Appellate Division (NYAD) analyzed the $25 million award in great detail, using as a model the "due process" tests applied by the U.S. Supreme Court in *BMW v. Gore.* Constitutional parameters did not strictly apply, the NYAD conceded, because no "state action" is at work in arbitration proceedings. Still, what better guidelines could be utilized than those outlined by the *Gore* Court for testing if an Arbitration Panel violated irrationality limitations in rendering a punitive damages award? "A grossly excessive award that is arbitrary and irrational under *Gore* should be equally arbitrary and irrational under the FAA," the NYAD reasoned. Offering considerable instruction on its comparison of the instant award to the "proportionality" criteria in *Gore,* the NYAD concluded that the $25 million assessment was "grossly excessive." However, the Award did not appear to have been born of bias, so the matter was remanded to the same Arbitration Panel for reconsideration (SLA 2003-07). Incredibly, the Panel stuck with its original decision, re-issuing the Award in September 2003 with the same $25 million punitive assessment. It did elaborate on the factual findings of reprehensible conduct by Waddell & Reed, but this, the reviewing Court rules, misses the point. The NYAD was not looking for embellishments on the degree of reprehensibility; rather, it considered that the conduct was outrageous and still held that, "an award of punitive damages must be proportional to the damage caused by that conduct, as measured by the compensatory damages that are awarded." The absence of any evidence that the Panel considered proportionality restrictions in reaching its award "conflicts with the Appellate Division's holding to the contrary. The panel thus acted contrary to law and beyond the scope and purpose of the remand. Accordingly, the matter must be remanded to a different panel." *(ed: Talk about your veteran, jaded arbitrators! To those who claim that repeat service as an Arbitrator generates anti-Claimant tendencies, let it be known that the three Arbitrators who have twice awarded the largest punitive damages award in SRO arbitration have, among them, more than 150 Awards to their credit. With that said, we think the remand to a different panel, in light of the Arbitrators' intransigence, imposes a new hardship on both parties in this seven-year battle. Panel resistance to judicial remand instructions also encourages an adversarial, rather than cooperative, relationship between courts and arbitrators.)* (SLC Ref. No. 2004-05-03)

Skinner v. Donaldson, Lufkin & Jenrette Securities Corporation, No. C 03-2625 VRW (N.D. Cal., 12/29/03). **Agreement to Arbitrate * Award Challenge * Confirmation of Award * Arbitrator Misconduct ("Pertinent & Material" Evidence; Fundamental Fairness) * Rationale of Award * FAA (§10) * Holder's Action * Discovery Issues * Preemption, Federal**

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*** Analyst Conflicts * State Statutes Interpreted (Cal. CCP §1281.92(b)) * Arbitration Agreement (Uniform Submission Agreement (USA)).** *A reviewing court may not overturn an arbitration award based on the arbitrator's determination of the relevancy or persuasiveness of the evidence submitted by the parties.*

Plaintiff Lemoine Skinner, III ("Plaintiff") initiated arbitration proceedings against Defendant Donaldson, Lufkin & Jenrette Securities Corporation ("DLJ") with the National Association of Securities Dealers ("NASD"). Both parties signed submission agreements incorporating NASD arbitration rules. Plaintiff sought to recover damages from Defendant arising from an investment brokerage margin account he maintained at DLJ from 1988 through March 15, 2001. Plaintiff alleges, *inter alia*, that investment advice provided to him by DLJ, George Frankenstein ("Frankenstein"), Plaintiff's DLJ broker, and Thomas Galvin ("Galvin"), DLJ's Chief Investment Officer, was reckless and was made without disclosure of conflicts of interest that violated DLJ's fiduciary duties to Plaintiff. Plaintiff specifically alleges that Frankenstein provided him with DLJ's March 2000 Factbook ("Factbook"), which contained DLJ's recommendations regarding technology stocks, and that he relied on the extremely optimistic predictions of Galvin when deciding not to sell his technology stock holdings. In addition, Plaintiff continued to purchase large cap technology stocks and exchange traded funds in the technology and biotech sectors on margin based upon the optimistic projections contained in the Factbook. The arbitration hearing was held in San Francisco on February 24-26, 2003 and, on March 11, 2003, the Panel dismissed all of Plaintiff's claims without stating any reason for its decision (NASD ID #01-05583). Plaintiff now seeks vacatur of this Award arguing, *inter alia*, that the Arbitrators were guilty of misconduct for their failure to adequately hear his claims and for their rulings on discovery and witnesses, which excluded the introduction of pertinent and material evidence. In denying Plaintiff's petition to vacate the arbitration award, the Court concludes that Plaintiff was not deprived of an adequate opportunity to present his side, nor were the arbitrators guilty of misconduct. Fundamental fairness only requires that the parties be provided an adequate opportunity to present their evidence and arguments sufficient to enable the arbitrators to make an informed decision. The Court explains that arbitration is intended to be efficient, expeditious, and economical and that arbitrators may restrict the scope of the arbitration accordingly. Although Plaintiff was restricted in the evidence that he was allowed to present, he was allowed to introduce adequate evidence on all his relevant claims in his complaint. Absent exceptional circumstances, a reviewing court may not overturn an arbitration award based on the arbitrator's determination of the relevancy or persuasiveness of the evidence submitted by the parties. *(P. Michaels) (EIC: DLJ was represented by Michael J. Lawson and Jojiro Takano, Steefel Levitt & Weiss, San Francisco, CA, both in the arbitration and the post-Award proceeding. A brief section of the Court's Opinion makes an important ruling on the enforceability of a state statute that prohibits a "private arbitration company" from administering "a consumer arbitration" if any party (or attorney for a party) has a financial interest in the PAC. Assuming that this provision of California law applies to NASD, the Court rules that, nonetheless, the protection was waived by the USA submission and is overcome by the FAA. "In these situations, the Federal Arbitration Act (FAA) sets out the exclusive grounds upon which an arbitration award may be vacated... Any state law that allows for additional grounds for dismissal of an arbitration award would be preempted by the FAA.")* (SLC Ref. No. 2004-08-01)

Slaughter v. Swicegood & Raymond James & Assocs., Inc., No. COA03-171 (N.C. App., 2/3/04). **Standard of Review, Appellate * Enforceability (Forgery) * Evidentiary Standards * Agreement to Arbitrate (Validity).** *A finding by a lower court of the non-existence of an agreement to arbitrate is binding on the appeals court.*

The trial court denied defendants' motion to compel arbitration on the grounds that defendants, in the court's view, failed to prove that an agreement existed. The trial court also denied defendants' motion for reconsideration. This Court affirms, noting that the person whom defendants claimed signed the agreement is deceased and, at the first hearing, the defendants did not satisfy questions concerning the validity of the agreement. Findings below "regarding the existence of an arbitration agreement are conclusive on appeal, where supported by competent evidence, even where the evidence might have supported findings to contrary." *(P. Hoblin: The record does not show why an expert witness was not called to state whether or not the signature of the deceased was valid, which should have settled the matter. After a final decision by the trial court, the issue should be raised again on appeal. Given the existence of a signed agreement, it does not appear that this issue was given full consideration.)* (SLC Ref. 2004-07-02)

Smith v. Bartolini, No. 01 C 4311 (N.D. Ill., 5/12/03). **Arbitrability * Award Challenge * Collateral Attack * Jurisdictional Issues (Arbitral) * Arbitration Agreement (Uniform Submission Agreement) * SRO Rules (Rule 10301) * Selling Away * Waiver * Competing Agreements * Confirmation of Award * Statutory Definition ("Customer").** *The "activities" of an "associated person," as that term is used in NASD Rule 10301, is not necessarily limited to his conduct as an "associated person."*

Martin W. Smith was the President and a major shareholder of World Securities, Inc., a broker-dealer, and President of Investors Financial, a separate investment advisory firm. The two firms shared office space and personnel and WSI executed transactions for IFI. However, WSI

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was a member of NASD while IFI was not and it is on this basis that Mr. Smith challenges the results of an Award granted an IFI client, Elizabeth Bartolini (NASD ID #99-05303, Chicago, 3/26/01). Ordered (along with World Securities) to pay Ms. Bartolini almost $600,000, including punitive damages and attorney fees, Mr. Smith argues that Ms. Bartolini was not his "customer," for purposes of NASD Rule 10301, and that the Arbitrators, therefore, lacked jurisdiction over this dispute. Since the transactions took place under IFI's umbrella, Mr. Smith was not an "associated person," for purposes of these transactions. Moreover, he argued, the investment of monies with an IFI-controlled hedge fund (which Mr. Smith managed) did not constitute a "security," and, again, NASD would not have jurisdiction over the dispute. The Court refuses to make such neat distinctions among the various entities or the vehicle that led to the trading losses. There is some precedent for the notion that, to be a customer, Ms. Bartolini must have dealt with Mr. Smith in his role as an "associated person," but the Court finds that the majority of courts have not interpreted the language of Rule 10301 that way. "…Bartolini need only show that she was Smith's customer … and that her dispute arose out of his activities." She is a "customer" because she met with him face-to-face and received and followed his investment advice. It was not her responsibility to decipher which entity he was working for at the time. "To the contrary, any person in this situation would have been reasonable in believing that Smith was working at least in part on behalf of WSI." Even the cases that would limit the scope of the "associated person's" arbitral obligations are distinguishable. "In such cases, the member firm came to court and contested jurisdiction on the ground that it had no connection with or close relationship to the agent and did not profit in any way from the agent's activities." Those dynamics are not present here. Finally, Mr. Smith signed a Uniform Submission Agreement upon entering arbitration, and, while he contested the Panel's jurisdiction at hearing, he made no challenge in court and stated his agreement to arbitrate "all of the claims set forth in Bartolini's Statement of Claim." *(ed: If the Court thought little of Mr. Smith's argument, it might have acted more promptly on the petition; more than two years passed between the issuance of the Award and its confirmation.)* (SLC Ref. No. 2004-02-02)

Stifel, Nicolaus & Co., Inc. v. May, No. 3:02-CV-688-S (W.D. Ky., 8/15/03). **Award Challenge * Manifest Disregard * State Statutes Interpreted (K.R.S. §292.320 & §292.480) * Statutory Definitions ("Seller"; "Purchaser") * Attorney Fees * Vacatur of Award.** *An arbitration award shall be vacated where the arbitrators refused to heed a clearly defined legal principle.*

Defendants filed an arbitration against Plaintiff alleging three acts of wrongdoing by Stifel's registered representative Smith: (1) that Smith sold a nonexistent bond and diverted the money to his personal use; (2) that Defendants directed Smith to sell shares of Qualcomm and that he failed to do so and later misrepresented to Defendants that he had sold the shares; and (3) that Smith failed to execute a sell order on shares of CMGI. Defendants alleged several legal theories including violation of the Kentucky Securities Act, K.R.S. § 292.480. At the close of the arbitration, Defendants dismissed all claims except the Kentucky Securities Act claim. Following the hearing, the arbitrators entered an Award exceeding $4.3 million, plus attorney fees. Stifel moved to vacate the Award on the grounds that the arbitrators manifestly disregarded the law as to the Qualcomm and CMGI claims. The District Court agrees, holding that the text of K.R.S. §292.480 provides a remedy for sellers against purchasers and for purchasers against sellers, but it does not provide a remedy for sellers of securities against their stockbrokers. Therefore, the Award on the Qualcomm and CMGI claims was in manifest disregard of K.R.S. §292.480, under which the arbitrators were required to decide the case. The Court vacates the award as to the Qualcomm and CMGI claims and confirms it as to the bond claim. *(W. Nelson) (EIC: The underlying Award (NASD ID #01-02950 (Louisville, 10/15/02) was highlighted in SAA 02-42, where we noted that the probable reason for dropping all but the KSA claim was to ensure an award of attorney fees if any compensatory award was granted. We're not sure, but it appears that the $670,712.33 allowed by the Court included the $117,500 in attorney fees awarded, pursuant to the Act. If so, it means that the Court sustained a full fee award on the single KSA claim.)* (SLC Ref. No. 2004-06-01)

Washington Square Securities, Inc. v. Walden, Civ. No. 02-4795 (MJD/JSM) (D. Minn., 1/6/04). **Constitutional Issues (Due Process) * Agreement to Arbitrate * Selling Away * Jurisdiction Issues (Federal Question; Personal) * Venue Issues * 1934 Act** (**§27 "Jurisdiction") * State Statutes Interpreted (Minn. "Long Arm: Statute).** *Broker-dealer cannot utilize the expanded jurisdiction of §27 of the 1934 Act to confer personal jurisdiction and venue on federal court in action to dismiss investor's arbitration alleging only state law claims in a selling away case.*

WSS Broker David Henderson sold defendant investors outside unregistered investments, including promissory notes and ETS Payphones. When defendants brought NASD arbitration against Washington Square, the broker- dealer sued in Minnesota federal court, filing a motion to dismiss the arbitration or transfer the proceeding to that court. Defendants, all residents of West Virginia whose dealings with Henderson took place in N.C. and W. Va., are alleging violations of the N.C. and W. Va. Securities Acts, N.C. Trade Practices Act, common law claims and failure to supervise. Plaintiff contends: (1) all supervisory activities took place

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from Minneapolis; and (2) it has no obligation to arbitrate because defendants were not its customers and the investments were not securities. Defendants argue that personal jurisdiction is lacking because they do not have requisite minimum contacts with the forum state and seek transfer to Pennsylvania, the designated situs of the NASD arbitration, where they previously filed a motion to compel arbitration. Although §27 of the 1934 Act provides for federal court jurisdiction in any district in which the defendant is found, inhabits or transacts business, the Court observes, defendants brought no claim for liability under the '34 Act. Washington Square relies on the '34 Act being "implicated" based on defendants' NASD arbitration and its own suit for a declaratory judgment that the investments are not securities under the Act. In Leroy v. Great Western United Corp., 443 U.S. 173 (1979), the Court held that venue was lacking under §27 of the '34 Act and, for the same reason, personal jurisdiction was lacking; the reference in §27 to actions to enforce "duties and liabilities created by the chapter" refers to explicit duties of certain participants in the securities market that subject such persons to actions brought by the Government, the SEC or private litigants. "The venue provision in §27 of the Exchange Act was purposely drafted to allow defrauded investors adequate means to redress harm caused by nationwide securities fraud." In that Washington Square is not seeking to enforce liability under the Act or to enjoin a violation of the Act, it cannot bypass the clear mandate of §27. "[T]he issue is not whether the federal district courts can exercise personal jurisdiction nationwide under this section; the issue is whether this suit qualifies for the expanded jurisdiction created by [§27] in the first place…. To find any differently would allow large investment firms, such as Washington Square, to haul individual investors into court far away from their homes to declare unlawful their previously-filed arbitration actions, simply because the arbitration touches on federal securities laws." Washington Square did not seek a declaratory judgment that it had no liability to defendants under the '34 Act, which was the basis of another court's finding personal jurisdiction in Washington Square v. Sowers, 218 F.Supp.2d 1108 (D. Minn. 2002). Personal jurisdiction and venue are also lacking under Minnesota's long-arm statute and 28 U.S.C. §1391. The long-arm statute is as broad as the requirements of due process, which require the necessary "minimum contacts" such that the defendant could reasonably anticipate being haled into court in the jurisdiction due to its engaging in some act by which it "purposely avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." It is insufficient that plaintiff's headquarters and supervisory practices are centered there. (*S. Anderson*) (LC Ref. No. 2004-04-01)

Winberg v. Salomon Smith Barney, No. F042866 (Cal. App., 5Dist., 2/13/04). **Preemption, Federal * Enforceability (Impossibility; Unconscionability) * California Standards * Arbitration Agreement * Choice of Law * Staff Interpretations, Effect of.** *The California Standards cannot be applied to SRO arbitration without conflict with the federal regulatory scheme, and, thus, a waiver provision in the SRO rules cannot render arbitration agreements selecting the SROs unenforceable.*

The Fifth Appellate District speaks for the first time on the enforceability of arbitration agreements that waive or compel the waiver of the state's July 2002 arbitrator disclosure rules ("California Standards). The Second Appellate District has, in its latest decisions, consistently held that the California Standards are federally preempted and that the SROs are not obliged to enforce those standards in their arbitration forums. In this decision, where a California investor defeated a motion to compel arbitration below, this Court reverses and finds preemption, based expressly in reliance upon the Second District's *Jevne* decision (SLA 2003-46). The section on preemption in the Court's Opinion consists of three pages of excerpts from *Jevene v. Superior Court*, after which the Court writes: "We decline to further adjudicate the preemption issue and apply the court's analysis in *Jevne.* Thus, we conclude the California Standards are preempted by the exchange Act... The California Standards, therefore, do not provide a basis for rescinding the contracts to arbitrate," whether the argument relates to impossibility or unconscionability. The impossibility argument relies upon the choice Claimants have to arbitrate out-of-state or to waive the Standards for an in-state arbitration. The difficulty and expense of arbitrating in a contiguous state must be so burdensome as to constitute impossibility, in order for the courts to excuse the obligation to arbitrate, and plaintiffs have made no factual showing to that effect. The unconscionability argument fails, not only because of the preemption bar, but also because the California Standards were adopted after the agreement in this case was executed. Thus, the "alleged unconscionability here did not exist at the time of the contracts' making..." which is key to an enforceability challenge. The motion to compel arbitration should have been granted. (SLC Ref. No. 2004-08-04)

Winokur v. Great Western Financial Securities Corp., 2004 WL 42904, 2004 Cal. App. Unpub. LEXIS 179 (Cal. App., 2 Dist., 1/9/04). **Arbitration Agreement (Form U-4) * Federal Arbitration Act * Employment Discrimination * Award Challenge (Forum Fees) * Modification of Award * Enforceability (Unconscionability) * Preemption, Federal.** *Arbitration provision in Form U-4 is procedurally unconscionable, but not substantively unconscionable except for assessing forum fees to the employee; the fee part is severed.*

In employment arbitration cases, California courts continue to impose forum fees on the party that imposed the arbitration agreement. "[W]hen an employer imposes mandatory arbitration as a condition of employment, the

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arbitration agreement or arbitration process cannot generally require the employee to bear any *type* of expense that the employee would not be required to bear if he or she were free to bring the action in court." *Armendariz v. Foundation Health* (SLA 2000-39). Moreover, an arbitration agreement cannot create the risk "that the employee would be required to pay unreasonable costs at the time the employer imposed mandatory arbitration clauses as a condition of employment." *McManus v. CIBC World Markets Corp* (SLA 2003-21). In this case, the former registered representatives signed U-4s and agent agreements with arbitration clauses invoking NASD rules. The trial court compelled arbitration of their suit for wrongful termination and discrimination. The Arbitrators denied their claims and assessed fees against both sides. Following confirmation of the Award, the Court of Appeals examined whether the order compelling arbitration was proper. Agreements between a securities company and its agents involve commerce and are subject to the FAA. The Court rejects the argument that "evaluating the Form U-4 under California's unconscionability standard would interfere with the federal scheme regulating the securities industry. … The Federal Arbitration Act subjects arbitration contracts to state law defenses." "The doctrine of unconscionability has both procedural and substantive elements. Both must be present … [b]ut they need not be present in the same degree. The more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa." The arbitration agreements were adhesive. "When the weaker party is presented the clause and told to 'take it or leave it' without the opportunity for meaningful negotiation, oppression, and therefore procedural unconscionability, are present." But NASD arbitration rules are not substantively unconscionable—except for the risk that the employee may have to pay forum fees. The decision remands to the trial court with directions that it "enter a modified judgment confirming the arbitration award in favor of Great Western, but deleting therefrom the fees imposed against the Winokurs that they would not have incurred in a court of law." (*C.T. Mason. One wonders if courts will sever the forum fee provisions in non-employment cases as well.*) *(EIC: The underlying Arbitration Award can be viewed online. NASD ID* #99-01502 (Los Angeles, 4/12/02).) (SLC Ref. No. 2004-05-01)

Woodley v. Warburg Dillon Read, In Re, No. 602785/01 (N.Y. Sup. Ct., NY Cty., 12/4/01**). Collection Issues (Arbitration Priorities) * Simultaneous Proceedings * Injunctive Relief * State Statutes Interpreted (NY CPLR 7502) * Remedies (Attachments).** *Post-Award assistance in collecting an arbitration Award is not available among the provisional remedies that New York law allows in aid of arbitration.*

One of the advantages of arbitrating in New York State lies in the strength of the provisional remedies available in aid of pending arbitrations. However, as this Court points out, there must be an arbitration pending or threatened for such remedies to become available. Here, Petitioner, a former client of Auerbach Pollak & Richardson, Inc. who had won a $3 million NASD Award against APR (see SAA 01-24), sought post-Award assistance from this Court in the form of attachments and injunctive relief. Ms. Woodley had confirmed her Award (NASD ID #98-04806) in Florida federal court (see SLA2001-50), where her arbitration had been held, but sought an order from this Court preventing APR from paying a $5 million-plus Award owed to Warburg, as a result of a separate arbitration proceeding (NYSE ID #1998-007473). That Award was ultimately vacated by a New York Appellate Court (see SLA 2002-31), but, at this time, a compromise payment could have threatened APR's ability to pay Ms. Woodley. Nevertheless, this Court declines to intervene. CPLR 7502(c), which provides for provisional remedies in connection with an arbitrable controversy, requires the application to be filed "in the county in which an arbitration is pending" or is expected to be brought. The Court protests: "No arbitration is pending in this county. The other provisions of the statute that might properly place petitioner's action in this county apply to arbitrations not yet commenced. Here, the arbitration between Warburg and Auerbach has ended." The petition is therefore dismissed. (SLC Ref. No. 2004-08-05)

SAC's Bulletin Board

The *Bulletin Board* is open to all subscribers who wish to post a message related to arbitration practice or process, free of charge. When insufficient room is available, you may not see your message until the next issue. Please check with us if you are uncertain about when we will be able to publish your announcement.

People

Bressler, Amery & Ross announces further expansion of the firm with the addition of eight new attorneys, all formerly of Morgan Lewis & Bockius, and the opening of its new office in South Florida. **Bennett Falk**, **Keith Olin** and **Alex J. Sabo** have joined the firm as partners, together with associates **Jill E. Dokson**, **Lillian M. Real**, **Izabela C. Reis**, **Beverly Jo Slaughter** and **Coren H. Stern**.

Brown Raysman Millstein Felder & Steiner is pleased to announce that the following attorneys have joined the firm: **Howard M. Appel** (Corporate practice group, Los Angeles, CA), **Jeffrey Berkowitz** (Corporate and Tax practice groups, Los Angeles, CA), **Jonathan Bristol** (Corporate practice group, Morristown, NJ) and **Andrew J. Lauer** (Labor and Employment practice group, New York, NY).

Norris McLaughlin & Marcus is pleased to announce that **Rikki Lamatino Field, Christa Hildebrand, Jeralyn L. Lawrence** and **Scott M. Baach** have become partners of the firm and that **Robert L. Schmidt, Carmine Battafarano, Keith D. McDonald, Melissa Peña** and **Glenn L. Stein** have joined the firm as associates.

Sutherland Asbill & Brennan announces that **Alan M. Wolper** has joined the firm as Counsel and will practice in the Securities Enforcement and Litigation Group. Most recently, Mr. Wolper served as District Director for District 7 in Atlanta for the NASD, Inc. At Sutherland, Mr. Wolper will focus his practice primarily in broker/dealer litigation, arbitration and enforcement matters.

People/Positions Wanted

Brooklyn Law School Securities Arbitration Clinic Seeks Part-Time Instructor: Five years ago, Brooklyn Law School was among the first law schools in the country to offer a Securities Arbitration Clinic in which students represent clients who have been defrauded by brokers and dealers. The students perform all of the work necessary to bring a claim, to negotiate a possible settlement, and appear at either mediations or arbitration proceedings before the NYSE and the NASD. Eight to ten students enroll for the full year and simultaneously take a weekly clinic seminar, which the instructor teaches. This position requires a commitment of at least three days a week, including the seminar. The law school also offers an independent simulation course in Securities Arbitration, which the instructor also could teach. Applicants should be familiar with securities arbitration practice and interested in training a group of very committed and enthusiastic law students.

To apply: send a resume and cover letter to Prof. Stacy Caplow, Director of Clinical Education, Brooklyn Law School, 250 Joralemon Street, Brooklyn, NY 11201 by mail or email (stacy.caplow@brooklaw.edu).

NASD Dispute Resolution has an opening for an attorney in its Chief Counsel's Office in **Washington, D.C**. The attorney will participate in developing and drafting arbitration and mediation rules, and providing legal interpretations regarding NASD rules and related laws and regulations. The attorney also will review staff and arbitrator training materials, answer general inquiries, conduct legal research, and prepare writen materials for review by mangement, the National Arbitration and Mediation Committee, or the Board of Directors. Must be admitted to practice law in the District of Columbia or any state, and have three or more years of significant, related legal experience. Excellent interpersonal and written communciation skills are required. Send resumes to NASD's Human Resources Dept. at careers.aw@nasd.com or fax to 202-728-8208.

SCHEDULE OF COMING EVENTS

If you know of an arbitration event scheduled in the coming quarter, please tell us and we'll post it here.

May 20-21: "Securities Laws Update 2004," sponsored by the Practicing Law Institute, will be held at Vanderbilt University Law School, **Nashville, TN**. Regis. Fee: $1,195. For info., contact PLI, 800/260-4PLI or register online at www.pli.edu.

June 7: "The 2004 NSCP Midwest Regional Membership Meeting," hosted by Nuveen Investments and sponsored by Ashland Partners & Co., LLP, Deloitte & Touche LLP, Lawrence, Kamin, Saunders & Uhlenhop, LLC and Warner, Norcross & Judd LLP, will be held at the Gleacher Center Conference Facilities, **Chicago, IL**. Regis. Fee: $250/$200/$175. For info., call 860-672-0843.

June 14-15: "Litigating Employment Discrimination & Sexual Harassment Claims – 2004," sponsored by the Practicing Law Institute, will be held at the PLI New York Center, **New York, NY**. Program Chair will be Paul I. Weiner of Weiner & Katz, LLC and speakers will include, among others, Hon. Denise Cote (SDNY) and Hon. Shira A. Scheindlin (SDNY). Regis. Fee: $1,295. For info., contact PLI, 800/260-4PLI or register online at www.pli.edu.

June 23-24 (optional workshop June 22): "The Defense Counsel's Forum on Securities Arbitration: New Strategies for the Latest Claims, Discovery, Hearings and Procedures" presented by American Conference Institute and sponsored by CCH, will be held at the Mark Hotel, **New York, NY**. Regis. Fee: $2,299 (conference and pre-conference workshop)/$1,699 (conference only). For info., visit www.AmericanConference.com or call 888-ACI-2480.

June 23-24: "HR's Trade Execution & Market Structure Congress 2004," sponsored by the Institute for International Research, will be held at the Marriott Financial Center Hotel, **New York, NY**. Speakers include Steve Swanson, President & CEO of Automated Trading Desk and Robert McSweeney, Senior VP, Competitive Position for the NYSE. Regis. Fee: $2,295 (conference and workshop)/ $1,795 (conference only). For info., call 888-670-8200.

August 11: "Securities Arbitration 2004: A Rapidly Evolving Process" sponsored by the Practicing Law Institute, will be held at the PLI New York Center, **New York, NY**. Program Chair will be David E. Robbins of Kaufmann, Feiner, Yamin, Gildin & Robbins LLP (Samantha B. Rabin, Vice President and Senior Editor of *Securities Arbitration Commentator* will be a speaker.) Regis. Fee: $795 (includes 2-volume course handbook); $199 (handbook only). For info., contact PLI, 800/260-4PLI or register online at www.pli.edu.

Sept. 13-14: "Securities Litigation & Enforcement Institute 2004," sponsored by the Practicing Law Institute, will be held at the PLI New York Center, **New York, NY** (the seminar will be held in **San Francisco, CA** on Sept. 30-Oct. 1 at the PLI CA Center). Regis. Fee: $1,395. For info., contact PLI, 800/260-4PLI or register online at www.pli.edu.

INFORMATION REQUESTS: SAC aims to concentrate in one publication all significant news and views regarding securities/commodities arbitration. To provide subscribers with current, useful information from varying perspectives, the editor invites your comments/criticism and your assistance in bringing items of interest to the attention of our readers. Please submit letters/articles/case decisions/etc.

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