March 30, 2006

Subject: Comment letter on Proposed NASD 10308 Rule Change

Mr. Jonathan Katz:

As a former stockbroker, a student of a former SEC commissioner, and now an attorney who has been concentrating in securities arbitration and litigation for the past four years or so, I feel that I have a unique perspective on the arbitration classification system, both as it stands and is proposed to change. Frankly, the below results speak for themselves.

In the past four years I have taken five cases to state court because of a lack of an arbitration clause in the broker-dealer's new account form. Three of those cases settled - at mediation - at approximately 75 cents on the dollar, way above the "average" (albeit skewed - see below) of an NASD award of 50%, according to NASD published statistics. None of the broker-dealers to date have even come close to wanting to try a case in front of a jury of my client's peers. They not only agree to engage in mediation - which is free in the court system, at least in Ohio - but actually negotiate in good faith. The forth case is set for trial later this year. However, in NASD arbitration, for some reason, the broker-dealers' attitudes take an abrupt change.

In this same time frame I have filed dozens of NASD arbitration claims. To date I have had exactly one broker-dealer agree to mediation, at a cost of $1200, split by the parties. Using my results of the past 12 months shows what a random - and impossibly unfair - walk arbitration is:

-12 cases scheduled;
- 1 settled at mediation for 50 cents on the dollar;
- 2 settled without mediation just prior to hearing at 50 cents on the dollar;
- 2 continued because of arbitrator removal or recusal;
- 1 dismissed with prejudice because the panel ruled that my nursing home bound client did not produce enough records in discovery - his 80 year old friend couldn't find things in my client's house!
- 1 dismissed on statute of limitations grounds without reasoning, even though the case was brought within four years of the wrongdoing (the panel apparently applied the state two year Statute of Limitations, which has never happened before in my experience - panels have always utilized the 6 year eligibility rule). The forum fees assessed forced my already insolvent clients - their losses exceeded $500,000 - into bankruptcy!
- 2 awards of zero, with in excess of $5,000 in forum fees assessed against my clients, who had filed claim because they had lost their life savings.
- 1 award of 13.5%, and forum fees assessed against my client = to the award!
- 1 award of 150%
- 1 award of 13%

Total awards, including dismissals, equal less than 15% of my client's aggregate Net Out of Pocket losses. Toss in the NASD filing and forum fees and the results are even more pitiful.

Are results alone reason enough to justify striking industry or non-public arbitrators from panels altogether? In my opinion, yes! When I was a broker for one of the large wire houses, I routinely saw unscrupulous, even illegal behavior ignored and in some cases encouraged by the office manager. It is why I quit the industry. The manager I believe is retired; many of the brokers are still scattered and employed in the business. Are any of these folks arbitrators? I don't know. Would I want to run the risk of having one of them on a jury? Of course not. Frankly, they would be removed by the judge from the jury pool without me even having to strike them for cause. Yet every time I explain to my clients that one of the three people who will be deciding their case works in the industry, or is a lawyer who defends the industry, the result is always incredulous disbelief. It is never an understanding of the reason always propounded by the industry: that there must be an industry member on the panels to explain the nuances of the business.

Believe me, try a few cases in front of NASD arbitration panels and you'll soon realize that most of the legal nuances sail over their heads. I recently had an NASD arbitrator tell me that the NASD is training their arbs to "take a hard look at mitigation" - I.e. the broker-dealers' ridiculous defense that somehow the client should not receive all of his or her losses back because the client wasn't sophisticated enough to know what was happening and fire the broker earlier. If the client was sophisticated at all, there would never be a claim, not only because plaintiff's lawyers wouldn't waste their time on such clients but because sophisticated clients don't deal with retail brokers in small towns, and put their entire life savings, and trust, in one basket.

In fact, in my experience, it is always the industry arbitrator who asks the most questions, and undoubtedly is the most influential on the other panel members. In one case last year the panel chair - a public CPA - recused herself after a full day of deliberations on whether or not state Statutes of Limitations trump the 6 year eligibility rule. From the room down the hall where my clients and I spent the day, we could actually hear the industry arb - a lawyer - screaming at the chair. She resigned at the end of the day. This industry arb was not explaining the nuances of the industry - he was utilizing his legal knowledge and skills to bully a public arb off the panel.

Given the documented differences in outcomes, the only apparent reason to me for the discrepancies are the inputs - of the industry arbitrator. Are all industry members prejudiced? Of course not. But one must wonder why successful and busy brokers, managers, compliance officers, and attorneys want to be arbitrators in the first place. Isn't the obvious reason to protect their own? And in my experience, they are winning. Look at the numbers.

I encourage the SEC to withdraw this proposal.

James S. Jones, Esq.