Law Offices of

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

February 10, 2005

VIA EMAIL: Rule-Comments@SEC.gov

Mr. Jonathan G. Katz, Secretary
SECURITIES AND EXCHANGE COMMISSION
450 Fifth Street, NW
Washington, D.C. 20549-0609

Re: "Random" Selection of Arbitrators by NLSS
SEC Release No. 34-51083; File No. SR-NASD-2004-164

Dear Mr. Katz:

I. Introduction

For approximately thirty (30) years, as a National Association of Securities Dealers and NASD Dispute Resolution (collectively "NASD") arbitrator or as legal counsel for either claimants or respondents appearing before a NASD hearing panel, I have witnessed the NASD arbitration system evolve. In the low volume 1970s, circuit-riding Staff would participate in arbitrator deliberations. In the 1980s and early 1990s, a Staff member would attend/observe each hearing session. From the late 1990s to the current time, Staff has had little direct contact with arbitration panelists.

The current watchword of Securities Industry Arbitration is: "Arbitrators should realize that they are viewed by parties in an arbitration proceeding much as a judge would be viewed in a court of law. … Arbitrators must be fair and impartial and must also appear to be fair and impartial. … In arbitration, even more than in court, not only must justice be done, but justice must also be seen to be done." (The Arbitrator's Manual [8/04]("Manual"), p. 3.) However, as set forth below, the reality is otherwise.

More than twelve (12) years ago, I complained to the NASD concerning its use of "career arbitrators" and suggested a random selection process. In substance, the NASD stonewalled my multiple inquiries.

The "random" selection of arbitrators would solve one problem, but there are more serious longstanding problems facing parties --- both claimants and respondents --- who seek justice before NASD arbitration panels, i.e., NASD arbitrators are not well-versed in the applicable law, the NASD resists arbitrator training as to applicable law, the NASD has no effective system to evaluate arbitrator competence.

II. My Background

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

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

I was admitted to the NASD panel of arbitrators in 1976. Also, I have served on the panels of arbitrators of the American Arbitration Association, Pacific Stock Exchange, NYSE and Municipal Securities Rule Making Board. Further, I serve the Los Angeles civil courts and the Los Angeles County Bar Association as an arbitrator.

III. The NASD Vigorously Resisted My 1992-1993 Efforts to Cause the NASD to Randomize the Arbitrator Selection Process

In response to my 1992-1993 complaint/inquiry concerning "career arbitrators," i.e. relatively frequent use of certain arbitrators, and the suggestion that arbitrators be randomly selected, the NASD responded to the effect that: I did not have sufficient information to support my allegations; the NASD would not provide me with information to support the allegations; the NASD employed an undefined "rotating system" to select arbitrators; and, the NASD is supervised by governmental agencies.

A. GAO Found Problems with the NASD Arbitrator Selection Process

In May 1992, the United States General Accounting Office ("GAO") stated that the NASD was engaging in the relatively frequent use of certain arbitrators. ["One practice of some SROS … is the relatively frequent use of certain arbitrators. The NASD and NYSE Directors of Arbitration said that they have been criticized for this practice, and NASD is acting to remedy the situation. The Director of Arbitration at NYSE told us that senior arbitrators were frequently used in the past but that the practice has been stopped." GAO Report (5/92), Securities Arbitration --- How Investors Fare ("GAO Report"), p. 57] The NYSE stated that it had "stopped" the practice. In contrast, the NASD was "acting to remedy the situation."

B. My Complaints to NASD Regarding Arbitrator Selection Process and Stonewall Responses

Beginning in 1992, I complained to the NASD with reference to what I perceived to be the NASD's use of "career arbitrators," i.e., relatively frequent use of certain

problem in arbitrator selection which is causing serious negative repercussions to retail investors within the securities industry. It is the problem of 'career arbitrators.'"] and suggested a solution ["I recently suggested to Ms. Masucci that the selection process be conducted more on a random basis … and that the number of times per year that an arbitrator is permitted to serve be limited." Letter dated 9/16/92 to Judith Hale Norris, NASD Regional Director --- Western Region.]. Ms. Deborah Masucci ("Masucci") was the then NASD Director of Arbitration.

In response, the NASD claimed that arbitrators were selected on "a rotating basis" and that my antidotal information was insufficient. ["(A)rbitrators are selected by the staff on a rotating basis with the aid of a computer generated report. … I am perplexed about how you came to the conclusions stated in your letter unless it recounts your global experience in arbitration which includes selections made at other arbitral forums." Letter dated 11/10/92 from Masucci.]

I explained the bases of my beliefs. ["(M)y observations dealt solely with NASD arbitration. … My information is derived from personal experience while serving as a NASD arbitrator, communications with fellow NASD arbitrators, observations while representing parties in NASD arbitration (including observing prior arbitration awards of selected panel members), and communications with other attorneys who are NASD arbitrators and/or represent parties in the NASD arbitrations." Letter dated 11/13/02 to Masucci.]

I suggested a means by which to verify whether the NASD's claimed "rotating basis" system was functioning properly and requested a copy of any internal selection guidelines. ["There is an additional method by which to measure the fairness of the arbitrator 'rotation' selection procedure. The NASD might list, by region, the amounts specified on the IRS '1099' Forms issued by the NASD for its arbitrators for each of the years 1987 through 1992, inclusive, and the respective arbitrators' identification numbers. … Lastly, is there any written internal policy or guideline of the NASD which deals with the procedure of selecting arbitrators from the NASD Panel of Arbitrators to serve on matters then pending? If so, may I be sent and/or obtain access to a copy of all such policies/guidelines?" Letter dated 1/8/03 to Masucci.]

The NASD failed and, thus refused to respond to several of my letters. ["It is very frustrating trying to get information from the NASD dealing with … the NASD's alleged arbitrator 'rotation' selection procedure. … On September 16, 1992, I wrote to Ms. Judith Hale Norris in reference to 'Selection of "Career Arbitrators."' She has never responded to that letter. When I approached her on September 30, 1992 at an NASD Arbitrator

Educational Forum, in Los Angeles, and inquired about the letter, she simple walked away from me." Letter dated 2/19/93 to Masucci.]

Eventually, the NASD took the position that it relies upon some undefined "mechanism to monitor arbitrator usage," the arbitrator selection process is supervised and that I should locate other persons who could corroborate my claims and cause them to communicate with the NASD. ["(W)e already have in place a mechanism to monitor arbitrator usage. This is done not only by our staff, but also by agencies and committees reporting to Congress concerned with the investing public's protection: the Securities and Exchange Commission, the General Accounting Office, and our National Arbitration Committee. … In your case we reviewed the arbitrator selections on cases where you were counsel and found no evidence of career arbitrators. It is up to you to suggest to others who say they observe career arbitrators that they relate their experience to us so we can investigate and determine the validity of the comments." Letter dated 3/30/93 from Masucci.]

After trying to communicate on the subject of "career arbitrators" with the NASD for nine (9) months, only to meet the NASD's stonewall, I recognized that it would be a useless act to further pursue the matter.

C. NASD Changes Arbitrator Selection Process

In 1998, five years later, the NASD adopted measures to relieve itself of "career arbitrators." ["In recent years, NASD Dispute Resolution has instituted numerous changes responsive to recommendations contained in prior GAO reports such as: … Instituting the Neutral List Selection System (NLSS), in November 1988, which gives the parties significant control in the selection of their panel…" Letter dated 3/26/03 from Linda D. Fienberg, President, NASD Dispute Resolution, to GAO Re: Follow-up Report on Matters Related to Securities Arbitration.]

On January 26, 2005, the NASD sought "Approval of Proposed Rule Change … Relating to the Random Selection of Arbitrators by the Neutral List Selection System" wherein it stated, "NASD Dispute Resolution proposes … to change the method used by the Neutral List Selection System ('NLSS') to select arbitrators from a rotational to a random selection function…" (SEC Release No. 34-51083; File No. SR-NASD-2004-164)

IV. NASD Has Much Larger Problems to Cure than the Arbitrator Selection Process

Changing the arbitrator selection process from "rotational" to "random" is merely nipping at the heels of the two most important problems facing NASD arbitration, i.e.,

arbitrator lack of knowledge of applicable law, lack of an effective means to evaluate arbitrator competence.

A. NASD Arbitrators Lack Knowledge of Applicable Law

1. Importance of Arbitrator Knowledge of Applicable Law

An arbitrator's knowledge of the law applicable to disputes is especially important. If an arbitrator does not understand the applicable law, the arbitrator cannot determine which facts are relevant and which are not or their significance. Thus, justice is not served.

2. GAO Report Recommended Arbitrator Training And Evaluation Programs

Congress requested that the GAO study the arbitrator education process. ["In response to the concerns of industry members and individual investors, the Chairmen of the House Committee on Energy and Commerce and its Subcommittee on Telecommunications and Finance, and the Chairman and four members of the Senate Committee on Banking, Housing, and Urban Affairs requested that we examine arbitration practices in the securities industry. As agreed with the Committees and Subcommittee, we examined issues related to … the selection and training of arbitrators." GAO Report, p. 21.]

The GAO Report expressly stated that it did not deal with the fairness of the arbitration process. ["GAO's review … did not directly address the fairness of the arbitration process." GAO Report, p. 6.] By implication, the GAO Report did not deal with lack of fairness that would result from an arbitrator's lack of knowledge of applicable law.

The GAO Report partially responded to the Congressional request, which dealt with "training." The GAO Report dealt with training in the "arbitration process," i.e., procedure as opposed to substantive issues, e.g., applicable law. ["Recommendations to SEC. GAO recommends that the Chairman, SEC, require SROS that administer arbitration forums to … establish a system to ensure these arbitrators are adequately trained in the arbitration process." GAO Report, p. 61.]

By 1992, the GAO, Securities and Exchange Commission ("SEC") and NASD were able to examine years of arbitration experience with respect to thousands of

arbitration hearings. Yet, they suggested an additional study with respect to providing "better" arbitrator training. ["Finally, with respect to our recommendation concerning

arbitrator training, SEC stated that 'it would be appropriate to study whether there are cost-effective means to assess arbitrators' training needs and provide better training.' This action is consistent with the intent of our recommendation, and the SROS told us they plan to begin such a study." GAO Report, p. 63.] Thirteen (13) years have passed. The investing public and the securities industry have yet to receive the results of the "study." On the other hand, the SROs only stated that "they planned to *begin* such a study" not to complete or publish one. (Emphasis added.)

The SEC commented to the GAO that the NASD should expand arbitrator training and evaluation efforts. ["Nevertheless, while the SROs should expand their training efforts, the Staff does not believe that a prescription of specified courses should, or could, become an acceptable substitute for careful, varied evaluation by the arbitration departments to assure the independence and capability of arbitrators." GAO Report, p. 102.] Subsequently, the NASD reduced its training program with respect to applicable law and informally advises panelists to ignore it. (See, Sections IV.A.4.a and IV.A.4.d, below.) Further, the NASD has disabled its ability to effectively evaluate an arbitrator's competence by eliminating Staff's direct observations of arbitration hearing sessions. (See, Section IV.B, below.)

3. NASD Requires That Intra-Industry Disputes Be Heard Before Arbitrators Who Have Extensive Knowledge of Applicable Law

The NASD recognizes that knowledge of the law is important and is willing and able to employ very competent arbitrators in intra-industry disputes. Parties receive some assurance that arbitrators are knowledgeable of applicable law only in disputes among NASD members or NASD members and their employees. ["Special Arbitrator Qualifications for Employment Discrimination Disputes … (b) Single Arbitrators or Chairs of Three-Person Panels … (C) substantial familiarity with employment law; and (D) ten or more years of legal experience…." NASD Code of Arbitration Procedure, Rule 10211.] (Emphasis added.) ["Temporary Injunctive Orders; Requests for Permanent Injunctive Relief … (3) Selection of Arbitrators and Chairperson. (A)(i) In cases in which all of the members of the arbitration panel are non-public … At least three of the arbitrators listed shall be lawyers with experience litigating cases involving injunctive relief. (B)(i) In cases in which the panel of arbitrators consists of a majority of public arbitrators … At least a majority of the arbitrators listed shall be public arbitrators, and at least four of the arbitrators listed shall be lawyers with experience litigating cases involving injunctive relief. … (4) Applicable Legal Standard. The legal standard for granting or denying a request for permanent injunctive relief is that of the state where the

events upon which the request is based occurred, or as specified in an enforceable choice

of law agreement between the parties." NASD Code of Arbitration Procedure, Rule 10335.] (Emphasis added.)

The NASD should have the same concern with the correct application of the law and the competence of arbitrators toward the law in customer disputes as it does in intra-industry disputes. Parties to customer disputes should not be treated as second class citizens.

4. NASD Prefers That Customer Disputes Be Heard Before Arbitrators Who Have Little or No Knowledge Of Applicable Law

a. Cessation of Arbitrator Educational Forums

In 1993, the NASD ceased educating arbitrators as to applicable law. Prior to 1993, the NASD (Los Angeles Region) would conduct Arbitration Improvement Discussions and Arbitrator Educational Forums. The Discussions were chaired by the NASD Director of Arbitration and attended by a limited number of local attorneys who represented parties in NASD arbitrations. Attendees were afforded an opportunity to discuss arbitration problems and suggest solutions. All members of the arbitration panel were invited (without charge) to the Forums, which were held in grand ballrooms of local hotels. Speakers presented topics of current interest, including applicable law, and the sessions were opened to questions from all present.

b. Rules Provide Little or No Guidance

The Manual and Code of Arbitration Procedure provide little or no guidance to arbitrators as to how to learn and/or deal with applicable law.

The NASD informs arbitrators that they are viewed by the parties "much as a judge would be viewed in a court of law." (Manual, p. 3.) However, it further informs arbitrators that they are not really required to follow the law in rendering their decisions. ["Deliberations. … Arbitrators are not strictly bound by case precedent or statutory law. Rather, they are guided in their analysis by the underlying policies of the law and are given wide latitude in their interpretation of legal concepts. On the other hand, if an arbitrator manifestly disregards the law, an award may be vacated." Manual, p. 30.] The NASD offers no guideline to determine what "the underlying policies of the law" are or how and in what manner to interpret a "legal concept."

["The Statement of Claim shall specify the relevant facts, the remedies sought and whether a hearing is demanded. … The Statement of Claim shall specify the relevant facts and the remedies sought." NASD Code of Arbitration, Sections 10302, 10314.] The NASD only requires that the parties plead facts vis-à-vis applicable law.

The NASD will not advise arbitrators of the applicable law. ["Function of the Arbitration Staff. The Director will assign a staff member to every case. The responsibility of the staff is to advise the panel concerning arbitration procedures. The staff members are not advocates, nor do they research legal issues. Staff members are on call and may be present to see that the sessions run smoothly and all rules are properly observed." Manual, p. 25.]

Many arbitrators lumber under the erroneous assumptions that they are forbidden from doing independent legal research and that they may not consider any legal authority unless it is presented by the parties. (See, Section IV.A.3.d, below.) Arbitrators are advised that they may read a rule referred to by a party. ["Before the hearing. … Arbitrators should not make independent factual investigations. Nothing, however, prohibits an arbitrator from reading the text of a rule referred to in a party's pleading (e.g., if the complaint charges a violation of a suitability rule, the arbitrator may read the rule)." Manual, p. 21.] Arbitrators are impliedly restricted from conducting independent legal research.

An arbitrator's quest for truth and justice should not be dependent upon the supposed competence of attorneys representing their client(s). There is no assurance that attorneys for the parties know or would present arbitrators with applicable law or that arbitrators would accept briefs on what counsel believe to be the applicable law. ["Admissibility of Evidence. … Although most arbitration claims present questions of fact that the panel will be able to decide on the evidence, some parties may rely on a specific law or statute. Generally, the party who has raised a legal issue will offer the panel a brief setting forth the law or statute and how it applies to the facts of the case. The arbitrators may encourage such a party to cover the issues orally. If the brief is accepted, the other party should be afforded an opportunity to respond. The arbitrators may also request that the parties submit briefs on any issue when the arbitrators feel a brief will assist them in deciding the case." Manual, pps. 27-28.] Attorneys for the parties, relying upon the erroneously assumed infinite wisdom of arbitrators, tend not to present any legal authority to support their positions. Some have applied irrelevant legal theories to their factual situations, while ignoring applicable law. Some misrepresent the applicable law.

c. Unresponsive to Requests for Arbitrator Training in Applicable Law

In 1992, I attempted to encourage the NASD to educate arbitrators as to applicable law. The NASD, in substance, stonewalled those efforts.

On July 27, 1992, in response to an invitation to attend an Arbitration Improvements Discussion and to suggest topics to discuss, I wrote to Ms. Deborah Masucci, who was then the NASD's Director of Arbitration. The letter stated, in part:

> Receipt of your letter dated July 23, 1992 is hereby acknowledged. It will be my pleasure to attend the meeting. The following sets forth some "constructive suggestions and frank discussion on how the arbitration process can be improved." However, the suggestions set forth herein might not be limited to "mechanical processing of cases and the rules." ….
> 1. The NASD should conduct educational forums where attendance is mandatory. I have repeatedly heard arbitrators state that they are not required to follow the law. Such usually occurs when they do not like a party or his/her attorney. The NASD should provide instruction as to what the law is (all views thereof) and that arbitrators should follow the law. The education forums could be presented by legal counsel from both the claimants' and respondents' prospective(s).
>
> Arbitrators harbor many legal misconceptions. I have communicated with "experienced" arbitrators who did not know that there was a defense dealing with applying the statutes of limitation….
>
> Attorneys (without securities litigation experience) and non-attorneys need to be educated on the basics of securities law and other legal principles upon which they are asked to rule.

The NASD ceased training sessions in applicable law soon thereafter. (See, Section IV.A.4.a, above.)

On October 1, 1992, in response to a request of Ms. Judith Hale Norris, NASD Director of Arbitration – Western Region, for additional topics to discuss at NASD Arbitrator Educational Forums, I suggested a discussion of what I described as the "unethical and intellectually dishonest" procedure of "arbitrator's judicial notice." I suggested that the subject "should be discussed among arbitrators so that it can be

recognized and prevented." I explained what true judicial notice is and how it was being perverted in arbitration. I wrote, in part:

> [T]he procedure for taking judicial notice is set forth in Evidence Code, Section 455, which states, in part:
> …
> (b) If the trial court resorts to any source of information not receive (sic) in open court … such information and its source shall be made a part of the record in the action and the court shall afford each party reasonable opportunity to meet such information before judicial notice of the matter may be taken. (Emphasis added.)
>
> The aforesaid procedure has been established so that a court may not decide cases based upon secretly obtained information of which the adversaries are unaware and thereby unable to respond.
>
> ….
>
> The situations which I have either personally observed or of which I have been informed occurred can be classified as follows:
> (1) the securities industry representative, during the deliberations, will, for the first time, inform the other arbitrators of crucial information which he/she claims existed within the securities industry at the relevant period;
> (2) a lawyer member of the Panel presents case law or legal concepts which were not presented by any party to the proceeding.
>
> In each situation, the Hearing, for all practical purposes, has been closed so that neither the expert witnesses nor the parties can be asked to comment upon the information. The aforesaid approach to "arbitrator's judicial notice" is nothing but a blatant attempt to sway the panel's decision based upon what can be and sometimes is false and/or misleading information and/or misinterpretation of the law.
>
> … Chairpersons should be encouraged, when they are aware of such thinking, to elicit comment on the alleged facts or law from the parties before deliberations commence. If an arbitrator knows of facts or law which he intends to bring to the attention of the other arbitrators, the parties should be offered the opportunity to present their views.

A copy of the letter was sent to Ms. Masucci. Neither Ms. Norris nor Ms. Masucci ever responded to the request.

d. Unwritten Policy to Discourage Arbitrator Knowledge or Use of Applicable Law

NASD arbitrators have uniformly revealed their misunderstanding that they are forbidden to employ legal authority not cited by the parties in their decision making process. They gathered that information from their NASD introductory training sessions.

The NASD recently attempted to dissuade an arbitrator, who is well-versed in law and experienced in securities litigation/arbitration, from informing co-panelists and attorneys for the parties of applicable case law. The arbitrator desired to learn the attorneys' opinions as to whether the case law was applicable to the matter and, if so, how it was applicable. The co-panelists refused to consider the law (as they believed that such would be a violation of some unspecified rule as the parties did not supply the legal authority) and/or allow its disclosure to the parties. The NASD solicited a promise from the arbitrator not to reveal the law to the parties or employ that law in the decision making process. When the arbitrator refused to disregard the law, the NASD suggested that the arbitrator invite a party's motion for recusal based on grounds of bias. The NASD does not understand that knowledge of the law and requests for full disclosure demonstrate competence not bias.

B. NASD Has No Effective Means to Evaluate Arbitrator Competence

The NASD has no effective means to assess an arbitrator's competence. Until the mid-1990s, Staff would attend each hearing session. Thereafter, Staff has little contact with arbitrators and does not attend hearing sessions.

Presently, the NASD employs a "Peer Evaluation" questionnaire "as an essential part of the NASD Dispute Resolution's continuing effort to ensure that arbitrators are qualified." However, few people want to be and/or want to be considered informants.

The NASD provides no guideline as to whether an arbitrator should use the Peer Evaluation form to report very revealing specific comments or actions by co-panelists. Some examples of actual events are as follows: A Chairperson (attorney) stated that he is not paid enough to take the time to learn applicable law and do an analysis to apply it to the facts under consideration. A co-panelist stated that a customer knew an allegedly omitted fact, because the customer was so wealthy. A co-panelist stated that he would never award punitive damages, but during a prior arbitration, represented to the parties that he was not adverse to awarding punitive damages. Co-panelists (attorneys)

repeatedly fraternized with counsel outside the presence of all other despite being advised that such conduct was improper. A Chairperson (attorney) stated, in substance, that he is unaware that a principal is legally responsible for the acts of its agent. A Chairperson's

pre-hearing discovery rulings demonstrated incompetence. A Chairperson (attorney) tentatively ruled that numerous claimants be excluded from a hearing, as they might hear each other's testimony. ["**(**A)ll parties to the arbitration and their counsel shall be entitled to attend all hearings. " NASD Code of Arbitration, Rule 10317.] Chairperson (attorney) engaged in repeated acts of verbal abuse against co-panelist. Which, if any, of the above were reportable events?

The NASD does not publish information as to the supposed effectiveness of its Peer Evaluation process, e.g. number of questionnaires submitted and actions, if any, taken in response.

V. Conclusion

"Random" vis-à-vis "rotational" selection of arbitrators may improve the arbitration system, but much more improvement is essential to assure fair arbitration proceedings.

Parties in an arbitration proceeding may view arbitrators "much as a judge would be viewed in a court of law," but, without adequate knowledge of the applicable law, the proceedings are more like that of a jury that attempts to function without guidance from a judge or approved jury instructions.

Justice will not be served unless and until the NASD takes effective measures to educate and evaluate its arbitrators as to their knowledge of applicable law.

Please communicate with the undersigned should the SEC conduct a Roundtable or otherwise seek additional information on the aforesaid matters.

Very truly yours,

LES GREENBERG

LG:ms

ec: Ms. Linda Fienberg, President, NASD Dispute Resolution

Ms. Jean I. Feeney, Vice President and Chief Counsel, NASD Dispute Resolution