SECURITIES ARBITRATION
COMMENTATOR

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CAN'T GET NO SATISFACTION!

How Explained Decisions Will Undermine the Arbitration Process

by Aegis J. Frumento*

Introduction

On January 27, 2005, the NASD announced that it intended to seek a rule change requiring arbitrators to explain their decisions. After long delay, the text of the proposed rule was finally filed with the SEC on March 15, 2005, just in time for Linda Fienberg, NASD Dispute Resolution's President, to trumpet it as a "reform" before a Congressional Subcommittee hearing on March 17, 2005. Now that we know what the proposed rule actually says, it seems appropriate to add my two cents to the "debate" between Professor Constantine N. Katsoris and H. Thomas Fehn, Esq., that appeared here a few issues ago (SAC, Feb. 2005).

I have a great deal of respect both for Professor Katsoris (although I do not know him personally) and for Tom Fehn (although I do know him personally), and their respective pieces do credit to, and neatly summarize, the arguments typically voiced concerning the proposal, pro and con. I am impelled to write, however, because I think that they—and other commentators—do not fully address what I think is the most fundamental issue raised by this proposal.

I, too, think that the proposed rule is a bad idea—a profoundly bad idea—but not for the reasons usually put forth. I agree with Professor Katsoris that the availability of explanations in decisions may mean more motions to vacate, but the grounds for vacating awards are so narrow that I do not think the existence of the minimal reasons envisioned by this proposal are likely to result in substantially more awards being upset on appeal. I also agree that explanations will probably delay decisions, but in a process that is already over eighteen months long on average, another month or so won't really matter. Maybe some arbitrators will not want to serve if they have to write decisions, but especially since virtually every panel has at least one lawyer on it, many others will relish the thought of channeling their inner Cardozos. The proposed rule might well cause all the effects noted in the Katsoris-Fehn Debate, but none of them bothers me so much.

Resolution-Based System

What does bother me is that requiring arbitrators to explain their decisions is fundamentally inconsistent with what arbitration should be—and in practice is—all about. Explained decisions are yet another effort to "fix" arbitration. Over the years, many have

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leveled charges against the arbitration process, but they all seem to boil down to this: Arbitrations do not decide cases as well as courts do.[1] I wholeheartedly agree, but I also think it is beside the point. Arbitrations are not supposed to decide cases like courts do. Arbitration is a dispute *resolution* process—not a case determination process—and discussions and expectations about arbitration would make a lot more sense if everyone kept that distinction in mind.

Arbitration is best understood as the last-resort method of *settling* disputes, rather than as an alternative method of *deciding* cases. If the parties cannot settle a dispute on their own, with or without the help of a mediator, the arbitrators settle it for them, and impose the settlement on the parties in the form of an award. The NASD's proposed explained decision option is inconsistent with this understanding. It will make it harder for arbitrators to impose settlements, because settlements, unlike determinations or decisions, will always be difficult if not impossible to explain with "reasons."

Proposal SR-NASD-2005-032

The proposal itself is deceptively simple: At the request of a claimant made before the case is heard, arbitrators must provide a statement of the reasons for their decision. The proposed rule purports only to open a window through which to observe the workings of the arbitrators' minds, and thus seems innocent enough. When I read it, however, I was reminded that it is impossible to make observations in some science experiments without affecting the outcome. The proposed rule is like that. The very need to rationalize will encourage awards based on legal grounds, because legal grounds can more easily be reduced to "reasons" than can equitable grounds, which often defy reasoned analysis. Now, some may well ask, "What's wrong with that?" It is a fair question and it deserves a serious attempt at an answer.

Requiring arbitrators to explain their decisions is not a new idea. Mr. Fehn notes he first proposed it 25 years ago. Ten years ago, one commentator explored the subject at length and also concluded that arbitrators should be required to explain their decisions in writing.[2] Most of the reasons there cited presaged the arguments currently being voiced, including this one: "A present investor who seeks to redress his or her rights through arbitration often feels 'psychologically unsatisfied' without a statement of reasons accompanying the award. The current rule destroys investors' perceptions of having had their fair day in court or, alternatively, their fair day in arbitration."[3]

Being left "psychologically unsatisfied" does not result only from arbitration. Juries do not give reasons for their decisions either, and there is no suggestion that we should reform the jury system to require any. For that matter, psychological dissatisfaction

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with legal outcomes is endemic anyway; most of us spend half our days wondering if we are really shrinks. That the psychological needs of unsuccessful claimants should drive rule-making is a dubious proposition, at best. And yet, alleviating customers' feelings of being "psychologically unsatisfied" is the NASD's *sole* justification for seeking reasons from arbitrators.

The proposing release notes, "The lack of reasoning or explanation in awards is one of the most common complaints of non-prevailing participants in NASD's arbitration forum."[4] The proposing release flatly states that the reason for the proposed amendment is "In order to increase investor confidence in the fairness of the NASD arbitration process."[5] In her congressional testimony, Ms. Fienberg pointed out the NASD's desire to promote "transparency" in the arbitration process "as a way to increase investor confidence in the fairness of the arbitration process."[6] We can well wonder why we need to go through the elaborate rule-making process in order to assuage the battered psyches of losing claimants, but Congressman Paul Kanjorski, the ranking Democratic Member of the Committee that Ms. Fienberg addressed on March 17, noted the proposed rule with approval.[7]

Claimant's Option Only

Naturally, since only customers' feelings of psychological dissatisfaction are seen to be at issue, only customers may invoke the proposed rule. Indeed, the proposing release gives two rationales for denying firms equal power to demand reasoned decisions. First, it will supposedly "protect customers and associated persons, because they alone will determine whether to request an explained decision while bearing in mind the potential costs and the prospect that a reviewing court might find grounds in the explanation to vacate the award."[8] It is a strange rationale given that the NASD identified only *unsuccessful* claimants as those clamoring for reasons, and they would not face a vacatur motion anyway.

The second rationale for not giving firms the same option to ask for a reasoned decision is even odder, that co-respondents may disagree on whether to request an explained decision.[9] That *is* a silly objection—whether you permit it only if there is unanimity among co-respondents, or if any one requests it, will matter in too few cases to be a valid objection to a rule of general applicability. Moreover, this issue needs to be resolved for multiple claimants, too; whatever is decided as to them can apply as well to multiple respondents.

Effect on Substantive Rights

In any event, the NASD clearly does not acknowledge that its proposal will affect substantive arbitration rights. There is no suggestion anywhere that the proposed rule will improve the arbitration process itself. It could not be otherwise, for if the proposed rule does affect substantive rights, the NASD could hardly argue that it should not be equally available to both sides. Rather, the NASD only claims that it will improve claimants' *perceptions* of the arbitration process. So let's call it as it is: It is an unvarnished public relations ploy, and one peculiarly timed to appeal to a congressional subcommittee to boot.

But even innocuous acts have unintended consequences. The problem is that the proposed rule *will* change how arbitrations work, and therefore it *does* affect substantive rights. It will make arbitration outcomes more "legal" and less "equitable." But before going further, let's be clear what I mean when I distinguish between "legal" and "equitable." Contrary to the usual understanding, I do not mean the technical difference between law courts and chancery. I mean a more colloquial distinction between deciding matters in accordance with strict legal rules versus resolving them on the basis of common sense notions of fairness.

Courts decide cases by applying legal rules to judicially determined facts. Facts become "judicially determined" when a judge or a jury applies the rules of evidence to the testimony and documents proffered by the two sides and "finds" what happened. But finding what happened is not an act of clairvoyance. When matters get to trial or arbitration, it usually is because the evidence does not clearly favor one side over the other; clear-cut cases tend to settle early. When the evidence does not clearly favor one side or the other, a legal finder of fact is really making a judgment call about what *probably* happened, based upon the "weight of the evidence."

The standard of proof generally is a preponderance of the evidence, which law professors will say means that if the evidence tips the probability scales even a little in one side's favor, that side is deemed to have proved the fact in question to the same effect as if the evidence were totally on his side. Once enough facts are judicially determined in one side's favor, that side has proved an element of a legal claim, and if all the necessary elements of a legal claim are thus proved, that side wins. It is all very logical, and thus easily explainable. But the result is that courts usually issue all-or-nothing rulings, where the side who manages to muster just a little more credibility of evidence than the other will win the whole case, even though the losing side may really be in the right, and is seldom 100% wrong in any event.

Winner-Take-All Approach

Because the consequences of an erroneous court decision—a total loss—are so draconian, we build extensive procedural protections into the judicial process. Hence, pretrial motions to eliminate claims that cannot succeed and to refine issues for trial, exhaustive discovery to ensure all evidence becomes available, strict rules of evidence to make sure only the proper evidence is considered, rules on addressing the jury in openings and closings so as to limit bias, strict compli-

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ance with jury instructions, appeals, and so on. But all those procedural protections are expensive and time-consuming, and frustrating to litigants, especially to business litigants, for whom getting the dispute resolved expeditiously so they can get on with their businesses is usually more important than getting the result absolutely right. Avoiding the delay and expense of all those procedural protections is what drove us to embrace arbitration in the first place.

The Equitable Alternative

However, we did not abandon those procedural protections because they were bad, but because we did not think we would need them as much. In arbitrations, the harsh winner-take-all outcomes that courts provide is replaced by a less rigorous but more holistically equitable approach to the allocation of business losses. Equivocal evidence generally means that neither side has a monopoly on right or wrong, and therefore neither should be a complete winner or loser. And, indeed, arbitration panels do very often allocate the loss between the parties in some way that seems roughly equitable.

As any parent knows, when two children squabble over a toy, each will usually have a more or less valid point of view. We do not decide that one child has the "weight of evidence" behind him, and award the toy to him exclusively. We force them to share. That is what arbitrators in real life do: When the evidence can go either way (as it often can), arbitrators will force the parties to share the loss—they will "split the baby." Instead of rendering a formal decision backed by rules and logic, arbitrators arrive at informal resolutions based on their own sense of rough justice, one where neither side, if it has a credible story, should expect a total loss or a total win, but one that allows the parties to end the dispute relatively quickly, and with finality. With the prospect of a total loss thus ameliorated, all the procedural protections that attend a court case become less critical, and they can safely be curtailed.

However, and this is my point here, in order for arbitrators to be free to do the rough justice of splitting babies, they cannot be too closely questioned as to how and why they do it. Rough justice is inherently imperfect. It is always, to some extent, arbitrary. It places resolution of the dispute above getting the resolution exactly right. This, then, brings me back to the proposed rule. To force a panel to give reasons for its decisions will chill a panel's ability to make rough-justice determinations, and will impel them to decide cases in ways that can be justified by "reasons." Inevitably, this will mean arbitrators will start deciding cases more like courts, resulting in more winner-take-all awards, but without the procedural safeguards of the judicial system to protect against wrong results.

Explained Award or Legal Ruling?

A close look at the proposal shows why this will be so. The proposal introduces substantive amendments to NASD Rules 10214 and 10330, and conforming amendments to 10104, 10321, and 10332. The proposal revolves around the new concept of an "explained decision." Under the proposal, customers and associated persons in industry disputes (but never NASD members) may require the arbitrators to render an "explained decision" in any arbitration, except for simplified cases without hearings and cases decided on default. Eligible parties must make the request twenty days prior to the first scheduled hearing date. Each arbitrator will be paid $200 more if the Panel must issue an explained decision, and the Panel may allocate $100 per Arbitrator to the parties. The added cost to a party seeking an explained decision, therefore, would seem to be a modest $300 at most.

What is an "explained decision?" "An explained decision is a fact-based award stating the reason(s) each alleged cause of action was granted or denied."[10] Legal citations and damage calculations are not required, but the explained decision must "relate to all claims involved in the case, whether brought by the requesting party or another party." This can only mean that once a customer requests an explained decision, the disposition of all cross-claims and counterclaims have the benefit of an explained decision as well.

One would do well to think hard about the NASD's definition of an explained decision, for there is more to it than meets the eye. The NASD emphatically purports that an explained decision is not a legal opinion. The rule specifically does not require legal citations. A recent amendment to the proposed rule even provides that an explained decision is not "precedent" (as if that would stop lawyers from citing them anyway). But the very definition of an "explained decision" gives away its true nature.

First, reasons must be given as to "each alleged cause of action." Causes of action set forth legal claims. It has almost become the norm for practitioners to assert causes of action in arbitration statements of claim that look for all the world to be legal complaints, and causes of action are alleged element by element as if in court. This practice would now seem to be required by any claimant contemplating asking for an explained decision.

Second, the explained decision must state why each cause of action "was granted or denied." So, not only do we need legal causes of action from the claimant, we now also need discrete rulings on each of those causes of action from the panel.

Given this definition, can one doubt that an explained decision is anything but a legal ruling? Can the reason why a legal cause of action is granted or denied be anything but a legal reason? Can we really expect that lawyers, who sit on all panels, when asked to give reasons for denying or granting legal claims, will give any but legal reasons for doing so? And notice what is missing from the definition: Any possibility that a cause of action is neither granted nor denied, or both granted and

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denied, or side-stepped completely, by an arbitration panel that applies not the law but its own common sense and rough justice to split the baby for parties where the evidence does not conclusively support one side to the exclusion of the other.

Consequences of Legal Ruling

What will a reasoned decision look like? An example will illustrate. Suppose a claimant charges a broker with unauthorized trading. The broker counters that he got the client's consent to the trade that very day and that the customer did not object for months after he received notice of the trade in confirms and monthly statements. The customer denies the phone call and says he was on vacation when the confirms and statements arrived and didn't see them until after the stock collapsed. The broker and the customer are equally credible witnesses. The customer lost his whole account.

Today, an arbitration panel might well award the customer some of his loss. On what basis? Because the evidence points in both directions. Perhaps the panel is not sure if the broker is telling the truth or the customer. Perhaps they think the customer should have made reasonable arrangements to look at his mail even if he was away. Perhaps the panel feels sorry for the customer and thinks the firm is in a better financial position to insure the loss. Perhaps the panel thinks one lawyer or the other is trying to pull a fast one. Perhaps the panel thinks all of the above, or one arbitrator thinks one thing and another something else. Whatever—the panel splits the baby, but no "reason" can ever be articulated. Nevertheless, the resolution is quick, the result is not unfair (the psychological needs of the claimant notwithstanding), and everyone goes on with their lives.

But if the panel had to give a reason for its decision, the result would likely be different. A reason might read like this: "We find by a preponderance of the evidence that the customer received statements in time to disavow the trade and failed to do so. Therefore, the trade was ratified and the customer's claim is dismissed." Or it could be the converse. Either way, it would make for a perfectly "reasoned" result. But would either result be fair? Generally speaking, no.

A winner-take-all result is compelled by legal logic, but it is not fair because when the evidence is equivocal, one can never be confident that one side is totally right and the other totally wrong, especially in the absence of judicial safeguards. For that reason, arbitration decisions that allocate losses among the parties rather than having those losses fall *in toto* upon one side or the other—that "split the baby"—are entirely appropriate. Such decisions in effect do for the parties what the parties have not been able to do for themselves: They *settle* the case based upon the arbitrators' common sense of what is fair. But fairness always defies definition, and therefore cannot be captured by a "reason."

Explanations as Advocacy Tool

Any party who asks for an explained decision, therefore, is really asking the arbitration panel not to apply individual notions of fairness to settle the case, but instead to apply the cold and rigorous logic of the law to reach a one-sided result. That being so, it is clear that the explained decision option is *not* just an innocent device to afford claimants "psychological satisfaction," but a strategic advocacy tool. Those claimants with strong legal claims will ask for explained decisions and hope for a winner-take-all outcome. Those claimants with weak legal claims will not, and hope for a rough-justice, "split the baby" settlement outcome.

But if the explained decision is a strategic advocacy tool, then clearly it should not be available to one side and not the other. The arbitration rules are supposed to be even-handed and the NASD as an arbitration forum is supposed to be neutral. However, the explained decision option as now written would tilt the system in favor of claimants, who can pick and choose an explained decision or not depending whether they have strong legal claims or not. What principle could possibly justify handing a trial weapon to claimants who have strong legal claims, while withholding it from respondents who have strong legal defenses? None. Fundamental fairness requires that the benefit of all rules be available to both sides.

Of course, if either side can ask for an explained decision, then invariably the party with the stronger legal argument will ask for one, and so most every case will likely result in an explained decision and a winner-take-all award. This is not a good outcome either.

The stereotype of the widow and orphan victims of the rapacious broker does exist, but it is rare. The egregious cases settle early if there is money to pay, and when the firm cannot pay, no amount of arbitration "reform" will help claimants anyway. In most arbitrations that get to hearings, customers are not hapless victims and their brokers are not rogues. Rather, in most cases, the broker and the customer look more like dancing partners, where the broker's enthusiasm for a stock and the customer's desire for profit play off each other to cause unwarranted risk-taking and the customer's ultimate ruin when the market turns against him. When the customer then claims the broker led him astray and the broker claims that the customer knew what he was doing—neither is completely right or completely wrong, and there is plenty of blame for them to share.[11] A system that is rigged to treat the one or the other as completely right or completely wrong does not do justice to the complexity of the typical broker-customer relationship.

Claimants' attorneys, I think, know this. More claimants succeed in arbitrations because of equitable considerations than because they have strong legal claims. The tendency of arbitration panels to make awards to claim-

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ants even when the law is dead against them is well-documented.[12] This follows the trend in arbitrations generally, where claimants win some portion of their claims almost twice as often as do their court-case counterparts.[13] If the proposed rule is made applicable to both sides, as it should be if it is adopted at all, successful claimants' cases are likely to decline in number.

To make matters worse for claimants' lawyers, the availability of reasons will give losing claimants—still searching for that elusive "psychological satisfaction"—more incentive to appeal, even though the odds of actually vacating an award are not likely to be any better than they are now. Thus, claimants' lawyers will inevitably spend more time pursuing losing causes through obligatory appeals, a prospect that is not likely to warm the heart of any contingent-fee lawyer. No one should have been surprised, then, that when this proposal was discussed at the recent SIA Annual Legal and Compliance Seminar, we heard some comments suggesting that the claimants' bar does not necessarily support it. Although early on PIABA officially supported the "concept" of explained decisions, in its comments to the March 17 Congressional Subcommittee hearing, it said not one word in support of the rule as actually proposed.

Conclusion

None of this is to say that arbitration cannot be improved. Tom Fehn is absolutely right that we need better arbitrators: Arbitrators who understand securities law, who themselves have brokerage accounts and understand how stock investing works, who are truly independent and seen to be so, who can bring to the process the wisdom of age without some of its starker infirmities. But the solution there is better arbitrator selection, retention and education, and better staffing of cases by the NASD, tasks requiring that the NASD actually *do* something to improve the process.

Most cases settle. Indeed, virtually all cases *should* settle, especially if the case is about money, as all brokerage cases are. Settlement is the most efficient way of ending disputes, while court litigation is the least. Arbitration is somewhere in the middle, but its efficiency is enhanced to the degree that it is accepted for what it is—a way to impose settlements upon recalcitrant parties. That will only happen if arbitrators remain free to craft fair solutions that defy articulable "reasons," but that end disputes quickly, relatively inexpensively, and with finality. That is a salutary goal in our overly litigious society and it should be nurtured. Mandatory explained decisions undermine that valuable social goal and for the dubious benefit of hoping to make some losing claimants a little less "psychologically unsatisfied." I say it again and with emphasis—this is a *profoundly* bad idea.

Endnotes

[1] See, e.g., Robert E. Shapiro, *I Hate Arbitration (Most of the Time)*, 30 LITIGATION 36 (Winter 2004).

[2] 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. 152 (1995).

[3] *Id.* at 192.

[4] NASD Proposed Rule Change on Form 19b-4, SEC File No. SR-2005-032 (Filed 3/15/2005), pp. 8-9.

[5] *Id.*, p. 9.

[6] Testimony of Linda D. Fienberg before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives, March 17, 2005.

[7] Opening Statement of Ranking Democratic Member Paul E. Kanjorski, Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, A Review of the Securities Arbitration System, March 17, 2005.

[8] NASD Proposed Rule Change, *supra* note 4, pp. 9-10.

[9] *Id.*, p. 10.

[10] Proposed Rule 10330(j)(2), at *id.*, p. 5.

[11] *See, e.g.*, Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 CALIF. L. REV. 627, 699 (1996)(positing "a joint responsibility hypothesis to explain a significant segment of sub-optimal investment decision making by otherwise sophisticated investors.")

[12] See Lewis D. Lowenfels and Alan R. Bromberg, *Beyond Precedent: Arbitral Extensions of Securities Law*, 57 BUS. LAWYER 999 (2002); Barbara Black and Jill I. Gross, *Making it Up As They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991 (2002)

[13] National Arbitration Forum, *Arbitration vs. Lawsuits: What Courts, Case Outcomes and Public Perceptions Show About How Contractual Arbitration Compares to the Litigation System* (2003), available at www.arbitration-forum.com/articles/whitepapers/fairness-4-03.pdf.

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IN BRIEF *(Covering SAAs 2005-07 thru 2005-11)*

(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.)***

SECURITIES ARBITRATION UNDER FIRE: ***Since NASAA met in July (SAA 2004-29), we have been hearing about efforts to interest Congress in holding hearings about the fairness of securities arbitration.*** Last fall, we reported that Rep. Barney Frank (D-MA), the ranking minority member of the House Financial Services Committee was pushing hard for hearings on the practices of the securities SRO arbitration forums (SAA 2004-43). A comment letter written to the SEC by former NYSE Arbitration Director Robert S. Clemente (now Of Counsel, Liddle & Robinson, LLP, New York City) last November strongly criticized a NYSE rule proposal that was designed to keep list selection as a subordinate offering for mutual agreement of the parties *(EIC: SAC also submitted a comment letter criticizing this proposal)* and, at the conclusion of the letter, he wrote: "[P]erhaps now is the time for the SEC to re-examine its 1977 decision to allow the SROs to control the arbitration process as well as the Commission's 1986 decision to support the enforcement of mandatory arbitration of securities industry disputes." *(EIC: As an aside, NYSE later withdrew that rule proposal and substituted it with another that gives claiming non-members the option to choose either list selection or staff appointment. SAA 2005-01).* On the same day, November 18, 2004, Mr. Clemente also wrote to Rep. Frank, urging reform and writing: "The time is ripe for a thorough review and overhaul of the process …. [I]t is time to reexamine the appropriateness of mandating investors and employees to bring their disputes to a forum administered by the SROs…. [A]rbitration should be a voluntary option for investors and employees. I welcome this opportunity to encourage your continuing efforts to publicly examine this process and offer my knowledge and experience to assist in any way I can." At the July NASAA Luncheon Forum, comments of a similar nature were heard from Matthew J. Nestor, then securities division head for the Commonwealth of Massachusetts, who said that, for NASAA, having the arbitration program administered by "an independent body" was a top priority. In addition, the ADRWorld WebSite (www.adrworld.com) reports in an article entitled "Groups Launch Campaign Against Binding Arbitration," that the "Give Me Back My Rights" plan of these "groups," which include AARP, Public Citizen, the National Association of Consumer Advocates, the U.S. Public Interest Research Group, and a score of consumer- or claimant-oriented organizations, is to campaign on the Internet and elsewhere against mandatory arbitration agreements and to "steer consumer dollars away from companies who use them." The groups also agreed to lobby for legislation "to limit the application of mandatory arbitration agreements to consumers," ADRWorld wrote. Now, with little fanfare, the House Financial Services Committee's Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises has announced an afternoon session on March 17, during which it will conduct a "Review of the Securities Arbitration System." (SAC Ref. Nos. 2005-10-02 & 2005-11)

CONGRESSIONAL HEARINGS ON ARBITRATION: ***The House Financial Services Committee's Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises heard testimony on March 17, entitled "Review of the Securities Arbitration System," from a list of securities arbitration providers, advocates and foes.*** Summarized below are the statements of representatives from organizations concerned with securities arbitration and others with independent views:

Linda D. Fienberg, President of NASD Dispute Resolution, provided statistics about the volume of cases NASD-DR has handled over the past five years and the overall outcomes. Combining settlements and awards to customers, she said, demonstrates that "roughly three out of every four investors who bring an arbitration claim are awarded some amount of compensation." She reported that, by the end of March, NASD-DR will have 68 hearing locations with at least one in every state. She makes the point that NASD does not require investors to arbitrate their claims; that is a matter of contract. NASD regulates the form and content of the arbitration agreements brokerage firms use, in order to "ensure that customers are aware that they are agreeing to arbitrate and understand the nature of the arbitration process." Customer claims constitute about 80% of the NASD docket, while disputes between broker-dealers represent about 15% or more of the claims. Disputes between firms and their employees "represent less than five percent of our overall case filings." There are approximately 7,000 arbitrators and 1,000 mediators on the NASD's rolls and neither the appointment nor the removal procedures involve reference to an Arbitrator's past Awards "to see whether the awards favor the investor or the industry" and an arbitrator can only be permanently removed if Dispute Resolution management and two public members of the NAMC approve removal. NASD has promulgated arbitrator classifications for Public and Non-Public Arbitrators to "provide additional assurance to investors" of arbitration's fairness and neutrality and is working on further classification changes for Board consideration. Ms. Fienberg covered discovery as well,

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referring to disciplinary sanctions that assure compliance. Two additional initiatives in the discovery area will allow appointment of a Discovery Arbitrator as a voluntary pilot and launch an updated version of the Discovery Guide Lists. The NASD presentation ended with a description of measures taken to ensure payment of Awards to customers and the recent awarding by NASD's Investor Education Foundation of a grant to Northwestern University's new securities arbitration clinic. (See *infra*.)

Prof. Constantine N. Katsoris presented himself as a participant in the resolution of securities disputes for over 35 years as an arbitrator, mediator, arbitration trainer and Public Member of the Securities Industry Conference on Arbitration. SICA's critical role in establishing the first small claims handling procedure led to the task of developing a Uniform Code of Arbitration dispelling the "Balkanization of the various SRO arbitration programs." SICA's participation was again critical in the late 80s in orchestrating a uniform SRO response, when post-*McMahon*, the SEC set out to overhaul the SRO process. In the 90s, SICA's role included opposing certain ill-advised proposals, as well as developing new recommendations for SRO consideration. Most recently, SICA has proposed a third-party subpoena process that requires a 10-day notice period and, at its most recent meeting, SICA adopted a model rule that grants a peremptory challenge to each side when administrative appointments are used to fill vacancies. The threat facing SRO arbitration today is the "backslide into a system of Balkanization," because SROs are not working through SICA and are going it alone.

Karen Kupersmith is the NYSE Director of Arbitration, elevated to that post in April 2004 after 20 years as a staff attorney in the Department. Over those years, she began, "one factor has remained constant – the commitment of the NYSE to providing investors with the fairest method for resolving disputes with brokerage firms." Unlike NASD's Fienberg, Ms. Kupersmith mentions SICA repeatedly as a body that has worked over the past thirty years and which "has responded to the concerns of various organizations and interest groups about the fairness of the process, including focus on increased arbitrator disclosure requirements and more extensive discovery procedures…." She also credits the securities arbitration clinics that an increasing number of law schools are supporting, "[f]or those investors not able to retain an attorney…" On the statistical side, Ms. Kupersmith combines settlements and monetary awards to customers to find that "public investors received monetary remuneration in 70.96% of the public investor cases closed in 2004 and, in 80.99% of the public investor cases closed in 2003." NYSE has a pool of 1,600 arbitrators available for service, 961 Public and 639 Securities Arbitrators. Arbitrators are selected in a variety of ways today and a new proposal, if approved by the SEC, would provide a choice between list selection or staff appointment. "Parties would still be able to agree on any other reasonable method of selection," the Director stated. She described the training and evaluation processes at the Exchange and some recent improvements. NYSE Awards are available on the Exchange WebSite; staff has doubled in size since the end of 2002 (12 attorneys, 8 arbitration specialists and 12 administrative personnel). She indicates in closing that improvements at NYSE "will continue to be expanded as the NYSE continues to work with the SEC, PIABA, and SICA."

Marc. E. Lackritz, President of the Securities Industry Association, agreed that "[p]ublic trust is critical" for our market and its dispute resolution processes and that arbitration must not only be fair in fact, but "also perceived to be fair." He argues that arbitration is superior to litigation for public investors, because disputes can be resolved "much faster and at far lower cost to customers…." Moreover, because more disputes are actually heard, "[a]ggrieved customers get what so many say is what they really want: their 'day in court.'" Statistics demonstrate that NASD is processing cases about ten months faster on average than New York federal court. That significant reduction in time to judgment benefits all parties involved in the process." Mr. Lackritz cites statistics from other studies as well, including the negative-positive from the non-SRO pilot, where Claimants failed to utilized alternative forums, for "strong evidence that all participants – customers and industry-related – believe that SROs provide a fair forum for resolution of securities customers' complaints." He also argues that the Industry Arbitrator requirement does not suggest a "systemic problem with arbitrator selection" and offers several reasons why an Industry Arbitrator helps to achieve a more fair and efficient result. That said, the SIA Chief turned to what is wrong with arbitration today, capsulizing it in the phrase, "creeping litigiousness." The SIA comes out against the new proposal for on-demand Award explanations. (See below, "NASD Files Award Explanation Rule.) "Although no doubt well-intended by people who believe written explanations will be helpful to customers, this new requirement will be anything but customer-friendly; it will undermine the chief benefit of arbitration by adding the opportunity for an additional layer of costs and legal maneuvering."

Rosemary Shockman, the current President of the Public Investors Arbitration Bar Association, described eliminating the "mandatory industry arbitrator" as the most important issue facing securities arbitration. The perception from the customer's perspective is that of being "faced with a panel that appears to be stacked against him." Industry arbitrators "tend to sanction industry practices … and apply those standards rather than the practices mandated by the NASD, the SEC, the NYSE, and the states." While many financial writers believe variable annuities are being oversold, for example, the Industry Arbitrator hearing suitability claims relating to variable annuities may work for an "employer [who] is reaping massive profits from the sale of variable annuities to the same type of clients." Ms. Shockman also disputes the need for knowledge that the Industry Arbitrator supposedly provides, because arbitration has become "an increasingly sophisticated process" where use of expert witnesses "to present industry practices, procedures and rules to the panel is typical." At the same time as eliminating Industry Arbitrators,

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PIABA would require NYSE and NASD to tighten the definitions of public arbitrators. "NASD and NYSE permit people to serve as public arbitrators who often look a lot like industry arbitrators." Discovery abuses and unpaid arbitration awards continue to be a problem. Insurance does not cover the awards arbitrators make and broker-dealers have "very small net capital requirements." Finally, Ms. Shockman specifically complained about delays at the NYSE forum, testifying that many practitioners "have become so frustrated with the delays at the exchange, that they have simply stopped bringing cases there. Thus, investors are effectively deprived of even the limited choice of industry run forums that now exist." *(EIC: Available on PIABA's WebSite, www.piaba.org, is a further statement by PIABA that appears to have been submitted to the Subcommittee. The paper expands the argument for eliminating the Mandatory Industry Arbitrator and covers the other points about discovery abuse, unpaid Awards, an overly broad definition of "Public" arbitrators, and the problems at NYSE in somewhat more detail than Ms. Shockman's short testimony could. The PIABA WebSite also displays a policy statement which endorses in somewhat muted terms the NASD Award Explanation concept*.)

Individual voices were also heard:

William Francis Galvin is the Secretary of the Commonwealth of Massachusetts, ranking member Barney Frank's home state. Secretary Galvin is also the "Chief Securities Regulator in Massachusetts" and speaks, he says, for the small investors who "call or visit my office in Massachusetts all the time." From this perspective, he sees securities arbitration as "worse in my opinion" than the recent "[c]orporate scandals and the collapse of the high-tech bubble," because it is a "rigged system [that is] fundamentally flawed and stacked against the individual investor." He calls the NASD a "so-called industry self-regulator" and labels the process "an industry-sponsored damage containment and control program masquerading as a juridical proceeding." Conceding that NASD "has been working on this arbitration process," Secretary Galvin mentions the $250,000 fines for discovery abuse meted out to three broker-dealers and the new proposal to explain Awards. "But no fine or regulatory tinkering," he postulates, "will address the more fundamental flaw of the so-called arbitration process – namely, that it's run by the industry and for the industry. The system is unfair." His advice: "Put someone beside the NASD in charge. That's the best solution."

Michael A. Perino is a Professor of Law whose securities arbitration credits include a report for the SEC (11/02) on the adequacy of arbitrator conflict disclosure requirements in NASD and NYSE proceedings and the establishment in 2004 of the St. John's University School of Law Securities Arbitration Clinic. His submitted statement runs almost 30 pages, so we are unsure what Prof. Perino actually stated to the Subcommittee, but his paper treats the likelihood that regulatory and legislative oversight of the arbitration process, plus the SROs' "rational self-interest," protect the system from "developing industry-favorable biases." He also presents statistical and other evidence which, in his view, do not support conclusions of "any apparent pro-industry bias." Congress, the SEC and the SROs can always undertake further measures to enhance public confidence in the process, but, he cautions, "imposing additional procedural requirements on the system should not in any way be viewed as a costless way to achieve that goal…. The net result may well be less accurate case resolutions and more judicial challenges to arbitral awards." Given the current picture and the safeguards inherent in the current structure, Prof. Perino states, "those seeking to revamp the securities arbitration system should have the burden of identifying through thorough and well-documented empirical evidence that actual problems in fact exist."

Daniel R. Solin, a Pittsfield, MA lawyer who represents investors and who authored *"Does Your Broker Owe You Money?"* to "educate investors about the industry's mandatory arbitration system" calls securities arbitration a "national disgrace." He will soon complete a "detailed statistical analysis of all awards issued by NASD and NYSE arbitration panels for the past ten years," which he anticipates will demonstrate that "investors have an exceedingly small statistical possibility of receiving any

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meaningful award from these [SRO] tribunals, regardless of the merit of their claims." An elderly client of Mr. Solin's serves as an example of that slim chance, he states, as she lost almost $1 million dollars and had arbitration as her sole recourse. Mr. Solin calculates his client's statistically probable recovery as "only 7.1% of her damages," given the factors stacked against her and, in reality, she only recovered in arbitration (#NASD ID #03-07760) less than enough to pay the forum fees. "This appalling situation yields only one rational conclusion," Mr. Solin argues. "The only appropriate course of action is to eliminate the role of the securities industry entirely from adjudicating disputes involving the misconduct of its members." Investors should be allowed the right to litigate and to bring claims in non-industry forums. (SAC Ref. Nos. 2005-12-01 & 2005-13-01)

NASD FILES AWARD EXPLANATION RULE: ***Moving quickly to back words with action, NASD Dispute Resolution has proposed changing its arbitration rules "to provide written explanations in arbitration awards upon the request of customers, or of associated persons in industry controversies."*** The Rule filing, SR-NASD-2005-32, is dated March 15, 2005 and follows a surprise announcement from the NASD parent in late January (SAA 2005-04) that its Board of Governors had approved the initiative. The proposal changes a number of rules to accommodate the "explained decision" demand, including IM-10104 (additional honorarium of $200 per arbitrator), Rule 10214 (associated person may request), Rule 10321 (request must be at least 20 days before first hearing session), and Rule 10330 (main Rule provision). Rule 10330, entitled "Awards," will contain a new subparagraph (i), which will expressly state that NASD Awards "may contain the rationale" of the Panel. New subparagraph (j) will make that possibility mandatory if a customer party or an associated person in an industry controversy makes a request for an "explained decision no later than the time for the pre-hearing exchange of documents and witness lists under Rule 10321(c)." An "explained decision" is described as "a fact-based award stating the reason(s) each alleged cause of action was granted or denied." Legal authorities and damage calculations need not be included, but the "explained decision" needs to address "all claims involved in the case, whether brought by the requesting party or another party." Explanations are not generally required of arbitrators, but NASD permits such explanations and, in subpara. (i), proposes to codify that policy. Such explanations are often requested, but the request usually comes after the final decision has issued. "The lack of reasoning or explanations in awards is one of the most common complaints of non-prevailing participants in NASD's arbitration forum," the rule filing reveals. NASD believes that investor confidence in the fairness of the process will be enhanced by allowing some parties this option. The reason that reference to legal authorities or calculations of damages are not part of the explanation relates to cost and processing time. "[I]t would result in the drafting of complex and lengthy judicial-type decisions." NASD members will not be accorded the right to demand explained decisions, NASD relates, in order to protect customers and associated persons. "[T]hey alone will determine whether to request an explained decision while bearing in mind the potential costs and the prospect that a reviewing court might find grounds in the explanation to vacate the award." The new rule provisions will not apply to simplified "on the papers" arbitrations or those conducted under the default procedures of Rule 10314. The need to declare before the first hearing is designed to allow parties time to reach the decision, while securing adequate notice to the Panel that a case will require an explained decision. The additional $600 ($200 per arbitrator) that the choice requires will be one-half absorbed by the NASD and the other half allocated among the parties, as the Panel determines. Without the demand, the additional honoraria will not apply, even if a Panel chooses to write an explained decision. *(EIC: The text of the rule appears faithful to the way the proposal was first described in the January Press release. Those planning to comment on the proposal are referred to SAC's last issue, Vol. 2005, No. 2, in which two guest authors, Prof. Constantine N. Katsoris and Los Angeles attorney H. Thomas Fehn, debated the concept proposal and predicted the potential changes this revolutionary proposal could bring.)* (SAC Ref. No. 2005-11-02)

CREDIT SUISSE FIRST BOSTON CORP. v. GRUNWALD, No. 03-15695 (9th Cir., 3/1/05). ***This long-awaited decision rules that the NASD arbitration process was intended to be covered when the California legislature and the State's Judicial Council promulgated disclosure and disqualification rules ("California Standards") for private "neutral arbitrators." However, it also finds that the California Standards cannot apply to the SRO arbitration process, because the 1934 Act preempts such coverage.*** Since 2002, the SRO arbitration forums offering hearing locations in California have been faced with the dilemma of choosing to abide by their own rules on arbitrator disclosure and disqualifications or complying with the California Standards. As this Ninth Circuit Panel finds, it would be impossible for NASD Arbitrators to comply with both, at least as to disqualification procedures. The disqualification provisions in the California Standards stand in actual conflict with the NASD rules and, given the SEC's oversight of SRO arbitration and its approval of all NASD rules, the NASD disqualification procedures must prevail. As to arbitrator disclosures, the two sets of disclosure provisions are not in direct conflict, but compliance with both the SRO provisions and the Standards would involve additional costs and complexity, rendering the California provisions an effective "obstacle" to the achievement of federal objectives. Thus, preemption applies here as well. The District Court below avoided the preemption question by construing the term "neutral arbitrator," which defines the intended reach of the California Standards, to exclude NASD arbitrators. Because the Ninth Circuit rejects that interpretation, it must rule on preemption and that ruling supports the outcome below. Mr. Grunwald must arbitrate his employment dispute before the NASD. *(EIC: A more detailed analysis of this decision appeared in Securities Litigation Alert (SLA 2005-09). The decision is not mentioned on NASD Dispute Resolution's "What's New" section of its HomePage, leading us to wonder with what degree*

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of delight (or closure) the SROs are greeting this ruling. While the ruling vindicates the SRO-SEC position on preemption, it also presents practical problems. Does the NASD drop its waiver procedures based upon the Court's ruling? Will it choose to wait for the disposition of potential requests from Mr. Grunwald for reconsideration en banc *or a petition for certiorari? Since* Grunwald *has been blocking the Ninth Circuit's consideration of* NASD-NYSE v. Calif. Judicial Council, *will NASD await that outcome – or the outcome in* Jevne (see below), *which was recently heard by the California Supreme Court? Deciding to wait may seem cautiously prudent, but it puts more pressure upon California litigants and may invite California courts to construe the NASD's insistence upon waivers as an effective refusal to arbitrate* (*a la* Alan v. Super. Ct., SAA 2005-01)). (SAC Ref. No. 2005-09-01)

***JEVNE* ARGUED BEFORE CALIFORNIA SUPREME COURT: ºA three-member Panel of the California Supreme Court heard oral argument ºon March 8, concerning the preemptive impact of SEC-approved arbitration rules on the application of the "California Standards" to cases arbitrated under the auspices of a securities SRO.** News articles and eye-witness accounts from attendees to the arguments are all we have to go on, but the consensus was that the State's top court will not rule in significant contradiction to the Ninth Circuit's holding on the same question (see CSFB v. Grunwald, above). As we reported above, the Ninth Circuit found the California Standards — a legislatively sanctioned set of arbitrator disclosure and disqualification rules — trumped by the regulatory structure established between the SEC and the securities self-regulatory organizations (SROs) under the Securities Exchange Act of 1934. The questions fromºthree of the seven *Jevne* judges (Justices Joyce Kennard, Ming Chin and District Court of Appeal Justice Steven Vartabedian (Fifth)) suggested a leaning in favor of finding preemption but left some doubt as to whether the California Standards are preempted in toto or only in part. ºThe California Supreme Court could disagree with the Ninth Circuit, in theory, but preemption is a federal issue and a contradictory ruling would throw this long-standing controversy into even greater chaos. *ºEIC: ºDefense lawyer Joseph Floren, Steefel Levitt & Weiss, San Francisco, was one of the attendees at the oral argument. ºHe told us that Justice Vartabedian expressly disagreed with the argument from the State's Deputy AG that there was no apparent conflict between the two sets of rules. ºNASD argued (as intervenor) that the California Standards would allow automatic disqualification of most arbitrators, especially industry arbitrators, if applied to SRO arbitration, and contended that, although the plaintiff's side claimed an interest in further securing arbitration's integrity, their "real agenda" is to tear down the securities arbitration process. ºSignificantly, there was no discussion of the Federal Arbitration Act, which the parties had briefed and which provided a separate ground for preemption findings in several federal cases.)* (SAC Ref. No. 2005-10-01)

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CALIFORNIA STANDARDS WAIVER EXTENDED: ***Prior to the ruling in Grunwald and oral argument in Jevne, NASD was granted an extension of the waiver provisions that allow it to offer arbitration in California without requiring its arbitrators to comply with that state's arbitrator disclosure requirements.*** The SEC approved the proposal (SR-NASD-2004-180), which was filed in early December (SAA 2004-50), after airing the rule in the Federal Register for the requisite period. NASD has been renewing this waiver rule every six months for the past three years, but this time it provided plenty of time for people to comment on its decision (and, with approval, the SEC's) to continue the path it has set. We related in a summary of the latest decision in *Alan v. Super. Ct.*, (SAA 2005-01), that at least one Appellate Court has expressed impatience with the SRO's decision to await a final ruling on the general question of preemption regarding the California Standards, when, in some cases, the NASD might rely on specific case rulings to proceed without a waiver. Although the pilot rule might have been tweaked at this juncture, there was evidently no pressure to do so. The SEC notes in the current Release, (SEC Rel. 34-51213, dtd. 2/16/05), that no comment letters were received, indicating that there is no strong opposition to the pilot being renewed as before. In the Commission's view, "the extension of the effectiveness of the pilot rule through September 30, 2005, will permit NASD to avoid disrupting the administration of cases covered by the pilot rule under the NASD Code of Arbitration Procedure." The Commission's approval was announced in 70 Fed. Reg. 35, p. 8862 (2/23/05). (SAC Ref. No. 2005-08-02)

NYSE SEEKS EXTENSION OF CALIFORNIA WAIVER PILOT: ***Those seeking to effect a change in the current waiver procedures employed by the SRO arbitration forums in California had a brief opportunity to submit their views to the Commission with respect to this new filing.*** The New York Stock Exchange submitted this filing on February 7, 2005, proposing to extend for an additional six-month period from March 31, 2005, a pilot rule (NYSE Rule 600(g)) that compels members and associated persons to waive the California Standards when claiming customers or associated persons execute a waiver and request a California hearing location. The *Grunwald* decision suggests that the NYSE may need a waiver procedure less than NASD does. NYSE's default procedure for appointing arbitrators employs staff appointment, while the California Standards are applicable to "neutral arbitrators," i.e., those who are "jointly selected by the parties." NYSE did not initially ask for accelerated approval but after Grunwald and approval of the NASD extension request, accelerated approval was requested and granted. (SAC Ref. Nos. 2005-09-02 & 2005-13-04)

BIRBROWER DEVELOPMENTS: ***When the California Legislature put the California Supreme Court's*** **Birbrower** ***ruling on hold for a half-decade, it did so with an intent to find a better solution in the interim to a blanket ban on out-of-state lawyers engaging in mediation or arbitration practice within the State. As the time approaches for the legislation's expiration (1/1/06), one proposal for change has hit the hopper.*** Assemblyman Tom Harman (R-67th Assembly Dist.) submitted a bill "to amend and repeal Section 1282.4 of the California Code of Civil Procedure, relating to arbitration," which would make permanent the existing law. Under the legislation as it currently reads, out-of-state attorneys who are engaged in private arbitration practice within the State are required to serve upon the arbitrators, the Bar, parties and counsel a certificate containing specified information. The certificate, which contains contact information, the name of an "attorney of record" who is licensed in California and submission to the oversight jurisdiction of the California courts, must be presented before the first hearing and the arbitrators or the arbitration forum retain the right of approval. The legislative intent provisions in subsection (i) is left the same and the only substantive deletion is the removal of the expiration date. (*ed: *The bill, dated February 15, 2005, has been denominated AB415. SAC thanks to W. Reece Bader, Orrick Herrington, Menlo Park, CA, for alerting us to this bill. **Non-attorney representatives have relied upon the legislative intent expressed in subsec. (i)(3) as support for their continued ability to represent parties in California arbitrations, even after* Birbrower. *That provision reads: "… it is the Legislature's intent that nothing in this section is intended to expand or restrict the ability of a party prior to the decision in* Birbrower *to elect to be represented by any person in a nonjudicial arbitration proceeding, to the extent those rights or abilities existed prior to that decision. To the extent that* Birbrower *is interpreted to expand or restrict that right or ability pursuant to the laws of this state, it is hereby abrogated except as specifically provided in this section." NASD's recent proposal to limit representation in its forum to pro se and attorney representation would presumably trump any allowance §1282.4 makes for non-attorney representatives who practice in NASD arbitrations*.) (SAC Ref. No. 2005-08-03)

"AWARD" DEFINED BY SEVENTH CIRCUIT: ***In a decision rendered in early February, the Seventh Circuit deemed an Order of the Arbitrators, dismissing one of multiple Respondents from an ongoing NASD Arbitration, to be a final Award, for purposes of Sections 10 and 12 of the FAA.*** The Federal Arbitration Act provides for limited judicial review of an arbitration Award, if application is made within "three months after the award is filed or delivered." In the arbitration (#98-02467) initiated by Lawrence Olson, Mr. Olson named Wexford Clearing Services as a Respondent and Wexford won a pre-hearing dismissal (see SAA 2002-19). Unfortunately, the Panel's decision was not in the traditional Award format, but was drafted as an Order. It was signed only by the Chair and contained "Other Rulings" besides the dismissal that pertained to the remaining parties in the case. More than four months passed before Mr. Olson launched a vacatur attempt challenging the dismissal of Wexford and that, the District Court ruled, went beyond the three-month time limit. On appeal, the Seventh Circuit affirmed (*Olson v. Wexford*

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Clrg., No. 03-1223 (2/3/05)), in an Opinion where the pivotal inquiry was whether the Order was an Award. The Court acknowledged that the Order did not conform with all of the requirements for an "Award" that are contained in NASD Rule 10330, but it did contain a final disposition between Wexford and the Claimant. While it was a partial Award, it was a final disposition. Thus, the time to move for vacatur began to run with the document's delivery and the action is time-barred. *(ed: The SROs and SICA have long ignored the reality that partial Awards should receive the same treatment as those issued at the termination of the hearings, meaning inclusion on the Arbitrator Disclosure Sheets and public availability through the SRO Public Awards Program. We understand that the NASD has changed tack and began issuing a "true" Award in the event of a full disposition of the claims against one of multiple Respondents. For administrative purposes, we are told, it then issues a new Docket Number to cover the ongoing proceeding against the remaining parties and if there is a subsequent Award after hearing, that Award will bear the new Docket Number. Partial Awards through pre-hearing dismissals are not frequent in occurrence, but they are important to parties and to those who want to review an Arbitrator's record. This authoritative ruling should make the SROs seek a uniform approach to making these "Awards" publicly available.)* (SAC Ref. No. 2005-07-01)

WORLDCOM SETTLEMENTS & RELATED ARBITRATIONS: ***The media has been filled during the past few weeks with news of settlements totaling more than $6 billion in the WorldCom class action (losses are estimated at more than $30 billion); an interesting offshoot of these settlements, if approved, will be their influence on pending and recently decided WorldCom arbitration Awards.*** SAC's sister publication, the *Securities Litigation Commentator*, has been following developments in this huge class action from the Court's first decision in the case. The recently announced settlements by the Underwriters and others have yet to be approved, but, in February, the trial Court was asked to deal with some related arbitrations on an Order to Show Cause basis. In the named arbitration proceedings, the Claimant-investors chose arbitration but evidently failed to opt out of an earlier settlement in this action. As a consequence, Dale D. Wheeler must respond to a letter application made by "the Citigroup Defendants" (Salomon Smith Barney, Jack Grubman and Citigroup) as to "why he should not be enjoined from pursuing his NASD arbitration claim against the Citigroup Defendants." The Court also instructed the "Citigroup Defendants and all other interested parties" to prepare "procedures for dealing with similar issues which may arise regarding [related] arbitrations." The Citigroup Defendants agreed to pay $2.6 billion to settle the WorldCom claims, which the trial Court approved. That approval was followed by an opt-out period and the opt-out deadline ended last September. Former Citigroup brokers Philip L. Spartis and Amy J. Elias were the subject of more than $450,000 in damage awards ordered by a Louisville, KY Panel in a recent WorldCom case (*Rich v. SSB*, NASD ID #02-03627 (1/20/05)). On February 2, 2005, the two brokers applied to the WorldCom Court for injunctive relief and the Court responded on February 9 with an Order to Show Cause why the Claimants, Elizabeth and Donald Rich, "should not be enjoined from enforcing their NASD arbitration award against Mr. Spartis and Ms. Elias." (*EIC: As a tactical matter, Claimants with WorldCom-related arbitration matters pending will have some choices to make, as new opt-out periods will soon be underway regarding the WorldCom underwriters (other than SSB). Some Claimant's lawyers may assume that their client's claims are not covered by the WorldCom settlement release, but class action releases are often very broad, even broader frequently than the claims in the original class action Complaint. Limited partnership veterans will recall the bar that prevented some brokers from pursuing claims against their former employer for ruined customer books or Form U5s, because they, as class members in the limited partnership class actions, released all claims relating to those limited partnerships. See, e.g.,* Prudential Securities Limited Partnership Litigation *(*PSI v. Nilson*, 9 SAC 3(12)*.) (SAC Ref. No. 2005-11-04)

NYSE PROPOSES DISCOVERY ENFORCEMENT POWER: ***In a rule filing that will amend NYSE Rule 619 on discovery, the Exchange proposes to "clarify" that a member or associated person violates just and equitable principles of trade when it does not appear or produce documents as directed under the arbitration rules.*** The rule filing, SR-NYSE-2005-18, dtd. 2/16/05, recites the current provisions of Rule 619, pointing out that the procedures for document production and appearances are specific and defined, with timetables for proceeding. The Rule also contemplates the involvement of the arbitrators in the discovery process through pre-hearing conferences or by assignment of a discovery matter to a "select arbitrator" upon party request. The filing states Exchange awareness of situations where noncompliance by members or associated persons of their discovery obligations has been alleged. Amendments are proposed to Rule 619 that will "make clear that it may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 476(a)(6) for a member, allied member, member organization, or associate person thereof to fail to appear or fail to produce any document in their possession or control as directed pursuant to provisions of the NYSE Arbitration Rules." This specific authority, the Exchange maintains, will enable it to "improve the efficacy of the arbitration process;" moreover, the changes are consistent with procedures in NASD Rule IM-10100, previously approved by the Commission. (SAC Ref. No. 2005-09-03)

SEC APPROVES CHANGES TO NYSE DOA REPORTING AND POWERS: ***This proposal (SR-NYSE 2004-31; SAA 2004-44) approves amendments to NYSE Rules 633, 634 and 635 relating to the administration of the Exchange's arbitration program; two amendments were adopted as part of the approval announcement (SEC Rel. 34-51273, dtd. 2/26/05).*** Under

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the new provisions the Chief Regulatory Officer (CRO) of the Exchange will have the power to designate the Director of Arbitration (DOA) and the Director will be authorized to appoint the pool of 2,000-3,000 non-securities and securities individuals who serve as NYSE Arbitrators. The DOA will also appoint the Board of Arbitration, which is the body of Arbitrators from which member-member Panels are selected. One comment letter was received from Robert S. Clemente, who was the NYSE Director for twelve years and worked for 18 years in the Department. Mr. Clemente indicates that he currently practices in both NYSE and NASD arbitrations and he contends, in his letter, that NYSE should separate itself and its management from the process of appointing arbitrators. Designation of the DOA, he recommends, should be subject to the approval of the NYSE Regulatory Oversight Committee. Moreover, delegation of the appointment function to the DOA is inadvisable. While the text of proposed Rule 635 does not specifically indicate that the Board would review the CRO's designation, the Commission writes that the CRO's power of "appointment is subject to the oversight of the Regulatory Oversight Committee as a function of the Exchange's routine corporate governance structure. Therefore, we believe the proposal sufficiently addresses the commenter's concerns." (SAC Ref. No. 2005-10-04) *(EIC: By way of disclosure, Mr. Clemente is a member of SAC's Board of Editors.)*

NASD STATS, 2/05: ***New case filings were down 16% in January from the year-end earlier month and in February that shortfall widened to 23%. There were 465 submissions received in February and 485 received in January, marking the first time since 2000 that filings have failed to exceed 500 for two months in a row.*** Even during the 90s, when the market moved upwards year after year, NASD arbitration case filings declined in annual volume only twice and those were not consecutive years. NASD new-case statistics were down 8% in 2004 from a record high of 8,945 in 2003. If they decline further this year, it will be the first time that has happened in 15 years. NASD began 2005 with a pending case docket of approximately 11,500, so the frantic activity that has characterized securities arbitration and mediation for the past few years is unlikely to subside over the next 12-15 months. Indeed, the pace quickens, as NASD continues to set a pace on the close-out side that could lead to 10,000 cases coming off the docket in 2005. If that occurs, and only 6-7,000 new cases are commenced, average turnaround time for disposing of cases should decline gradually to a level below 12 months. Right now, the overall average is 14.9 months, which compares favorably to 2004's overall average of 15.4 months, but decided cases are still growing in length and now stand at almost 18 months on average (17.8). While we might expect, as the flurry of new cases subsides somewhat, that settlement rates will begin to moderate, they continue very high for now. More than 55% of the closed cases were resolved by settlement, either directly between the parties (44%) or by mediation (11%), plus another 9% were withdrawn (some, no doubt, due to settlements), and another 14% were terminated by "other" means (including "Stipulated Awards," a settlement route still much used in cases filed before April 2004). At the same time that 70-75% of the cases are settling, decided cases are producing award amounts totaling $15-$18 million per month. NASD is claiming a heightened overall "win" rate for customers among the 2005 Awards of 57% and an even higher "win" rate for customers who submit their small claims cases for decision "on the papers." Historically, a high settlement rate tends to place downward pressure on the "win" rate, since fewer meritorious cases proceed to hearing; that does not seem to be the case at the moment. (SAC Ref. No. 2005-11-01)

PCX PROPOSAL ADDS HEARING VENUE SURCHARGE: ***The Pacific Exchange, which operates primarily in California, is proposing to amend its arbitration rules to include a new fee that will be applicable to "Holders" to cover the costs of arranging for an "off-site venue."*** Holders in the proposed change to PCX Rule 12.31 and PCXE Rule 12.32 are defined to include OTP Holders, ETP Holders and OTP Firms. The Holders named in the arbitration proceeding will bear the entire fee for such arrangements in the form of a surcharge. The Exchange explains in the "Purpose statement" of rule filing SR-PCX-2005-14 (dtd. 2/1/05): "Currently arbitration hearings at the PCX are held in conference rooms within the PCX corporate headquarters" and that does not work well for either the parties (confidentiality) or the PCX staff (security). "Therefore, the Exchange believes an off-site hearing venue, which would provide an appropriate and confidential environment for the arbitration parties, would be in the best interest of the arbitration parties as well as the Exchange." If multiple Holders are named in the case, then the Arbitrators will allocate the surcharge to the appropriate Holder or Holders. If associated persons are named, the Holder with whom s/he was associated at the time, even if a non-party, will be assessed the surcharge, according to the "Purpose statement." Two subsequent amendments on February 23 and March 8, 2005 clarified that intent in the Rule's text. The revised proposal was approved for immediate effectiveness by the Commission in SEC Rel. No. 34-51369. (SAC Ref. No. 2005-11-03)

LAW SCHOOL CLINICS MEET AT FORDHAM: ***Grants of $200,000 apiece to law schools around the State have funded securities arbitration clinics at most New York law schools and will now lead to the creation of a new organization.*** Some programs, such as those at Fordham Law, Brooklyn Law, Pace Law and Buffalo Law, began on their own, encouraged originally by then-SEC Chair Arthur Levitt. More recently, funding has come from the New York Attorney General's Office, which arranged the grants as part of settlements with securities violators (see, e.g., SAA 2004-09). Albany Law, New York Law, St. John's Law, Syracuse Law and Cardozo Law now have programs. On February 25, 2005, the Securities Arbitration Clinic (SAC??) at Fordham University School of Law sponsored a day-long Roundtable attended by directors of clinics at ten Law

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Schools (Northwestern University School of Law was the tenth). Representatives from the Attorney General's Office, NASD, NYSE, and SICA attended as well. Planned and organized by Romaine L. Gardner, Director of the Fordham Clinic, the Roundtable discussions included reports from Clinic representatives regarding their activities during the past year in teaching and supervising students who represent small investors in securities arbitration. These selected investors claim losses caused by their brokers, but they are unable to afford an attorney to represent them. Among the arbitration issues discussed by the group were the virtues and failings of the NASD Discovery Guide, the need for more effective arbitrator training, the retention of expert witnesses, and the appropriate criteria for vetting potential clients. Clinic problems, such as staffing during the summer months and financing the programs, also drew discussion. Attendees voted to form an informal association, tentatively called National Association of Securities Mediation and Arbitration Clinics ("NASMAC"), whose purpose will be to foster effective cooperation among the Clinics and to seek financial resources to support the Clinics. This latter objective will take on greater importance as the NYAG grant funding is exhausted. *(EIC: A recent article in the* New York Law Journal, "Legal Clinics Set to Bloom on 3 Campuses," *by Thomas Adcock (online ed., 2/25/05), reports on the formation of the new Clinics, the people they represent, and the nature of some of the claims.)* (SAC Ref. No. 2005-09-04)

SHORT BRIEFS:

NEW SECURITIES ARBITRATION CLINIC: Northwestern's program has been recently funded with a grant from the NASD. Its Investor Education Foundation recently gave away more than $1 million in First Grant Awards to 11 organizations for new educational programs and research projects. On the list in the NASD Press Release was a grant of $120,000 to: "Northwestern University's Bluhm Legal Clinic for the *Investor Protection Clinic*, which will establish the first securities arbitration clinic in the Midwest to provide legal representation for small investors, and develop a model securities arbitration clinic that can be easily replicated at other law schools throughout the nation." (SAC Ref. No. 2005-10-03)

AMEX ARBITRATION: In case you were wondering (we were), the recent buyback by ASE members of the American Stock Exchange from NASD will not affect the assignment by the ASE of its arbitration program to NASD-DR. (SAC Ref. No. 2005-10-07)

RANDOM SELECTION APPROVED FOR NASD: The Commission really likes this Rule change; it approved it twice. We reported in SAA 2005-05 that the SEC granted accelerated approval to this NASD proposal (SR-NASD-2005-164), which allows the forum to transform its Neutral List Selection System from a rotational basis to a random selection protocol. Of course, even with accelerated approval, a comment period follows, and, in this case, there were four commenters: Les Greenberg, Arnold Levine, Philip Zimmerman, and Irwin Sugerman. We have not seen this before, but evidently the Commission felt obliged to acknowledge the comments in a new approval Release. SEC Rel. 34-51339 (dtd. 3/9/05) summarizes these comments in a single paragraph and again announces approval of the change to NASD Rule 10308 (70 Fed. Reg. 49, p. 12763, dtd. 3/15/05). (SAC Ref. No. 2005-11-05)

NASD OFFERING LONDON HEARINGS: For some reason, this seemingly straightforward rule proposal (SR-NASD-2004-42) took more than a year to approve. We described the proposal in SAA 2004-11 and reported SEC's approval in SAA 2005-10 when SEC Rel. No. 34-51324 issued (3/7/05). The announcement appeared in the March 11 Federal Register (70 Fed. Reg. 47, p. 12257). The rule change to NASD Rule 10315 actually describes a more generalized foreign hearing location handling process; London is simply the first situs to be established. (SAC Ref. Nos. 2005-10-06, 2005-11-06)

NASD MEDIATORS AS ARBITRATORS: Under the new NASD classification rules adopted by NASD and made effective last summer (SAA 2004-27), the undefined term "professional" has pivotal importance in determining whether certain arbitrators are classified as "non-public" or "public." If mediators are "professionals" and, as mediators, they exert approximately half (more than 20% is the real cutoff) of their work effort on behalf of industry parties, they ought, arguably, to be classified as "non-public" when they serve as arbitrators. This required a rule change, NASD explains in its rule filing, because such a broad interpretation of the term "professional" was not intended. Service as a mediator and the fees earned are not to be included in the classification equation, the SEC agreed last week (SAA 2005-10); the approval release was published in the Federal Register (70 Fed. Reg. 48, p. 12523 (3/14/05)). *(EIC: Will we need a rule filing for expert witnesses? They are professionals who serve both sides and, despite the "hired gun" moniker, comment as neutral observers.)* (SAC Ref. No. 2005-11-07)

SANCTIONS AGAINST ATTORNEYS: That NASD has withdrawn its proposal to empower arbitrators with Rule 11-like sanctioning authority does not mean an end to caution for practitioners. We recently came across NASD ID #99-00144 in SAC's Sanctions Award Package, in which attorneys for the broker-dealer were hit with a monetary fine by the Panel of $100,000 for "deliberately and negligently" abusing the arbitration process. (SAC Ref. No. 2005-10)

PCX RULE APPROVED: The Pacific Exchange has received SEC approval of a proposal similar to that adopted by the NASD to compensate arbitrators for late adjournments. This Rule, amending PCX Rule 12.6 and PCXE Rule 12.7, provides for assessment of a $100 per-arbitrator fee, when an adjournment request is made within three business days of a scheduled hearing session. (SR-PCX-2004-124; 70 Fed. Reg. 44, p. 11304, dtd. 3/8/05). (SAC Ref. No. 2005-10-06)

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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Congress Lacks Will to Fix Arbitration Process, Investor Advocate Says, by Joe Hutnyan, SECURITIES WEEK, Vol. 32, No. 13, 3/28/05 (the public hearing in the House of Representatives on securities arbitration will not result "in any significant changes" in the arbitration system, according to former Indiana Securities Commissioner).

Court: NASD Arbitration Rules Trump California's Rules, by Lynn Cowan, WALL ST. JRNL. (on-line ed., 3/2/05)(reporting about the 9th Circuit's ruling in CSFB v. Grunwald).

Good Message, But No Audience, by Mark McNair, SECURITIES SLEUTH (on-line ed., 3/23/05)(Congressional hearing regarding securities arbitration held by subcommittee of the House Committee on Financial Services was attended by fewer than five members of the subcommittee).

Law Makers Are Asked to Abolish Wall Street's Slot in Arbitrations, by Susanne Craig, WALL ST. JRNL. (on-line ed., 3/17/05)(PIABA is calling on lawmakers to abolish the slot given to Wall Street on arbitration panels).

Legal Clinics Set To Bloom On 3 Campuses, by Thomas Adcock, NY L. JRNL. (on-line ed., 2/25/05)(New York Law School and St. John's University School of Law establish securities arbitration clinics to help small investors reclaim losses due to broker misconduct).

Markets Score in Fight Against California Arbitrator Standards, by Staff Reporters, ADRWORLD.COM (on-line ed., 3/4/05)(in CSFB v. Grunwald, the 9th Circuit rules that the CA Standards are preempted by the '34 Act).

Merrill Ordered to Pay 2 Clients Over Analyst Conflicts on Stocks, by Jed Horowitz, WALL ST. JRNL. (on-line ed., 3/1/05)(an NASD panel orders Merrill Lynch to pay a Florida couple more than $1 million [including a punitive damage award of $300,000] for failing to disclose that its analysts had conflicts of interest in recommending stocks (NASD #03-06176, Boca Raton, FL, 2/17/05)).

NY Court Says SRO Arbitration Contracts May Be Superceded, by Justin Kelly, ADRWORLD.COM (on-line, 2/16/05)(in CSFB v. Pitofsky, New York's highest court said brokerage firms are free to establish ADR procedures that supercede the arbitration provision contained in a Form U-4).

Officials Clash Over Wall Street's Arbitration System, by Siobhan Hughes, WALL ST. JRNL. (on-line ed., 3/17/05)(fairness of securities arbitration reviewed by House panel).

President Bush's Uncle Loses Securities Arbitration Case, by Lynn Cowan, WALL ST. JRNL. (on-line ed., 3/8/05)(a NASD arbitration panel awards $630,000 to former clients of money manager Jonathan J. Bush).

Proponents Defend Arbitration System Against Bias Criticism at House Hearing, by Richard Hill, SEC. REG. & L. REP., Vol. 37, No. 12 (on-line ed., 3/21/05)(in a debate before the House subcommittee on 3/17/05, proponents of securities industry arbitration touted the current system as an "efficient and cost-effective alternative to court," while critics claim bias in favor of the securities industry).

Rough Justice: Wall Street Panels For Settling Fights Draw Renewed Fire, by Susanne Craig, WALL ST. JRNL. (on-line ed., 3/17/05) (discussing, *inter alia*, the possible pitfalls inherent in the classification of "public" arbitrators).

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7Analyst and Broker-Dealer Liability Under 10(b) For Biased Stock Recommendations, by Ann Morales Olazábal, NYU JRNL. OF L. & BUS., Vol. 1, No. 1, Fall 2004, p. 1.

Arbitration Clauses Should Be Enforced According to Their Terms-Except When They Shouldn't Be: The Ninth Circuit Limits Parties' Ability to Contract for Standards of Review of Arbitration Awards, by Jonathan R. Bunch, JRNL. OF DISP. RES., Vol. 2004, No. 2, p. 461.

Arbitration: Governance Benefits and Enforcement Costs, by Keith N. Hylton, NOTRE DAME L. REV., Vol. 80, No. 2, Jan. 2005, p. 489.

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Welcome to the Jungle: Rethinking the Amount in Controversy in a Petition to Vacate an Arbitration Award Under the Federal Arbitration Act, by Christopher L. Frost, PEPPERDINE L. REV., Vol. 32, No. 2, Jan. 2005, p. 227.

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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: *Pursuant to NASD Rule 10301(a), a brokerage firm that has ceased operating and is no longer a member of the NASD can only arbitrate a dispute with a customer if the customer consents to the arbitration.* PROVENCIO V. WMA SECURITIES, INC. **(CA App.)**

AWARD CHALLENGE: *Arbitration Panel did not exceed its authority by awarding attorneys' fees and costs where the parties directly or indirectly, through signing NYSE Uniform Submission Agreement, submitted the issue to the Panel for decision.* LORELLI V. FIRST UNION SECURITIES, INC. **(NC App.)**

AWARD CHALLENGE: *Decisions on evidentiary matters fall within the broad discretion of the arbitrators.* NATIONAL CLEARING CORP. V. TREFF **(E.D. PA)**

CLASS ACTIONS, EFFECT OF: *Settling defendants can obtain injunctive relief to prevent the assertion, in another forum, of claims included in the settlement order.* WORLDCOM, INC. SECURITIES LITIGATION, IN RE (ROBERTS, ENTENMANN & GALITZER ARBITRATIONS) **(S.D. NY)**

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COMPETING AGREEMENTS: *A subsequent agreement to arbitrate in a non-SRO arbitration forum trumps an earlier-executed Form U4 arbitration undertaking, but only if the exceptions stated in the later contract do not exempt the U4 requirement.* CREDIT SUISSE FIRST BOSTON V. PITOFSKY **(NY)**

DEFINING AWARDS: *A Prehearing Conference Order granting a motion to dismiss can constitute a final award and start the 3-month period running in which to file a petition to vacate under the FAA.* OLSON V. WEXFORD CLEARING SERVICES CORP. **(7th Cir.)**

DEFINING AWARDS: *An arbitral award is final if it finally resolves a separate claim, or the liability of a particular party, even if other claims or other parties remain before the arbitrators.* OLSON V. WEXFORD CLEARING SERVICES CORP. **(N.D. IL)**

ENFORCEABILITY: *A written agreement to arbitrate between a clearing broker and a customer is enforceable as to the introducing broker.* PERELMAN V. FRIEDMAN BILLINGS RAMSEY & CO., INC. **(E.D. PA)**

FRAUDULENT INDUCEMENT: *Fraud in the inducement of an arbitration provision cannot be proven by parol evidence that directly contradicts the terms of the written agreement.* GLAZER V. LEHMAN BROTHERS, INC. **(6th Cir.)**

RATIONALE OF AWARD: *Arbitration award vacated and case remanded for further proceedings, where explanation given in Award indicated that panel refused to consider applicable state law governing payment of wages.* McCARTHY V. CITIGROUP GLOBAL MARKETS, INC. **(D. NH**)

RE-LITIGATION ISSUES: *The New York law of collateral estoppel employs a two-part test: a party is estopped from relitigating an issue when that issue was necessary to the resolution of the prior action, and the party against whom estoppel is invoked had a full and fair opportunity to contest that issue in the previous litigation.* PENNECOM B.V. V. MERRILL LYNCH & CO. INC. **(2nd Cir.)**

SANCTIONS: *Arbitration Awards can reveal a pattern of bad conduct that leads to regulatory actions, extreme personal liability, and even criminal sanctions against those responsible for victimizing the arbitration claimants.* USA V. TACHER **(2nd Cir.)**

UNCONSCIONABILITY: *Absent a real business purpose, an arbitration agreement that is signed as a condition of employment and that makes certain disputes excludable, at the employer's option, will be deemed unconscionable under Pennsylvania law.* ZIMMER V. COOPERNEFF ADVISORS, INC. **(E.D. PA)**

VACATUR OF AWARD: *Under the circumstances, an arbitration Panel's refusal to grant an extension of time to replace a disqualified expert amounted to misconduct, justifying vacatur.* WILDE V. O'LEARY, GURIEN & ZACHARY JACKSON SECURITIES, LP **(NJ App. Div.)**

Cases

Credit Suisse First Boston v. Pitofsky, No. 4 (N.Y. Ct. of App., 2/10/05). **Forum Selection * Forum of Choice * Form U-4 * Competing Agreements * SRO Rules (NYSE Rule 347) * Arbitration Agreement * Enforceability (Public Policy; Illegality) * Statutory Definitions ("Legal Requirement").** *A subsequent agreement to arbitrate in a non-SRO arbitration forum trumps an earlier-executed Form U4 arbitration undertaking, but only if the exceptions stated in the later contract do not exempt the U4 requirement.*

Two former employees of CSFB are Respondents in this case, Messrs. Pitofsky and Santorro. Both signed Form U4s upon being hired, agreeing to arbitrate under the rules of the NYSE and other SROs, if a future dispute should arise. Both also signed later employment agreements in which they adopted the terms of CSFB's internal Employment Dispute Resolution Program. The two agreements are in potential tension, however, in that the Form U4 calls for SRO arbitration and the EDRP calls for arbitration (in the event internal grievance and mediation procedures fail) before AAA, JAMS or the CPR Institute's rules. While the EDRP agreement is drafted to be exclusive and broad, it contains a "carve-out" provision which permits arbitration at an alternative forum, if "a registered representative is subject to a legal requirement that he or she arbitrate … in a particular forum." When, as ex-employees, the pair sought arbitration of compensation claims, CSFB moved to stay the NYSE proceeding. It argued that the carve-out did not apply here and that the EDRP, as a later agreement, superseded the Form U4 undertakings. The trial court agreed with CSFB, but the Appellate Division reversed, ruling both that the carve-out

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provision applied and that as a matter of state law, "'employment agreements cannot supersede the previously executed Form U-4 agreements between' registered representatives and an SRO." The Court of Appeals affirms, but only on one prong of the Appellate Division's holding. This Court "holds that the arbitration provisions of an employment agreement between a broker-dealer and a registered representative may be superseded by an earlier arbitration agreement between the registered representative and a stock exchange." This case simply presents a modification of an existing agreement by a subsequent superseding agreement. Contract law permits parties to modify and even supplant earlier undertakings by mutual agreement. That the original agreement happened to be between the SRO (not CSFB) and the registered representative does not change this view, because the terms of the agreement created obligations that flowed from the employees to CSFB. Turning to the carve-out provision, though, the Court finds it applicable and deems NYSE Rule 347 a "legal requirement" that excepts this dispute from the EDRP contractual obligations. Rule 347 contains the predicate phrase, "at the instance of any such party," CSFB argues, and that makes the "requirement" conditional. The Court responds: "That the parties could, in theory, agree to modify their obligation to arbitrate before the NYSE pursuant to Rule 347 does not make the rule any less of a 'legal requirement.'" *(EIC: *Precedent enforcing the EDRP over the Form U4 can be found in New York federal court (*CSFB v. Groves (SLA 2004-39) *and* CSFB v. Padilla [Gonzalez](SLA 2004-29)); *the Court expressly disagrees with these rulings in this Opinion, however, and its views on contract construction will likely bind future federal court decisions on this issue. **While both sides claimed victory in the press, we don't see it. Even if drafters of the EDRP agreement were to delete the "legal requirement" carve-out, which this Court says they are free to do, Rule 347 would continue to have its "legal" effect and courts will not enforce agreements that require "illegal" conduct.)* (SLC Ref. No. 2005-08-06)

Glazer v. Lehman Brothers, Inc., No. 03-4312 (6th Cir., 1/12/05). **Arbitration * Arbitrability * FAA (§§ 2, 4) * Enforceability (Fraudulent Inducement) * Contractual Issues (Voidable) * State Law, Applicability of * Evidentiary Standards (Admisibility); Parol Evidence Rule.** *Fraud in the inducement of an arbitration provision cannot be proven by parol evidence that directly contradicts the terms of the written agreement.*

Defendant securities firms appeal from a Federal District Court ruling denying a motion to stay pending arbitration, holding that arbitration provisions were fraudulently induced. Plaintiff customer testified that broker Gruttadauria represented to him that the arbitration provisions contained in the Account Agreements would not be enforced against him. The Court of Appeals finds two errors in the District Court's decision and holds that the motion to stay should have been granted. First, the District Court erred by considering the arbitration clauses as "separate, independent contracts" and analyzing the admissibility of parol evidence based upon that construction. Instead, and in accordance with the Supreme Court's ruling in *Prima Paint* (388 U.S. 395), arbitration agreements contained in larger contracts should be considered "separate" from the contract only insofar as the Federal Court, as opposed to the arbitrator, may examine whether the arbitration clause itself was fraudulently induced or is otherwise unenforceable. Second, the District Court erred in deciding that, under Ohio law, the parol evidence rule did not bar the customer's testimony of the broker's false promise, which was relied upon to show fraudulent inducement. The parole evidence rule does not prohibit a party from introducing parol or extrinsic evidence for the purpose of proving fraudulent inducement. However, under Ohio law, unless the false promise is either independent of or consistent with the written instrument, evidence thereof is inadmissible. In this case, the false promise was not only within the scope of the subject matter of the Account Agreement, it was directly contradicted by the broad arbitration clause contained in the Agreement. Because the customer's inadmissible testimony was the only evidence offered to show fraudulent inducement of the arbitration clause, the motion to stay pending arbitration should have been granted. *(J. Ballard)* (SLC Ref. No. 2005-05-01)

Lorelli v. First Union Securities, Inc., No. COA04-116 (N.C. App., 2/1/05). **FAA(§10) * Award Challenge (Exceeds Powers) * Attorney Fees * Scope of Agreement * Confirmation of Award * Arbitrator Authority, Scope of * State Law, Applicability of.** *Arbitration Panel did not exceed its authority by awarding attorneys' fees and costs where the parties directly or indirectly, through signing NYSE Uniform Submission Agreement, submitted the issue to the Panel for decision.*

First Union appeals following an arbitration award to former employee Lorelli, contending that arbitration panel lacked authority to award attorneys' fees. Lorelli sued for wrongful termination, various contractual claims and defamation based on his Form U-5, which stated the reason for termination as violations of firm policy and industry standards of conduct. By executing a Uniform Submission Agreement, both parties agreed to arbitrate the matter in accordance with the Constitution, By-Laws, Rules, Regulations and/or Code of Arbitration Procedure of the NYSE. Following a hearing, the Arbitration Panel ordered that Lorelli's Form U-5 be expunged from the Central Registration Depository and awarded him $196,911 in attorneys' fees and $26,715 in expenses. The Award, NYSE ID #2001-008918 (Charlotte, 5/20/03), was confirmed by the Superior Court. The arbitration dispute involves a contract affecting interstate commerce that is governed by the Federal Arbitration Act (FAA). Judicial review is severely limited to encourage use of arbitration and to avoid expensive and lengthy litigation. Lorelli submits three bases

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for his attorney fee award: (1) Rules of the NYSE; (2) the parties agreed to submit the issue to the Arbitration Panel; and (3) First Union's conduct in destroying documents and failure to timely produce documents. The Court of Appeals relies on the first two grounds in affirming the Superior Court's decision, without reaching the issue of discovery abuse. The Uniform Submission Agreement is binding as a contract, which defines the intent of the parties and the scope of the arbitrators' powers. NYSE Rule 629 provides that the panel may determine in its award both the forum fees and costs incurred and, unless applicable law directs otherwise, the costs and expenses of the parties, which has been interpreted by the First Circuit Court of Appeals and other state courts to include attorneys' fees. First Union's argument that North Carolina law does not allow a prevailing party attorneys' fees on a defamation claim is rejected in that both sides requested attorneys' fees. The arbitration agreement did not specify that North Carolina law would apply to the contract, nor should state law be construed to limit the authority of arbitrators. *(S. Anderson)* (SLC Ref. No. 2005-07-02)

McCarthy v. CitiGroup Global Markets, Inc., No. 04-477-JD (D. N.H., 1/28/05). **Appealability * Award Challenge (Disregard of Governing Law) * Federal Arbitration Act * State Statutes Interpreted (N.H. RSA § 275:42, et seq.) * Vacatur of Award * Manifest Disregard of Law * Rationale of Award * Remand to Arbitrators.** *Arbitration award vacated and case remanded for further proceedings, where explanation given in Award indicated that panel refused to consider applicable state law governing payment of wages.*

Claimant, former financial consultant, filed suit in Federal District Court and sought to vacate award in favor of former employer on his claim for violation of New Hampshire's wage laws. Respondent CitiGroup had for many years offered a "CAP" incentive program, permitting employees to designate a portion of their compensation to be used to buy restricted stock at a discounted price. In exchange, the employees agreed in writing that the stock would not vest until two years after the purchase, and only if they were still employed at CitiGroup. Claimant left his employment before some of his restricted shares had vested, and thereby forfeited those shares and the compensation used to purchase them. Claimant produced evidence of the New Hampshire wage laws in written motions and at the hearing. Those laws: (i) provide that incentive programs are compensation; (ii) restrict deductions that may be made from an employee's compensation to certain listed categories; and (iii) prohibit waiver of the wage laws by private agreement. *New Hampshire RSA § 275:42, et seq.* The arbitration panel denied Claimant's request for damages, and provided a legal explanation for its decision in the Award. ("New Hampshire wage law … [was] irrelevant because … case [was] a contract dispute regarding an incentive compensation plan commonly used at the firm and commonly used in the industry.") The District Court examines the Award and concludes that it conveys a manifest disregard for the New Hampshire statute. The panel set aside the governing law, the Court finds, because, given the fact that such plans are common in the securities industry, they felt it was more equitable to do so. The District Court concluded that this was one of the "exceedingly rare" cases where an arbitration decision was based on a manifest disregard of the govern-

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ing law, and vacated the award. The case is remanded to NASD for further proceedings. *(J. Ballard: The Arbitrators' inclusion of a statement in the award explaining the legal basis for their decision undoubtedly was helpful to Claimant in obtaining vacatur.)* (SLC Ref. No. 2005-08-03)

National Clearing Corp. v. Treff, No. 04-CV-4765, 2005 WL 67075 (E.D. Pa., 1/10/05). **Award Challenge (Irrationality; Public Policy) * Confirmation of Award * Modification of Award * FAA (§º10 "Exceeding Powers") * Manifest Disregard of Law * Irrationality * Evidentiary Standards * Statutory Definitions ("Award").** *Decisions on evidentiary matters fall within the broad discretion of the arbitrators.*

At the underlying arbitration hearing, National Clearing Corp. ("NCC") presented evidence that Treff, the customer, was not who he represented himself to be and that he was in reality one Thomas Morin. Treff/Morin had been convicted of grand theft in Florida in 1986 and he had been using a variety of Social Security numbers belonging to other persons on numerous occasions, including during the pendency of the arbitration proceedings themselves and on his account application with NCC's predecessor, J.B.ºOxford. Despite this evidence, the arbitration panel entered an award in Treff's favor for compensatory damages of $154,000. NCC moved to vacate the award (i) on the grounds that the arbitrators imperfectly executed their powers, (ii) because the award did not meet the test of fundamental rationality, and (iii) because it compels violation of the law and, therefore, was contrary to public policy. In denying the motion to vacate, the Court recognizes that there are additional nonstatutory bases upon which to vacate an arbitration award above and beyond the four circumstances set forth in §º10(a) of the FAA. An arbitration award may be set aside if it displays a manifest disregard of the law, if it fails to meet the test of fundamental rationality, if it is contrary to public policy or where the contracting parties agree to vacatur standards different from those set forth in the FAA. Here, while the Court did agree that Treff's identity and use of numerous Social Security numbers was indeed "suspect," the Court could not, on the record before it, find that the award violated any well-defined and dominant public policy, that it escaped the bounds of rationality or that the arbitrators imperfectly executed their powers in issuing it. Decisions on evidentiary matters fall within the broad discretion of the arbitrators and it is the arbitrators' province to accept or reject and to weigh the evidence concerning Treff's identity and credibility. *(W. Nelson)* (SLC Ref. No. 2005-08-04)

Olson v. Wexford Clearing Services Corp., No. 03-1223 (7th Cir., 2/03/05). **Award Challenge (Arbitrator Misconduct) * Clearing Broker Liability * FAA (§§10, 12) * FRCP (Rule 60(b)) * SRO Rules (NASD Rule 10330) * Timeliness Issues * Statutory Definitions ("Award").** *A Prehearing Conference Order granting a motion to dismiss can constitute a final award and start the 3-month period running in which to file a petition to vacate under the FAA.*

Plaintiff filed a statement of claim with the NASD naming Wexford and other respondents. Wexford filed a motion to dismiss, which the panel granted. The arbitration continued against the other respondents. Plaintiff subsequently filed a motion to amend the statement of claim, which the panel denied. Plaintiff then turned to the district court, filing a petition to vacate under the FAA. Plaintiff filed his petition less than 3 months after the panel denied his motion to amend, but more than 3 months from the date of the panel's "Prehearing Conference Order" granting Wexford's motion to dismiss. The district court dismissed the petition as untimely since it had not been filed within 3 months after the "award [was] filed or delivered," as required by Section 12 of the FAA. Plaintiff appealed the district court's dismissal, arguing, among other things, that the 3-month deadline under Section 12 of the FAA ran from the date the panel denied his motion to amend, rather than from the date the panel granted Wexford's motion to dismiss. The Seventh Circuit rejects this argument. The Court finds that the "Prehearing Conference Order" was a final "award" under NASD rules since it "leaves nothing further for the arbitration panel to adjudicate between [plaintiff] and Wexford." The Court observes that a litigant who is uncertain whether an arbitration award is final should "err on the side of compliance" and file a timely petition to vacate. As noted, Wexford's motion to dismiss did not involve the other respondents and the arbitration continued against them. The Seventh Circuit states expressly that it is not deciding whether the presence of claims against the other parties rendered the order granting the motion to dismiss non-final, stating that it was reserving that issue "for another day" since plaintiff failed to raise that argument. *(J. Komie) (EIC: Robert P. Bramnik, Duane Morris, Chicago, IL, appeared on behalf of Wexford. Mr. Bramnik also participated in the underlying arbitration on Wexford's behalf (NASD ID #98-02762, Chicago, 4/15/02). The pre-hearing dismissal was the subject of a report in SAC's Arbitration Alert, SAA 02-19. The District Court's Opinion is summarized below by SLC Editor Steven P. Krasner.)* (SLC Ref. No. 2005-08-01)

Olson v. Wexford Clearing Services Corp., No. 02-7644 (N.D. IL, 12/31/02). **Award Challenge * Confirmation of Award * Timeliness Issues * FAA (§§9, 10 and 12) * FRCP (§§12(c) "Judgment on Pleadings"; 12(b)(6) "Failure to State Cause of Action"; 54(b)) * SRO Rules (NASD Rule 10330).** **Pursuant to FAA §12, "[n]otice of a motion to vacate, modify, or correct an award must be served … within three months after the award is filed or delivered." **An involuntary dismissal is with prejudice unless a court or arbitration order specifies otherwise. ***Courts go beyond an arbitration award's form and delve into its substance and impact to determine whether an arbitration decision is final. ****An arbitral award is final if*

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it finally resolves a separate claim, or the liability of a particular party, even if other claims or other parties remain before the arbitrators.

On July 29, 1998, Lawrence W. Olson ("Olson") filed a statement of claim before the NASD naming, among others, R.D. Kushnir & Co. ("RDK") (the brokerage firm for Olson's accounts) and Wexford Clearing Services Corp. ("Wexford") (the clearing firm for Olson's RDK accounts) as respondents. The arbitration proceeding was terminated as to RDK after it was placed into receivership and, thereafter, Wexford moved to dismiss the claims against it. On February 18, 2001, the chairman of the arbitration panel (the "Panel") granted Wexford's motion leaving only a RDK sales manager and the brokerage firm that accepted RDK's transfer of Olson's accounts as respondents. Olson moved for reconsideration of Wexford's dismissal and on April 15, 2002, after the replacement of the Panel chairman and two separate briefing submissions by the parties, the Panel heard oral argument on Wexford's motion to dismiss. By letter dated April 29, 2002, the Panel once again ordered dismissal of Olson's claims against Wexford. On June 21, 2002, Olson filed a motion for leave to file an amended statement of claim, which was denied by the Panel on July 29, 2002. On October 24, 2002, Olson filed a petition to vacate the dismissal of his claims against Wexford alleging the Panel "denied him the opportunity to offer pertinent and material evidence in support of his claims." Wexford claims that Olson's petition is untimely because motions to vacate an arbitration award must be served within three months after the award is filed or delivered (FAA §12). Olson, however, does not dispute that his petition was filed more than three months after his claims against Wexford were dismissed. (It is not clear from the opinion whether Olson refers to the February 18, 2001 dismissal order or the April 29, 2002 dismissal order. Olson's petition was, in either event, filed more than three months after each dismissal date.) Instead, Olson claims the dismissal decision did not become final until the Panel delivered its decision denying his motion for leave to file an amended statement of claim on July 29, 2002, which makes his petition timely. Olson advances several arguments in support of his position, each of which the Court rejects. First, Olson claims the dismissal order was not final because it did not specifically state whether the dismissal was with prejudice. The Court holds that "an involuntary dismissal is with prejudice unless the order specifies otherwise." Next, Olson argues that the dismissal order was not final because, pursuant to NASD Rule 10330, it was not signed by a majority of the arbitrators. The Court holds that "Olson's argument champions form over substance" as the language of the dismissal order makes clear that the chairman signed on behalf of the Panel. The dismissal order is final as it "unambiguously resolves the arbitration in favor of Wexford." Olson, however, also argues that the dismissal order was

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not final because claims against other parties remained undecided. The Court dispenses with this argument by holding "some cases deem an arbitral award final if it finally resolves a separate claim, or the liability of a particular party, even if other claims or other parties remain before the arbitrators." Olson's petition to vacate is dismissed as untimely and the award dismissing Wexford from the arbitration is confirmed. *(Steven P. Krasner, Editor-at-Large and Securities Attorney*) (SLC Ref. No. 2005-08-02)

PenneCom B.V. v. Merrill Lynch & Co. Inc., No. 03-7774, 372 F.3d 488 (2nd Cir., 6/28/04). **Collateral Estoppel/Res Judicata (Arbitration) * FRCP (Rule 12(b)(6) "Claim for Relief"; Rule 59(e) "Amendment of Judgment") * Misrepresentations/ Omissions * Parallel Proceedings * Perjury/Witness Issues * Pleading Requirements/Issues * Punitive Damages * Re-Litigation Issues * Equitable Principles (In Pari Delicto) * International Issues * Remedies (Punitive Damages)**. **The New York law of collateral estoppel employs a two-part test: a party is estopped from relitigating an issue when that issue was necessary to the resolution of the prior action, and the party against whom estoppel is invoked had a full and fair opportunity to contest that issue in the previous litigation. **Since collateral estoppel is an equitable principle, the unclean hands doctrine may defeat its application where a defendant has committed some unconscionable act that is directly related to the subject matter in litigation and has injured the party attempting to invoke the doctrine*.

Prior to commencement of this action, PenneCom B.V. brought an arbitration in London before the International Chamber of Commerce against Elektrim, S.A., a Polish investment banking client of Merrill Lynch, for breach of a stock purchase agreement ("SPA") for the sale of one of PenneCom's subsidiaries. In the arbitration, PenneCom sought specific performance or, in the alternative, $100 million in damages plus punitive damages. PenneCom received an award of approximately $38 million in fees and compensatory damages, which was fully collected. Thereafter, PenneCom commenced this action for $100 million in damages against Merrill Lynch, alleging that Merrill Lynch actively assisted Elektrim's breach of the SPA. PenneCom also asserted that Merrill Lynch, in its evidence before the ICC panel, had falsely minimized the loss caused to PenneCom by Elektrim's breach. The District Court granted Merrill Lynch's motion to dismiss the complaint, by reason of collateral estoppel based upon the arbitration award, and thereafter denied PenneCom's motion to alter or amend the judgment. It held that the arbitration panel necessarily rejected the claim that PenneCom had been injured to any extent beyond $38 million and that PenneCom cannot, therefore, be permitted to relitigate that claim by pursuing claims against Merrill Lynch in the present action. Finding dismissal of the action to be premature, the Court of Appeals vacates the judgments of the District Court and remands for discovery and further proceedings. The arbitrators' finding that PenneCom's loss did not exceed $38 million may have preclusive effect if Merrill Lynch can establish all the requirements of collateral estoppel under applicable New York law. There are two potential differences in this case from the Circuit authority upon which Merrill Lynch relied. First, relating to the second element of collateral estoppel, PenneCom's allegations go to the very heart of whether its damages claims were fully and fairly adjudicated in the earlier proceeding. Second, PenneCom claims that Merrill Lynch devised a fraudulent scheme to dupe the arbitrators, both as to Elektrim's justification for abandoning its contractual commitment and as to the extent of PenneCom's loss. Thus, its claims that Merrill Lynch's allegedly unclean hands should bar Merrill Lynch from asserting collateral estoppel must be seriously considered. With respect to PenneCom's claim for punitive damages, although its complaint does not expressly demand punitive damages, it alleges facts designed to support an award of punitive damages, and on remand PenneCom may seek leave from the District Court to amend its complaint to assert such a claim. To the extent that PenneCom seeks punitive damages, it does not seek to evade or relitigate any matter previously decided by the arbitration panel. Even if the District Court determines after discovery that collateral estoppel bars the claim for compensatory damages, such determination should not necessarily preclude punitive damages against Merrill Lynch. *(C. Asher: Judge Leval's decision provides little insight into the specifics of PenneCom's claim that Merrill Lynch's ICC evidence (no doubt subject to greater cross-examination there than what would have been accorded in a New York court) could somehow have prevented PenneCom from obtaining a presumptively full and fair opportunity to contest the issue of its loss due to Elektrim's breach of contract.)* (SLC Ref. No. 2005-04-01)

Perelman v. Friedman Billings Ramsey & Co., Inc., No. 2:04-cv-00958-LP (E.D. Pa., 12/2/04). **Clearing Broker Issues * Breadth of Agreement * Arbitration Agreement * Non-Signatories to Agreement.** *A written agreement to arbitrate between a clearing broker and a customer is enforceable as to the introducing broker.*

Perelman opened a securities account with FBR, a broker-dealer clearing through Bear Stearns, and he signed an agreement, which included an arbitration clause. Perelman brings this action for failure to execute an order and FBR moves to compel arbitration. Perelman denies an agreement exists between FBR and him, but the Court holds that FBR is a third-party beneficiary of the agreement. "[B]ecause FBR was a third-party beneficiary to the customer agreement between Perelman and Bear Stearns, the arbitration provision of the agreement applies to this dispute." *(P. Hoblin: The Court's time should not be wasted on matters where the law is clear.)* (SLC Ref. No. 2005-07-01)

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Provencio v. WMA Securities, Inc., No. B171724, 2005 Cal. App. LEXIS 55 (Cal. App., 2Dist., 1/14/05). **Scope of Arbitration * SRO Rules (NASD Rule 10301) * Agreement to Arbitrate.** *Pursuant to NASD Rule 10301(a), a brokerage firm that has ceased operating and is no longer a member of the NASD can only arbitrate a dispute with a customer if the customer consents to the arbitration.*
WMA, which had ceased operating in April 2002 and thus was no longer a member of the NASD, appeals from a decision denying its motion to arbitrate a dispute with two customers. The lower court's decision was based on Rule 10301(a), which provides that, in the case of a member whose membership has terminated, arbitration will only occur if the customer consents to it; the customers here obviously would not consent since they had filed suit. WMA's appeal is based on a declaration submitted to the trial court by its president in which he testified that the NASD had accepted other cases filed against WMA subsequent to the termination of its membership without the customer's consent. The Appellate Court rejects this argument, noting that the trial court could have simply disbelieved this testimony, especially in light of the absence of any meaningful background information, including the number of cases, the nature of any claims, and whether the customers later gave their consent to the proceeding. But even if the testimony were accepted, implicit in WMA's reliance upon it is "the dubious contention that the NASD's occasional disregard of its own rules in other cases somehow strips [the customers] of their contractual right to rely on and enforce those rules." *(P. Dubow: Although we did not have access to the declaration of WMA's president, we suspect that the NASD did not disregard its rules in the other cases. Note that the declaration, as described by the Court, states that the NASD "accepted" other cases, not that courts compelled these cases to arbitration. If the NASD "accepted" a case, one presumes that the case was initially filed by the customer which, in effect, meant that the customer consented to arbitration.)* (SLC Ref. No. 2005-05-02)

USA v. Tacher, Nos. 03-1793(L) & 04-2180-cr (2nd Cir., 12/23/04). **Criminal Issues * Damages Calculations (Sentencing Guidelines) * Appealability.** *Denial of a downward departure for cooperation with the Government lies within the discretion of the trial court and will not be reviewable on appeal absent serious legal error.*
Elias and Salvador Tacher, former employees of Kensington Wells, were charged with securities fraud and money laundering in connection with a "pump and dump" securities fraud scheme. Both declared bankruptcy brought on in part by numerous arbitration Awards against them. Indeed, Salvador Tacher was the recipient of an award assessment in one case (NASD ID #97-04772, Louisville, 9/20/99; SAA 2000-06; SLA 2000-16) of $15 million in punitive damages and $4.7 million in compensatory damages. In this appeal, they seek to challenge their sentences after pleading guilty. Because of "substantial cooperation" with the Government in prosecuting other members of the conspiracy in which they were admittedly involved, the pair were sentenced to 57 months' imprisonment, even though that penalty was at "the very bottom of the 57-71 month range mandated by the Sentencing Guidelines." The Tachers argued that the Court's denial of the Government's motion for a downward departure based upon their cooperation was wrong. The Court rules that the denial is not reviewable on appeal, unless the trial court actually misapplies the Guidelines, it imposes "an illegal sentence," or it mistakenly finds it lacks authority to depart. None of those grounds applies here and the judgment below is affirmed. (*EIC: In refusing to grant a downward departure, the trial court commented: "This [conspiracy] was the most horrible thing I have heard in years…. I don't care how much you cry to me that your children need you, your wife needs you, everybody needs you. What about the other people who were defrauded by you? And it would have never stopped until the government grabbed you…. I'm angry on this one…. Though I have the right to downwardly depart for everything you said, I am not."*) (SLC Ref. No. 2005-02-08)

Wilde v. O'Leary, Gurien & Zachary Jackson Securities, LP, No. A-3345-03T2 (N.J. App. Div., 2/4/05). **Award Challenge * Vacatur of Award * Expert Testimony/Opinions * Arbitrator Misconduct (Pertinent & Material Evidence; Postponement Refusal) * Constitutional Issues (Fundamental Fairness) * State Statutes Interpreted (N.J.S.A. §2A:24-1 to –11) * Remand to Arbitrators.** *Under the circumstances, an arbitration Panel's refusal to grant an extension of time to replace a disqualified expert amounted to misconduct, justifying vacatur.*
Plaintiff, as an unsuccessful arbitration Claimant, sought to establish the unsuitability of investing in a mortgage business through a securities expert. The expert was disqualified by the Panel, because he did not have expertise relating to mortgage lending, and the Panel further denied an extension (beyond the end of the day) to obtain a replacement. Yet, as this Court points out, the expert was proffered in the original Statement of Claim, Respondents made no objection to his testifying until *voir dire*, and Respondents, as fact witnesses with considerable industry experience, testified in their own favor on suitability issues. The Panel's decision to exclude the expert may have been questionable, the Court states, but it was not "misconduct," as described in New Jersey's vacatur statute, NJSA 2A:24-8. It was "misconduct," however, for the Panel to refuse a reasonable extension, when Respondents raised no objections beforehand and Claimant had no reason to suspect the need for a replacement. The Court's indignation is clear from its words: "When a party is required to arbitrate before an industry-controlled arbitration panel in accordance with rules propagated by the industry, it is incumbent upon the arbitrators to provide a fair forum and to respect fundamental due process rights." The Court cites a

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similar fact pattern where vacatur also resulted. *Bordonaro v. Merrill Lynch*, SLA 2004-08, stating: "Here, as in the Ohio case [Bordonaro], plaintiff was precluded from presenting critical testimony on liability, specifically the suitability of the investment for plaintiff and defendants' exercise of due diligence." The decision below confirming the Award is reversed and the case remanded for a new arbitration hearing. *(EIC: Needless to say, the Award dismissed all claims, NASD ID #01-06817 (New York, 3/5/03). Arbitrators are used to relying upon their own industry and investment experience to determine critical issues, especially with respect to suitability matters, and may often regard expert testimony as helpful, but not essential. This case, taken together with* Bordonaro, *sounds a shrill warning to curb those assumptions, especially when the circumstances suggest facial unfairness in restricting a Claimant's presentation of her case.)* (SLC Ref. No. 2005-08-05)

WorldCom, Inc. Securities Litigation, In Re (Roberts, Entenmann & Galitzer Arbitrations), No. 02 Civ. 3288 (S.D. N.Y., 2/1/05). **Class Actions, Effect of (On Arbitration)* Settlement Issues (Enforcement) * Equitable Doctrines (Excusable Neglect) * Injunctive Relief * Timeliness Issues (Opt-Out Deadline) * SRO Rules (NASD Rule 10301) * Res Judicata/Collateral Estoppel.** *Settling defendants can obtain injunctive relief to prevent the assertion, in another forum, of claims included in the settlement order.*

Investors and Plaintiff class members Steven and Margot Roberts sought an arbitral order that they could proceed in arbitration with claims against some of the Citigroup Defendants, but those Defendants have settled similar claims in this class action. On motion for injunctive relief by the Citigroup Defendants, the Court recounts that the opportunity to opt out of the Citigroup settlement passed on September 1, 2004 and that the Court thereafter approved the huge $2.5 billion settlement in November 2004. Included in the Court's approval order was a bar enjoining members of the Plaintiff class from "instituting, commencing, or prosecuting any Released Claims against any Released Parties." When these investors sought permission to proceed with their arbitration claims against Salomon Smith Barney (SSB), Jack Grubman and other SSB employees, the affected Citigroup Defendants sought enforcement of the Court's November Order. Finding no excusable neglect that would explain the failure to timely request exclusion from the class, the Court acts to protect the settlement. That the Claimant-investors filed their arbitration in 2002, well before the settlement, does not separate them from the class or excuse them from requesting exclusion. The Court makes the determination that the claims in the NASD Statement of Claim fall within the scope of the Released Claims (a fairly detailed description of those Released Claims is included in this decision) and bars these Claimants from

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further asserting such claims. *(EIC: The Court issued a similar injunction regarding claims filed in arbitration by Richard Entenmann and Shari Galitzer in an Order dated February 1, 2005.)* (SLC Ref. No. 2005-07-08)

Zimmer v. CooperNeff Advisors, Inc., No. 04-3816 (E.D. Pa., 12/20/04). **Forum of Choice * Enforceability (Unconscionability; Mutuality of Obligation) * Contract Formation (Consideration) * Waiver * Arbitrability * State Law, Applicability of.** *Absent a real business purpose, an arbitration agreement that is signed as a condition of employment and that makes certain disputes excludable, at the employer's option, will be deemed unconscionable under Pennsylvania law.*

CooperNeff Advisors, Inc. manages hedge fund portfolios and employed Steven Zimmer from March 2003 until late June 2004. CooperNeff used a computer Model in its business to help rank stocks for possible purchase and, when Mr. Zimmer left, a dispute over ownership of the Model arose. CooperNeff brought an action in state court, which was removed to this Court, and CooperNeff sought an order compelling arbitration. The arbitration provision in Mr. Zimmer's contract with CooperNeff calls for the appointment of an "independent arbitrator" and that appointment, in the absence of mutual agreement, will fall to the AAA or NASD. The appointed Arbitrator will then decide which provisions of the NASD or AAA Rules will apply and his/her fees and expenses and the attorneys' fees will be allocated by the Arbitrator. The Court finds that the employment agreement containing the arbitration clause does not lack consideration, even though the agreement was signed well after Mr. Zimmer began employment at CooperNeff. The arbitration agreement is, however, unconscionable, the Court rules, on both a procedural and substantive basis. The substantive defect lay in the exclusion of access to the courts for Mr. Zimmer for all claims, while CooperNeff retained the right to choose court in the event of an intellectual property dispute. "[W]e find that no business realities justify giving CooperNeff sole access to the courts." In addition, CooperNeff's choice to invoke the judicial process in the first round of this dispute constituted waiver. "The Employment Agreement gave CooperNeff a choice to seek arbitration to enforce its purported intellectual property rights, or to file a judicial action, not both." *(EIC: While CooperNeff is not a broker-dealer, we chose to include this case because of the closeness of the hedge fund industry to securities and commodities brokerage and because of the agreement's unusual delegation of appointment powers to AAA or NASD.)* (SLC Ref. No. 2005-06-01)

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

Dobin & Jenks, LLP is pleased to announce that **Brian D. Buckstein** has joined the firm as an Associate. Mr. Buckstein will continue his practice in the areas of Labor and Employment Law and join the firm's partners in the areas of Securities Litigation, Arbitration and Regulation. Mr. Buckstein can be congratulated at Dobin & Jenks, LLP, 140 Intracoastal Pointe Drive, Suite 403, Jupiter, FL 33477; (t) 561-575-5880.

Keesal, Young & Logan, PC is pleased to announce that **Margaret A. Buckley** and **Garrett R. Wynne** have become associated with the firm in its San Francisco, CA office and **Travis R.A. Kuda** and **Ashley Young Adams** have become associated with the firm in its Long Beach, CA office. Ms. Buckley and Mr. Wynne can be congratulated at Kessal, Young & Logan, Four Embarcadero Center, Suite 1500, San Francisco, CA 94111; (t) 415-398-6000, and Mr. Kuda and Ms. Adams can be congratulated at Kessal, Young & Logan, 400 Oceangate, P.O. Box 1730, Long Beach, CA 90801; (t) 562-436-2000.

Dana N. Pescosolido is pleased to announce that, after more than 25 years in the private practice of law, he has decided to leave the firm of Saul Ewing and accept the position, effective March 21, 2005, of Vice President and Deputy General Counsel of **Legg Mason Wood Walker, Inc.** Mr. Pescosolido's primary function with Legg Mason will be to direct and manage the company's litigation. Mr. Pescosolido can be congratulated at Legg Mason Wood Walker, Inc., 100 Light Street, 23rd Fl., Baltimore, MD 21202; (t) 410-454-4950; dnpescosolido@leggmason.com.

Secure Financial Services, Inc. is pleased to announce that **Thomas W. Matt** has joined the company as Operations Manager.º Mr. Matt will focus on production and performance as he oversees daily operations and customer service.º Prior to joining SFS, Mr. Matt had worked for 20 years as project manager in the technology industry. Mr. Matt can be congratulated at 97 Blakely Road, Suite 102, Colchester,VTº05446, Tel. 802-879-2077; tmatt@tradeanalysis.com.

Relocations

Heller Ehrman White & McAuliffe LLP is changing its name and moving to a new location. As of April 11, 2005, the firm's new name will be **Heller Ehrman LLP** and the firm's new address will be Liberty, Times Square Tower, 7 Times Square, New York, NY 10036.

Davidson & Grannum, LLP is pleased to announce that it has relocated its main office to 30 Ramland Road, Suite 201, Orangeburg, NY 10962; (t) 845-365-9100; (f) 845-365-9190. The Firm also maintains law offices in New Jersey (201) 802-9000, in New York City (212) 265-3020 and Boston (617) 426-5111.

People/Positions Wanted

Tate, Lazarini & Beall, PLC, a Memphis and Tampa based firm with a national securities litigation and arbitration practice, is seeking attorneys with at least 2 years litigation experience, strong academic backgrounds and excellent organizational and communications skills. Please send resumes in confidence to Jerrod Smith, Esq. at jsmith@tatelazarini.com.

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.

April 28-29: "Securities Litigation: Planning and Strategies," sponsored by ALI-ABA Committee on Continuing Professional Education, will be held at the Westin Embassy Row, **Washington, DC**. This 30th annual advanced course study, comprising 12 full hours of instruction, is designed for outside and in-house counsel, accountants, compliance officers, members of government agencies, and others who have a current interest in securities litigation. The presentations will primarily examine issues confronted by the trial practitioner with attention also directed to strategies used to avoid litigation and to litigation management techniques. Tuition: $995. For info., contact ALI-ABA, 800-CLE-News, www.ali-aba.org.

May 24-25 (pre-conference workshop on May 23): "2nd Annual Broker/Dealer Defense Forum on Prevailing Against Customer Claims: Strategies for Discovery, Arbitration Hearings and Proceedings," sponsored by the American Conference Institute, will be held at The Warwick Hotel, **New York, NY**. Under the guidance of senior regulatory officials, industry executives and leading attorneys, attendees will learn the most successful techniques in defending against customer claims. Regis.: $1,795 (conference only); $2,395 (conference and workshop). For info. contact ACI, 888-ACI-2480; www.AmericanConference.com/dbarbs.

Jun. 2: "Securities Arbitration and Mediation: Hot Topics – 2005," sponsored by the Association of the Bar of the City of New York (ABCNY), will be held at the Association's Home of Law from 6-9 PM, in **New York City**. This Evening Forum, which is billed as "the most widely attended program in the United States on securities dispute resolution" drew more than 200 attendees last year. This year's Program, which will be moderated as in the past by Moderator and Mediator **Roger M. Deitz**, will present speakers representing a variety of perspectives: **Robert S. Banks**, Banks Law Office; **Karen Kupersmith**, NYSE Arbitration; **George H, Friedman**, NASD Dispute Resolution; **Sandra D. Grannum**, Davidson & Grannum; **Brian F. McDonough**, Drinker Biddle & Reath, LLP; **Richard P. Ryder**, SAC; **Brian N. Smiley**, Gard Smiley Bishop & Dovin, LLP; and **Jonathan S. Weber**, AIG Domestic Claims, Inc. (Financial Lines). For info., please contact Dana Berman, CLE, ABCNY. E-Mail: dberman@abc.ny.org. Fax: 212/768-0268.

Jun. 21-22: "NYSE Regulation First Annual Securities Conference," sponsored by the NYSE, will be held at the Grand Hyatt Hotel, **New York, NY.** Join NYSE Regulation senior staff and leading industry representatives to gain insight on the most pressing regulatory issues facing today's financial community. Regis.: $995 for NYSE Members and employees of Member organizations; $1,195 for non-members. Regis. includes selection of 12 workshops, two luncheon presentations, a Congressional panel, and a cocktail reception on the Exchange floor. For info., call 518-785-0721; nyse.com/regconference.

Aug. 17: "Securities Arbitration 2005: Telling Your Story," sponsored by the Practicing Law Institute, will be held at the PLI New York Center, **New York, NY**. At this highly acclaimed 19th annual program, PLI's experienced faculty will guide attendees through the fine points of telling "stories" to arbitrators. Attendees will also be provided with tips on techniques that will lead to more effective advocacy. Regis. Fee: $795. For info., contact PLI, 800/260-4PLI or register online at www.pli.edu. David E. Robbins, Kaufmann Feiner, et al. is the moderator of this popular securities arbitration program.