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August 5, 2005

Jonathan G. Katz, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington D.C. 20549-9303

Re: File No. SR-NASD-2005-032

Dear Mr. Katz:

We are writing in response to the SEC's request for comments concerning the Proposed Rule Change to Provide Written Explanations in Arbitration Awards upon the Request of Customers, or Associated Persons in Industry Controversies. We are commenting on behalf of the Pace Investor Rights Project ("PIRP") at Pace University School of Law, in furtherance of its mission to advocate on behalf of the rights of individual investors. We appreciate the opportunity to comment on this proposal and on the repercussions of requiring NASD arbitrators to issue explained awards upon the request of customers, or associated persons in industry disputes.

We support NASD's efforts to improve the arbitration process and find it difficult to oppose a rule designed to increase transparency and options available to investors participating in that process. We observe that the stated purpose for the proposed rule change is to increase investor confidence in the fairness of the process. We are not convinced that adoption of the proposed rule will improve the process itself, but merely claimants' *perceptions* of the arbitration process. Furthermore, in instances where an investor is denied recovery or is awarded only a small percentage of his claimed damages, we doubt that an explanation would obviate investors' concerns about the process. Nevertheless, while courts do not require arbitrators to write opinions on the policy ground that such a requirement would undermine the speed and thrift sought to be obtained by arbitration,[1] we do acknowledge several benefits to NASD's proposed rule change.

[1] *See* Eljer Mfg., Inc. v. Kowin Dev. Corp., 14 F.3d 1250, 1254 (7th Cir. 1994); Sargent v. Paine Webber Jackson & Curtis, Inc., 882 F.2d 529 (D.C. Cir. 1989).

Written explanations will provide insight into the arbitrators' reasons for granting an award and may provide the investor with "psychological satisfaction." By allowing parties to see how arbitrators previously decided controversies, explanations will also provide valuable information for parties to use when ranking and striking arbitrators during arbitrator selection in future cases. Moreover, requiring arbitrators to explain their decisions makes them directly accountable for their conclusions. Thus, they may be more likely to carefully evaluate all the evidence and reason through their conclusions rather than decide based on compassion, bias, or instinct.[2] Knowing that an explanation will increase the possibility of subjecting an award to judicial review[3] is also likely to encourage the panel to be more thoughtful in its decision-making.

On the other hand, written explanations will increase judicial review of the process and possibly make it easier for courts to apply a manifest disregard of the law standard.[4] It is more likely that "instead of being a window into the rationale of the arbitrators, a written explanation will be used as a platform and blueprint for . . .appeal, because it identifies or magnifies targets, meaningful or otherwise, for the losing party to attack."[5] This can lead to prolonged and expensive litigation, again subverting the goals of a quick, efficient, low-cost means of dispute resolution that arbitration seeks to accomplish.[6] The small investor, in particular, will be overwhelmed by attorneys' fees and a long, drawn-out court battle. Instead of providing a basis for meaningful review in those rare instances of arbitrator misconduct,[7] written explanations could open the floodgates to routine judicial review, undermining the finality of arbitrators' awards.

Moreover, the language of the rule as written raises specific concerns. <u>*First*</u>, we have strong doubts as to whether NASD arbitrators will be able to write short, clear explanations in thirty days. Professor Black has previously expressed her concerns regarding the qualifications of NASD arbitrators and their ability to perform the many judicial-like tasks currently expected of them.[8] The pool of arbitrators consists of "a broad cross-section of people" and "[t]here is no requirement that public arbitrators have

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[2] *See* Sarah Rudolph Cole, *Fairness in Securities Arbitration : A Constitutional Mandate, 26* PACE L. REV. __ (2005) (forthcoming).
[3] Barbara Black & Jill I. Gross, *Making it Up as They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 1034 (2002) (explaining that written explanations will increase the chance of judicial review).
[4] *See* Dawahare v. Spencer, 210 F.3d 666, 669 (6th Cir. 2000) (noting that if arbitrators do not explain their award, it is all but impossible to determine whether they acted with manifest disregard for the law).
[5] Constantine Katsoris, *SICA: The First Twenty Years,* 23 FORDHAM URB. L.J. 483, 518 (1996).
[6] Domke on Commercial Arbitration § 34:6 (3d ed. 2003) ("The general view is that a detailed opinion written by a layman might expose the award to challenge in the courts, jeopardizing both the speed and finality of arbitration.").
[7] The manifest disregard standard is designed to correct situations where arbitrators "willfully flouted" the governing law, not where they have made a mistake. Westerbeke Corp. v. Daihatsu Motor Co., 304 F.3d 200, 217 (2d Cir. 2002).
[8] Barbara Black, *Do We Expect Too Much From NASD Arbitrators?* SECURITIES ARBITRATION COMMENTATOR (Oct. 2004), at 1, 4.

any legal training or experience in the securities industry."[9] The most commonly expressed concern about arbitrators' performance [is] that the "skills and training of arbitrators are not always adequate to meet the challenges of contemporary securities arbitration."[10] Lawyers know that succinct and precise writing is difficult to achieve,[11] and the exchange of drafts among three arbitrators to permit revisions may well extend the period beyond thirty days.

Second, we believe that certain arbitrators currently on NASD's roster are philosophically opposed to writing explanations. The proposed rule calls for the request for a written explanation as late as twenty days prior to the first scheduled hearing date, after NASD already has appointed arbitrators and it is too late for arbitrators to decline the case. As a partial solution, we recommend that the rule instead require investors (or associated persons in industry controversies) to indicate at the time of arbitrator selection that they will request a written award. The rule should give the arbitrators the option to decline if they are philosophically opposed to explaining their decisions, or if, because of other commitments, they anticipate they would not be able to write a reasoned explanation within thirty days. Without this amendment to the rule, qualified arbitrators may drop out of the pool preemptively.

Third, we are concerned that the proposed amendments to Rule 10330 will not further NASD's goals of improving the arbitration process because they do not provide sufficient guidance to arbitrators. More specifically, the proposed rule change merely defines an explained decision as a "fact-based award stating the reasons each alleged cause of action was granted or denied." The proposed rule details that an explanation need not include legal authorities or damage calculations. However, the rule is ambiguous concerning the extent of fact-based detail sufficient to constitute an explanation. For example, it is unclear whether a statement such as "we awarded Mrs. Smith $24,000 because we felt sorry for her" would be an adequate explanation under the proposed rule. Furthermore, the proposed rule change is silent on whether the explanation would have to address each and every legal theory or theories presented by the claimant as well each affirmative defense presented by respondent(s). Without further clarity in the rules requirements, the panel's "explanation" might not increase investor confidence in the process.

Fourth, the language expressing the view that arbitration awards have no precedential value should be strengthened. In the first amendment to the proposed rule, a footnote indicated that the template of the award would state that "the award has no

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[9] *Id.*
[10] *See* DAVID S. RUDER, CHAIR, SECURITIES ARBITRATION REFORM: REPORT OF THE ARBITRATION POLICY TASK FORCE TO THE BOARD OF GOVERNORS NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC. 107-108 (1996) ("RUDER REPORT").
[11] *See, e.g.,* Hardy v. Walsh Manning, 341 F.3d 126 (2d Cir. 2003) (remanding an award for clarification as the brief written opinion was so ambiguous that it could not be enforced because it could have been interpreted as if the arbitrators manifestly disregarded the law).

precedential value and cannot be cited in any subsequent award."[12] The current version of the proposed rule has diluted this language somewhat by removing the second half of the phrase. We recommend that the rule itself include the precise language from the first amendment. By requiring arbitrators to explain their decisions, NASD runs the risk of imbuing awards with precedential value. It is well established that arbitration awards do not have precedential value because they are so fact-specific,[13] and the addition of a few reasons for the award should not change this view. Attorneys, however, with their training to search for and apply legal precedent will find the temptation to cite awards as authority nearly irresistible, and arbitrators may accede to this practice. We believe this would be an undesirable development. Arbitrators are tasked with the responsibility of deciding the dispute before them on its own facts, not with deciding disputes based on precedent. Some argue that giving arbitration awards precedential effect will lead to development of the law in the securities industry, making future cases more predictable and allowing investors to make informed decisions.[14] However, creation of law is a legislative and judicial function; it is not the role of arbitrators. Indeed, arbitrators are frequently non-lawyers, with no training in deciding legal issues. Most importantly, they are not required to apply the law.[15] It is a dangerous development to allow arbitrators to create law.

The SEC seeks specific comment on whether the reasoned award requirement should apply to simplified arbitrations proceeding without a hearing. We believe that NASD correctly proposes that the rule should not apply to paper cases. A claimant proceeding on a paper case with a claim under $25,000 has a simple, straightforward claim that requires less time and should need less explanation in an award. If a claimant in a simplified arbitration feels strongly about receiving an explanation, he or she can request a hearing and then invoke the reasoned award rule.

Finally, we note that this proposed rule change differed procedurally from most NASD proposed rule changes in controversial areas. Ordinarily, when dealing with a controversial issue such as the issuance of written explanations by arbitrators, NASD first issues a Notice to Members and requests comments. Instead, NASD proposed this rule change directly without seeking public input. Thus, this is the first opportunity the public

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[12] *See* National Association of Securities Dealers, Form 19b-4, File No SR-2005-032, Amendment No. 1 to Proposed Rule Change to Provide Written Explanations in Arbitration Awards Upon the Request of Customers or of Associated Persons in Industry Controversies, Apr. 14, 2005, at 9, n.7, *available at* http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_013823.pdf (last visited July 28, 2005).

[13] S*ee, e.g.,* Garcia v. Federal Ins. Co., 46 N.Y.2d 1040, 1041-42 (1979); *see also* Barbara Black & Jill I. Gross, *Economic Suicide: The Collision of Ethics and Risk in Securities Law*, 64 PITT. L. REV. 483, 507-508 (2003).

[14] *See* H. Thomas Fehn, *Arbitration Awards. . .Where the Sun Don't Shine*, SECURITIES ARBITRATION COMMENTATOR (Feb. 2005), at 1, 3.

[15] *See* Prima Paint v. Flood & Conklin Mfg. Co, 388 U.S. 395 (1967) (Black, J., dissenting); Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465, 1477 (D.C. Cir. 1997).

has had to provide comments on this highly controversial subject. We urge the SEC to consider the public comments carefully.

We appreciate the ability to voice our concerns and approval of NASD's efforts to protect the investor. Thank you for your consideration of these comments. Please do not hesitate to contact us if you would like to discuss these issues further.

Sincerely yours,

Jill I. Gross
Director

Barbara Black
Director

Melanie Serkin
Student Intern