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August 3, 2005

Secretary Jonathan G. Katz
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: **File No. SR-NASD-2005-032**
Proposed Rule Change to Provide Written Explanations in Arbitration Awards

Dear Mr. Katz:

Thank you for this opportunity to comment.[1] For several years I have been researching NASD arbitration. In particular, I am conducting a statistical study on the relationship between damage claims and awards.

Criticism about the transparency and fairness of NASD arbitration is currently at an all time high. The proposed rule change is a thinly veiled attempt to suppress further scrutiny and changes. The proposed "written explanation" is nothing like a judge's written explanation. It will not necessary explain fact finding, law, or damages. It will not increase transparency or fairness. In fact, it will further deceive and cheat customers and employees.

I recommend that the SEC reject the proposed rule change and in its place erect rules and procedures that actually do increase the transparency and fairness of securities arbitration.

NASD Arbitration without Written Explanations

The current NASD arbitration system does not require arbitrators to provide "written explanations" of their decisions. This poses several problems. It is worth reviewing these problems since the proposal ignores them.

[1] My comments on this rule change should in no way be construed as an endorsement of NASD arbitration. Indeed, NASD arbitration is grossly biased against customers and employees of securities firms and no amount of tweaking NASD arbitration can fix that. That said, I will comment on how the proposed rule change would affect NASD arbitration.

Since arbitrators are not required to provide written explanations, they have no incentive to understand and study the facts of the case. Frequently arbitrators do not take notes and they do not ask questions. In worst instances, arbitrators have been known to not pay attention to the hearing or even fall asleep. Arbitrators have been known to mischaracterize testimony or written statements that have just been presented.

Likewise, often arbitrators are not considering the law. The fact that they allow securities firms' counsels to introduce irrelevant and redundant testimony and argument is proof enough that they are guided by something other than the law. And in many cases arbitrators' damage calculation are capricious and unjust. For example, customers' or employees' damages may be well over $1 million and the arbitrators ostensibly rule in their favor, yet they award only a couple thousand dollars. And arbitrators almost never award punitive damages or legal fees – even when the securities firms' conducts were deliberately illegal and even fraudulent. Counsels often claim that arbitrators simply "split it down the middle." That is not justice.

Additionally, by not writing out a cogent explanation, arbitrators are not forced to ensure that their perception of the facts is reliable and their legal reasoning (or some other reasoning) is sound.

Another problem is that there is no database for the SEC or any other group to review arbitrators' competence and integrity. And there is no record for customers and employees and their counsels to know the legal basis (or any other basis) that arbitrators are using to decide awards. For example, do arbitrators think an investment in Florida swamp land is an appropriate place to stick a retired person's life savings? Or do arbitrators think a securities firm can pay an employee nothing for several years of productive and profitable work? Apparently some arbitrators do but some do not.

And worse of all, arbitrators are using the absence of written decisions to hide gross incompetence and bias in favor of securities firms. They allow securities firms to fill the record with implausible, incomplete, and inconsistent testimony and documents. Sometimes the veracity of testimony and/or documents is even dubious, but arbitrators condone it. Securities firms' counsels talk for hours or days making baseless accusations and frivolous arguments. Then the arbitrators ignore the facts and the law and decide in favor of the securities firm. At the very least it runs up customers' and employees' expenses, but at worst it denies them a fair arbitration. And without written explanations the proceedings are impenetrable and even the most egregious decisions are impossible to overturn. One would have to read the transcripts and all the evidence to prove the proceedings and final decisions were shams. In fact, the NASD admits as much.[2]

[2] "Dawahare v. Spencer, 210 F.3d 666, 669 (6th Cir. 2000) ('Arbitrators are not required to explain their decisions. If they choose not to do so, it is all but impossible to determine whether they acted with manifest disregard of the law.') (citation omitted)." [File No. SR-NASD-2005-032, Proposed Rule Change to Provide Written Explanations in Arbitration Awards]

NASD Arbitration proposal for "Written Explanations"

As stated above, the proposal does not discuss the problems of currently not having written explanations. In fact, it does not identify any problems. Rather is simply states, "NASD is proposing to amend the NASD Code of Arbitration Procedure … to provide written explanations in arbitration awards upon the request of customers, or of associated persons in industry controversies." Specifically, "An explained decision will constitute a fact-based award that states the reason(s) each alleged cause of action was granted or denied and will address all claims involved in the case, whether brought by the party requesting the explained decision or another party."

It goes on to state what the written decision is not: "The inclusion of legal authorities or damage calculations, however, will not be required in an explained decision in order to limit the additional costs and processing time associated with explained decisions."

Additionally, the proposal makes some lofty, unsubstantiated claims as to the virtues of the rule change: "In order to increase investor confidence in the fairness of the NASD arbitration process, NASD is proposing to amend the Code to allow customers or associated persons in industry controversies to require an explained decision." The proposal does not provide any further background or justification.

The proposal is too vague to know what the NASD means by a written decision. The NASD written decision may include some comments on the facts of the case, but it would not necessarily say anything about the legal basis or the damage calculations for the award. At best it is a cheap imitation of a judge's written decision for the NASD's poor-man's version of justice.

Thus a written explanation can be anything from a detailed explanation of how the arbitrators reached their decision to a general, boilerplate declaration that could apply to any arbitration. For example, the following statement would meet the proposals standards for a written explanation:

> *The arbitration panel rejected the customer's (or employee's) version of facts and accepted the securities firm's version. We deny all of the customer's (or employee's, respectively) claims.*

Even when the individual presented a plausible, complete, and consistent version of facts supported by documentary evidence, the arbitration panel would be free to reject it without any further explanation.

So it is baffling why the NASD would claim that its proposal offers any benefit to the customer or anyone else given that their alleged "written explanation" is in truth not a written explanation in any legal sense.

Thus the NASD's proposal will not address any of the problems cited above. And worse it will add insult to injury by asking the customer or employee to pay for something that has no informational or legal value.

I recommend that the SEC ask the NASD to give further explanation of what problems the rule change is addressing and how it will fix the alleged problems.

The Proposal is Disingenuous

Even before the NASD formally proposed the rule change, it was singing its praises:[3]

> *According to Chairman Robert R. Glauber the NASD is seeking to create greater transparency in securities arbitration. "Investors want to know more about how a panel reaches its decision," he said. "By giving investors the option of requiring a written explanation ... we will increase investor confidence in the fairness of the NASD arbitration process."*

Again the NASD invoked it slogan "increase investor confidence." There is no explanation of what this means let alone how the rule change will accomplish it. Given the numerous problems cited above, one could only conclude that the slogan is a euphemism for *further dupe the investor*. The NASD also promises "greater transparency." However, as already shown above, the proposed rule change will not explain arbitrators' decisions.

In fact, nothing about NASD arbitration is transparent. From arbitrator selection and training all the way to decisions and awards, there is almost no information. And no one even knows what happens to the hundreds of complaints …

NASD arbitration is like a black hole: One can not observe it directly but can only study the affect it has on things around it. In the case of NASD arbitration what is known is that it leaves in its wake thousands of customers and employees who were denied a fair arbitration and thus denied their equal protection under the law. These individuals lost their pensions, life savings, and college funds. Each year hundred of individuals complain to the NASD about securities firms' and arbitrators' abhorrent conduct and the NASD ignores them.

I recommend that the SEC adopt rules to open up every aspect of NASD arbitration for public scrutiny. In addition, the SEC should hold responsible the person or persons at the NASD who bury the thousands of customer and employee complaints.

The securities industry has already raised concerns that written explanations would give aggrieved customers and employees a better opportunity to overturn egregious decisions. But the NASD

[3] [Paul D. Boynton, "Explanation of decisions could change securities arbitration," *Kansas City Daily Record*, March 15, 2005]

was quick to assuage their constituency's fear that this rule change would undermine their free lunch:[4]

> *Linda Fienberg, president of NASD's dispute-resolution program, says some of these concerns about the proposed amendment, which has been in the works for more than a year, are likely misplaced. "This is not going to be the same as a court decision," she says. "The decision will be a more simplified document with a briefer explanation and there is no requirement that cases or statutes be cited."*

Ms. Fienberg is exactly right. Like everything else about NASD arbitration, the "written explanation" is intended to have the appearance of it court counterpart, but it is nothing like its counterpart. Additionally her cynical comment betrays her contempt for customers and employees as well as the law. Clearly NASD arbitration lacks a moral compass. I hope the SEC is noting these disturbing attitudes.

The Rule Change Would Only Build on a Defective Foundation

The soundness of providing explanations of decisions must be judged in the larger context of NASD arbitration. The Petition by Les Greenberg points out what may be the most significant problem with NASD arbitration. It shows that NASD arbitration has no conceptual foundation.[5]

Briefly, the Petition shows that the NASD does not require arbitrators to apply the law in their decisions. Moreover, it does not provide any guidelines on which to base decisions. Rather the NASD simply perpetuates numerous myths about its arbitration process one of which is that its arbitrators do "equity" – suggesting that they award customers and employees even when the law would not allow it. The NASD does not provide any explanation of how they allegedly do "equity." And there is no proof that customers and employees are receiving bigger awards in arbitration than they would in the US courts. On the contrary, the thousands of complaints from customers and employees and their counsels shows that arbitrators are <u>not</u> following the law or doing "equity."

In any case the Petition astutely concludes that arbitrators are essentially free to do whatever they like. The awards are at best random and at worst biased in favor of the securities firms. So the NASD is ostensibly administering the law without using the law.

It is irrational to be building on top of the NASD arbitration system before addressing NASD arbitration's foundational problems. <u>I recommend that the SEC reject the NASD proposal and</u>

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[4] Susanne Craig, "NASD May Require Written Decisions From Arbitrators," *The Wall Street Journal*, January 28, 2005.

[5] The interested reader should consult the Petition 4-502 is at http://www.sec.gov/rules/petitions/petn4-502.pdf as well as the related comments at http://www.sec.gov/rules/petitions/4-502.shtml .

instead ask the NASD to accurately and precisely define exactly what their arbitration system is based on.

Conclusion

As explained above, the so-called NASD "written explanation" does not address any problems. In particular, NASD arbitration is so riddled with holes that arbitrators can steer the case in favor of the securities firm long before it gets to the written explanation. They have too much leeway in deciding issues involving motions, discovery, examination, cross-examination, and argument. At present customers and employees with absolutely solid cases may still be awarded nothing and yet have no recourse. Clearly, customers and employees would prefer a fair arbitration that awarded them damages owed by law over a written explanation.

The NASD's proposed rule change is insulting to our intelligence. Numerous NASD lawyers spent countless hours coming up with a rule change that does nothing to improve NASD arbitration for the customer and employee. Clearly it was a cynical gesture designed to lull individuals into a false sense of security while still denying them their equal protection under the law.

The various comments on the rule change – from both supporters and detractors of NASD arbitration – all agree that it is ill-conceived and unworkable. It is a waste of the SEC's time and resources to evaluate and accept the inane rule change. I recommend that the SEC reject the NASD proposal.

Thank you.

Sincerely,

Richard Skora