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August 5, 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:

This supplements my comments of August 3, 2005 and specifically responds to comments from other persons.

Both critics and supporters of NASD arbitration have for the most part rejected the NASD rule change on the grounds that it does not solve any problems – perceived or real. Specifically, I asserted that there are numerous problems, including but not limited to that NASD arbitration is unfair, which the rule change does not address. Securities firms' representatives proclaimed that NASD arbitration is fair.

The SEC needs to address the bigger question of fairness. By the way, the opinions expressed here are my own. No one is paying me for my opinions.

NASD Arbitration is Unfair

To start, *fair* means fair in all instances to all parties. Something cannot simultaneously be fair and not fair. Either it is fair all the time or it is simply not fair. If securities firms have a different definition of fair, then they should let me know.

There is a plethora of information to ascertain the fairness of NASD arbitration. Thousands of customers and employees of securities firms and their counsels who have direct experience with the NASD arbitration system have described their encounters. These examples are well documented. Each year these individuals send complaints to the NASD and SEC. To my knowledge, neither the NASD nor SEC has denied the veracity of their assertions.

For example, arbitrators made numerous inexplicable, irrational, and inconsistent comments and decisions – the only pattern was a bias in favor of securities firms. They prevented individuals from presenting their cases. They denied individuals almost all documentary evidence that was helpful to their cases, but they allowed securities firms to subpoena everything that they thought was helpful to their case, including documents from individuals' families, friends, and other associates.

Often arbitrators prevented individuals' counsels from presenting their story; but they encouraged securities firms to stage their irrelevant, baseless, hateful smear campaigns. They cut short their counsels when they tried to cross-examine securities firms' witnesses, yet they permitted securities firms' counsels to badger individuals and their witnesses.

In other instances arbitrators wrongly disparaged individuals but condoned securities firms' unconscionable treatment of the individuals. They objected to individuals' witnesses but let securities firms' witnesses drone on with meaningless, redundant testimony. They even mocked and ridiculed individuals. Arbitrators unfairly accused individuals' counsels of wasting time; however they permitted securities firms to take up the vast majority of time and to delay the proceedings. They made baseless criticisms of individuals' counsels, while they commended the securities firms' counsels' for their flood of dirty tricks.

Frequently arbitrators went out of their way to find fault with the individuals but overlooked all of the securities firms' and their counsel's bad behavior. Securities firms' and their counsels flouted the rules with impunity. Securities firms presented bogus documents and testimony. They cooked up accounting numbers. Securities firms and their counsels hid responsive, discoverable evidence. The counsels heckled the individuals and made unsubstantiated, vicious accusations. They made false and prejudicial statements. They contradicted their own clients. With no threat of swift and severe public punishment, as in a legitimate court, in front of a genuine judge, the arbitrators invited securities firms and their counsels to break the law and then defile the arbitration process.

Finally, in many cases the arbitrators ignored the facts and the law and ruled in favor of the securities firms. As a result customers and employees with devastating loses but absolutely solid cases walked away with nothing (or less than nothing after legal fees and NASD forum fees).

If one has an aversion to the above primary evidence then one only has to look at the NASD's own publications for more proof. For example, the NASD has acknowledged that for several years many securities firms have been abusing its discovery process. They either have been giving phony excuses to not produce responsive, discoverable documents or have simply refused to produce them. (In one example, a single securities firm did it in 20 cases.[1]) The arbitrators have been condoning the abuses. As well the NASD knew about it and did not stop it. In each case, the customer or employee was denied a fair arbitration. Eventually the NASD issued a minor fine, but they did not compensate the aggrieved individuals. And there is no evidence that the fine halted the dishonest practice.[2]

Thus there is irrefutable proof that NASD arbitration is unfair. Clearly it denies countless customers and employees their rights to equal protection under the law. It does not allow individuals an opportunity to present their cases and it does not award them compensatory or other damages that

[1] Frances A. McMorris, "NASD Launching Program To Address Discovery Abuse," *On Wall Street,* August 1, 2005.

[2] The NASD has instituted a trial program of appointing a special arbitrator to oversee discovery. This just adds another layer of ineffectual formality and complexity. Anyway the NASD already had a mechanism to deal with abuses such as discovery abuses: Insist that securities firms and arbitrators follow the rules or discipline the securities firms and arbitrators.

they are entitled to under the law. This is the very definition of an unfair system. Moreover, the unfairness is worse than random awards or deficient awards. NASD arbitration is systemically biased in favor of the securities firms.

Denial that NASD Arbitration is Unfair

Despite the overwhelming evidence that NASD arbitration is unfair and biased in favor of securities firms, there are still bias deniers out there. They are typically representatives of securities firms, including members of the NASD's sister organization, the SIA. Their claims are usually based on misrepresentations of facts, including studies which are outdated, non-independent, superficial, and/or do not specifically address the issue of fairness. Likewise they make fallacious deductions.

Specifically, in response to the proposed rule change, the comment letter from Stephen G. Sneeringer declares, "Therefore, independent studies, data and conclusions all verify that SRO arbitrations are fair, just, and equitable and that the public agrees with this conclusion."[3] And the comment letter from Edward G. Turan of the SIA pronounces, "The current system is not only objectively fair to participants but that it is also subjectively perceived to be fair by the vast majority of investors who have participated in the arbitration process."[4]

Mr. Sneeringer starts by denying the above-cited personal testimonials that NASD is unfair. He dismisses them as he mistakenly writes, "The parties expressing these opinions rarely have direct experience in the arbitration process but rely on hearsay." He then goes on to concoct his own imagined evidence.

From the start Mr. Sneeringer undermines his own argument[5] when he bases it on the NASD-sponsored survey by Tidwell, et al. which studied "perceptions"[6] The parties were surveyed immediately after the hearings and, therefore, before the decisions on whether they felt it was fair. Up to that point all arbitrators have to do is act professionally and follow the rules. The least one would expect is that they created the perception of fairness. Apparently, of the parties that responded, most answered that it was fair. Mr. Sneeringer does not say what the arbitrators did in the hearings where so many other individuals did not respond or responded it was not fair. In any case, the other problem with the survey is that it was not independent. The first and main author was an employee of NASD Dispute Resolution.[7]

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[3] [Comment Letter from Stephen G. Sneeringer, Senior Vice President & Counsel, A.G. Edwards & Sons, Inc., July 28, 2005]

[4] [Comment Letter from Edward G. Turan, Chairman SIA Litigation and Arbitration Committee, August 2, 2005]

[5] Like almost everyone else, Mr. Sneeringer took offense to the NASD's alleged reason for the rule change: "In order to increase investor confidence in the fairness of the NASD arbitration process." He argues that the NASD rules should be based on "reality" and not "perception." But he has only his own industry to blame for the offensive uses of the phrases "investor confidence" and "investor perception."

[6] "The purpose of this new instrument was to obtain evaluations from [Office of Dispute Resolution] forum participants regarding their perceptions of case processing and of arbitrator performance." [Gary Tidwell, Kevin Foster, Michael Hummel, "Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations," August 5, 1999.]

[7] This study was so diabolical in its intent and unprofessional in its execution that representatives of securities firms would do better to distance themselves from it.

Next Mr. Sneeringer spins the Perino study. He does not mention that it did not primarily study the fairness of NASD arbitration or did not prove that it was fair. Rather it recommended more study.[8] Interestingly, it too faults the Tidwell, et al. study. [9]

Both Mr. Sneeringer and Mr. Turan misrepresent the two GAO studies and omit its admission that the studies could not ascertain whether NASD arbitration was fair.[10] [11] Together Mr. Sneeringer and Mr. Turan assert that in most cases the customer wins.[12] [13] Of course, they interpret win as receiving an award of anything greater than zero. They do not offer any evidence that awards bear any relationship to the cases' merits or the actual damages. Indeed, they consider as a win an award of a few thousand dollars to a customer who may have lost many hundreds-of-thousands of dollars. It happens.[14]

Mr. Turan goes on to implicitly argue that NASD arbitration must be fair because in his mind the rules are fair. He incorrectly writes, "The process in place to select the arbitration panel is also already balanced and very transparent." But the NASD misclassifies arbitrators so that persons with industry ties are classified as non-industry arbitrators. Even after public outcry, the NASD resisted even partially correcting it. The recent changes to the classification still allow persons with industry ties to be classified as non-industry arbitrators. And worst of all is that the NASD administrators assign to cases industry arbitrators with relationships to the securities firms that are parties to the cases.

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[8] "This Report recommends that the SROs sponsor additional independent studies to further evaluate the impartiality of the SRO arbitration process." [Michael A. Perino, "REPORT TO THE SECURITIES AND EXCHANGE COMMISSION REGARDING ARBITRATOR CONFLICT DISCLOSURE REQUIREMENTS IN NASD AND NYSE SECURITIES ARBITRATIONS," November 4, 2002]

[9] "Two limitations of the study suggest that its findings must be interpreted with caution. First, few arbitration participants completed the surveys; the authors concluded that the evaluation response rate was only between 10%-20%. Second, these responses may reflect selection bias problems. The authors performed some tests to detect possible problems and found none, but it is still possible that individuals that were more satisfied with the fairness of the process or that achieved favorable outcomes were more likely to complete the surveys." [Michael A. Perino, "REPORT TO THE SECURITIES AND EXCHANGE COMMISSION REGARDING ARBITRATOR CONFLICT DISCLOSURE REQUIREMENTS IN NASD AND NYSE SECURITIES ARBITRATIONS," November 4, 2002]

[10] "GAO did not attempt to subjectively evaluate the fairness of the decisions reached because to do so, GAO would have had to analyze and judge the merits of the facts and reasoning in each case in its study. GAO could not compare arbitration and litigation results because of the limited number of retail investor cases decided through litigation and the inherent differences between the processes." [SECURITIES ARBITRATION - How Investors Fare, GAO, May 1992]

[11] "We could not comment on the fairness of the SRO arbitration process based on the statistics alone unless they could be measured against the outcomes of securities cases at an independent forum or the courts because these are the only other venues for resolving securities disputes." [SECURITIES ARBITRATION - Actions Needed to Address Problem of Unpaid Awards, GAO, June 2000]

[12] 'The GAO found no statistically significant difference between results in industry-sponsored arbitrations versus American Arbitration Association arbitrations noting that investors prevailed 59% of the time." [Comment Letter from Stephen G. Sneeringer, Senior Vice President & Counsel, A.G. Edwards & Sons, Inc., July 28, 2005]

[13] "Public customers not only win more than one-half of the cases that proceed to an award by an NASD arbitration panel, but NASD's Dispute Resolution Statistics for 2004 also indicate that 54% of arbitration cases that were closed that year were settled prior to hearing." [Comment Letter from Edward G. Turan, Chairman SIA Litigation and Arbitration Committee, August 2, 2005]

[14] A 62 year-old, divorced, retired nurse had nearly her entire life savings invested with her broker. As a result of the broker's completely unsuitable investment decisions, she lost more than $915,000. The NASD arbitrators awarded her $4,994.77 and then assessed her $5,625.00 in NASD forum fees. [Testimony of Daniel R. Solin to U.S. House Subcommittee on Capital Markets, Insurance and Government Sponsored Entities, March 17, 2005]

Regardless, the justification for industry arbitrators is superficial, and consumer and employee advocates mostly agree that industry arbitrators should be banned.

Mr. Turan also misrepresents facts when he writes, "The NASD provides extensive disclosures from the potential arbitrators." That is false. For example, when the State of California asked for more disclosure, the NASD refused and sued them. And as a last resort he quotes Linda D. Fienberg, President of NASD Dispute Resolution, assuring everyone that NASD arbitration is "fair."[15]

Conclusion

The evidence irrefutably proves that NASD arbitration is unfair and is biased in favor of securities firms. It is cheating individuals out of vast amounts of money – sometimes their life savings. The only questions that remain are Can NASD arbitration be salvaged? Or does it need to be scrapped and replaced by something that is fair?

It is a tragedy that the NASD and other representative of the securities firms are not addressing the injustice, but rather they are denying the evidence and stubbornly claiming that it is fair. Their callous disregard for individuals and their cynical proclamations undermine the credibility of the entire industry.

But their reasons are obvious. The NASD arbitration system allows the securities industry to evade the law and avoid paying damages back to customers and employees. Moreover, arbitration proceedings are closed and, therefore, securities firms avoid public scrutiny. In particular, they conceal from regulators and legislators other corrupt business practices. Clearly the securities firms and the NASD have something to hide.[16]

I implore the SEC to open up the entire NASD arbitration process to public scrutiny. As well the SEC should investigate whether NASD arbitration should be salvaged or scrapped.

Thank you.

Sincerely,

Richard Skora

[15] "The process has been repeatedly recognized as providing a 'fair, efficient, and less expensive means of resolving disputes between investors and their brokers.'" [Comment Letter from Edward G. Turan, Chairman SIA Litigation and Arbitration Committee, August 2, 2005]

[16] Francis Galvin, the secretary of the commonwealth of Massachusetts, expressed the same opinion, "What we have in America is an industry-sponsored damage containment and control program masquerading as a judicial proceeding." [Lynn O'Shaughnessy, "Stockbroker losses bring no trials, lots of tribulations," San Diego Union-Tribune, July 31, 2005.]