July 28, 2005

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

Re: File Number SR-NASD-2005-032
Proposed Rule Changes to NASD Code of Arbitration
Relating to Written Explanations in Arbitration Awards

Dear Mr. Katz:

A.G. Edwards & Sons, Inc. ("Edwards") appreciates the opportunity afforded by the Securities and Exchange Commission ("SEC") to comment on the rule change proposed by the National Association of Securities Dealers, Inc. ("NASD"). Edwards applauds the NASD for providing an arbitration forum that is generally perceived to be just and equitable, giving claimants and respondents an equal and unbiased tribunal in which to resolve their disputes in an efficient and cost effective manner. Edwards believes that the goal of the NASD, as should be the goal of any arbitration forum, is to provide a dispute resolution system that is fair, equitable, and just to all parties involved.

Edwards is concerned that the recent actions and proposals of the NASD to further the goal of a just and equitable forum are directed at pursuing the "perception" that the forum is just and equitable rather than the reality. The media and other third parties are generally the source of the negative "perception" to which the NASD is responding. The parties expressing these opinions rarely have direct experience in the arbitration process but rely on hearsay, which hearsay is normally from disaffected, losing parties in that process. Edwards does not believe that the NASD should utilize questionable rule revisions to convince individuals with negative perceptions that their perceptions are incorrect.

NASD has Provided a Just and Equitable Forum

Several polls, government studies, and forum alternative projects have consistently substantiated that the participants in the arbitration process believe that a full and fair opportunity to be heard was provided by the forum and that the process was just and equitable.

The General Accounting Office ("GAO") in 1992 issued a report titled *Securities Arbitration: How Investors Fair*, Rep. No. GAO/GGD – 92 – 74 (May 1992) that reviewed arbitration decisions over the period January 19, 1989 to June 1990 and found no evidence of a pro-industry bias. 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. The GAO again reviewed decisions during the period of 1992 through 1998 in its report, *Securities Arbitration: Actions Needed to Address Problem of Unpaid Awards*, Rep. No. GAO/GGD – 00 – 115 (June 2000), and came to similar conclusions.

Evaluations submitted by participants to NASD arbitrations from December 1, 1997 to April 1, 1999 were reviewed in 1999. The vast majority strongly agreed that their cases were handled fairly and without bias. In fact, more claimants than respondents felt that their cases were handled justly and equitably. *See* Gary Tidwell, Kevin Foster & Michael Hummel, *Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrators* 3 (1999).

The Securities Industry Conference on Arbitration ("SICA") compiles data on arbitration outcomes. Reviewing this data yields no evidence indicating that one party is favored in arbitration. In fact, the award results have remained surprisingly consistent over 20-plus years notwithstanding the numerous changes that have been made to the definitions of who is a "public arbitrator" versus a "non-public or industry arbitrator." Most of these changes were again made to assuage negative "perceptions" of self-regulatory organization ("SRO") arbitrations. *See* Michael A. Perino's Recommendation Two in his *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* (November 4, 2002) ("Perino Report"). Dr. Perino noted that the change to the arbitration selection process was to answer "critics" even though there was

"little if any evidence" that the pre-1998 selection system utilizing appointment rather than list selection "caused arbitrators to render pro-industry decisions." *Id.* at 20.

In January 2000, SICA commenced a 2-year pilot program permitting public customers to elect to arbitrate their claims in selected non-SRO forums. This program was undertaken voluntarily by the industry in response to contentions that, given the negative "perceptions" of SRO arbitrations, public customers would select non-industry forums if given the opportunity. This contention proved to be resoundingly incorrect. Notwithstanding the hundreds of cases eligible for the program, only eight were submitted. SICA found that lower cost, familiarity with procedures, and fear of delays caused public customers to pick SRO arbitration, notwithstanding this alleged negative "perception." *See* SICA *Final Report Securities Industry Conference on Arbitration Pilot Program for Non-SRO Sponsored Arbitration Alternative* (2002).

In 2002, Dr. Perino was asked to evaluate conflict disclosure rules of the NASD and NYSE arbitration codes. In the Perino Report, Dr. Perino came to many of the same conclusions as the prior studies, programs, and analyses mentioned above. He concluded that the benefits of the California Ethics Standards would be few and the problems that they could generate may be several. *Id.* Dr. Perino also concluded that there was little evidence indicating that SRO arbitrations were unjust, inequitable, or unfair. *Id.*

Therefore, independent studies, data and conclusions all verify that SRO arbitrations are fair, just, and equitable and that the public agrees with this conclusion. Notwithstanding empirical evidence, certain individuals and the media continue to claim that there is a public "perception" problem that needs to be addressed. The NASD has determined that the manner in which this should be addressed is through a series of rule proposals, the one that is the subject of this letter being the most recent. Edwards does not believe that rule making is the proper methodology to respond to negative publicity, particularly when that publicity may be inaccurate or biased.

Written Decisions May Not Produce Positive Perceptions of Arbitration

Factual decisions rendered by arbitrators may not further the perception that a public customer's case has been heard and decided in a fair, equitable,

and just manner. If one written opinion out of 100 or 1,000 lacks the communicative skill to clearly transmit the arbitrators' logic and reasoning, that written opinion will be the subject of commentary, analysis, and possible derision by the same individuals and media who currently contend that there is a public "perception" problem. The perception of arbitration as a just and equitable forum will be further injured and drawn into question. This will be true even if 99 or 999 written opinions satisfy the goal of clarity and logic.

Written Awards Will Encourage Appeals

Appeals are rendered more difficult when the arbitrators do not provide written explanations for their conclusions and awards. Many appeals have turned on the simple fact that the court, lacking an opinion from the arbitrators, concluded after reviewing all the evidence that some factual and legal basis existed to support the arbitrators' decision, therefore they did not exceed their powers, imperfectly execute them, or manifestly disregard the law. With a written opinion, the possibility of being successful on an appeal is increased merely because a court may disagree with the factual basis stated by the arbitrators. Simple logic would then demand that more appeals occur due to the possibility of success being greater. As Brian Smiley, a noted claimant's attorney and member of the Public Investors Arbitration Bar Association ("PIABA"), stated in an article in 1987:

> "Since arbitrators need not explain the reasons for their decisions, it is, however, extraordinarily difficult to prove manifest disregard." *See* Brian N. Smile, *Stockbroker-Customer Disputes: Making A Case for Arbitration,* Georgia State Bar Journal, Vol. 23, No. 4, 195, (May 1987.)

Most statements of claim include a multitude of boilerplate allegations. Most answers include all possible defenses to a claimant's claims including boilerplate affirmative defenses. The proposed rule would require the arbitration panel to make a determination on every claim and defense asserted and to provide the facts to support each ruling. Making factual determinations on 10, 20, or more claims and defenses will raise the risk of error exponentially. An error increases the risk of appeal. This results in a process that is neither efficient nor cost effective.

Further, arbitration is about the equitable resolution of disputes. Often, there is no strict legal basis for the awards rendered or the damages determined, rather an underlying goal of "equitable fairness" grounds drives the decision – a goal that disproportionately favors investors' interests. *See* Louis D. Lowenfell and Alan R. Bromberg, *Suitability in Securities Transactions*, 54 Business Law 1557, 1567 (1999.) If a written award is required, a decision granted on "equitable" fairness will have to be substantiated by the facts. The facts will also have to substantiate the monetary award granted. Edwards does not believe the public customer will be well served by the scrutiny that will accompany such written justifications for those awards.

Unilateral Rights are Unjust and Unfair

Permitting only claimants to unilaterally request a written explanation of the Panel's decision in customer cases smacks of unfairness, is prejudicial on its face, and is entirely inconsistent with the legal and equitable principals on which arbitration is founded. *See e.g., Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (quoting the Federal Arbitration Act, 9 U.S.C. § (1976)); *see also* Constantine N. Katsoris, *Beware of What You Ask For*: *You Might Just Get It*, Sec. Arb. Commentator, Vol. 2005, No. 2 at 4 n.10, and H. Thomas Fehn, *Arbitrator Awards... Where the Sun Don't Shine,* Sec. Arb. Commentator, Vol. 2005, No. 2, at 3n.1. Frankly, it is difficult to construct the logic why such a rule could withstand legal scrutiny given that arbitration is normally mandatory because industry members are required to arbitrate at the public customer's demand by rule, and the public customer must arbitrate at the industry member's demand by contract. The proposal further flies in the face of the most basic idea that arbitration is a fair and equitable means of resolving disputes. *See* Deborah Masucci & Robert S. Clemente, *Securities Arbitration at Self-Regulatory Organizations: New York Stock Exchange, Inc., and National Association of Securities Dealers, Inc. – Administration and Procedures,* 851 P.L.I. Corp. 47, 75 (1994) ("Arbitration is successful if all those involved promote fairness and equity.").

Conclusion

In conclusion, Edwards does not believe that rule revisions should be made for the purpose of publicity and "perception" but to rectify provable, unjust, and inequitable procedures and policies. Further, written awards will neither provide positive publicity nor "perceptions" but will encourage

additional appeals of arbitration decisions. Lastly, the proposal itself is unjust and inequitable, in direct contravention of the appropriate goals of an arbitration forum. Quite simply, an arbitration forum cannot provide a dispute resolution system that is fair, equitable, and just to all parties involved by designing rules and procedures that favor one party over another.

Again, thank you for giving A.G. Edwards an opportunity to comment on this proposed rule change.

Sincerely,

Stephen G. Sneeringer
Senior Vice President & Counsel

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