August 25, 2005

Jonathan G. Katz
Secretary
Securities and Exchange Commission
Station Place
100 F Street, NE
Washington, DC 20549-9303

Re: Proposed Rule Change, and Amendments Nos. 1 and 2 Thereto, To Provide Written Explanations in Arbitration Awards Upon the Request of Customers, or of Associated Persons in Industry Controversies - SR-NASD-2005-032

Dear Secretary Katz:

The Massachusetts Securities Division appreciates this opportunity to comment on proposed changes to the rules of the National Association of Securities Dealers ("NASD") to amend the NASD Code of Arbitration Procedure (SR-NASD-2005-032) to provide written explanations in arbitration awards upon the request of customers, or of associated persons (brokerage employees) in industry controversies.

The Massachusetts Securities Division is a department within the Office of the Secretary of the Commonwealth of Massachusetts. The Securities Division is charged with the responsibility to implement and enforce the Massachusetts securities laws. As such, the Secretary of the Commonwealth is the chief securities regulator for Massachusetts.

While the Massachusetts Securities Division supports the proposed amendments, we believe the rule changes should go further. Explanations of arbitration decisions should include legal authorities and damage calculations, not just the factual grounds for the decision. Explained decisions should be provided in all cases, and not just upon the customer's request. The exceptions for simplified arbitrations conducted without a hearing and for default cases should be eliminated. We also urge the NASD and the Securities and Exchange Commission to take further step steps to make the arbitration process fairer for investors.

Introduction.

Currently, Rule 10330(e) of the Code requires only that arbitration awards contain the names of the parties and counsel; a summary of the issues; the damages and other relief requested and awarded; a statement of any other issues resolved; the names of the arbitrators; the dates the claim was filed and the award rendered; the location, number, and dates of hearing sessions; and the signatures of the arbitrators concurring in the award. Arbitrators may also include a statement of the rationale underlying their decision in the award, but they currently are not required to do so, and therefore they usually do not provide one.

The request for comments states that an explained arbitration decision will constitute a fact-based award that states the reasons each alleged cause of action was granted or denied and that will address all claims involved in the case, whether brought by the party requesting the explained decision or another party. Under the rule proposal, the explained decision will not be required to include legal authorities or damage calculations, in order to limit additional costs and time associated with the decision. Also, the NASD intends that, as with current arbitration awards, explained decisions will have no precedential value in other cases; the explanation will be for the information of the parties only.

The request for comments states that customers and associated persons who lose in arbitration (or consider their recovery insufficient) often request written explanations or opinions from the arbitrators. However, since these requests are usually made after the awards are issued, arbitrators are unlikely to provide them because they were not advised in advance that they would be writing an explained award and do not want to undermine their award. The lack of reasoning or explanation in awards is one of the most common complaints of non-prevailing participants in NASD's arbitration forum.

Comments.

Explained Decisions Promote Fairness in Arbitration.

We fully agree with the NASD's proposal to permit customers and associated persons to receive explained decisions in arbitrations. Common sense and fairness require this change.

Few investors would elect to take their disputes to NASD arbitration as it currently exists. We note that virtually every brokerage's new customer agreement requires customers to take any disputes with the brokerage to NASD arbitration. Because new customer agreements are contracts of adhesion, they are presented to retail customers on a take-it-or-leave-it basis. Brokerage customers are forced to agree to use NASD arbitration; they are not affirmatively selecting it or negotiating to make it the exclusive forum for resolving disputes.

We observe that many investors often do not even know they will be required to use NASD arbitration until after a dispute has arisen. Simply put, investors are having their disputes heard in a forum that they did not choose, and one they would not choose if they were given an alternative. Against this backdrop, allowing arbitrators to issue decisions that are not explained, even when the customers would want an explanation, compounds the sense that the arbitration process is unfair.

Written explanations will also have the important benefit of assisting courts in correcting bad decisions, again promoting fairness. Although judicial review of arbitration decisions is limited, fact-based explanations will provide a somewhat better record on which to appeal a badly flawed outcome.

Fundamental Fairness Requires an Explained Decision If the Customer Wants One.

An explained decision is a key protection against arbitrariness in resolving disputes. The process of drafting an explained decision will encourage arbitrators to deliberate carefully and to use reasoned decision-making in reaching their decisions.

Explained decisions will promote a sense that all litigants are being heard and treated fairly. Even in cases when the customer does not prevail or receives a smaller than requested recovery, an explanation can help make the result more acceptable. Conversely, a decision that is adverse to the customer, and that is not explained, can destroy the confidence of investors in the arbitration process.

Explained Decisions Should Be the Norm.

We note again that the proposed rule change will give customers the *option* to request an explained decision. We urge that the proposal be amended so that explained decisions will be the norm for all arbitrations. At a minimum, an explained decision should be required unless the investor "opts out," and elects not to receive one.

Decisions Should Include Legal Authorities and Damage Calculations.

The NASD should amend the rule proposal to require legal authorities and damage calculations, in addition to the fact-based reasons for the award. This change will help to provide fairer outcomes, enhanced investor confidence, a meaningful basis for appeal, and will promote the evolution of securities jurisprudence in arbitration cases. Without this, the rule amendment will fall short of its objective of improving confidence in the arbitration system.

Requiring legal authorities and damage calculations in written decisions is especially important for correcting serious errors in arbitration decisions. As noted above, the Federal Arbitration Act limits the judicial review of arbitration decisions. However, an arbitration award may be overruled for a "manifest disregard of the law" and a "miscalculation of figures." However, when arbitrators do not explain the factual and legal grounds for their decisions, courts find it nearly impossible to apply these standards

of review. For these reasons, requiring legal grounds and damage calculations in explanations is necessary to permit courts to conduct even a limited review.

Providing legal authorities and damage calculations in arbitration awards should not create serious additional burdens or delay; and the benefits should outweigh the burdens that are imposed.

Remove the Exceptions for Simplified Cases and Defaults.

The NASD should make the rule amendment applicable to all simplified cases, including those cases decided without a hearing. The NASD should also make the amendment applicable to default cases.

In simplified arbitrations, the parties should receive explained decisions whether or not a hearing is held. Even in disputes "involving a dollar amount not exceeding $25,000, exclusive of costs and interest," the parties deserve the benefits of explained decisions.

Claimants in arbitrations conducted under the default provisions also should receive explained decisions. Even in default cases, arbitrators must evaluate the claims and the evidence presented and must exercise their judgment in applying the law to the facts. While the award may be the same as the amount claimed, often it is not. All parties who are subject to an arbitrator's decision-making should have the benefit of an explanation of the decision.

Other Changes That Should Be Made in the Arbitration Process.

Arbitration Panels Should Not Be Required to Include Industry Arbitrators.

We urge the NASD to take further steps to make the arbitration process fairer to investors. In particular, we urge the NASD to improve the impartiality of arbitration panels by abolishing the current requirement in NASD Rule 10308(b) that, for disputes involving over $25,000 in damage claims, one arbitrator on a three-arbitrator panel be a non-public (industry) arbitrator. The current requirement for an industry arbitrator builds pro-industry prejudice (or the perception of such prejudice) into every arbitration panel. Also, use of industry arbitrators can operate to entrench problematic industry practices (particularly bad sales practices), which might be rooted out by a panel made up of only non-industry arbitrators.

Give Investors the Option to Arbitrate or Go to Court.

We urge the NASD to require its member firms to offer their customers a meaningful choice between binding arbitration and civil litigation, not just a contract of adhesion requiring arbitration. If arbitration really is fair, inexpensive, and quick, then these benefits will prompt investors to choose arbitration. If, on the other hand, arbitration

does not offer these advantages, then this mode of dispute resolution should not be forced on investors.

Improve the NASD Statistics on Arbitration Outcomes.

The NASD should improve the statistics that it collects and disseminates on arbitration, particularly with respect to outcomes. Proponents of arbitration, including the NASD, assert that investors receive some compensation in over half of the arbitrations that result in a decision. We urge that this statement suggests that investors "win" more than half the time, and that it is therefore misleading. An investor who recovers only a small fraction of their losses in the arbitration process can hardly be described as a "winner," especially when attorney's fees and costs are added to the mix. It would be far more useful and revealing to collect data showing the ratio of amounts awarded in relation to damages claimed. These kinds of statistics are necessary in order to assess the value of arbitration as a means of dispute resolution.

If you have any questions about this letter, or we can assist you in any way, please contact me or Bryan Lantagne, Director of the Massachusetts Securities Division, at (617) 727-3548.

Sincerely,

<signed>
William F. Galvin
Secretary of the Commonwealth