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July 12, 2005

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

Re: File Number SR-NASD-2005-079

Dear Mr. Katz:

Thank you for this opportunity to comment on the above-referenced NASD proposal.

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.

The NASD proposes a rule change to require a party to give 10 days prior notice before issuing a subpoena seeking discovery. The proposal does not give sufficient cause for adopting the rule change. Moreover, there are systemic problems with discovery which this rule change does not address, including that arbitrators are not following existing rules, and both arbitrators and the NASD are not enforcing existing rules. For these reasons I recommend that the SEC rejects the proposed rule change.

Payment for Deciding Discovery-Related Motions

The key element of the rule change is the described in the following new language:

> *No subpoenas seeking discovery shall be issued to or served upon non-parties to an arbitration unless, at least 10 days prior to the issuance or service of the subpoena, the party seeking to issue or serve the subpoena sends notice of intention to serve the subpoena, together with a copy of the subpoena, to all parties to the arbitration.*

As justification the proposal states only the following:

> *In order to make the pre-hearing discovery process more orderly and efficient, NASD is proposing to revise the Code to provide for a 10-day notice requirement before a party issues a subpoena to a non-party for pre-hearing discovery.*

The justification is superficial. It does not give any background information. In particular, it does not acknowledge that the present rule of no notice requirement causes numerous problems for customers and employees and their counsels. (My comments are below.) The NASD should reveal the full details so that people may critically analyze it for themselves and draw their own conclusions. Moreover, it does not explain "orderly" and "efficient."

However, the NASD offers two examples of how subpoenas may be used:

> *An investor's attorney might subpoena account records for other investors at a broker's firm, or a brokerage firm's attorney might subpoena records from the investor's cell phone company.*

The first example is misleading. A securities firm already holds its investors' account records, so it is unclear why an individual would need to subpoena the investors for their account records.

One the other hand, the second example is just the tip of the iceberg of how securities firms abuse the discovery process. Again, the securities firms by law must keep recordings of telephone conversations with their investors. So to subpoena investors' cell phone company only serves to harass customers and drive up their arbitration costs.

It is disturbing that arbitrators are allowing securities firms to file frivolous subpoenas. Securities firms have been known to subpoena the individuals' family, friends, neighbors, employers, and business associates – for the purpose to only embarrass and harass individuals and raise their arbitration costs.

This also reveals the arbitrators' frame of minds. As suggested above the securities firms already hold copies of virtually all relevant documentary evidence so there is rarely reason to even compel individuals to produce anything let alone subpoena their relations. Nevertheless, many arbitrators use the discovery process to steer the case in favor of the securities firms. Instead, of keeping focused on the relevant facts and the laws, the arbitrators allow the securities firms to go on fishing expeditions and, and for example, turn the cases into irrelevant smear campaigns against the individuals. As a result the securities firms fill the record with nonsense. Taken together with the arbitrators' unexplained rulings, it is difficult to know how the arbitrators reached their sometimes egregious decisions and, therefore, usually impossible to appeal.

At the end of the day, arbitrators are allowing securities firms to issue frivolous subpoenas. So it matters little whether the securities firms give "10-day notice" or not. A better rule change would

stop securities firm from issuing frivolous subpoenas. One such rule to consider would require arbitrators to give written explanations of why they grant securities firms' subpoenas.

NASD Arbitration's Discovery Process

The rule change should also be judged in the context of the discovery process to which the rule change pertains.

The US court system is designed to be as fair as possible to both parties. It tries to minimize the inequities between the parties. In particular, discovery affords the smaller party the opportunity to obtain documents and other information that would quickly establish relevant facts and, therefore, remove the burden of establishing those facts in some other manner.

NASD arbitration, on the other hand, has removed everything good about the US court that protects the smaller party. It accentuates the inequities between the parties. The arbitrators are given infinite leeway in deciding various issues, including discovery issues. These problems are magnified because the proceedings are closed to outside scrutiny and decisions are almost impossible to overturn.

Ironically, the proposal draws attention to its hypocrisy. It states part of the old language:

> *Parties shall produce witnesses and present proofs to the fullest extent possible without resort to the subpoena process.*

The new language is comparable:

> *To the extent possible, parties should produce documents and make witnesses available to each other without the use of subpoenas.*

But arbitrators and the NASD are already not enforcing the above rule. For example, many arbitrators allow securities firms to abuse discovery to the disadvantage of customers and employees of securities firms. Securities firms either offer obviously dubious excuses to not produce responsive, discoverable documents or they outright refuse to produce them. Arbitrators fail to scrutinize and record it as required by the rules.[1] Instead they condone such conduct or even congratulate securities firms' counsels on their success in manipulating the process.

[1] "II. Document Production Lists. .C. Affirmation in the Event that there Are No Responsive Documents or Information. If a party responds that no responsive information or documents exist, the customer or the appropriate person in the brokerage firm who has personal knowledge (i.e., the person who has conducted a physical search), upon the request of the requesting party, must: 1) state in writing that he/she conducted a good faith search for the requested information or documents; 2) describe the extent of the search; and 3) state that, based on the search, no such information or documents exist." [Discovery Guide, Last updated on: 06/21/01]

In one instance a securities firm made the excuse that the terrorist attack on 9/11 destroyed documents created *after* 9/11 and stored in locations *different from* the World Trade Center. The arbitrators allowed it. On the other hand they compelled the individual to turn over personal items to be examined by the securities firm. Later when the securities firm tried the same tactic in a legitimate court, the judge called it "obstructionist" and instructed the jury to draw a negative inference.[2]

Arbitrators too abuse discovery. They steer arbitration in the securities firms' favor. They make numerous inexplicable, irrational, and inconsistent decisions which have the affect of allowing only documents helpful to the securities firm. Arbitrators have been known to let the securities firm choose which documents would or would not be produced regardless of whether the individual or the securities firm held the documents. The arbitrators even made the individual produce privileged documents. As well the arbitrators allowed the securities firm to decide when to produce documents – sometimes as late as the time they enter the documents into evidence.

For several years the NASD has been aware of these abuses, but they have not disciplined the arbitrators or the securities firms. Instead it issued gentle reminders in it various publications.[3] [4] [5] [6] [7] [8] [9] [10] This confirms that the abuse was widespread. The response is notable not just for its indifference but for its implicit message that one could somehow rehabilitate arbitrators who so egregiously ignore such fundamentally important rules. Not surprisingly the notice did not solve the problem. To this day securities firms refuse to produce documents and arbitrators allow it.

The proposed rule change does not address the more significant problem that securities firms and arbitrators are abusing discovery to the detriment of customers or employees. It would be better to a rule change that requires arbitrators to give written explanations of <u>all</u> their discovery decisions as well as a rule change to require the NASD to enforce the former rule change.

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[2] Gretchen Morgenson, "All that missing E-mail … It's Back," *The New York Times*, May 8, 2005.
[3] Notice to Members, November 1999
[4] Notice to Member, November 2003
[5] Neutral Corner, October 2003
[6] Notice to Members, December 2003
[7] Notice to Parties, January 12, 2004
[8] Neutral Corner, February 2004
[9] Neutral Corner, June 2004
[10] Neutral Corner, October 2004

Conclusion

The proposal does not give adequate background information in order to critically analyze the latest rule change nor does it give sufficient justification to accept it. Rather the proposal draws attention to systemic problems with discovery which this rule change does not address, including that arbitrators are not following existing rules, and both arbitrators and the NASD are not enforcing existing rules.

The plethora of rule changes to NASD arbitration of the last 30 years indicates that it was ill-conceived from the beginning. Despite the changes it is still unfair to customers and employees of the securities firm. The numerous rule change patches have not made it fair but rather only made it more complicated.

For these reasons I urge the SEC to reject the proposed rule change. Thank you for your consideration.

Sincerely,

Richard Skora