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PACE INVESTOR RIGHTS PRQJECT

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Secretary, Securities and Exchange Commission
450 Fifth Street, N.W.
Washington D.C. 20549-0609

Re: Proposed Rule Change Relating to NASD 3110(f)
Governing Use of Predispute Arbitration Agreements with Customers
File No. SR-NASD-98-74

To Whom It May Concern:

We, the Directors of the Pace Investor Rights Project ("PIRP") at Pace University School of Law, are writing in response to NASD's request for comments to NASD's proposed rule change relating to NASD Rule 3110(f) governing the use of predispute arbitration agreements with customers. PIRP's mission is to advocate on behalf of investor justice, particularly with respect to the rights of small investors.

We applaud NASD's purposes in proposing the rule change: to require, in customers' predispute arbitration agreements (PDAAs), additional disclosure on the arbitration process; to require member firms to provide customers certain information upon request; and to clarify the rule regarding the use of choice of law provisions in PDAAs. These changes should help investors to have a better understanding of the consequences of PDAAs on their rights and should also assure a fairer process.

In the notice, NASD states that "many" broker-dealers require customers to sign a **PDAA** to open an account (at 53764). In our experience, this understates the prevalence of PDAAs in the securities industry. If there are broker-dealers who will permit a retail customer to open an account without signing a PDAA, we do not know of them. It is time to acknowledge frankly the universality of the practice. Indeed, it would be a laudable side-effect of this proposed rule

change if, by improving the disclosure of consequences of arbitration, some broker-dealers may seek to create competition for informed customers by advertising that they do not require customers to arbitrate their disputes. When courts and consumer protection statutes began to require fuller disclosure of warranty language in consumer goods, for example, it was reported that some manufacturers and sellers began to compete by offering better terms.

We support the revision of the required language to make clear its dual purpose. It not only provides disclosure of information in plain English, but the language is also language of contract, binding not only the customer but also the firm.[1] In the past, some courts have insufficiently recognized that the language is binding on the firms and limits their access to the courts as well as the customers'.[2] We urge that, in the future, NASD take disciplinary action against firms that violate their customers' contract by bringing judicial actions to thwart the arbitration process.

We are not certain of the meaning intended by the phrase in (f)(3)(A) stating that, in lieu of providing the customer with a copy of any PDAA, it may inform the customer that it "does not have a copy thereof..." It suggests that there may be a situation where there is a PDAA between the firm and the customer, but the firm does not have a copy of it. We cannot contemplate such a situation and suggest the wording be revised to cover what we assume is the intended situation: where there is no PDAA between the parties.

We also suggest, in (f)(3)(B), that the same 10 business day requirement be applied to the firm's obligation to provide the customer with information about arbitration forums.

According to NASD's rule filing, section (f)(4)(B) was revised to address two separate but equally valid concerns expressed by customers. First, by signing an agreement that contained a choice-of-law clause, the customer might inadvertently waive certain rights and remedies. Second, these choice-of-law clauses might select an arbitrary jurisdiction that has no relationship to the customer or the transaction at issue. We agree that the proposed revised language sufficiently addresses the second concern.

However, we do not believe that the proposed revision addresses the first concern involving unknowing waiver of remedies. Non-lawyer investors are not likely to understand the significance of a choice-of-law clause, no matter what jurisdiction's law is designated. The revised language fails to alert investors that the inclusion of the choice-of-law clause may alter available rights and remedies, or that certain jurisdictions limit the rights and remedies available to customers.[3] Moreover, the revised language does not alert the customer that the choice-of-law clause might be preempted by the Federal Arbitration Act (FAA) under certain limited

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[1] Specifically, the addition of the language in (f)(1): "By signing an arbitration agreement, the parties agree as follows:..."

[2] See, for example, Coleman & Co. Sec., Inc. v. Giaquinto Family Trust, No. 00 CIV. 1632, 2000 WL 1683450, at *1 (S.D.N.Y. Nov. 9, 2000), where the court held that the firm could sue for judicial determination of the statute of limitations despite NASD-required language that parties are waiving their right to seek judicial remedies and NASD policy that arbitrators decide statutes of limitations issues. For other examples, see Barbara Black, *The Irony of Securities Arbitration Today: Why do Brokerage Firms Need Judicial Protection?* (publication forthcoming in U. Cinn. L. Rev.).

[3] There are limits to the application of a choice-of-law clause apart from geography. NASD has previously stated that "the use of a governing law clause or other clause anywhere within a customer agreement that thwarts any NASD arbitration provision will be deemed violative." NASD Notice to Members 95-16, *Predispute Arbitration Clauses in Customer Agreements*, 1995 WL 1712330 (National/Federal) (Mar. 1995), at *2.

circumstances, supplanting the parties' choice if a state's law is hostile to the substantive purposes of the FAA. As a result, even after including these revisions in the PDAA, a firm can still accomplish the undesirable and unfair result of imposing a potential waiver of rights and remedies under applicable state law without the customer knowing or understanding it has happened. Thus, while we support the proposed revisions in section (f)(4)(B) as a better solution than no revisions at all, we urge the SEC and NASD to consider further revisions to achieve all of the goals identified in the rule filing.

Finally, we support the proposed revision in (f)(5), as it renders the process fairer to investors by withdrawing from the brokerage firm the power to force investors to pursue their claims on parallel tracks – court and arbitration. Allowing the firm to compel arbitration of only some of the claims a customer had filed in court increases the costs and decreases the efficiencies of pursuing those claims, making an equitable recovery for the customer far less likely.

Thank you for your consideration of these comments. Please do not hesitate to contact us if we can provide additional information.

Sincerely yours,

Barbara Black

Barbara Black, Director

Jill I. Gross

Jill I. Gross, Director