Public Investors Arbitration Bar Association

September 21, 2006

Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

Re: Proposed NASD Rule 12504 - Dispositive Motions
SR-NASD-2006-088

Dear Ms. Morris:

I write on behalf of the Public Investors Arbitration Bar Association (PIABA) in response to the Commission's request for comments on the NASD's proposed Dispositive Motion Rule, found at SEC Release 34-54360 (August 24, 2006). PIABA is an international bar association of attorneys who practice in the securities arbitration area. We are the voice for public investors who bring claims in arbitration. Our members and their clients have a strong interest in the rules governing the arbitration process at the NASD.

We agree with the Commission that it is time to re-examine the ultimate question in light of the 156 comment letters received since the NASD's original filing of the Code Rewrite and proposed dispositive motion rule in June, 2005.[1] PIABA has always believed, and continues to believe, that in virtually every case, no motion to dismiss should be considered until after a customer has completed the presentation of his entire case in a full evidentiary hearing. We recognize that there may be those extremely rare circumstances where fairness requires the consideration of a motion to dismiss before the evidentiary hearing. An example is mistakenly naming a party who had no possible connection with the customer, transactions or brokerage firm. In these situations, it would not be fair to require the individual respondent to bear the expense of a hearing. We can support the NASD's efforts to authorize the filing of a motion in those types of rare circumstances, so long as any rule will likewise adequately address the real problem, which is the improper filing of dispositive motions.

Our support of any dispositive motion rule is not without reservation. Proposed Rule 12504 is already creating more problems than it solves. Our members report a sharp increase in the filing of dispositive motions in 2006. We believe that the NASD's data, to which we are not privy, would empirically confirm that. As described in our comment letter of May 26, 2006 in response to NASD's Amendment 5, lawyers for the industry have publicly stated that they see the rule proposal as an invitation to engage in routine dispositive motion practice.

[1]SEC Release 34-54360 at 3-4 (August 24, 2006)

In a CLE program in New York City last May for lawyers representing industry clients in NASD customer arbitrations, attendees were taught that proposed Rule 12504 codified motion practice, gives the industry what it has been asking for, and stated that motions to dismiss should be raised in every case in the answer. That teaching has taken hold, as these motions are already becoming the rule rather than the exception. The sheer number of comment letters that the Commission has received is a testament to the new landscape that the proposed rule has created. The NASD's proposal needs to be modified to clarify the rule's intent so as to avoid further abuse.

Proposed Change to Rule 12504(a).

PIABA proposes the following modification to proposed Rule 12504(a) to address the problems identified above and create a more balanced rule:

> **(a) Generally, parties have the right to a full evidentiary hearing in arbitration, and except as provided in Rule 12206, motions to decide a claim, defense, or counterclaim before a full evidentiary hearing are discouraged and may only be granted in extremely rare circumstances.**

The NASD acknowledges in its rule filing that Section 15A(b)(6) of the Securities Exchange Act requires that the arbitration rules must be designed to prevent fraudulent and manipulative acts and must "protect investors and the public interest." Furthermore, in explaining the proposal, the NASD has stated that "[g]enerally, NASD believes that parties have the right to a hearing in arbitration." The rule proposal needs to be modified to ensure adherence to the spirit and purpose of the dispositive motion rule. We propose to do that by incorporating the NASD's own language into the rule, and by changing the phrase "extraordinary circumstances" to "extremely rare circumstances." Those changes will help to clarify that in almost all cases, parties have a right to a full evidentiary hearing in arbitration. That was the NASD's stated intent, and that is what is required to protect investors from abusive practices.

Our proposal also corrects another imbalance. As proposed by the NASD, the rule only applies to claims. If there is to be a dispositive motion rule, it must in fairness also apply to defenses and counterclaims.

The PIABA proposal also makes good policy sense. In most instances, applying a dispositive motion rule in NASD arbitration is like forcing a square peg into a round hole. It does not fit. Dispositive motions attacking the sufficiency of the "pleadings" (i.e., a federal rule 12(b)(6) type rule) do not work because the NASD Code only requires the

statement of claim to "specify the relevant facts and the remedies sought."[2] Parties are not required to plead ultimate facts, elements of legal claims, or causes of action. Indeed, the word "pleading" does not appear in the Code, and for good reason. The Code was designed to simplify the claims process, and sand not to impose technical pleading requirements. One reason for that is that many arbitrators are not attorneys and are not qualified to make decisions based upon laws governing civil procedure. The minimal requirements for bringing a claim is inconsistent with a procedure for attacking pleading deficiencies

There is also no room in NASD arbitration for dispositive motions based upon federal Rule 56 summary judgment-type principles, which apply the facts obtained in discovery to legal standards governing claims. In arbitration, the parties do not have the discovery opportunities available in court. Much of the "discovery" occurs at the hearing, when the claimant has his first and only opportunity to examine the broker, supervisor, branch manager and other witnesses under oath. Summary judgment jurisprudence rests necessarily upon the notion that, after the parties have had full opportunity to develop their case, no material facts are left in dispute. In court, if a party has not had an opportunity to investigate or develop the facts on an issue, the motion gets continued. See, e.g., Fed.R.Civ.P. 56(f). In arbitration, that opportunity is not available until the hearing, so a motion to dismiss based upon that standard should always be continued until the claimant has had a full opportunity to present his or her entire case at the hearing, if the claimant needs to develop facts to respond to the arguments.

It also important to bear in mind that there is effectively no appellate review in arbitration. If an arbitration panel erroneously grants a motion to dismiss and denies an investor the right to a hearing, the investor has no recourse. The extremely limited review of arbitration awards makes it virtually impossible to correct arbitrator error. A recent example illustrating this point is Reinglass v. Morgan Stanley Dean Witter, 2006 Ohio 1542 (Ohio Ct. App. 2006), where an arbitration panel dismissed a $500,000 claim in a pre-hearing telephone conference for failing to plead fraud with sufficient particularity to meet federal court pleading standards, even though the NASD Code only requires the claimant to file a statement of claim that includes "the relevant facts and the remedy sought." An Ohio appellate court refused to vacate the award, and the Ohio Supreme Court denied review. Reinglass v. Morgan Stanley Dean Witter, Inc., 2006 Ohio 4288 (Ohio 2006). From the record, it appears that no one ever explained the NASD requirements for stating a claim to the arbitrators or the court. As a result of a panel's granting a motion to dismiss based upon an inapplicable pleading standard, the investor was never able to present his claim, and was left with no recourse.

Finally, the Commission should keep in mind that customers are in arbitration

[2]Rule 10314(a).

because the industry has required them to sign arbitration agreements as a condition of opening a new account. In exchange for giving up their rights to go to court and have their claims decided by a court and jury, customers are supposed to have the opportunity to present their case to a panel of arbitrators in an evidentiary hearing. That opportunity should not be taken away, except in the rarest of circumstances.

The securities industry also agrees that in arbitration, parties should get to present their case at a hearing. As Marc E. Lackritz, the President of the Securities Industry Association, testified before the Committee on Financial Services, U.S. House of Representatives, on March 17, 2005:

> Aggrieved customers get what so many say is what they really want: their "day in court." Unlike in court cases, claimants in arbitration are not held to technical pleading standards. Unlike in court cases, pretrial discovery in arbitration is focused and limited, and rarely includes expensive and time-consuming taking of depositions. Unlike in court cases, the hearings themselves are not intimidating, technical proceedings bound strictly by the rules of evidence, but are designed to be flexible and allow the arbitrators to reach the most equitable conclusion. The more streamlined process of arbitration, as compared with the many procedural and financial obstacles that must be overcome by a plaintiff in a court case, means that nearly every case brought in arbitration (other than those that are settled) goes to a full merits hearing.

For all of those reasons, the Commission should incorporate the language we propose in Rule 12504(a). With those simple changes, there is thankfully no need to further define "extraordinary circumstances," which has proven to be a task that cannot be accomplished with any degree of consensus between claimant and industry representatives.

Proposed Change to Rule 12504(c)

The Commission asks if arbitrators should have the explicit authority to deny leave to file dispositive motions. We believe that they must have that authority, and that they would exercise it in most instances. Accordingly, we propose the following as an amendment to proposed Rule 12504(c), with proposed new language underlined:

> **(c) Motions under this rule will be decided by the full panel. The panel may defer consideration of the motion, and the time for the opposing party to file a response to it, until the conclusion of the presentation of the evidence at**

> **the full evidentiary hearing, or such other time as the arbitrators deem appropriate. The panel may not grant a motion under this rule unless a prehearing conference on the motion is held, or waived by the parties. Prehearing conferences under this rule shall be tape recorded.**

Most panels deny dispositive motions, but give the moving party an opportunity to renew the motion at the full hearing. The Code should specifically authorize a panel in its discretion to defer consideration of or decisions on dispositive motions until the conclusion of the evidence. In addition, opposing parties may not be in a position to fully respond to the motion until after the evidence has been presented at the hearing. Our proposal affords the arbitrators the discretion to allow the filing of responsive arguments until the appropriate time.

With the changes that PIABA proposes here, we can support the introduction of a dispositive motion rule to the NASD Code. I hope that our views have been helpful to the Commission. Please contact me if you need any additional information or have any further questions.

Very truly yours,

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PIABA President

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