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The P I A B A Quarterly

The Newsletter of the Public Investors Arbitration Bar Association

March 1996 Volume 3 Number 1

In This Issue...

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Volume 3 Number 1

MAR 6 1996

Editor's Notes

The deadline for receiving submissions for the second 1996 issue of the *QUARTERLY* is May 25, 1996. As always, we request that all submissions be accompanied by a computer disk of the submitted material.

Please review the Bulletin Board section and take the time to respond if you have any of the requested documents or information.

We would like to thank Thomas Mason for his submission of recent cases which we have digested in this issue.

Please note the annual meeting (October 17 - 20) information on page 2. Also look for the registration information in with your *QUARTERLY* mailing.

If you have any questions or comments, please fax them to (504) 926-4348.

The PIABA Quarterly is a publication of The Public Investors Arbitration Bar Association (PIABA) and is intended for the use of its members. Statements and opinions expressed are not necessarily those of PIABA or its Board of Directors. Information is from sources deemed reliable, but should be used subject to verification.

Letter From the President

L. Jerome Stanley, L. JEROME STANLEY, P.C., Baton Rouge, LA

Dear PIABA Members:

As you all know, the Ruder Commission Report was released in January 22, 1996, and with it came the most ambitious proposal for revamping securities arbitration in its history.

The PIABA Board met on January 29, in New York to review the Ruder Report and discuss what would be included as the Board's response.

After the New York meeting, a committee was formed to draft the official response. Largely due to the efforts of Jim Beckley and Seth Lipner, our response was finalized and was distributed with an accompanying press release. **We have reproduced a copy of the response for you in this issue of the *QUARTERLY*.**

A liaison of PIABA members has been invited by the NASD to meet with the NASD arbitration department to discuss the specifics of the implementation of the recommendations of the report and the specific areas where PIABA had differences with those recommendations. A meeting is scheduled for Tuesday, April 2, 1996 at the NASD office in New York.

The next scheduled meeting of the Board is set for the weekend of April 19 in New Orleans.

In This Issue...

We have selected Turnberry Isle Resort in Aventura, Florida for the 1996 Annual Meeting. Enclosed with this issue of your *QUARTERLY* are the registration forms for the Annual Meeting. Please make your registrations as early as possible so that we can plan accordingly. The schedule and individual presentations for the Annual Meeting will be one of the major topics at the Board's April meeting, so anyone with a desire to make a suggestion or be a participant should contact the Board as soon as possible.

Sincerely,

Jerry

PIABA Annual Meeting

Herbert M. Deutsch, DEUTSCH & LIPNER
Garden City, NY

The 5th Annual Meeting of PIABA will take place at Turnberry Isle Resort and Club in Aventura, Florida on **October 17-20, 1996**. It is near Fort Lauderdale, but easily accessible through Miami or Palm Beach as well.

Turnberry Isle is one of the premier resorts in the area. It has first class facilities, two championship golf courses and a beautiful spa. The room rate will be $185 per night, a substantial discount from the hotel's normal rate.

The meetings will begin with a cocktail party Thursday night, followed by meetings Friday morning, Saturday morning and Sunday morning. There will be a second cocktail party Friday night, and a dinner Saturday night. As we did last year, we plan a golf outing and an excursion for non-golfers.

Under the agreement we have with Turnberry, room space is plentiful now, but we cannot guarantee you a room if you book after June 1, 1996. A reservation form is attached, and you can call Laurie or Tyra at Kent Travel if you have questions or need extra assistance at (800) 537-8218.

Finally, anyone who wants either to volunteer to speak or who wishes to offer an idea for topics should contact Seth Lipner or Jerry Stanley.

NASD National Arbitration Committee

Congratulations to PIABA Board member Mark Maddox and PIABA member Roger Deitz for being elected to seats on the NASD's (newly renamed) National Arbitration and Mediation Committee. Mark replaces Boyd Page, whose term expired, and Roger ascends (we suspect) because of his substantial experience not only in securities law but also in mediation.

Bill Lapp (PIABA Director) retains his seat as well, so PIABA's interests are well-represented on that important committee.

PIABA Expert Directory and Expert Database

This month you received PIABA's updated Expert Witness Directory. It contains the resumes of 67 different experts (a/k/a "good guys") who have expressed a willingness to testify or consult on behalf of investors. Many thanks to Brooke for the hours of work spent in assembling this impressive volume.

This month you also received a request that you send us information about securities industry (a/k/a "bad guy") experts. As you know, this idea has been kicking around for a few years. Florida member Pat Shub revived it at the Business Meeting at LaCosta, and we are putting her suggestion to work.

Of course, Pat's idea **can't work without your help**. Send us the form for each industry-defense expert you have confronted in the last two years. We will keep it on file, and provide the

The PIABA QUARTERLY is published quarterly in the interest of the members of The Public Investors Arbitration Bar Association. Editor-In-Chief - Jerry Stanley; Associate Editor - Seth Lipner. The PIABA QUARTERLY welcomes information on cases or articles that would be of interest to PIABA members. Contributions should be mailed to:
The PIABA QUARTERLY, 7909 Wrenwood Boulevard, Suite C, Baton Rouge, Louisiana 70809; FAX (504) 926-4348. All copy is subject to the approval by the publisher. Any material accepted is subject to such revision as is deemed appropriate in the publisher's discretion.

information to other members upon request. To encourage participation and fairness, however, we are restricting access to the data base to those (individuals or firms) who provide us information on at least one defense expert. So send in a completed form on at least one industry expert so you can take advantage of this exciting new PIABA service.

New York Report

Seth Lipner, DEUTSCH & LIPNER, Garden City, NY

The last quarter has seen a number of interesting developments.

Timeliness: Following the decision last fall by the Appellate Division in Goldberg v. Parker (see last *Quarterly*), another New York State Supreme Court judge has weighed in on the timeliness question. Justice Schackman held in (the non-securities case) Beazer East v. Andritz Sprout-Bauer that unless the choice-of-law provision has the "and its enforcement" language of the Luckie and Manhard cases, the question of whether limitations has expired is one for the arbitrators, not the courts. The decision parallels Justice Schlessinger's decision last year in SLH v. Sacharow, still awaiting a decision on the appeal. Stay tuned. (We are also still waiting for Bybyk from the Second Circuit. It was argued on October 30.)

Meanwhile, in December, Justice Solomon handed down her decision in Kidder Peabody v. Margaretten, ruling that the AMEX's 6-year eligibility rule does not apply to an AMEX Window (AAA) arbitration. Justice Solomon simply quoted the AMEX Constitution, which says that the AMEX arbitration rules apply except [inter alia] when arbitrating through the Window. That should be the end of that ridiculousness.

On a much more disturbing score, however, read the Appellate Division's opinion in Kidder Peabody v. McArter, decided on February 1. In that case, the First Department was confronted with its first post-Luckie limitations case under an "and its enforcement" agreement. The Court held (1) the claim accrued in the investor's home state, not in New York (where the account was held); and (2) that in a churning case, the "period of limitations . . . ran from the date when respondents, as investors, were on notice, warranting inquiry, of the potential claim by receipt of trade confirmations or monthly statements detailing the allegedly excessive and unauthorized trading in their account, rather from the date of the last trade."

Ostensibly a decision applying Tennessee law (under the borrowing statute), the decision is bad news for discovery-tolling arguments, at least in a churning case. The decision is easily assailed, of course (e.g. was it "churning" when the investor received the first confirm, the second, the third, etc?;), but it is a piece of bad law with which we may have to deal.

Aside from Bybyk and Sacharow, watch for Pru v. Cotter, to be argued by us before Justice Solomon on March 11. Two different situations are involved. The first is a "no agreement" case, the second an agreement that invokes New York law, but does not say "and its enforcement." Both cases involve NY residents, however.

We say, Luckie requires the "and its enforcement" words for 7502 to come through the FAA-Volt door, a position supported by Goldberg v. Parker et al. They say, yeah but they are New Yorkers, so they are subject to CPLR 7502. Sounds dubious to us, but you never know. (We did point out that both Goldberg and Parker were New Yorkers.)

Jurisdiction: Pretty quiet, because Justice Solomon is being hard on the firms in this area, so they can't even get Orders to Show Cause signed unless the Petition alleges real New York contact. One decision, however, is of interest. In KP v. Donohue, Justice Solomon held that NY did not have jurisdiction over that limited partnership arbitration. The firm had argued that there was jurisdiction because the investor was a NY resident when the account was opened, and it was opened at a New York branch. The LP investment, however, was made after both the account and the investor had moved to New Jersey. No jurisdiction, she wrote.

Punitive Damages; Attorneys Fees: KP v. McArter, supra, dealt us a blow here too. Appellate Division decision: you can't get either in NY. No reasoning. Mastrobuono was not cited, but Garrity was. The decision on this point is one sentence. No real reasoning. And there will be no appeal - John Lawlor tells us that they are going to go to arbitration on the timely claims in June.

To make matters worse, earlier in January, Justice Solomon said the thing about punitives in ML v. Cornell. Can't get em in arbitration. She, however, addressed Mastrobuono: she said she wasn't bound by it because Mastrobuono was a case in which the federal court exercised its original jurisdiction, and that states therefore aren't bound. That recall, was among Justice Thomas' points in his dissent in Mastrobuono. Solomon and Thomas: what a pair!!

Another bad case is Layne v. Stratton Oakmont. A NY Supreme Court judge vacated a punitive damage award because the agreement stated that "the rights and liabilities of the parties shall be governed by NY law." Distinguishing Mastrobuono, Justice Ramos ruled that the words "and liabilities" brought in Garrity despite Mastrobuono. Pay attention to this case, not because of the decision itself, but rather because of the Defendant. Is Stratton going to escape???

The lesson of all these cases is simple: REMOVE TO FEDERAL COURT. McArter couldn't because the case came to John Lawlor too late. (If you are being 7502-ed, remember you have 30 days from service to remove.) Cornell couldn't - he was a New Yorker (no diversity). Once trapped in the New York state courts, these investors were doomed.

Thus, we, just removed one of these to federal court: AS Goldmen v. Bochner. The only issue is punitives. The investor is from California (account was in NY, so there is jurisdiction). We argue: Mastrobuono, Luckie (agreement here doesn't say "and its enforcement.") They argue: Cornell and Justice Thomas' dissent.

We'll see.

Florida Court Awards Claimant $299,119.50 in Attorneys Fees

Mark A. Tepper, Esq., Fort Lauderdale, FL

A Florida Court awarded Claimants attorneys fees of $299,199.50 following an extended arbitration procedure in Johnson v. D. H. Blair, et al., case No. 95-04080, 17th Judicial Circuit, Broward County, Florida.

The arbitration panel awarded the Claimants $32,278.83 in compensatory damages plus attorneys fees "determined by a court of competent jurisdiction."

The Court, under Fla. Stat. § 517.211(6), awarded attorneys fees based on the total hours worked plus a contingency multiplier—in this case 2.5 and 2 times, respectively, for the two attorneys who worked for Claimant on the case.

Tenth Circuit Finds That Determinations of Timeliness Issues Are For The Courts

On appeal from the U.S. District Court of Colorado, the Tenth Circuit sided with the majority of the Federal District Courts in finding that the timeliness issues presented by NASD Code of Arbitration Procedure § 15 were to be decided by the courts not by arbitrators. (Cogswell v. Merrill Lynch, 1996 WL 77815 [10th Cir.- Colo.]).

This case involved a Section 15 motion which was filed by Merrill Lynch in state court in New York. The New York court stayed the arbitration and Merrill Lynch moved for an order in a collateral federal court proceeding in Colorado permanently staying the arbitration. The federal District Court denied the motion, based on its finding that the New York court did not have subject matter jurisdiction over the issue, holding that the timeliness issue should have been decided by the arbitrators rather than the court.

On appeal, the Tenth Circuit addressed the Section 15 timeliness issue for the first time. Citing First Options of Chicago v. Kaplan, 115 S. Ct. 1920 (1995), and the arbitration agreement which provided that it should be "construed in accordance with the laws of the State of New York", the Tenth Circuit decided to follow what is now the majority of the federal circuits (the Fifth and Eighth Circuits being the minority) and found that the timeliness issue was for the courts to decide. This was based on the Court's finding that there was no "clear and unmistakable" evidence that the parties intended that the arbitrator rather than the court should determine the applicability of Section 15.

The case contains a cogent discussion of the NASD's interpretative history of Section 15 as well as a consideration and rejection by the Tenth Circuit of the oft-made arguments that NASD Arbitration Code § 1 and § 35 evidence the intention of the parties to allow for arbitrators to decide Section 15 questions.

South Carolina State Court Overturns Attorney Fee Award

According to a South Carolina state appeals court panel, a lower court erred in affirming an arbitration award which assessed attorneys fees. (Lybrand v. Merrill Lynch, SC Ctapp, No. 2446, 1/22/96). Citing the New York choice-of-law provision in the arbitration agreement, the Lybrand court found that the award of attorneys fees "constitutes resolution of an issue outside the scope of the arbitration agreement."

Massachusetts Federal Court Refers Timeliness Determination To Arbitrators

In Dean Witter v. Iverson 1996 WL 44823 (D. Mass.) the Court opined on the age-old question of whether the six year limitation of NYSE rule 603 should be held in court or referred to the arbitrators for decision.

The Court noted that three basic principals guided its decision: 1) the Federal Arbitration Act favors the courts' enforcement of arbitration agreements, (Allied-Bruce Terminex v. Dobson 115 S. Ct. 1920 (1995); 2) a court cannot force the parties to arbitrate disputes that they have not agreed to arbitrate, AT&T Technologies v. Communications Workers of America 475 U.S. 643 (1986); and 3) it is the duty of the court to decide whether the parties intended to arbitrate, First Options of Chicago v. Kaplan, 115 S. Ct. 1920 (1995).

After giving due respect to First Options, the Iverson Court, citing a prior Massachusetts decision, PaineWebber v. Landay, C.A. No. 94-10957 (D. Mass Sept. 21, 1995), found that the timeliness issue should be decided by the arbitrators, largely based on the Court's own "practical conclusion" that "a court's efforts to penetrate the facts surrounding the issue of timeliness will often inevitably entangle the judge in the merits of the dispute."
[It should be noted that this case involved claims based on investments purchased both within and without of the six year period.]

New York Bankruptcy Court Awards Damages On Churning Claim

In re: Thomson McKinnon Securities, Inc., 1996 WL 60480 (Bankr. S.D.N.Y.), a New York Bankruptcy Court handed down what now seems like a rarity, a court decision on churning.

In making its churning inquiry, the Court first cited the basic work, Churning by Securities Dealers, 80 Harv. L. Rev. 869, and determined that the turnover ration (ATR) was the "litmus test". However, the Court went on to opine that the objective measure of ATR was to be evaluated with the subjective measure of the investor's investment objectives. The Court sided with Thomson's assertion that the turnover ration should be computed on the "average net equity" rather than the end of the year computation presented by the Claimant.

In determining that a 2.22 turnover ratio presented evidence of churning, the Court cited a 1990 study which found that the turnover ratio of even the most aggressive mutual funds is 1.18, while more conservative funds' turnover is .58 (Winslow and Anderson, A Model for Determining the Excessive Trading Element in Churning Claims, 68 N. Ca. L. Rev. 327 [1990]).

Although the Court did find for the Claimants on the churning claim, the damages it allowed were limited to the amount of the commissions rather than the more favorable (to the Claimant) economic loss damages. The Court disallowed economic loss damages even after considering both Rolf v. Dillion, 570 f. 2d. 38 (2d Cir. 1978) and Miley v. Oppenheimer, 637 F. 2d. 318 5th Cir. 1981), two cases that had allowed economic loss, based on its factual finding that the Thomson Claimant has received confirmations and thereby ratified the trades.

Public Investors Arbitration Bar Assocation Analysis, Observations And Comments to NASD Task Force Report on Securities Arbitration Reform

INTRODUCTION

The Board of Directors of the Public Investors Arbitration Bar Association ("PIABA") has reviewed and considered the recommendations of the NASD Task Force on Securities Arbitration. On behalf of PIABA and the investing public, the PIABA Board offers the following analysis, observations and suggestions in response to the Task Force's Report.

PRELIMINARY STATEMENT

PIABA has long believed that SRO securities arbitration was in need of serious improvement. Improvement of the system is critical because, by industry mandate, SRO arbitration has become the only justice system available to public investors. Any justice system must meet four criteria: it must be efficient; it must be relatively inexpensive; it must be fair; and–equally important–it must give the appearance of fairness. PIABA thus welcomes the efforts of the Task Force and the NASD to improve the adjudicatory system for investor complaints.

The Directors of PIABA have intensively reviewed the Report based on these four criteria.[1] Notwithstanding PIABA's belief that the reforms suggested in the Report are on the whole beneficial, this organization has serious reservations about individual Task Force recommendations concerning punitive damages, eligibility, and the methodology developed in the Report for deciding statute of limitations issues. The remaining recommendations, especially those revising arbitrator selection and prohibiting pre-arbitration litigation, will benefit both investors and the securities industry.

PIABA believes that if a majority of the reforms suggested in the Report are fully and fairly implemented by the NASD, the result will be a vastly improved system of justice for investors. PIABA is concerned, however, that the recommendations of the Task Force will not be implemented completely. The result may well be that industry constituencies achieve the reforms they seek; reforms sought by investor groups will fall by the wayside. For example in, PIABA's view, the single most important reform recommended by the Task Force concerns list selection of arbitrators, early appointment, and consecutive hearing dates. If these reforms are implemented simply and expeditiously, the result will be increased fairness and quality for all participants in the SRO arbitration process.

PIABA is thus prepared to support the majority of the recommendations of the Task Force, and is committed to work with the NASD, Securities Industry Conference on Arbitration, the Securities Industry Association and the SEC to implement these recommendations to achieve a higher level of fairness in SRO arbitration than currently exists. If the recommendations are being implemented selectively or unfairly, or industry funding is insufficient to support the full level of reforms suggested,[2] PIABA will withdraw its support for the Task Force's recommendations or effectuating rules.

ANALYSIS, OBSERVATIONS AND COMMENTS

Despite the obvious benefits of the Task Force's recommendations for investors, PIABA nevertheless has areas of real concern with regard to several of the Task Force's recommendations. This document is intended not only to voice those concerns, but also to propose alternate methods of resolving them.

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1 J. Boyd Page (a member of the Task Force), William Lapp and Mark Maddox (public members of NAMC) took no part in the preparation of this Response to the Task Force Report.

2 Without adequate funding by the industry, no matter what level of reform obtains, the system will retreat to its current state–overburdened and unable to achieve the prime goals of arbitration: expedition, fairness, as well as the appearance of fairness.

CUSTOMER AGREEMENTS

PIABA remains concerned about permitting the securities industry to maintain its effective monopoly over the resolution of disputes between its members and their customers. PIABA continues to believe that the appearance of fairness requires that securities firms provide aggrieved investors with the opportunity to arbitrate at a neutral forum, such as the American Arbitration Association. Notwithstanding this belief, PIABA feels that, if fully implemented and funded, the disparities that currently exist between AAA arbitration and SRO arbitration will be narrowed. In the event, however, that the reforms do not achieve the necessary level of fairness in SRO arbitration, PIABA will advocate that a non-industry arbitration forum be available to aggrieved investors.

PIABA believes that the NASD should move quickly to amend its rules to achieve nationwide the reforms recommended by the Task Force. PIABA does not believe that the important improvements with regard to rbitrator selection, for example, should be ımplemented through a regional "pilot" project. The NASD cannot provide assurance that these improved methods can be implemented immediately.

PIABA applauds the Task Force's recommendation that the NASD Rules of Fair Practice 21(f) be strengthened and enforced by the NASD as well as arbitrators so that industry firms do not use the arbitration agreement to restrict substantive rights of the parties or the ability of arbitrators to make a just award. PIABA proposes that Rule 21(f) be amended to provide that "any provision in an arbitration agreement that violates the provisions of Rule 21(f) shall be null and void, that the parties and the arbitrators shall not be bound by any such violative agreement, and that the arbitrators have the express authority to rule that an arbitration agreement is violative of Rule 21(f)."

A related issue involves use of a choice-of-law provision in customer ıgreements. In the rules implementing Task Force's recommendations, it must be made clear that a firm may not achieve indirectly, through a choice-of-law provision, a result that it would be unable to achieve by direct agreement. Thus, the industry's current practice of using a New York choice of law provision to restrict the remedies that might otherwise be available to an aggrieved investor must cease (*e.g.* a statutory right to attorneys fees available in the state where the investor resides, but unavailable in New York). PIABA understands that the Task Force made an analogous recommendation with respect to using a New York choice-of law to restrict punitive damage awards. This recommendation should be extended.

ELIGIBILITY

PIABA believes that the eligibility rule was applied inflexibly and capriciously in the 1990's in limited partnership cases. This misapplication was the cause of monumental injustice. Such a rule so applied is wholly insupportable.[3] PIABA is convinced that arbitrators prudently assess statute of limitations issues at the present time. Industry claims to the contrary appear to be anecdotal and unfounded. PIABA applauds the Task Force's basic conclusion that the eligibility rule is unneeded, unwise, and should be abandoned.

Nevertheless, elements of the proposed rule do violence to the fundamental equitable nature of arbitration.[4] The Task Force demands that arbitrators be required to apply the "law" regarding statutes of limitations. Arbitration law of every jurisdiction provides that arbitrators are free to use the law as a guidepost; that they are not bound by the letter of the law; and that they may consider issues of fairness and justice outside

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3 PIABA believes the Task Force's Report supports the long-established understanding that the eligibility rule was not designed to cut off substantive rights, and that, in the event a claim is ineligible for arbitration, the investor has the right to go to court (subject to applicable statutes of limitations). Report at p.31. *See generally,* NEW YORK STOCK EXCHANGE SYMPOSIUM ON ARBITRATION, 62 Fordham U.Urb.Affs.L.Rev. 1501, 1583 (1995).

4 "Equity is justice in that it goes beyond the written law. And it is equitable to prefer arbitration to the law court, for the arbitration keeps equity in view, whereas the judge looks only at the law, and the reason why arbitrators were appointed was that equity might prevail." Aristotle, NICOMACHEAN ETHICS, THE COMPLETE WORKS OF ARISTOTLE, Edited by Jonathan Barnes, Princeton: Princeton University Press, 1984. (*CITED IN*) THE ARBITRATOR'S MANUAL at page i.

normal court-drawn boundaries. Consistent with the law and long history of arbitration, PIABA will oppose any rule proposal which expressly states that arbitrators "be directed that they *must* decide statute of limitations issues based on applicable law."[5]

The Task Force recommendation that arbitrators write a "reasoned" decision on statute of limitations will convolute the proceedings; prove difficult for *pro se* claimants; provide grounds for frivolous appeals; and discourage arbitrators from doing justice–or even serving at all.[6] The suggestion that limitations questions be decided on the papers in most cases ignores the fact that limitations questions are almost invariably fact-intensive. Such questions are intimately intertwined with the substantive issues in the case (*i.e.* who knew what, when). Arbitrators should not be discouraged from holding factual hearings on limitations questions. Nor should they be discouraged from delaying such decisions to the ultimate hearing of the matter should such deferral be justified by the circumstances.

The recommendation that early dispositive motions on statute of limitations issues be encouraged may well be an invitation to firms to convert arbitration to a two-step process in which limitations is raised in nearly every case as a method of burdening investors and delaying expeditious resolution. When implementing the Task Force's recommendation, the NASD would advance the interest of arbitration by including a provision for sanctions for frivolous motions on this issue.

The proposed three-year evaluation period for statute of limitations issues may well influence arbitrators to be overly strict on limitations questions. Drafters of rules should be aware that arbitration is an equitable proceeding where the strict rules of law may not apply. Along with the limitation periods themselves, arbitrators must also consider issues of tolling, accrual and concealment, as well as other concepts of fairness in making the ultimate limitations decision.[7] Furthermore, PIABA wonders what objective benchmarks can possibly be developed for the eventual evaluation process.[8]

PIABA believes it far better practice simply to eliminate the indefensible eligibility rule and trust arbitrators to treat staleness issues the same way they treat all other issues. A rule can be developed (and has already been suggested by responsible industry voices) which would permit motions to dismiss on the ground of limitations. Arbitrators could hold separate hearings or take the question with the merits. In no event would they be required to provide "reasoned" decisions which could be used to overturn awards. There would be no requirement that arbitrators strictly adhere to the "law."

PIABA does acquiesce in the Task Force's recommendation to suspend rather than eliminate eligibility because the recommendation also includes an express recommendation that NASD Rule 6 be amended and strengthened to eliminate collateral legal proceedings in court on limitations and other issues. In implementing

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5 PIABA believes the Task Force may have mislead arbitrators by stating on p.35 of the Report that ". . . even with application of equitable tolling, most claims over six years should not survive motions to dismiss in the arbitration forum." The limited partnership pricing fraud of the 1980's is an unfortunate and illuminating example of how blanket statements on limitations cannot be useful to the arbitration process.

6 The NASD Rules should thus be amended, mindful of *First Options v. Kaplan and MK Investments, Inc.*, ___U.S.___ (1995), 115 S.Ct. 1920 (May 22, 1995) to the effect that the parties expressly agree to refer all limitations questions to the arbitrators,

7 Arbitrator training on statutes of limitations must include such topics.

8 Because of compulsory arbitration, the decisional law of retail securities fraud was frozen in 1987 with*Shearson/American Express v. McMahon*, 482 U.S. 220 (1987). Arbitrators and the NASD must be wary of what might amount to static application of old law on, inter alia, statute of limitations questions. For example, if the lessons of limited partnership pricing and deception learned after McMahon are not incorporated into the common law of retail securities fraud, then a serious injustice will take place.

the recommendation, PIABA proposes that the mended Rule 6 will expressly state that **"In any case where any investor makes a demand for arbitration against a member firm, the member firm shall be prohibited from commencing any litigation against the investor until after a final dispositive award has been rendered by the arbitrator(s), and any provision in any customer agreement to the contrary shall be void."**

MEDIATION AND EARLY NEUTRAL EVALUATION

PIABA encourages the NASD to expand its efforts and experiment in this area, as recommended by the Report. PIABA has two concerns: (1) that the cost of arbitration to investors not increase as a result of these experiments, and (2) that mediators and evaluators be selected fairly.

On this latter point, PIABA requests that the NASD use the list method for selection of mediators and evaluators, rather than having the NASD assign the neutral. We believe that greater input by the parties into the selection of the neutral will improve the success rate of the program. If assignment is required, however, it should be on a rotating basis.

DISCOVERY

PIABA endorses the Task Force's recommendations on improving discovery in arbitration and, if implemented fairly, the recommendations on discovery will significantly improve arbitration.

Notwithstanding earlier failed attempts, PIABA is eager to work with the NASD, SICA and the SIA to develop the meaningful mandatory disclosure lists described in the Report. When implementing a mandatory disclosure system, PIABA cautions that the rules expressly state that any list of items not be deemed conclusive of the relevancy of other items not on the mandatory list.

ARBITRATOR POOLS AND SELECTION

PIABA believes the single most important reform recommended by the Task Force revises the method of arbitrator selection. The current system of assigned panels with a single peremptory challenge must be abandoned immediately. The list method recommended by the Task Force constitutes a dramatic improvement. The recommendation that arbitrator names be placed on lists on a "rotating basis" is crucial not only to fairness but also to the appearance of fairness.

PIABA has the following comments on other recommendations by the Task Force on arbitrators:

•The NASD must make a real effort to expand the arbitrator pool, as the Report states. In doing so, the NASD must be mindful that overly burdensome training requirements, and non-rotating selection for panels, discourage new individuals from joining the ranks of NASD arbitrators. The NASD currently charges for training. It should instead consider compensating arbitrators for time spent in training.[9]

•The distinction between industry arbitrators and public arbitrators needs development, but should be retained. As early as 1987, the SEC's Division of Market Regulation stated that it is essential that SRO arbitration panels have a majority of members who are unquestionably unaffiliated with the securities industry. PIABA is nevertheless prepared to work with the NASD, SICA and the SIA to refine the definitions of "industry" and "public" arbitrators so that the definitions are more aptly geared to the realities of bias and the perception of fairness.

•PIABA encourages the NASD to develop training programs that are unbiased and fair, with balanced presentations by all sides. PIABA is prepared to become more involved in arbitrator training, and is willing to provide the NASD with distinguished member-practitioners to serve in the capacity as trainers.

•PIABA suggests that arbitrator evaluation forms be distributed by the arbitrators at the end of the hearing, to increase the convenience of filling them

9 For instance, some other organizations who offer per diem work to lawyers and business people pay for time spent in training. Concerns about cost can be addressed in a variety of ways: offering a modest honorarium, rather than the normal per diem arbitrator rate; paying for training but disbursing the money after the arbitrator completes his or her first arbitration; and offering paid-for-training for a time until the arbitrator pool expands sufficiently.

out. Furthermore, PIABA believes it would be beneficial for the NASD to hire an independent firm to receive and process the forms to assure confidentiality (as a way of encouraging response).

NON-ATTORNEY REPRESENTATION

PIABA is an organization of professionals, and is therefore concerned that non-attorneys are engaged in the unauthorized practice of law, a misdemeanor in most states. A further apprehension is that investors are being injured by non-attorney representatives. We believe that arbitration, especially securities arbitration, is a legal proceeding requiring properly-trained advocates. PIABA believes that the NASD, by permitting non-attorney representation, is actively aiding and abetting what amounts to illegal conduct.

A common justification for nonattorney representation is that some cases are too small for attorneys to handle economically, and that non-attorney representatives thus fill an important gap. An informal survey of our members, however, indicates that most members are willing to handle small cases, and, with the increased "simplified arbitration" threshold to $30,000, attorney availability in cases between $10,000 and $30,000 will certainly increase.[10]

In short, PIABA believes that the dangers associated with non-attorney representatives far outweigh any benefit that accrues from permitting them to exist. PIABA believes that the NASD should adopt the SEC's approach to representation: the representative must be admitted to the practice before the highest court in his home state. PIABA believes the NASD should not permit nonattorney representation.

PUNITIVE DAMAGES

The Task Force recommends that the securities industry be permitted to continue requiring customers to execute contracts of adhesion (i.e. nonnegotiable, standard form customer agreements) thereby upholding SRO arbitration as the exclusive forum for the resolution of investor disputes. Implicit in the Supreme Court's decision in *Mastrobuono* was the belief that punitive damages constituted "an important substantive right."[11] In fact, the Task Force apparently agreed with the SEC's stated position that investors in arbitration should have available to them every remedy that would be available in court, even punitive damages. Unfortunately, the Task Force departs from that position by recommending the imposition of an arbitrary "cap" on this important remedy.

PIABA further disagrees with the formula proposed by the Task Force for a cap on punitive damages: $750,000 or double the actual damages, whichever is less. PIABA believes that the NASD should decline to implement the Task Force's recommendation on punitive damages.

Punitive damages are seldom awarded in arbitration. The multimillion dollar punitive damage award has not appeared in securities arbitration. With the presence of an arbitrator affiliated with the industry on every panel, runaway punitive damage awards are highly unlikely. Industry opposition to punitive damage awards by arbitrators is thus based on exaggerated fears of a lack of safeguards against "excessive" punitive damage awards.

By contrast, the threat of a punitive damage award is a significant and important curb on customer abuse. The Securities Exchange Commission and the industry self- regulatory associations simply lack the resources to prevent abusive practices aimed at public investors.[12] This important deterrent will be lost to investors by the

10 By contrast, the Securities Industry Conference on Arbitration found that the average size case for one non-attorney service was $60,000, hardly the "small case" used to justify the existence of nonlawyer representatives.

11 *Mastrobuono v. Shearson Lehman Hutton*, ___U.S.___, 115 S.Ct. 1212, (1995).

12 A commission headed by former Senator Warren Rudman noted that the NASD brings only two percent of customer complaints to disciplinary hearing.

imposition of any type of "cap" on punitive damages, especially the type of cap proposed by the Task Force.[13]

Because the Task Force's punitive damage proposal is enforced by a contract of adhesion, PIABA urges that the proposal be rejected. In the alternative, arbitration in punitive damage cases should be available <u>at the option of the member firm.</u> That recommendation would do far more to advance the interests not only of the investing public, but also the interest of the NASD in providing a justice system that is efficient, relatively inexpensive, fair, and providing the appearance of fairness.

<u>CONCLUSION</u>

Most of the Task Force recommendations will result in a more equitable, streamlined arbitration process. Drafting these recommendations required enormous effort and dedication on the part of the members of that committee. PIABA understands that substantial compromises were made by the members of the Task Force to reach a common ground. Nevertheless, important substantive rights should not be sacrificed to unanimity. Nor should putative improvements to the system render it cumbersome and investor-hostile.

PIABA cannot agree that the recommendation of a "2 times damages or $750,000, whichever is less" cap on punitive damages is at all wise. Nor can PIABA agree that the arbitration process is enhanced–let alone "reformed"–by a limitations provision which would burden arbitrators, complicate proceedings, and lead to flurries of post-arbitration litigation.

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13 PIABA identifies two situations where the Task Force's recommendation on punitive damages is unwise. In very large cases, a maximum punitive award of $750,000 is insufficient to curb abusive conduct. Second, and most important to small investors, is the fact that the "cap" is biased against them. If an investor loses his entire $20,000 investment because of a broker's outrageous conduct, a punitive damage award of $40,000 would be no deterrent to a broker/dealer with a net worth of many millions of dollars.

The very predictability of a "cap" makes it possible for a firm to nicely calculate the potential reward of abusive conduct versus probable recoveries. The possibility of such anti-investor calculation is simply antithetical to the notion that punitive damages should act as a deterrent.