Public Investors Arbitration Bar Association

March 28, 2003

Margaret H. McFarland, Deputy Secretary
U.S. SECURITIES & EXCHANGE COMMISSION
450 Fifth Street, N.W.
Washington, DC 20549-0609

BY FEDERAL EXPRESS

RE: Proposed Rule 2130 Concerning the Expungement of Customer Dispute Information From the CRD System
Release No.: 34-47435; File No.: SR-NASD-2002-168

Dear Ms. McFarland:

Please accept this as the Official Comment of the Public Investors Arbitration Bar Association (PIABA) and its 500+ members to the above-referenced rule proposal (the Proposed Rule).

At the outset, PIABA would like to extend its appreciation to the interested parties for the significant amount of thought and effort put into drafting the Proposed Rule. While PIABA has serious concerns about the Proposed Rule as it is currently drafted (*see* comments below), PIABA believes it represents a significant step toward reestablishing and maintaining the integrity of the CRD system and would therefore, on balance, endorse the Proposed Rule.

PIABA's Concerns With The Proposed Rule Change

The Proposed Rule Does Not Govern When Expungements Can Be Granted; It Only Governs When the NASD Will Oppose Expungement. Rather than prohibit expungements under all but extraordinary circumstances, the Proposed Rule only governs the NASD's participation in the process. The criteria set forth in the Proposed Rule for the NASD's participation in the process should, instead, be adopted as criteria for obtaining expungement at all - whether the NASD participates in the process or not.

Expungements As the Result of Settled Claims: This is the most pernicious and insidious aspect of the expungement system as it currently exists, and PIABA does not believe the Proposed Rule goes as far as it could and should in addressing this problem.

As originally drafted and presented in NASD Notice to Members 01-65, the Proposed Rule only allowed awards of expungement in the context of settled claims in instances of "factual impossibility" and/or "clear error."[1]

[1] The NASD defined these terms in NTM 01-65 by way of examples: "the associated person named in the proceeding did not work for the firm, or worked in a different office, and was named in error." *See* NTM 01-65, page 565.

PIABA is extremely disappointed that the NASD chose to expand the bases upon which expungements could be granted in the context of settled claims. The change of heart appears to be the result of arguments by the securities industry that such a circumscription of expungement practices in the context of settled claims would undermine the settlement of customer-member claims. This argument is a classic "red herring." Long before it became *de rigueur* for registered representatives to demand expungement as a condition of settlement, customer-member claims settled for the same reason settlements have always been effected - and always will be effected - in any sort of litigation: the settlement made economic sense. There is simply no legitimate argument that claims will not be settled if additional circumscriptions are placed on the ability of an associated person to extract the expungement of the claim. More importantly, it is directly contrary to the notions of full disclosure and investor protection to endorse any system which allows an associated person to "buy a clean record."

PIABA suggested in its comments to NTM 01-65 that any proposed rule which would allow expungement in the context of settled claims require an affidavit be filed by the Claimant (and, where applicable, the Claimant's attorney) attesting to the facts which support the criteria being relied upon to obtain the award of expungement and that such affidavit should be referenced in, incorporated in and attached to the award as part of the submission to the confirming court. Such a measure would ensure that the standards being relied upon to obtain the expungement are not being abused by the parties and would further serve to protect the beneficiary of the expungement by creating a permanent record of the facts exonerating him/her. PIABA suggests that such a requirement is even more necessary since the Proposed Rule expands the bases for obtaining expungements in the context of settled claims.

Use of the "Defamatory in Nature" Standard in Customer-Member Claims: PIABA believes this proposed criterion has the potential for abuse and other problems and should be modified.

The most obvious potential problem with incorporation of this criterion is the application of the appropriate law when the panel is making such a determination. As correctly noted in footnote 6 to NTM 01-65, various jurisdictions apply varying standards for determining whether statements constitute defamation. Likewise, whether any privilege attaches to statements made in the context of a quasi-judicial proceeding such as arbitration may differ from jurisdiction to jurisdiction. One can easily envision almost automatic post-award vacatur motions by both Claimants and Respondents challenging any finding of "defamatory in nature" on the grounds that the wrong law was applied.

Given the national publication of potentially defamatory statements via the CRD system, it is not difficult to imagine how these differing standards increase the possibility/likelihood of inconsistent application of this particular basis for expungement and/or could spawn an endless stream of secondary/collateral litigation simply to determine which law will apply. Which law will apply? The law of the state where the claimant resided at the time of the event or occurrence giving rise to the claim? The law of the state where the claimant resided when the claim was filed? If the claimant and his/her attorney reside in different states (which is not uncommon), the law of the state in which the claimant's attorney (who will often be the party responsible for the alleged defamatory statements) maintains his/her principal office? The potential for these problems is magnified when one takes into account the national presence of many member firms and the multi-state client base of many associated persons. These problems dictate that some framework be established for determining which law will be applied and who will make the final determination that statements in an arbitration claim were "defamatory in nature."

PIABA also believes that, absent some framework for making a determination of what constitutes "defamatory in nature" (and, perhaps, even in spite of such a framework), inclusion of this criteria in the context of customer-member claims threatens to produce an unwarranted and severe "chilling effect" on a customer's willingness to file otherwise meritorious and legitimate arbitration claim. Over the last several years, it has become automatic for respondents to request in their Statement of Answer an expungement of the claim from Respondent's CRD.[2]

Under the terms of the Proposed Rule, these requests will now by necessity be accompanied by the requisite charges of "defamatory in nature" in order to justify the request for expungement. A claim of "defamatory in nature" raises the specter that every customer claimant will be faced with defending charges of defamation, no matter how meritorious the claim. While the customer/claimant may feel comfortable in the veracity of his/her claim, and hence his/her likelihood of successfully defending a charge of "defamatory in nature," that same customer will nonetheless have to consider - at the outset - the additional hearing days (and hence, cost) involved in defending the claim in arbitration and the potential for a subsequent court proceeding involving a claim for defamation based on the Award should the panel find the claim to be "defamatory in nature."

Due to these myriad problems with the application of the "defamatory in nature" criterion and the chilling effect and additional cost to customers resulting from those problems, PIABA believes that the "defamatory in nature" criterion should be limited to intra-industry disputes in which part of the underlying claim is defamation, a not uncommon scenario. The rule should provide that the Panel will decide the claim of defamation based on the law of the state in which the party claiming defamation maintains his/her/its principal office, or in accordance with the terms of any agreement between the parties. Given that defamation is already a common basis for requesting expungement in associated person-member firm disputes, inclusion of the "defamatory in nature" criterion in those disputes does not act to impose any additional burdens or concerns than already exist. Removing "defamatory in nature" as a criterion in customer-member disputes removes the potential chilling effect discussed above.

If the "defamatory in nature" criterion is to exist as a basis for expungement in customer-member claims, then the law to be applied should be the law of the state in which the customer resides at the time of filing the Statement of Claim (the alleged defamatory act), the relief available for a finding of "defamatory in nature" should be limited to expungement of the claim from the prevailing party's CRD, and there should be an express prohibition against the prevailing party using the panel's finding of "defamatory in nature" as the basis for subsequent common-law claims of defamation. This can be accomplished by requiring that a finding of "defamatory in nature" be accompanied by a statement in the Award itself that the finding is meant to apply to the request for expungement only and, notwithstanding the law of issue and/or claim preclusion in any jurisdiction, the finding shall not serve as the basis for a subsequent claim of common-law defamation.

Adoption of Rule or Interpretive Material: PIABA agrees that Conduct Rule 2110, as currently written, empowers the NASD to take appropriate action in response to member firms or associated persons who might inappropriately seek expungement relief. However, in light

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[2] PIABA understands that, given the availability over the last several years of expungement as a possible remedy, Respondents' counsel may fear a charge of malpractice if they don't request expungement.

of the change in expungement practices represented by the Proposed Rule, PIABA believes that the purpose of the proposed rule would be well served by the adoption of a new rule or interpretive material emphasizing the seriousness with which the NASD views the expungement issue and clarifying that Conduct Rule 2110 (and the member firms' and associated persons' obligation to abide by it) empower the NASD to withhold expungement of the subject CRD if the terms of the new rule are not abided by. PIABA is heartened by the NASD's expression in the Proposed Rule of a willingness to "revisit" the issue of the adoption of a separate rule, or the promulgation of Interpretive Material, "explicitly articulating NASD's authority to pursue disciplinary actions" for violations of the Proposed Rule.

I reiterate that, notwithstanding the concerns outlined above, PIABA believes the Proposed Rule is a considerable improvement over the current absence of any rules or guidelines and would urge its adoption by the SEC. If, however, the SEC chooses to institute proceedings to determine whether the Proposed Rule should be disapproved, PIABA will most assuredly submit additional comment and participate in that process.

Respectfully submitted,

Charles W. Austin, Jr., Executive Vice-President
Public Investors Arbitration Bar Association