Public Investors Arbitration Bar Association

May 26, 2006

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

Re: Proposed Amended Revisions to NASD Rule 10322
SR-NASD-2005-079

Dear Ms. Morris:

I write on behalf of the Public Investors Arbitration Bar Association (PIABA) in response to the NASD's Amendment Number 5 to its proposed changes to the Code of Arbitration Procedure, originally filed as SR 2003-158. PIABA is a national bar association of attorneys who practice in the securities arbitration area. We are the voice for public investors who bring claims in NASD arbitration. Our members and their clients have a strong interest in the rules governing the arbitration process at the NASD.

RULE 13504(a) DISPOSITIVE MOTION RULE

Our members object to the NASD's new explanatory language for proposed Rule 13504(a) governing motions to decide claims before a hearing on the merits. The proposed rule itself remains unchanged and states in pertinent part that "motions to decide a claim before a hearing are discouraged and may only be granted in extraordinary circumstances." PIABA objected to the original rule because any formal procedure for dispositive motions in the context of final and binding arbitration without discovery safeguards is unfair to investors. We must object more vociferously now, in light of the NASD's new explanatory language. That language, which is sure to assume the status of legislative history, states that **"if a party demonstrates affirmatively that the legal defenses of, for example, accord and satisfaction, arbitration and award, settlement and release, or the running of an applicable statute of repose, the panel may consider these defenses to be extraordinary circumstances."**

That explanatory language substantially changes the scope of the proposed rule. It can and will be read to urge arbitrators to dismiss cases without an evidentiary hearing whenever a "legal defense" is stated, because there is nothing to differentiate the enumerated legal defenses from any other legal defense. It essentially opens the door to motion practice, which is contrary to the rule's original purpose of strictly limiting motion practice and preserving the parties'

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rights to a hearing. If a case can be dismissed without a hearing on a statute of repose grounds, it arguably can be dismissed on a statute of limitations defense, or any of the other defenses that are contemplated by Rules 8(c) and 12(b) of the Federal Rules of Civil Procedure. The explanatory language does nothing more than open the floodgates for motion practice. It says nothing about what is NOT an extraordinary circumstance under the rule, and offers no real guidance on how the rule, which was supposed to be extremely limited in scope and preserve the right to hearing in the vast majority of cases, should be interpreted to achieve that objective. Frankly, at this point, there probably is no explanation that investors and the securities industry can agree upon. If the SEC agrees to allow the rule over investors' strong objections, it should be passed without any explanatory language.

If there were any doubt that the explanatory language will open the door to a barrage of motions, it was set aside recently at the at the 3rd Annual Broker/Dealer Forum on Resolving Customer Complaints at the Marriott Marquis Hotel in New York City on May 24. There, one of the speakers made the following remarks to the defense counsel audience:

> 1. This rule codifies common law practice and finally gives industry counsel what they need;
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> 2. The examples are not intended to be exclusive and open the door to motions to dismiss based on all of the other affirmative defenses;
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> 3. There is no downside to filing a motion to dismiss in every case because it gives the industry another chance to "educate" the arbitrators on their position and will provide another issue for a court to look at on appeal if the motion is not granted; and
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> 4. Motions to dismiss should be raised in every statement of answer, at the close of the claimant's case and at the close of the respondent's case.

Those remarks notwithstanding, the Securities Industry Association, through its president, Marc Lackritz, testified before the U.S. House of Representatives on March 17, 2005, that arbitration is better than court for investors because it is "a far more cost-effective dispute resolution mechanism than traditional court-based litigation." Mr. Lakritz also stated that "unlike in court cases, claimants in arbitration are not held to technical pleading standards." The NASD's explanatory language is directly at odds with that justification for the mandatory arbitration process. Dispositive motions will be aimed at the wording in the arbitration statements of claim, and the motions will be judged, at least in part, based on how the claims are worded. The motions will impose a technical pleading standard in arbitration. Especially with the proposed explanatory language, dispositive motions will also make arbitration far less cost-effective than it is today.

The specific examples of extraordinary circumstances offered by the NASD illustrate the problems that the dispositive motion rule will present. All of the examples that the NASD uses are

the types of court motions that a party would file at summary judgment, but only after the opportunity for discovery, including sworn deposition testimony. And, all of examples involve complex questions of law that are frequently the subject of appellate review, and sometimes the subject of dissenting opinions on appellate panels.

One of the examples of a motion that the NASD now believes should meet the "extraordinary circumstances" requirement is the defense of accord and satisfaction. That defense requires the proof of several elements, and those elements differ from jurisdiction to jurisdiction. One court describes them as "(1) a disputed claim, (2) the debtor's tendering of a sum less than that claimed by the creditor, and (3) the creditor's acceptance of the payment." United States v. Bloom, 112 F.3d 200, 206 (5th Cir. 1997). Another court states, "there must be a disputed claim, a substituted performance agreed upon and accomplished and valuable consideration." International Union, United Auto., etc. v. Yard-Man, Inc., 716 F.2d 1476, 1492 (6th Cir. 1983). Because it involves a fact-intensive inquiry, court motions to dismiss for accord and satisfaction are almost always raised at summary judgment after full opportunity to take discovery. The defense is legally complex, and federal appellate judges have disagreed, even after full summary judgment briefing and a review of the trial court record, on whether the developed factual record meets the test as a matter of law. Compare: the majority and dissenting opinions in Yard-Man, at 1476, 1488, supra. Yet the NASD proposes that arbitrators should be permitted to deny investors a right to a hearing on their claims, without any discovery, based upon such motions.

Another of the NASD's examples of dispositive motions, the statute of repose, also presents complex legal and factual issues. To begin with, statutes of repose apply to specific claims for relief. See, e.g., Baxter v. Sturm, Ruger & Co., 32 F.3d 48, 49 (2d Cir. 1994)(holding that statute of repose applied to products liability claim but not negligence claim). In NASD arbitration, where statements of claim are not required to plead specific legally cognizable "claims for relief," there will often be a significant question about what legal claim is being made, and what repose statute may apply to it. Beyond that, there often the question of whether fraudulent concealment will equitably toll statutes of repose. See, e.g., Stuart v. American Cyanamid Co., 158 F.3d 622, 628 (2d Cir. 1998). For those statutes that do permit tolling, the issue arises of whether there was a fraudulent concealment, and if so, when the claimant discovered or should have discovered the basis for the claim. Still other issues concern whether the time period for purposes of the statute begins to run on the date of purchase, when damages are incurred, or some other date. See, e.g., Tidemann v. Schiff, Hardin & Waite, 2005 U.S. Dist. LEXIS 5607 (D. Ill. 2005). And, once those legal questions are answered, the applicable facts must be applied to the law and decided. Statute of repose arguments are usually made at summary judgment in court, after full opportunity for discovery, and with full appeal rights if the motion is granted.

Likewise, the NASD's settlement and release example is fraught with difficulties. Whether a valid settlement and release exists is a complex question of law and fact. It is a question that is governed by statutes that are not uniform, and which are interpreted differently by the courts. Some cases, for example, hold that settlements are enforceable so long as there is some evidence of an agreement on an amount and a release. Others, applying a more strict contract analysis, hold that there must be sufficient evidence of all material terms of the settlement for it to be enforceable. See, e.g., Behling v. Russell, 293 F. Supp. 2d 1178, 1183 (D. Mont. 2003).

Dispositive motions raising settlement and release are also typically filed in court in a summary judgment context, because they are so fact dependent.

The NASD's other example of "extraordinary circumstances" is the defense of arbitration and award. That, too, is a complex legal defense. It often raises issues of the preclusive effect of a prior arbitration between the same or similarly situated parties. There are multiple pronged tests to apply in determining whether the parties are similarly situated, to what extent the issues in an earlier arbitration are identical to the issues in the present case, and whether the parties had the opportunity to fully and completely litigate those issues. The applicable tests differ from state to state. See, e.g., Bard v. Appel (In re Appel), 315 B.R. 645, 650 (S.D.N.Y. 2004). When such motions are filed in court they are virtually always filed as summary judgment motions, because they, too, are fact dependent.

In judicial proceedings, if a party's claim is dismissed on summary judgment, that party has a right of review from an appellate court that is bound to closely scrutinize the legal and factual record to ensure that the plaintiff's rights have not been abridged. In arbitration, it is completely the opposite. A panel of non-lawyers, or a majority of non-lawyers, can decide to dismiss a case with prejudice, without an evidentiary hearing, even if the case involves complex factual and legal issues. When that happens, the claimant has virtually no recourse, given the fact that even clear errors of law are not sufficient grounds to vacate an arbitration award. Indeed, even if the arbitrators clearly erred, the party moving for vacatur is subject to sanctions unless they can prove that the arbitrators understood and deliberately ignored applicable law.

Additionally, some NASD cases, especially simplified cases, are filed by pro se investors. They have no way to respond to complex legal arguments to dismiss their cases. How are they to prepare a brief on accord and satisfaction or the statute of repose? Under the proposed language, they run the very real risk of having their cases dismissed merely because they did not know how to make an available legal argument, and they will never have an opportunity to present their case on the merits.

PIABA also takes exception to the NASD's statement in the explanatory letter to the SEC that "the various constituencies agreed" to the explanatory language on the dispositive motions rule. Although its leaders and membership played a substantive role in providing input on the proposed new code, PIABA was never consulted on the explanatory language, and would never have agreed to it, under any circumstances. Moreover, as PIABA's President, I have frequent contact with many investors' counsel throughout the country, and I do not know of any attorney for customers who was consulted on or approve of the NASD's proposed language. The NASD's statement implies that investor groups or their counsel consented to the language. To the best of our knowledge, that is inaccurate.

In summary, the NASD's explanatory language is pro-industry and anti-investor. It encourages and permits a panel of arbitrators, none of whom need be lawyers, and the majority of whom usually are not, to decide these critical and complex motions without even giving a claimant any meaningful discovery or an opportunity to present a case at a hearing. And, it does so without giving investors any rights of appeal. The consequences of the proposed explanatory language are

disastrous for a process that promises that cases will be resolved expeditiously and fairly. Every time a motion is filed by a firm, the cost to the customer, and the time required of the arbitrators, will increase substantially. For all of the reasons summarized above, the PIABA membership uniformly urges the SEC to reject the NASD's explanatory language to proposed Rule 13504(a).

DISCOVERY RULE CHANGE

The NASD also proposes to amend the discovery rule to require parties to produce documents that are in their control. PIABA also objects to this proposal. The rule could require investors to request from other brokerage firms all of their account records. Firms impose significant charges to customers for this information. Investors could be required to spend in the thousands of dollars just to satisfy such a request, and in many cases, especially smaller cases, it could force them to abandon their claims. As the process now works, firms can request the account records directly from non-party firms, and there have been no complaints that firms do not cooperate with one another. The proposed change to the rule will do nothing more than add additional costs to investors. PIABA urges the SEC to reject it.

We appreciate the opportunity to be heard on these issues. Please feel free to contact me if you have any questions or require additional information from PIABA.

Very truly yours,

Robert S. Banks, Jr.
PIABA President

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