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April 8, 2008

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

VIA EMAIL TO rule-comments@sec.gov

Re: Proposed Revisions to FINRA Rules 12206, 12504, 13206 and 13504 - Dispositive Motions SR-FINRA-2007-021

Dispositive Motions: Reduction Is Improvement

Dear Ms Morris:

This letter responds to the Securities and Exchange Commission's request for public comments regarding the proposed revisions to FINRA Rules 12206, 12504, 13206 and 13504 found in SEC Release 34-57497, dated March 14, 2008. Dispositive motions have been a subject of interest and importance to me during the last sixteen-plus years, as I have wasted countless hours fighting and defeating them on behalf of investors and retirees who only wanted the hearing promised them by the Code of Arbitration Procedure. I have written bar journal articles and spoken at continuing education conferences on dispositive motions in SRO arbitration as well.

I urge the SEC to read this letter in its broader context. A recent report to the Securities Industry Conference on Arbitration revealed a disturbing degree of distrust in the securities arbitration process. See Gross, Jill I., and Black, Barbara, *Perceptions of Fairness in Securities Arbitration: An Empirical Study, Report to the Securities Industry Conference on Arbitration*, February 12, 2008 (the "SICA Study").

At the same time, and far more broadly, a growing part of the public is clamoring for an end to the enforceability of mandatory arbitration clauses in contracts of adhesion. Employees and consumers (including investors) are increasingly distressed that they cannot obtain the basics of life without signing a form that requires them to give up their access to the third branch of their government. That is wrong, and the underlying fiction that an adhesive contract is the same thing as a contract is wrong as well.

The widespread and growing negative feelings about arbitration did not arise in a vacuum. Rather, great upward momentum has been imparted to them by abuses in the arbitration process. The dispositive motions discussed in this letter are prime examples.

Pre-hearing dispositive motions are a both a qualitative and a quantitative drain on the system. They make the system less fair because, at least some of the time, a dispositive motion will be granted in a case in which an investor would have prevailed if allowed to go to a hearing. They make the system less efficient because the large number of hours spent on dispositive motion practice by investors' counsel, industry counsel and arbitrators never can be made up by the savings in those rare instances in which a dispositive motion is granted.

Notwithstanding their cost, dispositive motions are good for the industry, because they afford frequent players in the arbitration process a no-risk opportunity to (1) take a shot at being one of the rare cases in which a dispositive motion is granted and (2) simultaneously make the arbitration process more arduous, time-consuming and expensive for investors even when the motion is denied. That explains why investors uniformly oppose the existence of dispositive motion practice while the industry is fighting hammer and tong to preserve it.

The qualitative and quantitative problems with dispositive motions in general are discussed at greater length in my September 24, 2006, comment letter regarding SR-NASD-2006-088, which is appended to and made a part of this letter. The arguments in that letter apply with equal force here, and lead inescapably to the conclusion that pre-hearing dispositive motions should be forbidden entirely in SRO arbitration.

It is in the context of my view that pre-hearing dispositive motions should be absolutely forbidden in SRO arbitration that I support the proposed rule change. The rule change will not solve the problem completely, but it looks like it should reduce it substantially, and that is desirable. To use a dermatological analogy, if you have a horrible, oozing, itching rash covering 90% of your body, it's a great improvement if a new medication can control it to the point where it covers only 10% of your body. It's still bad, it's still an itching, oozing rash, but at least the 80% of your body that was covered by it before is no longer impacted and is able to heal. Something still must be done about the remaining 10%, of course; and you must be monitored for side effects of the new medication.

The Remaining 10%. I am concerned about possible abuses of those narrow grounds for dispositive motion practice that are permitted by the proposed rule. For example, dispositive motions based on the eligibility rule give rise to the concern that eligibility issues often turn on factual questions. And a rule allowing persons not involved in an account to make pre-hearing dispositive motions might be abused by branch managers, officers, directors, control persons, successors in interest and others who, depending on the facts, can be liable for investors' losses. Thus, if the rule change is adopted, the SEC must monitor it closely to assure that parties that have liability as a matter of law are not escaping their responsibility as a result of the change.

Side Effects and Unintended Consequences. I share the concern voiced by Seth Lipner, Scott Shewan, Leonard Steiner and others about the potential for an upsurge in mid-hearing dispositive motions that will disrupt hearings and lead to long mid-hearing postponements. Those postponements would work an unfair disadvantage over investors and could be used to defeat any improvements in fairness and efficiency that the proposed rule otherwise might bring about. I still support the proposed rule because I believe it to be an improvement over the current situation. But the SEC should approve the new rule with a solemn promise that it will continue to monitor the forum for side effects and unintended consequences, and that it will act quickly and decisively to correct those problems if it appears that they may work to the disadvantage of investors whose trust is the only reason the markets can exist.

Investors have grown weary of securities and financial industry scandals. Our nation's capital markets have lost some of their former luster not because our regulatory costs have gotten too high but because the honesty of our market participants has fallen too low.

At the same time, the public has grown weary of mandatory arbitration clauses in contracts of adhesion, as discussed at the beginning of this letter. Senator Russ Feingold's and Representative Hank Johnson's Arbitration Fairness Act of 2007 would render pre-dispute arbitration agreements unenforceable in employment and consumer contracts. The SEC should support that bill and should support an end to mandatory arbitration, as the only broad and lasting way to make securities arbitration fairer will be to force arbitration to compete with the courts.

Returning to the immediate question, I urge the Commission to reduce one of the nettlesome abuses of the arbitration process by approving the proposed rule on an expedited basis.

Thank you for the opportunity to comment on this proposed rule change.

Respectfully submitted,

Scot Bernstein

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September 24, 2006

Nancy M. Morris, Secretary
Securities and Exchange Commission
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Washington, D.C. 20549-9303

VIA EMAIL TO rule-comments@sec.gov

→ **RESUBMITTED APRIL 10, 2008,**
AS PART OF COMMENT REGARDING
Proposed Revisions to FINRA Rules 12206, 12504,
13206 and 13504 - Dispositive Motions
SR-FINRA-2007-021

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

Dispositive Motions: A Qualitative and Quantitative Discussion

Dear Ms Morris:

This letter responds to the Securities and Exchange Commission's request for public comments regarding the proposed NASD dispositive motion rule found in SEC Release 34-54360, dated August 24, 2006. Dispositive motions are a subject of great interest and importance to me. I have represented numerous public investors in securities arbitration proceedings during the last fifteen years and have opposed many pre-hearing dispositive motions during that time. I have written bar journal articles and spoken at continuing education conferences on the subject as well.

The primary thrust of this letter will be a response to the Commission's invitation to commenters "to share quantifiable costs and benefits that they believe may result should the Commission approve or disapprove the proposed rules." The Commission is right to be inquiring about the costs and benefits of dispositive motion practice. Even if the Commission believes that *some* pre-hearing dispositive motions deserve to be considered, it still must address the very real possibility that the costs of permitting those motions so exceed the benefits that permitting the motions to be made at all produces a net loss on a societal basis.

At the same time, the Commission must consider that there are some costs and harms associated with dispositive motion practice that cannot be quantified. The Commission must, above all, avoid the classic mistake of treating unquantifiable costs as though they are zero.

I will begin this letter with a brief discussion of the unquantifiable costs and general inappropriateness of pre-hearing dispositive motion practice in arbitration proceedings. I then will discuss the quantitative costs and benefits of allowing those motions to be made.

I urge the Commission to reject the NASD's proposed rule and to require in its place a rule prohibiting pre-hearing dispositive motions in NASD arbitration proceedings. And I urge the Commission to remember, as a part of its mandate to protect investors, that a rule permitting dispositive motions has been proposed because the industry is clamoring for it, not because investors want it.

The Inappropriateness and Non-Quantifiable Costs of Dispositive Motion Practice

There are three and only three possible outcomes of a pre-hearing dispositive motion:

1. It is denied;
2. It is granted and an investor who would have received an award at a hearing doesn't get a hearing; or
3. It is granted and an investor who would have lost at a hearing doesn't get a hearing.

The cost-benefit analysis in the next section will discuss the quantifiable costs and benefits associated with the first and third possibilities. This section will focus primarily on the second – the situation in which an arbitration panel comes to a wrong result, creating on the industry side a laughing wrongdoer and, on the public side, an investor who all too often will have to live out her old age in poverty because the arbitrators wouldn't even let her have her "day in court."

Any saved hearing costs in such cases cannot fairly be counted as a "benefit" in a cost-benefit analysis – at least not by an agency charged with the duty to protect not only investors but also public trust in the nation's capital markets. The customer's uncompensated losses in such a case are a clear harm and, particularly for many elderly investors, tragic. Allowing a broker who has wronged an investor to get lucky and get away with it is antithetical to the deterrent function of private remedies under the securities laws.

Thus, those mistakes, which inevitably will happen, will inflict an unquantifiable but large harm upon the system. While they are not quantified, it would be irresponsible to pretend that they are zero. They clearly belong on the "cost" side of the cost-benefit ledger.

Nor can the laughing wrongdoer be ignored. The miscreant who "gets away with it" erodes trust in capital markets on the part of everyone who reads the story, encourages other wrongdoers, and is an affront to regulators whose rules and enabling statutes will taken less seriously.

The third possible outcome – denying a hearing to an investor who would have lost if the hearing had been held – can give rise to a harm that, while less disturbing than the one discussed immediately above, still merits consideration. Investors should be able to entrust their life savings to financial professionals with the knowledge that, in the event of a dispute, they will at least have an opportunity to have the facts of their cases heard. Allowing dispositive motions runs contrary to that need. At bottom, having your "day in court" is far more meaningful than having your "day in which your attorney attends a telephone conference."

Beyond those real but unquantifiable harms, there is the general inappropriateness of dispositive motion practice in arbitration. Dispositive motions based on pleadings are inappropriate in a forum that by design has adopted minimum pleading standards for simplicity and to enhance the ability of unrepresented parties to prosecute their own cases. Summary judgments are inappropriate in a forum where there are no depositions and the hearing is the first and only opportunity to find out what the witnesses will say. And a "motion to dismiss" with no standards at all – which is what most dismissal motions at the SROs really are – is utterly unacceptable, a dice roll by which a broker or firm occasionally gets lucky and always imposes a cost on the system.

Allowing Dispositive Motions Fails a Cost-Benefit Analysis

Allowing dispositive motions cannot be justified on a cost-benefit basis. I said above that there were only three possible outcomes to a pre-hearing dispositive motion. In this section, I will set the unquantifiable harms aside and will balance

> the costs of dispositive motion practice in the large number of cases in which those motions are denied
>
> against
>
> the "benefits" – *i.e.*, the savings in those rare cases in which a case that would have lost at a hearing is dismissed on a party's motion.

Even ignoring the unquantifiable harms in those cases where investors with claims that would have received an award if afforded a simple hearing are instead shut out, the balance of costs and benefits favors a rule placing pre-hearing dispositive motions outside the scope of the arbitrators' authority.

Most of the cost of dispositive motion practice – and of hearings – takes the form of attorney time and arbitrator time. NASD staff time is consumed as well, but in substantially smaller amounts. The costs of raw materials are one or two orders of magnitude smaller than the value of attorney time spent. Thus, the cost-benefit analysis loses little accuracy by focusing on attorney and arbitrator time.

An experienced practitioner who has represented public investors for many years, and has kept time records throughout that time, has calculated that a motion to dismiss consumes, on average, about 20 hours of attorney time on the claimant's side. It is a reasonable assumption that it should consume at least 20 hours of attorney time on the respondents' side as well, particularly since that side will draft not only the motion but also a reply to the claimant's opposition. Allowing two hours for each of the three arbitrators to read the briefs, hear oral argument, and decide the motion yields a total of 46 hours of attorney and arbitrator time for the average dispositive motion.

The same practitioner's time records show that hearings consume an average of 175 hours of attorney time on the claimant's side; the same amount on the defense side, presumably; and 100 hours of arbitrator time. Thus, the total time required for a hearing will average approximately 450 hours.

The benefits of allowing dispositive motion practice can outweigh the costs only if the time savings in those rare cases in which a dispositive motion is granted are greater than the total time spent on all dispositive motion practice. Dispositive motions are granted far too seldom to pass that test. Indeed, my experiences and those of my colleagues suggest that well less than five percent of pre-hearing dispositive motions are granted. Even if we are generous with the proponents of dispositive motion practice and we assume a five percent "success" rate, the time savings from one successful motion would have to equal or exceed the time spent on 20 of them for dispositive motion practice to hit the break-even point.

But 20 dispositive motions averaging 46 hours each would consume a total of 920 hours, and the single hearing prevented by the one "successful" motion in 20 would have consumed only 450 hours. Thus, the societal net cost of allowing dispositive motion practice in those 20 cases would be the difference: 470 hours of attorney and arbitrator time.

Looking at the larger picture, if 6,000 cases are filed in an average year, and if dispositive motions are filed in only a *tenth* of them, a total of 600 dispositive motions will be filed in an average year. At an average of 46 hours each, those 600 dispositive motions could be expected to consume 27,600 hours of attorney time. The savings from the 30 avoided hearings (if fully 5% of the 600 dispositive motions were granted, with a savings of 450 hours per hearing) would be 13,500 hours.

Thus, the societal net loss of attorney and arbitrator time resulting from a rule allowing dispositive motion practice, as contrasted with a rule forbidding it, would be the 14,100-hour difference. Moreover, as discussed in the first section of this letter, that loss does not consider the harm associated with cases in which an investor who would have received compensation if afforded a hearing is instead denied the opportunity to be heard. Clearly, the occasional savings of hearing time resulting from allowing dispositive motion practice come at far too high a cost.

What drives this result is the low "win" rate for dispositive motions. A five percent "win" rate means one "win" in twenty attempts. It is hard to overcome a factor of twenty. And even the five percent figure is generous in my view. But there is no point arguing about it. The NASD has access to all of the data need to determine that percentage with some accuracy. It should be compelled to provide that data in a matter of this importance.

(In the event that the NASD is compelled to provide "win-loss" data on dispositive motions, a word of caution is in order: the correct percentage of "winning" dispositive motions cannot be determined by examining the awards alone. While dispositive motions that are granted generally will result in a published award, those that are denied often will not, for at least two reasons: (1) many cases in which a dispositive motion was denied ultimately will have settled, so that no award will have been generated; and (2) even those that have gone to a full hearing may have generated an award that failed to recite the full motion history.)

Even if the industry quibbles with the time figures above, it cannot dispute the concept underlying them: if one dispositive motion in x is granted, and if the average dispositive motion battle consumes y hours, the average hearing that is avoided by a "successful" dispositive motion must be one that would have taken more than xy hours to try in order for the benefits of allowing dispositive motions to outweigh the costs. Because x is so large (*i.e.*, because the dispositive motion "win" percentage is so low), the industry is unlikely to come up with numbers that can show benefits exceeding costs. And once again, even this analysis is overly favorable to dispositive motions because it doesn't account for the unquantifiable harms already discussed.

Those enamored of economic "rational actor" arguments may ask why a rational industry respondent would spend money and attorney hours on a motion for which the costs could be expected to exceed the benefits. The answer is that, for repeat-player respondents, the benefits go beyond the savings associated with the small chance of avoiding a hearing. Those benefits for a firm that makes a habit of bringing dispositive motions include, at a minimum, (1) gaining a reputation for scorching the earth in defense of claims and (2) benefiting from that reputation when parties and counsel become more reluctant to bring cases against the firm. If a firm can acquire a reputation for making cases against it more time-consuming and expensive, the firm effectively increases the minimum damages required for a viable case against it.

It already is difficult for investors with smaller claims to locate counsel willing to represent them. Firms should not be permitted to make the problem worse and wholly deprive still larger numbers of investors of a forum by artificially increasing the cost of bringing a claim. A fair and reasonable defense is one thing; gaming the system by repeatedly bringing motions that rarely succeed goes well beyond that.

We as a civilization often face situations in which something that might reasonably be permitted for selected individuals must be prohibited for the greater good of all. There undoubtedly are large numbers of fourteen-year-olds who are smart enough, coordinated enough and responsible enough to operate an automobile safely. But the overall statistics for young drivers are such that they simply are not allowed to drive.

Similarly, industry respondents may be able to conjure up a few extreme factual scenarios that sound like they should justify early termination of a case. But the problem is that, once a procedure for early termination exists, respondents have an incentive to try their luck far too often. Consistent with that, dispositive motion filings are up dramatically since the NASD sought approval of a rule allowing such motions to be granted only in "extraordinary circumstances." Apparently, the number of "extraordinary" circumstances, as seen through the industry's lenses, is far greater than the definition of that word might have led one to expect.

The Commission should give those excesses a good, hard look. If the Commission does so, it will conclude that the making of dispositive motions must be forbidden for the good of arbitration and the protection of investors.

Thank you for your attention to this important matter.

Respectfully submitted,

Scot Bernstein

SDB:msw