September 21, 2006

Barbara Black
Professor of Law
Director, Corporate Law Center
University of Cincinnati College of Law

Jill I. Gross
Associate Professor of Law
Director, Pace Investor Rights Project
Pace University School of Law

File No. SR-NASD-2006-088

We are law professors who have written extensively about the securities arbitration process and have served as arbitrators at NASD Dispute Resolution. In addition, we have represented small investors in their disputes with brokers and advocated on behalf of the rights of individual investors. We base these comments on our cumulative experiences working in this area.

We previously have filed two comment letters addressing dispositive motions[1] that we call to the SEC's attention. The purpose of this letter is to address the specific issues on which the SEC requested comment.

(A) Need for a Dispositive Motions Rule

We believe that the Customer Code should include a rule making it clear that dispositive motions are appropriate only in very limited circumstances. While we recognize that courts have interpreted the Federal Arbitration Act to permit a securities arbitration panel to dismiss claims before a live hearing,[2] courts insist that such dismissals occur only if the panel afforded the parties a fundamentally fair hearing – whether live or paper -- of their claims.[3] Moreover, disputed issues of material fact and issues of credibility present in many arbitration claims make it fundamentally unfair to

[1] See Letters from Jill I. Gross and Barbara Black, Pace Investor Rights Project (July 14, 2005 and June 6, 2006).

[2] *See, e.g.*,Sheldon v. Vermonty, 269 F.3d 1202, 1206 (10th Cir. 2001) (arbitrators can grant pre-hearing motion to dismiss arbitration on the papers); Tricome v. Success Trade Secs, 2006 WL 1451502, *3 (E.D. Pa. May 25, 2006) (denying motion to vacate arbitrators' pre-hearing dismissal); Allen v. RBC Dain Rauscher, Inc., 2006 WL 1303119 (W.D. Wash. May 9, 2006) (refusing to vacate arbitrators' pre-hearing dismissal); Warren v. Tacher, 114 F. Supp.2d 600, 602-03 (W.D. Ky. 2000) (same); Max Marx Color & Chemical Co. Employees' Profit Sharing Plan v. Barnes, 37 F. Supp.2d 248, 250-51 (S.D.N.Y. 1999) (recognizing authority of NASD arbitrators to grant pre-hearing dismissal).

[3] *See* Bowles Financial Group, Inc. v. Stifel, Nicolaus & Co., Inc., 22 F.3d 1010, 1012-13 (10th Cir. 1994) (gathering cases); Patton v. J.P. Morgan Chase & Co., N.Y.L.J. (Sup. Ct. N.Y. Co. Aug. 23, 2004) (denying motion to vacate award that dismissed arbitration claim without a hearing, finding that such a dismissal does not deny a party fundamental fairness when arbitrator determines there is no relevant or material evidence to present at a hearing). *Cf.* Sroka Family, LLC v. Prudential Secs., Inc., 2006 WL 988808, *1 (9th Cir. 2006) (affirming district court's dismissal of petition to vacate securities arbitration award due to lack of subject matter jurisdiction because "a review of the fairness of arbitration proceedings does not involve a substantial question of federal law where petitioners were not denied adequate notice, a hearing on the evidence and an impartial decision by the arbitrator").

dismiss a claim without affording the claimant an opportunity to complete discovery and present evidence.

It is our impression, however, that there has been an increase in arbitrators dismissing customers' claims before a live hearing on the merits based on grounds applicable only in a court of law or based on standards designed to satisfy policy considerations appropriate only in court.[4] We believe these decisions are misguided, as NASD arbitrators should be permitted to dismiss claims before a live hearing only after the arbitration panel has fully considered the parties' claims through, at a minimum, paper submissions and/or telephonic pre-hearing conferences.[5] As a result, we agree with NASD that there is a need to provide guidance to arbitrators.

In addition, an important purpose of the Code is to provide guidance to those claimants, particularly those with small claims, who do not retain attorneys to represent them. It is important that the arbitration procedures be clear and explicit to promote transparency in the process.

The SEC also asks, assuming lack of uniformity among arbitrators on dispositive motions, if there are other ways to address this issue. We urge NASD to address this through more extensive arbitrator training.

(B) Proposed Rules

We believe the proposed rule strikes an appropriate balance between the claimants' right to a hearing and the authority of arbitrators to dismiss claims in limited, extraordinary circumstances. We continue to believe, however, that the exception for motions on eligibility rule grounds should be stricken. Since they frequently present issues of disputed facts and questions of credibility, there is no reason to except them from the general rule applicable to all dispositive motions.

(C) Explanatory Language

---

[4] For the most egregious example, *see* Reinglass v. Morgan Stanley Dean Witter, Inc., 2006 WL 802751 (Ohio Ct. App. Mar. 30, 2006) (refusing to vacate award where arbitrators granted motion to dismiss for failure to state a claim). *See also* Vento v. Quick & Reilly, Inc., 128 Fed. Appx. 719, 723 (10th Cir. 2005) (stating that "we hold that a NASD arbitration panel has full authority to grant a pre-hearing motion to dismiss with prejudice based *solely* on the parties' pleadings ….(emphasis added)); Wise v. Wachovia Secs., 450 F.3d 265 (7th Cir. 2006) (affirming denial of motion to vacate award where arbitrators granted respondent's motion for *summary judgment* before a live hearing); Prudential Secs. Inc. v. Dalton, 929 F. Supp. 1411 (N.D. Ok. 1996) (vacating award as fundamentally unfair where panel granted *summary judgment* denying a party an opportunity to present material evidence).

[5] Courts consider the NASD Simplified Arbitration process, in which arbitrators decide claims less than $25,000 based only on paper submissions, to be fundamentally fair. *See* Papayiannis v. Zelin, 205 F. Supp.2d 228 (S.D.N.Y. 2002) (confirming award arising out of NASD Simplified Arbitration procedure despite losing party's claim that he had no opportunity to be heard); Warehall v. Pasternak, 1993 WL 437784 (S.D.N.Y. 1993) (confirming NASD Simplified Arbitration award and finding that Rule 10302 provides ample opportunity to be heard).

We believe that the standard for deciding dispositive motions should be set forth in the rule and that "extraordinary circumstances" is an accurate description for the appropriate standard. Thus, our preference is not to include any narrative with specific examples. We continue to believe that arbitrators and parties would benefit from more specific guidance and that the rule itself should state that dispositive motions should be denied whenever (1) credibility is an issue; (2) there are disputed issues of material fact; or (3) the panel believes a hearing is necessary in the interests of justice. We believe setting forth standards in the rule is a better approach than providing in a narrative some legalistic examples that may not be readily obvious to non-attorneys.

(D) Standard of Pleading

Despite the fact that the current Code contains no requirement that statements of claim plead legally cognizable claims, some courts have imposed pleading requirements.[6] For this reason we strongly believe that the rule should make clear that arbitrators should not apply a "failure to state a claim" standard, since claimants are not required to plead legally cognizable claims.

(E) Authority of Arbitrators to Limit Filing of Dispositive Motions

We believe that the proposed rule gives the panel sufficient authority to manage the arbitration proceeding through its explicit grant of power to impose sanctions for motions made in bad faith.

(F) Additional Suggestions

We conclude by emphasizing that because of the universality of arbitration clauses in customers' brokerage agreements, investors are required to give up their day in court and arbitrate their brokerage disputes in industry-sponsored arbitration forums. As a result, the SEC should be vigilant to assure that the process is fundamentally fair to investors, and there should be a strong presumption that investors are entitled to a hearing.

Thank you for the opportunity to make these comments.

Barbara Black and Jill I. Gross

[6] *See supra* note 4 and accompanying text.