

**Securities Industry Association**

120 Broadway, New York, NY 10271-0080, (212) 608-1500, Fax (212) 608-1604
1401 Eye Street, NW, Washington, DC 20005-2225, (202) 296-9410, Fax (202) 296-9775
info@sia.com, <http://www.sia.com>

July 10, 1997

Ms. Mary Schapiro, President
National Association of Securities
Dealers-Regulation, Inc.
1735 K Street, NW
Washington, DC 20006

Ellyn Brown, Esq.
Theodore A. Levine, Esq.
Gertrude G. Michelson, Esq.
Mr. Alfred Osborne
Mark Sargent, Esq.
Pauline Schneider, Esq.
c/o Ms. Brown
100 West University Parkway
Suite 700
Baltimore, MD 21210

Re: Arbitration of Employment Discrimination Claims

Dear Ms. Schapiro and Members of the Panel:

The SIA and the member firms who participated in the June 16, 1997 panel discussions in Washington, DC appreciate having had the opportunity to present the industry's views in support of maintaining the current system requiring mandatory arbitration of employment discrimination disputes through the Form U-4. While we are aware that the NASD-R already has received a wealth of written material, we deem it important to underscore certain points made at the hearing, and to respond to concerns raised by the Panel.

THE ARBITRATION OF DISCRIMINATION CLAIMS IS INEXTRICABLY INTERTWINED WITH THE NASD'S REGULATORY FUNCTION**Issues of performance and conduct permeate employment discrimination cases**

It is axiomatic that the integrity of the industry depends on the conduct of its member firms, and that firms act through their employees. Disputes relating to the performance and conduct of employees - and the actions of employers in dealing with that conduct - therefore relate directly to our business and to the way in which we safeguard our public trust. The NASD has a direct interest in the competence and honesty of the individuals who do the work of the securities

industry, an interest that is reflected in the registration process.

Industry arbitration is the best mechanism for resolving disputes relating to the business of the securities industry, as recognized by the NASD itself in its Notice to Members 93-64.¹ Discrimination claims are, as a practical matter, inextricably linked with issues of business practice since virtually every claim of discrimination is based on an action taken by the employer firm, that the employer firm will defend as being a legitimate business decision. The sorts of circumstances that lead to such decisions are myriad. Often, they involve sales practices or conduct that are fundamental to our industry, but may be less familiar to outsiders. Examples include claims: (i) that customer accounts were not fairly assigned; (ii) that the registered representative did not receive a fair salary increase or bonus; or (iii) was denied a promotion due to race, gender, age, or ethnicity.

The opponents of maintaining the current system fail to appreciate the interrelationship between discrimination claims and the business and operations of the business. Such a view prompted Commissioner Steven Wallman of the SEC to posit that "the NASD disserves the markets, the industry, and the investing public when it attempts to regulate in areas outside the scope of securities related issues." See Letter from Commissioner Wallman to Ellyn Brown, Esq., dated June 16, 1997, p. 1 (emphasis supplied). As discussed above, and with all due respect to Commissioner Wallman, such an argument ignores the reality that discrimination claims are typically alleged in conjunction with a variety of other claims arising out of technical aspects of the securities business. ² The defense to a clear majority of discrimination claims is that conduct by the complaining employee is inconsistent with the rules and practices of the industry. Such conduct could relate to a simple failure to perform the job of a securities professional in a manner consistent with the goals and practices of the particular firm, or could involve conduct that may not be unique to the securities industry - such as theft, dishonesty or fraud - but that has unique implications for our business. In an effective self-regulatory structure, the NASD, the parties and the public have an interest in having an industry arbitrator on the panel who understands the significance of the employee's conduct and his/her possible transgressions. The lone industry arbitrator on the panel bring this knowledge, not (as critics claim) bias. As a self-regulatory body, the NASD should have an interest in promoting this sort of knowledgeable review.

In addition, the NASD's own enforcement capability will be diminished in the absence of an arbitration regime that includes employee disputes. Arbitration panels can and do refer matters for appropriate investigation and possible enforcement action if conduct inimical to the rules of the industry is uncovered during the course of an arbitration. It is a fallacy to think that discrimination claims exist in a vacuum and do not involve issues that go to the heart of the business of being a professional in our industry.

- **Coverage of employment discrimination claims by the U-4 is necessary to avoid wasteful bifurcation.**

As practitioners in this area will readily acknowledge (and we venture to say that even plaintiffs' lawyers will not credibly disagree), virtually all discrimination claims by registered representatives are brought in conjunction with other claims such as defamation, wrongful termination, failure to pay a bonus, and the like. Notably, at the hearing, the Panel asked whether there was such a thing as a "pure discrimination claim" that could be handily carved

out of the arbitration process. We respectfully submit that if such a claim exists, it is outside of the experience of the industry practitioners and firm counsel who appeared on June 16th. The removal of discrimination claims from arbitration would thus cause an unworkable bifurcation.

Dual proceedings would require both parties to address the same underlying set of facts in two separate proceedings, based on the same documents, the same witnesses, and the same testimony. As several of the members of the NASD advisory panel recognized, the resulting bifurcation would pose significant problems, not the least of which are the potential for inconsistent results and the waste of time, money, and judicial resources.

Another danger of bifurcation would be that the opportunity to require a hearing in a second forum will provide an incentive for employees to raise baseless discrimination claims they would not otherwise have brought. In other words, if the mere allegation of discrimination provides an employee with a procedural and tactical advantage, most plaintiffs will seek a way to raise the claim. While claims in court are subject to motions to dismiss, and while claimants and their counsel can be sanctioned there for raising frivolous claims, it is difficult for a defendant to prove that a claim is frivolous before having spent considerable time and money in litigation.³ As was pointed out at the hearing, it is the threat of these costs that adds to the settlement value of any case, and therefore the tactical value of raising the claim, even where it has no merit.⁴

- **Registered representatives voluntarily relinquish numerous rights in exchange for the privilege of membership in -- and for the good of -- the industry.**

At the hearing, opponents of the arbitration system asserted that employees were being forced to give up important civil rights, specifically the statutory rights conferred by the anti-discrimination laws. This argument has no merit. First, no substantive statutory rights are waived by employees when they sign a U-4; they merely agree as a procedural matter, to avail themselves of a forum which the Supreme Court has held is fully capable of adjudicating those rights.⁵

Second, to the extent that the limitation on the choice of forum itself is considered to be the waiver of a civil right -- an idea that we do not accept -- it is not the only personal right or freedom relinquished by individuals who choose to become associated with the securities industry. As was emphasized during the June 16th panel discussions, there are numerous personal rights and freedoms relinquished by individuals who choose to become associated with an industry whose integrity and existence depend on the extent of confidence bestowed on it by the public, and which therefore must police itself and its members in ways that other industries do not. Registered representatives may not maintain trading accounts at brokerage firms other than the one at which they are employed, except under very limited circumstances. The personal mail of registered representatives is subject to inspection by their firm's compliance department. Limitations are set on the political contributions that certain employees can make, and full disclosure of such contributions is required. Employees are fingerprinted, must disclose prior criminal convictions, and may be disqualified from employment if they have a criminal record. These sorts of restrictions, which would be unheard of, or even illegal, in other industries, are part and parcel of the self-regulatory structure in this one. The system of arbitration of employment claims is similarly part of that structure, and should not be dismantled.⁶

ABSENT COMPELLING EVIDENCE THAT ARBITRATION UNFAIRLY DISADVANTAGES ANY OF ITS PARTICIPANTS THERE IS NO JUSTIFICATION FOR ABANDONING THE CURRENT SYSTEM

As set forth in our prior submissions, arbitration is faster and cheaper than litigation and has been shown to be a fair forum. Absent evidence that the current system is unfair to its participants, there is no basis to implement drastic change.

Opponents of the arbitration system have offered no such evidence. On this point, one of plaintiffs' counsels alluded at the hearing to a recently published article by the Wisconsin Law Review which purportedly demonstrated that the results reached by SIA's survey (as described in SIA's April 25th letter) were somehow invalid. Having reviewed the law review article, we note that the author himself recognizes that his survey is of limited utility because only California verdicts were included and only a small sampling of cases was reviewed. The article openly concedes that the survey results were "admittedly sketchy." 1997 Wisc. L. Rev. 1, 66 (1997). The survey conducted by SIA staff (with the assistance of outside counsel) was compiled by reviewing the actual written awards by NASD and NYSE panels. These awards were contrasted with official court records furnished by the clerk's office of the United States District Court for the Southern District of New York - the jurisdiction which sees the predominate of securities cases. We respectfully submit that the results are eminently reliable.⁷

One fact that is not open to serious debate is that eliminating the mandatory arbitration requirement from the U-4 is a task with broad implications. It is for this reason among others, that several United States Senators and members of Congress urged the NASD and NASD-R not to institute wholesale changes, stating that "the arbitration process should not be modified or abandoned until convincing evidence has been presented that individuals are being disadvantaged by the system as it now exists." See letters dated April 25, 1997 and May 2, 1997, respectively, from Senator Spencer Abraham and 10 individual members of Congress to Mary L. Schapiro. The recognition by these elected officials that unwarranted precipitous change should not be the order of the day is all the more compelling in light of the government's own March 1994 study of this very issue as well as the recommendations made by the Ruder Task Force.

Indeed, it is somewhat surprising that draconian change is being considered when the majority of the recommendations made by the United States General Accounting Office (the "GAO") and by the Ruder Task Force have yet to be fully implemented by the NASD, despite the fact that the changes are supported by the industry. As explained in SIA's previous submissions, modifications to the system have begun over the last several years at the SROs, including improved arbitrator training in employment law and increased diversity of the arbitrator pool. The industry has already offered to work with the SROs to craft change that will benefit the system and improve the perception that it is unfair while at the same time, maintaining the efficiency of the process. Until the NASD has implemented the modifications and monitored their effect on both the results and the perception of the system, it is premature to abandon the process.

CONCLUSION

In sum, maintaining the mandatory nature of the process is essential to reduce the costs, in

terms of both money and human resources, incident to court-based litigation, and to ensure the equitable resolution of discrimination claims in the securities industry. The arguments against mandatory arbitration ignore: (1) the confidence placed in the arbitration process by the Supreme Court; (2) the documented success of SRO arbitration panels in resolving discrimination claims fairly and efficiently; (3) the increasing inability of the federal courts to resolve such claims fairly, effectively and efficiently; (4) the unwieldy bifurcation of claims that will result if plaintiffs are given the option of bringing employment discrimination claims in court, and (5) the NASD's interest in exercising its regulatory oversight powers to monitor all aspects of the employer-employee relationship and insure that its member firms and their employees act ethically, responsibly and legally in all aspects of their conduct.

We respectfully suggest that the NASD and NASD-R resist the urge to rush to drastic reform based on unsubstantiated rhetoric from well-intentioned but ill-advised politicians and self-interested plaintiffs' lawyers.

Sincerely,

SECURITIES INDUSTRY ASSOCIATION

Stuart J. Kaswell
Senior Vice President and General Counsel

cc: The Honorable Arthur Levitt, SEC
The Honorable Steven M.H. Wallman, SEC
Linda Fienberg, Esq., NASD-R

Footnotes

¹ NASD Notice to Members ("NTM") 93-64 expressly sets forth the NASD's view that disputes which "implicate industry practice" require industry expertise through the SRO arbitration process. Tellingly, this same NTM plainly indicates that, at the time the NASD instituted various changes to the Code of Arbitration Procedure relating to discrimination claims, the NASD considered the public policy implications of arbitrating race and sexual discrimination claims, aptly concluding that arbitration was an appropriate vehicle for the resolution of such claims.

² Likewise misplaced is Commissioner Wallman's suggestion that "arbitration panels in cases involving securities firms and their employees are not qualified to hear discrimination claims." *Letter from Commissioner Wallman* at p. 2. The Supreme Court of the United States has repeatedly disavowed such a notion, dismissing such "outdated" and "generalized attacks on arbitration" as "far out of step with our current endorsement of the federal statutes favoring" arbitration as a valuable method of dispute resolution. *Gilmer v. Interstate Lane Corp.*, 500 U.S. 20 (1991); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 478 U.S. 614 (1987). Further, the Supreme Court has explicitly "refused to indulge the presumption" that competent and impartial arbitrators cannot resolve all manner of complex disputes, from those arising under the RICO statute, the federal anti-trust laws, defamation, and even the Civil Rights laws themselves. *See, e.g., Rodriguez de Quijas v. Shearson/American Express, Inc.*, 482 U.S. 614 (1985); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987); *Gilmer, supra*.

³ In fact, if the proposed rule were adopted with a unilateral option, plaintiffs undoubtedly will regularly file in both forums. The court proceeding will be solely for the purpose of conducting discovery and once the discovery is concluded, the plaintiff probably would dismiss the court case without prejudice and amend the statement of claim to include the discrimination claim, imposing an unnecessary burden on the court system.

⁴ A representative of the National Employment Lawyers Association ("NELA") hypothesizes that settlements tend to be lower in arbitration. First, NELA has provided no meaningful evidence to support this proposition. Second, even if correct, settlements may be lower in arbitration because the defendant's projected costs are lower. Thus, since plaintiffs' attorneys typically receive a percentage of settlement, they are paid better for a court claim than an arbitration claim - even if the actual value of the claim is the same. None of this makes arbitration unfair; it just makes it potentially less lucrative for the plaintiffs' bar.

⁵ In all events, and as noted during the June 16th panel discussions, the Federal Judiciary itself has recently acknowledged that there exists clearly perceptible bias in the judicial treatment of parties, witnesses and counsels throughout the federal court system, and thus the court system is far from the flawless, time efficient or impartial forum it is claimed to be. See report issued by Second Circuit Task Force on Gender, Racial and Ethnic Fairness in the Courts, June 1997.

⁶ It should be noted, however, that our industry is far from the only industry which mandates arbitrations, as recently documented in a Newsweek article, June 30, 1997, pp. 48-49.

⁷ To that end, I would welcome any questions which you may have regarding the data or survey methodology.