

2007

# Explaining "Explained Decisions": NASD's Proposal for Written Explanations in Arbitration Awards

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## Recommended Citation

Marilyn B. Cane & Ilya Torchinsky, *Explaining "Explained Decisions": NASD's Proposal for Written Explanations in Arbitration Awards*, 16 U. Miami Bus. L. Rev. 23 (2007), available at <http://>

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# EXPLAINING “EXPLAINED DECISIONS”: NASD’S\* PROPOSAL FOR WRITTEN EXPLANATIONS IN ARBITRATION AWARDS

MARILYN BLUMBERG CANE\*\* AND ILYA TORCHINSKY\*\*\*

*“An explanation of cause is not a justification by reason.”<sup>1</sup>*

I.	INTRODUCTION .....	23
II.	SECURITIES ARBITRATION: OVERVIEW .....	25
III.	PROPOSED RULE .....	26
IV.	MANIFEST DISREGARD OF THE LAW DOCTRINE .....	27
V.	STUDIES, COMMENTARIES ON THE PROPOSED RULE CHANGE .....	32
VI.	OTHER ARBITRATION FIELDS: .....	38
VII.	CONCLUSION .....	41
	APPENDIX A: NASD PURPOSE STATEMENT .....	42
	APPENDIX B: RULES AFFECTED BY PROPOSED CHANGE .....	45

## I. INTRODUCTION

Imagine that a medium-size broker-dealer firm in Boca Raton, FL was found liable in an arbitration proceeding for mishandling an elderly couple’s

\* On July 26, 2007, the Securities and Exchange Commission approved the consolidation of the National Association of Securities Dealers (NASD) and NYSE Regulation, Inc. into a single self-regulating organization named the Financial Industry Regulatory Authority (FINRA). FINRA now handles all of the regulatory functions of the NASD, including arbitration. Therefore, NASD has changed its name to FINRA with regard to its regulatory functions, and any reference in this article to NASD is likewise a reference to FINRA. News Release, U.S. Sec. and Exch. Comm’n, SEC Gives Regulatory Approval for NASD and NYSE Consolidation (July 26, 2007) (2007 WL 21358805).

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<sup>1</sup> C.S. Lewis Quotes, <http://myfamousquotes.com> (last visited Nov. 3, 2007) (follow “Search by Last Name” hyperlink; then follow “L” hyperlink; then follow “Lewis, C.S.” hyperlink).

last savings, a scenario so common that even the news-hungry sharks of the local TV station would not find it worthy of broadcast. The couple was awarded \$12,000 while claiming damages in excess of \$600,000. The final award, produced by the arbitration panel, contained no explanation of the panel's rationale. The couple will spend its last golden years next to poverty, getting by only on Social Security. Imagine their securities broker had been astutely and carefully managing her clients' funds for decades when she is caught up in an arbitration proceeding alleging that she is liable to her life-long clients because she recommended unsuitable investments that were touted by her firm. It is her position that the firm, in effect, lied to her about the suitability of the investment for her clients. Again, assume the arbitration panel finds her liable for forty percent of the award, but doesn't explain why she is liable or why for forty percent. Neither the elderly couple nor the broker would be likely to challenge the arbitration award in court. The statutory grounds for vacating an arbitration award are very limited.<sup>2</sup> Moreover, it would be an exercise in futility to allege the panel's breach of manifest disregard of the law standard absent explanatory language in the record.

Arguably, to combat investor complaints and to give more credibility to this self-regulatory organization ("SRO"), the National Association of Securities Dealer Regulation ("NASD DR") announced on January 27, 2005 its intention to amend a rule requiring arbitrators to explain their decisions.<sup>3</sup> The Code of Arbitration Procedure would be amended "to provide written explanations in arbitration awards upon the request of customers . . . ."<sup>4</sup> This proposal also provided that such written explanations could be requested by individual brokers in intra-industry arbitrations.<sup>5</sup>

In order for a proposed rule to take effect, it must be consistent with the provisions of Section 15A(b)(6) of the Securities and Exchange Act of 1934, which requires, *inter alia*, that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public

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<sup>2</sup> See 9 U.S.C. § 10(a) (2000) (discussing the statutory grounds for vacating an arbitration award). Manifest disregard is a court-created, rather than statutory basis for vacating an award. See *infra* note 14 and accompanying text.

<sup>3</sup> NASD, News Release: New Arbitration Rule Requires Award Explanations Upon Investor Request (Jan. 27, 2005), <http://www.finra.org/PressRoom/NewsReleases/2005NewsReleases/P013145>.

<sup>4</sup> Notice of Filing of Proposed Rule Change to Provide Written Explanations in Arbitration Awards Upon the Request of Customers, or of Associated Persons in Industry Controversies, Exchange Act Release No. 34-52,009, 70 Fed. Reg. 41,065, 41,065 (proposed July 15, 2005) [hereinafter Proposed Rule].

<sup>5</sup> See *id.*

interest.<sup>6</sup> "NASD believes that allowing customers and associated persons in industry disputes to request explained decisions will enhance investor confidence in the fairness of NASD's arbitration forum."<sup>7</sup>

This article will evaluate the likely success of the proposed amendment, first, by briefly revisiting the arbitration history and source of its authority; second, by pointing out practical difficulties in applying the manifest disregard of the law standard; and third, by critiquing the language of the proposed rule. Finally, the article will conclude with the authors' own interpretations and resolutions of this issue.

## II. SECURITIES ARBITRATION: OVERVIEW

In 1925, Congress enacted the Federal Arbitration Act ("FAA"),<sup>8</sup> which requires Article III courts to enforce contracts that provide for arbitration as a remedy.<sup>9</sup> However, not until 1985 was there clarity as to the enforceability of a predispute agreement to arbitrate. In *Mitsubishi Motors Corp. vs. Soler Chrysler-Plymouth, Inc.*, the United States Supreme Court stated:

By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.<sup>10</sup>

In the late 1980s, the United States Supreme Court specifically upheld the validity of pre-dispute arbitration agreements between customers and brokers and brokerage firms under both the Securities Exchange Act and the Securities Act.<sup>11</sup>

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<sup>6</sup> 15 U.S.C. § 78o-3(b)(6) (2006).

<sup>7</sup> Proposed Rule, *supra* note 4, at 41,066.

<sup>8</sup> Federal Arbitration Act, ch. 213, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1-16 (2000)).

<sup>9</sup> Joseph R. Grodin, *Arbitration of Employment Discrimination Claims: Doctrine and Policy in the Wake of Gilmer*, 14 HOFSTRA LAB. & EMP. L.J. 1, 7-8 (1996).

<sup>10</sup> 473 U.S. 614, 628 (1985).

<sup>11</sup> See, e.g., *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 238 (1987) (Exchange Act claims); *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 485-86 (1989) (Securities Act claims). See generally MARILYN BLUMBERG CANE & PATRICIA A. SHUB, *SECURITIES ARBITRATION: LAW AND PROCEDURE* 232-45, 255-67 (BNA Books 1991) (explaining how arbitration of disputes became a part of the securities industry).

### III. PROPOSED RULE

As the Securities and Exchange Commission (“SEC”) notes, “[t]he lack of reasoning or explanations in [arbitration] awards is one of the most common complaints of non-prevailing participants in NASD’s arbitration forum.”<sup>12</sup>

NASD currently handles ninety percent of securities-related disputes among various U.S. markets and exchanges.<sup>13</sup> In 2006, NASD was the forum for 4614 new arbitration cases filed and 7212 cases were closed.<sup>14</sup>

At present, the NASD Code of Arbitration Rule 10330(e) requires only limited factual information, including a summary of the issues and the relief requested and awarded.<sup>15</sup> Although the arbitrators may include the rationale underlying their decision in the award, they are not required to do so.<sup>16</sup> “In order to increase investor confidence in the fairness of the NASD arbitration process, NASD is proposing to amend the Code to allow customers or associated persons in industry controversies to require an explained decision.”<sup>17</sup>

An “explained decision” is described in the Written Explanations as a “fact-based award that states the reason(s) each alleged cause of action was granted or denied and will address all claims involved in the case, whether brought by the party requesting the explained decision or another party” to the arbitration.<sup>18</sup> This “explained decision” may be requested by the customer or associated person regardless of whether she or he is the claimant or respondent.<sup>19</sup>

<sup>12</sup> Proposed Rule, *supra* note 4, at 41,065.

<sup>13</sup> THOMAS H. OEHMKE, SECURITIES EXCHANGES—NASD DISPUTE RESOLUTION, 1 COMMERCIAL ARBITRATION § 28:10 (2007), WL, CMLARB s. 28:10. *See also* About NASD – Corporate Description, available at <http://www.nasd.com/AboutNASD/CorporateInformation/CorporateDescription/index.htm> (last visited Feb. 1, 2007).

<sup>14</sup> FINRA, Arbitration and Mediation—Dispute Resolution Statistics, <http://www.finra.org> (last visited Oct. 19, 2007) (follow “Arbitration & Mediation” hyperlink; then follow “View Dispute Resolution Statistics” hyperlink).

<sup>15</sup> NASD, CODE OF ARBITRATION R. 10330(e) (1997), available at [http://www.finra.org/web/groups/med\\_arb/documents/mediation\\_arbitration/p018653.pdf](http://www.finra.org/web/groups/med_arb/documents/mediation_arbitration/p018653.pdf).

<sup>16</sup> FINRA, Arbitration and Mediation—Tour of the Dispute Resolution Process, <http://www.finra.org> (last visited Oct. 19, 2007) (follow “Arbitration & Mediation” hyperlink; then follow “Dispute Resolution” hyperlink; then follow “Tour of the Dispute Resolution Process” hyperlink); *see also* Proposed Rule, *supra* note 4, at 41,065.

<sup>17</sup> Proposed Rule, *supra* note 4, at 41,065.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 41,065 n.7.

What specifically is not included in such an "explained decision" is "[t]he inclusion of legal authorities or damage calculations . . . ." <sup>20</sup> The reason for these exclusions according to the SEC and NASD is that requiring their inclusion "would significantly increase the processing time of awards because it would result in the drafting of complex and lengthy judicial-type decisions." <sup>21</sup> This, in turn, would add more cost to the process as this would result in payment of "considerably more honoraria" to arbitrators. <sup>22</sup> Currently, arbitrators are paid \$200 per session. <sup>23</sup>

Significantly, only customers and associated persons, not NASD members, could require explained decisions, although NASD members could request them. The arbitration panel may or may not comply with such a request. The reason, according to the Proposed Release, is that this protects customers and associated persons, because they determine if the potential cost is worth it and "the prospect that a reviewing court might find grounds in the explanation to vacate the award." <sup>24</sup>

The SEC also noted that while NASD Rule 10323 of the Code provides that arbitrators shall determine materiality and relevance of evidence, "NASD intends that, as with current arbitration awards, explained decisions will have no precedential value in other cases." <sup>25</sup> In fact, NASD plans to include the following caveat in the award template: "If the arbitrators have provided an explanation of their decision in this award, the explanation is for the information of the parties only and is not precedential in nature." <sup>26</sup>

#### IV. MANIFEST DISREGARD OF THE LAW DOCTRINE

Arbitral explained awards may increase the chance of being overturned by the courts. Generally, while arbitration awards are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract" <sup>27</sup> courts may challenge the validity of an award using a statutory vehicle provided in 9 U.S.C. § 10(a) or by invoking the non-statutory manifest disregard of the law doctrine. <sup>28</sup>

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<sup>20</sup> *Id.* at 41,065.

<sup>21</sup> *Id.*

<sup>22</sup> Proposed Rule, *supra* note 4, at 41,065.

<sup>23</sup> NASD, NASD Dispute Resolution: Frequently Asked Questions, Arbitrator Honorarium (2006), [http://www.finra.org/web/groups/med\\_arb/documents/mediation\\_arbitration/p009505.pdf](http://www.finra.org/web/groups/med_arb/documents/mediation_arbitration/p009505.pdf).

<sup>24</sup> Proposed Rule, *supra* note 4, at 41,065 (citing *Dawahare v. Spencer*, 210 F.3d 666, 669 (6th Cir. 2000)).

<sup>25</sup> *Id.* at 41,065 n.8.

<sup>26</sup> *Id.*

<sup>27</sup> 9 U.S.C. § 2 (2000).

<sup>28</sup> 9 U.S.C. § 10(a) (2000).

The statutory reasons to vacate an arbitral award include:

- (1) where the award was procured by corruption, fraud, or undue means;
- (2) where there was evident partiality or corruption in the arbitrators, or either of them;
- (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, in refusing to hear evidence pertinent and material to the controversy, or of any other misbehavior by which the rights of any party have been prejudiced;
- (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made;
- (5) where an award is vacated and the time within which the agreement required the award to be made has not expired, the court may, in its discretion, direct a rehearing by the arbitrators.<sup>29</sup>

For three decades, federal courts upheld the FAA's grounds for vacatur holding them to be an exclusive remedy.<sup>30</sup> However, in 1953, the Supreme Court decided *Wilko v. Swan*.<sup>31</sup> The court stated:

[A] failure of the arbitrators to decide in accordance with the provisions of [relevant law] would 'constitute grounds for vacating the award pursuant to section 10 of the Federal Arbitration Act,' that failure would need to be made clearly to appear. In unrestricted submission [to arbitration] . . . the interpretations of the law by the arbitrators in contrast to *manifest disregard* [of the law] are not subject, in the federal courts, to judicial review for error in interpretation.<sup>32</sup>

The *Wilko* court suggested a potential for an alternative means of vacating an arbitral award based upon the manifest disregard standard. The opinion suggested that if the arbitrators "manifestly disregarded" the law, as opposed to merely misinterpreting it, that might provide grounds for vacatur. Over four decades later, in *Merrill Lynch, Pierce, Fenner & Smith, Inc.*

<sup>29</sup> *Id.*

<sup>30</sup> Gary W. Flanagan, *Expanded Grounds for Judicial Review of Employment Arbitration Awards*, 67 DEF. COUNS. J. 488, 489 (2000).

<sup>31</sup> 346 U.S. 427 (1953), *overruled by* *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989).

<sup>32</sup> *Wilko*, 346 U.S. at 436-37 (second emphasis added) (footnote omitted).

*v. Bobker*,<sup>33</sup> the Second Circuit defined what constituted the manifest disregard standard—a definition much needed:

The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, the term 'disregard' implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it. To adopt a less strict standard of judicial review would be to undermine our well established deference to arbitration as a favored method of settling disputes when agreed to by the parties. Judicial inquiry under the 'manifest disregard' standard is therefore extremely limited. The governing law alleged to have been ignored by the arbitrators must be well defined, explicit, and clearly applicable. We are not at liberty to set aside an arbitration panel's award because of an arguable difference regarding the meaning or applicability of laws urged upon it.<sup>34</sup>

"Every federal circuit, except the Fifth Circuit (which declines to adopt any nonstatutory grounds to set aside awards), expressly recognizes that 'manifest disregard of the law' is an appropriate reason to vacate an arbitration panel's decision."<sup>35</sup> To prove manifest disregard of the law in the Fifth Circuit, the aggrieved party must show that:

(1) the arbitrators must have 'appreciate[d] the existence of a clearly governing principle but decided to ignore or pay no attention to it'; (2) 'the governing law ignored by the arbitrators must be well defined, explicit, and clearly applicable'; and, separately, that (3) upholding the arbitrator's award would result in a 'significant injustice.'<sup>36</sup>

The Seventh Circuit, however, limited its application to vacate arbitration orders to instances where the arbitration award directs the parties

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<sup>33</sup> 808 F.2d 930 (2d Cir. 1986).

<sup>34</sup> *Id.* at 933–34. The Second Circuit's definition of manifest disregard of the law has been adopted by most appellate courts.

<sup>35</sup> THOMAS H. OEHMKE, *LIMITATIONS AND EXCEPTIONS, 3 COMMERCIAL ARBITRATION* § 149:4, WL, CMLARB § 149:4 (footnote omitted).

<sup>36</sup> Christopher D. Kratovil, *Judicial Review of Arbitration Awards in the Fifth Circuit*, 38 ST. MARY'S L.J. 471, 486–87 (2007) (footnote omitted).



to violate the law.<sup>37</sup> In *Wise v. Wachovia Securities, LLC.*,<sup>38</sup> investors sought to vacate an arbitration award in favor of a securities brokerage firm, on the investors' claim that the firm was liable for a former broker's fraud. Appellant argued that since there was no evidence to support the award, the award had to be set aside as being "arbitrary and capricious."<sup>39</sup> On appeal from the district court affirming the award, Judge Posner did not find manifest disregard of the law when the arbitration panel did not explain its decision.<sup>40</sup> He reasoned that "arbitrary and capricious" is not a ground for vacatur listed under FAA. Furthermore, the Seventh Circuit defines "'manifest disregard of the law' so narrowly that it fits comfortably under the first clause of the fourth statutory ground—'where the arbitrators exceeded their powers.'"<sup>41</sup> Additionally, the Seventh Circuit defined cases where "arbitrators exceed[] their powers" solely as cases in which arbitrators "direct the parties to violate the law."<sup>42</sup> Since there was no instruction to violate the law, the arbitration award was affirmed. Judge Posner further added:

When parties agree to arbitrate their disputes they opt out of the court system, and when one of them challenges the resulting arbitration award he perforce does so not on the ground that the arbitrators made a mistake but that they violated the agreement to arbitrate, as by corruption, evident partiality, exceeding their powers, etc.—conduct to which the parties did not consent when they included an arbitration clause in their contract. That is why in the typical arbitration . . . the issue for the court is not whether the contract interpretation is incorrect or even wacky but whether the arbitrators had failed to interpret the contract at all, for only then were they exceeding the authority granted to them by the contract's arbitration clause.<sup>43</sup>

In Tennessee, the Tennessee Supreme Court found "that the FAA contains no express provision preempting the entire field of arbitration;

<sup>37</sup> See OEHMKE, *supra* note 35 (citing *George Watts & Son, Inc. v. Tiffany & Co.*, 248 F.3d 577, 581 (7th Cir. 2001)) ("[T]he 'manifest disregard' principle is limited to two possibilities: an arbitral order requiring the parties to violate the law (as by employing unlicensed truck drivers), and an arbitral order that does not adhere to the legal principles specified by contract, and hence unenforceable under § 10(a)(4)."). *Id.* at 581.

<sup>38</sup> 450 F.3d 265 (7th Cir. 2006).

<sup>39</sup> *Id.* at 268.

<sup>40</sup> *Id.* at 268–69.

<sup>41</sup> *Id.* at 268.

<sup>42</sup> *Id.* at 268–69.

<sup>43</sup> *Id.* at 269 (citations omitted).

therefore, in Tennessee, a court limits its review strictly to the four vacatur standards under FAA § 10(a).<sup>44</sup>

The definition of manifest disregard of the law begs the question: can one successfully allege manifest disregard of the law if an arbitration award contains no explanatory language?<sup>45</sup> For example, in *UBS Warburg LLC v. Auerbach, Pollak & Richardson, Inc.*, the New York Supreme Court granted a motion to vacate an arbitration award.<sup>46</sup> The court cited to an arbitration record, which served as the premise to the court's conclusion that the panel manifestly disregarded the law.<sup>47</sup> Assuming that the record contained no such explanatory language, could the court hold that the arbitration panel manifestly disregarded the law?

Not in *Koruga v. Fiserv Correspondent Services, Inc.*,<sup>48</sup> in which, after an arbitration panel wrote a thirty-nine page opinion finding the defendant liable,<sup>49</sup> the defendant moved to vacate the arbitration award.<sup>50</sup> In addition to the liability award, the arbitrators awarded plaintiffs attorneys' fees and costs, by clearly disregarding the law.<sup>51</sup> Under applicable state statutes, the

<sup>44</sup> OEHMKE, *supra* note 35; *see also* Warbington Constr., Inc. v. Franklin Landmark, L.L.C., 66 S.W.3d 853, 854, 858 (Tenn. Ct. App. 2001) (noting that Tennessee courts have declined to adopt the non-statutory grounds of either "manifest disregard" or "public policy" for reviewing arbitration awards in FAA cases).

<sup>45</sup> *See generally* Marilyn Blumberg Cane & Marc J. Greenspon, *Securities Arbitration: Bankrupt, Bothered and Bewildered*, 7 STAN. J.L. BUS. & FIN. 131, 146-52 (2002).

<sup>46</sup> No. 119163/00, 2001 WL 1586978, at \*5 (N.Y. Sup. Ct. Oct. 2, 2001).

<sup>47</sup> *Id.* at \*3. The court cited the following record:

[Counsel for UBS]: I have a question about the briefs . . . We're going to be citing case law and regulatory authorities in the brief. Would it be useful for the panel for us to supply copies of the things that we cite, so that you don't have to look them up yourselves?

[Counsel for APR]: I don't believe we have an objection to that. I think it's really a question of what the panel would want. If you are going to be reading these cases--

[Arbitrator]: I am not. I'm not going to read it.

....

[Arbitrator]: Excuse me, but I never heard of a rule that says in accounting that you have to enter prospective charge [sic] just because you know it is going to come down.

[Counsel for UBS]: Well, Ms. Kunzler, I could give you of the uniform net capital rule [sic], 15c3-1, and the uniform net capital rule specifically says you have to take a charge against liabilities that you know you have, even though you haven't been called to put up the money.

<sup>48</sup> *Koruga v. Fiserv Correspondent Servs., Inc.*, 40 F. App'x 364 (9th Cir. 2002).

<sup>49</sup> *Koruga v. Ming Wang*, Docket No. 98-04276, 2000 WL 33534559 (N.A.S.D. Oct. 2, 2000).

<sup>50</sup> *Koruga v. Fiserv Correspondent Servs., Inc.*, 183 F. Supp 2d 1245, 1246 (D. Or. 2001).

<sup>51</sup> *Id.* at 1247. *See* Cane, *supra* note 45, at 154-57; *see also* Travelers Ins. Co. v. Nationwide Mut. Ins. Co., 886 A.2d 46, 49 n.13 (Del. Ch. 2005) (comparing *Koruga*). *See generally* Katz v. Fin. Clearing & Servs. Corp., 794 F. Supp. 88 (S.D.N.Y. 1992); Dillon v. Militano, 731 F. Supp. 634 (S.D.N.Y. 1990); Carlson v. Bear, Stearns & Co. Inc., 906 F.2d 315 (7th Cir. 1990); Schober v. Dep't of Labor, 97 CIV. 8623 (DLC), 1999 U.S. Dist. LEXIS 6844, at \*3 (S.D.N.Y. May 11, 1999).

claimants had to prove the defendant was a broker-dealer that materially aided in the sale.<sup>52</sup> In researching the statutory definition of “broker-dealer” and “material,” the panel disregarded well-settled case law, which stated that the functions performed by clearing firms that the *Koruga* panel labeled as “material” are “ministerial.”<sup>53</sup> The United States District Court for the District of Oregon denied a motion to vacate the award.<sup>54</sup> On appeal, the Court of Appeals for the Ninth Circuit produced a somewhat unusual opinion—stating that this Ninth Circuit opinion could *not* be cited as precedent—and affirmed the district court’s holding.<sup>55</sup> The court of appeals held that the arbitration panel did not manifestly disregard applicable law and that the defendant was responsible for reasonable attorneys’ fees.<sup>56</sup>

## V. STUDIES, COMMENTARIES ON THE PROPOSED RULE CHANGE

Some believe that when parties agree to arbitration without providing for a reasoned award, they waive any right to an explanation or clarification of the award.<sup>57</sup> Furthermore, requiring arbitrators to explain their reasoning undermines one purpose of arbitration, which is to provide a relatively inexpensive, quick, efficient, and informal means of private dispute settlement.<sup>58</sup> The American Arbitration Association does not encourage arbitrators to write opinions that give their reasons for the award.<sup>59</sup>

As discussed above, the NASD proposed rule would allow customers and brokers in intra-industry disputes to request a written explanation of the award from the panel. However, one practitioner warns against such requests, by listing several reasons why “investors and their lawyers should think twice about requesting such a decision”:

First, the reasoned award process is likely to result in delays due to appeals, and will pose a threat to the award should some court decide to overturn it. . . .

Second, a poorly-worded decision by an arbitration panel (particularly a panel composed of two or three non-lawyers) might

<sup>52</sup> See *Cane*, *supra* note 51, at 155.

<sup>53</sup> *Id.*

<sup>54</sup> *Koruga v. Fiserv Correspondent Servs., Inc.*, 183 F. Supp 2d 1245, 1246 (D. Or. 2001).

<sup>55</sup> *Koruga v. Fiserv Correspondent Servs., Inc.*, 40 F. App'x 364, 365 (9th Cir. 2002).

<sup>56</sup> *Id.* at 366.

<sup>57</sup> See, e.g., *Craig v. Barber*, 524 So. 2d 974, 976-77 (Miss. 1988) (holding that court order to compel arbitrator to explain arbitration award in response to claim that arbitrator exhibited evident partiality was improper) (later proceeding, 558 So. 2d 863 (Miss. 1990)).

<sup>58</sup> See, e.g., *Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211, 1214 (2d Cir. 1972).

<sup>59</sup> 44 Am. Jur. *Trials* 507, 10(A) § 81.

provide meritorious grounds for a brokerage firm to challenge the award when no such grounds would otherwise have existed.

Third, the issuance of reasoned awards by arbitration panels could lead to the creation of securities arbitration common law. Currently, arbitration awards have no precedential value in other cases. While arbitrators are encouraged to review and follow the law, there is no strict requirement that they do. Thus, it is likely that if a customer in one case received a "zero" award and a reasoned decision, that decision could be used against investors with similar cases as grounds to deny them awards.

Fourth, where an investor receives an award of punitive damages and requests a reasoned decision, there is likely to be greater scrutiny by a reviewing court given the recent United States Supreme Court decision limiting punitive damages. A punitive damage reasoned award also is more likely to be appealed by a brokerage firm, particularly where a decision is either poorly worded or is not in strict compliance with the Supreme Court decision.<sup>60</sup>

Furthermore, this author argues, "[r]easoned awards will create a paper trail or track record upon which customers and the securities industry will judge potential panelists. Thus, transparency may chill arbitrators who might otherwise issue pro-investor reasoned awards."<sup>61</sup>

Other commentators, while realizing the need for more transparency in the securities industry, are opposing the rule for several novel reasons.<sup>62</sup> The rule's adoption, they argue, "may be largely cosmetic if it does not improve the securities arbitration process itself, but merely [improves] claimants' *perceptions* of the process."<sup>63</sup> There are internal reasons why the proposal should not occur. If an arbitrator is "philosophically opposed to writing explanations" he or she will be unable to withdraw from the process since the "request for a written explanation [can be made] as late as [twenty] days prior to the first scheduled hearing date, after NASD already has appointed arbitrators and when it is too late for arbitrators to decline the

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<sup>60</sup> Jacob H. Zamansky, *A "Reasoned" Arbitration Decision? Be Careful What You Wish For*, WALLSTREETLAWYER.COM: SECURITIES IN THE ELECTRONIC AGE (Feb. 2005), available at WL 8 No. 9 GLWSLAW 8 (footnote omitted).

<sup>61</sup> *Id.*

<sup>62</sup> See generally Barbara Black & Jill Gross, *The Explained Award of Damocles: Protection or Peril in Securities Arbitration*, 34 SEC. REG. L.J. 17 (2006).

<sup>63</sup> *Id.*

case.”<sup>64</sup> In addition, the language of the proposal “does not provide sufficient guidance to arbitrators about how to craft the award. It merely defines an explained decision as a ‘fact-based award stating the reasons each alleged cause of action was granted or denied’ and states that an explanation need not include legal authorities or damage calculations.”<sup>65</sup> Notwithstanding any possible detrimental effects of the proposal, these commentators do find some clear benefits.<sup>66</sup> For example, being able to see previous written explanations would allow parties to see how arbitrators previously decided controversies, which would then provide “valuable information for parties to use when ranking and striking arbitrators during arbitrator selection in future cases.”<sup>67</sup>

Since NASD’s filing of the proposal to amend the rule, the SEC received numerous commentaries both praising and condemning the proposed action.<sup>68</sup> NASAA, for example, favors the rule change because “[it] will serve a number of important goals. It will improve the quality of arbitration, in that decision makers who must explain their thinking tend to arrive at more fair and correct results. Courts and commentators alike have noted that explanations improve the adjudicative process.”<sup>69</sup> In addition, NASAA argues for both the requirement of explained decisions, as well as the inclusion of legal authorities and damage calculations in the awards, two items which are excluded from the proposed rule.<sup>70</sup>

NASAA believes that inclusion of legal authorities and damage calculations in written arbitration opinions are important to “achieve more fully the benefits that written decisions can offer: fair outcomes, enhanced investor confidence, a meaningful basis for appeal, and the evolution of a securities jurisprudence in arbitration cases. Without this additional requirement, the rule amendment will fall short of its objectives.”<sup>71</sup>

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<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> Comments on File No. SR-NASD-2005-032, available at <http://www.sec.gov/rules/sro/nasd/nasd2005032.shtml>.

<sup>69</sup> Letter from Franklin L. Widmann, President, NASAA, to Jonathan G. Katz, Secretary, SEC 2 (Sept. 13, 2005), available at <http://www.sec.gov/rules/sro/nasd/nasd2005032/flwidmann5172.pdf> [hereinafter NASAA Letter] (citing *Williamson v. Tucker*, 645 F.2d 404, 411 n.3 (5th Cir.), cert. denied, 454 U.S. 897 (1981) (the findings required under FED. R. CIV. P. 52(a) “insure care on the part of the trial judge in ascertaining the facts”); Cane, *supra* note 44, at 160 (opinions demonstrate that the arbitrator thoughtfully contemplated each claim)).

<sup>70</sup> NASAA Letter, *supra* note 69, at 1-3.

<sup>71</sup> *Id.* at 3.

In addition, NASAA urges the industry to dispense with the requirement that written explanations be requested by one of the parties.<sup>72</sup> Currently, a party must request an explanation of an award; it is not automatic.<sup>73</sup> NASAA cites two reasons. First, procedurally, "investors, especially those appearing without counsel, may not understand their right to request an explanation of the award."<sup>74</sup> Second, if the proposed twenty day request requirement is retained, it needs to be corrected to avoid conflict with the proposed amendment to Rule 10330(j)(4), which provides that "any [request for a written explanation of an award] must be made 'no later than the time for the pre-hearing exchange of documents and witness lists under Rule 10321(c).'"<sup>75</sup>

A different practitioner, in condemning the proposed rule, points out that "[a]rbitration is best understood as the last-resort method of *settling* disputes, rather than as an alternative method of *deciding* cases. . . . It will make it harder for arbitrators to impose settlements, because settlements, unlike determinations or decisions, will always be difficult if not impossible to explain with 'reasons.'"<sup>76</sup> In addition, this practitioner argues that a reasoned opinion may not be fair. For example, a reason might read like this: "We find by a preponderance of the evidence that the customer received statements in time to disavow the trade and failed to do so. Therefore, the trade was ratified and the customer's claim is dismissed." Or it could be the converse. Either way, it would make for a perfectly "reasoned" result. But would either result be fair? Generally speaking, no.<sup>77</sup>

Some practitioners believe that arbitration is a fair and equitable forum to resolve disputes.<sup>78</sup> A.G. Edwards, in its letter to the SEC, cited several studies, which appeared to show that participants in the arbitration process believed that the forum and process during their cases was fair.<sup>79</sup> A.G. Edwards laid out two concepts explaining why some call for a rule change. They are "public perception" problems and an increase in appeals.<sup>80</sup>

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<sup>72</sup> *Id.* at 4.

<sup>73</sup> See generally Proposed Rule, *supra* note 4.

<sup>74</sup> NASAA Letter, *supra* note 69, at 4.

<sup>75</sup> *Id.*

<sup>76</sup> Aegis J. Frumento, *Can't Get No Satisfaction! How Explained Decisions Will Undermine the Arbitration Process*, 3 SEC. ARB. COMMENTATOR 1, 2 (2005).

<sup>77</sup> *Id.* at 5.

<sup>78</sup> Letter from Stephen G. Sneeringer, Senior Vice President & Counsel, A.G. Edwards & Sons, Inc., to Jonathan G. Katz, Secretary, SEC (July 28, 2005), available at <http://www.sec.gov/rules/sro/nasd/nasd2005032/sgsneeringer072805.pdf> [hereinafter A.G. Edwards Letter].

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

A.G. Edwards cites to The General Accounting Office (“GAO”), which issued a report<sup>81</sup> that reviewed arbitration decisions from January 1989 to June 1990: “The GAO found no statistically significant difference between results in industry-sponsored arbitrations versus American Arbitration Association arbitrations noting that investors prevailed 59% of the time.”<sup>82</sup> The GAO again reviewed decisions during the period of 1992 through 1998 in its report and came to the same findings: “The vast majority strongly agreed that their cases were handled fairly and without bias. In fact, more claimants than respondents felt that their cases were handled justly and equitably.”<sup>83</sup>

Further, A.G. Edwards cites to another study conducted by The Securities Industry Conference on Arbitration (“SICA”) that collects and processes data received from commercial arbitrations:

Reviewing this data yields no evidence indicating that one party is favored in arbitration. In fact, the award results have remained surprisingly consistent over 20-plus years notwithstanding the numerous changes that have been made to the definitions of who is a “public arbitrator” versus a “non-public or industry arbitrator.” Most of these changes were again made to assuage negative “perceptions” of self-regulatory organization (“SRO”) arbitrations.<sup>84</sup>

According to A.G. Edwards:

[I]ndependent studies, data and conclusions all verify that SRO arbitrations are fair, just, and equitable and that the public agrees with this conclusion. Notwithstanding empirical evidence, certain individuals and the media continue to claim that there is a public “perception” problem that needs to be addressed. . . . Edwards does not believe that rule making is the proper methodology to respond

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<sup>81</sup> U.S. GEN. ACCOUNTING OFFICE, SECURITIES ARBITRATION: HOW INVESTORS FARE, REP. NO. GAO/GGD- 92-74 (1992).

<sup>82</sup> A.G. Edwards Letter, *supra* note 77, at 2.

<sup>83</sup> *Id.* See also See Gary Tidwell, Kevin Foster & Michael Hummel, *Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrators 3* (1999).

<sup>84</sup> A.G. Edwards Letter, *supra* note 78, at 2 (citing Michael A. Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations*, Recommendation Two (2002)).

to negative publicity, particularly when that publicity may be inaccurate or biased.<sup>85</sup>

When addressing the written opinion issue, A.G. Edwards believes that even if one out of a hundred or a thousand opinions "lacks the communicative skill to clearly transmit the arbitrators' logic and reasoning, that written opinion will be the subject of commentary, analysis, and possible derision by the same individuals and media who currently contend that there is a public 'perception' problem."<sup>86</sup> Additionally, A.G. Edwards argues that the arbitration process is equitable in nature, rendering awards in times where legal remedies may not be available.<sup>87</sup> This would lead to an increase in appeals at the court level since the chance of successful litigation is greater if an award contains a written explanation.<sup>88</sup>

Another commentator proposes to reject the rule change, and "in its place erect rules and procedures that actually do increase the transparency and fairness of securities arbitration."<sup>89</sup> This author points out that arbitrators often do not take notes and they do not ask questions. In the worst instances, arbitrators have been known to not pay attention to the hearing or even fall asleep. "Arbitrators have been known to mischaracterize testimony or written statements that have just been presented."<sup>90</sup> "The proposed 'written explanation' is nothing like a judge's written explanation. It will not necessary [sic] explain fact finding, law, or damages. It will not increase transparency or fairness. In fact, it will further deceive and cheat customers and employees."<sup>91</sup>

Like other opponents of the rule change, Mr. Skora lists potential problems with NASD procedures. 1.) Since arbitrators are not required to provide written explanations, they have no incentive to understand and study the facts of the case. . . . [B]y not writing out a cogent explanation, arbitrators are not forced to ensure that their perception of the facts is reliable and their legal reasoning (or some other reasoning) is sound.<sup>92</sup>

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<sup>85</sup> A.G. Edwards Letter, *supra* note 78, at 3.

<sup>86</sup> *Id.* at 4.

<sup>87</sup> *Id.* at 5 ("If a written award is required, a decision granted on 'equitable' fairness will have to be substantiated by the facts. The facts will also have to substantiate the monetary award granted. Edwards does not believe the public customer will be well served by the scrutiny that will accompany such written justifications for those awards.")

<sup>88</sup> *Id.* at 4-6.

<sup>89</sup> Letter from Richard Skora to Jonathan G. Katz, Secretary, SEC (Aug. 3, 2005), available at <http://www.sec.gov/rules/sro/nasd/nasd2005032/rkskora080305.pdf> [hereinafter Skora Letter].

<sup>90</sup> *Id.* at 2.

<sup>91</sup> *Id.* at 1.

<sup>92</sup> *Id.* at 2.



2.) [O]ften arbitrators are not considering the law.<sup>93</sup> 3.) [T]here is no database for the SEC or any other group to review arbitrators' competence and integrity. And there is no record for customers and employees and their counsels to know the legal basis (or any other basis) that arbitrators are using to decide awards."<sup>94</sup> 4.) "Arbitrators are hiding gross incompetence and bias towards the securities firms when omitting any written explanation."<sup>95</sup>

On the one hand, it appears that this commentator is a proponent of the rule change, which would require the written arbitration awards. However, that is not the case. This commentator is actually suggesting that the proposed rule is "too vague to know what the NASD means by a written decision."<sup>96</sup> This commentator is warning the industry that boiler-plate explanations will be included in the awards, which will defeat the purpose of the proposed rule change. By way of an example, a panel could write the following explanation: "*The arbitration panel rejected the customer's (or employee's) version of facts and accepted the securities firm's version. We deny all of the customer's (or employee's, respectively) claims.*"<sup>97</sup> This commentator argues, and quite successfully, that such an explanation in reality would not be a "written explanation in any legal sense."<sup>98</sup> Mr. Skora concludes that since the proposed rule change would do no good, it is "insulting to our intelligence."<sup>99</sup>

## VI. OTHER ARBITRATION FIELDS

Written awards are not rare in other specialized arbitration—such as labor, maritime and international arbitration—and are even encouraged.<sup>100</sup> Attorneys often give "written arbitration opinions to their clients to permit the client to see for themselves that the arbitrator listened to the evidence and acted rationally based upon the evidence in the record."<sup>101</sup>

In an employment setting, an employer may include a mandatory arbitration clause mandating any dispute under an employment agreement to be resolved by arbitration.

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<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* at 3.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at 6.

<sup>100</sup> See EDWARD BRUNET & CHARLES B. CRAVER, ALTERNATIVE DISPUTE RESOLUTION: THE ADVOCATE'S PERSPECTIVE 494 (LexisNexis/Matthew Bender 2d ed. 2001).

<sup>101</sup> *Id.* at 495.

Possibly to prevent injustice, in 1994 President Clinton appointed a commission to address the following concerns over fairness of the employment arbitration process:

- What (if any) new methods or institutions should be encouraged, or required, to enhance workplace productivity through labor-management cooperation and employee participation?
- What (if any) changes should be made in the present legal framework and practices of collective bargaining to enhance cooperative behavior, improve productivity, and reduce conflict and delay?
- What (if anything) should be done to increase the extent to which workplace problems are directly resolved by the parties themselves, rather than through recourse to state and federal courts and governmental bodies?<sup>102</sup>

The Commission found that:

[I]f private arbitration is to serve as a legitimate form of private-sector enforcement of public employment law, arbitration policies must provide:

- a neutral arbitrator who knows the laws in question and understands the concerns of the parties,
- a fair and simple method by which the employee can obtain the necessary information to present his or her claim,
- a fair method of cost-sharing between the employer and employee to ensure affordable access to the system for all employees,
- the right to independent representation if the employee wants it,
- a range of legal remedies equal to those available through litigation,
- a **written opinion** by the arbitrator explaining his or her rationale for the decision, and

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<sup>102</sup> U.S. GEN. ACCOUNTING OFFICE, REP. NO. 95-150, EMPLOYMENT DISCRIMINATION: MOST PRIVATE-SECTOR EMPLOYERS USE ALTERNATIVE DISPUTE RESOLUTION 5 (1995), available at <http://www.gao.gov/archive/1995/he95150.pdf>.

- sufficient judicial review to ensure that the result is consistent with employment laws.<sup>103</sup>

Most relevant to this article, the Commission found that the “the arbitrator should issue a written opinion that states the findings of fact and reasons that led to his or her decision. This opinion need not correspond in style or length to a court opinion. . . . However, it **should** set out, in understandable terms, the basis for the arbitrator’s ruling.”<sup>104</sup>

The Judiciary answered this report by adopting some of the Commission’s standards. For example, California courts, deciding whether to enforce an employee arbitration agreement, now use the following analysis:

Arbitration agreements in the employer-employee context must provide for: (1) neutral arbitrators, (2) more than minimal discovery, (3) **a written award**, (4) all types of relief that would otherwise be available in court, and (5) no additional costs for the employee beyond what the employee would incur if he or she were bringing the claim in court.<sup>105</sup>

Similarly, District of Columbia courts hold that the following safeguards are needed in order for an employment arbitration contract to be valid:

- (1) a neutral arbitrator;
- (2) more than minimal discovery;
- (3) **a written award**;
- (4) all types of relief that would otherwise be available in court, and
- (5) no requirement that employees pay either unreasonable costs or any arbitrator’s fees or expenses as a condition of access to the arbitration forum.<sup>106</sup>

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<sup>103</sup> *Id.* (emphasis added).

<sup>104</sup> *Id.* at 14–15.

<sup>105</sup> *See, e.g., Fitz v. NCR Corp.*, 118 Cal. App. 4th 702, 712–13 (2004) (emphasis added) (voiding employment arbitration contract for lack of procedural safeguards).

<sup>106</sup> *Sapiro v. VeriSign*, 310 F.Supp. 2d 208, 214 (D.D.C. 2004) (emphasis added). *See also* *Cole v. Burns Int’l Sec. Servs.*, 105 F.3d 1465, 1484 (D.C. Cir. 1997).

## VII. CONCLUSION

It is evident that NASD is attempting to find a compromise between fairness (which requires a reasoned explanation of an arbitration award, even if it is without a discussion of legal authority and damage calculations) and efficiency of the arbitration proceedings (which requires a swift proceeding and a reduced likelihood of an appeal) in its attempt to amend the rule requiring arbitrators to provide reasoned explanations for their awards. Strangely enough, however, NASD wishes the written awards to have no precedential value whatsoever—the underlying basis of our legal system. While the future of the proposed rule is unknown, should it be approved, it will probably still be considered a step toward greater transparency and accountability for both arbitrators and the securities industry.

**APPENDIX A: NASD PURPOSE STATEMENT<sup>107</sup>**

The purpose of the proposed rule change is to amend the Code of Arbitration Procedure (Code) to provide written explanations in arbitration awards upon the request of customers, or of associated persons in industry controversies.

Currently, Rule 10330(e) of the Code requires only that arbitration awards contain the names of the parties and counsel; a summary of the issues; the damages and other relief requested and awarded; a statement of any other issues resolved; the names of the arbitrators; the dates the claim was filed and the award rendered; the location, number, and dates of hearing sessions; and the signatures of the arbitrators concurring in the award.<sup>108</sup> Arbitrators may also include the rationale underlying their decision in the award, but they are not required to do so<sup>109</sup> and, therefore, usually do not provide an explanation.<sup>110</sup>

Arbitration parties occasionally raise the issue of the lack of written explanations or opinions in arbitration awards. Specifically, customers and associated persons who lose in arbitration (or consider their recovery insufficient) often request written explanations or opinions from the arbitrators. Since these requests are usually made after the awards are issued, arbitrators are unlikely to provide them because they were not advised in advance that they would be writing an explained award and do not want to undermine their award. The lack of reasoning or explanations in awards is one of the most common complaints of non-prevailing participants in NASD's arbitration forum.

In order to increase investor confidence in the fairness of the NASD arbitration process, NASD is proposing to amend the Code to allow customers or associated persons in industry controversies to require an explained decision.<sup>111</sup> An explained decision will constitute a fact-based award that states the reason(s) each alleged cause of action was granted or denied and will address all claims involved in the case, whether brought by the party requesting the explained decision or another party. The inclusion

<sup>107</sup> The text below and the footnotes that follow are taken verbatim from NASD proposed rule change § 3 "Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change", page 8, Mar. 15, 2005.

<sup>108</sup> Pursuant to Rule 10214, awards in intra-industry cases involving employment discrimination claims also shall include "a statement regarding the disposition of any statutory claim(s)."

<sup>109</sup> NASD is proposing to codify this policy in Rule 10330(i).

<sup>110</sup> The United States Supreme Court has found that there is no general requirement for an arbitrator to explain the reasons for an award. *Wilko v. Swan*, 346 U.S. 427 (1953).

<sup>111</sup> A customer or associated person may require an explained decision regardless of whether he or she is the claimant or respondent in the arbitration.

of legal authorities or damage calculations, however, will not be required in an explained decision in order to limit the additional costs and processing time associated with explained decisions. Specifically, requiring the inclusion of legal authorities and damage calculations would significantly increase the processing time of awards because it would result in the drafting of complex and lengthy judicial-type decisions. This, in turn, would require the payment of considerably more honoraria to arbitrators. NASD believes that requiring only the fact-based reasons underlying an award in explained decisions will provide customers and associated persons with the information that they desire while at the same time maintaining the speed and thrift of arbitration.<sup>112</sup>

Although customers, and associated persons in industry controversies, will be able to require the issuance of explained decisions, NASD members will not have the ability to do so. Limiting the parties that can require an explained decision in this manner will protect customers and associated persons, because they alone will determine whether to request an explained decision while bearing in mind the potential costs and the prospect that a reviewing court might find grounds in the explanation to vacate the award.<sup>113</sup> Furthermore, providing member firms with the ability to request explained decisions could result in conflicts between co-respondents who may disagree on whether to request a decision. NASD members will be able to request that a panel issue an explained decision but, unlike those situations involving customers and associated persons, the arbitrator(s) will not be required to comply with the request.

In addition, parties will not be able to require explained decisions in two types of arbitration proceedings. The first is simplified arbitrations that are decided solely upon the pleadings and evidence filed by the parties, as described in Rules 10203 and 10302.<sup>114</sup> The second is arbitrations that are conducted under the default procedures provided for in Rule 10314(e). Explained decisions would not be appropriate in either of these situations due to the abbreviated nature of these arbitration proceedings.

Under the proposed rule, an eligible party that wishes to require an explained decision must make his or her request at least 20 calendar days prior to the first scheduled hearing date. This is the same time frame for the

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<sup>112</sup> NASD estimates that arbitrators will be able to render explained decisions within the 30 business day timeframe currently set forth in Rule 10330(d).

<sup>113</sup> See, e.g., *Dawahare v. Spencer*, 210 F.3d 666, 669 (6th Cir. 2000), ("Arbitrators are not required to explain their decisions. If they choose not to do so, it is all but impossible to determine whether they acted with manifest disregard of the law.") (citation omitted).

<sup>114</sup> An eligible party may request an explained decision if there is a hearing in a simplified arbitration proceeding.

parties to exchange documents and lists of the witnesses that they intend to present at the hearing, which is set forth in Rule 10321(c). NASD believes that this time frame provides eligible parties with sufficient time to determine whether they would like to request an explained decision and also allows arbitrators adequate notice that a case will require an explained decision. Any requests for an explained decision that are made after the deadline, including any post-award requests, would be granted only where the arbitrators agree to provide them after reviewing all the parties' arguments on the issue.

Since cases involving an explained decision will require additional time and effort on the part of arbitrators, the proposed rule provides each arbitrator with an additional \$200 honorarium for cases in which an explained decision is required under Rule 10330(j). The panel will allocate \$100 of each arbitrator's honorarium to the parties as part of the final award, along with the other allocable fees. NASD will pay the other \$100 of each arbitrator's honorarium in order to help defray the costs associated with explained decisions. In order to avoid any potential conflict of interest, the arbitrator(s) will not receive the additional \$200 honorarium if the panel issues an explained decision that is not required by Rule 10330(j).<sup>115</sup> Specifically, NASD does not want to provide a financial incentive for arbitrators to write an explained decision when they are not required to do so.

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<sup>115</sup> For example, the arbitrator(s) will not receive the additional \$200 honorarium for writing an explained decision pursuant to a NASD member's request or a request made by an eligible party after the deadline set forth in Rule 10321(c).

**APPENDIX B: RULES AFFECTED BY PROPOSED CHANGE**

The proposed rule change will affect the following rules:

- a. Rule IM-10104. Arbitrators' Honorarium
- b. Rule 10321. General Provisions Governing Pre-Hearing Proceedings
- c. Rule 10214. Awards
- d. Rule 10330. Awards
- e. Rule 10332. Schedule of Fees for Customer Disputes (ACE NOTE—Should this list of rules be in the same order as presented in the original document? See website referenced in FN i, above).

NASD proposes to include the following language in the rules below.<sup>116</sup>

1. Rule IM-10104. Arbitrators' Honorarium

....

*Adds the following sentence at the end:*

*Each arbitrator shall receive an additional honorarium of \$200 for a case requiring an explained decision under Rule 10330(j).*

2. Rule 10214. Awards

*Places current text under subsection (a) & adds the following subsection:*

*(b) A current or former associated person may request an explained decision under Rule 10330(j).*

3. Rule 10321. General Provisions Governing Pre-Hearing Proceedings

....

- (c) Pre-Hearing Exchange and Explained Decision Requests

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<sup>116</sup> For purposes of this Article, NASD's proposed text will be underlined, and other explanatory sentences will be in italics.



*Places current text under subsection (1) & adds the following subsection:*

*(2) At least twenty (20) calendar days prior to the first scheduled hearing date, a customer or an associated person in an industry controversy must submit any request for an explained decision under Rule 10330(j).*

*4. Rule 10330. Awards*

....

*Adds the following subsections:*

- (i) The award may contain the rationale underlying the award.*
- (j) Explained Decisions*
  - (1) The following individuals may require the arbitrator(s) to provide an explained decision:<sup>117</sup>*
    - (A) Customers (whether claimants or respondents); and*
    - (B) Associated persons (whether claimants or respondents) in industry controversies.*
  - (2) An explained decision is a fact-based award stating the reason(s) each alleged cause of action was granted or denied. Inclusion of legal authorities and damage calculations is not required.*
  - (3) Customers and associated persons must make any request for an explained decision no later than the time for the pre-hearing exchange of documents and witness lists under Rule 10321(c).*
  - (4) Each arbitrator will receive an additional honorarium of \$200 for writing an explained decision as required by this paragraph (j). The panel will allocate \$100 of each arbitrator's additional honorarium to the parties as part of the final award.*
  - (5) An explained decision will relate to all claims involved in the case, whether brought by the requesting party or another party.*
  - (6) This paragraph (j) will not apply to simplified cases decided without a hearing under Rules 10203 or 10302, or to default cases conducted under Rule 10314(e).*

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<sup>117</sup> NASD's proposed change lists these two items under headings "(A)" and "(b)".