86 Trinity Place
New York, New York 10006
212 306-1130

Kenneth R. Leibler
President and
Chief Operating Officer

October 18, 1988

American Stock Exchange

The Honorable David S. Ruder
Chairman
Securities and Exchange Commission
450 5th Street N.W.
Washington, D.C. 20549

Dear Mr. Ruder:

This is in response to your letter of July 8, 1988, as well as your July 12, 1988 testimony before the House Subcommittee on Telecommunications and Finance, in which you requested that the Exchange and other self regulatory organizations address a number of issues pertaining to securities industry arbitration. These issues focus on the need, underscored by the Supreme Court decisions in Dean Witter Reynolds v. Byrd and Shearson/American Express, Inc. v. McMahon, to take steps to ensure the continuation of both the reality and perception of arbitration as a fair and effective dispute resolution mechanism.

Based on our experience with our own forum and our close involvement with the process as a whole, we strongly believe that securities industry arbitration is an efficient, expeditious and economical process. Moreover, we make every effort to assure that the system functions in as neutral a manner as possible so as to achieve resolutions that are fair and equitable to all parties. In September 1987, upon recommending a number of modifications to arbitration rules and procedures, the staff of the SEC noted the Commission's belief that securities industry arbitration generally operates fairly. Furthermore, a survey conducted this fall by the New York Stock Exchange of several of its major retail broker-dealer member organizations, all of which are also members of the Amex, points to the benefits of arbitration in terms of fairness, cost-efficiency and timeliness. While the Amex chose not to conduct a similar survey so as to avoid unnecessary duplication, our statistics also bear out the fact that the arbitration process functions effectively and is not biased in favor of one side or the other; in fact, in 1987, 59% of the public customer cases decided in the Exchange's forum resulted in the customer receiving an award. In these cases, customers received, on average, 72% of the amount of damages originally sought.

Nevertheless, the Exchange agrees that the concerns raised over the past year are important ones that must be addressed to ensure that securities industry arbitration continues to enjoy a positive reputation and the confidence of all who participate in the forum. To this end, the Exchange has worked extensively with the other members of the Securities Industry Conference on Arbitration ("SICA"), as well as the staff of the SEC, to develop rules and procedures designed to achieve this goal. This effort has resulted in an extensive rules package, approved by the Exchange's Board of Governors on October 13, 1988, that addresses issues highlighted in both your comments and the SEC's recommendations. A copy of the package approved by our Board, which will be submitted shortly to the SEC, is attached for your information.

One aspect of securities industry arbitration that has received a great deal of attention is the inclusion in customer account agreements of pre-dispute arbitration clauses.* Of particular concern has been the adequacy of disclosures made by broker-dealers to customers regarding the nature and effect of such clauses. SICA has recognized and endorsed the need for more comprehensive disclosure, and has approved a rule which requires that all pre-dispute arbitration clauses must be highlighted and specifies the information that must be included in such clauses. Specifically, customers must be informed that arbitration is final and binding and that appeal rights are strictly limited, that by entering into an agreement containing an arbitration clause they waive their right to seek remedies in court, that pre-hearing discovery in arbitration is less extensive than in litigation, that the arbitration award is not required to include findings of fact or legal reasoning, and that arbitration panels typically include a minority of individuals affiliated with the securities industry. In addition, the rule requires that the agreement must contain a statement immediately preceding the signature line calling the customer's attention to the fact that a pre-dispute arbitration clause is included. We strongly believe that this comprehensive rule will help to greatly strengthen investors' understanding of the impact of arbitration clauses, and do much to ease the overall concerns that have been expressed regarding the use of such clauses.

The disclosure rule also contains a provision that precludes broker-dealers from including in customer account agreements any condition which limits or contradicts the rules of any SRO, limits the ability of any party to file an arbitration, or limits arbitrators' ability to make an award. While there do not appear to be widespread efforts by broker-dealers to attempt to affect the arbitration process in this manner, the Exchange agrees that it is important to emphasize that arbitrations must be conducted pursuant to SRO rules and applicable law.

You have also suggested that certain types of cases, such as those involving very difficult and complex litigation, class actions and multiple parties might be more appropriately resolved through the courts, and have asked us to consider procedures that might be developed to permit investor access to the courts in appropriate situations and

---

* Surveys conducted by the SEC and the Securities Industry Association last spring indicated that more than 90% of margin and option account agreements, and almost 40% of cash account agreements, contain pre-dispute arbitration clauses.

identify standards for determining those situations. SICA is carefully considering the complex issues raised by these suggestions, and has contacted committees of the American Bar Association for their input. It should be noted, however, that the Uniform Code of Arbitration already contains provisions on point, one of which provides that an SRO may decline the use of its arbitration facilities if the dispute does not involve a proper subject matter for arbitration, and another which provides that arbitrators may dismiss a proceeding and refer the parties to their remedies at law. Nevertheless, we will continue to study this area, and to consider the best way to develop and implement useful guidelines.

The SEC's September 1987 recommendations for modifications to the arbitration process focused on ways to improve procedures so as to further ensure that the system functions as efficiently and expeditiously -- and as fairly -- as possible. The amendments recently approved by SICA and by the Exchange's Board contain significant enhancements designed to implement the key aspects of the recommendations.

Guidelines have been developed to address the perception that arbitration panels may be biased in favor of the industry, which appears to stem not only from the fact that every arbitration panel includes a minority of individuals affiliated with the securities industry, but also from concerns that even those designated as from the public may have sufficient ties to the industry to prevent them from being completely neutral. While our experience has been that there is no inherent bias in the structure of the arbitration panel, it is important that specific limitations on who may serve as a public arbitrator be clearly delineated in SRO rules so as to remove any possible appearance of unfairness or conflict. The guidelines approved by SICA and the Exchange's Board accomplish this by listing the factors for determining who is to be deemed an industry arbitrator, thus clarifying the limitations on who may serve as a public arbitrator.

To further ensure that any potential conflict on the part of an arbitrator is discovered, the amendments specify the type of information regarding each proposed arbitrator's background that must be provided by the Exchange to the parties. In addition, a new rule provides that each arbitrator must disclose any circumstances which might impair his ability to render an objective and impartial determination, and sets forth the specific types of disclosures -- such as those pertaining to current or past financial, business, professional, family or social relationships -- that an arbitrator must make.

Another aspect of the arbitration process which has received much attention is the limited nature of pre-hearing discovery available to the parties, and the extent to which these limitations have often hampered parties in efforts to adequately prepare for a hearing or have caused unwarranted delays by requiring arbitrators to resolve preliminary matters upon commencement of the hearing rather than proceeding with the merits of the case. The Exchange has for some time recognized the need to make pre-hearing procedures more comprehensive, and we have in the past experimented with such things as pre-hearing conferences to ease the problems and disruptions that occur when parties are unable to amicably resolve disputes relating to preliminary matters. SICA has developed an extensive pre-hearing mechanism which sets forth detailed procedures

governing the exchange of information by parties, the use of pre-hearing conferences and preliminary hearings to resolve certain questions, and penalties for failure to exchange information on a timely basis. These guidelines will enable parties to more easily gain access to materials in the possession of their adversaries and will expedite the arbitration process by ensuring that once a hearing begins, the parties and the panel will be able to concentrate on the case's merits rather than on preliminary matters.

The form and content of written arbitration awards has also been considered extensively by SICA, and rule revisions have been approved to address concerns that they should be expanded in order to provide parties -- particularly public investors -- with more detailed information. Currently, awards indicate only whether claims have been sustained or denied and the amount of any award. Under the new rules, they must identify the parties and contain a summary of the issues involved, the relief sought, the issues resolved, the amount of any award or other relief granted, the names of the arbitrators and the signatures of those arbitrators concurring in the award. Including such information will not only give the parties to the actual proceeding a better understanding of the award, but will enable parties in other cases to gain insight into how matters involving similar issues were resolved. To help accomplish the latter goal, the proposal requires that the summary information contained in the awards be made publicly available.

SICA has also recognized the importance of preserving the record in an arbitration, and has approved a rule which codifies the existing policy of the Exchange and other SROs to require that such a record be kept. The rule gives the SROs discretion to determine whether to use a stenographic record or tape recording, and provides that the record will not be transcribed unless requested by the arbitrators or a party. It should be noted that the Exchange has for some time kept stenographic records of all arbitration proceedings.

The remainder of the rules package contains modifications designed to further clarify, expedite and make more efficient numerous aspects of the arbitration process. For instance, more comprehensive procedures for replacing an arbitrator removed from a panel for any reason following commencement of the first hearing session have been developed. Intended to minimize scheduling delays that typically occur in such cases, the procedures provide that a replacement will be appointed only if a party objects to the continuation of the proceeding with only the remaining panelists. The process by which pleadings are served will be significantly expedited by new procedures which provide for service of all pleadings other than the Statement of Claim by the parties themselves rather than by the Exchange. Rules have also been amended to set forth what is considered to constitute a complete hearing session, specify the amount of fees which arbitrators may determine to be chargeable to parties, and clarify the arbitrators' discretion to award other costs and expenses.

In addition to the rule amendments detailed above, SICA has endeavored to address certain other suggestions made by the SEC in its September 1987 letter. For instance, it was noted that SICA should develop a system for rotating public members of

the group to allow for access to the broadest possible perspectives. This has been implemented through a procedure which provides that a public member may be elected for no more than two consecutive four-year terms, and setting forth guidelines for the selection and appointment of new public members. SICA has also made significant progress in development of an extensive arbitrators' manual designed to provide arbitrators with comprehensive background information and instruction on the arbitration process. This manual will help to ensure that anyone who serves as an arbitrator is fully cognizant of all procedures, and completely prepared to deal effectively with the large variety of problems and situations with which a panel must deal.

We believe that the rules developed by SICA and approved by our Board will prove to be extremely effective in addressing the concerns that have been raised with respect to the arbitration process, and we are pleased to have had this opportunity to describe the efforts that have been undertaken to achieve this goal. We are committed to the ongoing integrity of the system, and are looking forward to working closely with the SEC and the other members of SICA in the future to ensure that arbitration continues to be the most efficient and equitable means by which to resolve disputes relating to the securities industry.

Very truly yours,

Kenneth Leibler

att.