

**NASD DISCOVERY GUIDE  
FROM THE CLAIMANT'S  
PERSPECTIVE:  
YOU BETTER GET YOUR  
MUCKLUCKS OUT OF THE  
CORNSTARCH**

Harry S. Miller

## **PREFACE**

The following was written in the year after adoption of the Arbitration Discovery Guide (Notice to Members 99-90) by the NASD. The Discovery Guide continues to be used by FINRA as the successor to the NASD for securities arbitration.

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NASD ARBITRATION DISCOVERY GUIDE  
FROM THE CLAIMANT'S PERSPECTIVE:

YOU BETTER GET YOUR MUCKLUCKS  
OUT OF THE CORNSTARCH

By Harry S. Miller

I. **INTRODUCTION**

The National Association of Securities Dealers ("NASD") has adopted a new Discovery Guide for use in securities arbitrations between customers and stock brokerage firms and brokers. The Discovery Guide is intended to address one of the most problematic areas of securities arbitration, and it includes Document Production Lists, to provide guidance to the parties and to the arbitrators as to which documents should be exchanged.

This article discusses the Discovery Guide in light of the discovery problem in arbitration. By reviewing the problem itself and the development of guidelines for document production lists, it is hoped that practitioners will gain a better understanding of the use and the limitations of the Discovery Guide. If utilized properly, the Guide should streamline the discovery process, and assist counsel in obtaining important documents while avoiding costly delays.

The Discovery Guide was approved by the SEC on September 2, 1999,<sup>1</sup> and was adopted by the NASD for immediate use in customer/industry disputes. The most important feature of the Discovery Guide is the standardization of Document Production Lists. The Guide includes fourteen Document Production Lists, two for use in all cases (one for the customer and one for the firm and

broker), and twelve lists of additional items to be produced in cases involving specific claims.

The Discovery Guide is, as its name suggests, merely a guide. It does not contain hard and fast rules, and it leaves flexibility for the arbitrators to exercise discretion if they determine that certain documents on the List should not be produced in a particular case.

The discovery process has been one of the weakest aspects of securities arbitration, and the adoption of the Discovery Guide is certainly a welcome step in the right direction, providing some semblance of standardized procedures and equity in this process. However, the Discovery Guide as adopted does not go nearly far enough in this direction, and leaves the persisting impression of a process that is controlled by the securities industry, at times unfair to public customers, and lacking in efficiency, predictability, and equity.

For a practitioner to navigate the maze of discovery in securities arbitration, it is important not just to understand the rules, which are fairly simple, but also to understand what is not in the rules and the shortcomings of the rules. This is necessary in order to avoid the traps and pitfalls of the discovery process. Parties to arbitration may not fully reap the intended benefits of the new NASD Discovery Guide without an understanding by counsel of the problems the Guide was designed to address and those problems which it does not sufficiently address.

This article is not intended as a "how to" manual for discovery,<sup>2</sup> although it is hoped that this will assist counsel in their discovery practice. This is intended as a critical analysis of the NASD Discovery Guide in the context of the overall securities arbitration discovery system, written from the perspective of a claimant's counsel. A brief description

of the Guide and its use is presented first. The underlying problem of discovery in securities arbitration is discussed next, followed by an overview of the discovery rules contained in the NASD Code of Arbitration Procedure. The discovery guidance provided in the Arbitrator's Manual is then reviewed, as well as a brief glance at the aborted effort by the NYSE to adopt a standardized discovery list. Finally, a detailed discussion of the NASD Discovery Guide is presented with particular focus on the Document Production Lists. Appendix A contains the results of a survey as to how the Guide is working so far, and Appendix B is a copy of the Discovery Guide.

The critical nature of this analysis should not be mistaken for a lack of respect for those who toiled to produce the Discovery Guide. On the contrary, it is with the greatest respect and appreciation for their efforts, in hopes that it may assist those efforts to continue to fully realize their goals. In the meantime, it is also hoped that this will provide some insight for those who must work with the Guide in its present form.

II. **HOW DO I WORK THIS THING?**  
**A USER'S GUIDE TO THE DISCOVERY**  
**GUIDE**

The Discovery Guide is reproduced in full in Appendix B hereto. Any attorney practicing in this field who has not already reviewed the Guide should read it and become familiar in particular with the Document Production Lists. The Lists are for use in all arbitrations between customers and brokerage firms (and brokers). Of course, arbitrators too should become familiar with the Discovery Guide, and to the extent that they are not, counsel should be ready to assist them by making reference to the Guide.

Pursuant to the Discovery Guide, the NASD sends the Document Production Lists to the parties when the Statement of Claim is sent to the respondents.<sup>3</sup> The documents in Lists 1 and 2 are considered “presumptively discoverable” in all cases, in addition to the documents in Lists 3 through 14 for cases alleging particular causes of action indicated therein.

Absent a written objection, the documents on the Lists should be produced no later than thirty days from the earlier of the date the Answer is due or filed. If a party objects to producing certain documents on the lists, objections must be filed within the same time, i.e., within thirty days following the Answer. Responses to objections must be served within ten days of the service of the objections. The arbitrators then decide whether to order production or whether the objections asserted sufficiently good reasons to overcome the presumption of discoverability.

A problem with this discovery arrangement is that most of the participants in the process do not take it seriously, at least not yet. The Discovery Guide is viewed (correctly or not) by most as merely providing suggestions, not mandatory, and therefore it is not treated as a binding rule which requires compliance. Counsel must still almost always file a motion to compel production. Prehearing conferences to address discovery disputes are still required in most cases.

Given the absence of many important items from the Document Production Lists, counsel must file Requests for Production in order to try to obtain these documents. The Discovery Guide clearly provides that these parties may request additional documents which are not included in the Document Production Lists.<sup>4</sup> Such additional discovery requests are governed by the general NASD discovery rules discussed further herein.

Because of the currently questionable status of the Lists sent out the by NASD, and in light of the fact that most respondents do not seem to be paying any attention to the Discovery Guide and Lists enclosed with the service of the Statement of Claim, it may be advisable to have the Lists also included in discovery requests from claimant's counsel. Attorneys should consider incorporating List 1 into every customer/claimant's discovery request. Lists 3 through 14, additional documents to be produced in cases involving specified causes of action, should also be examined for inclusion of discovery requests.

The request for production of documents should be served on the respondents 45 days after service of the Statement of Claim (the date the Answer is due). Counsel should carefully consider the use of List 1 (and the other Lists), rather than just copying verbatim from the Discovery Guide. As discussed in detail herein, to some degree the Lists are imbalanced as to the documents required to be produced by claimants compared to respondents.

Counsel should be cautious in drafting their discovery requests so as not to unwittingly import the inequities implicit in the Discovery Guide. There are strong arguments for demanding production of additional items from the broker and firm beyond what is included in the Lists, as well as demanding equitable, balanced treatment of all parties.

The Discovery Guide should also be studied by counsel to determine what is reasonable to produce, not only for what to demand from opposing parties. The Discovery Guide provides a welcome contribution to the field of civilized, adversarial legal practice (hopefully, not entirely an oxymoronic concept), to encourage voluntary compliance with discovery in order to avoid wasting time on discovery disputes. However, if opposing parties continue to play by the old rules (i.e., ignore discovery requests, object to

everything, delay, stone-wall, produce in dribs and drabs, delay some more, etc.), then any counsel rushing to embrace the new guidelines can feel enlightened but may be foolhardy.

Attorneys should be prepared to argue in prehearing conferences for the production of items included on the Lists. Any attorney refusing to produce documents on the Lists should have a good explanation, or risk the appearance of unreasonableness or ineptitude, or both.

As discussed further herein, there are reasons for demanding additional items not on the Lists, and for objecting to some items on the Lists, and the Discovery Guide does not preclude this approach. However, the adoption of the Discovery Guide does create certain presumptions as to what generally ought to be produced. Counsel must be aware of this in order to enforce it, to expand it, and where appropriate to limit its application in any particular case.

Attorneys should not be bashful about objecting to items on the List or insisting that additional documents are necessary. But they should be prepared to forcefully and cogently argue their positions in order to overcome tendencies which arbitrators may develop to take the easy way out and simply follow the Discovery Guide Lists.

Finally, although counsel should become familiar with the Discovery Guide, this is no substitute for those essential elements of discovery: knowing what the case is really about, the documentation that is relevant and necessary to prove (or defend) the claim, and the standard forms, procedures, records and documentation utilized in the securities industry which should be available to shed light on the facts and issues in dispute. While counsel should be wary to make sure they are obtaining all documents that are

relevant to the case, they should be equally cautious not to get dragged into the "black hole" of a protracted discovery dispute which distracts attention from the central issues or which can lead to getting buried in mountains of irrelevant documents.

III. **LITTLE KIDS, LITTLE PROBLEMS;**  
**BIG KIDS, BIG PROBLEMS;**  
**THE DISCOVERY PROBLEM**

As a system designed to provide efficient, economical and equitable dispute resolution, the world of securities arbitration lives with a little secret that has the ability to undermine the credibility of the system and challenges the fairness of the results. In order to achieve its goals, it is crucial that the securities arbitration process must not be viewed as unfair to public customers. However, as administered by an institution that is financed and to a certain extent controlled by the securities industry, with rules designed and approved by the securities industry, there is a perception that this is a system where the cards are stacked against public customers. Securities arbitration administered by the NASD is undeniably in a sense conducted "on their turf, according to their rules."

In any given case, the vast majority of the documents are in the possession of the broker and brokerage firm. The trading at issue was effectuated through the means of the brokerage firm, which retains voluminous documentation in connection with its operations and procedures. However, it is very common for public customers to find the focus of the case during discovery somehow shifts away from the allegedly wrongful activity and focuses instead on the customer, as if they personally are on trial.

In case after case with the implicit support of the arbitration system, brokers and brokerage firms fail to fully produce internal documents which are requested and instead seek to intrude into the customer's past personal and financial life. Arbitrators often uphold motions to compel production against customers, requiring them to bare their entire past financial life, while accepting brokerage firms' standard objections to production requests as "unreasonable, irrelevant, burdensome and unlikely to lead to the discovery of admissible evidence." Responses to requests for production of documents have come to be answered with such objections by brokerage firms as a matter of routine.

Even if a motion to compel production against the brokerage firm is upheld by the arbitrators, the firm may simply indicate that they have produced all existing documents, and a customer will not be in a position to question that assertion. Brokers and brokerage firms have seen repeatedly over the years that the discovery process has no teeth. Only rarely will arbitrators impose meaningful sanctions against a firm for failing to produce. The assertion of counsel for respondents that they have produced everything is generally accepted as gospel.

It is not uncommon for brokerage firms to drag their feet for months, responding to requests for production with a litany of excuses and delaying tactics. In this manner any documents that might be in the least bit damaging may be withheld until the last minute, sometimes literally until the eve of the arbitration, when it is too late for counsel to effectively analyze such material and incorporate it into their case. Besides, by then the majority of the cases will have settled without the claimants ever having the benefit of the full discovery, which they should have been entitled to in order to properly evaluate their case for settlement purposes. Even if they might sense the problem, arbitrators are generally impotent in dealing with this and usually cannot

comprehend how such discovery practices prejudice the case of claimants.

This manner of discovery practice results in serious frustration of the goal of efficient, economical and equitable dispute resolution. Discovery disputes become the focus of the case, with inordinate amounts of time, energy and expenses devoted to preliminary disputes relating to the production of documents, or more precisely the failure to produce documents. The NASD recognized this problem by acknowledging in its introduction to the Discovery Guide: "Discovery disputes have become more numerous and time consuming. The same discovery issues repeatedly arise." This is cited as the basis for the need for new discovery procedures, in order to minimize discovery disruptions.

#### IV. **TIRED OF WAITING: THE NASD CODE OF ARBITRATION PROCEDURE**

Notwithstanding the adoption of the Discovery Guide, NASD arbitration discovery practice is still to some extent governed by the NASD Code of Arbitration Procedure. The rules for discovery contained in the NASD Code of Arbitration Procedure are, in a word, vague. The only area of absolute clarity is the timetable, with deadlines that are almost uniformly ignored by the parties and arbitrators.

##### A. **The Discovery Request**

The basic discovery rule is set forth in NASD Code of Arbitration Procedure ("Code")<sup>5</sup> Rule 10321(b), which provides:

Any party may serve a written request for information or documents ("information request") upon another party 45 calendar days

or more after service of the Statement of Claim by the Director of Arbitration or upon filing of the Answer, whichever is earlier. The parties shall endeavor to resolve disputes regarding an information request prior to serving any objection to the request. Such efforts shall be set forth in the objection.<sup>6</sup>

Perhaps the most striking feature of this rule is that it provides a schedule which invites delay and immediately puts the claimant at a disadvantage. Although plaintiffs in litigation can usually serve Complaints upon defendants quite easily in a matter of days, the NASD often takes months to serve the Statement of Claim upon respondents. It is perhaps too obvious to require comment, but justice delayed is justice denied, and in the case of the NASD justice sometimes seems to take a back seat to bureaucratic inefficiency. Rather than acting as neutral administrator facilitating a system of dispute resolution, the NASD appears to have taken on the role of protector of the gates of justice, reminiscent of the Kafka story, "Before The Law."

Because the rule does not permit a discovery request until forty-five days after the service of the Statement of Claim, and since the service of the Statement of Claim is in the hands of the NASD, there is no telling how long it will be before the claimant can properly serve a discovery request upon the respondents. Meanwhile the claimant must just wait while the NASD sits on his or her case. After waiting for over a month, the claimant will receive copies of the NASD cover letters serving the Statement of Claim upon the respondents. Then claimant's counsel must continue to wait for forty-five more days, which is what the rule requires prior to sending a discovery request.

Why should claimants have to wait forty-five days after filing the Statement of Claim before serving a discovery

request? This time period gives respondents a more than adequate opportunity to organize and prepare their records and documents, and prepare their defense.

It is very interesting to note that the Discovery Guide aimed at streamlining the process calls for the immediate service of the Production Lists by the NASD with the service of the Statement of Claim. But then the Guide timetable provides that production is not required until thirty days after the Answer. Therefore, the actual due date for production is unchanged by the Discovery Guide, and the timing for requests of documents not on the Lists is also unchanged.

The respondents must file an Answer within forty-five days of service of the Statement of Claim.<sup>7</sup> "This gives the respondents the advantage of being able to file their Answer and their request for production of documents prior to the date on which the claimant is permitted to serve a request for documents. This may result in the claimant facing a production deadline ahead of the production deadline for the respondents, however briefly.

There is absolutely no reason for delaying the request for production of additional documents for forty-five days after the Statement of Claim. This serves no purpose other than delaying the proceedings and giving an unfair advantage to the respondents. It is common in litigation for discovery requests to accompany the Complaint, and the Document Lists are now served with the service of the Statement of Claim. This immediate discovery approach should be permitted for any document request in securities arbitration.

#### **B. The Response to the Request**

A response to the discovery request is due within thirty days. The Code provides:

Unless a greater time is allowed by the requesting party, information requests shall be satisfied or objected to within thirty calendar days from the date of service. Any objection to an information request shall be served by the objecting party on all parties and filed with the director of arbitration.<sup>8</sup>

The thirty day period for satisfaction of the document request is generally ignored, and one can expect a standard request for extension. Even the request for extension often does not come until well after the deadline. Arbitrators invariably grant the extension, and the only question is how much more time (beyond the delay which has already occurred) will be granted when the matter is finally considered in a prehearing conference.

The response to objections must be served within ten days of receipt of the objections.<sup>9</sup> This seems to be the only deadline which is even occasionally taken seriously. The failure to file a timely opposition to objections may be deemed a waiver. This generally becomes another disadvantage for the claimant. Since the vast majority of the documents and information relevant to any case will be in the possession of the brokerage firm, the widespread practice of across the board objections to discovery requests will put the burden upon the claimant to respond to the objections.

The claimant must then wait again until the respondents are eventually given an opportunity to answer the response to the objections. This step is not provided for in the rules, but it seems to generally be afforded out of a concern for "even-handedness" in the consideration of discovery disputes by the panel or a single arbitrator.

### C. Time Is Not On My Side

By the time of the prehearing conference to consider the discovery dispute, six months may have passed since the filing of the Statement of Claim by a claimant who was expecting this to be a quick and efficient means of dispute resolution. Following the preliminary hearing many more weeks may pass before documents are finally produced. Even then, the production will often be incomplete requiring a request for yet another prehearing conference, which will require another filing of a motion, explanation of what is missing and why it is necessary, further time for filing of a response by opposing counsel, arguments over what was intended by the original order, and yet further delay for picking a mutually available time and date for the second prehearing conference.

While all of this is going on, the actual arbitration hearing day may be fast approaching, with the claimant typically still waiting for critical documents necessary to prove his or her case. The manner in which the discovery process is administered often results in claimants being deprived of access to evidence thereby prejudicing their case, while the respondents are not held accountable for their action since it is implicitly tolerated if not encouraged by the rules.

As to what is actually to be produced, the Code is extremely vague. The general rule provides:

The parties shall cooperate to the fullest extent practicable in the voluntary exchange of documents and information to expedite the arbitration. Any requests for documents or other information should be specific, relate to the matter in controversy, and afford the party to whom the request is

made a reasonable period of time to respond without interfering with the time set for the hearing.<sup>10</sup>

Although it might be said that the rule is elegant in its simplicity and noble in its goal, in fact it is undermined by its operation. The first sentence, which is echoed in the Discovery Guide, has become a cruel joke. Voluntary cooperation to expedite the arbitration is professed by all, claimants and respondents alike, and almost universally ignored. The guidance in the second sentence as to what may be requested can hardly be called guidance for either the parties or the arbitrators. The final clause of the section is meaningless in that there is a specific time in the Code for a response, which is also generally ignored.

The delay in production may interfere with the time set for the hearing, and it certainly does hinder the ability to prepare for and conduct a fair and equitable hearing. For claimants who have suffered severe financial losses, the delays may exacerbate their financial hardship and leave them with a harsh choice to proceed on schedule without the material they need or face further delays which they cannot afford.

V. **MAKING A LIST, CHECKING IT TWICE:  
THE ARBITRATOR'S MANUAL**

Given the vague provisions of the Code rules on discovery, it is not surprising that efforts have been made to flesh out the discovery process. The Arbitrator's Manual, which is distributed to NASD arbitrators to guide and assist them in conducting the arbitration, includes a section relating to discovery. In fact, the Arbitrator's Manual includes a discovery list, and recognized years ago that discovery disputes had become a problem in the arbitration process.

The Arbitrator's Manual (the "Manual") is published by the Securities Industry Conference on Arbitration ("SICA"), which includes members chosen from and by the ranks of the securities industry. The Manual is intended to supplement the Code, which also was developed in conjunction with SICA.

Customers who have the benefit of examining the Rules and the Manual prior to filing a Statement of Claim, cannot help but be struck by the fact that not only is the forum for the resolution of their claim controlled by the securities industry, but the Rules and Manual for guiding the arbitrators are also the product of the securities industry. Perhaps this is inevitable given the self-regulatory nature of the industry, but it is undeniable that this does not foster a perception of fairness, which is crucial to the success of the system.

The introductory paragraph of the Arbitrator's Manual recognizes the critical role of public perception in the process as follows: "As arbitration becomes a primary means of resolving disputes in the securities industry, the public perception of its fairness becomes even more important."<sup>11</sup>

The Manual also states: "Arbitrators must be fair and impartial and must also appear to be fair and impartial."<sup>12</sup> Unfortunately, the guidance provided in the Manual does not necessarily engender fairness nor the appearance of fairness and impartiality. The Preface to the Manual provides: "The procedures and policies contained in this Manual may be altered by arbitrators and should not be used to restrict a panel's discretion."<sup>13</sup> In what sense then does this Manual provide standardization of the process? The Manual intended to guide the arbitrators may be ignored by the arbitrators without explanation, but with possibly dire consequences for the parties to the arbitration.

This anomaly of the Manual is perhaps nowhere more apparent than in the section on discovery. The Manual observes: "Pre-hearing conferences to resolve discovery disputes are becoming more numerous and time consuming. The same issues repeatedly arise."<sup>14</sup> However, while the Manual goes on from there to present "standard" discovery lists, it does so in a manner which makes it clear that the lists are for general guidance and in no way to be considered a hard and fast rule. The Manual introduces the lists as follows:

The following documents frequently have been produced by parties or ordered produced by arbitrators, where relevant, in other cases. This list is neither exhaustive, nor are all of the documents necessary to every case. Consideration should be given to the type of controversy and the issues involved in a particular case. Before ordering that a party produce a particular document, you should weigh a party's ability to fully develop his/her case against the reasonableness of the burden to produce the document. You may limit, as appropriate, the time periods of the documents covered by your order to the relevant time periods in the case.<sup>15</sup>

In presenting the list, the Manual points out that these items need not always be produced and that the reasonableness of the burden to produce the document should be weighed by the arbitrator. As if taking their cue from the Manual, almost without exception the objection "unreasonably burdensome" is raised by brokerage firms. The firms are legally obligated to keep the records in question, and they have the items within their control and possession, readily accessible if they so desire. Yet the

objections of brokerage firms on the grounds of "unreasonably burdensome" are frequently upheld by arbitrators.

The Arbitrator's Manual itself undermines the effectiveness of the list as a means of achieving the goal of "a quick, fair, and relatively inexpensive method of dispute resolution." The preface to the Manual announces, and in introducing the discovery list the Manual again points out, that this is merely provided for consideration by arbitrators, and is not binding as a standard to be applied in all cases. This might be understandable if the list was so voluminous as to be clearly inapplicable to all cases. But the list itself is so basic that in light of the repeated admonitions that it is not obligatory, it renders the discovery guidance of the Manual slight at best.

The Manual list<sup>16</sup> is quite similar to the new Discovery Guide Lists, and it is interesting to compare the lists. The Discovery Guide List of documents to be produced in all cases by the firm or broker has been cut back from 13 categories (in the Manual) to 12 in the new Discovery Guide List. Whereas the list for documents to be produced in all cases by the customer has been expanded from 6 items in the Manual to 13 in the Discovery Guide. It is difficult to see how the new Discovery Guide lists present a significant improvement to the Arbitrator's Manual list in terms of the perception of lack of fairness in the discovery process.

In considering the new Discovery Guide, it is important to recognize that it was formulated in an effort to address the problems that developed in the discovery process as administered under Rule 10321 and the provisions of the Arbitrator's Manual. The obvious question is how the Discovery Guide will work in practice to meet the prior short-comings in the discovery process.

VI. **A BRIEF HISTORY OF DISCOVERY LISTS:  
NYSE PHANTOM LIST**

The NASD's effort to promulgate a standardized Discovery List is not the first such SRO effort in securities arbitration. Approximately nine years ago the New York Stock Exchange arbitration administrators recognized the problem, and attempted to address it through the promulgation of a standardized list which would be required for production in all arbitration cases.<sup>17</sup>

The NYSE policy statement set forth in a memorandum from the Director of Arbitration to Arbitration Counsels and Arbitrators, pointed out that "Pre-Hearing Conferences are becoming more numerous and more time consuming. The same issues are fought over again and again."<sup>18</sup> The memorandum directed that certain documents should be produced in all cases, without the necessity of wasting time and effort on motions, objections and preliminary hearings.<sup>19</sup>

The NYSE memorandum, which quickly made the rounds of the securities arbitration bar, was used by some claimants' counsel as an exhibit attached to motions to compel production. Some defense counsel responded that the list was merely part of a memorandum issued in connection with a specific case (ignoring the language of the memorandum itself which indicated that such items should be produced in all cases), and others questioned the origin and authority of the memorandum.

Just as quickly as the NYSE discovery list had appeared, it mysteriously disappeared. The list was disclaimed by the NYSE. The NYSE then went so far as to prohibit reference to the memorandum which had included the discovery list, in an effort to backtrack on the ill-fated, progressive policy. There was no explanation as to why a

policy decision had been suddenly overturned, or why the prior state of uncertainty and confusion would be considered preferable to a standardized discovery procedure.

VII. **GUIDE FOR THE PERPLEXED:**  
**THE NEW NASD DISCOVERY GUIDE**

In the context of more than a decade of lack of clarity in the discovery process, the NASD's publication of a new Discovery Guide is certainly a welcome development. It should add some element of standardized procedures and predictability to the process. If it works as intended, it may also enhance the battered credibility of a system perceived to be unfairly slanted in favor of the securities industry and against the claims of public customers.

In adopting the Guide, the NASD recognized the nature of the problem that had developed in the discovery area, and the need for certain standards. However, as will be seen, to some extent the very causes of the past problems, delays and unpredictability, are still embedded in the new Guide.

The NASD Notice to Members adopting the Discovery Guide states: "The Discovery Guide will be used as a supplement or an addendum to the guidance regarding discovery provided in the Arbitrator's Manual, published by the Securities Industry Conference on Arbitration (SICA)..."<sup>20</sup> It goes on to paraphrase the Preface of the Arbitrator's Manual as follows: "The procedures and policies described in the Arbitrator's Manual are discretionary and may be changed by the arbitrators."<sup>21</sup>

The NASD announcement of the new Discovery Guide described the problem and the need for new discovery procedures as follows:

Discovery disputes have become more numerous and time consuming. The same discovery issues repeatedly arise. To minimize discovery disruptions, the NASD Regulation Office of Dispute Resolution has developed two initiatives to standardize the discovery process: early appointment of arbitrators to conduct an initial prehearing conference and Document Production Lists.<sup>22</sup>

A. **Fast Times at NASDR**

As for the first above-mentioned initiative, the early appointment of arbitrators, the jury is still out. It is too soon to be able to determine the level of success of the NASD in implementing this initiative and the extent to which, if properly implemented, it will ameliorate the problem.

At this time the NASD is still falling woefully short of anything that could be described as "early" appointment of arbitrators, unless it is merely early by reference to its own past performance. The NASD is still allowing an inordinate amount of time to pass following the filing of cases and the development of discovery disputes before appointing a panel to address discovery problems.

The NASD often does not even meet its own requirements under the Arbitrator List Selection System. Rule 10308 requires the NASD to send the list of prospective arbitrators to the parties thirty days after the last Answer is due. Rule 10308(c)(2) provides that if a party does not return the list within twenty days that party is deemed as having accepted all of the arbitrators on the list without preference. But there is no method to enforce the obligation of the NASD to send out the list of proposed arbitrators in a reasonably prompt or timely manner. The Rule itself provides cushion

for the NASD by merely requiring the list to be sent out by the NASD "approximately thirty days after the last answer is due."<sup>23</sup>

Given the past practice of administering the intake and service of claims by the NASD, it was not uncommon for up to six months (or more) to pass from the filing of a Statement of Claim until the appointment of arbitrators. The early appointment of arbitrators would be a welcome change in the process. If actually done, this could certainly go a long way towards resolving discovery disputes before they have seriously interfered with a party's ability to prepare and present their case.

**B. When Is A List Not A List?**

The Document Production Lists, which constitute the heart of the new Discovery Guide, also provide reason for hope, but at the same time, cause for skepticism. Once again the NASD goes out of its way to repeatedly emphasize that the Document Production Lists are merely offered for guidance, and that there is nothing required, obligatory or enforceable in connection with the Lists. The introduction points out:

The Discovery Guide, including the Document Production Lists, will function as a guide for the parties and the arbitrators; it is not intended to remove flexibility from arbitrators or parties in a given case. For instance, arbitrators can order the production of documents not provided for by the Document Production Lists or alter the production schedule described in the Discovery Guide. ... The arbitrators and the parties should consider the documents described in Document Production Lists 1 and

2 [documents to be produced in all cases]  
presumptively discoverable.<sup>24</sup> (Emphasis  
added.)

Just because a document is on the List does not mean that the arbitrators will be bound to order the production of such document. The Discovery Guide explicitly reserves to the discretion of the arbitrators to determine if there is good cause not to order production, in which case the fact that such document may be on the List shall be ignored.

The retention of a degree of flexibility is certainly commendable. It must be recognized that regardless of the formulation of any rule, there will almost always be some room for the exercise of judgment and discretion by the decision maker. But the adoption of the Document Production Lists with no requirement that they be utilized and enforced in a uniform manner, will not end the problems plaguing the arbitration discovery process.

For example, since the adoption of the Guide parties still refuse to produce certain documents which they would have refused to produce previously, in spite of the fact that such items now appear on the Document Production Lists. Attorneys are still filing objections (and presumably will continue) insisting that such documents should not be produced in this case for "good cause," thus requiring pre-hearing conferences with uncertain results.

On the other hand, overly formalistic, inflexible positions taken by arbitrators interpreting the Discovery Guide may result in rulings refusing to order the production of documents not on the Document Production Lists which may be crucial to a claimant's case. This is clearly not intended by the Discovery Guide.

Far-reaching reform of the discovery rules could achieve the goal of standardization, avoid time-consuming and costly delays, produce predictable results, and enhance the fairness and perception of fairness of the process. But these goals are not greatly advanced by the failure to adopt the Document Production Lists in a balanced manner which would require their uniform use and application.

VIII. **I HAVE IN MY HAND A LIST:  
THE DOCUMENT PRODUCTION LISTS**

A. **List 1 Documents To Be Produced In All  
Cases by Firm and Associated Person**

The Discovery Guide contains two lists of items to be produced in all cases. List 1 is the list of documents to be produced in all cases by the brokerage firm or associated person. List 2 is the list of documents to be produced by the customer. These Lists may now be incorporated into every discovery request in securities arbitration cases.<sup>25</sup>

List 1 and List 2 are quite comprehensive and certainly a step in the right direction of standardizing discovery procedures. The documents included in the Lists are fairly obvious, and there is no need to enumerate them here as practitioners should review the Lists themselves, which appear in their entirety in Appendix B hereto. However, the Lists are as remarkable for what they do not include as they are for what they do include.

1. **What's Missing From This Picture?  
Commission Runs**

List 1 notably does not include the commission runs of the broker. Commission runs were included in the Arbitrator's Manual and the aborted NYSE Discovery List. The commissions of the broker are in fact very relevant to the

vast majority of cases, if not all cases. Claimant's counsel should still request the commission run in most cases in spite of its absence from List 1.

As discussed further below, List 3 for churning cases does include commission runs, which of course are central to any churning case. However, the commissions of the broker on any particular trade or series of trades may be critical to the claimant's case, even if there is no claim for churning.

The tension between the self-interest of the broker and the interest of the customer lies at the heart of most cases. The production of the commission runs cannot possibly be considered a burden for the brokerage firm, compared to the need of the customer for such information in developing his or her case. The customer ought to be given the benefit of reviewing the commission runs in all cases.

## 2. **Marketing Materials**

List 1 also omits marketing materials, which also had been included in the Arbitrator's Manual. The marketing materials used by the firm can be important to the claimant in developing almost any case. Such materials may become crucial in cases which degenerate into swearing contests with both sides accusing the other of lying. A brokerage firm, which is subject to strict record keeping rules, should be required to produce such documents in all cases.

As discussed further below, List 7, for use in cases regarding misrepresentations and omissions, contains a requirement for production of documents regarding the products at issue, which presumably will cover marketing materials. However, there is no reason for omitting this item from the List for use in all cases. This could lead to side disputes as part of the prehearing conference as to exactly

what claims were articulated in the Statement of Claim so as to determine which Document Production List is applicable.

3. **What Else Is Missing?**  
**Broker's Tax and Financial Data**

Also noticeable in its absence from List 1 is any reference to financial data or tax returns for the registered representative. The claimant who files a case accusing a broker or brokerage firm of unlawful activities has his personal and financial life open to scrutiny, which frequently becomes a central issue in arbitration hearings through the practiced skill of misdirection used by defense counsel. Although this may be a time honored practice, it is inexcusable that the customer's personal, financial and tax records are considered fair game for defense counsel, while the same records of the registered representative who has been accused of wrongdoing must be protected. The financial circumstances of the registered representative are relevant to most cases, and in any event should be available for review by claimants to determine if such circumstances may have played a role in the improper conduct at issue.

Financial statements and tax returns of the customer may be relevant to a suitability claim, e.g., for evaluating a claimant's prior trading experience and level of sophistication. But the registered representative's financial statements and tax returns may be equally relevant, in almost any type of case. Once it is recognized that such documents may be relevant, counsel for the claimant must be given an opportunity to review such documents in order to determine whether they should be used in the hearing.

Given the potential importance of such information in the context of many cases, there is no reason that the privacy of the registered representative should be considered more worthy of protection than the privacy of the customer. After

all, it is the customer who is accusing the registered representative of wrongdoing, and any evidence that could assist in proving such wrongdoing should be made available to the customer.

Document Production Lists that seem to favor the broker and disfavor the customer, by requiring the same information to be produced by one and not the other, create the appearance of lack of fairness in the process. In actual practice, this material as used to grill claimants in order to shift the focus of the case onto their lives, has frequently been perceived as proof of an unfair system which favors the brokerage firms and brokers while punishing the customers who dare file claims.

Unbalanced discovery rules would not be tolerated in litigation, and there is no reason for such lack of balance to be not only tolerated but encouraged by the NASD arbitration guidelines. The production of such documents should not be burdensome for a broker, any more so than it is for the customer. And the privacy of both may be protected by confidentiality stipulations.

4. **Also Omitted: Broker's Personal Account**

Equally disturbing in its absence from List 1 is any reference to the personal trading records of the registered representative. The trading by the broker for his own account, including in particular, in securities similar to those traded in the customer's account around the time of or prior to the customer's trading, could certainly be relevant to the claims of the customer. Such trading may be indicative of several types of wrongful practices. However, unless this information is made available to the claimant, he will never know if such trading occurred.

Did the registered representative have other motivations for encouraging the claimant to invest in a particular security? Did the registered representative profit at the expense of the customer by trading in that same security? Did the registered representative's actions in his own personal account contradict the advice he was giving to the customer? The answers to these questions would certainly be relevant to virtually any case, but will be impossible to answer without having access to the registered representative's personal trading records.

The registered representative's personal investing may be irrelevant to a case, just as his tax return may be irrelevant to any given case. However, the trading and finances of the registered representative may be extremely relevant. It should be up to the claimants, after reviewing the information, to determine if they desire to introduce such facts as evidence to prove their claims. Once the decision has been made to require such documents to be produced by the claimant in NASD arbitration, there is no justification not to require the same to be produced by the respondent. This is another instance of not only the appearance of unfairness but actual unfairness within the system.

#### 5. **Other Complaints**

List 1 also includes "customer complaints of a similar nature," and records of disciplinary action against the broker for "conduct similar to the conduct alleged to be at issue." In both of these instances, the Document Production List leaves it to the brokerage firm to determine whether prior customer complaints or disciplinary actions involve issues "similar" to the issues in the instant case.

What possible justification can there be for leaving this determination up to the party accused of the wrongdoing? The brokerage firm should be required to

produce all customer complaints and all disciplinary actions relating to the registered representative. It should be up to counsel for the claimant to determine whether the prior complaints or disciplinary actions were for activity in any way similar to or relevant to the issues involved in the current case. If the claimants do make that determination in the first instance, it should be up to the arbitrators to determine the weight to give to such history of prior problems in the final analysis.

Under the Discovery Guide, the claimant will never have an opportunity to question the judgment of the brokerage firm in determining that certain prior complaints or disciplinary actions were not "similar" to the current issues in dispute. The claimant may never see those other complaints or disciplinary actions; the firm need not produce such information unless it determines that the prior activity is "similar." Even if such prior complaints or disciplinary actions are relevant to the current case (if for no other reason than to show a history of prior problems which should have put the brokerage firm on notice as to a problem broker), the claimant and the arbitrators may never know about it.

It should be noted that List 1 does require firms to produce all RE-3, U-4 and U-5 regulatory filings regarding the broker, including all customer complaints identified on those forms. That does not mean that all complaints must be produced, but only those so listed (although that represents significant progress). However, the responses to the complaints do not have to be produced in all cases. This omission could result in very relevant information being concealed from the Claimant.

The failure to require production of all prior complaints and all prior disciplinary action leaves the impression of protecting the broker and the brokerage firm. This undermines more than just the appearance of fairness.

This directly contributes to the failure to produce documents which could have been used by a claimant in proving his case. Certainly in cases that degenerate into "he said/she said" swearing contests, this deprives the arbitrators of critical information which could have been dispositive in reaching their decision on the merits of the case.

6. **Other Omissions: Order Tickets and Cross-Reference Sheets**

There are other very relevant items omitted from List 1, which claimant's counsel should often be seeking, including, most importantly, order tickets and product cross-reference holding sheets.

7. **You Won't Get It If You Don't Ask. But Even Then...**

It can be argued that for all of the above-mentioned omissions from the List, a party is free to argue that such additional items should still be produced. Although this may be true in theory, it is not an adequate answer. The NASD's adoption of the Document Production Lists indicates a procedure and policy which is now part of the NASD arbitration process. The Lists create a presumption (that items on the List are presumptively discoverable), and this may be viewed as also implicitly suggesting a negative presumption, although there is no such negative presumption stated in the Guide.

The Discovery Guide allows counsel to argue that items should be produced even when they are not included on the Document Production Lists, and indeed claimants' counsel should do so. The arbitrators are given discretion to order the production of documents not included on the Lists. However, now that the NASD has articulated its position as to document production by its determination of which

documents are included on the Lists, counsel will be fighting an uphill battle to convince arbitrators of the need for documents that the NASD seemingly determined were not always necessary.

This is particularly true when items are included on the List for documents that the customers must produce (List 2) but not included on the List for the firm (List 1), or are included on the List but only in a qualified manner (for example "similar" prior complaints). In such instances, arbitrators may conclude in a pre-hearing conference that such items were omitted from the List or included only in a qualified manner after careful consideration by the NASD. They may be reluctant to "overrule" the determination of the organization responsible for administering the arbitration process.

**B. List 2, Documents To Be Produced In All Cases By Customers**

The List of items to be produced by customers in all cases is remarkable for its clarity, and also for its broad scope. The Arbitrator's Manual included six categories to be produced by customers in all cases. The Discovery Guide List 2 more than doubles that to thirteen categories of documents to be produced by customers in all cases. While some of these additional items are understandable and relevant, others simply reinforce the lack of balance between the document production required of customers and the production of brokers and firms.

**1. Taxing Matters**

List 2 lays to rest any question that claimants may have had going into a case as to whether they will be required to produce their tax returns. Claimants' counsel generally

have assumed that tax returns will be required to be produced, but claimants often hold out hopes that their tax returns will somehow be considered more private than others or that they will simply be overlooked. If claimants, for whatever reason, would prefer not to disclose the contents of their tax returns, they should now think twice about whether they truly want to file a claim for arbitration.

One might wonder what possible relevance a claimant's tax returns might have in a case of, for example, unauthorized trading or failure to follow instructions. Wonder some more, because now it will be up to claimant's counsel to overcome the presumption that somehow claimants' tax returns are always relevant and that claimants have no right to privacy. Claimants should recognize that their financial background and tax returns will be open to scrutiny as a result of filing for arbitration.

The Discovery Guide List 2 has the advantage of at least providing a definitive answer to the question of how many years of tax returns must be produced. Tax returns from three years prior to the first transaction at issue through the date of the Statement of Claim should be produced in all cases.

## 2. **Financial Data and Other Accounts**

The same clarity is provided for the time period for financial statements and other account statements, i.e. those dating from three years prior to the first transaction in dispute through the date of the Statement of Claim. Although it may be argued that there should be reciprocal provisions for the registered representative (as discussed above), at least these provisions in List 2 provide some certainty for the customer as to what he will be required to produce, like it or not, regarding his past and current financial circumstances and trading with other firms.

The period of coverage for tax returns, financial statements and trading at other firms provided in List 2 seems to be a fair compromise. Of course, counsel for respondents frequently ask for ten years of prior tax, financial and trading records, and counsel for claimants have not been unknown to argue that all such documents are irrelevant. It seems justifiable in many cases that the tax, financial and trading records dating back three years prior to the first trade in dispute would be reasonable for respondents to examine as to questions of customer sophistication, prior financial dealings and securities experience. Counsel should make sure that the claimant understands this in advance.

### 3. **Subsequent Securities Trading**

A question may arise as to production of any securities trading records subsequent to the date of the trades in dispute. This may not be an insignificant time period, as it is not unusual for years to pass from the first disputed trade until the filing of the Statement of Claim. Frequently during this period, there are repeated promises by brokers to make up for the prior problems, repeated delays by brokerage firms in looking into complaints, reluctance by claimants to take action which could lead to problems for a broker with whom they may have developed an amicable relationship, simple inertia, lack of discovery and/or concealment of the wrongdoing, and initial contacts and possibly negotiations between the parties prior to ever filing a Statement of Claim.

During this period claimants have often become educated as to types of trading that they were previously unaware of or did not fully understand, which may be at the core of the dispute. As a result of the dispute and consulting with other brokers or counsel, a claimant may learn about that method of trading and may now seek to utilize such trading with his or her eyes open. This should not be

accepted as evidence that the claimant understood and ratified such earlier trading without a strong challenge by counsel.

The Guide does acknowledge that just because something is discoverable does not create a presumption of admissibility. Counsel should consider objections to the admissibility of this type of material, even if solely for the purpose of showing its limited relevance.

#### 4. **Prior Complaints**

Another example of the lack of balance in the Document Production Lists is that customers are required under List 2 to produce all prior complaints by the customer involving securities matters. The broker is only required to produce "similar" prior complaints brought against the broker, and it is left to the brokerage firm to determine just what constitutes "similar" for this purpose. The fact that a customer may have been the victim of prior or subsequent fraudulent activity should not be used against the customer in this case.

It is well known that certain personality types are frequently victimized by overbearing, aggressive, hard-sell techniques and cold-call practices, which have been cited repeatedly by regulators as a threat to public investors. It is a sad commentary that the prior victimization of a customer should now be required to be produced for use by the current firm accused of wrongful activities as evidence against the customer.

Going even further in this direction is category 12 of List 2, requiring the customer to produce all complaints and pleadings in any civil actions regarding securities matters or arbitration proceedings including the final decisions. Again, like item 11, there is no limitation of this to actions "similar"

to the issues in dispute in the instant case. The customer must produce everything relating to any securities case in which he or she has been involved, while the registered representative is free to selectively produce those which the broker and firm determine are "similar" to the issues in dispute in the instant case.

The prior victimization of the claimant and the outcome of the prior case, should not be considered evidence as to whether he or she has been defrauded in the instant case. This broad category of documents was not in the Arbitrator's Manual list or in the aborted NYSE list. There is no doubt that the inclusion of this item in List 2 of the Guide, to be produced by claimants in all cases, is the result of industry pressure and a prejudice which would paint all claimants as "whiners" who are just looking to blame others for their problems. This attitude so permeates the defense bar that it has become not only the pervasive argument of Answers to Statements of Claim, but it is an almost uniformly featured theme of defense counsels' opening statements and closing arguments in virtually all arbitrations (besides calling claimants liars).

**C. Lists 3 and 4, Additional Documents for Cases Alleging Churning**

Document Production Lists 3 through 14 include items to be produced in cases that involve specified causes of action. For each particular type of claim there is a separate List for the customer and for the brokerage firm and associated person. These are items to be produced in addition to the items included in Lists 1 and 2.

List 3 is for additional documents to be produced by the firm and broker in cases involving claims of churning. This List, as mentioned previously, includes commission

runs relating to the customer's accounts. Of course, a standard defense to a churning case is that the customer asked for it and that the broker was only following the instructions of the customer. Therefore, it would be helpful to see how the trading in this account compares to patterns of trading in accounts of other customers of the registered representative. However, List 3 does not require production of commission runs relating to accounts other than those of the claimant. Claimant's counsel should seek this, nevertheless.

Item 2 on the churning List requires production of documents reflecting compensation, including commissions from all sources generated by the broker for two months preceding through two months following the transactions at issue or up to twelve months, whichever is longer. Although this recognizes the relevance of activity by the broker outside of the customer's account as it reflects on a tendency for churning, the period covered is so limited as to render it minimally useful.

This is another unfortunate instance of the NASD's appearance of unfairness. Customers are required to produce information going back three years prior to the trading at issue, whereas the broker is not required to produce any personal information whatsoever, and commission information must be produced going back only two months prior to the trading at issue.

There is no basis for the lack of balance in the time frames for claimants compared to brokers. Although a broker's prior excessive trading activity may not prove a present case of churning, this is hardly an excuse for not requiring the production of such information. It is certainly relevant and should be made available to the claimant and to the arbitrators. Counsel should be insistent on this point.

List 4, which is additional documents to be produced by the customer in churning cases, includes no additional documents.

**D. Lists 5 and 6, Additional Documents to be Produced in Cases Alleging Failure to Supervise**

List 5 includes the additional items to be produced by the firm in a case involving a claim of failure to supervise. This List includes exception reports, supervisory activity reviews, internal audit reports and examination reports, as would be expected. What is noteworthy is the relatively short time frame which is afforded to the broker and brokerage firm. The required records are only those from one year prior to the transactions at issue through one year following the transactions at issue.

Claimant's counsel should be prepared to argue that any disparity in the timeframe for claimants and respondents is unreasonable, and that both sides should be held to the same requirements. There is no justification for the position that a customer's records going back three years prior to the activity in question should be considered relevant and produced in all cases, whereas only one prior year of supervisory records reflecting the respondent's activity should be considered relevant and required to be produced .

In the case of a claim of failure to supervise, it may be impossible to uncover the problem by focusing on just a one year period. Such problems develop over many years. Sometimes getting caught and reprimanded once will result in a more careful and quiet period of "good behavior" for at least a while in the wake of the "lapse." Only by carefully examining the records over a longer period of time can counsel uncover certain patterns or repeated instances of

activity that should have put the firm on notice or reflect a failure of the brokerage firm to properly supervise.

List 6 contains no additional documents to be produced by customers in cases of claims of failure to supervise.

E. **Lists 7 and 8, Documents to be Produced in Cases Alleging Misrepresentations/Omissions**

List 7 is for additional items to be produced by the firm in a case involving claims of misrepresentations and omissions. This contains no surprises, other than the fact that it is not included in List 1 with items to be produced in every case. Claimant's counsel should request and carefully review the items on this list in almost every case.

The additional items to be produced by the customer in a case of misrepresentations or omissions, set forth in List 8, involve the complete disclosure of the customer's business activities, investment entities, and educational and employment background. Presumably this information is necessary for an evaluation of whether the customer reasonably relied upon the misrepresentations. But experience has proven all too often that regardless of a person's business and educational background, even the brightest, experienced, and successful individuals can be and have been taken by lies.

This is another example of the Discovery Guide subtly shifting the burden and the focus to the customer, even though it is the broker and broker/dealer that have been accused with wrongful actions. Why should the customer's background become the prime area for scrutiny when the issue of the case is whether or not the broker and brokerage firm made misrepresentations? Underlying this discovery

structure is the assumption that the broker or brokerage firm did nothing wrong, and even if they may have stated something that could be interpreted as a possible misrepresentation, the customer should not have relied upon it. Regardless of the question of the broker's lies, the burden is shifted to the customer, implicitly requiring the customer to prove his own reasonableness and innocence.

The Document Production List requirement that the customer produce such background information not only permits the respondents to shift the focus of the case onto the claimant. It also gives the respondents adequate information to dig up the entire past history of business relations, customer and supplier relations, banking relations and legal involvements of the claimant's business activity over his entire life. Claimant's counsel must be vigilant not to let this occur in a manner which turns the case into an inquisition of the claimant.

Aside from the manifest unfairness of subjecting the claimant to this manner of assault on his privacy, which is clearly unrelated to the securities transactions in dispute, this also cries out for an answer as to why the same information is not required to be produced by the broker, not to mention the branch office manager, compliance officer and any other personnel of the firm involved with the matter. Certainly such information as to their educational, employment, business and investment background would be relevant to evaluating their level of expertise, sophistication and credibility.

The imbalance created by not requiring this same background information from respondents heightens the perception of unfairness. There are many cases in which the respondents' information is at least as relevant, if not more so, then the background information of the claimant. The result of the imbalanced rule is to strengthen the perception

of a system protecting its own and making it more difficult for those who would bring claims against a broker or brokerage firm.

**F. Lists 9 and 10, Documents for Cases Alleging Negligence And Breach Of Fiduciary Duty**

Document Production Lists 9 and 10 are the additional items that should be produced by the firm and the customer, respectively, in cases involving claims of negligence or breach of fiduciary duty. These Lists are identical to Lists 7 and 8 discussed above for cases involving claims of misrepresentations and omissions. As such, they are subject to the same criticism.

The NASD's underlying attitudes may be revealed in the fact that there is no difference in the items to be produced by a brokerage firm for a claim of negligence as opposed to a claim of misrepresentation. It is surprising that in cases of misrepresentations the relevant discovery does not include additional information relating to prior activities and statements that might tend to reflect upon veracity. Whereas in cases of negligence one would expect to find a requirement to produce documents relating to standards of care, procedures, due diligence, etc. In fact, neither are required under either category. Counsel will have to request such information even though absent from the Lists.

**G. Lists 11 and 12, Documents For Cases Involving Claims of Unauthorized Trading**

Lists 11 and 12 indicate additional items to be produced by the brokerage firm and the customer in cases of unauthorized trading. Copies of telephone records and any documents that would establish the authorization or lack of authorization of the trading are included here. Item 1 for List

11 also requires the brokerage firm to produce order tickets for the trades at issue. The only surprising point here is that order tickets were not required to be produced in all cases under List 1. As is well known, certain trading irregularities and improprieties may be discovered from examining order tickets.

Order tickets were included on the List in the Arbitrator's Manual and the NYSE List of items to be produced in all case. It is difficult to imagine any reason for the NASD's failure to include them in the Discovery Guide in List 1 and instead only including them in List 12 for cases of unauthorized trading. The result of this omission is to keep another category of relevant and potentially crucial evidence out of the hands of the claimant, unless he has specifically alleged unauthorized trading.

**H. Lists 13 and 14, Documents For Cases Alleging Unsuitability**

List 13 includes additional Items to be produced by the brokerage firm and associated person in cases involving claims of unsuitability. Item 1 is basically the same as the additional material required to be produced by List 7 and List 9 (for cases of misrepresentations and cases of negligence and breach of fiduciary duty), including materials used by the brokerage firm or broker relating to the transactions or products at issue.

Item 2 on List 13 relates to the compensation of the broker, and is basically the same as Item 3 on List 3 for cases of churning.

The additional items for production by the customer in cases of unsuitability under List 14 include the same items required to be produced by the customer under Lists 8 and 10 for cases of misrepresentations and negligence/breach of

fiduciary duty. This includes information primarily regarding the customer's business interests, resume and educational and employment background. In addition, List 14 requires the customer to produce all written documents relied upon in making the investment decision.

**IX. TELL ME ALL THAT YOU KNOW:  
INFORMATION REQUESTS**

A fundamental goal of arbitration is to avoid the extensive discovery practice of litigation involving depositions and interrogatories. Although it has long been assumed that interrogatories and depositions were not permitted in securities arbitration absent extraordinary circumstances, this practice has gradually changed over recent years. As requests for production of documents and information have become more extensive, they have begun to resemble interrogatories in many respects.

The Discovery Guide acknowledges that parties may serve requests for information under the discovery rules. However, the Discovery Guide bars the practice of trying to overwhelm parties with litigation-style interrogatories. The Guide states:

Requests for information are generally limited to identification of individuals, entities, and time periods relating to the dispute; such requests should be reasonable in number and not require exhaustive answers or fact-finding. Standard interrogatories, as utilized in state and federal courts, are generally not permitted in arbitration.<sup>26</sup>

Any efforts by brokerage firms to intimidate individual claimants with exhaustive and intrusive

interrogatories should be resisted by claimant's counsel with reference to this provision to the Discovery Guide.

Objections to information requests must be filed within thirty days. If there is no objection, then the information request should be satisfied within thirty days from the service of the request. The response to objections to an information request must be filed within ten days of the objections. The discovery dispute will then be resolved by the chairperson of the panel, either on the papers or through a prehearing conference.

The Discovery Guide also makes it clear that depositions may be used in connection with arbitration only in very limited circumstances. The authorization to use depositions is specifically provided to accommodate witnesses who are unable or unwilling to travel long distances to be present at the hearing.

Although the Discovery Guide states that the production of documents does not create a presumption of admissibility in the arbitration, this arguably may not be the case for depositions. If one fits into the circumstances provided for depositions under the Discovery Guide, such depositions may be admissible in the hearing. However, counsel should be extremely cautious about the use of depositions. Claimant's counsel should strenuously oppose the admission of depositions into evidence by respondents which might deprive the claimant of an adequate opportunity to confront and cross-examine anyone associated with or formerly associated with the brokerage firm.

X. **WHERE'S THE TEETH?**  
**SANCTIONS, SANCTIONS, SANCTIONS**

Perhaps the greatest shortcoming of the discovery process in arbitration is the lack of "teeth." This problem is

widely perceived by counsel familiar with securities arbitration. It was one of the most common comments of the responses to "The Dirty Dozen" survey on the NASD Discovery Guide."<sup>27</sup>

Quite simply, the perception is that parties and attorneys (of course just opposing attorneys) do not take the discovery process seriously because there is no enforcement of the rules and no consequences for the failure to comply with the rules.

In litigation, frivolous objections to discovery requests or other improper methods of frustrating discovery result in sanctions. Litigators understand this and take the process much more seriously. Without any fear of repercussions in arbitration, discovery is not accorded the same degree of respect.

The Discovery Guide does address the issue by providing that the panel should issue sanctions for failure to produce in response to a written order. But just what the sanctions should be is left open. The panel is given "wide discretion" to address failure to comply with an order to produce. This directive is totally vague and often results in the panel taking action much too late.

Intentional flaunting of the discovery rules should result in sanctions at the time of the violation of the rules. Without any bite in the rules, a party or counsel intent on stonewalling will not produce any meaningful documents until an order to produce is issued. This can be six months after the documents were supposed to be produced according to the rules.

As for drawing negative inferences, precluding certain defenses, or prohibiting the introduction of evidence as a result of failure to comply with discovery rules - this just

doesn't happen. Claimant's counsel must insist that arbitrators take such bold steps, in addition to assessing substantial penalties as sanctions for failures to produce, if the discovery process is to be taken seriously.

## XI. CONCLUSIONS

The Arbitrator's Manual opens with the following quote from Domke on Aristotle:

Equity is justice in that it goes beyond the written law. And it is equitable to prefer arbitration to the law court, for the arbitrator keeps equity in view, whereas the judge looks only to the law, and the reason why arbitrators were appointed was that equity might prevail.<sup>28</sup>

The noble goal of arbitration expressed in the opening of the Arbitrator's Manual continues to find expression in the efforts of those who would improve the securities arbitration process to better achieve its goal of equity. Hopefully, adherence to the spirit of the Discovery Guide will help avoid the problems which have plagued discovery in securities arbitration.

The question of a level playing field frequently arises in discussions of securities arbitration. Unfortunately, efforts to create the appearance of an even playing field cannot make up for certain inherent inequities in the process.

One is reminded of the famous New England Patriots football game against the Miami Dolphins played in Foxboro, Massachusetts during a heavy snowstorm a number of years ago. With the game tied and only seconds remaining on the clock, the Patriots called time-out and lined up to kick a field goal. During the time-out, a John Deere tractor

suddenly raced out onto the field and cleared the snow around the area where the ball would be held for the kicker to kick the winning field goal. The NFL Rulebook contains no rules against John Deere tractors clearing snow for the home team.

Devising rules to level the playing field can be tricky business. There is seemingly no end to the creativity of attorneys to avoid the impact of rules which might conceivably disadvantage their client. But with ongoing and determined efforts, the playing field can be leveled.

The Discovery Guide is a good step in the right direction towards leveling the playing field of securities arbitration. However, the process must continue with more balanced document production lists and with mandatory sanctions. Until then, counsel for claimants will have to walk a fine line to take advantage of the advances made in the Discovery Guide, while at the same time insisting on the equitable treatment which goes beyond the provisions of the Discovery Guide.

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<sup>1</sup> SEC Release No. 34-41833, File No. SR-NASD-99-07.

<sup>2</sup> There are resources available for that purpose, including The Securities Arbitration Procedure Manual, by David E. Robbins, Lexis Law Publishing (1999).

<sup>3</sup> NASD Notice to Members 99-90, November, 1999, page 689.

<sup>4</sup> Id. at 690.

<sup>5</sup> All references to Rules herein are to the NASD Code of Arbitration Procedure, May, 1999.

<sup>6</sup> Rule 10321(b)(1).

<sup>7</sup> Rule 10314(b)(1).

<sup>8</sup> Rule 10321(b)(2).

<sup>9</sup> Rule 10321(b)(3).

<sup>10</sup> Rule 10321(a).

<sup>11</sup> The Arbitrator's Manual, preface.

<sup>12</sup> The Arbitrator's Manual, page 1

<sup>13</sup> Id.

<sup>14</sup> Id at Page 12.

<sup>15</sup> Id at Page 13.

<sup>16</sup> The Arbitrator's Manual, pages 13-14, includes the following Document List for customer cases:

From the Firm:

- (1) RE-3s, U-4s and U-5s of registered representative (RRs).
- (2) Relevant parts of Compliance Manual.
- (3) Client agreements and opening account documents.
- (4) RRs holding pages for customer and/or product.
- (5) Commission run of RRs.
- (6) Correspondence with regulators.
- (7) Exception reports (i.e., activity concentration print-outs).
- (8) Order tickets.
- (9) Marketing materials.
- (10) Other customer complaints of a similar nature.
- (11) Redacted copy of holding pages of other customers in the same product.
- (12) Any analysis or account reconciliation prepared by the firm.
- (13) Notes or recordings made by the firm.

From Customers:

- (1) Income Tax Returns (can be limited to Form 1040, Pages 1&2 and Schedules D and E).
- (2) Customer copy of account statements.
- (3) Statements for accounts at other brokers.
- (4) Any analysis or account reconciliation prepared by the customer.
- (5) Notes or recordings made by the customer.
- (6) Correspondence by Claimant with the brokerage firm or financial consultant.

<sup>17</sup> Memorandum of NYSE, Edward W. Morris, Jr., dated January 2, 1991.

<sup>18</sup> Id.

<sup>19</sup> The NYSE discovery list for documents to be produced in all cases set forth the following:

From Customers:

- (1) Income tax returns (can be limited to 1040 page 1 and 2 and Schedules D and E).
- (2) Customer copy of account statements.
- (3) Statements for accounts at other brokers
- (4) Investment publications subscribed to.
- (5) Correspondence with regulatory authorities.
- (6) Research reports obtained/used by the customer.
- (7) Profit and loss analysis.
- (8) Any analysis or account reconciliations prepared by the customer.
- (9) Notes or recordings made by the customer.
- (10) Resume of customer.

From the Firm:

- (1) Monthly statements and confirms (if necessary).
- (2) RE-3's, U-4's and U-5's of registered representatives.
- (3) Relevant parts of Compliance Manual.
- (4) Research reports.
- (5) Client agreements and opening account documents.
- (6) RR's holding pages for customer and/or product.
- (7) Commission run of RR.
- (8) Profit and loss analysis.

- (9) Correspondence with regulators.
- (10) Exception reports (i.e., activity concentration printouts).
- (11) Order tickets.
- (12) Marketing materials.
- (13) Other customer complaints of a similar nature.
- (14) Redacted copy of other customers in the same product.

<sup>20</sup> NASD Notice to Members 99-90, November, 1999.

<sup>21</sup> Id.

<sup>22</sup> Id.

<sup>23</sup> Rule 10308(b)(5).

<sup>24</sup> Discovery Guide, NASD Notice to Members 99-90, pg. 689.

<sup>25</sup> See Appendix B hereto for the complete text of the Discovery Guide and the Document Production Lists.

<sup>26</sup> Discovery Guide, NASD Notice to Members 99-90, pg. 691.

<sup>27</sup> See Appendix A hereto.

<sup>28</sup> The Arbitrator's Manual, inside cover page.

## **APPENDIX A**

### **The Dirty Dozen: Survey on NASD Discovery Guide** **By Harry S. Miller**

In an effort to gauge opinions on how the NASD Discovery Guide is working so far, a survey was circulated on a limited basis among securities arbitration attorneys. The survey was conducted in a non-scientific manner, limited to twelve questions (hence, the title) to get feedback from practitioners around the country regarding the new Discovery Guide.

The response from attorneys primarily representing claimants was less than enthusiastic in reaction to the new Discovery Guide. As will be seen below, the majority of those responding were critical in their opinion of the new Discovery Guide and the NASD discovery process in general.

The majority of responses confirmed that there has been a serious problem with discovery in securities arbitration, and that the new Discovery Guide will only make a slight improvement. The vast majority were of the opinion that the Discovery Guide does not go far enough in addressing the abuses in the discovery process. There were sentiments expressed to put more teeth into the process by requiring the use of sanctions where appropriate.

As for actual changes in practice since the adoption of the Discovery Guide, most practitioners have not seen earlier appointments of arbitrators or earlier pre-hearing conferences. Although most practitioners reported that they have modified their standard discovery requests in light of the Discovery Guide, only a small minority report any

difference in the conduct of counsel and parties in the discovery process. The vast majority report that there has not been an increased level of cooperation in voluntary exchange of documents and information.

The following shows the results of the survey, with a summary of the responses following each question.

1. Do you believe that there has been a problem in the past with the discovery process in NASD arbitration?
  - a. Serious problem.
  - b. Moderate problem.
  - c. What problem?

**Response:** Approximately two-thirds of those responding to the survey indicated that there has been a serious problem with the arbitration discovery process.

2. Do you think that the Discovery Guide Document Production Lists will make a difference in the conduct of discovery in NASD arbitration?
  - a. Great improvement.
  - b. Slight improvement.
  - c. Same as it ever was.

**Response:** Approximately two-thirds of those responding to the survey thought that the Discovery Guide document production lists will make a slight improvement in the conduct of discovery.

3. In your opinion does the NASD Discovery Guide go far enough in addressing abuses in the arbitration discovery process?

**Response:** Approximately eighty percent of those responding to the survey expressed the opinion that the Discovery Guide does not go far enough in addressing discovery abuses.

4. Since the NASD adoption of the Discovery Guide (September 1999), have you noticed earlier appointments of arbitrators and earlier pre-hearing conferences than in the past?

**Response:** Approximately two-thirds of those responding to the survey have not noticed an earlier appointment of arbitrators or earlier pre-hearing conferences.

5. Since the adoption of the Discovery Guide, have you modified your standard discovery requests to follow the Discovery Guide Document Production Lists?

**Response:** Approximately two-thirds have modified standard discovery requests to follow the Document Production Lists.

6. Since the adoption of the Discovery Guide, have you seen opposing counsel using more uniform Document Production Lists modeled on the Discovery Guide?

**Response:** Only approximately sixteen percent have noticed opposing counsel using more uniform document production lists modeled on the Discovery Guide.

7. a. Have you noticed any difference in the conduct of counsel and parties in the discovery process since the NASD adoption of the Discovery Guide?

**Response:** Approximately half of those responding to the survey have not noticed any difference in the conduct of counsel or parties. Sixteen percent have noticed a difference in conduct, and approximately twenty-six percent have noticed some difference in some cases.

b. Has there been an increased level of cooperation and voluntary exchange of documents and information?

**Response:** Approximately eighty percent have not noticed an increased level of cooperation and voluntary exchange of documents and information. Comments on this included: "Are you kidding?" "Absolutely not!" "The cornerstone of big law firm respondent practice is discovery obstreperousness."

8. a. Have you noticed any difference in the decisions of arbitrators in handling discovery disputes since the adoption of the Discovery Guide?

**Response:** Approximately one-third have noticed a difference in the decisions of arbitrators handling discovery disputes since adoption of the Discovery Guide.

b. Have rulings become more predictable with standardized categories of documents required to be produced?

**Response:** Only sixteen percent reported that rulings on discovery disputes have become more predictable.

9. What specific categories listed in the Discovery Guide Document Production Lists do you find the most problematic?

**Response:** The answers to this question were fairly diverse, with the absence of commission runs being one point which was mentioned repeatedly.

10. Which past discovery problems have you seen improved or do you expect to see improved as a result of the NASD Discovery Guide? What new problems do you think it could cause?

**Response:** Answers to this also ran the gamut from "No improvements" to "Less sandbagging" and "Less time wasted over routine requests." As for new problems, many expressed a concern over an increased difficulty in obtaining documents which are not on the Document Production Lists.

11. How would you characterize the changes in discovery provided by the NASD Discovery Guide?

- a. Just what the doctor ordered.
- b. A step in the right direction.
- c. A band aid.
- d. The emperor's new clothes.

**Response:** Approximately one-half of those responding characterized the Discovery Guide as a step in the right direction.

12. What else do you think the NASD should consider in the future to improve the arbitration discovery process?

**Response:** Rather than attempting to summarize the answers to this question, the following is a cross-section of excerpts taken from the responses:

"Better training for the chair in discovery issues."

"NASD should hire full-time magistrates to deal with discovery."

"Sanctions used more often and enforced."

"Make it faster."

"Allow parties to communicate -- by letter only -- directly to the chair (with simultaneous copy to opposition and NASD)."

"Get the NASD out of the arbitration business."

"The NASD does not want to improve arbitration. Its member firms like it where the customer always loses."

"Take the administration of arbitration away from the NASD and give it to a neutral body like NASAA. As long as member firms get a vote each year on whether they want arbitration to be fair or not, it won't be."

"Eliminate time restrictions in List 5 (Failure to Supervise) and allow them to be decided on a case-by-case basis."

"Be more emphatic in the directive that these are guidelines only and not be accorded wholesale reality by the arbitrators. Of course, that would make the guidelines more of a 'paper tiger' than they already are."

"Specifically empowering panels to order sanctions for discovery abuse, separately from awards on the merits."

"Automatic disclosure of certain documents upon filing of the first responsive pleading."

"Put more teeth to prevent abusive practices."

"Don't mess with the Discovery Guide."

"The Discovery Guide is for sissies. Real, competent attorneys don't need this stuff."

"Let's face it, the weasel is guarding the chicken house."