SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54407; File No. SR-NYSE-2005-43)

September 6, 2006

Self-Regulatory Organizations; New York Stock Exchange LLC.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto to Rule 607 Relating to the Classification of Arbitrators as Public or Industry

I. Introduction

On June 17, 2005, the New York Stock Exchange, Inc. ("NYSE" or the "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend Rule 607 relating to the classification of arbitrators as public or industry. On August 4, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.[3] In this amendment, the Exchange stated that the rule change will become effective 90 days following the publication of this order in the Federal Register. The NYSE will update and reclassify arbitrators during this time period. The proposed rule change was published for comment in the Federal Register on August 29, 2005,[4] and the Commission received 38 comments on the

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 In Amendment No. 1, which supplemented the original filing, the Exchange modified the implementation date for the proposed rule change and clarified certain aspects of the filing.

4 See Exchange Act Release No. 52314 (Aug. 22, 2005), 70 FR 51104 (Aug. 29, 2005).

proposal.[5] The majority of commenters are lawyers that represent investors in arbitrations. This order approves the proposed rule change as amended.

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[5] Several commenters filed letters regarding the amendments to Exchange Rule 607 in connection with the proposed change to NASD Rule 10308 (NASD 2005-094), which also governs non-public/industry and public arbitrators. The NYSE and the Commission have identified letters in response to both rule filings that address the proposed changes to NYSE Rule 607.

See letters from Bradford D. Kaufman, Esq., Greenberg Traurig, dated Oct. 7, 2005 ("Kaufman"); Jonathan W. Evans, Esq., Jonathan W. Evans & Associates, dated Sept. 21, 2005 ("Evans"); L. Jerome Stanley, dated Sept. 20, 2005 ("Stanley"); Thomas D. Mauriello, Law Offices of Thomas D. Mauriello, dated Sept. 20, 2005 ("Mauriello"); William P. Torngren, Law Offices of William P. Torngren, dated Sept. 20, 2005 ("Torngren"); Jason R. Doss, Page Perry, LLC, dated Sept. 20, 2005 ("Doss"); Brian M. Greenman, Esq., dated Sept. 20, 2005 ("Greenman"); Teresa M. Gillis, Shustak, Jalil & Heller, dated Sept. 20, 2005 ("Gillis"); Susan N. Perkins, Esq., dated Sept. 20, 2005 ("Perkins"); Charles C. Mihalek, Esq. and Steven M. McCauley, Esq., Charles Mihalek, P.S.C., dated Sept. 20, 2005 ("Mihalek"); Steven J. Gard, Esq., Gard, Smiley, Bishop & Dovin LLP, dated Sept. 20, 2005 ("Gard"); Scott L. Silver, Blum & Silver, LLP., dated Sept. 20, 2005 ("Silver"); Mitchell S. Ostwald, Esq., Law Offices of Mitchell S. Ostwald, dated Sept. 20, 2005 ("Ostwald"); Joel A. Goodman, Esq., Goodman & Nekvasil, P.A., dated Sept. 20, 2005 ("Goodman"); Alan C. Friedberg, Pendleton, Friedberg, Wilson & Hennessey, P.C., dated Sept. 19, 2005 ("Friedberg"); Debra G. Speyer, Law Offices of Debra G. Speyer, dated Sept. 19, 2005 ("Speyer"); Harvey H. Eckart, Eckart & Leonetti, P.A., dated Sept. 19, 2005 ("Eckart"); G. Mark Brewer, Esq., Brewer Carlson, LLP, dated Sept. 19, 2005 ("Brewer"); Steve A. Buchwalter, first letter dated Sept. 19, 2005 and second letter dated Sept. 13, 2005 ("Buckwalter"); Royal B. Lea, III, Esq., Bingham & Lea, and Randall A. Pulman, Esq., Pulman, Bresnahan & Pullen, LLP, dated Sept. 19, 2005 ("Lea"); Richard P. Ryder, Securities Arbitration Commentator, Inc., dated Sept. 19, 2005 ("Ryder"); Eliot Goldstein, Esq., dated Sept. 19, 2005 ("Goldstein"); Philip M. Aidikoff, Aidikoff & Uhl, dated Sept. 16, 2005 ("Aidikoff"); Bruce E. Baldinger, Esq., Baldinger & Levine, L.L.C., dated Sept. 16, 2005 ("Baldinger"); Henry D. Fellows, Jr., Fellows Johnson & La Briola, LLP, dated Sept. 16, 2005 ("Fellows"); Rosemary J. Shockman, Public Investors Arbitration Bar Association, dated Sept. 15, 2005 ("PIABA"); James D. Keeney, dated Sept. 15, 2005 ("Keeney"); Bill Fynes, dated Sept. 15, 2005 ("Fynes"); Jay A. Salamon, Hermann, Cahn & Schneider LLP, dated Sept. 14, 2005 ("Salamon"); Jorge A. Lopez, Esq., Law Offices of Jorge A. Lopez, P.A., dated Sept. 14, 2005 ("Lopez"); Steven B. Caruso, Esq., Maddox Hargett & Caruso, P.C., dated Sept. 14, 2005 ("Caruso"); Scott C. Ilgenfritz, dated Sept. 14, 2005 ("Ilgenfritz"); Tracey Pride Stoneman, Tracey Pride Stoneman, P.C., dated Sept. 14, 2005 ("Stoneman"); Michael J. Willner, Miller Faucher and Cafferty LLP, dated Sept. 13, 2005 ("Willner"); Richard M. Layne, Layne & Lewis, LLP, dated Sept. 13, 2005 ("Layne"); Michael Knoll,

II. Description of the Proposal

Arbitration panels for disputes involving customers or non-members in which the damages are alleged to exceed $25,000 are comprised of three arbitrators: two public arbitrators and one from the securities industry. A customer or non-member also may request at least a majority of arbitrators from the securities industry.

Exchange Rule 607(a)(2) currently classifies an arbitrator as from the securities industry if he or she: (1) is, or within the past five years was, associated with certain entities related to the securities industry (or retired from, or spent a substantial part of his or her career with such an entity); (2) is an attorney or other professional who devoted 20 percent or more of his or her work effort to securities industry clients within the past two years; or (3) is registered under the Commodity Exchange Act, or is a member of a registered futures association or any commodity exchange or is associated with any such person.

Exchange Rule 607(a)(3) currently classifies an arbitrator who is not from the securities industry as a public arbitrator. However, a person cannot be classified as a public arbitrator if he or she has a spouse or household member who is associated with certain entities related to the securities industry.

The NYSE is concerned that some arbitrators currently classified as public have affiliations with entities that have securities industry ties such as banks, insurance companies, mutual funds, holding companies and asset management firms. In an effort to

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Esq., Law Offices of Michael Knoll, dated Sept. 13, 2005 ("Knoll"); John J. Miller, Law Offices of John J. Miller, P.C., dated Sept. 13, 2005 ("Miller"); and Seth E. Lipner, Professor of Law, Zicklin School of Business Baruch College and Member, Deutsch & Lipner, dated Sept. 8, 2005 ("Lipner").

enhance investor confidence in the NYSE arbitration forum, and in order to further ensure that persons serving as public arbitrators do not have ties to the securities industry or related firms, the Exchange proposed to amend Rule 607.

The proposed amendments would: (1) expand the list of entities engaged in the securities business by adding certain membership categories not previously specifically mentioned (but, nevertheless, contemplated by the current rule), and by adding a catch-all for any "other organization engaged in the securities business;"[6] (2) preclude any individual who is associated with any entity that controls, is controlled by, or is under common control with an entity on the expanded list from being classified as a public arbitrator; and (3) preclude any individual from being classified as a public arbitrator who has an immediate family member associated with an entity on the expanded list. The amendment would also define which persons are included within the term "immediate family member."

In order to ensure the integrity of the classification of public arbitrators, the Exchange will update and reclassify arbitrators in compliance with the amended rule if approved.

III. Summary of Comments

The Commission received 38 letters on the proposal.[7] Several commenters believed that the changes proposed were laudatory.[8] Many, nonetheless, viewed the

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6 These organizations would include any entity engaging in securities transactions, including banks and other financial institutions. Telephone conversation among Karen Kupersmith, Director of Arbitration, NYSE; Lourdes Gonzalez, Assistant Chief Counsel – Sales Practices, SEC; and Michael Hershaft, Special Counsel, SEC (July 26, 2006).

7 See footnote 5.

proposed amendments as insufficient to address what they considered as an arbitration process that is unfair to investors. Their concern generally centered in three areas: (1) the inclusion of any industry arbitrators on arbitration panels; (2) the criteria for qualifying as a public arbitrator; and (3) the desire to harmonize NYSE and NASD rules on this issue.[9]

Inclusion of Industry Arbitrators

The majority of commenters expressed the view that the mandatory inclusion of arbitrators from the securities industry on arbitration panels creates an unfair burden for investors seeking redress, and stated that arbitration panels should be comprised only of individuals with no ties to the securities industry.[10] A number of commenters maintained that the mandatory inclusion of securities industry arbitrators creates a perception, rightly or wrongly, that the process is unfair and biased against investors. Their suggestion was to eliminate the securities industry arbitrator.[11] One commenter opined that, in cases where special expertise is important, the securities industry arbitrator becomes a de facto expert witness, providing the public arbitrators with his or her opinion in secret, and depriving investors of due process because they and their counsel would have notice of or a chance to rebut the opinion.[12]

Criteria for Public Arbitrators

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8 See, e.g., Ilgenfritz, Stoneman, Buchwalter, Willner, and PIABA.

9 See Ryder.

10 See, e.g., Willner, Caruso, Knoll, PIABA, Ilgenfritz, Buchwalter, Mauriello, Torngren, Aidikoff, Doss, Brewer, Lea, Speyer, Keeney, Stanley, Layne, Baldinger, Eckart, and Fellows.

11 See, e.g., Torngren and Lewis.

12 See Willner.

Several commenters also stated that the proposed rule change would not adequately preclude persons with ties to the securities industry from meeting the definition of public arbitrator.[13] Currently, Rule 607(a)(2)(iv) permits an attorney, accountant or other professional to serve as a public arbitrator if that person has devoted less than 20 percent of his or her work to securities industry clients within the last two years.[14]

Some commenters favored amending the definition of public arbitrator to exclude all attorneys, accountants or other professionals who have represented the securities industry.[15] One commenter stated that arbitrators with industry ties have an "inherent bias" in favor of the industry, and noted that the rule currently allows persons with industry bias, such as an attorney with ties to the securities industry, to serve on panels "under the guise of being public."[16] Another commenter maintained that attorneys with industry ties who serve as public arbitrators would have a vested interest in keeping monetary awards low.[17]

Harmonizing NYSE and NASD Rules

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13 See, e.g., Evans, Caruso, Lipner and Lopez.

14 Several commenters explicitly or implicitly cited to NASD Rule 10308(a)(5)(A)(iv), which prohibits an attorney, accountant or other professional whose firm derived 10 percent or more of its annual revenue in the past two years from securities activities instead of the NYSE limitation. See, e.g., PIABA, Stoneman, Buchwalter, Salamon, and Keeney.

15 See, e.g., Evans and Caruso.

16 See Lopez.

17 See Lipner.

One commenter expressed concern that the proposed rule change would "differ significantly" from the Uniform Code of Arbitration ("UCA") classification rule, and stated that the NYSE rule change and NASD's proposal to amend its rule on the same subject should have been "brought to the Commission with the same text after being vetted by [the Securities Industry Conference on Arbitration ("SICA")]."[18] In this commenter's view, the SEC should "at least compel" the NYSE and NASD to develop "identical solutions" to this issue.[19]

IV. NYSE Response to Comments

Responding to commenters' concerns, the NYSE noted that securities industry arbitrators add value to the arbitration process.[20] It also stated that, as the administrator of a neutral forum, it believes public investors, non-members and members should have input into procedures by which arbitrators are appointed. Moreover, NYSE is a member of SICA, and it will continue to consider any rule changes regarding panel compositions that SICA may adopt to the UCA.

The NYSE also stated that the 20 percent limitation on the securities activities of public arbitrators allows individuals that have minimal ties to the securities industry to

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[18] See Ryder.

[19] Id. In particular, this highlighted the differences in who would be considered an "immediate family member" under each rule. While the NYSE rule would exclude immediate family members of associated persons, the NASD rule would exclude immediate family members of all control-related parties. In addition, the NYSE definition of immediate family member would include in-laws, while the NASD definition would not. Moreover, the NASD include step-relatives, while the NYSE rule would not. Finally, while the NYSE definition of "control" would not extend to the immediate family of the "control-related parties," the NASD's definition would.

[20] See Letter from Mary Yeager, NYSE, to Katherine A. England, SEC, dated June 5, 2006 ("Yeager").

serve as arbitrators. In its view a complete bar on professionals with any ties to the securities industry could also prohibit professionals who primarily represent public investors from serving on arbitration panels.

Acknowledging commenters' concerns regarding ties public arbitrators have to the securities industry, the NYSE also indicated that it will review the definition of public arbitrator to address persons whose firms receive a percentage of revenue derived from securities industry clients. NYSE stated that it will propose a separate rule amendment to prohibit certain individuals from serving as public arbitrators if their firms receive a certain percentage of revenue from securities industry clients, which would be similar to the current restrictions in NASD Rule 10308.

In addressing the specific differences between its proposed rule change and the rule change proposed by NASD, the NYSE stated that it defined "immediate family" and "control" to ensure that people with perceived ties to the securities industry would not be defined as public arbitrators, while avoiding eliminating from the arbitrator pool individuals with minimal ties to the securities industry.

Finally, the NYSE stated that alternatives to panel composition and the method by which arbitrators are classified are beyond the scope of this rule filing. It therefore declined to address these issues at this time.[21] The NYSE also stated that it is prepared to discuss those issues at the appropriate time.[22]

V. Discussion and Commission Findings

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21 Id.

22 Id.

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the Act and, in particular, with Section 6(b)(5) of the Act, which requires, among other things, that the NYSE's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.[23]

The Commission believes that the proposed rule change will promote the public interest by limiting certain people who have ties to the securities industry from serving as public arbitrators. In particular, by expanding the list of entities engaged in the securities business and companies they control, the rule will further limit the industry ties the public arbitrator may have. The new definition of "immediate family member" should have a similar result.[24]

The Commission appreciates the comments suggesting the elimination of securities industry arbitrators, and the further restriction on persons who have any ties to the securities industry from serving as public arbitrators. While these comments are beyond the scope of this rule filing, they raise important questions regarding the arbitration process. We understand that SICA is actively considering proposals from its membership regarding these issues. We note that the NYSE has stated it will review any rule regarding panel composition that SICA adopts to the UCA, and that it will propose a separate amendment further limiting the definition of public arbitrator.

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[23] 15 U.S.C. 78f(b)(5).

[24] Section 19(b)(2) of the Act requires the Commission to approve a proposed rule change if it finds that the proposed rule change is consistent with the requirements of the Act, and the applicable rules and regulations thereunder. This standard does not require the NYSE, NASD or SICA rules to be identical.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act[25] that the proposed rule change (SR-NYSE-2005-43), as amended, be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[26]

Nancy M. Morris
Secretary

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25 15 U.S.C. 78s(b)(2).

26 17 CFR 200.30-3(a)(12).