SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55158; File Nos. SR-NASD-2003-158; SR-NASD-2004-011)

January 24, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendments 1, 2, 3, and 4 to Amend NASD Arbitration Rules for Customer Disputes and Notice of Filing and Order Granting Accelerated Approval of Amendments 5, 6, and 7 thereto; Order Approving Proposed Rule Change and Amendments 1, 2, 3, and 4 to Amend NASD Arbitration Rules for Industry Disputes and Notice of Filing and Order Granting Accelerated Approval of Amendments 5, 6, and 7 thereto

I. Introduction

The National Association of Securities Dealers, Inc. ("NASD"), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. ("NASD Dispute Resolution"), filed with the Securities and Exchange Commission ("SEC" or "Commission") proposed rule changes to amend the NASD Code of Arbitration Procedure in connection with rules applicable to customer disputes ("Customer Code") and to industry disputes ("Industry Code") on October 15, 2003 and January 16, 2004, respectively, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder.[2] Amendments 1, 2, 3, and 4 to the Customer Code were filed with the Commission on January 3, January 19, April 8, and June 10, 2005, respectively. Amendments 1, 2, 3, and 4 to the Industry Code were filed with the Commission on January 3, February 26, April 8, and June 10, 2005, respectively. The Customer Code and Amendments 1, 2, 3, and 4 thereto ("Customer Code Notice") and the Industry Code and Amendments 1, 2, 3, and 4 thereto ("Industry Code Notice") were published for comment on June 23, 2005.[3] The Commission received 51 comments[4] in response to the Customer Code

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

[2] 17 CFR 240.19b-4.

[3] See Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, 3, and 4 Thereto to Amend NASD Arbitration Rules for Customer Disputes, Securities Exchange Act Rel. No.

51856 (Jun. 15, 2005), 70 FR 36442 (Jun. 23, 2005); Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, 3, and 4 Thereto to Amend NASD Arbitration Rules for Industry Disputes, Securities Exchange Act Rel. No. 51857 (Jun. 15, 2005), 70 FR 36430 (Jun. 23, 2005).

[4] See Letter from Norman B. Arnoff, Esq., dated Aug. 12, 2004 ("Arnoff"); Letter from Daniel A. Ball, Esq., Selzer Gurvitch Rabin & Obecny, Chtd., dated Jul. 14, 2005; Letter from Gail E. Boliver, Esq., Boliver Law Firm, dated Jul. 13, 2005 ("Boliver"); Letter from Timothy A. Canning, Esq., Law Offices of Timothy A. Canning, dated Jul. 14, 2005 ("Canning"); Letter from Steven B. Caruso, Esq., Maddox Hargett & Caruso, P.C., dated Jul. 13, 2005 ("Caruso"); Letter from Rebecca C. Davis, Esq., Tate, Lazarini & Beall, PLC, dated Jul. 14, 2005 ("R. Davis"); Letter from James J. Eccleston, Esq., Shaheen, Novoselsky, Staat, Filipowski & Eccleston, P.C., dated Jul. 14, 2005 ("Eccleston"); Letter from Barry D. Estell, Esq., dated Jul. 14, 2005 ("Estell"); Letter from Jonathan W. Evans, Esq., Jonathan W. Evans & Associates, dated Jul. 14, 2005 ("Evans"); Letter from Martin L. Feinberg, Esq., dated Jul. 13, 2005 ("Feinberg"); Letter from Jeffrey A. Feldman, Esq., dated Jul. 11, 2005 ("Feldman"); Letter from Stuart Finer, Esq., dated Jul. 15, 2005 ("Finer"); Letter from William A. Fynes, dated Jul. 13, 2005 ("Fynes"); Letter from W. Scott Greco, Esq., Greco and Greco, P.C., dated Jun. 24, 2005 ("Greco"); Letter from Scott C. Ilgenfritz, Esq., Johnson, Pope, Bokor, Ruppel, and Burns, LLP, dated Jul. 14, 2005 ("Ilgenfritz"); Letter from James S. Jones, Esq., dated Mar. 30, 2006 ("Jones"); Letter from Wayne M. Josel, Esq., Kaufmann, Feiner, Yamin, Gilden, & Robbins LLP, dated Jul. 13, 2005 ("Josel"); Letter from Spiro T. Komninos, Esq., Komninos, Fowkes & Farrugia Law Group, LLC, dated Jul. 14, 2005 ("Komninos"); Letter from Stephen Krosschell, Goodman & Nekvasil, dated Jul. 14, 2005 ("Krosschell"); Letter from Cary S. Lapidus, Esq., Law Offices of Cary S. Lapidus, dated Jul. 14, 2005 ("Lapidus"); Letter from Richard M. Layne, Esq., Layne & Lewis LLP, dated Jul. 12, 2005 ("Layne"); Letter from Royal Lea, Esq., Bingham & Lea, P.C., dated Jul. 14, 2005 ("Lea"); Letter from Dale Ledbetter, Adorno & Yoss, dated Jul. 14, 2005 ("Ledbetter"); Letter from Prof. Seth E. Lipner, Zicklin School of Business, Member/Deutsch & Lipner, dated Jul. 13, 2005 ("Lipner"); Letter from Jorge A. Lopez, Esq., dated Jul. 21, 2005 ("Lopez"); Letter from Angela H. Magary, Brickley, Sears & Sorett, dated Jul. 14, 2005 ("Magary"); Letter from Stuart D. Meissner, Esq., Law Offices of Stuart D. Meissner LLC., dated Jul. 12, 2005 ("Meissner"); Letter from John J. Miller, Esq., Law Office of John J. Miller, P.C., dated Jul. 12, 2005 ("Miller"); Letter from Jill I. Gross and Barbara Black, Directors, Pace Investor Rights Project, dated Jul. 14, 2005 ("PACE"); Letter from J. Boyd Page, Esq. and Samuel T. Brannan, Esq., Page Perry, LLC, dated Jul. 14, 2005 ("Page"); Letter from Rosemary J. Shockman, President, and Robert S. Banks, Jr., Executive Vice President, President Elect, Public Investors Arbitration Bar Association, dated Jul. 13, 2005 ("PIABA"); Letter from Rosemary Shockman, President, Public Investors Arbitration Bar Association, dated Aug. 2, 2005 ("PIABA #2"); Letter from Herbert E. Pounds, Herbert E. Pounds, Jr., P.C., dated Jul. 14, 2005 ("Pounds"); Letter from M. Clay Ragsdale, Esq., Ragsdale LLC, dated Jul. 14, 2005 ("Ragsdale"); Letter from Howard M. Rosenfield, Esq., dated Jul. 14, 2005 ("Rosenfield"); Letter from Richard P. Ryder, President, Securities Arbitration Commentator, Inc., dated Jul. 21, 2005 ("Ryder"); Letter from J. Pat Sadler, dated Jul. 13, 2005 ("Sadler"); Letter from Laurence S. Schultz, Esq., Driggers, Schultz & Herbst PC, dated Jun. 8, 2005 ("Schultz"); Letter from Laurence S. Schultz, Esq., Driggers, Schultz & Herbst, dated Jul. 14, 2005 ("Schultz #2"); Letter from Scott R. Shewan, Esq., Born, Pape & Shewan LLP, dated Jul. 14, 2005 ("Shewan"); Letter from Edward G. Turan, Esq., Chair, Arbitration and Litigation

Notice and one comment[5] in response to the Industry Code Notice, all of which are available on the Commission's Internet Web site at (http://www.sec.gov/rules/sro.shtml). On May 4, 2006, NASD filed Amendments 5 to the Customer Code and to the Industry Code. The Commission received 125 comments following NASD's posting of Amendment 5 to the Customer Code on its Web site.[6] The Commission did not receive any comments in connection with Amendment 5 to

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Committee, Securities Industry Association, dated Jul. 13, 2005 ("SIA"); Letter from Jeff Sonn, Esq., Sonn & Erez, dated Jul. 14, 2005 ("Sonn"); Letter from Debra G. Speyer, Esq., Law Offices of Debra G. Speyer, dated Jul. 14, 2005 ("Speyer"); Letter from Arnold Y. Steinberg, P.C., dated Jul. 14, 2005 ("Steinberg"); Letter from Steven A. Stolle, Esq., Rohde & Van Kampen PLLC, dated Jul. 8, 2005 ("Stolle"); Letter from Andrew Stoltmann, Stoltmann Law Offices, P.C., dated Jul. 14, 2005 ("Stoltmann"); Letter from Mark A. Tepper, Esq., Mark A. Tepper, P.A., dated Jul. 14, 2005 ("Tepper"); Letter from Richard A. Karoly, Vice President and Senior Corporate Counsel, Schwab & Co., Inc., dated Jul. 14, 2005 ("Schwab"); Letter from John E. Sutherland, Esq., Brickley, Sears & Sorett, dated Jul. 14, 2005 ("Sutherland"); Letter from Steele T. Williams, P.A., dated Jul. 15, 2005 ("Williams"); Letter from Michael J. Willner, Esq., Miller Faucher and Cafferty LLP, dated Jul. 16, 2005 ("Willner"); Letter from A. Daniel Woska, Woska & Hayes, LLP, dated Jun. 15, 2005 ("Woska").

[5] Letter from Marvin Elster, dated Jun. 30, 2005 ("Elster").

[6] Letter from Philip M. Aidikoff, Aidikoff, Uhl & Bakhtiari, dated May 16, 2006 ("Aidikoff"); Letter from Ronald M. Amato, Shaheen, Novoselsky, Staat, Filipowski & Eccleston, P.C., dated May 30, 2006 ("Amato"); Letter from Sarah G. Anderson, dated May 15, 2006 ("Anderson"); Letter from Anonymous, dated May 15, 2006 ("Anonymous"); Letter from Robert W. Anthony, dated May 16, 2006 ("Anthony"); Letter from John G. Appel, Jr., dated May 18, 2006 ("Appel"); Letter from Kurt Arbuckle, Kurt Arbuckle, P.C., dated May 22, 2006 ("Arbuckle"); Letter from C.W. Austin, Jr., dated May 15, 2006 ("Austin"); Letter from Daniel E. Bacine, Barrack, Rodos & Bacine, dated May 15, 2006 ("Bacine"); Letter from Bruce E. Baldinger, Levine & Baldinger, LLC, dated May 16, 2006 ("Baldinger"); Letter from Scott I. Batterman, Esq., Clay Chapman Crumpton Iwamura & Pulice, dated May 15, 2006 ("Batterman"); Letter from Scot Bernstein, Law Offices of Scot Bernstein, dated May 26, 2006 ("Bernstein"); Letter from Brian P. Biggins, Esq., Brian P. Biggins & Associates Co., L.P.A., dated May 15, 2006 ("Biggins"); Letter from Rob Bleecher, Esq., dated May 15, 2006 ("Bleecher"); Letter from Gail E. Boliver, Boliver Law Firm, dated May 15, 2006 ("Boliver #2"); Letter from Sam Brannan, Page Perry LLC, dated May 16, 2006 ("Brannan"); Letter from Steve Buchwalter, Law Offices of Steve A. Buchwalter, P.C, dated May 15, 2006 ("Buchwalter"); Letter from John S. Burke, Higgins & Burke, P.C, dated May 15, 2006 ("J. Burke"); Letter from Thomas F. Burke, May 22, 2006 ("T. Burke"); Letter from Tim Canning, dated May 15, 2006 ("Canning #2"); Letter from Carl J. Carlson, Carlson & Dennett, P.S., dated May 12, 2006 ("Carlson"); Letter from Jeremy B. Chalmers, Mars, Mars and Chalmers, dated May 16, 2006 ("Chalmers"); Letter from Roger F. Claxton, Claxton & Hill, dated May 15, 2006 ("Claxton"); Letter from Erwin Cohn, Cohn & Cohn, dated

May 16, 2006 (“Cohn”); Letter from Patrick A. Davis, P.A, dated May 16, 2006 (“P. Davis”); Letter from William F. Davis, dated May 15, 2006 (“W. Davis”); Letter from Adam Doner, dated May 16, 2006 (“Doner”); Letter from James J. Eccleston, Shaheen, Novoselsky, Staat, Filipowski & Eccleston, dated May 16, 2006 (“Eccleston #2); Letter from Richard Elliott, dated May 16, 2006 (“Elliot”); Letter from Barry D. Estell, dated May 15, 2006 (“Estell #2); Letter from Barry D. Estell, Esq., dated May 16, 2006 (“Estell #3); Letter from Jonathan W. Evans, Esq., Jonathan W. Evans & Associates, dated May 15, 2006 (“Evans #2); Letter from Allan J. Fedor, Esq., dated May 22, 2006 (“Fedor”); Letter from Martin L. Feinberg, dated May 15, 2006 (“Feinberg #2”); Letter from Teresa M. Gillis, Esq., Shustak & Partners, dated May 16, 2006 (“Gillis”); Letter from Robert W. Goehring, Esq., dated May 15, 2006 (“Goehring”); Letter from Eliot Goldstein, Esq., Law Offices of Eliot Goldstein LLP, dated May 16, 2006 (“Goldstein”); Letter from Jan Graham, Graham Law Offices, dated May 15, 2006 (“Graham”); Letter from W. Scott Greco, Greco & Greco, P.C., dated May 15, 2006 (“Greco #2”); Letter from Brian M. Greenman, Esq., dated May 15, 2006 (“Greenman”); Letter from Randall R. Heiner, Heiner Law Offices, dated May 15, 2006 (“Heiner”); Letter from Eric Hewko, dated May 20, 2006 (“Hewko”); Letter from Charles C. Hunter, Esq., Woska & Hayes, LLP, dated May 23, 2006 (“Hunter”); Letter from Scott C. Ilgenfritz, dated May 15, 2006 (Ilgenfritz #2”); Letter from Wayne M. Josel, Kaufmann, Feiner, Yamin, Gildin & Robbins, LLP, dated May 15, 2006 (“Josel #2”); Letter from Jeffrey B. Kaplan, Dimond Kaplan Rothstein, P.A., dated May 16, 2006 (“Kaplan”); Letter from James D. Keeney, dated May 15, 2006 (“Keeney”); Letter from T. Michael Kennedy, dated May 15, 2006 (“Kennedy”); Letter from Joseph C. Korsak, Esq., Law Office of Joseph C. Korsak, dated May 15, 2006 (“Korsak”); Letter from Richard M. Layne, Layne & Lewis LLP, dated May 13, 2006 (“Layne #2”); Letter from Royal Lea, Bingham & Lea, P.C., dated May 16, 2006 (“Lea #2); Letter from Dale Ledbetter, Adorno & Yoss, dated May 15, 2006 (“Ledbetter #2”); Letter from Prof. Seth E. Lipner, Zicklin School of Business, Member/Deutsch & Lipner, dated May 15, 2006 (“Lipner #2); Letter from Jorge A. Lopez, Esq., Jorge A. Lopez, P.A., dated May 15, 2006 (“Lopez #2”); Letter from Michael B. Lynch, Esq., Law Offices of James Richard Hooper, PA, dated May 16, 2006 (“Lynch”); Letter from Daniel I. MacIntyre, Esq., Shapiro Fussell, dated May 16, 2006 (“MacIntyre”); Letter from Angela H. Magary, Brickley, Sears & Sorett, dated May 31, 2006 (“Magary 2”); Letter from Jenice L. Malecki, Esq., Malecki Law, dated May 16, 2006 (“Malecki”); Letter from Emerson R. Marks, Jr., Emerson R. Marks, Jr., P.L.C., dated May 15, 2006 (“Marks”); Letter from Thomas D. Mauriello, Law Offices of Thomas D. Mauriello, dated May 15, 2006 (“Mauriello”); Letter from Steven M. McCauley, Esq., Charles C. Mihalek, P.S.C, dated May 16, 2006 (“McCauley”); Letter from C. David Mee, Esq., Ajamie LLP, dated May 15, 2006 (“Mee”); Letter from Stuart Meissner, Esq., The Law Offices of Stuart D. Meissner LLC., dated May 15, 2006 (“Meissner #2”); Letter from David P. Meyer, Esq., David P. Meyer Associates, Co. LPA, dated May 16, 2006 (“D. Meyer”); Letter from Stephen P. Meyer, Esq., Meyer & Ford, dated May 16, 2006 (“S. Meyer”); Letter from John Miller, Law Office of John J. Miller, P.C., dated May 15, 2006 (“Miller #2”); Letter from Stephen David Murakami, Esq., Hooper & Weiss, LLC, dated May 16, 2006 (“Murakami”); Letter from Bryan Lantagne, Director, Massachusetts Securities Division, Chair, NASAA Broker-Dealer Arbitration Project Group, dated Jul. 19, 2006 (“NASAA”); Letter from Mitchell Ostwald, Law Office of Mitchell Ostwald, dated May 16, 2006 (“Ostwald”); Letter from Jill Gross and Barbara Black, Directors, Pace Investor Rights Project, Jun. 6, 2006 (“PACE 2”); Letter from Boyd Page, Page Perry LLC, dated May 16, 2006

the Industry Code. NASD filed Amendments 6 to the Customer Code and Industry Code on July 21, 2006 and Amendments 7 to Customer Code and Industry Code on August 15, 2006. NASD

("Page #2"); Steve Parker, Page Perry, LLC, dated May 16, 2006 ("Parker"); Letter from Henry I. Pass, Esq., The Law Offices of Henry Ian Pass, dated May 15, 2006 ("Pass"); Letter from Joseph C. Peiffer, Correro Fishman Haygood Phelps, dated May 15, 2006 ("Peiffer"); Letter from Susan N. Perkins, dated May 16, 2006 ("Perkins"); Letter from Steven B. Caruso, President-Elect, Public Investors Arbitration Bar Association, dated May 16, 2006 ("PIABA #3); Letter from Robert S. Banks, Jr., President, Public Investors Arbitration Bar Association, dated May 26, 2006 ("PIABA 4"); Letter from Robert C. Port, Esq., Cohen Goldstein Port & Gottlieb, LLP, dated May 20, 2006 ("Port"); Letter from Herbert Pounds, Herbert E. Pounds, Jr., P.C., dated May 15, 2006 ("Pounds #2"); Letter from Thomas Quarles, Jr., Esq., Devine, Millimet & Branch, P.A., dated May 16, 2006 ("Quarles"); Letter from Adam T. Rabin, Esq., Dimond Kaplan & Rothstein, P.A, dated May 16, 2006 ("Rabin"); Letter from Kirk Reasonover, Esq., Smith & Fawer, L.L.C., dated May 16, 2006 ("Reasonover"); Letter from Robert H. Rex, Esq., Dickenson Murphy Rex & Sloan, dated May 15, 2006 ("Rex"); Letter from David E. Robbins, Kaufmann, Feiner, Yamin, Gildin & Robbins LLP, dated May 29, 2006 ("Robbins"); Letter from J. Pat Sadler, dated May 16, 2006 ("Sadler #2); Letter from Jay H. Salamon, Hermann Cahn & Schneider LLP, dated May 15, 2006 ("Salamon"); Letter from Robert K. Savage, Esq., The Savage Law Firm, P.A., dated May 16, 2006 ("Savage"); Letter from Martin Seiler, dated May 15, 2006 ("Seiler"); Letter from Steven Sherman, Law Offices of Steven M. Sherman, dated May 15, 2006 ("Sherman"); Letter from Scott R. Shewan, Born, Pape & Shewan LLP, dated May 15, 2006 ("Shewan #2"); Letter from Rosemary J. Shockman, Shockman Law Office, dated May 16, 2006 ("Shockman"); Letter from Brian N. Smiley, Gard Smiley & Bishop LLP, dated May 15, 2006 ("Smiley"); Letter from James A. Sigler, dated May 15, 2006 ("Sigler"); Letter from Scott Silver, Esq., Blum & Silver, LLP, dated May 17, 2006 ("Silver"); Letter from Donald A.W. Smith, Esq., dated May 17, 2006 ("Smith"); Letter from Jeff Sonn, dated May 22, 2006 ("Sonn #2"); Letter from Ben Stewart, dated May 16, 2006 ("Stewart"); Letter from Tracy Pride Stoneman, Tracy Pride Stoneman, P.C., dated May 16, 2006 ("Stoneman"); Letter from Mark A. Tepper, Mark A. Tepper P.A., dated May 15, 2006 ("Tepper #2); Letter from William P. Torngren, dated May 15, 2006 ("Torngren"); Letter from Al Van Kampen, Rohde & Van Kampen PLLC, dated May 15, 2006 ("Van Kampen"); Letter from James V. Weixel, Jr., Weixel Law Office, dated May 15, 2006 ("Weixel"); Letter from Michael J. Willner, Esq., Miller Faucher and Cafferty LLP, dated May 15, 2006 ("Willner #2"); Letter from A. Daniel Woska, Esq., Woska & Hayes, LLP, dated May 12, 2006 ("Woska #2"); Letter from Todd Young, dated May 15, 2006 ("T. Young"); Letter from William B. Young, Jr., Hooper Weiss, LLC, dated Florida, May 18, 2006 ("W. Young"); Letter from Elizabeth Zeck, Esq., Willoughby & Hoefer, P.A., dated May 16, 2006 ("Zeck"). In addition, the Commission received 15 form letters from individuals that were substantially similar ("Letter Type A") and three other form letters ("Letter Type B").

requested accelerated approval in connection with Amendments 5, 6, and 7.[7] This Order approves the Customer Code and Industry Code, as amended, accelerating approval of Amendments 5, 6, and 7 thereto.

II. Purpose for and Description of the Proposal

A. Background

NASD proposed to amend the NASD Code of Arbitration Procedure ("current Code") to simplify the rule language into plain English, reorganize the rules, codify certain practices, and implement several substantive changes. The current Code would be reorganized into three separate procedural codes: the NASD Code of Arbitration Procedure for Customer Disputes; the NASD Code of Arbitration Procedure for Industry Disputes; and the NASD Code of Mediation Procedure.[8] The three new codes are intended to replace the current Code in its entirety.

This approval order pertains to the Customer Code and Industry Code, the final texts of which are available on the NASD Web site at http://www.nasd.com/web/groups/med_arb/documents/mediation_arbitration/nasdw_018335.pdf. Charts comparing the current Code to the Customer Code and Industry Code are also available at the URL above. Descriptions of the proposed rule changes, as amended by Amendments 1, 2, 3, and 4, are contained in the Customer Code Notice and Industry Code Notice[9] and are also

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[7] Because the Customer Code and Industry Code, as amended by Amendments 1, 2, 3, and 4 to each code, already have been published for comment, the request for accelerated approval applies only to Amendments 5, 6, and 7 to each code.

[8] The Mediation Code was filed separately with the Commission as SR-NASD-2004-013. The Commission approved the Mediation Code on October 31, 2005, and it became effective on January 30, 2006. See Order Granting Approval to Proposed Rule Change and Amendments Nos. 1 and 2 Thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3, to Amend NASD Rules for Mediation Proceedings, Securities Exchange Act Rel. No. 52705 (Oct. 31, 2005), 70 FR 67525 (Nov. 7, 2005) (SR-NASD-2004-013).

[9] See supra n. 3.

available at NASD's principal office and at the Commission's Public Reference Room.

B. Purpose and Description

In 1998, the SEC launched an initiative to encourage issuers and self-regulatory organizations ("SROs") to use "plain English" in disclosure documents and other materials used by investors. Because the current Code is used by investors, including investors who appear pro se in the NASD forum, NASD undertook to rewrite the current Code in "plain English." Over time, the goals of the plain English initiative expanded beyond simplifying the language and sentence structure of the rules in the Code to include:

- Reorganizing the current Code in a more logical, user-friendly way, including creating separate codes for customer and industry arbitrations, and for mediations; and
- Implementing several substantive rule changes, including codifying several common practices, to provide more guidance to parties and arbitrators, and to streamline the administration of arbitrations in the NASD forum.

1. Plain English

When it launched its "plain English" initiative in 1998, the SEC published a "Plain English Handbook" to provide guidance to issuers and SROs in drafting materials intended to be used by investors. The SEC's Plain English Handbook recommended using shorter, more common words; breaking long rules into shorter ones; using the active voice whenever possible; and putting lists into easy-to-read formatting, such as bullet points.

NASD stated that, in revising the current Code, it implemented these guidelines wherever possible. Throughout the Customer and Industry Codes, NASD simplified language and eliminated unnecessarily legalistic or arcane terminology. Long rules, such as current Rule 10308 (Selection of Arbitrators) and current Rule 10321 (General Provisions Governing Pre-

Hearing Proceedings), have been broken into several shorter rules.[10] Where appropriate, NASD has presented lists in bullet point format and used active verbs.

The Customer and Industry Codes also contain new definitions rules (Proposed Rules 12100 and 13100, respectively) that define commonly used terms applicable throughout the current Code.[11] NASD believes that a comprehensive definitions rule will make the Customer and Industry Codes easier to understand and to use and will help eliminate confusion about the meaning and scope of frequently used terms. It will also allow NASD to use shorter phrases, or single words, in place of longer phrases in its rules.[12] This makes rules easier to read and understand, without changing the meaning of the current Code.

2. Reorganization

One of the most frequent criticisms of the current Code is that it is poorly organized. Parties, particularly infrequent users of the forum, have difficulty finding the rules they are looking for, because the organization of the rules is not clear. The confusion is compounded because certain rules in the current Code apply only to customer cases, some apply only to industry cases, and others apply to both types of disputes. In addition, the current Code contains the NASD mediation rules, even though many matters are submitted directly to mediation, and do not arise out of an arbitration proceeding.

[10] For example, Rule 10308 of the current Code is contained in Proposed Rules 12400-12406 for the Customer Code and 13400-13406 for the Industry Code.

[11] Some rules in the current Code, such as Rule 10308, contain definitions applicable to that rule only. However, there is no general definitions rule that applies to the entire current Code.

[12] For example, the phrase "dispute, claim, or controversy" has been replaced by the word "dispute," which has been defined in Proposed Rules 12100 and 13100, respectively, to mean the longer phrase.

To address these concerns, NASD proposed to divide the current Code into three separate Codes: the Customer Code, the Industry Code, and the Mediation Code.[13] Although many of the rules in the Customer and Industry Codes will be identical, NASD believes that maintaining separate arbitration codes will eliminate confusion regarding which rules are applicable to which types of disputes. NASD intends to maintain electronic versions of each code on its Web site, www.nasd.com, and will make paper copies available upon request.

In keeping with the current NASD rule numbering system, each code will be numbered in the thousands, and major sections will be numbered in the hundreds. Individual rules within those sections will be numbered in the tens (or ones, if necessary). The current method for numbering and lettering paragraphs within individual rules will remain unchanged. In particular, the Customer Code will use the Rule 12000 series, and the Industry Code will use the Rule 13000 series.[14]

To make it easier to find specific rules, the Customer Code will be divided into the following nine parts, which are intended to approximate the chronological order of a typical arbitration:

- Part I (Rule 12100 et seq.) contains definitions, as well as other rules relating to the organization and authority of the forum;
- Part II (Rule 12200 et seq.) contains general arbitration rules, including what claims are subject to arbitration in the NASD forum;

[13] As noted above, the Commission approved the Mediation Code in October 2005. See supra note 8.

[14] Both of these series are currently unused. The Mediation Code uses the Rule 14000 series. NASD will reserve the Rule 10000 series, which is currently used for NASD's dispute resolution rules, for future use.

- Part III (Rule 12300 et seq.) contains rules explaining how to initiate a claim, how to respond to a claim, how to amend claims, and when claims may be combined and separated;
- Part IV (12400 et seq.) contains rules relating to the appointment, authority and removal of arbitrators;
- Part V (Rules 12500 et seq.) contains rules governing the prehearing process, including proposed new rules relating to motions and discovery;
- Part VI (Rules 12600 et seq.) contains rules relating to hearings;
- Part VII (Rules 12700 et seq.) contains rules relating to the dismissal, withdrawal, or settlement of claims;
- Part VIII (Rules 12800 et seq.) contains rules relating to simplified (small cases) arbitrations and default proceedings; and
- Part IX (Rules 12900 et seq.) contains rules relating to fees and awards.

The Industry Code will use the same divisions, numbered under the 13000 series.

3. Description of Other Changes

In addition to simplifying and reorganizing the current Code, the Customer and Industry Codes include other changes that NASD states are intended to make the NASD arbitration process as simple, uniform, and transparent as possible. Some of these changes codify or clarify current NASD practice. Others are intended to provide guidance to parties, resolve open questions, or streamline or standardize the administration of NASD arbitrations.

4. Relationship Between Proposed Customer Code and Industry Codes

Although the Customer Code and Industry Code are similarly organized and numbered, there are two main differences. First, some rules in the current Code contain different provisions

for customer and industry disputes.[15] For such rules, the Customer Code contains only the provisions that relate to customer disputes, and the Industry Code contains only the provisions that relate to industry cases.

Second, some rules in the current Code apply only to industry disputes. These rules are included in the Industry Code but have no counterpart in the Customer Code.[16] NASD has not proposed any substantive changes to those parts of the current Code that are unique to industry cases.

III. Summary of Comments on the Customer Code as Amended by Amendments 1, 2, 3, and 4 Thereto and Description of Amendments 5, 6, and 7 to the Customer Code[17]

As noted above, in Amendment 5 to the Customer Code, NASD responded to comments on the Customer Code Notice,[18] proposed additional rule changes, most of which were in response to comments, and requested accelerated approval of the Customer Code.[19] After NASD filed Amendment 5 with the Commission, the Commission received 125 additional comments. Many of the comments centered on: (1) NASD's request for accelerated approval;[20]

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[15] E.g., current Rule 10308 (Selection of Arbitrators) requires that three-arbitrator panels in customer cases consist of a majority of public arbitrators but provides that the composition of the panel in industry disputes depends on the nature of the claim.

[16] See, e.g., Rules 10210 and 10211 of the current Code, governing statutory employment discrimination claims, and Rule 10335 of the current Code, governing injunctive relief.

[17] Section III discusses Amendments 5, 6, and 7 to the Customer Code. Section IV, below, discusses Amendments 5, 6, and 7 to the Industry Code.

[18] See supra note 3.

[19] The request for accelerated approval applies to all amendments filed after the Customer Code Notice, which are Amendments 5, 6, and 7.

[20] See, e.g., Aidikoff, Appel, Arbuckle, Austin, Baldinger, Baccine, Batterman, Bernstein, Biggins, Bleecher, Brannan, Buchwalter, T. Burke, Canning #2, Chalmers, Claxton, Cohn, P. Davis, Doner, Elliott, Evans #2, Feinberg #2, Gillis, Goldstein, Graham, Greco #2, Greenman, Hewko, Hunter, Kaplan, Keeney, Korsak, Lea #2, Levine, Lopez #2, Lynch, MacIntyre, Magary #2, Malecki, Marks, McCauley, Mee, Meissner #2, Meyer, S. Meyer, Miller #2, Murakami, Ostwald, Page #2, Parker, Pass, Peiffer, Perkins, PIABA #3, Port, Pounds #2, Quarles, Rabin,

(2) provisions of Proposed Rules 12506 (Document Production Lists) and 12514 (Exchange of Documents and Witness Lists Before Hearing), as published in the Customer Code Notice, that concern the production during discovery of documents within a party's "control";[21] and (3) Proposed Rule 12504 (Motions to Decide Claims Before a Hearing on the Merits), as amended by Amendment 5.[22] In response to these comments, NASD filed Amendment 6 to the Customer Code with the Commission on July 21, 2006, in which it withdrew Proposed Rule 12504 (Motions to Decide Claims Before a Hearing on the Merits) and all references thereto from the Customer Code.[23]

NASD filed Amendment 7 to the Customer Code with the Commission on August 15, 2006. In this amendment, NASD further responded to comments concerning Proposed Rules 12506 (Document Production Lists) and 12514 (Exchange of Documents and Witness Lists Before Hearing) by amending Proposed Rule 12508 (Objecting to Discovery; Waiver of Objection). In addition, NASD amended other proposed rules, provided additional clarification concerning certain NASD practices and rules, and responded to one comment submitted in response to Amendment 5 to the Customer Code.

A summary of comments received in connection with the Customer Code Notice and NASD's responses, as well as a description of the amendments to proposed rule text made in

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Reasonver, Robbins, Sadler, Salamon, Savage, Seiler, Sherman, Shewan #2, Shockman, Sigler, Silver, Smiley, Smith, Sonn #2, Stewart, Stoneman, Van Kampen, W. Young.

[21] See, e.g., Eccleston #2, Fedor, Kaplan, Lipner #2, Page #2, Perkins, PIABA #4, Shockman, Smiley.

[22] See e.g., Aidikoff, Brannan, Boliver #2, Carlson, Fedor, Kaufman, Lantagne, Lipner, PACE #2, Page #2, PIABA #3, PIABA #4, Robbins, Rothstein, Shockman, Smiley, Sonn #2, Tepper #2.

[23] Proposed Rule 12504 has been re-filed as a separate proposed rule change and published for public comment. See Securities Exchange Act Rel. No. 54360 (Aug. 24, 2006), 71 FR 51879 (Aug. 31, 2006) (SR-NASD-2006-088).

Amendments 5, 6, and 7 are included below. References to Amendments 5, 6, or 7 in this Section III refer to Amendments 5, 6, or 7 to the Customer Code only, unless otherwise specified. For the text of Amendments 5, 6, and 7, please see the NASD Web site at http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_009306&=802.

A. General Comments

In the Customer Code Notice, the Commission solicited comment on the differences between provisions in the Customer Code and their counterparts in the Uniform Code of Arbitration ("Uniform Code") developed by the Securities Industry Conference on Arbitration ("SICA").[24] One commenter favored the Uniform Code provisions over those of the Customer Code, stating that because NASD's arbitration program operates from a position of dominance, it has abandoned the premise of uniformity under which SICA operates.[25]

In Amendment 5, NASD responded that it participates actively in SICA and values the input of SICA participants. In some instances, however, the nature and volume of NASD's caseload require NASD to adopt rules either in advance of other SROs or that differ from other SROs'. NASD also stated that to gather a wide range of ideas and information, it regularly discusses rule proposals with the same constituencies represented at SICA: representatives of the investor and industry communities, as well as arbitrators and mediators.

B. Proposed Rule 12100 – Definitions

[24] SICA is a cooperative organization that is composed of public members, as well as representatives of the SROs and the Securities Industry Association. SICA works toward improving the dispute resolution process by considering current issues, case law, and policy in connection with arbitration, and amending the Uniform Code in light of those considerations when appropriate. SROs have often revised their own arbitration rules in accordance with changes in the Uniform Code.

[25] Ryder.

1. Definitions Added in Amendment 5

As noted above, the Customer Code includes a comprehensive definitions section. Two commenters suggested defining the term "customer" to help clarify jurisdictional and standing issues related to arbitration.[26] One commenter also suggested defining the term "pleadings" to assist pro se claimants to understand which documents are required for their arbitration claims.[27] Another commenter suggested defining the term "award" to minimize the confusion concerning what type of ruling by the panel constitutes an award.[28]

NASD proposed to define these terms in the Customer Code in Amendment 5.[29] As amended, Proposed Rule 12100 would define an "award" in paragraph (b) as "a document stating the disposition of a case." Paragraph (i) would define a "customer" as not including a broker or dealer. NASD noted that the definition of "customer" would be the same as that found in the general definitions for NASD rules, Rule 0129(g). Paragraph (s) of the rule would define a "pleading" as "a statement describing a party's causes of action or defenses. Documents that are considered pleadings are: a statement of claim, an answer, a counterclaim, a cross claim, a third party claim, and any replies."

2. Proposed Rule 12100(a) – Definition of Associated Person; Proposed Rule 12100(r) -- Definition of Person Associated with a Member

Proposed Rules 12100(a) and 12100(r) provide that, for purposes of the Customer Code, an associated person includes a person formerly associated with a member. One commenter

[26] PACE and Ryder.

[27] PACE.

[28] Ryder.

[29] As a result of these new definitions, the remaining definitions would be re-designated in alphabetical order.

suggested that, consistent with NASD By-Laws,[30] the concept of a formerly associated person should be limited to persons who have been associated within two years.[31] This commenter asserted that when read in conjunction with Proposed Rule 12200 (concerning mandatory arbitration), these definitions would subject formerly associated persons to NASD Dispute Resolution's jurisdiction in perpetuity. In the commenter's view, no NASD by-laws or NASD Dispute Resolution rules permit lifelong jurisdiction.

In Amendment 5, NASD responded that the two-year retention of jurisdiction in Article V, Section 4 of NASD's By-Laws is for NASD regulatory purposes and does not apply to arbitrations. In the arbitration context, NASD maintains jurisdiction over a formerly associated person for events that occurred while the person was associated with a member firm (or related to the person's termination of employment with a member firm, in the case of industry disputes). NASD noted that such arbitrations would be subject to any applicable statutes of limitation, as well as the six-year eligibility rule under Proposed Rule 12206. NASD thus is not proposing to amend Proposed Rules 12100(a) and 12100(r).

3. Proposed Rule 12100(u) -- Definition of Public Arbitrator; Proposed Rule 12100(p) -- Definition of Non-Public Arbitrator

NASD proposed to define "public arbitrator" and "non-public arbitrator" in the Customer Code the same way as in Rules 10308(a)(5) and (a)(4), respectively, of the current Code. Twenty-three commenters expressed concern with the definitions of public arbitrator and non-public arbitrator.[32] As a preliminary matter, they urged NASD to change the term "non-public

[30] See NASD By-Laws, Art. V, Sec. 4.

[31] SIA.

[32] Boliver, Canning, Caruso, Estell, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, Miller, PIABA, Pounds, Rosenfield, Sadler, Schultz #2, Shewan, Stoltmann, Sutherland, and Willner.

arbitrator" to "industry arbitrator." In their view, the current terminology is not consistent with the goal of rewriting the Customer Code in plain English. They suggested that the term "industry arbitrator" would assist pro se parties or inexperienced attorneys with no background in arbitration.

In Amendment 5, NASD noted that it has used the term "non-public arbitrator" since the Commission approved the Neutral List Selection System ("NLSS") in 1998.[33] NASD expressed the belief that users of its forum understand the term, and thus did not agree that the term should be changed.

Commenters also suggested several changes to the definition of "public arbitrator" and objected to the inclusion of a non-public arbitrator on three-person panels.[34] In Amendment 5, NASD responded that because it did not propose substantive amendments to these provisions in the Customer Code, those suggestions are outside the scope of the rule filing. The Commission notes that changes to the definition of "public arbitrator" are addressed in a separate rule filing.[35]

C. Proposed Rule 12102 – National Arbitration and Mediation Committee

Proposed Rule 12102 includes the size and composition requirements of the National Arbitration and Mediation Committee ("NAMC"). One commenter noted that these

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[33] See Securities Exchange Act Rel. No. 40555, 63 FR 56670 (Oct. 22, 1998) (SR-NASD-1998-48).

[34] Boliver, Canning, Caruso, Estell, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, Miller, PIABA, Pounds, Rosenfield, Sadler, Schultz #2, Shewan, Stoltmann, Sutherland, and Willner.

[35] The Commission recently approved the rule changes proposed in the rule filing. See Order Approving Proposed Rule Change and Amendment No. 1 Thereto Relating to Amendments to the Classification of Arbitrators Pursuant to Rule 10308 of the NASD Code of Arbitration Procedure, Securities Exchange Act Rel. No. 54607 (Oct. 16, 2006), 71 FR 62026 (Oct. 20, 2006) (SR-NASD-2005-094); Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Amendments to the Classification of Arbitrators Pursuant to Rule 10308 of the NASD Code of Arbitration, Securities Exchange Act Rel. No. 52332 (Aug. 24, 2005), 70 FR 51365 (Aug. 30, 2005) (SR-NASD-2005-094).

requirements are not in the current Code.[36] NASD responded in Amendment 5 that Proposed Rule 12102 would codify the requirements of the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries.[37]

D. Proposed Rule 12103 -- Director of Dispute Resolution

Proposed Rule 12103 includes a delineation of the duties and responsibilities of the Director of Dispute Resolution with respect to the NAMC. One commenter noted that the proposed rule would change the Director's relationship with the NAMC.[38] Specifically, the current Code provides that the Director "shall be directly responsible to the NAMC and shall report to it at periodic intervals established by the Committee and at such other times as called upon by the Committee to do so." The Customer Code provides that the Director "shall consult with the NAMC upon the NAMC's request."

In Amendment 5, NASD noted that the proposed rule reflects current practice. Pursuant to Article V, Section 5.1 of the NASD Dispute Resolution By-Laws, the Director reports to the President of NASD Dispute Resolution and, ultimately as an officer, to the NASD Dispute Resolution Board. The Director meets with the NAMC, usually every quarter, and updates the Committee on the state of the arbitration forum. At this time, the Director receives feedback and suggestions on arbitration rules and procedures from NAMC.

Another commenter expressed concern regarding provisions in Proposed Rule 12103 that would give the Director the authority to delegate certain functions.[39] In this commenter's experience, arbitrators seek out the advice of NASD staff on certain issues, such as subpoenas,

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[36] Ryder.

[37] See NASD Manual, Plan of Allocation and Delegation of Functions by NASD to Subsidiaries, Part V(c)(1)(b); Securities Exchange Act Rel. No. 37107 (Apr. 11, 1996) (SR-NASD-96-16).

[38] Ryder.

[39] Magary.

discovery matters, and motions. This commenter believes NASD staff should not provide opinions on such issues, but rather they should be addressed to the panel and, if necessary, argued by the parties.

NASD responded in Amendment 5 that its current policy is for staff to advise arbitrators on procedural matters, but not to provide opinions on substantive issues. If arbitrators ask staff about substantive matters, NASD staff suggest that the arbitrators ask the parties to brief the issue so that the arbitrators can make a decision. NASD stated that it would emphasize this policy when it trains its staff on the Customer Code.

E. Proposed Rule 12104 -- Effect of Arbitration on NASD Regulatory Activities

Proposed Rule 12104 provides that submitting a dispute to arbitration does not prevent NASD from taking additional regulatory action, if warranted. The rule would allow any arbitrator to make disciplinary referrals at the conclusion of an arbitration.

One commenter suggested that the proposed rule also should authorize regulatory sanctions for breaches of the procedural requirements of the arbitration rules.[40] In Amendment 5, NASD responded that because Proposed Rule 12104 is substantially the same as Rule 10105 of the current Code, the comment is outside the scope of the rule filing.

F. Proposed Rule 12105 -- Agreement of the Parties

As published in the Customer Code Notice, Proposed Rule 12105(a) would allow parties to modify a provision of the Code or a decision of the Director or the panel by written agreement. Proposed Rule 12105(b) provides that if the Director or the panel determines that a named party is inactive in the arbitration or has failed to respond after adequate notice has been given, the Director or the panel may determine that the written agreement of that party is not

[40] Ryder.

required while the party is inactive or not responsive. In the Customer Code Notice, the Commission requested comment on whether the term "inactive" is defined sufficiently.

While one commenter thought the concept of an "inactive" party is sufficiently clear,[41] others suggested specifying that an "inactive" party is a party in default for failure to file a response to a claim, counter-claim, or cross claim.[42]

In Amendment 5, NASD stated that based on current practices in its forum, the term "inactive" could apply to: (1) a party who answers and then fails to respond to administrative matters or correspondence; (2) a claimant who cannot be found, after the claimant's attorney withdraws; or (3) a party who does not answer. In Amendment 7, NASD proposed to include a non-exhaustive list inactive parties. Proposed Rule 12105 is amended in Amendment 7 as follows (new language in italics):

12105. Agreement of the Parties

(a) No change.

(b) If the Director or the panel determines that a named party is inactive in the arbitration, or has failed to respond after adequate notice has been given, the Director or the panel may determine that the written agreement of that party is not required while the party is inactive or not responsive. *For purposes of this rule, an inactive party could be, but is not limited to: (1) a party that does not answer; (2) a party that answers and then fails to respond to correspondence sent by the Director; (3) a party that answers and then fails to respond to correspondence sent by the panel in cases involving direct*

[41] PACE.

[42] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

communication under Rule 12211; or (4) a party that does not attend pre-hearing conferences.

G. Proposed Rule 12200 -- Arbitration Under an Arbitration Agreement or the Rules of NASD

1. Insurance Business Exception

Proposed Rule 12200 provides that parties must arbitrate a dispute under the Customer Code if (1) a written agreement requires it or the customer requests it; (2) the dispute is between a customer and a member or associated person of a member; and (3) the dispute arises in connection with the business activities of a member or associated person, unless the claims involve the insurance business activities of a member that is also an insurance company. Eighteen commenters argued that the rule could be read to exclude variable annuity claims from arbitration because some state statutes treat these products solely as insurance products, not securities.[43] In their view, the choice of whether to arbitrate variable annuity claims against NASD members should belong to the investor.

In Amendment 5, NASD noted that variable annuities are securities and are not excluded from arbitration under the exception for disputes involving the insurance business of a member that is also an insurance company in current Rule 10101 (concerning matters eligible for submission). According to NASD, no substantive change is intended in Proposed Rule 12200.

2. Requests by the Customer to Arbitrate

Under Proposed Rule 12200, parties must arbitrate if "requested by the customer," and if the other requirements of the rule are satisfied. One commenter suggested inserting the words

[43] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

"of the member" after the word "customer" in the proposed rule text.[44] This commenter asserted that this change would eliminate attempts by customers to demand arbitration of disputes against firms with which the customer does not have an account or other relationship. Another commenter opposed this suggestion because it could preclude "selling away" claims (allegations that an associated person engaged in securities activities outside his or her firm).[45] This commenter stated that substantial judicial precedent supports the right of a customer to file a selling away claim against the brokerage firm that employed such an associated person, even if the customer has no account with that firm.

In Amendment 5, NASD responded that adding the words "of the member" after the word "customer" would inappropriately narrow the scope of claims that are required to be arbitrated under the Customer Code. Further, NASD noted that because Proposed Rule 12200 is substantially the same as Rule 10301 of the current Code, the comment is outside the scope of the rule filing.

3. "Business Activities"

Rule 10301(a) of the current Code provides that a dispute, claim, or controversy arising in connection with the "business of" a member or the "activities of" an associated person is eligible for arbitration. In comparison, Proposed Rule 12200 would provide that disputes arising from the "business activities of the member or the associated person" must be arbitrated if the other conditions of the rule are satisfied. One commenter suggested that this change could alter the scope of disputes that members must arbitrate with customers, as well as the scope of the exception for disputes involving "insurance business activities" of a member.[46]

[44] SIA.

[45] Eccleston.

[46] Ryder.

In Amendment 5, NASD noted that Proposed Rule 12200 is substantively the same as Rule 10301 of the current Code and is not intended to change the scope of arbitrable disputes. NASD also proposed deleting the insurance company exception from Proposed Rule 12200, noting that it is included in Proposed Rule 12201.

NASD reconsidered this decision in Amendment 7, and again proposed to include the insurance business exception in Proposed Rule 12200. Rule 10101 of the current Code provides that insurance disputes are not eligible for arbitration,[47] and Rules 10201 and 10301 of the current Code delineate the eligible disputes that parties are required to arbitrate. According to NASD, the proposed rules in the Customer Code were rearranged to place the mandatory arbitration provision before the elective arbitration provision in the Customer Code. Because of this organization, NASD believes that clarity requires the insurance exception to be included in both provisions.

NASD also proposed to clarify in Amendment 7 that the term "business activities of a member" in Proposed Rule 12200 would include "selling away" claims. Under the current Code, NASD accepts cases brought by customers against associated persons in selling away cases, and cases by customers against the associated person's member firm if there is any allegation that the member was or should have been involved in the events, such as an alleged failure to supervise the associated person. As stated in Amendment 5, Proposed Rule 12200 is not intended to change the scope of arbitrable disputes. NASD reiterated in Amendment 7 that it would continue to accept these types of cases under the Customer Code.

[47] Rule 10101 provides, "This Code of Arbitration Procedure is prescribed and adopted pursuant to Article VII, Section 1(a)(iv) of the By-Laws of the Association for the arbitration of any dispute, claim, or controversy arising out of or in connection with the business of any member of the Association, or arising out of the employment or termination of employment of associated person(s) with any member, with the exception of disputes involving the insurance business of any member which is also an insurance company."

H. Proposed Rule 12201 -- Elective Arbitration

1. Business Activities

The elective arbitration provision of Proposed Rule 12201, like the mandatory arbitration provision of Proposed Rule 12200, describes the scope of disputes that parties may choose to arbitrate, if the other conditions of the rule are satisfied, as relating to the "business activities of a member or an associated person, except disputes involving the insurance business activities of a member that is also an insurance company." One commenter suggested that this phrasing, and in particular the term "business activities," could alter the scope of disputes that parties could elect to arbitrate.[48] This commenter viewed the reference to "business activities" of an associated person as a substantive change to the types of cases that parties may agree to arbitrate, stating that the phrase implies a "scope of employment" construction. This commenter also noted that including the "insurance company" exception in the elective arbitration rule implies that NASD cannot entertain the arbitration of such disputes, even if all the parties agree.

In Amendment 5, NASD disagreed with the commenter, stating that Proposed Rule 12201 is not intended to alter the scope of claims that currently are eligible for voluntary arbitration under Rule 10101 of the current Code. Thus, NASD did not propose to amend Proposed Rule 12201. (See also Section III.G.2, regarding selling away claims.)

2. Disclosures Regarding Insurance

Three commenters suggested that respondents should be required to disclose "the presence and amount of insurance, if applicable."[49] These commenters stated that small brokerage firms that have insurance are able to coerce small settlements by falsely claiming an inability to pay. Two commenters also stated, "[c]laimants, who are selecting arbitrators (some

[48] Ryder.

[49] Canning, Lipner, and Sutherland.

of whom have insurance affilations) need to know whether an insurance company lawyer is defending."[50] In Amendment 5, NASD stated that because Proposed Rule 12201 is substantively the same as Rule 10101 of the current Code, these comments are outside the scope of the rule filing.

I. Proposed Rule 12203 -- Denial of NASD Forum

Rule 10301(b) of the current Code provides that the Director of Arbitration, upon approval of the NAMC or its Executive Committee, may decline to permit the use of the NASD arbitration forum if the "dispute, claim, or controversy is not a proper subject matter for arbitration." Proposed Rule 12203(a) would provide that the Director "may decline to permit the use of the NASD arbitration forum if the Director determines that, given the purposes of NASD and the intent of the Code, the subject matter of the dispute is inappropriate, or that accepting the matter would pose a risk to the health or safety of arbitrators, staff, or parties or their representatives." To ensure that the authority to deny the forum could not be delegated by the Director, the rule would provide that only the Director or the President of NASD Dispute Resolution may exercise the Director's authority under the rule.

One commenter suggested that the proposed rule should clarify that if the Director or President denies the use of the forum, and if there is no alternative forum specified in the arbitration agreement, a customer can pursue his or her remedies in court.[51] In Amendment 5, NASD responded that it does not believe it is appropriate for NASD to offer an opinion as to any other remedies that a party might be able to pursue. Accordingly, NASD amended the title of the proposed rule to read "Denial of NASD Forum" to avoid the suggestion that it is under an obligation to refer a party to another forum.

[50] Canning, Lipner.

[51] PACE.

Another commenter expressed concern that the proposed rule would no longer require the Director to obtain the approval of the NAMC or the Executive Committee to deny access to the arbitration forum.[52] In Amendment 5, NASD stated that the proposed rule is intended to address circumstances that may require immediate resolution, such as security concerns and other unusual but serious situations, and in which the Director needs flexibility. Noting that the proposed rule provides that this authority may only be exercised by the Director or the President of NASD Dispute Resolution, NASD did not propose an amendment to Proposed Rule 12203 in connection with this comment.

J. Proposed Rule 12204 -- Class Actions

Rule 10301 of the current Code provides that a claim is not eligible for arbitration at NASD if it is (1) submitted as a class action, or (2) filed by a member or members of a putative or certified class action, if the claim is encompassed by a putative or certified class action filed in federal or state court, or is ordered by a court for class-wide arbitration at an arbitral forum not sponsored by an SRO. Such claims, however, may become eligible for arbitration at NASD if a claimant demonstrates that he or she has elected not to participate in the putative or certified class action or, if applicable, has complied with any conditions for withdrawing from the class prescribed by the court. Rule 10301 of the current Code also provides that a panel of arbitrators may hear disputes concerning whether a particular claim is encompassed by a putative or certified class action. Alternatively, either party may elect to petition the court with jurisdiction over the putative or certified class action to resolve such disputes. As published in the Customer Code Notice, Proposed Rule 12204 is intended to be substantively the same as Rule 10301.

[52] Ryder.

Eighteen commenters raised two interpretive issues with respect to the class action rule under the current Code.[53] First, they indicated that respondents may argue that any claim involving a security that is also the subject of a pending class action lawsuit is ineligible for arbitration. In their experience, respondents have offered this argument even though claims in the arbitration case are factually and legally distinguishable from those in the class action. They also stated that respondents that are not defendants in the class action may make motions to dismiss, citing this argument.

Second, the commenters argued that, although the current Code allows a party to opt out of the class action, it does not explain how a party can demonstrate to NASD that he or she is not participating in the class action, either before or after a class has been certified.

In Amendment 5, NASD proposed to clarify in Proposed Rule 12204(b) that only claims based on the same facts and law and that involve the same defendants as in a class action are not arbitrable. NASD also proposed to clarify in Proposed Rule 12204(b) the procedure a party would use to demonstrate to NASD that he or she is opting or has opted out of a class action. In particular, NASD proposed to amend Proposed Rule 12204 as follows (new language underlined; deleted language in [brackets]):

12204. Class Action Claims

(a) No change.

(b) [No claim that is included] Any claim that is based upon the same facts and law, and involves the same defendants as in a court-certified class action or a putative class action, or that is ordered by a court for class-wide arbitration at a forum not

[53] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

sponsored by a self-regulatory organization, [will] shall not be arbitrated under the Code, unless the party bringing the claim [shows] files with NASD one of the following:

(1) a copy of a notice filed with the court in which the class action is pending that [it is not participating] the party will not participate in the class action[,] or in any recovery that may result from the class action, or has withdrawn from the class according to any conditions set by the court[,if any]; or

(2) a notice that the party will not participate in the class action or in any recovery that may result from the class action.

(c) No change.

(d) No change.

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K. Proposed Rule 12206 -- Time Limits

Proposed Rule 12206 provides, in pertinent part, that claims are not eligible for arbitration under the Customer Code when six years have elapsed from the occurrence or event giving rise to the claim, and that the panel will resolve any questions regarding the eligibility of a claim. One commenter suggested eliminating the proposed rule.[54] In this commenter's view, the Customer Code should authorize the arbitration panel to apply relevant statutes of limitation instead. In Amendment 5, NASD responded that because Proposed Rule 12206 is substantively the same as Rule 10304 of the current Code, this comment is outside the scope of the rule filing.

[54] PACE.

One commenter suggested that NASD amend the proposed rule to state that it is not a statute of repose.[55] In Amendment 5, NASD responded that it believed the suggestion could make the proposed rule confusing and therefore declined to amend the rule on this issue.

L. Proposed Rule 12207 -- Extension of Deadlines

In relevant part, Proposed Rule 12207(c) provides that the Director may extend or modify any deadline set by the Code for good cause, or by the panel in extraordinary circumstances. Two commenters suggested that the standard for extending deadlines for answering the statement of claim should remain the same as under Rule 10314 of the current Code, which provides that extensions of the time to answer are disfavored and will not be granted by the Director except in extraordinary circumstances.[56] In their view, Proposed Rule 12207, when read together with Proposed Rule 12303, would be less stringent than the current standard.

In Amendment 5, NASD responded that it believes that having a single, uniform standard for extensions of deadlines by the Director simplifies the Customer Code and is in the public interest. Such extensions would not be automatic upon request but would require respondents to demonstrate that they have good cause for seeking an extension of time to answer the statement of claim.

One commenter noted that the proposed rule would give the Director authority to override a panel deadline.[57] Even though this rule would expressly limit this authority to extraordinary circumstances, the commenter questioned the Director's need for this authority and for overriding a case-specific ruling made by a panel.

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[55] Magary.

[56] Canning and Feinberg.

[57] Ryder.

NASD responded that the phrase "extraordinary circumstances" would encompass such unexpected and uncontrollable events as a weather-related or security emergency. NASD noted that there have been instances, such as hurricanes and terrorist attacks, when NASD Dispute Resolution offices had to be evacuated, the offices of parties and counsel were damaged, and hearings could not be held safely. NASD believes that in such situations, the Director needs the authority to postpone deadlines until order is restored. For the above reasons, NASD is not proposing to amend Proposed Rule 12207 at this time.

M. Proposed Rule 12212 – Sanctions

Rule 10305(b) of the current Code (Dismissal of Proceedings) provides that the "arbitrators may dismiss a claim, defense, or proceeding with prejudice as a sanction for willful and intentional material failure to comply with an order of the arbitrator(s) if lesser sanctions have proven ineffective." In addition, the NASD Discovery Guide ("Discovery Guide") states that "[t]he panel has wide discretion to address noncompliance with discovery orders." Proposed Rule 12212 would incorporate and codify these current sanctions provisions and extend them beyond the discovery context to apply to non-compliance with any provision of the Code, or order of the panel or a single arbitrator authorized to act on behalf of the panel. NASD stated that this rule change would encourage parties to comply with both the Customer Code and orders of the panel, and would also clarify the authority of arbitrators to ensure the fair and efficient administration of arbitration proceedings when parties do not comply.

1. Procedural Guidance

Two commenters stated that Proposed Rule 12212 grants broad authority to the panel to impose sanctions without providing guidance on how and when sanctions should be applied.[58]

[58] Ragsdale and SIA.

One of these commenters suggested that the lack of procedural and substantive standards creates the risk that sanctions will become a routine part of arbitration practice.[59] This commenter urged NASD to, among other things, require notice and an opportunity to be heard and eliminate the panel's authority to sanction a party for failing to comply with any provision of the Customer Code.

In Amendment 5, NASD explained that the panel has the authority to control all aspects of an arbitration, and, therefore, must have the ability to enforce the rules of the forum as well as its orders. Therefore, the proposed rule specifically provides that the panel has the authority to impose sanctions for violations of any provision of the Customer Code. NASD believes that underscoring the panel's authority will deter parties from violating the Customer Code and from employing abusive tactics, which require considerable time and effort to address. In turn, NASD believes reducing the incidence of violations and abusive tactics will expedite arbitrations. NASD also stated that it intends to provide guidance in arbitrator training materials on the Customer Code on how and when this proposed rule should be applied.

2. Sanctions Between the Time a Claim Is Filed and the Time a Panel Is Selected

One commenter expressed support for Proposed Rule 12212 but noted that no panel is available to enforce compliance with the provisions of the Customer Code between the time a claim is filed and the time a panel is selected.[60] This commenter suggested amending the proposed rule to provide explicit authority to a single arbitrator appointed during this time, or the panel, once appointed, to sanction parties for abusive or violative conduct that may occur during this time.

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[59] SIA.

[60] PACE.

In Amendment 5, NASD stated that Proposed Rule 12212 would give the panel discretion to impose sanctions for any violations of the Customer Code, regardless of when they occurred. For this reason, NASD is not proposing to amend the proposed rule at this time.

3. Disciplinary Referrals

One commenter suggested that Proposed Rule 12212 should emphasize that a panel can make a disciplinary referral for a violation of NASD rules that either occurred during an arbitration or is related to conduct addressed as a claim in arbitration.[61] In Amendment 5, NASD explained that it intends to address the use of disciplinary referrals in NASD arbitrator training materials on the Customer Code.

4. Other Comments

One commenter noted that a party cannot appeal an abusive or excessive ruling, and that arbitrators are not required to explain their decision to impose sanctions.[62] This commenter suggested amending Proposed Rule 12212 to require forum fees to be assessed against respondents, except when a claim is brought in bad faith. This commenter also suggested requiring the panel to explain its findings if it assesses fees against a party.

In Amendment 5, NASD responded that a panel's rulings cannot be appealed under the Customer Code, and NASD is not proposing to create an appellate process. NASD stated that parties may ask the arbitrators to explain their imposition of sanctions in the award. It also noted that, as under the Customer Code, parties may seek to vacate or modify an award under the Customer Code on grounds provided by applicable federal or state arbitration laws. Although sanctions are rarely imposed, NASD intends to recommend in arbitrator training that arbitrators

[61] Magary.

[62] Ragsdale.

provide a written explanation for any sanctions in the award. Thus, NASD is not proposing to amend Proposed Rule 12212 at this time.

N. Proposed Rule 12213 – Hearing Locations

Proposed Rule 12213 provides that the Director generally will select the hearing location closest to the customer's residence at the time of the events giving rise to the dispute. The proposed rule also would clarify that before arbitrator lists are sent to the parties under Rule 12403, the parties may agree in writing to a different hearing location other than the one selected by the Director, and that the Director may change the hearing location upon motion of a party.

One commenter supported the proposed rule but expressed concerned that a pro se customer might be discouraged from submitting an arbitration claim because the customer could not afford to travel to a distant hearing location.[63] This commenter suggested that NASD amend the proposed rule to clarify that a customer may request a more convenient hearing location upon filing a claim.

In Amendment 5, NASD noted that Proposed Rule 12213 is substantively the same as Rule 10315 of the current Code and stated that the commenter's suggested change may provide customers with the false impression that their request will be the only factor used to determine where the hearing is held. Currently, parties may request a hearing location, and this request is considered along with other factors in determining the hearing location for an arbitration. This practice would not change under the Customer Code.

NASD also noted that the panel, once appointed, would have the authority to change the hearing location. Although this authority is already included in Proposed Rule 12503(c)(2), NASD stated that it would be logical to include this authority in Proposed Rule 12213, as well.

[63] PACE.

Therefore, NASD proposed to amend Proposed Rule 12213 as follows (new language underlined):

12213. Hearing Locations

(a) U.S. Hearing Location

(1) No change.

(2) No change.

(3) No change.

(4) After the panel is appointed, the panel may decide a motion relating to changing the hearing location.

(b) Foreign Hearing Location

No change.

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O. Proposed Rule 12300 -- Filing and Serving Documents; Proposed Rule 12302 -- Filing an Initial Statement of Claim

Under the current Code, initial statements of claim are filed with the Director and served on the other parties by the Director. This procedure would be the same under Proposed Rules 12300 and 12302. Two commenters suggested that the proposed rules should allow a claimant to directly serve the respondent with the statement of claim and the uniform submission agreement.[64] In their view, this would be especially helpful to a claimant when time is of the essence.

In Amendment 5, NASD noted that Proposed Rules 12300 and 12302 do not change the current process for serving claims. It also explained that it currently tries to serve claims as

[64] Canning and Feinberg.

quickly as possible, and if its staff is notified that a party is elderly or infirm, NASD will try to expedite the process even further.[65]

One commenter suggested that NASD amend Proposed Rule 12302 to state that the statement of claim is not required to plead legal causes of action or legal theories.[66] In Amendment 5, NASD responded that because Proposed Rule 12302 is substantially the same as paragraphs (1) and (2) of Rule 10314(a) of the current Code, the comment is outside the scope of the rule filing.

P. Proposed Rule 12301 -- Service on Persons Currently Associated with a Member

Proposed Rule 12301 provides that service on an associated person may be made either on the member or directly on the associated person. If service is made on the member, the member would be required to serve the associated person, even if the member would not be representing the associated person in the arbitration. One commenter noted that the proposed rule is not limited to use by the Director or to initial pleadings.[67] The commenter noted that Proposed Rule 12301 would allow a claimant to serve all documents only on the member, which could cause confusion if the member and associated person are separately represented. It also would delay service on the associated person. Thus, the commenter suggested amending the proposed rule to apply only to service of initial pleadings, or only to the Director for service of statements of claim.

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[65] See Press Release, NASD, NASD Implements Expedited Dispute Resolution Proceedings for Elderly or Seriously Ill Parties (Jun. 18, 2004), available at http://www.nasd.com/PressRoom/NewsReleases/2004NewsReleases/NASDW_002820.

[66] PACE.

[67] SIA.

In Amendment 5, NASD responded that it did not intend to make any substantive changes from the current Code, which permits (but does not require) the Director to serve statements of claim on currently employed associated persons through their firms when the associated person and the firm are both respondents. NASD stated that in practice, it rarely uses this form of service. NASD nonetheless proposed to clarify the proposed rule to reflect current procedure and to specify that only the Director may serve associated persons by serving the member, and that this method of service may only be used for initial statements of claim. Proposed Rule 12301, as amended in Amendment 5, provides (new language underlined; deleted language in [brackets]):

12301. Service on Associated Persons [Currently Associated with a Member]

(a) [If a member and a person currently associated with the member are named as respondents to the same arbitration,] The Director will serve the initial statement of claim on [service on the person] an associated person [with the member] directly at the person's residential address or usual place of abode [may be made on the member or directly on the associated person]. If service cannot be completed at the person's residential address or usual place of abode, the Director will serve the initial statement of claim on the associated person at the person's business address.

(b) If a member and a person currently associated with the member are named as respondents to the same arbitration, and the Director cannot complete service as provided in paragraph (a), then the Director may serve the member with the initial statement of claim on behalf of the associated person. If service is made on the member, the member must serve the associated person, even if the member will not be representing the associated person in the arbitration. If the member is not representing the associated

person in the arbitration, the member must notify, and provide the associated person's current address to, all parties and the Director.

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Q. Proposed Rule 12307 -- Deficient Claims

Proposed Rule 12307 provides that the Director will not serve any claim that is deficient and lists the reasons that a claim may be deficient. In the Customer Code Notice, the Commission specifically asked for comment on whether any changes intended to be nonsubstantive were actually substantive. In the event commenters identified substantive changes, the Commission asked why they are substantive, how they will affect the arbitration process or the rights of the parties, and whether they are an improvement over the current Code.

Several commenters stated that Proposed Rule 12307 represents a substantive change and is biased in favor of respondents.[68] They explained that if claimants file a deficient claim, the arbitration would be delayed until all deficiencies are corrected, and if the respondent files a deficient answer the claims also would be delayed. They suggested amending the rule to provide that deficient filings by respondents shall not delay the service of the arbitrator list selection materials, so as not to delay the case. Similarly, some commenters suggested that NASD should not transmit a deficient answer and gave as examples respondents' failure to submit a uniform submission agreement, or filing of a one-page denial as an initial answer, and subsequent submission of an amended answer.[69] These commenters also argued that there should be uniformity in application of the proposed rule.

[68] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

[69] Meissner.

Two commenters expressed concern that the sanctions imposed on respondents under Proposed Rule 12308 (Loss of Defenses Due to Untimely or Incomplete Answer) are not the same as those imposed on claimants for similar conduct.[70] They noted that if a claimant fails to file a uniform submission agreement, then NASD would consider the claim to be deficient under Proposed Rule 12307, but if the respondent fails to file a uniform submission agreement, the arbitration would proceed. These commenters suggested that NASD amend Proposed Rule 12308 to require respondents to submit a uniform submission agreement in a timely manner. They also suggested that NASD not transmit the answer to arbitrators unless the respondent files a uniform submission agreement, and that respondents should be precluded from engaging in any arbitration-related activity until they file the uniform submission agreement.

In Amendment 5, NASD confirmed that a deficient claim would not be processed until the deficiencies are corrected, and that the same is not true if a respondent's answer is deficient. NASD explained that it does not have a mechanism to delay or prevent service of answers because while it serves initial statements of claim, it does not serve answers. NASD further responded that the proposed rule codifies current deficiency practice. NASD noted that, nonetheless, a respondent could lose the ability to assert any claims or defenses at the hearing under Proposed Rule 12308 for an untimely or deficient answer and also could be subject to sanctions under Proposed Rule 12212. Therefore, NASD is not proposing to amend the proposed rule at this time based on these comments but stated that it would consider them when determining whether future amendments are warranted.

R. Proposed Rule 12308 – Loss of Defenses Due to Untimely or Incomplete Answer

[70] Canning and Feinberg.

One commenter, citing the proposed definition of "claim," stated that Proposed Rule 12308(a) could impose a severe penalty, including default proceedings under Proposed Rule 12801, for failure to answer any allegation regardless of materiality, a party's ability to investigate by the time the answer is due, or the "boilerplate" nature of the allegation.[71]

In Amendment 5, NASD noted that Proposed Rule 12308 is substantially the same as Rule 10314(b)(2) of the current Code and that the comments made on this issue are outside the scope of the rule filing. In Amendment 7 NASD further explained that Rule 10314(b)(2)(C) of the current Code, which is the basis for Proposed Rule 12308(a), is meant to address the timeliness of the answer, rather than its completeness. It stated that the other provisions of Rule 10314(b)(2)(C), addressing completeness, were included in Proposed Rule 12308(b). NASD also proposed in Amendment 7 to clarify that: (1) the listed sanctions apply only if a party does not file an answer within the time period specified in the Code; and (2) default proceedings apply only if the other conditions of Proposed Rule 12801, such as a member's expulsion from NASD, for example, are met. The proposed rule is amended as follows (new language underlined; deleted language in [brackets]):

12308. Loss of Defenses Due to Untimely or Incomplete Answer

(a) If a party [fails to] does not answer [any claim] within the time period specified in the Code, the panel may, upon motion, bar that party from presenting any defenses or facts at the hearing, unless the time to answer was extended in accordance with the Code. The party may also be subject to default proceedings under Rule 12801, if the conditions of Rule 12801(a) apply.

(b) No change.

[71] SIA.

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S. <u>Proposed Rule 12309 -- Amending Pleadings; Proposed Rule 12310 – Answering Amended Claims</u>

Rule 10314 of the current Code establishes the general procedures for filing initial pleadings and answers. Rule 10328 of the current Code pertains to amended pleadings and their responses. Two commenters reported that under the current Code, respondents attempt to prevent claimants from submitting a response to amended pleadings by alleging that Rule 10314 only allows the claimant to reply to a counterclaim, even though Rule 10328 of the current Code permits any party to submit a response to any amended pleading, in accordance with Rule 10314(b).[72] They suggested that NASD amend Proposed Rule 12310, which pertains to answering amended claims, to clarify that all parties have a right to file a response to any amended pleading, as currently permitted by Rule 10328.

In Amendment 5, NASD responded that it did not intend to change current practice in the Customer Code. NASD explained that Rule 10314 neither prohibits nor permits the practice of responding to amended pleadings.[73] NASD proposed to revise Proposed Rule 12309 to clarify that all parties have a right to file a response to any amended pleading. The proposed rule would allow 20 days from the receipt of the amended pleading for the service of the response, unless the panel determines otherwise. NASD also proposed to clarify in Proposed Rule 12309(a)(1) that the service requirements of Proposed Rule 12300 (Filing and Serving Documents) also apply to Proposed Rule 12309. The proposed rule change is amended as follows (new language <u>underlined</u>):

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[72] Canning and Meissner.

[73] Telephone conversation among Jean Feeney, Vice President, NASD; Mignon McLemore, Assistant Chief Counsel, NASD Dispute Resolution; Lourdes Gonzalez, Assistant Chief Counsel – Sales Practices, Division of Market Regulation, SEC; and Gena Lai, Special Counsel, Division of Market Regulation, SEC (Dec. 1, 2006).

12309. Amending Pleadings

(a) Before Panel Appointment

Except as provided in paragraph (c), a party may amend a pleading at any time before the panel has been appointed.

(1) To amend a statement of claim that has been filed but not yet served by the Director, the claimant must file the amended claim with the Director, with additional copies for each arbitrator and each other party. The Director will then serve the amended claim in accordance with Rules 12300 and 12301.

(2) No change.

(b) No change.

(c) No change.

(d) Responding to an Amended Pleading

Any party may file a response to an amended pleading, provided the response is filed and served within 20 days of receipt of the amended pleading, unless the panel determines otherwise.

* * * * *

T. Proposed Rule 12310 -- Answering Amended Claims

Proposed Rule 12310 establishes the procedural requirements for answering amended claims. One commenter noted that the proposed rule would give a respondent 20 days to answer an amended statement of claim and suggested that NASD amend the proposed rule so that the 20-day period would be calculated from the respondent's receipt of the amended statement of claim.[74]

[74] SIA.

In Amendment 5, NASD responded that, as part of the initiative to standardize time limits in the Customer Code, the time to answer an amended claim was extended from 10 business days to 20 calendar days. Thus, a respondent would have more time to respond to an amended claim under the Customer Code that under the current Code. Therefore, NASD is not proposing to amend the proposed rule at this time.

U. Proposed Rule 12312 -- Multiple Claimants; Proposed Rule 12313 -- Multiple Respondents

Proposed Rules 12312 and 12313 set forth standards by which parties or claims may be joined in the same arbitration case. Proposed Rule 12312 provides that one or more parties may join multiple claims in the same arbitration if the claims contain common questions of law and fact and the claims: (1) assert any right to relief jointly and severally; or (2) arise out of the same transaction or occurrence, or series of transactions or occurrences. Proposed Rule 12313 provides that one or more parties may name one or more respondents in the same arbitration if the claims contain any questions of law or fact common to all respondents and the claims: (1) assert any right to relief jointly and severally; or (2) arise out of the same transaction or occurrence, or series of transactions or occurrences. Both proposed rules also provide that the Director may separate claims into two or more cases and establish procedures for parties to appeal the Director's action.

1. "Joint and Several Relief"

Two commenters compared Rule 10314(d) of the current Code and Proposed Rules 12312 and 12313 to Rule 20 of the Federal Rules of Civil Procedure (Permissive Joinder of Parties) ("FRCP Rule 20").[75] In their view, Proposed Rules 12312 and 12313 do not track FRCP

[75] Krosschell and SIA. FRCP Rule 20 provides "All persons may join in one action as plaintiffs if they assert any right to relief jointly, severally, or in the alternative in respect of or arising out

Rule 20 correctly. They explained that parties seeking to join claims or respondents under FRCP Rule 20 must satisfy two criteria: (1) the parties' claims must have arisen out of the same transaction or occurrence or series of transactions or occurrences; and (2) the claims must contain common questions of law or fact. Both commenters argued that joint and several relief should not be an alternative to the "same transaction or occurrence or series of transactions or occurrences" requirement, and therefore should be deleted from the rule. They also stated that Proposed Rules 12312 and 12313 substantively change the joinder requirements for multiple parties contained in Rule 10314(d).

In Amendment 5, NASD responded that the joinder requirements in Proposed Rules 12312 and 12313 were not intended to differ in substance from those in Rule 10314(d). In NASD's view, the reference to joint and several relief in FRCP Rule 20 and Rule 10314(d) of the current Code is an alternative requirement to the "same transactions or occurrences" requirement and is appropriately written in the alternative in the proposed rules. Therefore, NASD did not propose changes to the proposed rules on this issue.

2. Standards for Severing Claims

Proposed Rule 12312(b) provides that after all responsive pleadings have been served, claims joined together under paragraph (a) of the rule may be separated into two or more arbitrations by the Director before a panel is appointed, or by the panel after the panel is appointed. One commenter argued that Proposed Rule 12312(b) would give the Director unfettered discretion to sever claims, without providing any standards for doing so.[76] This commenter also contended that severing claims could impose a financial hardship on some

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of the same transaction, occurrence, or series of transactions or occurrences and if any question of law or fact common to all these persons will arise in the action."

[76] Magary.

parties. The commenter suggested that NASD amend the proposed rule to incorporate the standards used to determine when to sever a claim.

In Amendment 5, NASD explained that Proposed Rules 12312 and 12313 provide the standard for when cases may be joined. Conversely, cases involving multiple claimants or multiple respondents that do not meet these criteria may be severed. NASD explained that it did not intend to change the current policy that the Director's decision to consolidate claims is preliminary and may be reconsidered by the panel. The Director's decision to sever claims also is preliminary. Accordingly, in Amendment 5, NASD proposed to clarify the current procedure for appealing the Director's decision to sever claims. Because there are at least two surviving panels when the Director severs claims, multiple panels could review the Director's decision, with potentially conflicting results. To avoid inconsistent results and to expedite the arbitration process, NASD currently forwards any motion to rejoin severed claims to the panel on the lowest numbered case (i.e., the panel from the first-filed claim in the matter that was severed) to decide a motion to re-join the claims. In Amendment 5, NASD amended Proposed Rules 12312(b) and 12313(b) as follows to codify current practice (new language underlined):

12312. Multiple Claimants

(a) No change.

(b) After all responsive pleadings have been served, claims joined together under paragraph (a) of this rule may be separated into two or more arbitrations by the Director before a panel is appointed, or by the panel after the panel is appointed. A party whose claims were separated by the Director may make a motion to the panel in the lowest numbered case to reconsider the Director's decision.

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12313. Multiple Respondents

(a) No change.

(b) After all responsive pleadings have been served, claims joined together under paragraph (a) of this rule may be separated into two or more arbitrations by the Director before a panel is appointed, or by the panel after the panel is appointed. A party whose claims were separated by the Director may make a motion to the panel in the lowest numbered case to reconsider the Director's decision.

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3. Greater Panel Discretion to Join Claims

One commenter expressed concern that the changes to Proposed Rule 12312 would prevent the joinder of claimants in certain situations, which would result in added expense and repetitious hearings for the parties.[77] The commenter argued that the proposed rule should be revised to give a panel more discretion to join claims if it would save time and money and not be unreasonably prejudicial to the parties. In Amendment 5, NASD responded that the joinder requirements in Proposed Rules 12312 and 12313 were not intended to differ in substance from those in Rule 10314(d), and that therefore this comment is outside the scope of the rule filing.

V. Proposed Rule 12314 – Combining Claims

Proposed Rule 12314 provides that before ranked arbitrator lists are due to the Director under Proposed Rule 12404(c), the Director may combine separate but related claims into one arbitration. Once a panel has been appointed, the panel may reconsider the Director's decision upon motion of a party. One commenter expressed concern that the panel would no longer have

[77] Greco.

the authority to review the Director's decision to sever or consolidate claims sua sponte.[78] In this commenter's view, the Director has preliminary authority to make rulings on these issues, but the panel has plenary authority to review any such rulings.

In Amendment 5, NASD disagreed with the commenter and stated that, under Rule 10314(d) of the current Code and current practice, panels review these rulings upon a motion of a party.

W. Proposed Rule 12400 – Neutral List Selection System and Arbitrator Rosters

1. Proposed Rule 12400(a) -- Neutral List Selection System

Nineteen commenters suggested that NASD hire a neutral third-party, not connected to NASD or the securities industry, to conduct an annual audit of NLSS[79] and make the results of the audit publicly available on NASD's Web site.[80]

In Amendment 5, NASD responded that it is committed to ensuring that its list selection system operates as described in the Customer Code. Thus, NASD stated that it plans to hire an independent auditor to conduct an initial audit of the system and will make public the results of the audit. NASD stated that thereafter, it will conduct audits on an as-needed basis.

2. Proposed Rule 12400(b) -- Arbitrator Rosters

[78] Ryder.

[79] NLSS is the computer program NASD Dispute Resolution uses to appoint arbitrators. NASD Dispute Resolution is upgrading its computer technology platform, in what is known as the MATRICS Computer Project. MATRICS stands for Mediation and Arbitration Tracking and Retrieval Interactive Case System. MATRICS will replace two legacy case management systems, NLSS and CRAFTIS, the software application that NASD Dispute Resolution uses to support its case administration functions.

[80] Boliver, Canning, Estell, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

As published in the Customer Code Notice, Proposed Rule 12400(b) provides that NASD will maintain three separate arbitrator rosters: one of public arbitrators who may serve as a chairperson of a panel ("chair-qualified"), one of public arbitrators not eligible to serve as a chairperson ("non-chair public"), and one of non-public arbitrators. Lists would be generated from these rosters and sent to the parties so that the parties may select their arbitrators. Chair-qualified public arbitrators would not be included in the non-chair public roster. The Commission solicited comment on whether this approach would limit the pool of arbitrators available to serve on panels, particularly in regions where relatively few arbitrators are available, and whether chair-qualified arbitrators should be permitted to serve in a non-chair capacity, as well.

Twenty-three commenters stated that excluding chair-qualified arbitrators from the non-chair public arbitrator roster would decrease the pool of experienced, knowledgeable public arbitrators, particularly in regions of the country where the size of the arbitrator pool is already limited.[81] Many of these commenters also asserted that arbitration panels selected under this approach would have less overall experience and expertise than current panels, which would be bad for all parties.

Eighteen commenters stated that the proposed rule would create a class of "professional" arbitrators who would strive for the appearance of fairness to both sides by issuing more compromise awards.[82] In Amendment 5, NASD disagreed, stating that the random selection function of the list selection system would allow the full use of the entire arbitrator pool. NASD

[81] Boliver, Canning, Evans, Feldman, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, Miller, PACE, PIABA, Pounds, Rosenfield, Schwab, Shewan, Stolle, Stoltmann, Sutherland, and Willner.

[82] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

also noted that all arbitrators take an oath in which they affirm their neutrality and ability to decide a matter fairly, and that NASD expects all arbitrators to adhere to these basic principles, regardless of their classification.

NASD further stated in Amendment 5 that it believes chair-qualified arbitrators should be included in the non-chair public roster, as well as in the chair-qualified roster. Therefore, it proposed to amend Proposed Rule 12400(b) to adopt this approach.[83] NASD also clarified that its list selection software would be programmed so that no arbitrator's name would appear on both the chair-qualified and non-chair public lists sent to the parties for arbitrator selection in a particular case. NASD believes this approach would provide users of the forum with access to the most experienced public arbitrators.

The proposed rule, as amended in Amendment 5, is as follows (new language underlined; deleted language in [brackets]):

12400. Neutral List Selection System and Arbitrator Rosters

(a) Neutral List Selection System

No change.

(b) Arbitrator[s] Rosters

NASD maintains the following roster of arbitrators:

- A roster of non-public arbitrators as defined in Rule 12100(n);
- A roster of public arbitrators as defined in Rule 12100(r); and
- A roster of arbitrators who are eligible to serve as chairperson of a panel as described in paragraph (c). Arbitrators who are eligible to serve as

[83] NASD also proposed to amend the title of Proposed Rule 12400(b) to correct a typographical error.

chairperson will also be included in the roster of public arbitrators, but will only appear on one list in a case.

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Subsequent to the filing of Amendment 5 with the Commission, one commenter expressed opposition to NASD's proposal to include chair-qualified arbitrators with non-chair public arbitrators on the non-chair public roster.[84] This commenter included statistical models in support of his position that chair-qualified arbitrators would be selected more frequently than non-chair public arbitrators. This commenter also asserted that chair-qualified arbitrators would become "professional" arbitrators.

In Amendment 7, NASD declined to comment on the statistical analysis provided by the commenter, stating that the hypothesized outcome was speculative. NASD explained that it believes having arbitrators with the most experience serving more frequently on panels would be in the public interest. Moreover, NASD stated that the proposed standards to become eligible to serve as chair-qualified arbitrators are reasonable and necessary to provide investors with access to well-qualified arbitrators. NASD believes this proposal will enhance the efficiency of the arbitration process. Therefore, NASD declined to amend the proposed rule on this issue.

Subsequent to Amendment 7, this commenter submitted a second letter reiterating his arguments and providing additional information.[85] The Commission staff obtained data from NASD relating to the number of arbitrators at each NASD hearing location, including the number of arbitrators who are classified as "public" under the definition found in rule 10308(a)(5) of the current Code, and who would be classified as chair-qualified under Proposed

[84] See Bernstein.

[85] See Letter from Scot D. Bernstein, Esq. and C. Thomas Mason III, Esq., dated Oct. 20, 2006.

Rule 12100(u) of the Customer Code.[86] Applying the formulas provided in the letter, the Commission staff determined that NASD's proposal to include chair-qualified arbitrators with non-chair public arbitrators in the non-chair public roster would not in all circumstances increase the frequency of chair-qualified arbitrators being appointed to panels. Moreover, even assuming that the odds would increase in certain circumstances, the staff could not find empirical evidence to indicate that the increased odds would result in bias in the NASD arbitration forum or otherwise outweigh the benefit of the increased training and experience among arbitrators.

3. Proposed Rule 12400(c) -- Eligibility for Chairperson Roster

To be chair-qualified, Proposed Rule 12400(c) would require an arbitrator to complete the NASD training program or have "substantially equivalent training or experience," and be either: (1) an attorney who has sat through two SRO arbitration cases through the award stage; or (2) a non-attorney who has sat through at least three such cases. Twenty-five commenters opposed the creation of the chair-qualified roster and questioned the eligibility requirements.[87] One commenter supported the concept of the chair-qualified roster but criticized the eligibility requirements.[88] Commenters' key concerns were that: (1) the term "substantially equivalent training or experience" is not defined and allows for subjective interpretation, which could lead to inexperienced persons serving as chairs; (2) the chair roster would create a class of "professional arbitrators" who would strive for the appearance of fairness to both sides by

[86] See Letter from Linda D. Fienberg, President, NASD Dispute Resolution, to Catherine McGuire, Chief Counsel, Division of Market Regulation, SEC, dated Nov. 9, 2006.

[87] Boliver, Canning, Caruso, Estell, Evans, Greco, Ilgenfritz, Josel, Komninos, Lapidus, Layne, Lea, Lipner, Lopez, Magary, Meissner, Miller, PIABA, Pounds, Rosenfield, Sadler, Shewan, Stoltmann, Sutherland, and Willner.

[88] PACE.

issuing more compromise awards;[89] and (3) a law degree and litigation experience are better predictors of chair qualification than serving as an arbitrator on two or three cases.

In Amendment 5, NASD stated that it believes that the term "substantially equivalent training or experience" was defined sufficiently in the narrative portion of its rule filing. In particular, the rule filing states that "substantially equivalent training or experience would include service as a judge or administrative hearing officer, chairperson training offered by another recognized dispute resolution forum, or the like." NASD also noted that other factors, such as peer, party, and staff evaluations and a willingness to serve as chair, would be used in determining whether an arbitrator should be added to the chair roster. It stated that while these standards would require the use of judgment, the Commission oversees NASD for its compliance with its own rules. NASD also stated that it does not plan to grandfather any current arbitrators solely because they may have served as chairs on previous panels.

In addition, NASD stated that it believes the requirement that an arbitrator serve on at least three arbitrations through award to be eligible for the chair roster is an objective standard that is easily measured,[90] though not easy to meet. NASD stated that of the arbitration cases filed in the past four years, approximately 22% went to hearing.[91] NASD believes that the experience and training gained in the time it takes to serve on three hearings through award should qualify an arbitrator to serve as a chair, even without legal training or experience.

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[89] See NASD's response to comments regarding professional arbitrators in Section III.W.2, Proposed Rule 12400(b) (Arbitrator Rosters), above.

[90] Similarly, the requirements that the chair have a law degree and be a member of the Bar are also objective standards, subject only to verification.

[91] NASD stated that this average is based on data on NASD's Web site under Dispute Resolution Statistics, How Arbitration Cases Close (visited Apr. 13, 2006) at <http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=516&ssSourceNodeId=12>.

For the reasons stated above, NASD is not proposing to amend the proposed rule change in connection with these issues.

X. Proposed Rule 12401 – Number of Arbitrators

As published in the Customer Code Notice, Proposed Rule 12401 provides that in cases involving claims of more than $25,000 but not more than $50,000, the panel will consist of one arbitrator, unless any party requests a panel of three arbitrators. One commenter suggested that NASD amend the proposed rule to increase the limit for a single arbitrator panel to $150,000 or more.[92] In this commenter's view, the current limitation of $25,000 is antiquated, and there is no empirical evidence to suggest that a single arbitrator cannot decide a claim involving a larger amount in dispute. In Amendment 5, NASD responded that, although this comment is beyond the scope of the rule filing, it would consider it when determining whether future amendments are warranted.

In Amendment 7, NASD amended Proposed Rule 12401(b) to require that the request for a three-arbitrator panel be made in a party's initial pleading. NASD stated that proposed change would codify current practice in the forum.[93] The proposed rule is amended as follows (new language underlined):

12401. Number of Arbitrators

(a) Claims of $25,000 or Less

No change.

[92] Caruso.

[93] See Rule 10308(b)(1)(A)(ii) of the current Code.

(b) Claims of More Than $25,000 Up To $50,000

If the amount of a claim is more than $25,000 but not more than $50,000, exclusive of interest and expenses, the panel will consist of one arbitrator unless any party requests a panel of three arbitrators in its initial pleading.

(c) Claims of More Than $50,000; Unspecified or Non-Monetary Claims

No change.

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Y. Proposed Rule 12403 -- Generating and Sending Lists to Parties; Proposed Rule 12404 – Striking and Ranking Arbitrators

Under the current Code, NLSS provides the parties with a list of five names for a single arbitrator customer case, and one list of ten public arbitrators and one list of five non-public arbitrators for a three-arbitrator case.[94] Once the parties receive the lists, they begin the process of selecting the members of their panel by striking arbitrators from each list and ranking the remaining ones.

1. Reducing Need for Extended Lists

Currently, the parties have an unlimited number of strikes, which they may exercise for any reason. This often results in so many strikes by both sides that an insufficient number of names remain on the list to fill a panel. When this happens, NLSS must generate additional names in the appropriate public/non-public categories and "extend" the list to fill the panel.

[94] The Commission approved NASD's generating lists of only three names per arbitrator slot in the smaller hearing locations. See Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 3 and 4 to Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Selection of Arbitrators in Arbitrations Involving Public Customers, Securities Exchange Act Rel. No. 40555, 63 FR 56670, 56673 (Oct. 22, 1998) (SR-NASD-98-48).

Parties have often expressed concern with extended lists because the parties may not exercise additional strikes and can only challenge the inclusion of "extended list" arbitrators for cause.

As published in the Customer Code Notice, Proposed Rule 12403 increases the number of arbitrators on each list and limits the number of strikes that the parties may exercise. NASD intended this change to increase the likelihood that more names from the initial lists would remain after the striking process. In cases involving three-member panels, NASD proposed that seven arbitrators from each arbitrator roster (chair-qualified, non-chair public, and non-public) would be selected at random to generate the lists to be sent to the parties. Each separately represented party could strike up to five of the seven arbitrators on each list for any reason, but two names would remain on each list.

Some commenters found the proposed procedures to be an improvement over the current system, but noted that entire lists could still be stricken.[95] For example, if a claimant strikes arbitrators one through five from a seven-name list and a respondent strikes arbitrators three through seven, then the parties collectively will have stricken the entire list. Thus, these commenters believed the likelihood that NASD would need to extend lists would remain high. Commenters suggested amending the rule to provide that if all the arbitrators are stricken from a list, a subsequent list would be generated, accompanied by a limited number of strikes. Commenters also noted that if each party only ranks two arbitrators from the list, there is a likelihood for ties in the rankings by claimants and respondents.[96]

In Amendment 5, NASD proposed to increase the number of arbitrators on each list to eight, and to allow each separately represented party to exercise only four strikes. By increasing

[95] Boliver, Canning, Caruso, Estell, Evans, Greco, Ilgenfritz, Josel, Komninos, Lapidus, Layne, Lea, Lipner, Lopez, Magary, Meissner, Miller, Pounds, Rosenfield, Sadler, Shewan, Stoltmann, Sutherland, and Willner.

[96] Id.

the number of arbitrators and reducing the number of strikes per list, NASD believes there is a greater likelihood that arbitrators from each initial list would remain on the list after the parties exercise their strikes and the lists are consolidated.[97] This, in turn, should reduce the likelihood that extended lists would be necessary, thus providing parties with more control in the arbitrator selection process. In addition, in light of the comments concerning Proposed Rule 12400(b), NASD is proposing to amend Proposed Rule 12403 to clarify that chair-qualified arbitrators also would be included in the roster of non-chair public arbitrators, but would only appear on one list in a particular case. The proposed rule change is amended as follows (new language underlined; deleted language in [brackets]):

12403. Generating and Sending Lists to the Parties

(a) Generating Lists

(1) If the panel consists of one arbitrator, the Neutral List Selection System will generate a list of [seven] eight public arbitrators from the NASD's chairperson roster.

(2) If the panel consists of three arbitrators, the Neutral List Selection System will generate:

- A list of [seven] eight arbitrators from the NASD's non-public arbitrator roster;

[97] NLSS will select randomly one name at a time for each list (i.e., chair-qualified, non-chair public, non-public), and list the names in the order in which they were selected. The first arbitrator selected would be Arbitrator #1; the second would be Arbitrator #2, etc. After the parties have made their selections and the lists have been consolidated, in the unlikely event of a tie among arbitrators, NLSS will break the tie based on the order in which the arbitrators were initially placed on the list. So, for example, if Arbitrators 3 and 5 are "tied" after the non-chair public lists are consolidated, NLSS will select Arbitrator 3 for the non-chair public position.

- A list of [seven] eight arbitrators from the NASD's public arbitrator roster; and
- A list of [seven] eight public arbitrators from the NASD's chairperson roster.

(3) If the panel consists of three arbitrators, the Neutral List Selection System will generate the chairperson list first. Chair-qualified arbitrators who were not selected for the chairperson list will be eligible for selection on the public list. An individual arbitrator cannot appear on both the chairperson list and the public list for the same case.

(4) No change.

(b) Sending Lists to Parties

No change.

* * * * *

12404. Striking and Ranking Arbitrators

(a) Each separately represented party may strike up to [five] four of the arbitrators from each list for any reason by crossing through the names of the arbitrators. [Two] At least four names must remain on each list.

(b) No change.

(c) No change.

* * * * *

2. Pre-Screening for Conflicts

One commenter suggested that Proposed Rule 12404 should include a procedure for replacing arbitrators who have disqualifying conflicts before the parties are required to submit their rankings.[98]

In Amendment 5, NASD responded that it intends to implement a new computer platform, MATRICS,[99] which would be programmed to check for certain conflicts before the lists are sent to the parties. For example, MATRICS would eliminate from a list any arbitrator who is currently employed by a firm that is a party to the case. MATRICS would also eliminate any arbitrator with a securities account at a firm that is a party to the case. In these instances, parties would not have to use a strike to eliminate an arbitrator with such conflicts.

Z. Proposed Rule 12406 -- Appointment of Arbitrators; Discretion to Appoint Arbitrators Not on List

Proposed Rule 12406 provides that each three-arbitrator panel will consist of a non-public arbitrator, a chair-qualified public arbitrator, and a non-chair public arbitrator. Many commenters opposed the inclusion of a non-public arbitrator on three-person panels.[100] In Amendment 5, NASD noted that because Proposed Rule 12406 would not change the substantive requirements in Rule 10308(c)(4) of the current Code concerning arbitrator appointments, the comments are outside the scope of the rule filing. NASD also noted that it proposed changes to the definition of "public arbitrator" in a separate rule filing.[101] In addition, NASD stated that in approving the NLSS, the Commission found that NASD had created reasonable procedures for implementing the list selection process, which it determined should give investors and other

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[98] SIA.

[99] See supra note 79.

[100] See, e.g., Boliver, Canning, Caruso, Estell, Evans, Fynes, Greco, Ilgenfritz, Jones, Josel, Komninos, Lapidus, Layne, Lea, Lipner, Lopez, Magary, Meissner, Miller, PIABA, Pounds, Rosenfield, Sadler, Shewan, Stoltmann, Sutherland, and Willner.

[101] These proposed rule changes were recently approved by the Commission. See supra note 35.

parties more input into the selection of the arbitration panel, and were consistent with the Exchange Act.[102] Finally, NASD indicated that independent studies performed on the NASD arbitration forum do not show bias on the part of industry arbitrators.[103] For these reasons, NASD is not proposing to amend the proposed rule at this time.

In the Customer Code Notice, the Commission noted that under Proposed Rules 12406 (Appointment of Arbitrators; Discretion to Appoint Arbitrators Not on List), 12410 (Removal of Arbitrator by Director), and 12411 (Replacement of Arbitrators), parties to an arbitration would not be given a peremptory strike for arbitrators appointed from an extended list. The Commission specifically asked for commenters' views on which is the better alternative when the Uniform Code differs from the proposed NASD rules with respect to appointment of arbitrators by the Director.

Many commenters stated that allowing a peremptory strike when an arbitrator is appointed from an extended list would be preferable.[104] In their view, the proposed requirements for the removal of an arbitrator would be overly restrictive and unlikely to provide assurances of impartiality to an investor regarding an arbitrator whom he or she had no voice in selecting.

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[102] See Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 3 and 4 to Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Selection of Arbitrators in Arbitrations Involving Public Customers, supra note 94.

[103] See Industry Arbitration Award Survey, Securities Arbitration Commentator, Volume 2005, No. 4 (May 2005); U.S. General Accounting Office, Securities Arbitration: How Investors Fare, GAO/GGD 92-74 (May 11, 1992); E-mail from Mignon McLemore, Assistant Chief Counsel, NASD Dispute Resolution, to Gena Lai, Special Counsel, Division of Market Regulation, SEC, dated Dec. 1, 2006.

[104] Boliver, Canning, Caruso, Evans, Greco, Ilgenfritz, Josel, Komninos, Lapidus, Layne, Lea, Lipner, Lopez, Magary, Meissner, Miller, PACE, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

In Amendment 5, NASD noted that because Proposed Rule 12410 has not changed the substantive requirements concerning arbitrator removal in Rules 10308(d)(1) – (3) and (f), and Rule 10312(d) of the current Code, the comments are outside the scope of the rule filing. NASD also believes that the changes proposed to Proposed Rules 12403 and 12404 in Amendment 5 would minimize the need for extended lists. Therefore, NASD is not proposing to allow peremptory strikes when the list is extended.

AA. Proposed Rule 12408 -- Disclosures Required of Arbitrators

As published in the Customer Code Notice, Proposed Rule 12408(a) provides, in relevant part, that arbitrators must disclose "any existing or past service as a mediator." In the Customer Code Notice, the Commission indicated that Proposed Rule 12408(a)(4) could be interpreted as either requiring arbitrators to disclose (1) only any service as a mediator that might preclude the arbitrator from rendering an objective and impartial determination in the proceeding, or (2) any existing or past service as a mediator, even if it has no connection with the proceeding. The Commission asked whether the proposed rule should be amended to reflect one or the other interpretation.

Many commenters thought the proposed rule should require disclosure of service as a mediator on any case, not just service that the arbitrator thinks would affect his/her impartiality in a particular proceeding.[105] One commenter asserted an arbitrator's ethical obligations would preclude a more constrained reading of the rule.[106]

In Amendment 5, NASD responded that it believes interpreting Proposed Rule 12408(a)(4) to require disclosure of all existing or past service as a mediator is too broad. NASD

[105] Boliver, Canning, Caruso, Estell, Evans, Greco, Ilgenfritz, Josel, Komninos, Lapidus, Layne, Lea, Lipner, Lopez, Magary, Meissner, Miller, PACE, PIABA, Pounds, Rosenfield, Sadler, Shewan, Stoltmann, Sutherland, and Willner.

[106] PACE.

stated that some of the arbitrators in NASD's forum have served as mediators for a significant number of cases, and the list of cases could change frequently. NASD believes that it would be unduly burdensome and of little value to parties, and may result in a significant reduction in the arbitrator roster, to require these arbitrators to disclose all of their existing or past service as a mediator on any case. In Amendment 5, NASD stated that it believes that arbitrators who serve as mediators should disclose whether they have served as a mediator for any of the parties in the case for which they have been selected. NASD also stated that it plans to update its arbitrator disclosure forms to include a question that will require arbitrators to provide this information.

In Amendment 7, NASD determined to include the requirement to make this disclosure in the proposed rule. NASD amended the proposed rule as follows (new language underlined):

12408. Disclosures Required of Arbitrators

(a) Before appointing arbitrators to a panel, the Director will notify the arbitrators of the nature of the dispute and the identity of the parties. Each potential arbitrator must make a reasonable effort to learn of, and must disclose to the Director, any circumstances which might preclude the arbitrator from rendering an objective and impartial determination in the proceeding, including:

(1) No change;

(2) No change;

(3) No change; and

(4) Any existing or past service as a mediator for any of the parties in the case for which the arbitrator has been selected.

(b) No change.

(c) No change.

* * * * *

One commenter suggested that NASD's arbitrator disclosure obligations should parallel those established by the California Judicial Council, which require a prospective arbitrator to disclose, among other things, all arbitrations in which he or she was a panelist, which forums conducted the arbitrations, and whether any of the parties or their counsel in the current proceeding were involved in any proceeding in which the arbitrator was a panelist.[107]

In Amendment 5, NASD noted that, apart from subparagraph (a)(4) of Proposed Rule 12408, which was added to reflect approval of a proposed rule change by the SEC on March 7, 2005,[108] Proposed Rule 12408 does not contain any substantive changes from Rules 10312(a), (b), (c), and (e) of the current Code, and that therefore, this comment is outside the scope of the rule filing.

BB. Proposed Rule 12409 -- Arbitrator Recusal

Proposed Rule 12409 provides that any party may ask an arbitrator to recuse himself or herself from the panel for good cause, and that such requests are decided by the arbitrator who is the subject of the recusal. One commenter asserted that parties have attempted to engage in "panel shopping" by requesting the recusal of an arbitrator on the grounds that an adverse ruling prior to the hearing on the merits constituted good cause.[109] This commenter suggested that NASD should amend the rule to provide that a prior ruling adverse to the party requesting recusal does not constitute good cause.

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[107] Canning.

[108] See Order Approving Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to a Proposal to Adopt a New IM-10308 on Mediators Serving as Arbitrators, Securities Exchange Act Rel. No. 51325 (Mar. 7, 2005), 70 FR 12522 (Mar. 14, 2005) (SR-NASD-2005-007).

[109] SIA.

In Amendment 5, NASD responded that arbitrators are aware that some parties may use recusal requests as a way to obtain a more favorable panel. NASD believes that arbitrators have the discretion to determine whether the party making the request has demonstrated good cause for its request and does not believe it is appropriate to limit this discretion. Therefore, NASD is not proposing to amend the rule at this time.

CC. Proposed Rule 12410 -- Removal of Arbitrator by Director

In pertinent part, Proposed Rule 12410 provides that the Director will grant a party's request to remove an arbitrator if the arbitrator "is biased, lacks impartiality, or has a direct or indirect interest in the outcome of the arbitration," and that close questions regarding challenges to an arbitrator by a customer will be resolved in favor of the customer. One commenter asserted that the term "indirect" is vague and should not be used in the rule.[110] This commenter also stated that the rule would create a "double standard" that lacks justification and suggested revising the proposed rule to provide that arbitrator challenges will be resolved in favor of the party making the challenge.

In Amendment 5, NASD responded that because Proposed Rule 12410 does not change the substantive requirements of current Rules 10308(d)(1) – (3) and (f), and Rule 10312(d) of the current Code, concerning arbitrator removal, these comments are outside the scope of the rule filing.

DD. Proposed Rule 12411 -- Replacement of Arbitrators

In pertinent part, Proposed Rule 12411 provides that, if an arbitrator is removed or becomes otherwise unable or unwilling to serve, the Director will appoint a replacement arbitrator, unless the parties agree in writing to proceed with the two remaining arbitrators. Rule

[110] Id.

10308(d) of the current Code, on the other hand, provides that the director "shall provide the parties information" concerning the proposed replacement arbitrator, and the parties "shall have the right to object." One commenter, noting that Proposed Rule 12411 lacks the notice requirement, expressed concern that the Director could replace an arbitrator before the parties become aware of the vacancy.[111]

In Amendment 5, NASD stated that Proposed Rule 12411 codifies current practice in the forum, which NASD has determined is the most efficient method for addressing arbitrator replacements. Currently, if an arbitrator becomes unavailable and must be replaced, the parties rarely agree to proceed with only the two remaining arbitrators. To expedite the replacement process, NASD selects the replacement arbitrator and notifies the parties of the replacement simultaneously. NASD currently gives the parties five business days from the date of the notice to accept the replacement or agree to proceed with the two remaining arbitrators. This procedure would continue under Proposed Rule 12411, except that the parties have an unlimited time to elect to proceed with only the remaining arbitrators.[112]

EE. Proposed Rule 12500 – Initial Prehearing Conferences; Proposed Rule 12501 -- Other Prehearing Conferences

Proposed Rules 12500 and 12501 establish procedures for scheduling initial and other prehearing conferences. Two commenters expressed concern that, in contrast to the current Code, Proposed Rules 12500 and 12501 would not give the Director the authority to hold an initial prehearing conference ("IPHC") with the parties before the panel is selected. [113]

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[111] Ryder.

[112] Parties may at any time stipulate to the removal of an arbitrator, including a replacement arbitrator. Telephone conversation among Jean Feeney, Vice President, NASD; Mignon McLemore, Assistant Chief Counsel, NASD Dispute Resolution; and Gena Lai, Special Counsel, Division of Market Regulation, SEC (Dec. 19, 2006).

[113] Canning and Feinberg.

In Amendment 5, NASD agreed that the proposed rules would not grant the Director the explicit authority to hold an IPHC before the panel is selected. It also agreed that on rare occasions, parties may need to request a prehearing conference before the panel is appointed to resolve discovery disputes or to discuss jurisdictional issues. Thus, NASD proposed to revise Proposed Rule 12501 to make this authority explicit. Proposed Rule 12501 is amended as follows (new language underlined):

12501. Other Prehearing Conferences

(a) A prehearing conference may be scheduled upon the joint request of the parties or at the discretion of the Director. The Director will set the time and place of the prehearing conference and appoint a person to preside.

(b) No change.

(c) No change.

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FF. Proposed Rule 12503 – Motions

Proposed Rule 12503 establishes procedures to make and decide motions or responses to motions.

1. Oral Motions

One commenter contended that Proposed Rule 12503(a)(1) would allow a party to make an oral motion on short notice and would allow the panel to decide on motions without giving the opposing party an adequate opportunity to respond.[114] The commenter suggested that oral motions should be limited to matters that could not have been anticipated and that require immediate consideration. The commenter also suggested that the party opposing the oral motion

[114] SIA.

should be given 10 days to respond, unless there is good cause for deciding the motion on a shorter timeframe.

In Amendment 5, NASD responded that Proposed Rule 12503(a)(1) requires a party to make an effort to resolve a matter with the other parties before making a motion, and that both oral and written motions must describe that effort. Therefore, the panel would be able to consider these factors, and any objections, in ruling on a motion or in deferring a decision to allow more time to respond.

2. Service Methods

One commenter suggested that Proposed Rule 12503(a)(2) should allow for some variation in service methods, rather than requiring all parties to be served at the same time and in the same manner.[115] NASD responded that, based on current practice in the forum, NASD believes the service requirements in Proposed Rule 12503(a)(2) are reasonable because they would prevent a party from attempting to gain an advantage in the proceeding by delaying service of a motion on some parties.

3. Panel Approval of Motions on Short Notice

Two commenters opposed requiring panel approval in Proposed Rule 12503(a)(3) for motions filed within 20 days before the hearing.[116] In their experience, motions are usually filed because of an emergency, and requiring a panel to grant advance permission would reduce the time for the panel to decide a motion. They suggested that parties should not need permission to file a motion in arbitration, and that Proposed Rule 12503(a)(4) should be amended to allow a party to submit additional documents with a motion to amend a pleading to add a party.

[115] Krosschell.

[116] Canning and Feinberg.

In Amendment 5, NASD responded that, in order to prevent any unnecessary delays to the start of a hearing, it believes the panel should control events and procedures that occur close to that time. In addition, NASD noted that Proposed Rule 12300 (Filing and Serving Documents) allows for additional information to be submitted in connection with amended pleadings.

4. Deadlines for Responses

One commenter urged NASD to delete the provision in Proposed Rule 12503(b) requiring responses to written motions within 10 calendar days of receipt.[117] The commenter suggested that NASD continue with current procedure, in which responses to motions are due after the first IPHC. The commenter suggested that thereafter, deadlines to respond to motions should be set by the panel at the prehearing conference or otherwise.

In Amendment 5, NASD responded that, if a party submits a motion before the IPHC, NASD staff forwards it to the panel, along with any responses that were voluntarily submitted by other parties. Based on current practice in the forum, NASD believes Proposed Rule 12503(b) would provide parties with adequate time to respond to written motions. In addition, the parties and the panel have the ability to extend the 10-day timeframe under Proposed Rule 12207.

5. Motions Regarding Hearing Location

Two commenters opposed giving the Director authority to decide motions regarding hearing location, under Proposed Rule 12503(c)(2).[118] In their view, the hearing location should always be set where it would be most convenient for the customer, as indicated on the customer's statement of claim. In Amendment 5, NASD responded that, under the Customer Code, a party may request a convenient hearing location, but there may be reasons that a party's

[117] Krosschell.

[118] Canning and Stolle.

request is not granted. NASD believes the Director should have the authority to change the hearing location before a panel is appointed.[119]

6. Number of Arbitrators to Hear Motions

One commenter, noting that Proposed Rule 12503(c)(3) would allow the full panel to hear discovery motions only under certain circumstances (e.g., at the request of a party or on the arbitrator's initiative), contended that the full panel should be required to hear and decide any discovery-related motion.[120] In Amendment 5, NASD responded that Proposed Rule 12503(c)(3) is based on current practice in the forum and allows the parties or designated arbitrator to determine which motions require consideration by the full panel. Further, NASD believes the commenter's suggestion would increase the costs of arbitration, since the parties would have to pay the honorarium for two additional arbitrators.

For the reasons stated above, NASD is not proposing to amend Proposed Rule 12503 at this time.

GG. Proposed Rule 12504 -- Motions to Decide Claims Before a Hearing on the Merits

As published in the Customer Code Notice, Proposed Rule 12504 provided that, except in connection with time limits under arbitration, motions to decide a claim before a hearing ("dispositive motions") "are discouraged and may only be granted in extraordinary circumstances." Most commenters criticized the proposed rule. Some industry commenters argued that it would improperly discourage dispositive motions and improperly impose an "extraordinary circumstances" requirement.[121] In their view, dispositive motions could be

[119] See also discussion concerning hearing locations in Section III.N, above.

[120] SIA.

[121] R. Davis, Schwab, and SIA.

appropriate in circumstances that are not extraordinary. One industry commenter also contended that NASD should continue to allow arbitrators to decide whether to grant dispositive motions on a case-by-case basis, instead of codifying a limit on dispositive motions.[122] Moreover, this commenter argued that the lack of guidance on the meaning of "extraordinary circumstances" would have a chilling effect on the filing of dispositive motions and may expose respondents' counsel to sanctions.[123]

Investor representatives also criticized the proposed rule, but for different reasons.[124] Most of these commenters asserted that a party has a fundamental right to a hearing in arbitration and that Proposed Rule 12504 would eliminate this right. They also predicted that the proposed rule would be a tool for abuse by defense counsel to delay the arbitration process and would hinder claimants' attempts to have their claims heard by an arbitration panel. In addition, they believed that the proposed rule would cause claimants, who have already suffered losses, to incur additional expense and delay in responding to these motions. In their view, Proposed Rule 12504 would cause the use of these motions to become more prevalent.

Some commenters believed the proposed rule should be amended to expressly safeguard the rights of the non-moving party, particularly an investor who has suffered harm or loss.[125]

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[122] Schwab.

[123] Id.

[124] Ball, Boliver, Brannan, Canning, Estell, Finer, Ilgenfritz, Krosschell, Layne, Ledbetter, Lopez, Miller, Page, Pounds, Schultz, Schultz #2, Shewan, Sonn, Speyer, Steinberg, Stolle, Sutherland, Tepper, Williams, and Woska.

[125] PACE, PIABA, Lea, Josel, Evans, Komninos, Stoltmann, Willner, Rosenfield, Lapidus, Lipner, Magary, and Eccleston. In particular, they suggested that:

- All factual allegations made by the non-moving party are to be taken as true for the purposes of the motion.
- The motion must be denied whenever credibility is at issue, there are any facts in dispute, or the panel must make factual findings against the non-moving party.

Another commenter also supported the safeguards, while also stating that the rule should not be included in the Customer Code.[126]

Two commenters suggested that Proposed Rule 12504 should be amended to require the costs incurred in opposing a dispositive motion to be awarded against the firm immediately and automatically upon the denial of a motion.[127] In their view, the panel should not wait to include costs in the final award, as the deterrent effect would be lost with a delay in assessing penalties. NASD responded that Proposed Rule 12504 is not intended to change the current practice of assessing costs and expenses of a hearing at the end of a case, in the award. Thus, NASD stated that these comments are outside the scope of the rule filing.

Finally, another commenter suggested that a claimant should not have to respond to a dispositive motion if it is frivolous or without merit.[128] This commenter also noted that the proposed rule does not expressly state that the panel can deny leave to make such a motion, and contended that by setting forth timeframes for briefing and consideration, it implies that all motions will be considered. In Amendment 5, NASD responded that it would revisit this issue when the forum has some experience with the new motions practice rules.

Acknowledging the commenters' concerns, NASD stated that it had considered the effects the proposed rule would have on public and industry users of the forum. NASD noted, however, that the current Code does not provide any guidance with respect to motions to dismiss,

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- If the non-moving party asserted that it can cure any defect by filing an amended statement of claim, that party should be given an opportunity to do so.
- The rule should clarify that arbitrators should not apply a "failure to state a claim" standard, since claimants are not required to plead legally cognizable claims.

[126] Schultz #2.

[127] Canning and Lipner.

[128] Ryder.

and that arbitrator decisions in this area may lack uniformity. NASD stated that, as motions to dismiss are filed more frequently, the proposed rule is necessary to provide some uniform guidelines to arbitrators and users of the forum concerning this practice. NASD believes that the proposed rule would provide valuable guidance to parties and arbitrators and make the administration of arbitrations more uniform and transparent.

NASD also agreed with commenters that the term "extraordinary circumstances" should be explained to clarify when Proposed Rule 12504 would apply and that more guidance should be provided on the standards to use when deciding a motion to dismiss. NASD stated that, in meeting with various constituent groups of the arbitration forum, including investor and industry representatives, it suggested amending the proposed rule to provide that a panel may grant a motion to dismiss before a hearing only if it determines that there are no material facts in dispute or that there are no credibility determinations to be made. NASD stated that none of the constituencies indicated that they would support the suggested amendments, and that they were unable to reach a consensus on any amendments to the proposed rule. As a compromise, NASD suggested amending the narrative portion of the rule filing to explain under what circumstances a motion to dismiss might be granted. NASD stated that it believed the various constituencies supported this compromise.

Therefore, in Amendment 5, NASD proposed the following guidance:

> For purposes of this rule, if a party demonstrates affirmatively the legal defenses of, for example, accord and satisfaction, arbitration and award, settlement and release, or the running of an applicable statute of repose, the panel may consider these defenses to be extraordinary circumstances. In such cases, the panel may dismiss the arbitration claim before a hearing on the

merits if the panel finds that there are no material facts in dispute concerning the defense raised, and there are no determinations of credibility to be made concerning the evidence presented.

The Commission received 125 comment letters on Amendment 5. Most of the commenters objected to NASD's proposed guidance. As a result, NASD filed Amendment 6 to the proposed rule change, withdrawing Proposed 12504 and all references to the rule from the Customer Code.[129] The text of Amendment 6 is available on NASD's Web site: http://www.nasd.com/RulesRegulation/RuleFilings/2003RuleFilings/NASDW_009306?=802.

HH. Proposed Rule 12505 -- Cooperation of Parties in Discovery

As published in the Customer Code Notice, Proposed Rule 12505 provides that the parties must cooperate to the fullest extent practicable in the voluntary exchange of documents and information to expedite the arbitration. One commenter contended that the proposed rules should explicitly provide that the discovery procedures are mandatory and suggested eliminating the word "voluntary" from Proposed Rule 12505.[130]

NASD agreed with this comment, stating that this change would help to ensure that the parties understand the importance of complying with the discovery process. The proposed rule change is amended as follows (new language underlined; deleted language in [brackets]):

12505. Cooperation of Parties in Discovery

[129] Proposed Rule 12504 has been re-filed as a separate proposed rule change and published for public comment. See supra note 23.

[130] PACE.

The parties must cooperate to the fullest extent practicable in the [voluntary] exchange of documents and information to expedite the arbitration.

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II. Proposed Rule 12506 -- Document Production Lists

Proposed Rule 12506 establishes procedures for producing or objecting to document production requirements under the Discovery Guide and the document production lists it contains ("Document Production Lists"), as amended in the Customer Code.

1. "Control"

As published in the Customer Code Notice, Proposed Rule 12506(b) provides that parties must produce to all other parties all documents in their "possession or control" that are described in the applicable Document Production Lists. Similarly, Proposed Rule 12514(a) (Exchange of Documents and Witness Lists Before Hearing) provides that parties must exchange certain materials in their "possession or control" that they intend to use at the hearing that have not already been produced. Several commenters argued that the term "control" should be deleted from Proposed Rules 12506(b) and 12514(a), noting that the concept of "control" in the discovery context has been defined, through case law, to include not only possession of the requested documents, but also the legal right to obtain those documents.[131] As a result, these commenters contended that customers could incur increased costs to comply with these proposed rules, or face sanctions if they are unable to gain access to documents from third-parties or unable to do so in a timely manner.

In Amendment 5, NASD responded that the addition of the term "control" to Proposed

[131] Boliver, Canning, Estell, Evans, Feinberg, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stolle, Stoltmann, Sutherland, and Willner.

Rules 12506(b) and 12514(a) is intended to expand, not narrow, the range of documents that are to be produced in discovery. NASD believes that under these proposed rules, it should be easier for customers to gain access to documents held by third-parties on behalf of respondents, because respondents would be required to produce documents, regardless of where the documents are stored or maintained. NASD believes that, under these proposed rules, the customer would have more control in the discovery process. For these reasons, NASD did not propose to amend Proposed Rules 12506(b) and 12514(a) in response to this issue. In Amendment 7, however, noting additional comments submitted on this issue,[132] NASD stated that it is sensitive to customers' concerns regarding the costs they could incur under the discovery process and amended Proposed Rule 12508 to address this issue.[133]

2. Good Faith Standard

Proposed Rules 12506(b)(1) and 12507(b)(1) provide that, in response to a Document Production List requirement or a discovery request, a party has the option of identifying and explaining the reason that a particular document or piece of information cannot be produced within the required time, and stating when the documents would be produced ("delay provisions"). Several commenters asserted that parties would abuse the delay provisions by setting a self-imposed deadline with the purpose of impeding and delaying discovery.[134] They also noted that the proposed rules would not subject a party to sanctions for using the delay provisions in bad faith, including Proposed Rule 12511 (Discovery Sanctions).

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[132] See supra note 21 and accompanying text.

[133] See Section III.KK, Proposed Rule 12508 (Objecting to Discovery; Waiver of Objection), below.

[134] Boliver, Canning, Evans, Feinberg, Ilgenfritz, Josel, Komninos, Lapidus, Lipner, Lea, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stolle, Stoltmann, Sutherland, and Willner.

NASD responded that it believes the expectation for parties to act in good faith is implied in the discovery provisions of both the current Code and the Customer Code. NASD agreed, however, that Proposed Rules 12506(a) and 12507(b) of the Customer Code should be amended to eliminate any ambiguity concerning the applicability of a "good faith" standard. Therefore, NASD proposed in Amendment 5 to include an explicit "good faith" standard so that frivolous delays, unreasonable timeframes, or bad faith objections would be subject to sanctions. Proposed Rule 12506 is amended as follows (new language underlined):

12506. Document Production Lists

(a) No change.

(b) Time for Responding to Document Production Lists

(1) Unless the parties agree otherwise, within 60 days of the date that the answer to the statement of claim is due, or, for parties added by amendment or third-party claim, within 60 days of the date that their answer is due, parties must either:

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(2) A party must act in good faith when complying with subparagraph (1) of this rule. "Good faith" means that a party must use its best efforts to produce all documents required or agreed to be produced. If a document cannot be produced in the required time, a party must establish a reasonable timeframe to produce the document.

(c) No change.

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3. Discovery Deadlines

Proposed Rules 12506(b) and 12507(b) would extend the time to produce documents from 30 days under the current Code to 60 days. Some commenters viewed this as authorizing a

delay of another month before parties may initiate the process to compel discovery and suggested that the standard timeframe for document exchange should remain 30 days.[135] In Amendment 5, NASD responded that this extension of time is intended to address concerns of many frequent users of the forum that the current time frame is unrealistic and sometimes leads to unnecessary disputes.

Several commenters observed that because Proposed Rule 12506 would require parties to produce documents required by the Document Production Lists within 60 days of the date the answer to the statement of claim is due, and Proposed Rule 12303 would provide that an answer is due 45 days from the receipt of the statement of claim, respondents would have 105 days to produce documents required by the Document Production Lists.[136] They argued that Proposed Rule 12506 should be amended to require a party to provide substantial justification for the failure to produce documents within 105 days, or face sanctions.

In Amendment 5, NASD responded that a party would face sanctions for failing to comply with the discovery provisions of the Customer Code under Proposed Rule 12511, unless the panel determines that there is substantial justification for the failure to comply. A party would have to provide evidence of substantial justification for the panel to make this determination. For the above reasons, NASD is not proposing to amend these proposed rules at this time in response to these issues.

4. Discovery of Insurance Coverage

Several commenters contended that the Document Production Lists should be revised to require the production of information and documents regarding insurance policies that might

[135] Canning, Estell, Feinberg, Feldman, Komninos, and Stolle.

[136] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

provide coverage on the dispute.[137] They stated that courts uniformly require production of this information because it assists the parties in evaluating settlement possibilities and aids in screening for conflicts. In Amendment 5, NASD responded that Proposed Rule 12506(a) has not changed the documents or information required under the current Document Production Lists, and that therefore these comments are outside the scope of the rule filing.

5. Standard by Which Documents are Discoverable

One commenter believes that the documents on the Document Production Lists should be automatically, not presumptively, discoverable.[138] This commenter also expressed the view that brokerage firms do not have grounds to assert confidentiality of compliance manuals and recommended amending the Customer Code to state that the party asserting confidentiality has the burden of establishing that the documents in question legitimately require confidential treatment. In Amendment 5, NASD responded that, although this comment is outside the scope of the rule filing, it would be considered when NASD determines whether future amendments are warranted.

JJ. Proposed Rule 12507 -- Other Discovery Requests

Proposed Rule 12507 establishes procedures for making and responding to discovery requests for items that are not included in the Document Production Lists. This and certain other discovery provisions of the Customer Code would codify provisions of the current Discovery Guide. Three commenters recommended also incorporating into the Customer Code the provisions of the Discovery Guide concerning the limited purpose of information requests, to

[137] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltman, Sutherland, and Willner.

[138] PACE.

discourage the use of overly broad information requests that are the equivalent of interrogatories.[139]

In light of these comments, NASD incorporated Section V of the Discovery Guide into Proposed Rule 12507(a). In addition, as discussed under Proposed Rule 12506, NASD included an express "good faith" standard in 12507(b).[140] Proposed Rule 12507 is amended as follows (new language underlined; deleted language in [brackets]):

12507. Other Discovery Requests

(a) Making Other Discovery Requests

(1) Parties may also request additional documents or information from any party by serving a written request directly on the party. Requests for information are generally limited to identification of individuals, entities, and time periods related to the dispute; such requests should be reasonable in number and not require narrative answers or fact finding. Standard interrogatories are generally not permitted in arbitration.

(2) [Such] Other discovery requests may be served:

Remainder of subparagraph (2) – No change.

(b) Responding to Other Discovery Requests

(1) Unless the parties agree otherwise, within 60 days from the date a discovery request other than the Document Production Lists is received, the party receiving the request must either:

Remainder of subparagraph (1) – No change.

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[139] PACE, PIABA, SIA.

[140] See Section III.II.2, above.

(2) A party must act in good faith when complying with subparagraph (1) of this rule. "Good faith" means that a party must use its best efforts to produce all documents or information required or agreed to be produced. If a document or information cannot be produced in the required time, a party must establish a reasonable timeframe to produce the document or information.

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KK. Proposed Rule 12508 -- Objecting to Discovery; Waiver of Objection

Proposed Rule 12508(a) describes how a party may object to producing a document required by the proposed Document Production Lists or requested by a party. Proposed Rule 12508 requires a party to specifically identify which documents or requested information the party is objecting to and why. One commenter contended that the proposed rule would impose a burden on the parties to locate and identify the specific documents and information to which they are objecting.[141] This commenter suggested amending the proposed rule to require an objecting party to specify only the request for documents or information that it is objecting to and the reasons for its objection.

In Amendment 5, NASD responded that it believes the provisions of Proposed Rule 12508(a) are appropriate, and that allowing parties to object to an entire document or information request would undermine the purpose of the proposed rule, which is to require more specificity in objections.

Proposed Rule 12508(b) provides that any objection not made within the required time is waived unless the panel determines that the party had substantial justification for failing to make the objection within the required time. One commenter contended that this provision would

[141] SIA.

unnecessarily require the parties to anticipate every possible objection or face the penalty of waiver.[142] In this commenter's view, the proposed rule would encourage objections as a protective measure, even though a party may be sanctioned under Proposed Rule 12511 for frivolous objections. Stating that parties would need to balance the risk of waiver against the risk of sanctions, this commenter suggested deleting Proposed Rule 12508(b). In Amendment 5, NASD responded that Proposed Rule 12508 is based on current practice in the forum, and that it believes the provisions and intent of Proposed Rule 12508(b) are clear.

For the above reasons, NASD is not proposing to amend the proposed rule in connection with these issues at this time.

In connection with commenters' concerns regarding the term "control" in Proposed Rules 12506 and 12514, discussed above,[143] NASD amended Proposed Rule 12508 as follows (new language underlined):

12508. Objecting to Discovery; Waiver of Objection

(a) No change.

(b) No change.

(c) In making any rulings on objections, arbitrators may consider the relevance of documents or discovery requests and the relevant costs and burdens to parties to produce this information.

LL. Proposed Rule 12509 -- Motions to Compel Discovery

Proposed Rule 12509 provides that a party may make a motion asking the panel to order another party to produce documents or information if the other party has: (1) failed to comply

[142] Id.

[143] See Section III.II.1, Proposed Rule 12506 (Document Production Lists), above, and Section III.QQ, Proposed Rule 12514 (Exchange of Documents and Witness Lists Before Hearing), below.

with Proposed Rules 12506 or 12507; or (2) objected to the production of documents or information under Proposed Rule 12508. Two commenters contended that the proposed rule should include other reasons that a motion to compel may be filed, such as a bad faith use of the delay provisions of Proposed Rules 12506(b) and 12507(b), which would allow parties to name self-imposed deadlines for producing specified documents.[144] These commenters argued that a motion to compel may be warranted if the parties' reason for using the delay provisions is in bad faith or the self-imposed deadline is unreasonably long and expressed concern that this conduct would not be subject to sanctions under Proposed Rule 12511.

As discussed in connection with Proposed 12506 and 12507, above, NASD stated in Amendment 5 that the concept of "good faith" is implied in the discovery provisions of the current Code and the Customer Code, and proposed to amend those rules to explicitly include a "good faith" standard for compliance. NASD believes the issues raised concerning Proposed Rule 12509 would be addressed with these proposed changes.

Several commenters suggested that costs and attorneys fees be assessed immediately against the losing party in a discovery motion seeking the production of documents and information required by Document Production Lists 1 and 2, absent a finding by the panel of substantial justification.[145] In Amendment 5, NASD responded that motions to compel are issued to enforce compliance with the discovery rules and are not meant to be punitive. It noted, however, that arbitrators may impose a range of sanctions, as provided in Proposed Rules 12212 and 12511, in appropriate circumstances.

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[144] Feinberg and Canning. See Section III.II.2, Proposed Rule 12506 (Document Production Lists), above, concerning delay provisions.

[145] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

For the reasons stated above, NASD is not proposing to amend Proposed Rule 12509 at this time.

MM. Proposed Rule 12510 – Depositions

Proposed Rule 12510 provides that depositions are discouraged but may be approved by the panel in very limited circumstances. Some commenters contended that, when time is of the essence, the requirement to receive arbitrator approval in advance could result in the loss of testimony or evidence.[146] They suggested that the proposed rule should include a procedure that permits a deposition to be taken before a panel is selected.

In Amendment 5, NASD responded that it is sensitive to the commenters' concerns and noted that the proposed rule would not prevent parties from mutually agreeing to take the testimony of an ill or dying witness before a panel has been selected. For this reason, NASD is not proposing to amend Proposed Rule 12510 at this time.

NN. Proposed Rule 12511 -- Discovery Sanctions

Under Proposed Rule 12511, a party would face sanctions for failing to cooperate in the exchange of documents and information as required under the Customer Code. Several commenters suggested that the proposed rule also should permit sanctions if parties do not timely produce the requisite documents from Document Production Lists 1 and 2 without good cause.[147] In Amendment 5, NASD responded that Proposed Rule 12511 specifically states that the panel may issue sanctions against any party in accordance with Proposed Rule 12212(a) for failure to comply with the discovery provisions of the Customer Code. It thus believes the commenters' concern is sufficiently addressed under Proposed Rule 12511.

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[146] Canning and Feinberg.

[147] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

One commenter noted that Proposed Rule 12511 expands the scope of a panel's authority beyond current practice by permitting arbitrators to impose sanctions for violations of the Customer Code, rather than for violations of panel orders only.[148] In Amendment 5, NASD explained that the purpose of this provision is to specify that the panel has the authority to control all aspects of an arbitration, not just discovery, and therefore must have the ability to enforce the rules of the forum as well as its orders.

Two commenters noted that a bad faith use of the delay provisions in Proposed Rules 12506 and 12507 is not subject to sanctions under Proposed Rule 12511 and suggested amending Proposed Rule 12511 to address this issue.[149] As previously discussed, NASD proposed in Amendment 5 to amend Proposed Rules 12506 and 12507 to include expressly a "good faith" standard for compliance. NASD believes the issues raised concerning Proposed Rule 12511 will be addressed with the proposed changes in Proposed Rules 12506 and 12507.

For these reasons stated above, NASD is not proposing to amend Proposed Rule 12511 at this time.

OO. <u>Proposed Rule 12512 – Subpoenas</u>

Proposed Rule 12512 provides that subpoenas may be issued "as provided by law." Similarly, Rule 10322 of the current Code provides, "The arbitrators and any counsel of record to the proceeding shall have the power of the subpoena process as provided by law." Seven commenters contended that brokerage firms abusively issue overly broad subpoenas to non-parties, while failing to provide notice of the subpoena to claimants in a timely manner.[150] These commenters stated that claimants usually receive a copy of the subpoena only after the

[148] SIA.

[149] Canning and Feinberg.

[150] Canning, Feinberg, Greco, Layne, Miller, Stolle, and Stoltmann.

subpoenaed party has produced the requested documents, thereby eliminating the opportunity to make a meaningful objection. They argued that parties should be allowed to object to the subpoena before it is issued. Several commenters also suggested that the proposed rule should state clearly that only arbitrators may issue subpoenas.[151]

In Amendment 5, NASD agreed that changes to the subpoena process were needed and noted that it had separately filed proposed rule changes relating to subpoenas.[152] NASD stated that it intends to incorporate any approved changes into the Customer Code.

PP. Proposed Rule 12513 -- Authority of Panel to Direct Appearances of Associated Person Witnesses and Production of Documents Without Subpoenas

Proposed Rule 12513 allows the panel to order the appearance of any employee or associated person of an NASD member without the use of subpoenas. One commenter noted that Proposed Rules 12100(a) and (r) consider former associated persons to be associated persons.[153] In this commenter's view, while Proposed Rule 12513 would permit a panel to order a former associated person to attend an arbitration hearing, this would be impractical because the panel would have no means to enforce an order compelling that person's attendance. This commenter suggested limiting the proposed rule to current associated persons and stated that the attendance of former associated persons should be compelled by subpoena only.

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[151] Canning, Feinberg, Greco, Layne, Stolle, Stoltman.

[152] The Commission recently approved these proposed rule changes. See Order Approving Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 4 to Revise Rule 10322 of the NASD Code of Arbitration Procedure Pertaining to Subpoenas and the Power to Direct Appearances, Securities Exchange Act Rel. No. 55038 (Jan. 3, 2007), 72 FR 1353 (Jan. 11, 2007) (SR-NASD-2005-079).

[153] SIA. See also Section III.B.2, Proposed Rule 12100(a) (Definition of Associated Person) and Proposed Rule 12100(r) (Definition of Person Associated with a Member), above.

In Amendment 5, NASD responded that Proposed Rule 12100(r) is a codification of current policy, under which, in the arbitration context, NASD maintains jurisdiction over a former associated person for events that occurred while the person was associated with a member firm (or are related to the person's termination of employment with a member firm). It also noted that such arbitrations would be subject to any applicable statute of limitations and the six-year eligibility rule under both the current Code and Proposed Rule 12206. With regard to Proposed Rule 12513, NASD acknowledged that arbitrators have limited means of requiring former associated persons to appear or produce documents. Nevertheless, some former associated persons may cooperate with these orders to facilitate resolution of the matter. If they do not, they may be subject to a subpoena. Because Proposed Rule 12513 is substantively the same as current policy, NASD is not proposing to amend this proposed rule at this time.

QQ. Proposed Rule 12514 -- Exchange of Documents and Witness Lists Before Hearing

As published in the Customer Code Notice, Proposed Rule 12514(c) provides that parties may not present at the hearing any documents or other materials not already produced or any witnesses not already identified at an earlier stage in the arbitration, unless the panel determines that good cause exists for the earlier failure. Proposed Rule 12514(c) also specifically states that the need to use documents or call witnesses for rebuttal or impeachment purposes based on developments during the hearing constitutes good cause.

1. "Control"

Proposed Rule 12514(a) (Documents and Other Materials) provides that at least 20 days before the first scheduled hearing date, all parties must provide all other parties with copies of all documents and other materials in their possession or control that they intend to use at the hearing that have not already been produced. Several commenters objected to the use of the term

"control" in Proposed Rule 12514(a) and Proposed Rule 12506.[154] NASD responded in Amendment 5 that it believed the use of the term "control" would make it easier for customers to gain access to documents held by third-parties on behalf of respondents, because respondents would be required to produce documents regardless of where the documents are stored or maintained. In Amendment 7, NASD proposed to amend Proposed Rule 12508 to address this issue.[155]

2. Scope of "Rebuttal"

Several commenters suggested that, to avoid any misunderstanding of what constitutes rebuttal, Proposed Rule 12514(c) should include information currently contained in a form letter that NASD sends to the parties advising them of the hearing date and location.[156] This information instructs parties that documents and lists of witnesses in defense of a claim are not considered rebuttal and, therefore, must be exchanged by the parties. In response to this comment, NASD agreed in Amendment 5 to include this provision, noting that it would be codifying current practice.[157] The proposed rule is amended as follows (new language underlined; deleted language in [brackets]):

12514. Exchange of Documents and Witness Lists Before Hearing

(a) Documents and Other Materials

No change.

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[154] Boliver, Canning, Estell, Evans, Feinberg, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stolle, Stoltmann, Sutherland, and Willner.

[155] See Sections III.II.1, Proposed Rule 12506 (Document Production Lists), and III.KK, Proposed Rule 12508 (Objecting to Discovery; Waiver of Objection), above.

[156] Boliver, Canning, Evans, Feinberg, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

[157] NASD also proposed to amend Proposed Rule 12514(b) to correct a grammatical error.

(b) Witness Lists

At least 20 days before the first scheduled hearing date, all parties must provide each other party with the names and business affiliations of all witnesses they intend to present at the hearing. At the same time, [each party] all parties must file their witness lists with the Director, with enough copies for each arbitrator.

(c) Exclusion of Documents or Witnesses

Parties may not present any documents or other materials not produced and or any witnesses not identified in accordance with this rule at the hearing, unless the panel determines that good cause exists for the failure to produce the document or identify the witness. Good cause includes the need to use documents or call witnesses for rebuttal or impeachment purposes based on developments during the hearing. Documents and lists of witnesses in defense of a claim are not considered rebuttal or impeachment information and, therefore, must be exchanged by the parties.

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3. "Good Cause"

One commenter expressed concern that the exception allowing documents not exchanged to be admitted for "good cause" would create uncertainty that a panel would accept documents or witnesses not produced or identified during the 20-day exchange during the hearing.[158] Similarly, two commenters expressed concern that the phrase "impeachment purposes based on developments during the hearing" is ambiguous, would create more uncertainty in the hearing preparation process, and would be difficult for arbitrators to apply.[159] These commenters recommended retaining the "good cause" requirement, but replacing the standard of "rebuttal or

[158] Ryder.

[159] Canning and Feinberg.

impeachment purposes" with the cross-examination standard from Rule 10321 of the current Code.[160]

Another commenter objected to the provision in Proposed Rule 12514(c) that would require parties to exchange documents contemplated for use on cross-examination, stating that this disclosure is antithetical to the concept of cross-examination because it would give each party time to formulate responses.[161] This commenter suggested that the proposed rule should specifically except cross-examination documents from the 20-day exchange, as under the current Code.

In Amendment 5, NASD responded that the proposed rule creates a presumption that, at the hearing, parties may not present any documents that were not exchanged or witnesses who were not identified within the time provided by the proposed rule. NASD stated, however, that the "good cause" exception is intended to allow for the need to use documents or call witnesses for rebuttal or impeachment purposes based on developments at the hearing. NASD also stated that in developing Proposed Rule 12514(c), it learned from some of its constituents that parties have been abusing the "cross examination" exception of Rule 10321 of the current Code by inappropriately designating certain documents as cross-examination documents. Subsequently, at the hearing, parties allegedly "surprised" their opponents with these documents, which limited the opponents' ability to effectively rebut their significance. NASD stated that Proposed Rule 12514(c) is intended to prevent this practice. For these reasons, NASD is not proposing to amend the proposed rule at this time.

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[160] Canning and Feinberg. Current Rule 10321 (General Provisions Governing Pre-Hearing Proceedings) provides in relevant part that parties do not need to exchange documents or identify witnesses "which parties may use for cross-examination or rebuttal."

[161] Schwab.

4. Other Comments

Under the current and proposed Discovery Guides, if a party states that no responsive information or documents exist in connection with a discovery request, that party must make certain affirmations at the request of the party seeking the discovery request. Specifically, the responding party must: (1) state in writing that he/she conducted a good faith search for the requested information or documents; (2) describe the extent of the search; and (3) state that, based on the search, no such information or documents exist. Two commenters asserted that these affirmations are inadequate and suggested that they be amended.[162] NASD responded that the Customer Code is not changing the affirmation provision in the Discovery Guide, and thus that this comment is outside the scope of this rule filing.

Two commenters asserted that Proposed Rule 12514 would cause parties to provide more documents than they intend to use at the hearing, thus limiting any meaningful analysis of the evidence that the opposing parties actually intend to offer at the hearing.[163] They suggested that Proposed Rule 12514 should require parties to provide notebooks of numbered exhibits with an index to opposing parties 20 days before hearing, and to the panel at the hearing.

In Amendment 5, NASD responded that Proposed Rule 12514 is meant to provide general guidance on the exchange or documents and witness lists before a hearing, and is substantively the same as Rule 10321(a) of the current Code. Thus, it stated that these comments are outside the scope of the rule filing.

RR. Proposed Rule 12600 -- Required Hearings

As published in the Customer Code Notice, Proposed Rule 12600(c) provides that if a hearing will be held, the Director will notify the parties of the time and place of the hearing at

[162] Canning and Feinberg.

[163] Canning and Layne.

least 10 days before the hearing begins, unless the parties agree to a shorter time. The Commission specifically solicited comment on whether parties need notice of the hearing earlier than 10 days in advance. Several commenters indicated that the proposed 10-day notice could be insufficient.[164] One commenter stated that such short notice might cause a small investor to lose his or her counsel, as that counsel's schedule might not allow an appearance for a hearing on 10 days' notice, which in turn could mean that the investor could be forced to proceed at the hearing without counsel.[165] Other commenters suggested that it would be difficult for parties and witnesses who are traveling from out of town to make travel arrangements on 10 days' notice.[166]

In Amendment 5, NASD explained that the term "place" in Proposed Rule 12600(c) refers to the specific facility where the hearings will be held, and that under current practice, parties normally are notified of the city in which the hearing will take place prior to the IPHC. Parties also generally agree to hearing dates at the IPHC. NASD stated that it does not expect this practice to change under Proposed Rule 12600(c). In response to the comments and to ensure consistent timeframes under the Customer Code, however, NASD is proposing to amend Proposed Rule 12600(c) to increase the notice period from 10 to 20 days. The proposed rule change is amended as follows (new language underlined; deleted language in [brackets]):

12600. Required Hearings

(a) No change.

(b) No change.

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[164] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PACE, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

[165] PACE.

[166] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

(c) The Director will notify the parties of the time and place at least [10] 20 days before the hearing begins, unless the parties agree to a shorter time.

* * * * *

In addition, Proposed Rule 12600 provides that hearings will be held, unless the arbitration is administered under the provisions under the Customer Code applicable to simplified arbitrations or default proceedings, the parties agree otherwise in writing, or the arbitration has been settled, withdrawn, or dismissed. One commenter noted that Proposed Rule 12600(a) would not include cases dismissed without a hearing under Proposed Rule 12504 and suggested amending the proposed rule to include this additional exception.[167]

In Amendment 5, NASD responded that it believes the language and intent of Proposed Rule 12600(a) are clear, and as a result, did not propose to amend this rule. In Amendment 6, NASD withdrew Proposed Rule 12504 and all references to that rule from the Customer Code.[168] Therefore, this comment is no longer applicable to this rule filing.

SS. Proposed Rule 12601 -- Postponement of Hearings

Proposed Rule 12601 governs the postponement of hearings and provides, in relevant part, that a panel may not grant a motion to postpone a hearing made within 10 days of the date that the hearing is scheduled to begin, unless the panel determines that good cause exists.

One commenter asserted that, at times, arbitrators have attempted to ignore the agreement of the parties to postpone an arbitration and compel parties to proceed.[169] To eliminate this possibility, this commenter suggested that the proposed rule should provide that a hearing must

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[167] SIA.

[168] Proposed Rule 12504 has since been re-filed as a separate proposed rule change. See supra note 23.

[169] SIA.

be postponed by agreement of the parties and may be postponed under the other listed circumstances. Another commenter noted that Proposed Rule 12601(a) appears to give the parties the unfettered right to postpone the hearing whenever they agree to do so, which would contradict an arbitrator's duty to keep cases moving toward resolution.[170] This commenter suggested incorporating some provisions from Rule 10319(c) of the current Code to give the panel express control over the number of times a case may be postponed and to eliminate repeat postponements.

NASD responded that it believes the parties should have the discretion to postpone a hearing if they mutually agree, to facilitate settlement negotiations among the parties. NASD believes, however, that the proposed postponement fees in the rule, which are non-refundable, should serve as a deterrent to multiple postponements.[171] Moreover, Proposed Rule 12601(c) would allow a panel to dismiss an arbitration without prejudice if the parties request or agree to more than two postponements. In this situation, a party could re-file the claim, subject to all applicable fees and costs under the Customer Code.

In light of these comments, however, NASD also amended Proposed Rule 12601 to expressly distinguish between when a hearing may be postponed and when a hearing must be postponed. NASD also added paragraph (b)(2) to the rule, which includes provisions of a proposed rule change that had been approved by the Commission, but were inadvertently omitted

[170] Elster. While this commenter's views pertained to Proposed Rule 13601(a) of the Industry Code, his comments are relevant to the Customer Code as well. See supra note 5.

[171] Both Rule 10319(b) of the current Code and Proposed Rule 12601(b) require parties to pay a postponement fee equal to the applicable hearing session fee if the party's postponement request is granted. Under Rule 10319(b), a party would pay twice the hearing session fee for each subsequent postponement, whereas under Proposed Rule 12601(b), the fee would not increase for subsequent requests. See Section V.Y, below.

from the last amendment to the Customer Code.[172] The proposed rule change is amended as follows (new language underlined; deleted language in [brackets]):

12601. Postponement of Hearings

(a) [When a Hearing May Be Postponed] Postponement of Hearings

(1) When a Hearing Shall Be Postponed

A hearing shall be postponed by agreement of the parties.

(2) When a Hearing May Be Postponed

A hearing may be postponed [only]:

- [By agreement of the parties;]
- By the Director, in extraordinary circumstances;
- By the panel, in its own discretion; or
- By the panel, upon motion of a party. The panel may not grant a motion to postpone a hearing made within 10 days of the date that the hearing is scheduled to begin, unless the panel determines that good cause exists.

(b) Postponement Fees

(1) No change.

(2) If a postponement request is made by one or more parties and granted within three business days before a scheduled hearing session, the party or parties making the request shall pay an additional fee of $100 per arbitrator. If more than one party requests the postponement, the arbitrators

[172] See Order Approving Proposed Rule Change and Amendment Nos. 1 and 2 Relating to the Adjournment of an Arbitration Hearing Within Three Business Days of the First Scheduled Hearing Session, Securities Exchange Act Rel. No. 49716 (May 17, 2004), 69 FR 29342 (May 21, 2004) (SR-NASD-2003-164).

shall allocate the $100 per arbitrator fee among the requesting parties. The arbitrators may allocate all or a portion of the $100 per arbitrator fee to the non-requesting party or parties, if the arbitrators determine that the non-requesting party or parties caused or contributed to the need for the postponement. In the event that a request results in the postponement of consecutively scheduled hearing sessions, the additional fee will be assessed only for the first of the consecutively scheduled hearing sessions. In the event that an extraordinary circumstance prevents a party or parties from making a timely postponement request, the arbitrators may use their discretion to waive the fee, provided verification of such circumstance is received.

(3) No change.

(c) No change.

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One commenter asked whether a motion for postponement outside of the 10-day window under Proposed Rule 12601(a) would require a "good cause" explanation.[173] In Amendment 5, NASD explained that if a party requests to postpone a hearing more than 10 days from the date the hearing is scheduled to begin, it would not need to demonstrate good cause. Rather, a panel may grant a party's request based solely on the request, and the party would be required to pay any applicable fees.

TT. Proposed Rule 12602 -- Attendance at Hearings

[173] Ryder.

Proposed Rule 12602 provides that the parties and their representatives are entitled to attend all hearings, and the panel will decide who else may attend any or all of the hearings. Several commenters viewed Proposed Rule 12602 as inconsistent with directions given in the Securities Industry Conference on Arbitration Manual, which creates a presumption for the attendance of expert witnesses and an investor's representative.[174] They suggested that the proposed rule should expressly allow expert and other fact witnesses to attend hearings.

In Amendment 5, NASD agreed that expert witnesses should be allowed to attend all hearings, but stated that the panel should have the discretion to allow other persons to attend hearings (e.g., an individual assisting an elderly or disabled party) or to bar someone who may be disruptive to the proceeding.

In response to comments, the proposed rule change is amended as follows (new language underlined):

12602. Attendance at Hearings

The parties and their representatives are entitled to attend all hearings. Absent persuasive reasons to the contrary, expert witnesses should be permitted to attend all hearings. The panel will decide who else may attend any or all of the hearings.

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UU. Proposed Rule 12607 -- Order of Presentation of Evidence and Arguments

Proposed Rule 12607 provides that while the claimant generally will present its case, followed by the respondent's defense, the panel may vary the order in which the hearing is conducted, as long as each party is given a fair opportunity to present its case. Three commenters noted that no other proposed rule addresses the order of the presentation of

[174] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, Page, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, and Sutherland.

evidence.[175] They recommended that Proposed Rule 12607 should expressly address opening statements and closing arguments, and clarify that rebuttal testimony is allowed. Several commenters suggested that Proposed Rule 12607 should give claimants the right to reserve any or all of their closing argument for rebuttal, some noting that this would be consistent with current practice and IM-10317 under the current Code.[176]

NASD responded that it believes the panel has the authority to control a hearing, which includes determining the order in which the hearing is conducted. Consistent with that principle, Proposed Rule 12607 is intended to provide the panel with discretion to vary the order in which the hearing is conducted, provided each party is given a fair opportunity to present its case. For these reasons, NASD is not proposing to amend this rule at this time.

VV. Proposed Rule 12700 -- Dismissal of Proceedings Prior to Award

Proposed Rule 12700 lists the circumstances in which a panel may or must dismiss an arbitration or claim prior to award. One commenter stated that dismissals under Proposed Rule 12700(b) should be classified as an award and put into writing pursuant to Proposed Rule 12904 (Awards).[177] In this commenter's opinion, because dismissal orders require a dispositive determination of the arbitrators and are subject to vacatur challenges in court, they are legally "awards."

In Amendment 5, NASD responded that it believes its proposed definition of "award" under Proposed Rule 12100 addresses this commenter's concern.[178] Moreover, NASD explained that panels issue awards under current practice if they determine that cases should be dismissed,

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[175] Canning, Feinberg, and Stoltmann.

[176] Boliver, Canning, Evans, Feinberg, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, Page, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

[177] Ryder.

[178] See discussion in Section III.B, Proposed Rule 12100(b) (Definition of Award), above.

with or without prejudice. For these reasons, NASD is not proposing to amend Proposed Rule 12700(b) at this time.

WW. Proposed Rule 12702 -- Withdrawal of Claims

Proposed Rule 12702(a) provides that before a claim has been answered by a party, the claimant may withdraw the claim against that party with or without prejudice. Proposed Rule 12702(b) provides that after a claim has been answered by a party, the claimant may only withdraw the claim against that party with prejudice unless the panel decides, or the parties agree, otherwise. In the Customer Code Notice, the Commission asked whether Proposed Rule 12702(b) appropriately addresses the concern of allowing claimants to withdraw claims without prejudice, while protecting respondents from expending significant resources to respond to a claim that is later withdrawn or having to respond to the same claim multiple times.

Several commenters opposed Proposed Rule 12702(b), contending that, in their collective experiences, there are few instances in which a claim had to be withdrawn after an answer was filed.[179] These commenters argued that, at the very least, the proposed rule should provide arbitrators with the authority to decide whether a claim, if withdrawn after an answer is filed, should be withdrawn with or without prejudice.

In Amendment 5, NASD responded that Proposed Rule 12702(b) is intended to deter claimants' gamesmanship in withdrawing and refiling claims in order to select a new panel. NASD noted that under Proposed Rule 12702, if claimants have legitimate reasons to withdraw claims without prejudice after the answer is filed, they may ask the arbitrators to allow them to do so. NASD believes that this provision is a reasonable accommodation of the competing interests in the forum and declined to amend Proposed Rule 12702(b) at this time.

[179] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

XX. Proposed Rule 12800 -- Simplified Arbitration

Proposed Rule 12800 establishes procedures for simplified arbitration, which are claims of $25,000 or less. While respondents have only 20 days to answer a simplified arbitration claim under the current Code, they would have 45 days to do so under the Customer Code, consistent with cases submitted under regular arbitration. In the Customer Code Notice, the Commission asked whether the proposed 45-day deadline should be shortened in simplified cases to reflect the fact that they are meant to take place more expeditiously than regular cases.

Several commenters opposed the proposed 45-day deadline, contending that firms should be able to respond more quickly to small, uncomplicated claims.[180] Moreover, these commenters believe that the longer deadline would diminish the benefits of simplified arbitrations as a quick, inexpensive option for small investors. As an alternative, several commenters suggested a 30 day deadline, similar to the requirements in most state courts for the filing of an answer.[181]

In Amendment 5, NASD responded that it is sensitive to the commenters' concerns, but noted that the 45-day deadline reflects current practice in the forum. NASD stated that frequent users of the forum and NASD staff report that parties routinely extend the deadlines in simplified arbitration that are provided under Rule 10302 of the current Code. Because parties so often extend existing deadlines, NASD believes that Proposed Rule 12800 would simplify and streamline the administration of simplified arbitrations without resulting in additional delay.

[180] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PACE, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

[181] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

One commenter contended that, while the current Code permits a claimant to reply to the respondent's answer, the Customer Code does not explicitly authorize this practice.[182] In this commenter's view, because many claimants filing simplified arbitration claims are pro se, the procedures controlling these arbitrations should be expressly stated. This commenter suggested defining "pleadings" to clarify that replies can be filed to respondents' answers in simplified arbitration. This commenter also suggested providing that claimants have 10 days to file such replies following the close of the discovery period.

In Amendment 5, NASD responded that although it agrees that a definition of "pleadings" should be included in the Customer Code, (see Section III.B, above) it does not agree with the suggestion that claimants be given 10 days to file a reply following the close of the discovery period. NASD explained that, because time limits under the Customer Code are meant to be standardized, the proposed rule does not include the special time limits or deadlines for simplified cases from the current Code.

One commenter objected that the only arbitrators eligible to hear simplified arbitration cases are those included on the chairperson-eligible arbitrator roster.[183] In Amendment 5, NASD responded that, because simplified arbitration cases are decided by only one arbitrator, it believes the arbitrator should have had the experience of sitting on prior cases. Proposed Rule 12800, however, would give parties the option to select an arbitrator from a different roster if they mutually agree.

For these reasons, NASD is not proposing to amend Proposed Rule 12800 at this time.

YY. Proposed Rule 12801 -- Default Proceedings

[182] PACE.

[183] Caruso.

Proposed Rule 12801 addresses the applicability of, and procedures involved in, default proceedings. One commenter noted that default proceedings under Rule 10314(e) of the current Code apply to defunct firms only, and asserted that the reference to default proceedings in Proposed Rule 12308, concerning failure to answer claims, would expand the use of default proceedings to all respondents who fail to answer, whether active or defunct.[184] NASD explained that, like Rule 10314(e) of the current Code, Proposed Rule 12801 would apply only to a respondent within one of the following four categories: (1) a member whose membership has been terminated, suspended, canceled, or revoked; (2) a member that has been expelled from the NASD; (3) a member that is otherwise defunct; or (4) or an associated person whose registration is terminated, revoked, or suspended. Therefore, Proposed Rule 12801 would not apply to active firms and would not change the substantive requirements of the default procedures under the current Code.

Two commenters suggested that Proposed Rule 12801 should: (1) permit default proceedings when a respondent (including current members and associated persons with active registrations) has failed to file both an answer and a uniform submission agreement; (2) limit the time a party has to file the answer and uniform submission agreement; (3) provide that, under the proposed default process, determinations should be dispositive only in favor of the claimant; and (4) give movants the opportunity to present the case in evidentiary hearing on any issues not favorably ruled on.[185]

In Amendment 5, NASD responded that Proposed Rule 12801 has not changed the substantive requirements concerning default procedures in Rule 10314(e) of the current Code,

[184] Ryder.

[185] Canning and Feinberg.

which requires claimants to present a sufficient basis to support the granting of an award. It therefore stated that this comment is outside the scope of the rule filing.

ZZ. Proposed Rule 12900 -- Fees Due When a Claim Is Filed

Proposed Rule 12900 establishes filing fees due from each party based on the amount in controversy. Several commenters contended that industry members should pay the majority of the customer filing fee, suggesting that the filing fee for public customers should be limited to $200.[186] In their view, while public customers should be subject to the panel's allocation of fees in the award, they should not have to incur undue expense at the outset to file a claim.

Another commenter suggested that the lack of an increase in fees for claims above one million dollars seems to favor wealthier claimants.[187] This commenter indicated that the fee schedules could be perceived as unfair because mid-level claimants appear to be shouldering a disproportionate percentage of the forum fees. To shift the cost burden to those who stand to benefit the most, while eliminating the perception that the fee changes impact the middle-class investor the most, this commenter suggested that NASD should amend Proposed Rule 12900 to charge a fixed percentage as an additional fee for any amounts claimed over one million dollars.

In Amendment 5, NASD responded that Proposed Rule 12900 made very minimal changes to the fee schedules in Rule 10332 of the current Code, and that the proposed changes would not result in an increase in the total amount of fees paid by customers or associated persons when filing a claim. As NASD explained, for claims of $30,000 to $50,000, the customer's overall filing fees would decrease by $50, and for claims of $1 million to $3 million, the customer's overall filing fees would decrease by $100. NASD also stated that its fee

[186] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, Page, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

[187] Ryder.

schedules are commensurate with the dollar amount of the claims filed and damages requested. In its view, the proposed, simplified fee schedules would make it easier for parties to understand the total amount due upon filing. For these reasons, NASD is not proposing to amend Proposed 12900 at this time.

One commenter expressed concern that the expense of arbitration (i.e., filing fees) may prevent access to the forum and suggested that NASD amend Proposed Rule 12900(d) to expressly disclose that fee waivers may be granted to parties who can demonstrate financial hardship.[188] This commenter also stated that the proposed rule should explain the practice and procedure for applying for fee waivers and NASD's criteria for granting them. In Amendment 5, NASD responded that, although this comment is beyond the scope of the rule filing, it would consider the comment in considering whether future amendments are warranted. In Amendment 7, NASD noted that the procedures to request a filing fee waiver already are located on NASD's Web site in the Uniform Forms Guide, at: http://www.nasd.com/web/groups/med_arb/documents/mediation_arbitration/nasdw_007954.pdf.

AAA. Proposed Rule 12902 -- Hearing Session Fees, and Other Costs and Expenses

Proposed Rule 12902 establishes hearing session fees due from the parties based on the amount in controversy. Several commenters noted that, although Proposed Rule 12902 would require a party to pay one fee, which includes the filing fee and the hearing session deposit fee, it does not provide that any of the fee will be applied to any hearing fees incurred.[189] These commenters contended that a claimant would pay for the first hearing session twice – once through the filing fee and then again when the hearing session fees are assessed.

[188] PACE.

[189] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

NASD responded that it did not intend to increase the fee for submitting a claim to arbitration under the Customer Code and agreed that clarification is needed. Thus, NASD proposed to amend Proposed Rule 12902(b) to provide that an amount equal to one hearing session fee would be deducted from the total amount of the hearing session fees assessed against the party who paid the filing fee. The proposed rule change is amended as follows (new language underlined):

12902. Hearing Session Fees, and Other Costs and Expenses

(a) No change.

(b) Payment of Hearing Session Fees

(1) No change.

(2) No change.

(3) In the award, the amount of one hearing session fee will be deducted from the total amount of hearing session fees assessed against the party who paid the filing fee. If this amount is more than any fees, costs, and expenses assessed against this party under the Code, the balance will be refunded to the party.

(c) No change.

(d) No change.

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In Amendment 5, NASD also proposed to amend Proposed Rule 12902 to address the issue of refund payments. NASD stated that it receives numerous requests from non-parties to make refunds payable to the attorneys or other non-parties that may have made payment on behalf of named parties. Currently, when any money remains in a party's account after all fees

and charges are assessed, NASD's practice is to refund the money directly to the party. Because parties themselves sign the uniform submission agreement and are liable for any fees or costs incurred under the current Code, NASD believes it is inappropriate to issue refunds to anyone other than a party. Therefore, NASD is proposing to codify its practice by adding a new provision to Proposed Rule 12902. The proposed rule change is amended as follows (new language underlined):

12902. Hearing Session Fees, and Other Costs and Expenses

* * * * *

(e) Refund Payments

Any refunds of fees or costs incurred under the Code will be paid directly to the named parties, even if a non-party made a payment on behalf of the named parties.

* * * * *

BBB. Proposed Rule 12904 – Awards

Proposed Rule 12904, in pertinent part, establishes the required content of awards. One commenter suggested defining the term "award" under the Customer Code.[190] In Amendment 5, NASD agreed with this comment and included a definition of "award."[191]

The same commenter also stated that dismissal of an entire claim should be considered an award. In Amendment 5, NASD agreed and stated that the proposed definition of "award" under Proposed Rule 12100 addresses this issue.

Finally, this commenter noted that although Rule 10330 requires all awards to be in writing and signed by a majority of the arbitrators, parties nonetheless may agree to permit one arbitrator to sign a stipulated award that directs expungement relief on behalf of the whole panel.

[190] Ryder.

[191] See Section III.B, Proposed Rule 12100 (Definitions), above.

In this commenter's view, parties should not be allowed to have one arbitrator sign a stipulated award on behalf of the entire panel, even if the parties mutually agree.

In Amendment 7, NASD explained that under current practice, which would continue under the Customer Code, parties are not permitted to agree to the appointment of selected arbitrators for the sole purpose of entering a stipulated award.[192] Moreover, parties may not agree to having only one arbitrator of a three-member panel sign the stipulated award. Stipulated awards, like awards issued after a hearing on the merits, must be signed by a majority of the panel.[193]

IV. Summary of Comments on the Industry Code as Amended by Amendments 1, 2, 3, and 4 and Description of Amendments 5, 6, and 7 to the Industry Code

A. Summary of Comments on the Industry Code as Amended by Amendments 1, 2, 3, and 4

NASD filed Amendment 5 to the Industry Code with the Commission on May 4, 2005. Only one commenter specifically addressed the Industry Code Notice.[194] This commenter noted that Proposed Rule 13601(a) appears to give the parties the unfettered right to postpone the hearing whenever they agree to do so, which the commenter viewed as contradicting an arbitrator's duty to keep the cases moving toward resolution. The commenter suggested incorporating some provisions from current Rule 10319(c) (Adjournments) to give the panel some express control over the number of times a case may be postponed and to eliminate repeat postponements. NASD's response to the commenter's concerns is discussed above in Section

[192] Telephone conversation between Mignon McLemore, Assistant Chief Counsel, NASD Dispute Resolution, and Gena Lai, Special Counsel, Division of Market Regulation, SEC (Sept. 15, 2006). In Amendment 5, NASD responded that, under the current Code and Customer Code, if the parties mutually agree for one arbitrator to sign a stipulated award on behalf of the panel, the request should be honored.

[193] See Proposed Rule 12904(a).

[194] See Elster, supra note 5.

III.SS, Proposed Rule 12601 (Postponement of Hearings). NASD amended Proposed Rule 13601 of the Industry Code consistent with Proposed Rule 12601 of the Customer Code.

B. Amendment 5 to the Industry Code

As noted above, the Commission received 51 comments on the Customer Code. While none of these comments specifically addressed the Industry Code, because the two codes contain similar rules and procedures, comments on the Customer Code were also relevant to the Industry Code. Thus, NASD made corresponding amendments to both the Customer Code and the Industry Code. Amendment 5 to the Industry Code also corrects typographical, grammatical, and other technical errors. NASD requested accelerated approval for the amendments to the Industry Code that were not yet published. As with the Customer Code, this request applies to the amendments filed after the Customer Code Notice.

The table below shows which Industry Code and Customer Code rules were similarly amended in Amendments 5 to each proposed code.

CHANGES TO CUSTOMER & INDUSTRY CODES AS A RESULT OF COMMENT LETTERS

Customer Code	Industry Code
12100 – Definitions	13100 – Definitions
12203 – Denial of NASD Forum	13203 – Denial of NASD Forum
12204 – Class Action Claims	13204 – Class Action Claims
12213 – Hearing Locations	13213 – Hearing Locations
12214 – Payment of Arbitrators	13214 - Payment of Arbitrators
12301 – Service on Associated Persons	13301 – Service on Associated Persons
12309 – Amending Pleadings	13309 – Amending Pleadings
12312 – Multiple Claimants 12313 – Multiple Respondents	13312 – Multiple Claimants 13313 – Multiple Respondents
12400(b) – Arbitrator Rosters	13400(b) - Arbitrator Rosters
12403 - Generating and Sending Lists to Parties	13403 – Generating and Sending Lists to Parties
12404 – Striking and Ranking Arbitrators	13404 – Striking and Ranking Arbitrators
12501 – Other Prehearing Conferences	13501 – Other Prehearing Conferences
12505 – Cooperation of Parties in Discovery	13505 – Cooperation of Parties in Discovery

12506(b) – Time for Responding to Documents Production Lists 12507(b) – Responding to Other Discovery Requests	 13507(b) – Responding to Discovery Requests
12507(a) – Making Other Discovery Requests	13506(a) – Discovery Requests
12514(c) – Exclusions of Documents or Witnesses	13514(c) – Exclusion of Documents or Witness
12600 – Required Hearings	13600 – Required Hearings
12601 – Postponement of Hearings	13601 – Postponement of Hearings
12602 – Attendance at Hearings	13602 – Attendance at Hearings
12902(b) – Payment of Hearing Session Fees	13902(b) - Payment of Hearing Session Fees
12902(e) – Refund Payments	13902(e) – Refund Payments

C. Amendment 6 to the Industry Code

In Amendment 6 to the Industry Code, in response to commenters' concerns regarding Proposed Rule 12504 (Motions to Decide Claims Before a Hearing on the Merits) of the Customer Code, NASD withdrew Proposed Rule 13504 (Motions to Decide Claims Before a Hearing on the Merits) and all references to that rule.[195]

D. Amendment 7 to the Industry Code

In Amendment 7 to the Industry Code, NASD made changes that correspond to those in Amendment 7 to the Customer Code.[196] NASD also amended Proposed Rule 13800(c) (Simplified Arbitration) to provide that no hearing will be held in simplified arbitrations of industry cases unless the claimant requests a hearing. Previously, the rule inaccurately provided that a customer could request a hearing under the rule, although Proposed Rule 13800(c) does

[195] See Section III.GG, Proposed Rule 12504 (Motions to Decide Claims Before a Hearing on the Merits), above.

[196] There were no changes corresponding to those for Proposed Rule 12200 (concerning insurance business activities of a member), however, because there is no corollary in the Industry Code.

not apply to customer cases. Proposed Rule 13800(c) is amended as follows (new language underlined; deleted language in [brackets]):

13800. Simplified Arbitration

(a) – (b) No change.

(c) Hearings

(1) No hearing will be held in arbitrations administered under this rule unless the [customer] claimant requests a hearing.

(2) No change.

(d) – (f) No change.

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For the text of Amendments 5, 6, and 7 to the Industry Code, including amendments to the narrative portion and exhibits of the Industry Code filing, please see NASD's Web site at the following URL: http://www.nasd.com/RulesRegulation/RuleFilings/2004RuleFilings/NASDW_009295.

V. Discussion

After careful review, the Commission finds that the proposed rule changes (SR-NASD-2003-158 and SR-NASD-2004-011), as amended, are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.[197] In particular, the Commission finds that the proposals, as amended, are consistent with the

[197] In approving this proposal, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

provisions of Section 15A(b)(6) of the Act,[198] which requires, among other things, that the rules of a national securities association 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. The Commission finds that NASD's proposals, as amended, are designed to protect investors and the public interest by providing an accessible and clearly organized set of rules to facilitate the resolution of disputes by users and administrators of the arbitration forum. The revision of the current NASD rules into plain English will make the process of arbitration more transparent and more accessible to users of the forum, including those who may file arbitration claims pro se. Moreover, the reorganization of the current Code into three separate codes should minimize confusion as to which rules apply to customer cases or industry cases and further improve the transparency of the arbitration process, thereby improving the efficiency with which cases are processed in the NASD dispute resolution forum.[199]

Particular provisions of the Customer Code and Industry Code that vary substantively from the current Code are discussed below.

A. Proposed Rules 12105 and 13105 -- Agreement of the Parties

The current Code does not specifically address the parties' modification of a provision of the current Code or a decision of the Director or the panel by written agreement. Proposed Rules 12105(a) and 13105(a) of the Customer Code and Industry Code, respectively, generally allow these modifications. Furthermore, Proposed Rules 12105(b) and 13105(b) provide that if the Director or the panel determines that a named party is inactive in the arbitration or has failed to respond after adequate notice has been given, the Director or the panel may determine that the written agreement of that party is not required while the party is inactive or not responsive.

198 15 U.S.C. 78o-3(b)(6).

199 The Commission already has approved the Mediation Code. See supra note 8.

Proposed Rules 12105(b) and 13105(b) are designed to allow the active parties in an arbitration to continue to exercise the control intended by Proposed Rules 12105(a) and 13105(a), in the event that a party whose agreement is needed is not participating in the arbitration or is otherwise unresponsive. The Commission notes that NASD has clarified the meaning of "inactive party" by amending Proposed Rules 12105(b) and 13105(b) to provide examples of who an inactive party is in the rule text. As amended, these proposed rules should improve the efficacy and efficiency with which arbitration cases can proceed.

B. Proposed Rules 12203 and 13203 -- Use of the Forum

Rule 10301(b) of the current Code allows the Director of Arbitration to decline the use of the NASD arbitration forum only if the "dispute, claim, or controversy is not a proper subject matter for arbitration," and only upon approval of the NAMC or its Executive Committee. Proposed Rules 12203(a) and 13203(a) of the Customer Code and Industry Code, respectively, provide that the Director "may decline to permit the use of the NASD arbitration forum if the Director determines that, given the purposes of NASD and the intent of the Code, the subject matter of the dispute is inappropriate, or that accepting the matter would pose a risk to the health or safety of arbitrators, staff, or parties or their representatives." Proposed Rules 12203 and 13203 are intended to give the Director the flexibility needed in emergency situations. The proposed rules also would provide that this authority may be exercised only by the Director or the President of NASD Dispute Resolution and cannot be delegated.

The Commission believes that the proposed rules should facilitate excluding cases from the NASD arbitration forum that are beyond its mandate, allowing it to focus on the cases that are appropriately in the forum. This, in turn, should promote the efficacy and efficiency of the arbitration forum in processing its claims. The Commission agrees that in emergency situations,

it is reasonable for the Director to have the authority and flexibility to act quickly to protect the health and safety of users and administrators of the forum. We note that this authority, which cannot be delegated by the Director or President of NASD Dispute Resolution, should be limited by application in only a very narrow range of unusual circumstances.

C. Proposed Rules 12205 and 13205 -- Shareholder Derivative Actions

The current Code does not specifically address whether shareholder derivative actions may be arbitrated at NASD. NASD has stated that such claims are not eligible for arbitration in it is forum because, by definition, they involve corporate governance disputes that do not arise out of, or in connection with, the business of a member firm or an associated person. Nonetheless, the question arises from time to time, occasionally after a claimant has filed a statement of claim. Proposed Rules 12205 and 13205 of the Customer Code and Industry Code, respectively, would provide that shareholder derivative actions are not eligible for arbitration at NASD.

The Commission believes that the inclusion of these proposed rules should provide guidance to parties and obviate the need for parties to expend resources in an attempt to arbitrate shareholder derivative claims at NASD, thereby improving the efficiency of the arbitration forum. Clarifying which cases may be heard in the Customer Code and Industry Code is consistent with the purposes of the proposed rule changes.

D. Proposed Rules 12207 and 13207 -- Extensions of Deadlines

Rule 10314(b)(5) of the current Code provides that deadlines established by the Code for filing or serving pleadings may be extended by the Director, or with the consent of the initial claimant. It further provides that extensions for filing an answer are disfavored and will only be granted in extraordinary circumstances, but does not provide guidance with respect to the

extensions of other deadlines established by the Code, the panel, or the Director. Proposed Rules 12207(a) and 13207(a) of the Customer Code and Industry Code, respectively, provide that the parties, with written notification to the Director, may agree in writing to extend or modify any deadline for serving an answer, returning arbitrator or chairperson lists, responding to motions, or exchanging documents or witness lists. Proposed Rules 12207(b) and 13207(b) provide that the panel also may extend or modify any of the specified deadlines, or any other deadline set by the panel, either on its own initiative or upon motion of a party. Finally, Proposed Rules 12207(c) and 13207(c) provide that the Director may extend or modify any deadline set by the Customer Code or Industry Code, respectively, for good cause, or by the panel in extraordinary circumstances.

The Commission believes that Proposed Rules 12207 and 13207 should give parties more control over various aspects of the arbitration process, subject to their mutual agreement. The proposed rules also would give arbitrators and the Director more authority to manage the arbitration process. We note that under Proposed Rules 12207(c) and 13207(c), respectively, the Director must satisfy a good cause standard to extend a deadline established by the Customer Code or Industry Code, or find that extraordinary circumstances exist to extend a deadline established by the panel. By introducing more flexibility into the arbitration process and providing parties, arbitrators, and the Director with more authority to control the process, the proposed rules should promote the efficacy and efficiency of the arbitration process and forum.

E. Proposed Rules 12210 and 13210 -- Ex Parte Communications

The current Code does not explicitly address ex parte communications. Proposed Rules 12210 and 13210 in the Customer Code and Industry Code, respectively, are intended to provide additional guidance to arbitrators and parties and to further ensure the integrity of the NASD

arbitration process. Proposed Rules 12210 and 13210 would expressly prohibit ex parte communications between parties and arbitrators, except in accordance with Proposed Rules 12211 and 13211, respectively.[200] NASD stated that Proposed Rules 12210 and 13210 are based on general ex parte rules applicable in court proceedings, and current NASD practice, as reflected in the NASD Arbitrators' Manual, other NASD arbitrator training materials, and materials provided to parties, all of which advise against ex parte communications.

The Commission believes that the proposed rules should aid arbitrators in maintaining neutrality and avoiding the appearance of impropriety, thereby promoting the fairness of the arbitration process and forum.

F. Proposed Rules 12212 and 13212 – Sanctions

Rule 10305(b) of the current Code, governing the dismissal of proceedings, provides that the "arbitrators may dismiss a claim, defense, or proceeding with prejudice as a sanction for willful and intentional material failure to comply with an order of the arbitrator(s) if lesser sanctions have proven ineffective." In addition, the current Discovery Guide states that "[t]he panel has wide discretion to address noncompliance with discovery orders." For example, the panel may make an adverse inference against a party or assess adjournment fees, forum fees, costs and expenses, and/or attorneys' fees caused by noncompliance."

Proposed Rules 12212 and 13212 of the Customer Code and Industry Code, respectively, would codify the sanctions available to arbitrators that are described in the current Discovery Guide, and extend them beyond the discovery context to apply to non-compliance with any

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200 Proposed Rules 12211 and 13211 (Rule 10334 in the current Code) allow direct communication between parties and arbitrators subject to certain conditions. These conditions include the representation of parties by counsel, an agreement to use direct communication by all arbitrators and parties, an agreement regarding the scope of the direct communication, and facsimile or e-mail capability by all arbitrators and parties.

provision of the Customer Code or Industry Code, respectively, or order of the panel or a single arbitrator authorized to act on behalf of the panel. The rules also would allow a panel to dismiss a claim, defense, or arbitration under the same conditions as they may currently, although it would use the term "prior," rather than "lesser," sanctions, in order to avoid potential confusion regarding whether a prior sanction was "lesser" or "greater."

The Commission notes the authority of NASD arbitrators to impose sanctions for violations of any provision of the Customer Code or the Industry Code, rather than only for violations of orders of the panel, as under the current Code. The Commission believes that this expanded authority should help to promote just and equitable principles of trade, and in general, to protect investors and the public interest by deterring conduct that seeks to generate frivolous additional disputes or hinder dispute resolution, and by clarifying that arbitrators have the authority to ensure the fair and efficient administration of arbitration proceedings when parties fail to comply with the Customer Code or Industry Code or orders of the panel. The Commission also notes that under the Customer Code and Industry Code, arbitrators would continue to have the authority to make disciplinary referrals at the end of arbitrations in connection with potential violations of NASD rules.

G. Proposed Rules 12213 and 13213 -- Hearing Locations

In relevant part, Rule 10315 of the current Code provides that the Director shall determine the time and place of the first meeting of the arbitration panel and the parties, whether that meeting is a pre-hearing conference or a hearing, and shall notify the parties of the time and place at least 15 business days before the meeting. The arbitrators determine the time and place for all subsequent meetings, whether the meetings are pre-hearing conferences, hearings, or any other type of meetings, and give notice as the arbitrators may determine. Proposed Rule

12213(a)(1) of the Customer Code provides that the Director will select the hearing location for the arbitration, and that generally, this selection will be the hearing location closest to the customer's residence at the time of the events giving rise to the dispute. Proposed Rule 13213(a)(1) of the Industry Code provides that the Director generally will select the hearing location closest to where the associated person was employed at the time the dispute arose.[201] Proposed Rules 12213(a)(2) and 13213(a)(2) also provide, however, that before arbitrator lists are sent to the parties, the parties may agree in writing to a hearing location other than the one selected by the Director, and that the Director or panel may change the hearing location upon a party's motion.

NASD stated that Proposed Rules 12213 and 13213 codify current practice and are intended to make the arbitration process more transparent. The proposed rules also would give the Director discretion to select another location that would be more appropriate or less burdensome to the parties given the specific facts of the case.

The Commission believes that the proposed rules should provide useful guidance to the parties and thereby facilitate and improve the transparency of the arbitration process. We also note that NASD clarified in Amendments 5 to the Customer Code and Industry Code that parties may appeal the Director's selection of hearing location to the arbitration panel, once it is assembled.

H. Proposed Rules 12304, 12305, 13304 and 13305 -- Time to Answer Counterclaims and Cross Claims

[201] This standard would be interpreted to refer to the time of the events giving rise to the dispute. Telephone conversation among Jean Feeney, Vice President, NASD; Mignon McLemore, Assistant Chief Counsel, NASD Dispute Resolution; and Gena Lai, Special Counsel, Division of Market Regulation, SEC (Dec. 19, 2006).

Rule 10314 of the current Code provides that claimants have 10 days to answer a counterclaim, and respondents have 45 days to answer a cross claim. Proposed Rules 12304 and 13304 of the Customer Code and Industry Code, respectively, would extend the time that a claimant has to answer a counterclaim from 10 to 20 days from receipt of the counterclaim. In addition, Proposed Rules 12305 and 13305 of the Customer Code and Industry Code, respectively, would shorten the time that a respondent has to answer a cross claim from 45 days to 20 days from the date that the respondent's answer to the statement of claim is due, or from the receipt of the cross claim.

NASD stated that standardizing these time frames would give parties who have already filed or served a pleading the same amount of time to respond to subsequent pleadings, and would reduce unnecessary delay in the proceeding.

The Commission believes that standardizing the time frames within which parties may answer counterclaims and cross claims is consistent with the purpose of maintaining a transparent, efficient, and fair arbitration forum.

I. Proposed Rules 12307 and 13307 -- Deficient Claims

Under current NASD practice, if a claimant files a deficient, or incomplete, claim, NASD will notify the claimant, and the claimant has 30 days to correct the deficiency. If the deficiency is not corrected within that time, the claim is dismissed without prejudice. NASD stated that this practice is consistent with SICA's published Arbitration Procedures. The current Code, however, does not expressly address what constitutes a deficiency, or explain the process for identifying and correcting deficiencies.

Proposed Rules 12307 and 13307 of the Customer Code and Industry Code, respectively, would codify NASD's deficiency practice and provide that the Director will not serve a

deficient, or incomplete, claim. They also would enumerate the most common types of deficiencies. The proposed rules also would make clear that the same standards apply to deficient counterclaims, cross claims, and third-party claims served directly by parties, and would prohibit arbitrators from considering such claims unless the deficiencies were corrected within the time allowed.

The Commission believes that, by including deficiency standards and procedures in the Customer Code and Industry Code and clarifying the information required in an initial statement of claim, the proposed rules should help to reduce delay in NASD arbitrations by reducing the number of deficient claims. They thus should improve the efficacy and efficiency of the arbitration process and of the forum generally. We note that NASD stated it would consider comments raised regarding Proposed Rule 12307 when considering whether future amendments are made.

J. Proposed Rules 12309 and 13309 -- Amending Pleadings to Add Parties

Under Rule 10328 of the current Code, parties may amend their pleadings at any time prior to the appointment of the arbitration panel but must obtain approval of the arbitrators before amending a pleading after panel appointment. If a party is added to an arbitration proceeding before the Director has consolidated the other parties' arbitrator rankings, the newly-added party may participate in the arbitrator selection process. However, if a party amends a pleading to add a new party to the proceeding between the time that the Director consolidates the arbitrator rankings and the time the panel is appointed, the newly-added party is not able to participate in the arbitrator selection process, or to object to being added to the arbitration.

Proposed Rules 12309 and 13309 of the Customer Code and Industry Code, respectively, would provide that no party may amend a pleading to add a party between the time that ranked

arbitrator lists are due to the Director and the time the panel is appointed. Proposed Rules 12309(c) and 13309(c) would provide that the party to be added after panel appointment must be given an opportunity to be heard before the panel decides the motion to amend. This is intended to ensure that a party added to an arbitration by amendment either will be able to participate in the arbitrator selection process, or will have the opportunity to object to being added to the proceeding.

The Commission believes that the proposed rules should promote the efficacy and efficiency of the arbitration process and of the forum generally. We also note that the proposed rules explain the rights of a party added to an NASD arbitration proceeding with respect to arbitrator selection.

K. Proposed Rules 12310 and 13310 -- Time to Answer Amended Pleadings

Rule 10328 of the current Code provides that parties have 10 business days to answer an amended pleading. Other rules in the current Code refer to calendar days. In the interest of uniformity, Proposed Rules 12100(j) and 13100(j) of the Customer Code and Industry Code, respectively, define the term "day" to mean calendar day. To reflect these definitions, Proposed Rules 12310 and 13310 would give parties 20 calendar days, rather than 10 business days, to respond to amended pleadings. NASD stated that, although this represents a slight extension of time, it is consistent with the time to respond to counterclaims and cross claims under Proposed Rules 12304 and 12305 under the Customer Code and Proposed Rules 13304 and 13305 under the Industry Code. NASD further stated that standardizing time frames is part of NASD's plain English initiative, and 20 calendar days is an appropriate time period for responding to amended pleadings.

The Commission believes that standardizing the time frames for answering amended pleadings is consistent with the purpose of maintaining a transparent, efficient, and fair arbitration forum.

L. Proposed Rules 12400 and 13400 -- Neutral List Selection System and Arbitrator Rosters

Under the current Code, NASD maintains a roster of public and non-public arbitrators. Whether a panel consists of public or non-public arbitrators, and in what combination, depends on the amount in dispute, and, in industry cases, the nature of the dispute. Once the panel is appointed, the parties jointly select the chairperson from the panel, or, if the parties do not agree, the Director appoints the highest-ranked arbitrator on the panel to serve as chairperson.[202] Although NASD provides voluntary chairperson training to its arbitrators, arbitrators who serve as chairpersons are not currently required to have chairperson training, to have any particular experience, or to meet any other specific criteria beyond the requirements for serving as an arbitrator. NASD stated that, over the years, one of the most frequent suggestions for improving the quality and efficiency of NASD arbitrations is to ensure that chairpersons, who play a vital role in the administration of cases, have some degree of arbitrator experience and training.

Both the Customer Code and Industry Code would require NASD to create and maintain a third roster of arbitrators who are qualified to serve as chairpersons. Proposed Rule 12400 would provide that, to be chair-qualified, an arbitrator would need to be a public arbitrator and complete the NASD training program or have "substantially equivalent training or experience,"

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[202] NASD estimates that parties agree on a chairperson only about 20% of the time. See supra note 3, Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, 3, and 4 Thereto to Amend NASD Arbitration Rules for Customer Disputes, Securities Exchange Act Rel. No. 51856, at n. 6, and Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, 3, and 4 Thereto to Amend NASD Arbitration Rules for Industry Disputes, Securities Exchange Act Rel. No. 51857, at n. 8.

and be either: (1) an attorney who has sat through two SRO arbitration cases through the award stage; or (2) a non-attorney who has sat through at least three such cases. Chairperson eligibility requirements under Proposed Rule 13400 of the Industry Code are the same as under the Proposed Rule 12400, except that chairpersons in industry cases could be public or non-public, depending on the nature of the claim.

The Commission believes that these specified criteria balance the need to have qualified and experienced chairpersons administer NASD arbitration cases with the goal of allowing arbitrators of all professional backgrounds to qualify as chairpersons. The proposed rules should help to ensure that chairpersons, who play a vital role in the administration of cases, have some degree of arbitrator experience and training, which in turn should improve the administration of cases in NASD's forum.

M. Proposed Rules 12401 and 13401 -- Number of Arbitrators

Rule 10308(b) of the current Code provides that if the amount of a claim is $25,000 or less, the arbitration panel consists of one arbitrator, unless that arbitrator requests a three-arbitrator panel. If the claim is more than $25,000 but not more than $50,000, the panel consists of one arbitrator, unless either that arbitrator, or any party in its initial pleading, requests a three-arbitrator panel. A claim of more than $50,000 is heard by a three-arbitrator panel.

Proposed Rules 12401 and 13401 of the Customer Code and Industry Code, respectively, would eliminate the ability of a single arbitrator to request a three-arbitrator panel for any claim of $50,000 or less. Parties, however, could still request a three-arbitrator panel in cases involving more than $25,000, but not more than $50,000. NASD stated that the proposed change is intended to streamline the administration of smaller claims and minimize the cost of pursuing small claims.

The Commission believes that allowing only the parties to decide whether additional arbitrators are needed in these smaller claims should give the parties more control over the costs of this aspect of arbitration. This, in turn, should improve the efficacy of the arbitration process.

N. Proposed Rules 12403 and 13403 -- Generating and Sending Lists to the Parties

Rule 10308 of the current Code provides that if the panel will consist of one arbitrator, NASD will send the parties one list of public arbitrators, unless the parties agree otherwise. If the panel will consist of three arbitrators, NASD will send the parties two lists, one with the names of public arbitrators and one with the names of non-public arbitrators. The lists of public and non-public arbitrators are provided in a ratio of approximately two to one, respectively, to the extent possible, based on the roster of available arbitrators. The parties have an unlimited number of strikes. In addition, parties may request that the lists include arbitrators with particular, designated expertise.

Proposed Rules 12403 and 13403 of the Customer Code and Industry Code, respectively, would expand the number of arbitrators named on each list, but limit the number of strikes that each party may exercise. In addition, the proposed rules would eliminate the ability of parties to unilaterally request arbitrators with particular expertise, which NASD stated is an ongoing source of controversy, and burdensome for NASD staff to administer.

The Commission believes that expanding the lists, but limiting the number of strikes each party may exercise, should expedite panel appointment and reduce the likelihood that the Director will have to appoint an arbitrator who was not on the original lists sent to parties. The Commission notes that in Amendments 5 to the Customer Code and Industry Code, NASD proposed additional changes to the list selection procedures to further reduce the likelihood that extended lists would be needed. NASD also explained changes in the list selection software that

would check for certain arbitrator conflicts before lists are sent to parties.[203] Taken as a whole, these changes should improve the efficacy and efficiency of the arbitration process and of the forum generally.

O. Proposed Rules 12406 and 13406 -- Appointment of Arbitrators

While the current Code is silent on when arbitrators are appointed, it can be the subject of questions. NASD stated that Proposed Rules 12406(d) and 13406(d) under the Customer Code and Industry Code, respectively, would clarify that the appointment of arbitrators occurs when the Director sends notice to the parties of the names of the arbitrators on the panel. In addition, consistent with the purpose of reorganizing the current Code, the arbitrator oath requirement that is in Rule 10327 of the current Code would be included in Proposed Rules 12406 and 13406.

The Commission believes that these proposed rules should improve the clarity of the arbitration rules and promote the efficacy and efficiency of the arbitration process and forum generally.

P. Proposed Rules 12409 and 13409 -- Arbitrator Recusal

The current Code does not address arbitrator recusal. To provide guidance to parties, Proposed Rules 12409 and 13409 of the Customer Code and Industry Code, respectively, would provide that any party may ask an arbitrator to recuse himself or herself from the panel for good cause. The proposed rule would also clarify procedures for seeking an arbitrator's recusal.

The Commission believes that, in clarifying the procedures for seeking an arbitrator's recusal, the proposed rules promote the efficacy and efficiency of the arbitration process and forum.

[203] For example, MATRICS would exclude from the lists sent to the parties arbitrators who are family members, employees, clients, or shareholders of a party, or have an account with, have initiated legal action against, or performed legal services for a party.

Q. Proposed Rules 12411 and 13411 -- Replacement of Arbitrators

Under the current Code, the provisions regarding the replacement of arbitrators are contained in several different sections, and contain numerous cross-references to other rules. Proposed Rules 12411 and 13411 of the Customer Code and Industry Code, respectively, consolidate the various current rules, but contain no substantive changes, with two exceptions. Under Rule 10313 of the current Code, if an arbitrator is disqualified or becomes otherwise unable or unwilling to serve after the first pre-hearing conference or the first hearing begins, whichever is earlier, but before the award is issued, the parties may elect to proceed with the remaining arbitrators by notifying the Director within five business days of their being notified of the vacancy. Under Proposed Rules 12411 and 13411 of the Customer Code and Industry Code, respectively, the parties may agree to proceed with only the remaining arbitrators regardless of when the vacancy occurs.[204]

The Commission believes that, by allowing for more flexibility in the arbitration process and giving parties more control in arbitrator selection, the proposed rules should improve the efficacy and efficiency of the arbitration process and of the forum generally. We also note that NASD has explained that parties would be informed of the vacancy and their options simultaneously.

R. Proposed Rules 12414 and 13414 -- Determinations of Arbitration Panel

Rule 10325 of the current Code provides that all rulings and determinations of the panel must be made by a majority of the arbitrators. Proposed Rules 12414 and 13414 of the Customer Code and Industry Code, respectively, provide that all rulings and determinations of the panel

[204] In addition, parties may stipulate to the removal of an arbitrator, including a replacement arbitrator, at any time. Telephone conversation among Jean Feeney, Vice President, NASD; Mignon McLemore, Assistant Chief Counsel, NASD Dispute Resolution; and Gena Lai, Special Counsel, Division of Market Regulation, SEC (Dec. 19, 2006).

must be made by a majority of the arbitrators, unless the parties agree, or unless the Customer Code or Industry Code, respectively, or applicable law, provides otherwise. The proposed rules reflect that under the Customer Code or Industry Code, and applicable law, some decisions of the panel may be made by a single member of a three-arbitrator panel.[205] Also, applicable law may permit a single arbitrator to issue a subpoena. The Commission notes, however, that an award must contain the signature of a majority of the panel, notwithstanding the agreement of the parties.[206]

The Commission believes that, by allowing for more flexibility in the arbitration process and by clarifying that arbitrators must make determinations in accordance with applicable law, the proposed rules promotes the efficacy and efficiency of the arbitration process and of the forum generally.

S. Proposed Rules 12500 and 13500 -- Initial Prehearing Conferences

Since the adoption of the current Discovery Guide in 1999, IPHCs have become standard practice in NASD arbitrations. The IPHC gives the panel and the parties an opportunity to organize the management of the case, set a discovery cut-off date, identify and establish a schedule for potential motions, schedule hearing dates, determine whether mediation is desirable, and resolve many other preliminary issues. NASD stated that users of the forum have found the IPHC to be a valuable tool in managing the administration of arbitrations. Proposed Rules 12500 and 13500 of the Customer Code and Industry Code, respectively, would codify the portion of the current Discovery Guide relating to IPHCs.

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[205] For example, Proposed Rules 12503 and 13503 provide that some motions may be decided by a single arbitrator.

[206] See Section III.BBB, Proposed Rule 12904 (Awards).

The Commission believes that codifying the provisions in the current Discovery Guide concerning IPHCs should streamline the administration of arbitrations and clarify the purposes and procedures of IPHCs. Thus, the proposed rules should promote the efficacy and efficiency of arbitration proceedings and of the forum generally.

T. Proposed Rules 12502 and 13502 -- Recording Prehearing Conferences

The current Code is silent with respect to whether and under what circumstances a prehearing conference will be tape-recorded. Proposed Rules 12502 and 13502 of the Customer Code and Industry Code, respectively, would provide that prehearing conferences are generally not tape-recorded as a matter of course, but that a panel may decide to tape-record a prehearing conference on its own initiative, or at the request of a party.

The Commission believes that the proposed rules would inform parties that the option to tape-record a prehearing conference is available and provide useful guidance to parties and arbitrators regarding when and under what circumstances prehearing conferences may be tape-recorded. Thus, the proposed rules should promote the efficacy and efficiency of arbitration proceedings and of the forum generally.

U. Proposed Rules 12503 and 13503 – Motions

Although motions are increasingly common in arbitration, the current Code does not refer to motions or provide any guidance with respect to motions practice. As a result, NASD stated that motions practice lacks uniformity, and that both parties and arbitrators are often unsure how motions should be made, responded to, or decided. Proposed Rules 12503 and 13503 of the Customer Code and Industry Code, respectively, would establish procedures and deadlines for making, responding to, and deciding motions.

The Commission believes that the proposed rules would provide standardized guidance to parties concerning a frequent practice in arbitration, while balancing the goal of maintaining the informal nature of arbitration. This is consistent with the purpose of providing an accessible, user-friendly set of rules to users and administrators of the arbitration forum and of improving the efficacy and efficiency of the arbitration forum. Infrequent users of the arbitration forum in particular should benefit from being informed that motions practice may be a part of arbitration, and what procedures may be involved.

In light of concerns expressed by commenters, the Commission expects NASD to monitor the effects of these rules on the efficacy and efficiency of the arbitration forum, including any increases in hearings scheduled as a result of motions, the length of time in which cases are resolved, or costs to the customer, in an ongoing effort to determine whether future amendments may be warranted.

V. Proposed Rules 12505 – 12511 and 13505 – 13511 – Discovery

The current Discovery Guide establishes guidelines for discovery, rather than mandatory procedures. As a result, NASD stated that a frequent comment made by users of the NASD forum, particularly with respect to customer cases, is that discovery procedures are routinely ignored, resulting in significant delay and the frequent need for arbitrator intervention in the discovery process.

Proposed Rules 12505-12511 of the Customer Code would codify the discovery procedures outlined in the current Discovery Guide, with some changes designed to minimize the number of discovery disputes in NASD arbitrations. The Customer Code would not contain the Document Production Lists, which would remain in the Discovery Guide, but would make clear that either producing or objecting to documents on applicable lists, as well as other documents

requested by parties, is mandatory. Proposed Rules 13505-13511 of the Industry Code would contain similar changes, providing specific guidance about how to make and respond to discovery requests, and clarifying that compliance with the discovery provisions of the Industry Code is mandatory.

The proposed rules would also extend the time that parties have to respond from 30 to 60 days. In addition, Proposed Rules 12512 and 13512 would codify the sanctions provisions of the Discovery Guide, and clarify the authority of arbitrators to sanction parties for non-compliance with discovery rules or orders of the panel.

The Commission believes that codifying the discovery procedures outlined in the Discovery Guide and the authority of arbitrators to impose sanctions for violating those procedures should encourage parties to comply with their discovery obligations, thereby minimizing discovery disputes and allowing cases to proceed as expeditiously as possible. Thus, the proposed rules should improve the efficacy and efficiency of the arbitration process and of the forum generally.

W. Proposed Rules 12512 and 13512 – Subpoenas

Rule 10322 of the current Code provides that arbitrators and any counsel of record to a proceeding shall have the power of the subpoena process as provided by law, and that all parties must be given a copy of a subpoena upon its issuance. The rule also provides that parties shall produce documents and make witnesses available to each other to the fullest extent possible without resort to the subpoena process.

Proposed Rules 12512 and 13512 of the Customer Code and Industry Code, respectively, are substantially similar to Rule 10322, but also would require a party issuing a subpoena to send

copies to all other parties at the same time and in the same manner as the party that was issued the subpoena.

The Commission believes that the proposed rules should help ensure that all parties receive notice of a subpoena in a timely manner. Thus, they should improve the efficacy and efficiency of the arbitration process and of the forum generally. We note that NASD acknowledged commenters' concerns and noted that a separate rule filing, recently approved by the Commission, addresses additional changes to the subpoena process.[207]

X. Proposed Rules 12514 and 13514 -- Exchange of Documents and Witness Lists

Rule 10321 of the current Code provides that, at least 20 calendar days before the first scheduled hearing date, all parties must serve on each other copies of the documents in their possession and identify the witnesses that they intend to present at the hearing. The arbitrators may exclude from the arbitration any documents not exchanged or witnesses not identified as part of this exchange. Parties need not exchange copies of documents or identify witnesses that may be used for cross-examination or rebuttal, however.

Proposed Rules 12514 and 13514 would provide that parties would only need to exchange the documents or identify the witnesses that they intend to present at the hearing that were not already exchanged or identified, e.g., through the discovery process. The proposed rules would create a presumption that parties could not present any documents not exchanged or call any witnesses not identified within the time provided by the rules, unless the panel determines that good cause exists. The proposed rules specifically provide that good cause

[207] See Order Approving Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 4 to Revise Rule 10322 of the NASD Code of Arbitration Procedure Pertaining to Subpoenas and the Power to Direct Appearances, supra note 152.

includes the need to use documents or call witnesses for rebuttal or impeachment purposes based on developments at the hearing.

The Commission believes that the proposed rules, by minimizing the volume of documents and amount of information that parties must exchange before a hearing, should improve the efficiency of the arbitration process. We particularly note that in Amendments 5 to the Customer Code and Industry Code, NASD clarified the meaning of "rebuttal or impeachment purposes."

Y. Proposed Rules 12601 and 13601 -- Postponements

Rule 10319 of the current Code provides that the arbitrator(s) may, in their discretion, adjourn any hearing either upon their own initiative or upon the request of any party to the arbitration. Proposed Rules 12601 and 13601 of the Customer Code and Industry Code, respectively, would provide that a panel may not grant requests to postpone a hearing that are made within 10 days of a scheduled hearing session unless the panel determines that good cause exists. NASD stated that these provisions are intended to reduce the number of last-minute requests for postponements, a practice that many users of the forum believe results in unnecessary delay and unfairness to parties. The proposed rules also would codify applicable postponement fees. Under the Proposed Rule 12601(b), however, the postponement fee would no longer double for a subsequent postponement request by the same party, as under the current Code. According to NASD, this change is intended to avoid the confusion that may result when one party requesting a postponement has made a previous request, but another party requesting the same postponement has not. Instead, parties would pay the same amount per postponement request.

The Commission believes that the proposed rules strike a balance between providing parties with the flexibility to postpone hearings, while discouraging parties from abusing this flexibility by requiring good cause for last-minute postponements. The proposed rules also reasonably address potential confusion in the way postponement fees are imposed and respond to the unnecessary delay and potential unfairness that last-minute postponements may cause.

Z. Proposed Rules 12702 and 13702 -- Withdrawal of Claims

The current Code does not contain any guidance with respect to withdrawing claims. According to NASD, this occasionally causes confusion, particularly with respect to the consequences of withdrawing a claim at a particular stage in an arbitration. To provide guidance to parties, Proposed Rules 12702 and 13702 of the Customer Code and Industry Code, respectively, would provide that before a claim has been answered by a party, a claimant may withdraw the claim against that party with or without prejudice. However, after a claim has been answered by a party, a claimant may only withdraw its claim against that party with prejudice, unless the panel decides, or the claimant and that party agree, otherwise.

In the Customer Code Notice and Industry Code Notice, the Commission solicited comment on whether Proposed Rules 12702 and 13702 of the Customer Code and Industry Code, respectively, appropriately address the concern of allowing claimants to withdraw claims without prejudice, while protecting respondents from expending significant resources to respond to a claim that is later withdrawn or having to respond to the same claim multiple times. Several commenters stated that Proposed Rule 12702(b) has no corollary in any court's civil procedure rules.[208] These commenters suggested that Proposed Rule 12702 should give arbitrators the

[208] Boliver, Canning, Evans, Ilgenfritz, Josel, Komninos, Lapidus, Lea, Lipner, Lopez, Magary, PIABA, Pounds, Rosenfield, Shewan, Stoltmann, Sutherland, and Willner.

authority to decide whether a claim, if withdrawn after an answer is filed, should be withdrawn with or without prejudice.

The Commission notes that Proposed Rules 12702(b) and 13702(b) would provide arbitrators with the authority suggested by the commenters and also allow a claim to be withdrawn without prejudice after an answer is filed if the parties mutually agree. The Commission believes that the rationale for the proposed rules would deter the withdrawal and refiling of claims in order to select a new panel, and are a reasonable accommodation of the competing interests in the forum.

AA. Proposed Rules 12800 and 13800 -- Simplified Arbitration

Rule 10302 of the current Code includes the provisions that apply to simplified arbitrations. Some of these provisions repeat procedures that also apply to regular cases, while others, such as deadlines for pleadings, are particular to simplified cases. Proposed Rules 12800 and 13800 of the Customer Code and Industry Code, respectively would be streamlined, by including only those provisions that are unique to simplified cases. The proposed rules also would harmonize the deadlines for pleadings in simplified cases with those in regular cases. NASD stated that frequent users of the forum report that the deadlines in simplified cases are routinely extended under the current rule. To provide better guidance to parties, NASD stated that the Customer and Industry Codes should reflect that, in practice, the time to answer in simplified cases is typically the same as it is in regular cases. Therefore, as in regular cases, requests for extensions would now be governed by Proposed Rules 12207 or 13207 (Extension of Deadlines), as appropriate, which would provide that deadlines set by the Customer Code or Industry Code, as appropriate, may be extended by the Director for good cause. In simplified

cases, the Director would consider the expedited nature of simplified cases in determining whether good cause existed.

In addition, Proposed Rules 12800 and 13800 would address the selection and use of a single arbitrator and when a three-arbitrator panel would be required, and would eliminate the ability of the single arbitrator to require a hearing, but still allow the customer to request a hearing. Furthermore, the arbitrator would no longer have the option of dismissing without prejudice a counterclaim or other responsive pleading that increased the amount in dispute above the simplified case threshold. If a pleading increased the amount in dispute above the threshold, the case would be administered under the regular provisions of the Code.

The Commission believes that these changes should make the simplified arbitration process easier for parties to understand, and should streamline and simplify the administration of small claims in the NASD forum. The proposed rules thus should promote the efficacy and efficiency of the arbitration process and of the forum generally, for simplified cases.

BB. Proposed Rules 12900-12903 and 13900-13903 -- Fees

NASD stated that a frequent criticism of the current Code is that the fee schedules are difficult to understand, particularly with respect to what claimants must pay at the time of filing. To address this issue, and to make the fee schedules easier to read, the fee schedules in Proposed Rules 12900-12903 and Proposed Rules 13900-13903 of the Customer Code and Industry Code, respectively, vary from those of the current Code in two significant ways.

First, the filing fee and the hearing session deposit – two separate fees due at filing – have been combined into one single fee that is paid when a claim is filed. With two exceptions, described below, the amounts paid by claimants would not change. Although what is now the refundable hearing session deposit would no longer be paid separately, an amount equal to the

current hearing session deposit or a portion thereof may be refunded if NASD receives notice that the case has been settled more than 10 calendar days prior to the hearing on the merits. The consolidation of the filing fee and the hearing session deposit is intended to make it easier for claimants to understand how much they have to pay when they file a claim and what, if any, portion of that fee may be refunded.

Second, the filing fee schedule has been simplified. Currently, there are 14 separate fee brackets in the filing fee schedule for claimants. The proposed changes would result in little change to the total amount of fees paid by claimants when filing a claim. In particular, a claimant's overall filing fees would decrease by $50 for claims of $30,000 to $50,000, and would increase by $100 for claims of $1 million to $3 million. The member filing fee schedule includes corresponding changes.

The Commission believes that the proposed changes will simplify the fee schedule, eliminate three repetitive high-end brackets, and align the brackets in the filing fee schedule with the brackets in the member filing fee and surcharge schedules. Taken as a whole, the proposed rules should make the fee schedules easier to understand and therefore make the arbitration process more transparent. The Commission finds that these proposed changes are consistent with Section 15A(b)(5)[209] of the Act, which requires that a national securities association have rules that provide for the equitable allocation of reasonable dues, fees, and other charges among its members and other persons using its facilities. In addition, the Commission finds that these proposed changes are consistent with Section 15A(b)(6),[210] which provide, among other things, that the rules of a national securities association may not be designed to permit unfair discrimination between customers, issuers, brokers or dealers, to fix minimum profits, or to

[209] 15 U.S.C. 78o-3(b)(5).

[210] 15 U.S.C. 78o-3(b)(6).

impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members.

VI. Amendments 5, 6, and 7 to the Customer Code and Amendments 5, 6, and 7 to the Industry Code

The Commission finds that the proposed changes in Amendments 5, 6, and 7 to the Customer Code and Amendments 5, 6, and 7 to the Industry Code are consistent with the Act and, in particular, are 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. The Commission finds that the proposed changes are designed to accomplish these ends by providing a user-friendly, reorganized set of rules that make the arbitration process more transparent and by clarifying certain aspects and procedures of arbitration in the NASD forum.[211]

A. Amendment 5 to the Customer Code and Amendment 5 to the Industry Code

The Commission finds good cause for approving Amendment 5 to the Customer Code and Amendment 5 to the Industry Code prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. The Commission believes that NASD's responses and proposed changes in Amendment 5 to the Customer Code and Amendment 5 to the Industry Code, as summarized in Sections III and IV, above, reasonably address concerns expressed in comments submitted in connection with the Customer Code and Industry Code. The changes proposed in Amendment 5 to the Customer Code and Amendment 5 to the Industry Code provide clarification and do not significantly alter the Customer Code and Industry Code, as amended by Amendments 1, 2, 3, and 4 of each respective code, which were subject to a full notice and comment period.

[211] In approving these amendments, the Commission has considered the amendments' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

In connection with the Customer Code, commenters suggested various substantive changes relative to current practices or policies established under the current Code. NASD stated that many of these comments were beyond the scope of the rule filing, the principal purposes of which were stated in the Customer Code Notice as: (1) revising the current Code into plain English; (2) reorganizing the current Code into more logical, user-friendly sections, including creating separate codes for customer and industry arbitrations and for mediations; and (3) implementing specific substantive rule changes, including codifying several common practices to provide more guidance to parties and arbitrators, and streamlining the administration of arbitrations in the NASD forum.[212] The Commission finds NASD's determination that these comments are beyond the scope of the rule filing to be reasonable because they suggest substantive changes from the current Code that were not intended to be addressed by this rule filing. Thus, the Commission finds NASD's determination not to amend the proposed rule changes in connection with these comments at this time also to be reasonable. We note that NASD has committed to consider some of these comments in determining whether future amendments are warranted, as indicated in Section III.

[212] See comments relating to Proposed Rule 12100(n) – Definition of Public Arbitrator/Proposed Rule 12100(r) – Definition of Non-Public Arbitrator (Section III.B.3); Proposed Rule 12200 – Arbitration Under an Arbitration Agreement or the Rules of NASD (Section III.G.2); Proposed Rule 12101 – Elective Arbitration (Section III.H.2); Proposed Rule 12206 – Time Limits (Section III.K); Proposed Rule 12300 – Filing and Serving Documents/Proposed Rule 12302 – Filing an Initial Statement of Claim (Section III.O); Proposed Rule 12307 – Deficient Claims/Proposed Rule 12308 – Loss of Defenses Due to Untimely or Incomplete Answer (Section III.Q); Proposed Rule 12312 – Multiple Claimants/Proposed Rule 12313 Multiple Respondents (Section III.U); Proposed Rule 12401 – Number of Arbitrators (Section III.X); Proposed Rule 12406 – Appointment of Arbitrators; Discretion to Appoint Arbitrators Not on List (Section III.Z); Proposed Rule 12408 – Disclosures Required of Arbitrators (Section III.AA); Proposed Rule 12410 – Removal of Arbitrator by Director (Section III.CC); Proposed Rule 12506 – Document Production Lists (Sections III.II.4, III.II.5); Proposed Rule 12514 – Exchange of Documents and Witness Lists Before Hearing (Section III.QQ.4); Proposed Rule 12801 – Default Proceedings (Section III.YY); Proposed Rule 12900 – Fees Due When a Claim is Filed (Section III.ZZ).

For all the foregoing reasons and the overall importance of the proposed rules, the Commission finds good cause for granting accelerated approval to Amendments 5 to the Customer Code and Industry Code, and finds that these amendments are consistent with Section 19(b)(2) of the Act.

B. Amendment 6 to the Customer Code and Amendment 6 to the Industry Code

The Commission finds good cause for approving Amendment 6 to the Customer Code and Amendment 6 to the Industry Code prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. In these amendments, NASD responded to concerns raised by commenters in connection with Amendment 5 to the Customer Code, which has not previously been published by the Commission for public comment but nonetheless was the subject of 125 comments after it was made public by NASD. These commenters' concerns centered on Proposed Rule 12504, summarized in Section III, above. In Amendment 6 to the Customer Code and Amendment 6 to the Industry Code, respectively, NASD withdrew Proposed Rule 12504 and all references thereto from the Customer Code, and withdrew Proposed Rule 13504 and all references thereto from the Industry Code.[213]

The Commission finds that NASD's withdrawal of Proposed Rules 12504 and 13504 from the proposed rule changes is a reasonable response to commenters' concerns that will allow the present proposed rule changes to proceed while providing NASD with time to consider concerns relating to dispositive motions separately. For all the foregoing reasons and the overall importance of the proposed rules, the Commission finds good cause for granting accelerated approval to Amendment 6 to the Customer Code and Amendment 6 to the Industry Code, and finds that they are consistent with Section 19(b)(2) of the Act.

[213] Proposed Rule 12504 has been re-filed as a separate proposed rule change and published for public comment. See supra note 23.

C. Amendment 7 to the Customer Code and Amendment 7 to the Industry Code

The Commission finds good cause for approving Amendment 7 to the Customer Code and Amendment 7 to the Industry Code prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. In these amendments, NASD makes further clarifications to the proposed rule changes and responds to certain comments, as described in Sections III and IV, above. The Commission believes that NASD's responses and proposed changes in these amendments reasonably address commenters' concerns. The Commission believes the changes proposed in Amendment 7 to the Customer Code and Amendment 7 to the Industry Code provide clarification and do not significantly alter the Customer Code and Industry Code, as amended by Amendments 1, 2, 3, and 4 of each code, which were subject to a full notice and comment period. For all the foregoing reasons and the overall importance of the proposed rules, the Commission finds good cause for granting accelerated approval to Amendment 7 to the Customer Code and Amendment 7 to the Industry Code, and finds that they are consistent with Section 19(b)(2) of the Act.

VII. Text of Amendments 5, 6, and 7 to the Customer Code

For the text of Amendment 5, 6, and 7 to the Customer Code, as well as amendments to the narrative portion and the exhibits of the Customer Code filing, please see NASD's Web site at the following URL:.

http://www.nasd.com/RulesRegulation/RuleFilings/2003RuleFilings/NASDW_009306?=802.

VIII. Text of Amendments 5, 6, and 7 to the Industry Code

For the text of Amendments 5, 6, and 7 to the Industry Code, as well as amendments to the narrative portion and exhibits of the Industry Code filing, please see NASD's Web site at the

following URL:

http://www.nasd.com/RulesRegulation/RuleFilings/2004RuleFilings/NASDW_009295.

IX. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendments 5, 6, and 7 to the Customer Code and Amendments 5, 6, and 7 to the Industry Code are consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2003-158 or SR-NASD-2004-011, as appropriate, on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2003-158 or SR-NASD-2004-011, as appropriate. The file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule changes that are filed with the Commission, and all written communications relating to the proposed rule changes between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's

Public Reference Section, 100 F Street, NE, Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to SR-NASD-2003-158 or SR-NASD-2004-011, as appropriate, and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

X. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[214] that the proposed rule changes (SR-NASD-2003-158 and SR-NASD-2004-011), as amended, be, and hereby are, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[215]

Florence E. Harmon
Deputy Secretary

[214] 15 U.S.C. 78s(b)(2).

[215] 17 CFR 200.30-3(a)(12).