

Notice to Members

NOVEMBER 2003

SUGGESTED ROUTING

Legal & Compliance
Senior Management

KEY TOPICS

Arbitration
Discovery

INFORMATIONAL

Discovery

NASD Reminds Members of Their Duty to Cooperate
in Arbitration Discovery Process

Executive Summary

NASD rules require parties to NASD arbitrations to cooperate in the voluntary exchange of documents and information, and to respond to discovery requests from other parties within a certain time. In addition, the NASD *Discovery Guide* and Document Production Lists specify which documents are presumed to be discoverable in customer disputes. Absent a written objection, or an agreement by the parties to the contrary, parties must exchange documents listed on applicable Document Production Lists within the specified time frames.

NASD has become increasingly aware of instances in which parties are not complying with their duty to cooperate in the exchange of documents requested by parties or listed on applicable Document Production Lists within the specified time. NASD will not tolerate abuses of the discovery process. NASD is issuing this *Notice to Members* to: (1) remind members and associated persons of that duty; and (2) notify them that NASD Dispute Resolution will continue to monitor compliance with its discovery rules, and will refer perceived abuses to NASD Regulatory Policy and Oversight for disciplinary review.¹

Questions/Further Information

Questions regarding this *Notice* may be directed to Laura Gansler, Counsel, NASD Dispute Resolution, at (202) 728-8275, or via e-mail, laura.gansler@nasd.com.

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Discussion

Rule 10321(a) of the NASD Code of Arbitration Procedure (Code) provides that “[t]he parties shall cooperate to the fullest extent practicable in the voluntary exchange of documents and information to expedite the arbitration.” Rule 10321(b) provides that parties may request documents or information from one another, and that a party has 30 days to produce or object to the production of documents or information requested by a party. Rule 10321(b) also states that parties must try to resolve any dispute regarding the production of the documents or information before objecting under the rule.

In addition to these rules, the NASD *Discovery Guide* provides guidance to parties in NASD arbitrations regarding documents that should be exchanged automatically, without arbitrator or staff intervention, and includes timetables and procedures for the exchange of such documents. The *Discovery Guide* includes Document Production Lists that specifically identify which documents are presumed to be discoverable in customer disputes. Document Production Lists 1 and 2 apply to all customer disputes, while Lists 3 through 14 apply to specific types of claims. The *Discovery Guide* makes clear that, absent a written objection, or an agreement by the parties to the contrary, parties must exchange documents listed on applicable Document Production Lists within the specified time frames.

Despite the guidance provided in the Code and the *Discovery Guide*, NASD continues to receive complaints regarding possible abuses of the discovery process. One measure of the problem is the increasing frequency with which arbitration panels have imposed sanctions for discovery abuse. In October 2003, an arbitration panel sanctioned a member \$10,000 a day for each day that the firm continued to withhold documents that the panel ordered the firm to produce. Other recent examples of discovery sanctions include:

- ◆ A panel found that a member firm intentionally concealed documents, delaying the discovery process. The panel assessed the firm over \$10,000 in sanctions and \$2,500 in attorney’s fees.
- ◆ A panel awarded the claimant over \$7,000 due to a member firm’s failure to cooperate in the discovery process.
- ◆ A panel awarded the claimant \$2,750 in attorney’s fees as a sanction for the member’s failure to provide discoverable material.
- ◆ A panel awarded the claimant \$3,000 in sanctions for a respondent’s failure to provide discoverable material as ordered by the panel.
- ◆ A panel sanctioned a member \$10,000 for failure to produce documents required by the chairperson of the panel.

The increasing frequency with which arbitration panels are awarding monetary sanctions for discovery abuse, as well as increasing complaints from parties, leads NASD to conclude that discovery abuse is on the rise. This trend suggests that some parties believe that noncompliance with their duty to cooperate in the discovery process—to voluntarily turn over documents listed on applicable Document Production Lists, or requested by other parties under Rule 10321—is a routine and acceptable part of arbitration strategy. NASD is also concerned that these parties may not be deterred by monetary sanctions alone.

This is a trend that NASD will not tolerate. Discovery abuse hinders the efficient and cost-effective resolution of disputes in this forum, and undermines the integrity and fairness of the NASD forum.

Arbitrators have several tools available for addressing discovery abuse, including issuing monetary sanctions during or at the end of an arbitration, striking claims or defenses, and making disciplinary referrals at the end of a case (see Rule 10105). As part of an effort to reduce discovery abuse, NASD has taken several steps recently to enhance arbitrator training regarding these tools. The October 2003 issue of NASD Dispute Resolution's arbitrator newsletter, *The Neutral Corner*, features a front-page article entitled "Proactive Arbitrators Keep the Case Moving" by Robert D. Herschman, which describes several proactive approaches arbitrators may use for handling discovery problems. In addition, NASD Dispute Resolution's new online chairperson training course includes an extensive section on "Managing the Prehearing Discovery Conference." NASD Dispute Resolution is also currently working on the creation of a discovery "mini-course" that will be offered to all arbitrators online during the first quarter of 2004.

Although NASD believes that enhanced arbitrator training will help reduce instances of discovery abuse, NASD also believes that it is important to remind parties of their duty to cooperate in the discovery process, and to comply with the discovery provisions of the Code and the *Discovery Guide*. In addition, NASD Dispute Resolution staff has recently initiated a practice of bringing all alleged discovery abuses to the attention of the Director of Arbitration and the President of NASD Dispute Resolution. These cases will be carefully reviewed and, when appropriate, NASD Dispute Resolution will refer such cases to NASD Regulatory Policy and Oversight for disciplinary review.

NASD hopes that these measures will lead to a significant reduction in the instances of discovery abuse in the forum, and alleviate the need for future rule changes or other additional steps to deter such abuse.

Endnote

- 1 NASD recognizes that claimants as well as respondents may be responsible for discovery abuse. NASD also intends to remind claimants and their representatives of their duty to cooperate with NASD discovery rules and procedures.

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