December 18, 2000

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Mail Stop 10-1

Re: File No. SR-NASD-00-02 - Amendments to NASD Code of Arbitration Procedure Rules 10335 and 10205(h) Relating to Injunctive Relief – Amendment No. 3; Response to Comments; and Extension of Time for Commission Action

Dear Ms. England:

Pursuant to Rule 19b-4, NASD Dispute Resolution, Inc. hereby responds to the comments received by the Commission in response to the publication in the *Federal Register* of Notice of Filing of SR-NASD-00-02, and amends the rule filing as described herein.

Background

Rule 10335, the NASD's pilot injunctive relief rule, allows interim injunctive relief to be obtained in arbitrations involving member firms and associated persons. The rule has primarily been used in "raiding cases," or cases involving the transfer of an employee to another firm. Rule 10335 took effect on January 3, 1996 for a one-year pilot period. The Commission has periodically extended the initial pilot period in order to permit the NASD to assess the effectiveness of the rule. The pilot rule is currently due to expire on January 5, 2001.

The development of the currently pending rule change was a long and deliberate process. The NASD first filed a rule filing proposing to amend Rule 10335 and to make it a permanent part of the Code in July 1998 (SR-NASD-98-49). The NASD filed amendments and response to comments received by the Commission regarding that rule filing in December 1998. In response to additional formal and informal comments received after the amendments and response to comments were filed, the

Injunctive Relief Rule Subcommittee ("Subcommittee") of the National Arbitration and Mediation Committee ("NAMC") undertook to reconsider every aspect of the proposed rule change. In addition to its NAMC members, the Subcommittee included representatives from member firms that had expressed an interest in the rule, including all of the retail firms that commented negatively on the prior rule filing.

After more than six months of lengthy deliberation and careful compromise, the Subcommittee recommended withdrawing the previous rule filing and replacing it with the currently pending rule filing, which was filed on January 12, 2000. The purpose of the proposed rule change is to streamline the process for obtaining injunctive relief, and to expedite the disposition on the merits of cases in which injunctive relief is ordered.

Response to Comments

The Commission has received seven comment letters regarding the proposed amendments to Rule 10335. Five are critical of the proposed rule change, while two support it.[1] The aspects of the proposed rule change generating the most criticism are the elimination of the option of seeking temporary injunctive relief in arbitration, and the composition of the NAMC Subcommittee that drafted the proposed rule change. Other comments relate to the nature and duration of injunctive relief that may be obtained in court, and the legal standards applicable to requests for permanent injunctive relief in arbitration. These concerns are addressed below.

Elimination of Temporary Injunctive Relief in Arbitration

Under the current rule, parties may seek injunctive relief either in arbitration or in court. In arbitration, parties may request either an Immediate Injunctive Order or a Regular Injunctive Order, which are roughly parallel to temporary restraining orders and preliminary injunctions available in court. In either case, the merits of the underlying case are submitted to arbitration on an expedited basis. The proposed rule change would eliminate the option of seeking temporary injunctive relief in arbitration. Parties would still be able to seek temporary injunctive relief in a court of competent jurisdiction, and the merits of the underlying case, including requests for permanent injunctive relief, would still be submitted to arbitration before a panel of three arbitrators on an expedited basis.

The decision to eliminate the option of seeking temporary injunctive relief in arbitration is based on more than four years of experience with the rule. Although such requests are expedited under the current rule, experience has shown that it is still not possible to obtain such injunctive relief in arbitration

[1] The following commenters oppose the proposed rule change: National Association of Investment Professionals ("NAIP"); Thomas M. Campbell, Smith Campbell & Paduano; Dan Jamieson; Sutro & Co., Inc.; and Ferris Baker Watts, Inc., Janney Montgomery Scott LLC, Legg Mason Wood Walker, Incorporated, Morgan Keegan & Company, Inc., and Raymond James and Associates, Inc., whose views are jointly represented in a letter filed by Dana Pescosolido. Two commenters, American Express Financial Corporation, and Joseph G. Kathrein, Jr., support the proposed rule change.

as quickly as in court, due largely to the need to appoint and convene arbitrators specifically for each case. The proposed rule change is an attempt to balance the interest of parties in being able to seek immediate temporary injunctive relief with the need to ensure that underlying disputes are resolved in arbitration in a timely manner.

The five negative commenters tend to oppose the issuance of temporary injunctions against associated persons in raiding cases in any forum, because they believe that such orders often unduly restrict broker mobility, and may have unfair adverse consequences for customers of enjoined brokers. They oppose the elimination of the option of seeking temporary injunctive relief in arbitration because they believe that courts are more likely than arbitrators to grant injunctive relief against associated persons.

NASD Dispute Resolution believes that this premise is flawed. Rule 10335 is a procedural, not a substantive rule, that governs where and how requests for temporary injunctive relief in intra-industry arbitrations may be made, and how injunctive relief orders obtained in court are integrated into the arbitration of the underlying merits of a dispute. The proposed rule change is simply a recognition that, given the usual timeframes in the arbitrator selection process, courts are in a better position to offer immediate temporary injunctive relief than is the NASD arbitration forum. Rule 10335 does not govern when such relief is appropriate, either in court or in arbitration. In fact, the same substantive legal standards for granting injunctive relief apply in both forums. Therefore, the elimination of the option of seeking temporary injunctive relief in arbitration could only discriminate against associated persons and investors only if courts applied the applicable legal standards in a discriminatory manner. Since there is no evidence that courts do in fact discriminate against associated persons or investors, the elimination of the option of seeking temporary injunctive relief in arbitration should be viewed as a neutral procedural change.

Several commenters are also critical of the proposed rule change on broader grounds. They question whether NASD Rule 11870, which requires member firms to cooperate in executing any customer-requested account transfer, adequately protects the interests of the investing public in raiding cases. They argue that either Rule 10335 or Rule 11870 should be amended to prohibit NASD member firms from seeking temporary injunctions in employment disputes when doing so would interfere with a customer's ability to transfer his or her account.

In addition, several commenters argue that temporary injunctions in raiding cases are unfair to investors and restrict broker mobility, and therefore, Commission approval of the proposed rule change to eliminate temporary injunctive relief in arbitration would violate provisions in the Securities Exchange Act of 1934 ("Exchange Act") that prohibit the Commission from approving SRO rules that permit unfair discrimination between customers, issuers, brokers or dealers. They also claim that because injunctions that limit broker mobility are anti-competitive, the rule would violate the Exchange Act's prohibition on SRO rules that impose unnecessary burdens on competition.

While these questions may warrant attention, NASD Dispute Resolution believes that Rule 10335 is not the appropriate vehicle for addressing them. As noted above, Rule 10335 is a procedural, not substantive, rule. Moreover, if the pilot rule, which provides procedures for obtaining temporary injunctive relief in both arbitration and in court, is consistent with the Exchange Act, as the Commission found when it approved the original pilot, it stands to reason that amending the rule to eliminate the option of seeking such relief in arbitration in order to expedite resolution of the merits of the underlying dispute in arbitration would also be consistent with the Exchange Act.

In sum, NASD Dispute Resolution continues to believe that the elimination of the option of seeking temporary injunctive relief in arbitration will benefit all parties to intra-industry arbitrations by simplifying the process of seeking such relief, and expediting the hearing on the merits of requests for permanent injunctive and other relief in arbitration.

Composition of NAMC Subcommittee on Injunctive Relief

Several commenters also object to the process by which the proposed rule change was drafted. Specifically, they criticize the lack of representation of the interests of associated persons and/or customers on the NAMC's Injunctive Relief Subcommittee, and the fact that the previous rule filing proposing amendments to Rule 10335 was only withdrawn after the SEC received negative comments regarding that proposal subsequent to the expiration of the comment period.

The decision to reconsider the earlier rule filing was based on the cumulative effect of comments received before and after the close of the comment period with respect to that filing. In light of all of the comments received, the NASD came to the conclusion that the earlier proposal to amend Rule 10335 did not go far enough in simplifying and streamlining the procedures for obtaining temporary injunctive relief in intra-industry cases.

With respect to the composition of the Injunctive Relief Subcommittee, NASD Dispute Resolution believes that the interests of all relevant parties, including member firms, associated persons and the investing public, were well-represented during the process of reconsidering the amendments to Rule 10335. The Subcommittee includes member firms with interests on both sides of raiding cases. Because the interests of associated persons in raider cases are generally aligned with the interests of "raiding" firms, the interests of associated persons in the context of raiding cases were represented at the subcommittee level by those firms. While the investing public was not directly represented at the subcommittee level because Rule 10335 applies only to intra-industry disputes, NASD Dispute Resolution believes that the collateral interests of investors in raiding cases were represented by both the raider and raidee firms participating in the deliberations. Most importantly, the proposed rule change was reviewed and approved by the full NAMC, which consists of a majority of public members, as well as the Board of Directors of NASD Regulation, Inc.[2] Advocates of the interests of associated

[2] The proposed rule change was reviewed by the Board of NASD Regulation, Inc. in December 1999, before NASD Dispute Resolution, Inc. was incorporated.

persons, as well as investors, have had ample opportunity to express opinions about the proposed rule change at all levels of review, and changes have been made throughout the process to address the interests of both constituencies.

Limits on Effectiveness of Court Orders

As noted in the rule filing, one of the most difficult aspects of integrating court-ordered injunctive relief with arbitration of the underlying claims in the same dispute is the treatment of a pending court order in effect at the commencement of the hearing on the request for permanent relief. This becomes a potentially important issue in the event that the pending court order conflicts with the decision of the panel, because conflicting orders from a court and the arbitration panel could place parties in the position of either having to be in contempt of a pending court order or violation of an arbitration order.

To address this issue, the proposed rule change would provide that a hearing on a request for permanent relief must commence within 15 days of the issuance of a court-issued temporary injunctive order. In the event that the order is still in effect after a "full and fair presentation of evidence" from all relevant parties, an arbitration panel may prohibit the parties from seeking an extension of the pending court order, and, if appropriate, may order the parties jointly to move the court to modify or dissolve the pending court order.

A number of commenters argue that prohibiting arbitrators from ordering parties to seek modification or dissolution of a pending court order before a "full and fair presentation" of the evidence on a request for permanent injunctive relief would result in open-ended court orders that would give undue leverage to parties obtaining them. They argue that some additional limits should be imposed on the duration of such orders, either directly or through arbitrator authority to order parties to seek modifications of pending court orders.

NASD Dispute Resolution does not believe that arbitration panels have the authority to dissolve, modify or supersede a court order. Arbitrators do have the authority to order parties not to seek extensions of pending orders, or to jointly ask the court to modify or dissolve a pending order, if necessary. However, the broad consensus of the Subcommittee was that arbitrators should not exercise this authority until they had heard a full and fair presentation of the evidence regarding a request for permanent relief. This ensures that arbitrators will be in a position to make an informed decision. Moreover, statistics on the average length of evidentiary hearings on requests for permanent injunctive relief suggest that, in most cases, arbitrators will be in a position to make that decision in a short period of time. Currently, the average duration of such hearings is 1.36 days, and almost 80% of all cases that go to a hearing are resolved after one day of hearings.

Given the relatively short period of time required for a full and fair presentation of the evidence in the vast majority of cases, NASD Dispute Resolution believes that this provision will ensure that

arbitrators will not order parties to seek the dissolution or modification of a pending court order before hearing from all interested parties, but will not cause undue delay.

Legal Standard Governing Requests for Permanent Injunctive Relief

The proposed rule change provides that the decision to grant or deny a request for permanent injunctive relief would be governed by an enforceable choice of law agreement between the parties, or, if there were no such agreement, then by the law of the state where the events upon which the request is based occurred. Several commenters argue that this provision is unfair to associated persons, because employment contracts and non-compete agreements are adhesion contracts that should not be sanctioned by the NASD.

The purpose of this provision is to preserve the status quo. It would not render any otherwise unenforceable choice-of-law provision or employment contract enforceable. However, it would eliminate any ambiguity that might exist as to the applicability of an enforceable choice-of-law agreement to requests for injunctive relief in arbitration.

Amendments to Rule Filing

Arbitrators Specializing in Injunctive Relief

The new rule filing requires that a majority of arbitrators hearing requests for permanent injunctive relief be lawyers specializing in injunctive relief. A number of commenters claim that this requirement is overly vague, would result in more arbitrators with a bias in favor of member firms, and would give the staff too much discretion in determining who met the criteria.

NASD Dispute Resolution continues to believe that it is in the interests of all parties that the arbitrators hearing requests for permanent injunctive relief be lawyers who are familiar with injunctive relief. However, upon reconsideration, NASD Dispute Resolution agrees that the term "specializing in" may be overly vague and open to conflicting interpretations. Therefore, it is amending the text of the proposed change to provide that a majority of arbitrators hearing a request for permanent injunctive relief be lawyers "with experience litigating cases involving injunctive relief."

Specifically, paragraph (b)(3) of the proposed rule is amended as follows, with new language underlined, and deleted language in brackets:

Rule 10335. Temporary Injunctive Orders; Requests for Permanent Injunctive Relief

* * *

(a) – (b)(2) Unchanged.

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(b) Hearing on Request for Permanent Injunctive Relief

(3) Selection of Arbitrators and Chairperson

(A) In cases in which all of the members of the arbitration panel are non-public under paragraph (b)(2) of this Rule, the Director shall generate and provide to the parties a list of seven arbitrators from a national roster of arbitrators. At least a majority of the arbitrators listed shall be lawyers [specializing in] with experience litigating cases involving injunctive relief. Each party may exercise one strike to the arbitrators on the list. Within three days of receiving the list, each party shall inform the Director which arbitrator, if any, it wishes to strike, and shall rank the remaining arbitrators in order of preference.

(B) In cases in which the panel of arbitrators consists of a majority of public arbitrators under paragraph (b)(2) of this Rule, the Director shall generate and provide to the parties a list of nine arbitrators from a national roster of arbitrators. At least a majority of the arbitrators listed shall be (1) public arbitrators and (2) lawyers [specializing in] with experience litigating cases involving injunctive relief. Each party may exercise two strikes to the arbitrators on the list. Within three days of receiving the list, each party shall inform the Director which arbitrators, if any, it wishes to strike, and shall rank the remaining arbitrators in order of preference.

(C) Each party shall inform the Director of its preference of chairperson of the arbitration panel by the close of business on the next business day after receiving notice of the panel members. If the parties do not agree on a chairperson within that time, the Director shall select the chairperson. In cases in which the panel consists of a majority of public arbitrators, the chairperson shall be one of the public arbitrators who is a lawyer [specializing in] with experience litigating cases involving injunctive relief. In cases in which the panel consists of non-public arbitrators, the chairperson shall be a lawyer specializing in injunctive relief. Whenever possible, the Director shall select as chairperson the lawyer specializing in injunctive relief whom the parties have ranked the highest.

Allocation of Fees

The proposed rule change provides that the parties shall jointly bear the travel-related costs and expenses of the arbitrators hearing the request for permanent relief or any subsequent hearing on other relief, as well as the additional honoraria required by the rule, and prohibits arbitrators from reallocating costs and expenses among the parties.

A number of commenters are critical of the prohibition on reallocation of these costs and expenses, arguing that it unnecessarily deprives arbitrators of discretion, and might cause unfair results, particularly to Claimants. In response to these comments, and to questions raised by the SEC staff, NASD Dispute Resolution is amending the text of the proposed rule change to delete the prohibition on reallocation of the travel-related costs and expenses of arbitrators hearing requests for permanent injunctive relief or any subsequent hearings, as well as any additional honoraria required by the rule. The rule would still provide that the parties shall jointly bear these expenses and costs unless the arbitrators specify otherwise.

Specifically, the proposed rule is amended as follows, with deleted language shown in brackets:

Rule 10335. Temporary Injunctive Orders; Requests for Permanent Injunctive Relief

(a) – (b)(5) Unchanged.

* * *

(b) Hearing on Request for Permanent Injunctive Relief

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(6) Fees, Costs and Expenses, and Arbitrator Honorarium

(A) The parties shall jointly bear the travel-related costs and expenses of the arbitrators appointed to hear the request for permanent injunctive relief. [The arbitrators shall not reallocate such costs and expenses among the parties.]

Remainder unchanged.

If you have any questions, please contact me at (202) 728-8275; e-mail Laura.Gansler@nasd.com. The fax number of NASD Dispute Resolution, Inc. is (202) 728-8833.

Very truly yours,

Laura Leedy Gansler
Counsel
NASD Dispute Resolution, Inc.