

January 22, 2001

Florence Harmon  
Senior Special Counsel  
Division of Market Regulation  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-1001

Re: **File No. SR-NASD-01-08** - Amendment to Code of Arbitration Procedure Rule 10301  
Relating to Enforcement of Predispute Arbitration Agreements by Terminated or Suspended  
Members

Dear Ms. Harmon:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word to facilitate production of the Federal Register release.

If you have any questions, please contact Laura Leedy Gansler, Counsel, NASD Dispute Resolution, Inc., at (202) 728-8275; e-mail [laura.gansler@nasd.com](mailto:laura.gansler@nasd.com). The fax number of NASD Dispute Resolution, Inc. is (202) 728-8833.

Very truly yours,

Joan C. Conley  
Senior Vice President  
and Corporate Secretary

Enclosures

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C.

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Form 19b-4

Proposed Rule Change

by

**NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.**

Pursuant to Rule 19b-4 under the  
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. (“NASD Dispute Resolution”), is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend Rule 10301 of the NASD Code of Arbitration Procedure to prohibit a firm that has been terminated, suspended, or barred from the NASD, or that is otherwise defunct, from enforcing a predispute arbitration agreement against a customer in the NASD arbitration forum. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

\* \* \*

**10301. Required Submission**

(a) Any dispute, claim, or controversy eligible for submission under the Rule 10100 Series between a customer and an active member and/or associated person arising in connection with the business of such member or in connection with the activities of such associated persons shall be arbitrated under this Code, as provided by any duly executed and enforceable written agreement or upon the demand of the customer. A claim involving a member in the following categories shall be ineligible for submission to arbitration under the Code unless the customer agrees in writing to arbitrate the claim after it has arisen:

1. A member whose membership is terminated, suspended, canceled, or revoked;

2. A member that has been expelled from the NASD; or

3. A member that is otherwise defunct.

(b) – (d) Unchanged.

\* \* \*

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Dispute Resolution at its meeting on December 6, 2000, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Resolution, Inc. have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on December 7, 2000. No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

The NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Questions regarding this rule filing may be directed to Laura Leedy Gansler, Counsel, NASD Dispute Resolution, at (202) 728-8275.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

In October 1998, the GAO undertook a study of the securities industry arbitration process, focusing on the number of unpaid arbitration awards. In its report, Securities Arbitration: Actions Needed to Address Problem of Unpaid Awards (“GAO Report”), the GAO found that a significant percentage of the awards favorable to customers that were issued in 1998 were unpaid. The majority of unpaid awards involved arbitration cases against firms that the NASD had terminated from membership for serious violations of the federal securities laws and NASD rules, or that had filed for bankruptcy. In fact, investors collect their awards in well over 90 percent of the NASD cases involving active firms.

The GAO noted that the NASD takes aggressive action to address complaints about non-payment of awards. However, in response to the recommendations in the GAO Report, NASD Dispute Resolution has taken the following additional steps to track and address non-payment. In *NASD Notice to Members 00-55*, published August 10, 2000, NASD Dispute Resolution introduced a new system of monitoring and tracking compliance with arbitration awards by members and associated persons. On September 18, 2000, NASD Dispute Resolution began asking Claimants to notify it if a member or associated person has not paid the arbitration award within 30 calendar days of receipt of the award. In addition, member firms are now required to notify NASD Dispute Resolution in writing within 30 days of receipt of an award that they or their associated persons have paid or otherwise complied with the award, or to identify a valid basis for

non-payment. NASD Dispute Resolution has agreed to provide the Commission with quarterly reports on the results of this process. These steps will enable the NASD to institute suspension proceedings promptly when appropriate, and will prevent unnecessary regulatory effort in cases in which the award is the subject of a pending motion to vacate or there is another valid basis for non-payment.

Even in light of NASD Dispute Resolution's vigorous efforts to ensure payment of awards, the GAO Report highlighted the fact that customers in arbitration cases involving terminated or suspended members face a significantly higher risk of non-payment than in cases involving active members. While non-payment of awards by terminated or suspended members is beyond the control of NASD Dispute Resolution, NASD Dispute Resolution recognizes that it may be inappropriate to permit terminated or suspended members to require customers who have claims against them to arbitrate such claims in the NASD forum when an arbitration award may be unenforceable against the terminated or suspended member. In such cases, NASD Dispute Resolution believes that even customers who have signed a predispute arbitration agreement should be able to seek relief in court, where they could obtain a judgment that could be enforced against any assets of the member that could be located. This will avoid the possibility that customers would not be able to avail themselves of judicial remedies that might be available under state law, including any remedies to stop the dissipation of assets. Moreover, due to the time required for the appointment of arbitrators, and the delay inherent in the process of converting an arbitration award into an enforceable judgment, the ability to go directly to court to seek pre-judgment relief may save customers precious time in cases in which the dissipation of assets is a threat.

Therefore, NASD Dispute Resolution is proposing to amend Rule 10301 of the Code of Arbitration Procedure to prohibit a firm that has been terminated, suspended, or expelled from the NASD, or that is otherwise defunct, from enforcing a predispute arbitration agreement against a customer in the NASD forum. As a corollary to this rule change, NASD Dispute Resolution will advise customers making claims against a terminated or suspended member of the member's status, so that the customers can decide whether to proceed in arbitration, to file their claim in court, or to take no action.

The proposed rule change precludes terminated, suspended, barred, or otherwise defunct members from requiring a customer to arbitrate in the NASD forum under Rule 10301, unless the customer agrees in writing to arbitrate the claim in the NASD forum after the claim has arisen. The proposed rule change is similar to Rule 10301(d) of the Code of Arbitration Procedure, which provides that class actions are ineligible for arbitration in the NASD forum, and NASD Rule 10201(b), which provides that statutory discrimination claims in intra-industry disputes are not required to be arbitrated unless the parties agree in writing to arbitrate the dispute after the claim has arisen. It is also similar in principle to New York Stock Exchange ("NYSE") Rule 600(f), which makes employment discrimination claims ineligible for arbitration in the NYSE forum unless the parties agree to arbitrate after the claim has arisen.

(b) Statutory Basis

NASD Dispute Resolution believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must 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. Because terminated, suspended, barred or otherwise defunct firms have a significantly higher incidence of non-payment of arbitration awards than do active firms, NASD Dispute Resolution believes that the proposed rule change will protect investors and the general public by giving customers greater flexibility to seek remedies against such firms.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD Dispute Resolution does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

NASD Dispute Resolution does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.



7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Dispute Resolution has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD DISPUTE RESOLUTION, INC.

BY: \_\_\_\_\_  
Joan C. Conley, Senior Vice President and  
Corporate Secretary

Date: January 22, 2001

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- ; File No. SR-NASD-01-08)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Amendments to Rule 10301 of the Code of Arbitration Procedure to Prohibit Terminated, Suspended, Barred or Otherwise Defunct Firms From Enforcing Predispute Arbitration Agreements in the NASD Arbitration Forum

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on , 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”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Dispute Resolution. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD Dispute Resolution is proposing to amend Rule 10301 of the Code of Arbitration of the National Association of Securities Dealers, Inc. (“NASD” or “Association”), to prohibit a firm that has been terminated, suspended, or barred from the NASD, or that is otherwise defunct, from enforcing a predispute arbitration agreement against a customer in the NASD arbitration forum.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

\* \* \*

### **10301. Required Submission**

(a) Any dispute, claim, or controversy eligible for submission under the Rule 10100 Series between a customer and an active member and/or associated person arising in connection with the business of such member or in connection with the activities of such associated persons shall be arbitrated under this Code, as provided by any duly executed and enforceable written agreement or upon the demand of the customer. A claim involving a member in the following categories shall be ineligible for submission to arbitration under the Code unless the customer agrees in writing to arbitrate the claim after it has arisen:

1. A member whose membership is terminated, suspended, canceled, or revoked;
2. A member that has been expelled from the NASD; or
3. A member that is otherwise defunct.

(b) – (d) Unchanged.

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## **II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE**

In its filing with the Commission, NASD Dispute Resolution included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

Item IV below. NASD Dispute Resolution has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

In October 1998, the GAO undertook a study of the securities industry arbitration process, focusing on the number of unpaid arbitration awards. In its report, Securities Arbitration: Actions Needed to Address Problem of Unpaid Awards (“GAO Report”), the GAO found that a significant percentage of the awards favorable to customers that were issued in 1998 were unpaid. The majority of unpaid awards involved arbitration cases against firms that the NASD had terminated from membership for serious violations of the federal securities laws and NASD rules, or that had filed for bankruptcy. In fact, investors collect their awards in well over 90 percent of the NASD cases involving active firms.

The GAO noted that the NASD takes aggressive action to address complaints about non-payment of awards. However, in response to the recommendations in the GAO Report, NASD Dispute Resolution has taken the following additional steps to track and address non-payment. In NASD *Notice to Members* 00-55, published August 10, 2000, NASD Dispute Resolution introduced a new system of monitoring and tracking compliance with arbitration awards by members and associated persons. On September 18, 2000, NASD Dispute Resolution began asking Claimants to notify it if a member or associated person has not paid the arbitration award within 30 calendar days of receipt of the award. In addition, member firms are now required to

notify NASD Dispute Resolution in writing within 30 days of receipt of an award that they or their associated persons have paid or otherwise complied with the award, or to identify a valid basis for non-payment. NASD Dispute Resolution has agreed to provide the Commission with quarterly reports on the results of this process. These steps will enable the NASD to institute suspension proceedings promptly when appropriate, and will prevent unnecessary regulatory effort in cases in which the award is the subject of a pending motion to vacate or there is another valid basis for non-payment.

Even in light of NASD Dispute Resolution's vigorous efforts to ensure payment of awards, the GAO Report highlighted the fact that customers in arbitration cases involving terminated or suspended members face a significantly higher risk of non-payment than in cases involving active members. While non-payment of awards by terminated or suspended members is beyond the control of NASD Dispute Resolution, NASD Dispute Resolution recognizes that it may be inappropriate to permit terminated or suspended members to require customers who have claims against them to arbitrate such claims in the NASD forum when an arbitration award may be unenforceable against the terminated or suspended member. In such cases, NASD Dispute Resolution believes that even customers who have signed a predispute arbitration agreement should be able to seek relief in court, where they could obtain a judgment that could be enforced against any assets of the member that could be located. This will avoid the possibility that customers would not be able to avail themselves of judicial remedies that might be available under state law, including any remedies to stop the dissipation of assets. Moreover, due to the time required for the appointment of arbitrators, and the delay inherent in the process of converting an arbitration award

into an enforceable judgment, the ability to go directly to court to seek pre-judgment relief may save customers precious time in cases in which the dissipation of assets is a threat.

Therefore, NASD Dispute Resolution is proposing to amend Rule 10301 of the Code of Arbitration Procedure to prohibit a firm that has been terminated, suspended, or expelled from the NASD, or that is otherwise defunct, from enforcing a predispute arbitration agreement against a customer in the NASD forum. As a corollary to this rule change, NASD Dispute Resolution will advise customers making claims against a terminated or suspended member of the member's status, so that the customers can decide whether to proceed in arbitration, to file their claim in court, or to take no action.

The proposed rule change precludes terminated, suspended, barred, or otherwise defunct members from requiring a customer to arbitrate in the NASD forum under Rule 10301, unless the customer agrees in writing to arbitrate the claim in the NASD forum after the claim has arisen. The proposed rule change is similar to Rule 10301(d) of the Code of Arbitration Procedure, which provides that class actions are ineligible for arbitration in the NASD forum, and NASD Rule 10201(b), which provides that statutory discrimination claims in intra-industry disputes are not required to be arbitrated unless the parties agree in writing to arbitrate the dispute after the claim has arisen. It is also similar in principle to New York Stock Exchange ("NYSE") Rule 600(f), which makes employment discrimination claims ineligible for arbitration in the NYSE forum unless the parties agree to arbitrate after the claim has arisen.

(b) Statutory Basis

NASD Dispute Resolution believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must 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. Because terminated, suspended, barred or otherwise defunct firms have a significantly higher incidence of non-payment of arbitration awards than do active firms, NASD Dispute Resolution believes that the proposed rule change will protect investors and the general public by giving customers greater flexibility to seek remedies against such firms.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Dispute Resolution does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority,  
17 CFR 200.30-3(a)(12).

Jonathan G. Katz  
Secretary