

September 29, 1998

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-98-64 - Arbitrator List Selection Method
for Intra-Industry Disputes, Amendment No. 1

Dear Ms. England:

NASD Regulation hereby amends the above-captioned rule filing in response to comments made in telephone conversations with Commission staff. Attached as Exhibit A is the text of the proposed rule change, in which proposed new language is underlined; proposed deletions are in brackets. Also enclosed is revised Exhibit 1 to the rule filing and a 3-1/2" disk containing a revised Exhibit 1 in Microsoft Word 7.0 to facilitate production of the Federal Register release.

In brief, the changes are as follows:

1. Rule 10202(b)(1) is revised and reformatted to include new subparagraphs (A) and (B), which address the two subcategories of cases involving claims of \$50,000 or less. These changes parallel those made in Amendment No. 3 to SR-NASD-98-48, the companion list selection rule proposal for customer arbitration, except that the panels will consist of either one or three non-public arbitrators unless the parties agree otherwise. The proposed amendment to paragraph (b)(1) clarifies that certain cases that are for a claim of \$50,000 or less may be arbitrated by a three-person panel rather than by one arbitrator in certain circumstances. For a claim of \$25,000 or less, a single arbitrator already appointed to the case may request that the Director appoint two additional arbitrators. For a claim of more than \$25,000 and not more than \$50,000, any party (in its initial filing) or an appointed arbitrator may request that the Director appoint a three-arbitrator panel. Also, the phrase, "a party," is used to clarify that either a claimant or a respondent may request a three-arbitrator panel under this subparagraph.

2. References in Rule 10202(c) to Rule 10335 have been amended to include terminology used in the current pilot injunctive relief rule, which was recently extended to January 3, 1999, rather than the proposed revised rule currently pending Commission review in SR-NASD-98-49. This was done because this rule filing is expected to become effective before SR-NASD-98-49. An amendment will be made to SR-NASD-98-49 to conform the terminology in Rule 10202 when that filing becomes effective.

3. References in Rules 10202 and 10203 to “public” and non-public” arbitrators no longer are followed by the phrase “as defined in Rule 10308” since proposed Rule 10202(d) already states that the provisions of Rule 10308 apply to intra-industry disputes unless otherwise provided. This makes the proposed rule change less cluttered and easier to follow.

4. References to the term “tracking” in the rule filing narrative portion have been deleted.

5. Minor typographical corrections have been made.

If you have any questions, please contact Jean I. Feeney, Office of General Counsel, NASD Regulation, Inc., at (202) 728-6959; e-mail FeeneyJ@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

John M. Ramsay
Vice President and
General Counsel

cc: Robert A. Love
Heather Seidel

Attachments: A - Revised rule language
B - Revised Exhibit 1 to the rule filing

Enclosure: Computer disk

Text of Proposed Rule Change

Marked to Show Changes from Original Rule Filing

10202. Composition of Panels

(a) In disputes subject to arbitration that arise out of the employment or termination of employment of an associated person, and that relate exclusively to disputes involving employment contracts, promissory notes or receipt of commissions, the panel of arbitrators shall be appointed as provided by paragraph (b)(1) or (2) or Rule 10203, whichever is applicable. In all other disputes arising out of the employment or termination of employment of an associated person, the panel of arbitrators shall be appointed as provided by Rule 10302 or Rule 10308, whichever is applicable.

(b) [(1) Except as otherwise provided in paragraph (a) or Rule 10203, in all arbitration matters between or among members and/or persons associated with members, and where the amount in controversy does not exceed \$50,000, exclusive of attendant costs and interest, the Director of Arbitration shall appoint a single arbitrator to decide the matter in controversy. The arbitrator chosen shall be a non-public arbitrator as defined in Rule 10308. Upon the request of a party in its initial filing or the arbitrator, the Director of Arbitration shall appoint a panel of three (3) arbitrators, all of whom shall be non-public arbitrators as defined in Rule 10308.]

(1) Composition of Arbitration Panel**(A) Claims of \$50,000 or Less**

If the amount of a claim is \$50,000 or less, the Director shall appoint an arbitration panel composed of one non-public arbitrator, unless the parties agree to the appointment of a public arbitrator.

(i) If the amount of a claim is \$25,000 or less and an arbitrator appointed to the case requests that a panel of three arbitrators be appointed, the Director shall appoint an arbitration panel composed of three non-public arbitrators, unless the parties agree to a different panel composition.

(ii) If the amount of a claim is greater than \$25,000 and not more than \$50,000 and a party in its initial filing or an arbitrator appointed to the case requests that a panel of three arbitrators be appointed, the Director shall appoint an arbitration panel composed of three non-public arbitrators, unless the parties agree to a different panel composition.

(B) Claims of More than \$50,000

If the amount of a claim is more than \$50,000, the Director shall appoint an arbitration panel composed of three non-public arbitrators, unless the parties agree to a different panel composition.

(2) Except as otherwise provided in paragraph (a), in all arbitration matters between or among members and/or persons associated with members and where the amount in controversy exceeds \$50,000, exclusive of attendant costs and interest, a panel shall consist of three arbitrators, all of whom shall be non-public arbitrators [as defined in Rule 10308].

(c) In proceedings relating to [temporary restraining orders] injunctions under Rule 10335, the provisions of Rule 10335 shall supersede the provisions of this Rule.

(d) Except as otherwise provided in this Rule or Rule 10203, the provisions of Rule 10308 shall apply to intra-industry disputes.

10203. Simplified Industry Arbitration

(a) Any dispute, claim, or controversy arising between or among members or associated persons submitted to arbitration under this Code involving a dollar amount not exceeding \$25,000, exclusive of attendant costs and interest, shall be resolved by an arbitration panel constituted pursuant to the provisions of subparagraph (1) hereof solely upon the pleadings and documentary evidence filed by the parties, unless one of the parties to the proceeding files with the Office of the Director of Arbitration within ten (10) business days following the filing of the last pleading a request for a hearing of the matter.

(1) In any proceeding pursuant to this Rule, an arbitration panel shall consist of no fewer than one (1) but no more than three (3) arbitrators, all of whom shall be non-public arbitrators [as defined in Rule 10308].

(2) (Unchanged)

(b) (Unchanged)

* * *

in brackets.

* * *

10202. Composition of Panels

(a) In disputes subject to arbitration that arise out of the employment or termination of employment of an associated person, and that relate exclusively to disputes involving employment contracts, promissory notes or receipt of commissions, the panel of arbitrators shall be appointed as provided by paragraph (b)(1) or (2) or Rule 10203, whichever is applicable. In all other disputes arising out of the employment or termination of employment of an associated person, the panel of arbitrators shall be appointed as provided by Rule 10302 or Rule 10308, whichever is applicable.

(b) [(1) Except as otherwise provided in paragraph (a) or Rule 10203, in all arbitration matters between or among members and/or persons associated with members, and where the amount in controversy does not exceed \$50,000, exclusive of attendant costs and interest, the Director of Arbitration shall appoint a single arbitrator to decide the matter in controversy. The arbitrator chosen shall be from the securities industry. Upon the request of a party in its initial filing or the arbitrator, the Director of Arbitration shall appoint a panel of three (3) arbitrators, all of whom shall be from the securities industry.]

(1) Composition of Arbitration Panel

(A) Claims of \$50,000 or Less

If the amount of a claim is \$50,000 or less, the Director shall appoint an arbitration panel composed of one non-public arbitrator, unless the parties agree to the appointment of a public arbitrator.

(i) If the amount of a claim is \$25,000 or less and an arbitrator appointed to the case requests that a panel of three arbitrators be appointed, the Director shall appoint an arbitration panel composed of three non-public arbitrators, unless the parties agree to a different panel composition.

(ii) If the amount of a claim is greater than \$25,000 and not more than \$50,000 and a party in its initial filing or an arbitrator appointed to the case requests that a panel of three arbitrators be appointed, the Director shall appoint an arbitration panel composed of three non-public arbitrators, unless the parties agree to a different panel composition.

(B) Claims of More than \$50,000

If the amount of a claim is more than \$50,000, the Director shall appoint an arbitration panel composed of three non-public arbitrators, unless the parties agree to a different panel composition.

(2) Except as otherwise provided in paragraph (a), in all arbitration matters between or among members and/or persons associated with members and where the amount in controversy exceeds \$50,000, exclusive of attendant costs and interest, a panel shall consist of three arbitrators, all of whom shall be [from the securities industry] non-public arbitrators.

(c) In proceedings relating to injunctions under Rule 10335, the provisions of Rule 10335 shall supersede the provisions of this Rule.

(d) Except as otherwise provided in this Rule or Rule 10203, the provisions of Rule 10308 shall apply to intra-industry disputes.

10203. Simplified Industry Arbitration

(a) Any dispute, claim, or controversy arising between or among members or associated persons submitted to arbitration under this Code involving a dollar amount not exceeding \$25,000, exclusive of attendant costs and interest, shall be resolved by an arbitration panel constituted pursuant to the provisions of subparagraph (1) hereof solely upon the pleadings and documentary evidence filed by the parties, unless one of the parties to the proceeding files with the Office of the Director of Arbitration within ten (10) business days following the filing of the last pleading a request for a hearing of the matter.

(1) In any proceeding pursuant to this Rule, an arbitration panel shall consist of no fewer than one (1) but no more than three (3) arbitrators, all of whom shall be [from the securities industry] non-public arbitrators.

(2) (Unchanged)

(b) (Unchanged)

* * *

10308. Selection of Arbitrators [in Customer Disputes]

This rule specifies how parties may select or reject arbitrators, and who can be a public arbitrator [in arbitration proceedings involving a customer].

(Remainder unchanged)

* * *

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 Regulation 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 Regulation 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

The proposed rule change is designed to conform the arbitrator selection process for intra-industry disputes to the recently proposed list selection method for disputes involving public customers, as proposed in SR-NASD-98-48.^{3, 4}

Background

In its report published in January 1996, the Arbitration Policy Task Force (“Task Force”)⁵ made several broad recommendations to improve the securities arbitration process administered by the NASD. Recommendation No. 8 provided: “Arbitrator selection, quality, training, and performance should be improved by various means, including adoption of a list selection method, earlier appointment of arbitrators, enhancement of arbitrator training, and increased compensation.” A footnote in the Task Force report stated, “We also recommend that a form of list selection be used in employee-firm and member-member arbitration.”⁶

³ See note 1 above.

⁴ This proposed rule change relates only to process, rather than substance. NASD Regulation may, at a later date, consider amendments to the panel composition rules for industry disputes in general and for statutory employment discrimination disputes in particular.

⁵ The NASD formed the Arbitration Policy Task Force in September 1994 for the purposes of studying the securities arbitration process administered by the NASD and of making suggestions for reform. The Task Force, chaired by David S. Ruder, former Chairman of the SEC, delivered its Report to the NASD Board in January 1996.

⁶ Task Force Report, supra, at 96 n.134.

Principles Underlying the Previously Filed Customer List Selection Rule Proposal

NASD Regulation considered the Task Force's recommendations at length, and consulted with the National Arbitration and Mediation Committee ("NAMC") and others about the efficacy of the proposals. All persons consulted favored the selection of arbitrators by the parties using some form of list selection. In addition, most were in favor of developing a system featuring the capability, when appropriate and as technologically feasible, to generate the arbitrator lists from a computer system programmed to incorporate relevant selection factors, such as geographic proximity of an arbitrator to the proposed site of the hearing, subject matter knowledge, and classification of an arbitrator as a public arbitrator or a non-public arbitrator, rather than developing a system in which the lists of arbitrators to be forwarded to parties for ranking would be generated solely on the basis of the staff's judgment.

Following the principle that parties in arbitration should be given more input into the selection of arbitrators, NASD Regulation developed a rule for customer arbitrations providing that, in a one-arbitrator case, the parties to the arbitration will be provided a list of public arbitrators, and, in a three-arbitrator panel case, the parties will be provided a list of public and a list of non-public arbitrators. The parties will use the lists to express numerical preferences for the arbitrators listed and those rankings will determine the outcome of the arbitrator selection process, unless an arbitrator declines to serve because the arbitrator is unavailable, recuses him or herself, or is disqualified because of a conflict of interest.

Extension of List Selection Method to Intra-Industry Disputes

NASD Regulation believes that the proposed methodology for selecting arbitrators in customer arbitration will also benefit employees and members in their use of the arbitration

forum for intra-industry disputes. The same considerations of giving parties more choice in choosing their panelists and allowing for computerized rotation of arbitrators will also apply in the intra-industry context. The proposed rule change is also expected to result in cost savings as compared with continuing the current method of staff selection of arbitrators only for intra-industry arbitrations after the new system for customer arbitration is effective.

NASD Regulation expects that the proposed rule will be viewed as a significant improvement over the current method of selecting arbitrators in intra-industry disputes, in that it provides employees and members with the same choices in picking their arbitration panels that are being extended to customers and members in the area of customer disputes.

The computerized Neutral List Selection System (NLSS) now in the final stages of development will not need to be amended to accommodate the requested change, because it already has the capability of generating lists of public or industry arbitrators. Moreover, the pool of arbitrators from which panelists are chosen is the same for both customer and intra-industry disputes. For those intra-industry disputes that require use of an all-industry (non-public) panel, only the non-public arbitrator list will be generated. For disputes that currently require a public arbitrator or a majority of public arbitrators, as provided in the second sentence of Rule 10202(a), the provisions of Rule 10308 will apply in the same way as they would apply to customer disputes.

The arbitrator database contains information relating to the background of the arbitrators, so subject matter knowledge can be considered if the parties would like an arbitrator with specialized experience, such as employment compensation, employment discrimination, or specific securities products. The extension of list selection to intra-industry arbitration will not have any effect on the quality of arbitrators chosen for a particular case, and gives the

parties more of a voice in choosing their panelists than they currently have. It also will allow computerized rotation of arbitrators used in both customer and intra-industry arbitrations.

Description of Amendments

The proposed rule change amends Rules 10202, 10203, and 10308. References in Rules 10202 and 10203 to arbitrators “from the securities industry” have been amended to comport with the terminology used in Rule 10308, “non-public arbitrators.” Existing references to the appointment of arbitrators have been left unchanged, since those references deal with the number of arbitrators to be selected and their classification as public or non-public, and those provisions are not proposed to be changed at this time. The method of arbitrator selection is not currently specified in Rules 10202 and 10203. A new paragraph has been added to Rule 10202, however, to make it explicit that the arbitrator selection method of Rule 10308 will apply to intra-industry disputes.

Rule 10202(a) continues to provide that, in disputes subject to arbitration that arise out of the employment or termination of employment of an associated person, and that relate exclusively to disputes involving employment contracts, promissory notes or receipt of commissions, a panel of non-public arbitrators will be appointed as provided by paragraph (b)(1) or (2) or Rule 10203, whichever is applicable.⁷ In all other disputes arising out of the employment or termination of employment of an associated person, the panel of arbitrators will be appointed as provided by Rule 10302 or Rule 10308, whichever is applicable. This

⁷ Under Rule 10202(b)(1), for claims of \$50,000 or less, a single arbitrator is appointed. Under paragraph (b)(2), for claims of more than \$50,000, three arbitrators are appointed. Under Rule 10203, there are simplified procedures for claims that do not exceed \$25,000.

means that claims involving allegations such as defamation or employment discrimination⁸ would be heard by a public panel as provided in Rules 10302 (for small claims) or 10308 (for all other claims).⁹

The amendment to Rule 10202(b)(1) parallels the provisions of proposed amendments to Rule 10308(b)(1) made in Amendment No. 3 to SR-NASD-98-48, the companion list selection rule proposal for customer arbitration, except that the panels will consist of either one or three non-public arbitrators unless the parties agree otherwise. Rule 10202(b)(1) provides that, for claims of \$50,000 or less, the Director will appoint a single non-public arbitrator, unless the parties agree to the appointment of a public arbitrator. Paragraph (b)(1) clarifies that certain cases that are for a claim of \$50,000 or less may be arbitrated by a three-person panel rather than by one arbitrator in certain circumstances. For a claim of \$25,000 or less, a single arbitrator already appointed to the case may request that the Director appoint two additional arbitrators. For a claim of more than \$25,000 and not more than \$50,000, any party (in its initial filing) or an appointed arbitrator may request that the Director appoint a three-arbitrator panel. Also, the phrase, "a party," is used to clarify that either a claimant or a respondent may request a three-arbitrator panel under this subparagraph.

Rule 10202(b)(2) provides that, except as otherwise provided in paragraph (a), in all

⁸ Pursuant to recent amendments to Rule 10201, claims of employment discrimination in violation of a statute are not required by NASD rules to be arbitrated after January 1, 1999; however, parties may agree to arbitrate such claims for a number of reasons. See SR-NASD-97-77, approved by the Commission in Exchange Act Rel. No. 40109 (June 22, 1998), 63 F.R. 35299 (June 29, 1998).

⁹ Amendment No. 3 to SR-NASD-98-48, filed August 10, 1998, states that in simplified arbitration proceedings under Rule 10302, the proposed list selection method of Rule 10308 will be followed unless superseded by provisions of Rule 10302.

arbitration matters between or among members and/or persons associated with members and where the amount in controversy exceeds \$50,000, exclusive of attendant costs and interest, a panel shall consist of three arbitrators, all of whom shall be non-public arbitrators.

New paragraph (c) was added to Rule 10202 to avoid any confusion over the interaction between this rule and the injunction rule, Rule 10335.¹⁰ Paragraph (c) provides that, in proceedings relating to injunctions under Rule 10335, the provisions of Rule 10335 shall supersede the provisions of Rule 10202. Rule 10335 contains a corresponding provision, stating that, except as otherwise provided in Rule 10335, the remaining provisions of the Code shall apply to proceedings instituted under that Rule.

New paragraph (d) makes explicit the current practice of using the same arbitrator selection method for both industry and customer disputes. This provision was added to alert parties to the fact that the proposed list selection method will also be used for intra-industry disputes, because the proposed list selection rule was initially intended to apply only to customer disputes until further changes were made to the industry arbitration rules.

In Rule 10308, references to customers in the title and introductory language have been deleted to avoid confusion when those rules are used in intra-industry arbitration. NASD Regulation does not believe that other amendments are needed to Rule 10308 to indicate differences that might apply in intra-industry arbitration, because Rule 10204 already provides as follows:

Except as otherwise provided in the Rule 10200 Series, the Rules

¹⁰ This rule filing does not treat as adopted the changes to Rule 10335 proposed in SR-NASD-98-49, filed July 16, 1998, since that rule proposal will not be effective prior to this rule filing.

and procedures applicable to arbitrations concerning industry and clearing controversies shall be those set forth hereinafter under the Rule 10300 Series.

Therefore, specific provisions of the Rule 10200 Series will supersede any contrary provisions of Rule 10308. Any doubts as to whether a provision should be superseded would continue to be resolved in the negative, that is, in favor of using the Rule 10300 Series provision.

Because the current practice is for the customer arbitration rules to apply by default where they are not specifically superseded by the intra-industry rules, NASD Regulation does not believe that confusion will occur.

(b) Statutory Basis

NASD Regulation 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. NASD Regulation believes that the proposed rule change will promote the public interest by simplifying the arbitration process and reducing administrative time and expense by conforming the intra-industry arbitrator list selection process to the customer process.

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

NASD Regulation 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

NASD Regulation has requested that the Commission find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the NASD and, in particular, the requirements of Section 15A and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in that accelerated approval will benefit parties in intra-industry arbitration by extending to them the same arbitrator list selection method proposed to be implemented for customer arbitration.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and hereby is, approved.

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

Jonathan G. Katz
Secretary