

**Alden S. Adkins**  
Sr. Vice President and  
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July 23, 1998

**By Hand**

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-98-48, Amendment No. 2**  
Proposed Rule Change to Amend the Method of  
Selecting Arbitrators in Customer Disputes

Dear Ms. England:

Pursuant to Rule 19b-4, the National Association of Securities Dealers, Inc. (“NASD”) and NASD Regulation, Inc. (“NASD Regulation”) (collectively, the “Association”) file this letter as Amendment No.2 to SR-NASD-98-48. Proposed new language is underlined and proposed deletions are in brackets. (For ease of reference, the numerical and captions referenced are those found in Exhibit 1.)

1. In part II(A)(a)(2)(B)(ii), “NLSS Functions and Capabilities,” in the paragraph beginning with the sentence, “The second subcategory of subject matter expertise, security . . . option of a party.”, the Association proposes to amend the next to the last sentence as follows:

“If available in the hearing location, certain arbitrators may be included in [added to] the arbitrator lists generated by NLSS.”

2. In part II(A)(a)(2)(B)(iii), “Conflicts-of-Interests,” the Association proposes to amend the second and third paragraphs of the section as follows:

The second review for conflicts of interest will occur after the NLSS creates a list of arbitrators, but before the list is finalized. ODR will perform a review based upon information that each arbitrator discloses to ODR and, for non-public arbitrators, additional information found in the CRD. After a review of available information, ODR may remove an arbitrator based upon such disclosure.<sup>27</sup> [ See also proposed amendments to Rule 10312.] ODR's screening for a conflict of interest will avoid limiting the parties' choices later. ODR will eliminate arbitrators from a list who would almost certainly be disqualified at a later stage in the proceeding due to a conflict of interest. If arbitrators are eliminated during this process, ODR will replace them by returning to NLSS so that the minimum number of public arbitrators, and, if applicable, non-public arbitrators, are on the list or lists that will be mailed to the parties.

After the parties receive the lists, the parties also will have the ability to review information disclosed by the potential arbitrators to determine if a conflict of interest exists. Under proposed paragraph (b)(6), for each arbitrator listed, the Director will provide the parties with the arbitrator's employment history for the past 10 years and other background information [any other information disclosed by the arbitrator under Rule 10312]. This information may disclose a conflict of interest between a party and the arbitrator listed and permits the parties to make more informed decisions during the process of ranking and striking the listed arbitrators. Under paragraph (b)(6), the parties may request additional information from the arbitrators; any response by an arbitrator is forwarded to all parties. If a party identifies a conflict of interest, the party's remedy is to strike the person from the list, in the process described in greater detail below. Proposed Rule 10308 (c)(1)(A).

3. In part II(A)(a)(2)(C)(iii), "Appointing Arbitrators," in the second paragraph, the Association proposes to amend the second sentence to read:

Based upon the information that the arbitrator has previously provided [under Rule 10312], any information provided to the Director under Rule 10312,<sup>32</sup>

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<sup>27</sup> At this stage of the arbitrator appointment process, ODR staff would not make telephone inquiries.

<sup>32</sup> Current Rule 10312, also discussed below, requires an arbitrator to disclose, with respect to a particular case and the issues, parties, and witnesses in the case, any information which might preclude the arbitrator from rendering an objective and impartial determination in the case.

and any information obtained from any other source, the Director shall determine if the arbitrator should be disqualified.

In addition, the footnotes after new footnote 32 should be renumbered.

4. In part II(A)(a)(2)(D), “Arbitrator Disclosures and Removing Arbitrators-- Paragraph (d),” the Association proposes to amend the section by adding a new first paragraph, amending the original first and third paragraphs, and deleting the original second paragraph as set forth below:

Proposed Rule 10308(d)(1) provides a mechanism for the Director to disqualify an arbitrator after the arbitrator has been appointed by the Director under proposed paragraph (c)(4). As noted previously, during the period that a party is reviewing and ranking the lists of arbitrators (see paragraphs (c)(1) and (2)), a party has an unlimited right to eliminate a listed arbitrator by striking the arbitrator from the list, and may do so to eliminate an arbitrator who the party believes may not be impartial or fair, among other reasons. Thus, prior to sending the party’s rankings to the Director for consolidation, the party has an unlimited right to strike any potential arbitrator as to whom the party suspects bias. Proposed paragraph (d)(1) applies after the parties have exercised this unlimited right to strike, the arbitrator lists have been consolidated, the arbitrators have made initial disclosures to the Director under Rule 10312 about concerns regarding the specific parties, issues and witnesses in the case as discussed below, and the arbitrators have been appointed.<sup>34</sup>

An arbitrator has a continuing obligation under Rule 10312 of the Code to disclose to the Director any circumstances that might preclude the arbitrator from rendering an objective and impartial determination in an arbitration including, a direct or indirect financial or personal interest in the outcome of the arbitration, or any existing or past financial, business, professional, family or social relationships with a party, counsel, or representative (or, when later identified, a witness) that might affect impartiality or might reasonably create an appearance of partiality or bias. Generally, t[T]he ODR, in turn, must disclose to the parties any information the arbitrators provide. [As noted previously, under proposed Rule 10308(c), ODR forwards to the parties the information disclosed to the Director under Rule 10312.]

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<sup>34</sup> As noted above, disqualification issues that arise after the Director, using NLSS, has begun consolidating parties’ preferred arbitrators, may be addressed by the Director directly as part of the appointment process described in paragraph (c)(4).

[If the parties believe that the information forwarded to them from ODR or information from any other source suggests that the arbitrator may not be impartial regarding the issues or the case, and if such information is received before the party has returned the arbitrator lists to the Director, a party may simply strike the arbitrator under proposed Rule 10308(c). Thus, prior to sending in the party's preferences to the Director for consolidation, a party has an unlimited right to strike any potential arbitrator as to whom the party suspects bias.]

[Proposed paragraph (d)(1) provides for disqualification after an arbitrator has been appointed by the Director under paragraph (c)(4).] Under [proposed Rule 10308] paragraph (d)(1), a party or the Director may raise a disqualification issue. However, the decision to disqualify an arbitrator already appointed [selected under proposed Rule 10308(c)(4)] lies solely with the Director. The Director may not make any decision to disqualify an arbitrator, however, after the commencement of the earlier of two events: (i) the first prehearing conference or (ii) the first hearing. Proposed Rule 10308(d)(2). At that point or thereafter, if a party believes that an arbitrator should be disqualified, the matter must be raised before the arbitration panel. Vacancies created as a result of a disqualification under proposed paragraph (d)(1) are filled by the Director by referring to the appropriate consolidated list from which the panelists were originally obtained (proposed Rule 10308(d)(3)) or, if there are no persons remaining on the consolidated list, by a person the Director selects under proposed Rule 10308(c)(4)(B)[(5)].

If you have any questions, please contact Sharon Zackula, Assistant General Counsel, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8985. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

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General Counsel