

Notice to Members

OCTOBER 2002

SUGGESTED ROUTING

Legal & Compliance
Registered Representatives
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KEY TOPICS

Arbitration
Associated Persons
California Disclosure Standards
Members

INFORMATIONAL

SEC Approves Rule Change to IM-10100

Industry parties in California arbitration proceedings must waive contested California arbitrator disclosure standards if all parties who are investors, or associated persons with claims of statutory employment discrimination, have executed waiver agreements

Executive Summary

The Securities and Exchange Commission (SEC or Commission) has approved amendments to IM-10100 of the NASD Code of Arbitration Procedure (Code) governing Failure to Act Under Provisions of Code of Arbitration Procedure.¹ The amendments provide that members and associated persons involved in NASD arbitration proceedings in the State of California are required to waive application of California Ethics Standards for Neutral Arbitrators in Contractual Arbitration (the "California Standards") to their arbitration proceedings upon the request of investors or, in industry cases, of associated persons with claims of statutory employment discrimination, for a six-month pilot period (or until the conclusion of pending litigation contesting application of the standards to NASD).

The new procedures will apply to the appointment of arbitrators on or after September 30, 2002, to serve in California arbitrations.

The text of the rule change described in this *Notice* is included as Attachment A. A sample Memorandum to Parties and Counsel of Record and Waiver Agreement are included as Attachment B.

Questions/Further Information

Questions regarding this *Notice* may be directed to Jean I. Feeney, Chief Counsel and Associate Vice President, NASD Dispute Resolution, at (202) 728-6959, or e-mail, jean.feeney@nasd.com.

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Discussion

For several months, NASD has taken many steps to address concerns raised by the California Standards, which NASD believes to be in conflict with the Code of Arbitration Procedure. Since July 1, 2002, NASD has postponed appointing arbitrators in arbitration proceedings scheduled to take place in California. Additional information on the history of this issue, and the measures NASD has taken to provide alternatives for parties, can be found in NASD's rule proposal, SR-NASD-2002-126,² which was approved on an accelerated basis by the SEC on September 26, 2002.

Effective September 30, 2002, NASD is implementing a six-month pilot amendment to IM-10100, "Failure to Act Under Provisions of Code of Arbitration Procedure," for cases that are affected by the new California Standards. The amendment requires industry parties to waive the California Standards in all cases in which all the parties in the case who are investors (referred to as "customers" in the Code) or associated persons with claims of statutory employment discrimination agree to waive application of the California Standards. Under such a waiver, the case would proceed in California under the existing NASD Code, which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest.

NASD has resumed issuing lists of proposed arbitrators in California cases from which the parties select their panels under the current Neutral List Selection System (NLSS). NASD will send memoranda to investors and to associated persons with claims of statutory employment discrimination, giving them the option of waiving the

California Standards and providing them with waiver forms. A sample of such a memorandum is attached to this *Notice*.

NASD is also notifying industry parties in all pending California cases that they must waive the California Standards where the investors agree to a waiver (or associated persons, in the circumstances described above). Industry parties in such cases will be required to execute waiver agreements; however, their failure to do so will not stop the cases from moving forward and the failure to sign as required by the new rule will be referred for disciplinary action.

Upon receipt of completed waiver forms signed by investors and their counsel, or by associated persons with claims of statutory employment discrimination and their counsel, NASD will immediately commence the arbitrator appointment process under existing NASD rules, and current NASD disclosure requirements.

Effective Date

The new procedures will apply to the appointment of arbitrators on or after September 30, 2002, to serve in California arbitrations.

Endnotes

1. Exchange Act Release No. 46562 (September 26, 2002) (File No. SR-NASD-2002-126).
2. This rule filing may be found on the NASD Web site at: www.nasdaq.com/app_orders_index.asp#02-126.

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ATTACHMENT A

Code of Arbitration Procedure

* * *

IM-10100. Failure to Act Under Provisions of Code of Arbitration Procedure

It may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member or a person associated with a member to:

(a) – (e) No change.

(f) fail to waive the California Rules of Court, Division VI of the Appendix, entitled, “Ethics Standards for Neutral Arbitrators in Contractual Arbitration” (the “California Standards”), if all the parties in the case who are customers have waived application of the California Standards in that case; or

(g) fail to waive the California Standards, if all the parties in the case who are associated persons with a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute have waived application of the California Standards in that case.

(Remainder unchanged.)

ATTACHMENT B

NEW WAIVER OPTION EFFECTIVE SEPTEMBER 30, 2002

MEMORANDUM

TO: Parties and Counsel of Record
FROM: NASD Dispute Resolution
RE: New Waiver Option re: Appointment of Arbitrators In California
DATE: September 30, 2002

Effective September 30, 2002, customers in all cases and associated persons in cases involving employment discrimination claims may waive all rights and remedies they might otherwise be entitled to under the California Standards. Industry parties in such cases are required to execute waiver agreements. Upon receipt of the completed waiver form signed by all of the customers and their counsel, arbitrators will be appointed under existing NASD rules, and current NASD disclosure requirements.

Since July 1, 2002, NASD has not appointed arbitrators in arbitration proceedings scheduled to take place in California. On that date, the state enacted Ethics Standards for Neutral Arbitrators ("California Standards"), which NASD and the Securities and Exchange Commission ("SEC") believe to be in conflict with the SEC-approved Code of Arbitration Procedure. These standards require significantly more disclosure by arbitrators of their financial and personal relationships; include provisions for arbitrators to be removed from a case on demand of a single party to the case; and also provide that an arbitrator's failure to provide the required disclosure is a basis for challenging the arbitration award in court. Trying to implement these standards would require NASD to violate its own SEC-approved rules, increase costs of arbitrations, reduce the number of arbitrators willing to serve on cases, and reduce the speed and certainty of arbitration proceedings. For these reasons, NASD and the New York Stock Exchange are challenging the California Standards in federal court in California.

In July, NASD announced that it was taking steps to help investors deal with the delay in California cases. Specifically, we said we would provide venue changes for arbitration cases and absorb the extra administrative costs associated with the change of venue, using non-California arbitrators when appropriate. To accommodate cases being heard outside of California, we added Reno, Nevada as a new hearing location to the existing sites in Portland, Oregon; Seattle, Washington; Phoenix, Arizona; and Las Vegas, Nevada. On September 3, we further enhanced the venue selection for investors by announcing that cases would be moved outside of California at the request of an investor; industry party acquiescence is no longer required.

We also encouraged parties to mediate their disputes by waiving our administrative fees for NASD-sponsored mediations, and assigning mediators who agreed to reduce their usual hourly rate. Finally, we assigned arbitrators from outside of California to all simplified arbitration cases, that is, claims involving under \$25,000 that are decided by a single arbitrator without a hearing.

In a further effort to provide arbitration hearings to parties who do not wish to travel outside of California or mediate, NASD has adopted a rule permitting arbitrators to be appointed in cases in California where customers waive the application of the California Standards to their arbitration proceedings. This rule was approved by the Securities and Exchange Commission on September 26, 2002, and is effective on Monday, September 30, 2002.

The new rule provides that arbitrators will be appointed under existing NASD rules, and current NASD disclosure requirements, in cases where all of the customers and their counsel agree to waive all rights and remedies they might otherwise be entitled to under the California Standards. If all of the customers agree to waive the California Standards, then the rule *requires* industry parties (securities firms and their associated persons, a technical term for securities industry employees) to do the same. This rule applies to customers, whether they are the claimants or the respondents in an arbitration.

In intra-industry cases involving claims of statutory employment discrimination, the rule provides that if associated persons and their counsel waive the California Standards, then the firms they are suing must also waive them. The rule does not apply to associated persons bringing non-statutory employment claims or other claims against firms or other associated persons; and it does not apply to associated persons who are respondents in a claim brought by a customer or another associated person.

Customers and associated persons who want to have arbitrators appointed under current NASD rules must execute the attached Waiver Form and return it to NASD. Customers and associated persons who execute the waiver form acknowledge that the arbitrator disclosure requirements under NASD rules are different from and not as expansive as the disclosure requirements under the California Standards. They agree that they are arbitrating their cases under NASD rules and the Federal Arbitration Act, and not under the California Standards, and they agree that they will not seek to challenge the arbitration or arbitrators for failure to comply with the California Standards. *Customers and associated persons should seek the advice of counsel before executing this waiver form, and counsel must also sign the form for the waiver to be effective.*

Industry parties in all pending California cases must waive the California Standards where the investor (or associated person, in the circumstances described above) agrees to a waiver. Industry parties in such cases will be required to execute waiver agreements; however, their failure to do so will not stop the cases from moving forward and the failure to sign as required by the proposed rule change will be referred for disciplinary action to the NASD Regulatory Policy and Oversight Division.

NASD will start the arbitrator appointment process immediately for customers (in all cases) or associated persons (in employment discrimination cases) who execute and return the enclosed Waiver Forms.

This procedure is available for customers (or associated persons with employment discrimination claims) who:

- ♦ Have filed claims, but have not yet received arbitrator ranking forms;
- ♦ Have received arbitrator ranking forms that are not yet due to be returned;
- ♦ Have timely returned their arbitrator ranking forms, but have not been provided the names of the selected arbitrators;
- ♦ Have received the names of their arbitrators, but a replacement arbitrator is needed; and
- ♦ Have agreed to a non-California hearing location, but would prefer to have the case heard in California, with California arbitrators, now that this option is available (submission of the waiver form will render the agreement to use a non-California hearing location null and void).

Completed forms should be mailed or faxed to:

NASD Dispute Resolution
300 South Grand Avenue
Suite 900
Los Angeles, CA 90071
Facsimile: 213-613-2677

WAIVER AGREEMENT

The undersigned parties hereby agree that this arbitration shall be governed by the NASD Code of Arbitration Procedure and the Federal Arbitration Act, notwithstanding any contrary federal or state substantive or procedural law. In particular, the parties agree that the provisions of the NASD Code of Arbitration Procedure, specifically including its arbitrator disclosure requirements, arbitrator selection procedures, and arbitrator disqualification provisions, and not any provisions of the California Ethics Standards for Neutral Arbitrators in Contractual Arbitration in California ("California Standards"), will apply in this arbitration. The California Standards shall have no application whatsoever to any aspect of this arbitration, including without limitation any proceedings to obtain judicial review or judicial enforcement of any arbitration award that may be entered in this arbitration.

The parties accept the disclosures required under the NASD Code of Arbitration Procedure as fully sufficient for purposes of this case, notwithstanding the fact that such disclosures may be less extensive than those required by the California Standards in cases to which those Standards apply. The parties further accept that the NASD Code of Arbitration Procedure's disqualification procedures vest the ultimate authority in the Director of Arbitration to determine whether to disqualify an arbitrator, whereas the California Standards purport to eliminate the Director of Arbitration's discretion in determining whether to disqualify arbitrators. In recognition of these, and other, variances between the NASD Code of Arbitration Procedure and the California Standards, the parties hereby expressly waive any and all rights, obligations, and/or benefits that might be conferred on them by the California Standards in this arbitration, expressly agree that they will not seek to enforce any rights or claim any remedies under or pursuant to the California Standards in any court, proceeding or forum in any matter relating to this arbitration, and expressly and irrevocably release any claim or claims that they may have based on the California Standards in connection with this arbitration or any proceedings relating thereto.

In addition, and without limiting in any way the scope of the waiver and release set forth in the foregoing paragraph, the parties specifically agree not to assert, in any forum, that non-compliance with the California Standards is a basis for challenging the validity of any arbitrator or of any arbitration award, whether asserted during the arbitration proceeding or after an arbitration award has been issued. The parties also specifically agree not to seek any relief against NASD Dispute Resolution or NASD, or any arbitrator, for any failure to comply with the Standards.

The parties understand and acknowledge that this waiver and release applies to and includes all unknown or unsuspected consequences or results arising from or relating to the parties' waiver of any and all rights under the California Standards in connection with this arbitration. The parties represent and warrant that they have read the contents of California Civil Code section 1542, which provides as follows:

"A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected this settlement with the debtor."

The Parties Expressly Waive Any and All Rights and Benefits Under California Civil Code Section 1542.

The parties hereby agree that this agreement may be signed in counterparts.

Date:
Claimant(s):

Date:
Respondent(s): (Print here)

Claimant (print name and sign above)

Counsel for Respondent

Claimant (print name and sign above)

Counsel for Respondent

Claimant (print name and sign above)

Counsel for Respondent

Counsel for Claimant
(add signature lines if additional space needed)

Counsel for Respondent
(add signature lines if additional space needed)