

**INFORMATIONAL**

## Rules For Arbitrator Challenges

**REVISED — SUPERSEDES  
NTM 01-04<sup>1</sup>**

**SEC Approves Amendments To Director's Authority To Remove Arbitrators For Cause; Effective Date: March 8, 2001**

**SUGGESTED ROUTING**

*The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.*

- Legal & Compliance
- Registered Representatives

**KEY TOPICS**

- Arbitration
- Arbitrator Challenges

### Executive Summary

On December 8, 2000, the Securities and Exchange Commission (SEC) approved amendments to National Association of Securities Dealers, Inc. (NASD<sup>®</sup>) Rules 10308 and 10312 to provide authority for the Director of Arbitration (Director) to remove arbitrators for cause after hearings have begun.<sup>2</sup> The Code of Arbitration Procedure (Code) presently provides that the authority of the Director to remove an arbitrator for cause ceases after the earlier of the first pre-hearing conference or the first hearing. The amendments eliminate this restriction, and allow the Director or the President of NASD Dispute Resolution, Inc. (NASD Dispute Resolution) non-delegable authority to remove an arbitrator for cause<sup>3</sup> at any time and, if the challenge is raised after the initial pre-hearing or hearing session, to require that it be based on information not known to the parties when the arbitrator was appointed.

Included with this *Notice* is Attachment A, the text of the amendments that will become effective on March 8, 2001.

### Questions/Further Information

Questions regarding this *Notice* may be directed to George H. Friedman, Senior Vice President and Director, NASD Dispute Resolution, Inc., at (212) 858-4488; or Jean I. Feeney, Special Advisor to the President, NASD Dispute Resolution, Inc., at (202) 728-6959.

### Discussion

#### **Background**

In order to protect the integrity of the arbitration process and to ensure the impartiality of arbitrators, Rule 10312(a) requires that arbitrators make full disclosure of certain enumerated interests,

relationships, and circumstances, as well as "any circumstances which might preclude such arbitrator from rendering an objective and impartial determination." Under the current list selection method for choosing arbitrators, Rule 10308(b)(6) requires the Director to send the parties the employment history and other background information about the arbitrators on their lists. The parties may request additional information. Then, as provided in Rule 10308(c), they may strike any number of arbitrators from the list for any reason, and rank those who remain. The Director or his staff<sup>4</sup> consolidates the parties' lists in ranking order and, if the number of arbitrators available to serve from the consolidated list is not sufficient to fill a panel, the Director uses the Neutral List Selection System (NLSS) to extend the list and appoints one or more additional arbitrators to complete the panel. Parties receive information about any arbitrators appointed by extending the list, and have the right to raise for-cause challenges as provided in Rule 10308(d)(1).

Rule 10308(c)(4)(A) provides that the Director appoints arbitrators "subject to availability and disqualification." "Availability" refers to the arbitrator's ability to serve on the case in the desired location during the relevant time period. "Disqualification" could occur either (i) when a disqualifying fact is revealed to the Director after the parties have completed the striking and ranking process, or (ii) when the Director consults with a ranked arbitrator candidate just prior to appointment and the candidate, upon hearing more case-specific information, reveals information that the Director determines is a basis for disqualification. In the latter case, the Director would either drop the arbitrator, or disclose the information to the parties and invite their views on whether the arbitrator should serve.

Under Rule 10312(c), an arbitrator's disclosure obligation continues throughout the arbitration. If a disqualifying fact comes to light after a panel has been appointed, Rules 10308(d) and 10312(d) permit the Director to remove an arbitrator based on such information before the earlier of the first pre-hearing conference or the first hearing. Once one of these events occurs, Rules 10308(d)(2) and 10312(f) currently state that the Director's authority to remove an arbitrator ceases.

Nevertheless, current Rule 10312(f) requires the Director to inform the parties of any potentially disqualifying information disclosed after the first pre-hearing or hearing session. At that point, however, a party can no longer use a challenge for cause to remove the arbitrator. Therefore, when a for-cause objection is raised after the first pre-hearing or hearing session, the arbitrator can only be removed where he or she agrees to step down or all the parties agree that the arbitrator should be removed. Failing that, an aggrieved party's only recourse is to seek judicial intervention, which increases the party's legal expenses, causes delays, and reduces confidence in the fairness and efficiency of the arbitration process.

NASD Dispute Resolution believes that an alternative dispute resolution forum should be able to resolve all issues relating to an arbitration without forcing the parties to go to court. Accordingly, NASD Dispute Resolution has amended the Code to permit the Director to remove an arbitrator for cause at any time and, if the challenge is raised after the initial pre-hearing or hearing session, to require that it be based on information not known to the parties when the arbitrator was appointed. In addition, certain

minor language changes have been made to clarify that both relationships and circumstances must be disclosed if they fit within the criteria of Rule 10312, and that the Rule is not limited to personal relationships and circumstances of the arbitrator, as described in more detail below.

Some users of the arbitration forum may be concerned about the ability of the staff to remove arbitrators who were selected by the parties, based on one party's objection. To address that concern, the amendments provide that the only persons who can remove arbitrators after the first pre-hearing or hearing session are the Director and the President of NASD Dispute Resolution. This authority cannot be delegated. In addition, as discussed above, removal after the first pre-hearing or hearing session can only be based on information: (1) that is required to be disclosed pursuant to Rule 10312; and (2) that was not known to the parties at the time the arbitrator was appointed.

### **Description Of Amendments**

NASD Dispute Resolution has amended Rule 10308, the list selection rule, to provide that the authority of the Director to disqualify or remove arbitrators does not end when the first pre-hearing or hearing session begins. Rather, amended 10308(d)(2) provides that, after that first session, the Director may remove an arbitrator from an arbitration panel based on information that is required to be disclosed pursuant to Rule 10312 and that was not previously disclosed.

Rule 10312, the arbitrator disclosure rule, has been amended in several places. Rule 10312(a)(2) has been amended to include disclosure of existing or past financial, business, professional, family, social, or other relation-

ships or circumstances that are likely to affect impartiality or might reasonably create an appearance of partiality or bias. The word "personally" has been deleted from the second sentence of Rule 10312(a)(2), as it might be read too narrowly, and the phrase "or circumstances" has been added to paragraphs (b) and (e) of Rule 10312. This clarifies that the arbitrator is required to disclose *any* relationships or circumstances that might fit under Rule 10312.

NASD Dispute Resolution also has amended Rule 10312 to provide, as in Rule 10308, that the Director's authority to remove arbitrators does not cease with the first pre-hearing or hearing session. There are two restrictions on the exercise of this authority, however, once such sessions have begun. Amended Rule 10312(d)(2) provides that, after the earlier of the first pre-hearing conference or the first hearing, the Director may remove an arbitrator based only on information not known to the parties when the arbitrator was selected. This provision is intended to prevent parties from raising challenges late in the process that could have been raised at the outset. Amended Rule 10312(d)(2) also provides that the Director's authority under this subparagraph may only be exercised by the Director or by the President of NASD Dispute Resolution.

Rule 10312(e) has been amended to be consistent with the above changes, and Rule 10312(f) is deleted as no longer necessary in light of the preceding changes.

### **Effective Date**

The amended rule will apply to claims filed on or after March 8, 2001, and all claims currently pending before NASD Dispute Resolution on March 8, 2001.

### Endnotes

- 1 This *Notice to Members* supersedes *Notice to Members 01-04*, which is hereby rescinded and should be disregarded.
- 2 Exchange Act Release No. 43695 (Dec. 8, 2000) (File No. SR-NASD-00-34), 65 Federal Register 78520 (Dec. 15, 2000).
- 3 The standard for circumstances that would be considered "for cause" would be the same as the general disclosure standard contained in Rule 10312: "any circumstances which might preclude such arbitrator from rendering an objective and impartial determination."
- 4 Rules 10103 provides that the duties and functions of the Director may be delegated, as appropriate (but see revised Rule 10312(d)(2), contained in the Attachment, which prohibits delegation in certain circumstances).

**ATTACHMENT A**

**Text Of Amendments**

*New language is underlined;  
deletions are in brackets.*

**10000. Code Of Arbitration Procedure**

**10308. Selection of Arbitrators**

(a) - (c) Unchanged.

(d) Disqualification and Removal of Arbitrator Due to Conflict of Interest or Bias

(1) Disqualification by Director  
After the appointment of an arbitrator and prior to the commencement of the earlier of (A) the first pre-hearing conference or (B) the first hearing, if the Director or a party objects to the continued service of the arbitrator, the Director shall determine if the arbitrator should be disqualified. If the Director sends a notice to the parties that the arbitrator shall be disqualified, the arbitrator will be disqualified unless the parties unanimously agree otherwise in writing and notify the Director not later than 15 days after the Director sent the notice.

(2) [Authority of Director to Disqualify Ceases] Removal by Director  
After the commencement of the earlier of (A) the first pre-hearing conference or (B) the first hearing, the Director's authority to may remove an arbitrator from an arbitration panel [ceases] based on information that is required to be disclosed pursuant to Rule 10312 and that was not

previously disclosed.

(3) Unchanged.

(e) Unchanged.

**10312. Disclosures Required of Arbitrators and Director's Authority to Disqualify**

(a) Each arbitrator shall be required to disclose to the Director of Arbitration any circumstances which might preclude such arbitrator from rendering an objective and impartial determination. Each arbitrator shall disclose:

(1) Any direct or indirect financial or personal interest in the outcome of the arbitration;

(2) Any existing or past financial, business, professional, family, [or] social, or other relationships or circumstances that are likely to affect impartiality or might reasonably create an appearance of partiality or bias. Persons requested to serve as arbitrators should disclose any such relationships or circumstances that they [personally] have with any party or its counsel, or with any individual whom they have been told will be a witness. They should also disclose any such relationship or circumstances involving members of their families or their current employers, partners, or business associates.

(b) Persons who are requested to accept appointment as arbitrators should make a reasonable effort to inform themselves of any interests, [or] relationships or circumstances described in paragraph (a) above.

(c) The obligation to disclose interests, relationships, or circumstances that might preclude

an arbitrator from rendering an objective and impartial determination described in paragraph (a) is a continuing duty that requires a person who accepts appointment as an arbitrator to disclose, at any stage of the arbitration, any such interests, relationships, or circumstances that arise, or are recalled or discovered.

(d) Removal by Director  
[Prior to the commencement of the earlier of (1) the first pre-hearing conference or (2) the first hearing, the]

(1) The Director may remove an arbitrator based on information that is required to be disclosed pursuant to this Rule.

(2) After the commencement of the earlier of (A) the first pre-hearing conference or (B) the first hearing, the Director may remove an arbitrator based only on information not known to the parties when the arbitrator was selected. The Director's authority under this subparagraph (2) may be exercised only by the Director or the President of NASD Dispute Resolution.

(e) [Prior to the commencement of the earlier of (1) the first pre-hearing conference or (2) the first hearing, t]The Director shall inform the parties to an arbitration proceeding of any information disclosed to the Director under this Rule unless either the arbitrator who disclosed the information withdraws voluntarily as soon as the arbitrator learns of any interest, [or] relationship, or circumstances described in paragraph (a) that might preclude the arbitrator from rendering an objective and impartial determination in the proceeding, or the Director removes the arbitrator.

[(f) After the commencement of the earlier of (1) the first pre-hearing

---

## **NASD Notice to Members 01-13**

---

conference or (2) the first hearing, the Director's authority to remove an arbitrator from an arbitration panel ceases. During this period, the Director shall inform the parties of any information disclosed by an arbitrator under this Rule.]

*© 2001, National Association of Securities Dealers, Inc. (NASD). All rights reserved. Notices to Members attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.*