

NASD NOTICE TO MEMBERS 97-59

NASD Regulation
Requests Comment On
Injunctive Relief And
Expedited Proceedings;
**Comment Period
Expires October 31,
1997**

Suggested Routing

- ☒ Senior Management
- ☐ Advertising
- ☐ Continuing Education
- ☐ Corporate Finance
- ☐ Government Securities
- ☐ Institutional
- ☐ Internal Audit
- ☒ Legal & Compliance
- ☐ Municipal
- ☐ Mutual Fund
- ☐ Operations
- ☐ Options
- ☒ Registered Representatives
- ☒ Registration
- ☐ Research
- ☐ Syndicate
- ☐ Systems
- ☐ Trading
- ☐ Training
- ☐ Variable Contracts

Executive Summary

NASD Regulation, Inc. (NASD RegulationSM) is seeking from members, associated persons, and others, comments on the procedures for obtaining injunctive relief and expedited proceedings under Rule 10335 of the Code of Arbitration Procedure (Code).

Questions concerning this *Request For Comment* should be directed to Deborah Masucci, Vice President, Office of Dispute Resolution, NASD Regulation, at (212) 858-4400; or Elliott R. Curzon, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8451.

Request For Comment

NASD Regulation encourages all members and interested parties to respond to the issues raised in this *Notice*. Comments should be mailed to:

Joan Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500;

or e-mailed to:
pubcom@nasd.com

Comments must be received **by October 31, 1997**. Before becoming effective, any rule change developed as a result of comments received must be adopted by the NASD Regulation, Inc. Board of Directors, may be reviewed by the NASD Board of Governors, and must be approved by the SEC.

NASD REGULATION REQUEST FOR COMMENT 97-59

Executive Summary

NASD Regulation, Inc. (NASD RegulationSM) is seeking from members, associated persons, and others, comments on the procedures for obtaining injunctive relief and expedited proceedings under Rule 10335 of the Code of Arbitration Procedure (Code).

Questions concerning this *Request For Comment* should be directed to Deborah Masucci, Vice President, Office of Dispute Resolution, NASD Regulation, at (212) 858-4400; or Elliott R. Curzon, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8451.

Background

On January 3, 1996, the National Association of Securities Dealers, Inc. (NASD[®]) implemented a one-year pilot arbitration procedure to govern injunctive relief claims between or among members and associated persons. The pilot procedure, codified in Rule 10335 (Rule) (formerly Section 47), was extended for another year on January 3, 1997, in order to permit NASD Regulation's Office of Dispute Resolution to gain additional experience with the Rule in anticipation of making the Rule a permanent addition to the Code. NASD Regulation is seeking comments from members, associated persons, and others concerning how the injunctive relief rule and expedited proceedings work and how to improve the Rule and procedures. The text of Rule 10335 is set forth following this *Notice*.

Rule 10335 provides, among other things, that:

- Parties may seek temporary injunctive relief either in court or in arbitration.
- Parties who seek temporary injunctive relief in court must simultane-

ously submit the claim to arbitration for permanent relief.

- Parties may obtain interim injunctive relief in arbitration in the form of either an Immediate Injunctive Order or a Regular Injunctive Order.
- Permanent injunctive relief may be obtained in arbitration as part of the final relief sought by a party in connection with a claim.
- Applications for interim injunctive relief are expedited.
- Where a court grants interim injunctive relief to one of the parties, arbitration proceedings on the dispute must be expedited.

From January 3, 1996, when the Rule took effect, through August 18, 1997, the Office of Dispute Resolution has had the following experiences with injunctive relief actions.

- 433 cases were filed seeking injunctive relief.
- The national average number of days between filing and the arbitrator's initial injunctive relief order was approximately 7.5 days.
- Few cases went forward to a hearing on the merits following issuance of an injunctive order by either a court or arbitrator because most of the cases were: (i) settled shortly after filing; (ii) settled just before an injunctive hearing in arbitration; or (iii) settled shortly following an injunctive hearing in arbitration.
- Most of the cases filed under the Rule concerned associated persons leaving one firm for employment at another firm (often referred to as "raiding" cases). The associated person's former firm was generally, though not in all instances, the petitioner in arbitration. In most such cases, the firm filed the action to pre-

vent a former employee from soliciting clients the employee serviced at the firm. The causes of action asserted in many of the cases included: (i) breach of contract; (ii) misappropriation or conversion of trade secrets (customer information); and (iii) defamation (relating to the circumstances of the employee's departure from the firm).

In connection with the plan to extend the effectiveness of Rule 10335 or make it permanent, NASD Regulation is soliciting comments on the functioning of the Rule. Since the Rule was adopted, NASD Regulation's Office of Dispute Resolution (Office) has received comments from users of the Rule. These comments form the basis for the questions set forth below.

Availability Of Temporary Injunctive Relief In Court

Some users of Rule 10335 have complained that, although the Rule permits a party to obtain temporary injunctive relief (a temporary restraining order or TRO) in court prior to seeking other relief in arbitration, some courts have become reluctant to entertain requests for TROs because temporary relief is available in arbitration under the Rule.

Question 1. Should the Rule be modified to eliminate the TRO equivalent in arbitration?

Question 2. Should the Rule be modified to eliminate the TRO equivalent in arbitration and eliminate the option of resorting to the courts for TROs, or to vacate TROs, leaving the parties the remedies (including injunctions) available in an expedited proceeding?

Question 3. If the TRO equivalent is retained in arbitration, should the Rule be modified to eliminate the

option of resorting to the courts for TROs, thereby requiring parties to seek all relief in arbitration?

Question 4. If the option of obtaining a TRO in court is not eliminated, should parties be barred from seeking a court injunction if an arbitration panel has already denied the request?

Question 5. If the option of obtaining a TRO in court is not eliminated, should the parties be barred from seeking relief other than the TRO in court? For example, should they be barred from seeking discovery and/or a preliminary injunction in court?

Terminology

Some users of the Rule have noted that the terminology of the Rule is confusing. The Rule provides for Immediate and Regular Injunctive Orders, and both types can be "interim" in nature. The Rule also does not specify whether an injunctive order can be permanent.

Question 6. Should the rule be modified to adopt the terminology and practice generally used in courts relating to injunctive relief (TRO, Preliminary Injunction, Permanent Injunction)?

Time Limits On Injunctive Relief

Some users of the Rule have noted that it does not specify time limitations on the effectiveness of temporary or preliminary relief, or the time limitations specified are contingent on a party seeking the next step in arbitration.

Question 7. Should the Rule provide that TROs or preliminary injunctions expire after certain specific times, or upon the failure of a party to seek further relief?

Question 8. Should the arbitrators be required to specify an expiration

date for TROs or preliminary injunctions?

Question 9. Should the Rule provide a procedure for extending or extinguishing a court- or arbitrator-issued TRO or preliminary injunction?

Discovery

Ordinarily, discovery is not available in connection with a TRO, often because it is an emergency proceeding and the relief is of very short duration. Discovery is reserved for later in a proceeding, either limited discovery designed to ascertain facts necessary to support or defeat an application for a preliminary injunction, or comprehensive discovery relating to the main action for complete relief.

Question 10. Should the Rule specifically provide for discovery in injunctive relief proceedings, or do the other provisions of the Code that provide for the exchange of information in connection with the substantive claims for relief give the arbitrators sufficient authority to address discovery issues in connection with claims for injunctive relief?

Service Of Process

Paragraph (c) of the Rule provides that service of the application for injunctive relief in the form of a Statement of Claim and a statement of facts demonstrating the necessity for injunctive relief is to be made by the claimant. Rule 10314 of the Code provides that, in ordinary arbitration cases, the Statement of Claim is served on respondents by the Director of Arbitration (Director). Some users of the injunctive relief process have noted that these provisions create confusion about who serves the Statement of Claim and the manner in which an action should be initiated. Further, parties in an

injunctive relief action are not always served simultaneously.

Question 11. Should the service provisions be amended to require that all papers relating to an injunctive relief action be served simultaneously?

Question 12. Should the parties or the Director serve papers that relate to injunctive relief actions?

Hearing Procedure

The Rule provides that a party may apply for a "Regular Injunctive Order" under paragraph (d)(2). The procedures in paragraph (d)(2) specify very short time frames for Regular Injunctive proceedings. Paragraph (g) of the Rule also provides that if a court has issued an injunction, the arbitration must proceed on an expedited schedule in accordance with procedures specified by the panel of arbitrators, but it does not provide for specific deadlines or schedules. The Rule also does not preclude parties from seeking a Regular Injunctive Order under paragraph (d)(2) if they have obtained temporary relief. Nevertheless, some courts, after granting an application for a TRO, have ordered further proceedings to occur under paragraph (g). Some users believe that parties should be able to obtain a Regular Injunctive Order under paragraph (d)(2) even though they obtained the initial relief in court.

In addition, the Rule does not specify whether hearings on applications for injunctive orders under the Rule should be comprehensive evidentiary hearings on the merits of a dispute, or abbreviated inquiries concerning facts and issues relating to the applicant's entitlement to a temporary or permanent injunction.

Finally, the Rule does not address situations where several separately filed actions for injunctive relief involve

the same applicant or respondent.

Question 13. Should parties be able to request a Regular Injunctive Order under paragraph (d) even if a court has ordered the parties to proceed under paragraph (g)?

Question 14. Should the Rule be amended to specify more clearly the type of hearing and the evidentiary showing required for each type of injunctive relief requested?

Question 15. Should there be page limitations on submissions in injunctive relief actions?

Question 16. Should the Rule be amended to permit a single arbitrator, who is hearing several applications for interim injunctive relief involving the same applicant or respondent, to consolidate the actions?

Arbitrator's Authority

The Rule is not clear about the authority of arbitrators to modify or vacate an injunction issued by a court. The Rule also is not clear about the authority of sole arbitrators appointed under the Rule to sanction any party who does not comply with an arbitrator's order.

Question 17. Should the Rule be amended to specify that arbitrators have the authority to modify or vacate any injunctive order issued by a court?

Question 18. Should the Rule be amended to specify that arbitrators have the authority to sanction any party that does not comply with an arbitrator's orders?

Forum Shopping

The Rule requires a party seeking a temporary injunction in court to file simultaneously a claim for permanent relief in arbitration. NASD

Regulation has noted that some firms that have obtained court injunctions are filing their arbitration proceedings with another forum that does not require such proceedings to be expedited (the forum will, however, expedite proceedings upon the request of both parties). In this circumstance, the party that obtained injunctive relief in court benefits from the delay by filing in a forum other than NASD Regulation's.

Question 19. Are there benefits to parties seeking injunctive relief to be able to have their claims heard in other forums?

Question 20. Should parties who have sought temporary injunctive relief in court be barred from seeking permanent relief in forums that have not adopted procedures for adjudicating expedited injunctive relief claims unless the party that sought the injunctive relief agrees to expedite the proceeding?

Question 21. Should the NASD's rules be amended to provide that failure to file an arbitration action after obtaining temporary injunctive relief in court as required by the Rule, or that filing an arbitration action in a forum that does not expedite such proceedings will be considered a failure to submit to arbitration, subjecting the member to disciplinary action?

Other Issues

Mixed Industry/Public Cases. The availability of the procedures under the Rule has been limited to intra-industry cases. Although rare, the Office has encountered cases involving an industry party (an employee or former employee of a member) and the spouse of the party.

Question 22. Should the injunctive relief procedures be available in such cases and should the effect of any

injunctive order extend to the non-industry party?

Fees. NASD Regulation understands that some users of the injunctive relief proceedings believe that the fees charged for the proceedings should be refunded if the proceeding is not expedited. The Office is aware that on occasion circumstances arise which prevent expedited resolution of the proceedings. Parties who have sought injunctions sometimes request delays in order to secure necessary discovery and sometimes the arbitrators will grant requests for delays from responding parties. These circumstances are beyond the control of the Office and, indeed, are a predictable outcome in the process of resolving a dispute. The fees are designed to defray the costs of administering expedited proceedings and the Office often expends significant resources administering these cases even if the final resolution is not expedited. While NASD Regulation will continue to monitor the Office's actual costs of administering injunctive relief proceedings and will consider fee adjustments as necessary for the process to remain as cost-effective as possible, fee refunds are unlikely.

Request For Comment

NASD Regulation encourages all members and interested parties to respond to the issues raised in this *Notice*. Comments should be mailed to:

Joan Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500;

or e-mailed to:
pubcom@nasd.com

Comments must be received by
October 31, 1997. Before becoming

effective, any rule change developed as a result of comments received must be adopted by the NASD Regulation, Inc. Board of Directors, may be reviewed by the NASD Board of Governors, and must be approved by the SEC.

Text Of Rule 10335 Of The Code Of Arbitration Procedure 10335. Injunctions

In industry or clearing disputes required to be submitted to arbitration pursuant to Rule 10201, parties to the arbitration may seek injunctive relief either within the arbitration process or from a court of competent jurisdiction. Within the arbitration process, parties may seek either an "interim injunction" from a single arbitrator or a permanent injunction from a full arbitration panel. From a court of competent jurisdiction, parties may seek a temporary injunction. A party seeking temporary injunctive relief from a court with respect to an industry or clearing dispute required to be submitted to arbitration pursuant to Rule 10201 shall simultaneously file a claim for permanent relief with respect to the same dispute with the Director in the manner specified under this Code. This Rule contains procedures for obtaining an interim injunction. Paragraph (g) of this Rule relates to the effect of court-imposed injunctions on arbitration proceedings. If any injunction is sought as part of the final award, such request should be made in the remedies portion of the Statement of Claim, pursuant to Rule 10314(a).

(a) Single Arbitrator

Applications for interim injunctive relief shall be heard by a single arbitrator.

(b) Showing Required

In order to obtain an interim injunc-

tion, the party seeking the injunction must make a clear showing that it is likely to succeed on the merits, that it will suffer irreparable injury unless the relief is granted, and that the balancing of the equities lies in its favor.

(c) Application for Relief

Interim injunctions include both Immediate Injunctive Orders and Regular Injunctive Orders, as described in paragraph (d) below. In either case, the applicant shall make application for relief by serving a Statement of Claim, a statement of facts demonstrating the necessity for injunctive relief, and a properly-executed Submission Agreement on the party or parties against whom injunctive relief is sought. The above documents shall simultaneously and in the same manner be filed with the Director of Arbitration, together with an extra copy of each document for the arbitrator, proof of service on all parties, and all fees required under Rule 10205. Filings and service required under this Rule may be made by United States mail, overnight delivery service or messenger.

(d) The procedures and timetable for handling applications for interim injunctive relief are as follows:

(1) Immediate Injunctive Orders.

(A) Upon receipt of an application for an Immediate Injunctive Order, the Director shall endeavor to schedule a hearing no sooner than one and no later than three business days after receipt of the application by the respondent and the Director.

(B) The filing of a response to an application for an Immediate Injunctive Order is optional to the party against whom the immediate order is sought. Any response shall be served on the applicant. If a response is submitted, the responding party shall, prior to the hearing or at the hearing,

file with the Director two copies of the response and proof of service on all parties.

(C) Notice of the date, time and place of the hearing; the name and employment history of the single arbitrator required by Rule 10310; and any information required to be disclosed by the arbitrator pursuant to Rule 10312 shall be provided to all parties via telephone, facsimile transmission or messenger delivery prior to the hearing.

(D) The hearing on the application for an Immediate Injunctive Order may be held, at the discretion of the arbitrator or the Director, by telephone or in person in a city designated by the Director of Arbitration.

(E) The arbitrator shall endeavor to grant or deny the application within one business day after the hearing and record are closed.

(F) If the application is granted, the arbitrator shall determine the duration of the Immediate Injunctive Order. Unless the parties agree otherwise, however, the order will expire no later than the earlier of the issuance or denial of a Regular Injunctive Order under subparagraph (2) or a decision on the merits of the entire controversy by an arbitration panel appointed under this Code.

(2) Regular Injunctive Orders.

(A) Upon receipt of an application for a Regular Injunctive Order, the Director shall endeavor to schedule a hearing no sooner than three and no later than five business days after the response is filed or due to be filed, whichever comes first.

(B) The party against which a Regular Injunctive Order is sought shall serve a response on the applicant within three business days of receipt of the application. The responding

party shall simultaneously and in the same manner file with the Director two copies of the response and proof of service on all parties. Failure to file a response within the specified time period shall not be grounds for delaying the hearing, nor shall it bar the respondent from presenting evidence at the hearing.

(C) Notice of the date, time and place of the hearing; the name and employment history of the single arbitrator required by Rule 10310; and any information required to be disclosed by the arbitrator pursuant to Rule 10312 shall be provided to all parties via telephone, facsimile transmission or messenger delivery prior to the hearing.

(D) The hearing on the application for a Regular Injunctive Order may be held, at the discretion of the arbitrator or the Director, by telephone or in person in a city designated by the Director of Arbitration.

(E) The arbitrator shall endeavor to grant or deny the application within one business day after the hearing and record are closed.

(F) If the application is granted, the arbitrator shall determine the duration of the Regular Injunctive Order. Unless the parties agree otherwise, however, a Regular Injunctive Order shall expire no later than a decision on the merits of the entire controversy by an arbitration panel appointed under this Code.

(e) Challenges to Arbitrators

There shall be unlimited challenges for cause to the single arbitrator appointed to hear the application for injunctive relief, but there shall be no peremptory challenges. Parties wishing to object to the arbitrator shall do so by telephone to the Director, and shall confirm such objection immediately in writing or by facsimile trans-

mission, with a copy to all parties. A peremptory challenge may not be made to an arbitrator who heard an application for an injunctive order and who subsequently participates or is to participate on the arbitration panel hearing the same arbitration case on the merits.

(f) Hearing on the Merits

Immediately following the issuance of an Immediate or Regular Injunctive Order, the Director shall appoint arbitrators according to the procedures specified in the Code to hear the matter on the merits. The arbitration shall proceed in an expedited manner pursuant to a schedule and procedures specified by the arbitrators. The arbitrators may specify procedures and time limitations for actions by the parties different from those specified in the Code.

(g) Effect of Court Injunction

If a court has issued an injunction against one of the parties to an arbitration agreement, unless otherwise specified by the court, any requested arbitration concerning the matter of the injunction shall proceed in an expedited manner according to a time schedule and procedures specified by the arbitration panel appointed under this Code.

(h) Security

The arbitrator issuing the Immediate or Regular Injunctive Order may require the applicant, as a condition to effectiveness of the order, to deposit security in an amount that the arbitrator deems proper, in a separate bank trust or escrow account for the benefit of the party against whom injunctive relief is sought, for the payment of any costs and damages that may be incurred or suffered by the party against whom injunctive relief is sought if it is found to have been wrongfully enjoined.

(i) Effective Date

This Rule shall apply to arbitration claims filed on or after the effective date of this Rule. Except as otherwise provided in this Rule, the remaining provisions of the Code shall apply to proceedings instituted under this Rule. This Rule shall expire one year after its effective date unless extended by the Association's Board of Governors.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.