

NASD Notice to Members 98-56

SEC Approves Rule Change Regarding Arbitration Of Statutory Employment Disputes; Effective January 1, 1999

Suggested Routing

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Executive Summary

On June 22, 1998, the Securities and Exchange Commission (SEC) approved an amendment to National Association of Securities Dealers, Inc. (NASD[®]) Rule 10201 to modify the current requirement that associated persons arbitrate all disputes arising out of their employment or termination of employment with a member broker/dealer.¹ The amended rule provides that associated persons no longer will be required, solely by virtue of their association or their registration with the NASD, to arbitrate claims of statutory employment discrimination. Associated persons still will be required to arbitrate other employment-related claims, as well as any business-related claims involving investors or other persons. **The amended rule will be effective on January 1, 1999, for claims filed on or after that date.** The text of the amended rule is attached.

Interpretive questions concerning the amended rule should be directed to Jean I. Feeney, Assistant General Counsel, NASD Regulation, Inc. (NASD RegulationSM), at (202) 728-6959.

Background

The NASD, other self-regulatory organizations (SROs), and state regulatory authorities require all applicants for registration as persons associated with a broker/dealer to complete and sign the Form U-4, the "Uniform Application for Securities Industry Registration or Transfer." Form U-4 requires registered persons to submit any claim to arbitration that is eligible under the rules of the organizations with which they register. Thus, the Form U-4 incorporates by reference the rules of the SRO with which the individual is to be registered. NASD Rule 10201 requires arbitration of disputes arising in connection with the business of a member or the activities of an

associated person, and disputes arising out of the employment or termination of employment of associated persons with a member. These disputes must be arbitrated at the request of any member or associated person.

As described in the SEC release, courts generally have upheld the arbitration requirement, including cases in which there were allegations of statutory employment discrimination.² Nevertheless, registered persons and others have continued to question the policy of requiring the arbitration of statutory discrimination claims. The NASD formed the Arbitration Policy Task Force (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 SEC Chairman, delivered its report to the NASD Board of Governors (NASD Board) in January 1996. The Task Force found that employment arbitration offers the advantages of speed and cost that are identified with customer arbitration, and observed that statutory discrimination claims are almost always interwoven with industry-specific issues. Moreover, the Task Force believed that arbitration's equitable approach to dispute resolution is fully capable of vindicating the important public rights expressed in the anti-discrimination statutes. The Task Force, therefore, found compelling reasons to keep employment-related disputes within NASD arbitration. The Task Force report recommended that employment-related disputes, including statutory discrimination claims, remain eligible for arbitration with certain enhancements, many of which had been recommended elsewhere in the report in the context of customer arbitration.

In May 1997, NASD Regulation

formed an Advisory Committee to assist it in considering the suggested enhancements to the employment arbitration process. The Advisory Committee, which consisted of six persons of varying and distinguished backgrounds, held meetings in June 1997 and heard from representatives of civil rights organizations, the Equal Employment Opportunity Commission, general counsels of member firms, attorneys who represent employees, employee organizations, attorneys who represent member firms, and arbitration experts. After consideration of all the views presented, and in light of the public perception that civil rights claims may present important legal issues better dealt with in a judicial setting, the NASD determined that the appropriate action was to remove the arbitration requirement for such claims, but to further improve the forum so that it is viewed by both registered employees and firms as the fairest and most efficient forum for resolving all employment disputes. In August 1997, proposals were presented to the NASD Regulation Board of Directors and the NASD Board, which authorized the rule change. The text of the proposed rule was provided to the Boards at their meetings in September and October 1997.

The NASD filed the rule proposal with the SEC for approval on October 17, 1997. The SEC published notice of the proposed rule in the *Federal Register* on December 17, 1997.³ The SEC received nine comment letters on the proposed rule. The NASD filed a response to the comments and a minor amendment to the rule proposal on April 14, 1998. The SEC approved the proposed rule, as amended, on June 22, 1998. For a more complete discussion of the history of the rule, members and associated persons should review the SEC release.

Description Of Rule

Paragraph (a) of the rule adds an introductory phrase indicating that the general requirement to arbitrate employment disputes contains an exception, set forth in paragraph (b).

New paragraph (b) provides that claims alleging employment discrimination, including sexual harassment claims, in violation of a statute are not required to be arbitrated by NASD rules. This means that such claims may be filed in the appropriate court, if the employee chooses to do so and is not under an enforceable predispute obligation to arbitrate the dispute. An employee also may agree to arbitrate after a dispute arises. Some member firms use private arbitration agreements that require employees to arbitrate employment disputes apart from any arbitration requirement in SRO rules, and such agreements would not be affected by this rule change. Because arbitration offers many advantages to parties, the NASD expects that many employees will continue to file their discrimination claims in arbitration, particularly in light of planned enhancements to make the arbitration forum even more attractive to parties.

Paragraph (b) applies only to claims alleging employment discrimination, including a sexual harassment claim, in violation of a statute. The term "statute" is to be interpreted broadly, to include any formal written enactment of a legislative body, whether federal, state, city, or county. The Supreme Court has held that sexual harassment is a form of sex discrimination and thus a violation of laws prohibiting discrimination on the basis of sex. However, since the term "sexual harassment" may not be found in some statutes dealing with sex discrimination, the phrase "including a sexual harassment claim" was added to clarify that such claims are meant to be included in

the category of statutory employment discrimination. Paragraph (b) does not apply to causes of action created solely by judicial precedents or to other causes of action under state or federal law, which remain subject to mandatory arbitration under paragraph (a). Such judicially created causes of action might include, for example, claims alleging "wrongful discharge" without any accompanying claim of discrimination on account of age, sex, race, or other status protected by a specific law.

Paragraph (c) of the proposed rule is former paragraph (b), which is unchanged except for the renumbering.

Effective Date

The NASD originally requested that the proposed rule become effective one year from the date of SEC approval. In light of comments received in response to the SEC's publication of the proposed rule and in consultation with SEC staff, the NASD subsequently asked that the proposed rule change become effective on January 1, 1999. Accordingly, the rule change will apply to claims filed on or after the effective date of the rule change. The practical effect is that the rule will apply to all claims filed on or after the effective date without regard to the date the alleged discrimination occurred or the date that the employee signed a Form U-4, but subject to the usual time limitations for bringing such claims.

Text Of Amendments

(Note: New language is underlined; deletions are bracketed.)

10201. Required Submission

(a) Except as provided in paragraph

(b). [Any] a dispute, claim, or controversy eligible for submission under the Rule 10100 Series between or among members and/or associated persons, and/or certain others, arising in connection with the business of such member(s) or in connection with the activities of such associated person(s), or arising out of the employment or termination of employment of such associated person(s) with such member, shall be arbitrated under this Code, at the instance of:

(1) a member against another member;

(2) a member against a person associated with a member or a person associated with a member against a member; and

(3) a person associated with a member against a person associated with a member.

(b) A claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute is not required to be arbitrated. Such a claim may be arbitrated only if the parties have agreed to arbitrate it, either before or after the dispute arose.

[(b)] (c) Any dispute, claim or controversy involving an act or failure to act by a clearing member; a registered clearing agency; or participants, pledgees, or other persons using the facilities of a registered clearing agency, under the rules of any registered clearing agency with which the Association has entered into an agreement to utilize the Association's arbitration facilities and procedures shall be arbitrated in accordance with such agreement and the rules of such registered clearing agency.

Endnotes

¹ See Exchange Act Release No. 40109 (June 22, 1998) 63 FR 35299 (June 29, 1998) ("SEC Release"). The text of the SEC Release may be viewed on the NASD Regulation Web Site at www.nasdr.com.

² As described in the June *Notices to Members*, one federal circuit court has recently held that the Form U-4 arbitration agreement is unenforceable with regard to claims under certain federal and state anti-discrimination laws. *Duffield v. Robertson Stephens & Co.*, No. 97-15698 (9th Cir. May 8, 1998).

³ Exchange Act Release No. 39421 (December 10, 1997), 62 FR 66164 (December 17, 1997).

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