

Notice to Members

AUGUST 2004

GUIDANCE

SUGGESTED ROUTING

Legal & Compliance

Direct Communication

**SEC Approves New Rule 10334 To Allow Direct Communication Between Parties and Arbitrators;
Effective Date: September 30, 2004**

KEY TOPICS

Arbitration

Arbitrators

Dispute Resolution

Executive Summary

The Securities and Exchange Commission has approved new Rule 10334 of the NASD Code of Arbitration Procedure to permit direct communication among arbitrators and the parties to the arbitration (through their counsel) where all parties and arbitrators agree, and to establish guidelines for such direct communication.¹ Included with this *Notice* is Attachment A, the text of the new rule. The rule will be effective on September 30, 2004.

Questions/Further Information

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

Background and Discussion

Under current procedures, parties must address all communications intended for the arbitrators to NASD Dispute Resolution staff, who then forward the communications to the arbitrators. If the communication includes a motion or similar request, staff members customarily solicit a response from the other parties before forwarding the motion or request to the arbitrators. Similarly, the arbitrators transmit their orders and any other communications through the staff.

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In response to a recommendation of the NASD National Arbitration and Mediation Committee, the Chicago Office of NASD Dispute Resolution began a pilot project in June 2001 to determine whether direct communication between parties (through their counsel) and arbitrators would enhance the arbitration process. The Chicago Office developed the parameters governing whether a case would be eligible for inclusion in the pilot and changed the script used by the panel chairperson at the Initial Prehearing Conference (IPHC) on those cases. A modified IPHC Order also was given to the panel chairperson to memorialize all direct communication matters agreed to by the parties and the arbitrators.

In total, 839 cases were eligible for inclusion in the project. Parties (all represented by counsel) and arbitrators in 255 of these cases participated in the program. At the end of the one-year pilot period, staff formulated a survey for those arbitrators and party representatives who participated in the pilot. NASD received responses from about one-third of those surveyed: 193 came from arbitrators and 75 from party representatives. Overall, 73 percent of party representatives and 69 percent of the arbitrators who responded to the survey favored continuing direct communication with the arbitrators. Favorable comments reflected the opinion that direct communication expedited the arbitration process and was more convenient than the normal method of communicating through staff.

In light of the success of the Chicago pilot, NASD developed a nationwide rule that would permit direct communication with the arbitrators where all parties and arbitrators agree. The rule also establishes guidelines for direct communication.

New Rule 10334

The new rule is based largely on procedures used in the Chicago pilot, with a few changes to reflect NASD's experience with the pilot and to provide for possible issues that might occur in a larger-scale application of the rule. Only parties that are represented by counsel may use direct communication under the new rule. If, during the proceeding, a party chooses to appear pro se (without counsel), the rule no longer will apply. All arbitrators and all parties must agree to the use of direct communication before it can be used. The scope of direct communication will be set forth in an arbitrator order, and parties may send the arbitrators only the types of items that are listed in the order. All the arbitrators and parties must have facsimile or e-mail capability before such a delivery method may be used.

Materials must be sent at the same time and in the same manner to all parties, all arbitrators, and the Director of Arbitration (through the assigned staff member), and staff must receive copies of any orders and decisions made as a result of direct communications among the parties and the arbitrators. To avoid tying up busy fax machines and printers, however, the rule contains a provision stating that materials more than 15 pages long shall be sent to the Director only by mail or courier. Arbitrators (or parties) with similar concerns could include a similar provision as to themselves in the direct communication order. NASD has prepared a template for direct communication orders to guide the arbitrators and parties in considering these issues.

Normally, the decision to use direct communication will be made at the IPHC; however, parties and arbitrators also may agree to use direct communication later in the course of an arbitration proceeding, so long as the agreement is contained in a written order of the arbitrators as provided in Rule 10334. The new rule provides that either an arbitrator or a party may rescind his or her agreement at any time, with notice to all arbitrators and parties, if direct communication is no longer working well.

One-sided (ex parte) communications outside the scope of the new rule are still prohibited; parties must not communicate orally with the arbitrators outside the presence of all parties.

Effective Date

The new rule will be effective on September 30, 2004.

Endnotes

1. Securities Exchange Act Release No. 49950 (June 30, 2004), 69 FR 41321 (July 8, 2004) (File No. SR-NASD-2003-163).

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ATTACHMENT A

New language is underlined; deletions are in brackets.

Code of Arbitration Procedure

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10334. Direct Communication Between Parties and Arbitrators

- (a) This rule provides procedures under which parties and arbitrators may communicate directly.
- (b) Only parties that are represented by counsel may use direct communication under this Rule. If, during the proceeding, a party chooses to appear pro se (without counsel), this Rule shall no longer apply.
- (c) All arbitrators and all parties must agree to the use of direct communication during the Initial Prehearing Conference or a later conference or hearing before it can be used.
- (d) Parties may send the arbitrators only items that are listed in an order.
- (e) Parties may send items by regular mail, overnight courier, facsimile, or email. All the arbitrators and parties must have facsimile or email capability before such a delivery method may be used.
- (f) Copies of all materials sent to arbitrators must also be sent at the same time and in the same manner to all parties and the Director. Materials that exceed 15 pages, however, shall be sent to the Director only by regular mail or overnight courier.
- (g) The Director must receive copies of any orders and decisions made as a result of direct communications among the parties and the arbitrators.
- (h) Parties may not communicate orally with any of the arbitrators outside the presence of all parties.
- (i) Any party or arbitrator may terminate the direct communication order at any time, after giving written notice to the other arbitrators and the parties.

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