

Notice to Members

MAY 2005

SUGGESTED ROUTING

Legal and Compliance

KEY TOPICS

Arbitration

Dispute Resolution

Mediation

GUIDANCE

Mediators as Arbitrators

SEC Approves New Interpretive Material to Rule 10308
Regarding Arbitrators Who Also Serve as Mediators;
Effective Date: May 6, 2005

Executive Summary

The Securities and Exchange Commission (SEC) has approved a new Interpretive Material (IM) to Rule 10308 of the NASD *Code of Arbitration Procedure* (Code) relating to mediators who also serve as arbitrators.¹ The amendments clarify that (1) fees for service as a mediator are not included in determining whether an attorney, accountant, or other professional derives 10 percent of his or her annual revenue from industry-related parties; and (2) service as a mediator is not included in determining whether an attorney, accountant, or other professional devotes 20 percent or more of his or her professional work to securities industry clients. IM-10308 can be found in this *Notice* as Attachment A.

The effective date of this rule change is **May 6, 2005**, for arbitrator applications received or arbitrator disclosures reviewed on or after that date.

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; or Barbara L. Brady, Associate Vice President and Director of Neutral Management, Dispute Resolution, at (212) 858-4352 or barbara.brady@nasd.com.

Background and Discussion

Rule 10308 of the Code classifies arbitrators as “public” or “non-public.” When investors have a dispute with broker-dealer firms or associated persons in NASD arbitration, they are entitled to have their cases heard by a single public arbitrator or a majority-public panel consisting of two public arbitrators and one non-public arbitrator, depending on the amount of the claim.² Several rule changes relating to arbitrator classification were approved by the SEC and implemented by NASD on July 19, 2004.³ These changes amended the definitions of public and non-public arbitrators.

In the course of implementing the 2004 arbitrator classification amendments, NASD surveyed its entire roster of arbitrators, asking questions that tracked the new definitions. In light of information contained in their responses, some arbitrators were reclassified from public to non-public or from non-public to public, and some arbitrators were dropped from the roster for various reasons.

One new part of the rule provided that arbitrators who were otherwise qualified as public could not continue to serve as public if their firms derived more than 10 percent of their revenue from industry parties. Specifically, Rule 10308(a)(5)(A) was amended to read as follows:

The term “public arbitrator” means a person who is otherwise qualified to serve as an arbitrator and...(iv) is not an attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past 2 years from any persons or entities listed in paragraph (a)(4)(A)....

Some arbitrators who also serve as mediators raised a concern about the application of the above rule to their practice, because both sides in mediation normally pay a share of the mediator’s fees. They noted that the above rule change could be construed broadly enough to encompass income in the form of mediation fees paid by industry parties, meaning that these mediators would no longer qualify as public arbitrators under the new rule. A similar situation could arise with regard to Rule 10308(a)(4)(C), which classifies an arbitrator as non-public if the person devoted 20 percent or more of his or her professional work in the past two years to securities industry clients. This was not the intent of the recent rule changes. Mediators are expected to be neutral and do not represent either side in a mediation.

Therefore, NASD is issuing a clarification in IM-10308 to make clear that, so long as the mediator is acting in the capacity of a mediator and is not representing a party in the mediation: (1) fees for service as a mediator are not included in determining whether an attorney, accountant, or other professional derives 10 percent of his or her annual revenue from industry-related parties under Rule 10308(a)(5)(A)(iv); and (2) service as a mediator is not included in determining whether an attorney, accountant, or other professional devotes 20 percent or more of his or her professional work to securities industry clients, for purposes of Rule 10308(a)(4)(C).

In considering this matter, NASD recognizes that parties may wish to know that an arbitrator on their list also serves as a mediator and may be familiar with the industry parties or their counsel. NASD will prepare materials to inform arbitrators of the need to disclose this fact on their disclosure forms, and will provide this information to parties on whose case the arbitrators may serve.

Effective Date Provisions

The new Interpretive Material will become effective on **May 6, 2005**. The amendments will apply to arbitrator applications received or arbitrator disclosures reviewed on or after that date. Because this Interpretive Material clarifies NASD's original intent in changing arbitrator classifications in July 2004, it will apply to all arbitrators on the NASD roster, as well as to new and pending applications. NASD Dispute Resolution staff will contact those arbitrators who were removed from the roster because of misunderstandings over the effect of mediator fees on Rule 10308(a)(4)(C) and (a)(5)(A)(iv). Other arbitrators who believe they are affected by this change may request reinstatement to the roster.

Endnotes

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| <p>1 Exchange Act Rel. No. 51325 (Mar. 7, 2005), 70 Fed. Reg. 12522 (Mar. 14, 2005) (File No. SR-NASD-2005-007).</p> <p>2 See Rule 10308(b). Rules governing intra-industry arbitrations use the same definitions of public and non-public, although the panel composition may vary depending on the nature of the dispute, as well as the amount in dispute. See Rule 10202.</p> | <p>3 See Securities Exchange Act Rel. No. 49573 (Apr. 16, 2004), 69 Fed. Reg. 21871 (Apr. 22, 2004) (File No. SR-NASD-2003-095), and <i>Notice to Members 04-49</i> (SEC Approves Amendments to Rules 10308 and 10312 Regarding Arbitrator Classification, Disclosures, and Challenges; Effective Date: July 19, 2004) (June 2004).</p> |
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ATTACHMENT A

New text is underlined.

IM-10308. Arbitrators Who Also Serve as Mediators

Mediation services performed by mediators who are also arbitrators shall not be included in the definition of “professional work” for purposes of Rule 10308(a)(4)(C), so long as the mediator is acting in the capacity of a mediator and is not representing a party in the mediation.

Mediation fees received by mediators who are also arbitrators shall not be included in the definition of “revenue” for purposes of Rule 10308(a)(5)(A)(iv), so long as the mediator is acting in the capacity of a mediator and is not representing a party in the mediation.

Arbitrators who also serve as mediators shall disclose that fact on their arbitrator disclosure forms.