

**NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondent.

Non-Summary Suspension Proceeding
No. ARB000026

Hearing Officer—Andrew H. Perkins

DECISION

April 26, 2001

NASD Dispute Regulation, Inc. notified a member firm, pursuant to Rule 9513(a), that its registration would be suspended, in accordance with Article VI, Section 3 of the NASD By-Laws and Rule 9510 et seq., for failing to pay an arbitration award in favor of one of its customers. In accordance with IM-10100, the Hearing Officer held that the member firm was not entitled to pay the arbitration award by offsetting the award against a debt due the member firm in its customers' margin account. The Hearing Officer ordered that the member firm's registration be suspended effective as of the date of the issuance of this Decision, and that such suspension shall continue until it provides documentary evidence of one of the following to NASD Regulation, Inc.: (1) it has paid the arbitration award; (2) it has settled with the arbitration claimants; or (3) it has either filed a bankruptcy petition in a United States Bankruptcy Court or the debt has been discharged by a United States Bankruptcy Court.

Appearances

For the Department of Enforcement: David A. Watson, Esq., Regional Counsel, Los Angeles, California.

For the Respondent: _____, Esq., New York, New York.

DECISION

I. Introduction

Pursuant to Rule 9513(a), NASD Dispute Resolution, Inc. notified _____, by letter dated December 11, 2000, that its registration would be suspended in accordance with Article VI, Section 3 of the NASD By-Laws and Rule 9150, et seq., as a result of its failure to pay the arbitration award entered on October 31, 2000, in the matter of _____, NASD Arbitration No. 99-04753 (the "Award"). By letter dated December 12, 2000, _____ requested a hearing pursuant to Rule 9514(a), asserting that it had paid the Award. _____ alleged that it paid the claimants \$12,097 in cash and offset the remainder of the award against the debt due _____ in the claimants' margin account, in accordance with the terms of the claimants' pre-existing margin agreement.

A pre-hearing conference was held on January 4, 2001. At the conference, the Parties waived a hearing and agreed that the only issue to be decided in this case is whether IM-10100 of the NASD Code of Arbitration prohibits payment of an arbitration award by offsetting a debt due in the claimant's account pursuant to the terms of a pre-existing customer agreement. In lieu of a hearing, the Parties submitted briefs in support of their respective positions.

After a review of the Parties' briefs, the Hearing Officer finds that _____ failed to pay the Award timely. Accordingly, _____ is suspended until it provides documentary evidence to NASD

Regulation that: (1) it has paid the Award; (2) it has settled with the claimants; or (3) it has either filed a bankruptcy petition in a United States Bankruptcy Court or the debt has been discharged by a United States Bankruptcy Court.

II. Facts

The underlying facts are undisputed. On October 31, 2000, a monetary award in the sum of \$30,000 was entered against _____ in the matter of _____, NASD Arbitration No. 99-04753. Thereafter, _____ paid the claimants \$12,097 and offset the balance of the Award in the sum of \$17,903 by a debt it claimed was due to _____ in the claimants' account. A copy of the margin agreement dated February 1996, was attached to _____'s request for a hearing.

The Award does not authorize _____ to credit the claimants' account with the dollar amount of the Award. And the margin agreement does not address expressly _____'s right to offset amounts due in the claimants' account against an arbitration award.

III. Discussion

IM-10100 provides in part as follows:

All awards shall be honored by a cash payment to the prevailing party of the exact dollar amount stated in the award. Awards may not be honored by crediting the prevailing party's account with the dollar amount of the award, unless authorized by the express terms of the award or consented to in writing by the parties. Awards shall be honored upon receipt thereof, or within such other time period as may be prescribed by the award.

The pre-existing margin agreement grants _____ a general lien on any customer funds in its possession for the discharge of any obligation of the customer to the firm and permits _____ to take such action as it deems appropriate to protect its interests in accordance with the terms of the margin agreement. _____ contends that this agreement satisfies the requirement of IM-10100 that there be a

written consent to credit the claimants' account with the dollar amount of the Award. The Hearing Officer disagrees. To satisfy IM-10100, the writing must specifically evidence mutual consent to permit payment of the arbitration award by such a credit. This determination is supported by the history of IM-10100.

The language of IM-10100 quoted above was added in 1987 to specifically address the decision in Dist. Bus. Conduct Comm. Dist. No. 4 v. Ameritrade, Inc., Complaint No. KC-318 (NASD Apr. 25, 1996). In Ameritrade, the respondents were charged with violating Article III, Section 1 of the Rules of Fair Practice (now NASD Conduct Rule 2110) based on their failure to pay promptly an arbitration award rendered in favor of one of their customers. In their defense, the respondents argued that they had discharged the award by crediting the amount of the award against a debit balance in the customer's account and forwarding the difference to the customer. Ameritrade argued that it was entitled to offset the award under the terms of its standard customer agreement, which gave Ameritrade a general lien on any customer funds in its possession for the discharge of obligations of the customer to the firm. After the disciplinary proceeding commenced, the firm sent a second check to cover the amount offset by the credit. After a hearing, the District Committee found that the respondents had not paid the award timely. The District Committee therefore sanctioned the respondents, and the respondents appealed to the NASD's Board of Governors. On appeal, the NASD reversed the District Committee, noting that no rule prescribed the method of payment of arbitration awards or prohibited the payment method the respondents had used.

Thereafter, the NASD filed a proposed rule change with the Securities and Exchange Commission ("SEC") to amend the NASD's policy regarding the payment of arbitration awards. Proposed Rule Changes by National Association of Securities Dealers, Inc. Relating to Amendments to

Code of Arbitration Procedure, 52 Fed. Reg. 18,633 (1987). The rule filing states that the proposed change was intended to “clarify that awards must be paid in cash, rather than by offsetting the award against other monies owed to the prevailing party.” The SEC approved the proposed amendment effective July 1, 1987. SEC Approval Order, 52 Fed. Reg. 24,082 (June 26, 1987).

From the foregoing, it is clear that the NASD implemented the amendment to its payment policy to prohibit the very type of offset used by _____ in this case. The NASD intended to prohibit member firms from using the generic lien and remedy provisions in their customer account agreements to frustrate the prompt payment of arbitration awards in cash. Thus, the Hearing Officer finds that the pre-existing lien and self-help provisions in the claimants’ margin agreement do not satisfy the requirements of IM-10100, and, therefore, _____ did not pay the Award timely.

IV. Order

Accordingly, it is hereby ordered, pursuant to Article VI, Section 3 of the NASD By-Laws and Rule 9514(g), that _____ registration shall be suspended effective as of the date of the issuance of this Decision.¹ Such suspension shall continue until _____ provides NASD Regulation with documentary evidence showing that: (1) the award is paid in full; (2) _____ and the claimants have entered into a settlement agreement; or (3) _____ has filed a bankruptcy petition in a United States Bankruptcy Court or that the debt underlying the Award has been discharged by a United States Bankruptcy Court.

Andrew H. Perkins
Hearing Officer

¹ The Hearing Officer considered all of the arguments of the Parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.