

NASD OFFICE OF HEARING OFFICERS

NASD TREASURER,

Complainant,

v.

Respondent.

Rule 9530 Suspension Proceeding
No. DFC020018

Hearing Officer— SW

February 21, 2003

Member firm failed to pay fees assessed in connection with three NASD arbitrations. Respondent's registration is suspended, pursuant to Rule 9533, until Respondent pays the fees, arranges for payment, or files a bankruptcy petition.

Appearances

Pamela L. Shu, Esq., for NASD Treasurer.

JJ, Esq., for Respondent.

DECISION

I. Introduction

A. Suspension Notices

By three letters dated August 14, 2002 ("Suspension Notices"), NASD Finance Department ("Finance") notified Respondent, now known as Respondent ("Respondent"), that its membership would be suspended, pursuant to Procedural Rule 9531, effective 15 days after the date of service of the Suspension Notices, unless Respondent paid the past due fees owed for processing the three arbitration proceedings.

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NASD assessed the fees against Respondent pursuant to Code of Arbitration Procedure Rule 10333 in connection with NASD arbitration cases, T v. Respondent, Inc. et al., NASD Arbitration Case No. _____ (“T”), The CFT v. Respondent, Inc. et al., NASD Arbitration Case No. _____ (“C”), and R v. Respondent, Inc. et al., NASD Arbitration Case No. _____ (“R”).

B. Suspension Proceeding

On August 19, 2002, Respondent filed a request for a hearing with the Office of Hearing Officers. The Office of Hearing Officers granted the request and stayed the effective date of the three Suspension Notices pursuant to NASD Procedural Rule 9532(a).

Respondent requested a hearing to vacate the fee assessments, arguing that: (1) the arbitrations involved transactions that occurred before Respondent was in existence; (2) Respondent did not expressly agree to arbitrate the issue of whether it can be named in an arbitration matter involving transactions that occurred before the Respondent was in existence; and (3) the courts, not the arbitration panel, have the power to decide the first and second issues. Respondent did not raise any of the permitted defenses enumerated in the Suspension Notices.

Respondent clarified that the basis for its request that the Suspension Notices be set aside was that the underlying cases were not the proper subject of arbitration, and accordingly the fees were not properly imposed and not owed. The Hearing Officer set the case for hearing to determine whether the fees were properly imposed.

The Hearing Officer conducted a hearing on November 25, 2002. At the Hearing, Finance offered one witness, Richard Berry, Director of Case Administration of NASD

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Dispute Resolution, and seven exhibits, which the Hearing Officer admitted without objection. Respondent presented the testimony of EH, its president, and offered 32 exhibits, which were admitted.¹ On December 16 and 17, 2002, the Parties filed post-hearing memoranda, in compliance with a November 26, 2002 Order of the Hearing Officer.

On January 13, 2003, Finance filed a motion to supplement the record with the written decision in Respondent, Inc. v. NASD and NASD Dispute Resolution, Case No. ____.² On February 10, 2003, Respondent filed a motion to supplement the record with (i) the notice of appeal in the NASD case, and (ii) agreements by the arbitration claimants in the three underlying arbitration proceedings to stipulate to the dismissal of Respondent. The Hearing Officer granted the motions of Finance and Respondent to supplement the record.

¹ Hereinafter, the statements in the first volume of the Transcript of the November 25, 2002 hearing will be designated as "Volume I, Tr. p." and statements in the second volume of the Transcript will be designated as "Volume II, Tr. p." Finance's exhibits will be designated as "CX-" and Respondent's exhibits will be designated as "RX-" with the appropriate exhibit and page numbers.

² Respondent filed a case in federal district court, seeking to enjoin NASD from proceeding with arbitrations in which it was named as a party. (RX-30). The U.S. District Court for the District of _____ issued an order dismissing Respondent's injunctive action with prejudice. (Finance's January 13, 2003 Supplement).

II. Discussion

A. NASD arbitration fees imposed on Respondent

Respondent became an NASD member on October 23, 2001, after acquiring certain assets from NASD member MS, Inc. ("MS") on August 31, 2001.³ (CX-1, p. 2; RX-1). Respondent acquired the assets from MS, pursuant to an Asset Purchase Agreement dated July 26, 2001.⁴ (RX-1).

Subsequent to the purchase, Respondent was named as one of the respondents in the three arbitration proceedings underlying this proceeding, T, C, and R.⁵ (RX-3; RX-11; RX-14). There is no dispute that Respondent was "named" a party in the initial statements of claim in T, C, and R. (Id.).

In T, Respondent was assessed a \$2,250 member surcharge fee, a \$750 pre-hearing processing fee, and a \$5,000 hearing processing fee. (CX-4, pp. 3-4). NASD later deleted the hearing-processing fee, leaving a balance owed of \$3,000 in T. (Volume I, Tr. p. 29). In C, Respondent was assessed a \$1,700 member surcharge fee and a \$750 pre-hearing processing fee. (CX-4, pp. 5-6). NASD deducted funds from Respondent's CRD account in the amounts of \$1,140 and \$45, leaving a balance remaining of \$1,256 in C. (Volume I, Tr. pp. 47-48; CX-4, p). In R, Respondent was assessed a \$1,700 member surcharge fee. (CX-4, pp. 1-2).

³ Respondent was incorporated under the laws of the State of _____ on May 15, 2001. (Volume I, Tr. p. 103; RX-16, p. 197).

⁴ Mr. H testified that Respondent primarily purchased the loan syndication assets and servicing portfolio of MS. (Volume I, Tr. p. 106; RX-1).

⁵ Each of the claimants alleged that Respondent's acquisition of assets of MS was a fraudulent scheme whose purpose was to hide assets from parties to pending litigation against MS, and that Respondent was a successor in interest to MS. (Volume I, Tr. pp. 34-40). Subsequently, the arbitration claimants in the three arbitration proceedings stipulated that Respondent was not the successor in interest. (Respondent's February 10, 2003 submission).

Rule 10333 of the NASD Code of Arbitration Procedure provides that when a member is named as a party in an arbitration proceeding, whether in the initial claim, a counter-claim, a cross-claim or a third-party claim, a member surcharge fee based upon the dollar amount of the claim is assessed and becomes due and payable. Mr. Berry, Director of Case Administration of NASD Dispute Resolution, testified that when the statement of claim is filed and served on the member, the member surcharge becomes due. (Volume I, Tr. p. 77).

In T, C, and R, Respondent was named in the statement of claim, and NASD served the statement of claim on Respondent. (RX-3; RX-11; RX-14; Volume I, Tr. pp. 90-91). Subsequently, in T and C, pre-hearing processing fees were assessed. (Volume I, Tr. pp. 45-47). Consequently, pursuant to Rule 10333, NASD assessed Respondent member surcharge fees and pre-hearing processing fees totaling \$7,150, of which \$1,185 was paid, leaving a balance owed of \$5,965. Respondent has not paid the balance.

B. Respondent argues that the arbitrability of the underlying claims determines whether fees can be imposed

Respondent argued that this is a case of interpretation of contract between Respondent and NASD, a contract that includes all of the NASD Code of Arbitration Procedure Rules. (Volume II, pp. 5-6). Respondent argued that, under the contract, arbitration fees may only be assessed if, pursuant to the arbitration code, the matter to be decided is eligible for submission for arbitration. Further, Respondent argued that if there is a question about whether the matter is eligible for arbitration it must be decided by the court, rather than by an arbitration panel.

The Parties agreed that the proper subject of arbitration is defined in Rule 10101 of the NASD Code of Arbitration Procedure, which provides that the matter must be in

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connection with the business of a member and be between or among the members or associated persons, and public customers, or others.⁶

Respondent argued that it had no business relation with the arbitration claimants, and the arbitration claimants were not its public customers, within the meaning of Rule 10101. (Volume II, pp. 6-7). Respondent further argued that a complex matter involving successor liability, which involves a review and analysis of judicial authorities, other precedents, and extensive factual investigations, is not a matter that is eligible for arbitration. (Volume II, Tr. p. 8). Accordingly, Respondent argued that it was being assessed fees that were not contemplated by the contract that it entered into with NASD. (Volume I, Tr. p. 15).

C. Respondent agreed to be bound by Rule 10333, which does not list arbitrability as a requirement, and the requirements of Rule 10333 have been satisfied

Pursuant to Section F of its membership agreement dated October 19, 2001, Respondent explicitly agreed to “pay such dues, assessments, and other charges in the manner and amount as from time to time shall be fixed pursuant to the NASD By-Laws, Schedules to the NASD By-Laws, and the Rules of the Association.” (CX-2, p. 2). Under the authority of Article VI, Section 1 of the By-Laws of the Association, Rule 10333 was

⁶ Arbitration Rule 10101 provides that:

This Code of Arbitration Procedure is prescribed and adopted . . . for the arbitration of any dispute, claim, or controversy arising out of or in connection with the business of any member of the Association, . . .

(a) between or among members;

(b) between or among members and associated persons; and

(c) between or among members or associated persons and public customers, or others. . .

adopted.⁷

Rule 10333 authorizes the NASD to assess member surcharge fees,⁸ pre-hearing processing fees,⁹ and hearing processing fees against each member named as a party in an arbitration proceeding. Because the arbitrations at issue named the Respondent as a party, NASD assessed arbitration fees against the firm in compliance with the rule.

Rule 10333 states only that the member be named a respondent in an arbitration proceeding.¹⁰ There is no requirement that the party named be ultimately determined to be liable or even correctly named. Nor is there any requirement that the subject matter be later determined to be arbitratable.

In fact, Rule 10333 explicitly stated that the member surcharge and the process fees are non-refundable. In Notice to Members 98-1 (January 1998), the NASD explained that if a member concludes its involvement in a case through dismissal or settlement, the process fees that have accrued to the point of the dismissal nevertheless will be assessed.¹¹

NASD prescribed Rule 10333 to help fund a neutral and independent forum for the arbitration of controversies between members and between members and customers

⁷ Article VI, Section 1 of the By-Laws of the Association, provides that the Association “shall fix and levy the amount of admission fees, dues, assessments, and other charges to be paid by members of the NASD.”

⁸ Rule 10333(a) states that “[e]ach member who is named as a party to an arbitration proceeding . . . shall be assessed a non-refundable surcharge . . .” The schedule in Rule 10333(a) lists the surcharge fees to be charged by NASD, which vary depending upon the amount at issue in the arbitration.

⁹ Rule 10333(d) states, “[e]ach member that is a party to an arbitration proceeding will pay a non-refundable process fee as set forth in the schedule below for each stage of a proceeding.” The schedule contained in Rule 10333(d) lists different pre-hearing processing fees and hearing processing fees, depending on the amount in dispute in the arbitration.

¹⁰ Rule 10101's requirement for the arbitration of “any dispute, claim or controversy” “between or among members or associated persons and public customers, or others” constitutes a broad arbitration clause, and justifies a presumption of arbitrability.

¹¹ See Notice to Members 98-1 (January 1998) at <http://www.nasdr.com/pdf-text/9801ntm.pdf>, 1998 NASD LEXIS 2 (Jan. 1998).

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or others.¹² Mr. Berry confirmed that the Dispute Resolution staff does not make any determination of the merits of a claim filed. (Volume I, Tr. p. 31). The Securities and Exchange Commission approved Rule 10333 pursuant to Section 19(b) of the Securities Exchange Act of 1934 and Rule 19b-4 thereunder.

NASD has established two procedures to assure timely payment of fees. First, as with other fees, any overdue, unpaid arbitration process fees may be deducted from member funds maintained in the member's Central Registration Depository account.¹³ Second, there is a 15-day notice suspension proceeding for failure to pay dues, assessments, and charges in a timely manner. Neither of these procedures requires that the underlying matter be deemed arbitratable.

Upon becoming a member of NASD, Respondent agreed to pay the dues, assessments, and other charges as shall be fixed in the arbitration forum in accordance with the Rules of the Association.¹⁴ Respondent does not contest that NASD correctly calculated the arbitration fees under Rule 10333. Respondent is responsible for \$5,965 in member surcharge and process fees imposed in compliance with the requirements of Rule 10333.

Although the application of Rule 10333 may be viewed as leading to an inequitable amount of fees because of the number of cases involved, it does not justify

¹² Id.

¹³ See Notice to Members 97-71 (October 1997) at <http://www.nasdr.com/pdf-text/9771ntm.txt>.

¹⁴ Article IV, Section 1 of the NASD By-Laws provides that an application for membership in the NASD shall contain an agreement to pay such dues, assessments, and other charges, in the manner and amount as from time to time shall be fixed pursuant to the NASD By-Laws, Schedules to the NASD By-Laws, and the Rules of the Association.

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disregarding a Rule that NASD plainly and intentionally provided.¹⁵ Noting the possibility of inequities in this procedure, in a recent Notice to Members, NASD announced that it will refund member surcharge fees paid by member firms named as parties in arbitrations filed by customers after January 13, 2003 in which the arbitration panel ultimately denies all of the customers' claims and allocates all of the forum fees against the customer.¹⁶

III. Order

It is hereby ordered, pursuant to Article VI, Section 3 of the NASD By-Laws and Rule 9530 *et seq.*, that Respondent's registration shall be suspended effective as of the date of service of this Decision and that such suspension shall continue until the Respondent provides documentary evidence to the Office of Hearing Officers showing: (1) the Respondent has paid the fees in full; (2) the NASD Finance Department has agreed to an installment payment plan; or (3) the Respondent has filed a bankruptcy petition in a United States Bankruptcy Court (which petition has not been dismissed) or

¹⁵ Respondent indicated that AL, a representative responsible for the filing of the statement of claims in T, C, and R, had previously dismissed a similar arbitration against Respondent, after Respondent was able to obtain an injunction in federal court. (Volume I, Tr. p. 122-123). Respondent also provided evidence that, based on the same theory of successor liability, it was named as respondent in an additional 10 arbitrations and fees have been assessed in seven of those additional arbitrations. (RX-2; RX-4-RX-9; RX-12; RX-13; RX-19-23, RX-25; RX-26).

¹⁶ Pursuant to Notice to Members 03-06 at <http://www.nasdr.com/pdf-text/0306ntm.txt>, Rule 10333(c) was amended, effective January 13, 2003, to state explicitly that the Director may refund or cancel the member surcharge in extraordinary circumstances. Nevertheless, because the Director of Arbitration is charged with the performance of all administrative duties and functions in connection with matters submitted for arbitration pursuant to Rule 10103, this Decision does not preclude the Director of Arbitration from utilizing her discretion to waive or reduce the Rule 10333 fees in this case.

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that the fees have been discharged by a United States Bankruptcy Court.¹⁷

SO ORDERED.

Sharon Witherspoon
Hearing Officer

¹⁷ The Hearing Officer has considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.