

September 23, 2003

Florence Harmon
Senior Special Counsel
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: File No. SR-NASD-2003-101 – Amendments to Rule 10304 of the NASD Code of Arbitration Procedure Governing Time Limits On Submission of Claims – Response to Comments and Amendment No. 1

Dear Ms. Harmon:

This letter responds to the comment letters received by the Securities and Exchange Commission in response to the publication in the *Federal Register* of Notice of Filing of SR-NASD-2003-101 proposing amendments to Rule 10304 of the NASD Code of Arbitration Procedure (“Code”) governing time limits on the submission of claims.

Rule 10304, often called the “eligibility rule,” provides that claims that are older than six years are ineligible for arbitration under the Code. To reflect the decision of the United States Supreme Court in *Howsam v. Dean Witter Reynolds, Inc.*,¹ the proposed rule change would amend Rule 10304 to clarify that questions regarding whether a claim is ineligible under the Rule are for the arbitrators, and not courts, to decide. The proposed rule change would also make clear that dismissal of a claim on eligibility grounds does not preclude a claimant from pursuing the claim in court, and would provide that by requesting dismissal of a claim under the rule, the requesting party agrees that the claimant may pursue all related claims in court.

The eligibility rule has long been the subject of controversy, and an on-going source of expensive and time-consuming collateral litigation. NASD believes that, by clarifying the scope and application of Rule 10304, the proposed rule change will reduce the cost and delay caused by collateral litigation, and streamline the administration of arbitrations in NASD’s forum.

¹ 537 U.S. 79 (Dec. 10, 2002).

The SEC received comment letters from the following commenters in response to the proposed rule change: Public Investors Arbitration Bar Association (“PIABA”); Mr. James A. Keeney; A.G. Edwards & Sons, Inc. (“A.G. Edwards”) and Charles Schwab & Sons, Inc. (“Schwab”).²

In general, PIABA supports the proposed rule change. Although PIABA would prefer that Rule 10304 be eliminated entirely, PIABA describes the proposed rule change as “far superior to the rule in its present form.” PIABA suggests, however, that Rule 10304 be further amended to provide that motions to dismiss a claim under the rule be filed within 30 days of the appointment of the panel of arbitrators. NASD agrees that questions of eligibility should be resolved early in the arbitration process. However, given that eligibility questions are more fact-intensive or complicated in some cases than in others, NASD believes that the arbitrators, rather than the Code, should set deadlines for raising and responding to challenges based on Rule 10304 on a case-by-case basis. Establishing a schedule for submitting and responding to such challenges is one of the purposes of Initial Prehearing Conferences (“IPHCs”), which are held routinely in NASD arbitrations. At the IPHC, parties may request that the arbitrators set deadlines for any challenges based on Rule 10304.

Mr. Keeney objects to the proposed rule change. Like PIABA, Mr. Keeney contends that the current six-year eligibility rule should be eliminated entirely. Unlike PIABA, Mr. Keeney argues that the proposed rule change is “hostile to investors.” Among other things, Mr. Keeney objects to the proposal to amend the rule to provide that, by requesting dismissal of a claim on the basis of Rule 10304, the requesting party agrees that if the panel dismisses a claim under the rule, the party that filed the dismissed claim may withdraw any remaining related claim without prejudice and may pursue all of the related claims in court. Mr. Keeney argues that this provision would force a claimant to choose between bifurcating, abandoning older claims, or fighting the entire case in court.

NASD respectfully disagrees that the proposed rule change is “hostile to investors.” In fact, NASD notes that the purpose of this provision is to provide claimants with more options than are available under the current rule. Under the current rule, claimants do not have the choice of pursuing all related claims in the same forum, as they would under the proposed rule. Currently, if claimants file related claims, some of which are eligible for arbitration under the six-year rule, and some of which are not, they can be forced to bifurcate their claims, or abandon the

² Letter from J. Pat Sadler, President, Public Investors Arbitration Bar Association to Secretary, Securities and Exchange Commission (August 18, 2003); Letter from James D. Keeney, P.A., to Mr. Robert Love, Division of Market Regulation, Securities and Exchange Commission (July 17, 2003); Letter from Stephen G. Sneeringer, Senior Vice President and Counsel, A.G. Edwards & Sons, Inc. to Mr. Jonathan G. Katz, Secretary, Securities and Exchange Commission (August 22, 2003); Letter from Gregory M. Scanlon, Vice President & Senior Corporate Counsel, Charles Schwab & Co., Inc. (August 26, 2003).

older ones altogether. NASD believes that giving claimants more choice with respect to where they can pursue related claims is in the best interest of investors.

Schwab also objects to the anti-bifurcation provision, but for different reasons. Schwab contends that this provision will encourage claimants to intentionally include ineligible claims in their Statement of Claim, forcing respondents to choose between arbitrating stale claims, or seeking dismissal of an older claim on eligibility grounds and having to litigate all related claims in court.

NASD acknowledges that a theoretical possibility exists that some claimants may try to abuse the provision. However, NASD believes that this possibility must be weighed against the very real problem of claimants' being forced to bifurcate their claims between court and arbitration, which can occur under the current rule. As noted by the Ruder Task Force in its 1996 report, *Securities Arbitration Reform: Report of the Arbitration Policy Task Force to the Board of Governors National Association of Securities Dealers, Inc.*, "the potential for bifurcation" under current Rule 10304 "is wasteful of financial resources for both the investor community and member firms." NASD also notes that, as a practical matter, most claims that are older than six years will also be barred by applicable statutes of limitations.

Furthermore, NASD notes that the anti-bifurcation provision only applies to "related claims." Schwab argues that the term "related claims" is vague, and suggests that a definition of the term be included in the rule. NASD did not include a definition of the term in the rule because it believes that what constitutes a meaningful nexus between or among any particular claims can vary significantly depending on the circumstances of a given case. The decision as to whether certain claims are sufficiently related to warrant application of the rule will be made by the arbitrators on a case-by-case basis. Respondents who believe that claimants intentionally included a stale claim in order to trigger the application of the provision can bring this concern to the attention of the arbitrators, who may factor that into their decision. Such determinations are uniquely within the province of the arbitrators to determine.

Schwab also expressed concern that the rule does not explicitly state that only a respondent may request dismissal of a claim against it on eligibility grounds. Schwab believes that it is possible for the rule to be read to permit claimants to seek dismissal of their own claims on eligibility grounds, thus triggering the provision that would allow all related claims to be brought in court. NASD does not believe that this is a practical concern, and notes that the proposed rule change is not intended to apply to parties who move to dismiss their own claims.

Mr. Keeney also objects to the elimination of the provision in current Rule 10304 stating that the rule does not apply to claims ordered to arbitration by a court. NASD is proposing to eliminate this provision because it is inconsistent with the Supreme Court's decision in *Howsam* that eligibility is an issue for the arbitrators, and not the courts, to resolve. Mr. Keeney contends

that if the provision is deleted, “the six-year rule will apply even if one of my clients is directed to arbitrate by a court. The arbitrators can then dismiss the older claims and send me and my clients back to court.”

Mr. Keeney is correct that deletion of the provision may mean that claims older than six years will be ineligible for arbitration. However, NASD notes that this is, in fact, the purpose of the long-standing six-year time limit on eligibility of claims. The provision that NASD is proposing to delete was a narrow exception to the six-year rule that made sense when courts were able to rule on the eligibility of claims before compelling arbitration of those claims. If a court determined that a claim was eligible for arbitration, or was so related to other eligible claims that it should be included in the same case as other claims compelled to arbitration, respondents could not raise the eligibility rule as a defense once the court compelled the claim to arbitration. However, now that courts may not rule on the eligibility of claims before compelling them to arbitration, the narrow exception, if retained, would swallow the general rule. Claimants could circumvent the eligibility rule simply by filing claims that are subject to a predispute arbitration agreement in court, because neither the court nor the arbitrators would be able to apply the six-year eligibility rule. To close this loophole, NASD is proposing to eliminate the narrow exception to the six-year time limit in the current rule.

Finally, A.G. Edwards points out a typographical error in the rule filing. The second sentence of Rule 10304(a) states that “This Rule shall not extend applicable statutes of limitations, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.” As explained above, NASD is proposing to delete the second clause of that sentence, beginning with the word “nor.” However, in the text of the proposed amendment to Rule 10304, the bracket indicating the beginning of the deletion was inadvertently placed at the beginning of the sentence, rather than before the word “nor.” As evidenced by the fact that the explanation of the proposed change does not refer to the first phrase of the second sentence in Rule 10304(a), NASD is not proposing to delete the provision that the six-year rule shall not extend the applicable statute of limitations. Therefore, NASD is amending the proposed rule change to correct this error. Specifically, the proposed rule change is amended as follows:

Rule 10304. Time Limitation Upon Submission

(a) No dispute, claim, or controversy shall be eligible for submission to arbitration under this Code where six (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim or controversy. The panel will resolve any questions regarding the eligibility of a claim under this Rule. []This Rule shall not extend applicable statutes of limitations[, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.]

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NASD notes that no other commenter commented favorably or unfavorably on the deletion of the first phrase of the second sentence of Rule 10304(a).

If you have any questions, please contact me at (202) 728-8275 or laura.gansler@nasd.com.

Very truly yours,

Laura Gansler
Counsel
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