

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- 49950; File No. SR-NASD-2003-163)

June 30, 2004

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 Thereto, by the National Association of Securities Dealers, Inc., Relating to Voluntary Direct Communication Between Parties and Arbitrators

I. Introduction

On October 31, 2003, the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. (“NASD Dispute Resolution”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change pursuant to the Securities Exchange Act of 1934 (“Exchange Act” or “Act”)<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> On February 23, 2004, NASD filed Amendment No. 1 to the proposed rule change.<sup>3</sup> Notice of the proposed rule change was published for comment in the Federal Register on May 19, 2004.<sup>4</sup> The Commission received two comments regarding the proposal.<sup>5</sup> On June 29, 2004, NASD filed Amendment No. 2 to the

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 140.19b-4.

<sup>3</sup> See letter from Jean Feeney, Vice President and Chief Counsel, Dispute Resolution, NASD, to Katherine England, Assistant Director, Division of Market Regulation, SEC (Feb. 20, 2004).

<sup>4</sup> See Securities Exchange Act Release No. 49688 (May 12, 2004), 69 FR 28966.

<sup>5</sup> See letter from Rosemary J. Shockman, Vice-President/President Elect, Public Investors Arbitration Bar Association, to Jonathan G. Katz, Secretary, SEC (June 7, 2004) (“PIABA Letter”). See also E-mail from Joel E. Davidson, Davidson and Grannum, LLP, to Jonathan G. Katz, Secretary, SEC (May 21, 2004) (“Davidson E-mail”).

proposed rule change.<sup>6</sup> This order approves the proposed rule change, grants accelerated approval of Amendment No. 2, and solicits comment from interested persons on Amendment No. 2.

## II. Description of the Proposed Rule Change

NASD Dispute Resolution has proposed new Rule 10334 (the “Proposed Rule”) to permit parties in an arbitration to communicate directly with the arbitrators if all parties and arbitrators agree, and to establish guidelines for such direct communication. Only parties that are represented by counsel may use direct communication with the arbitrators under the Proposed Rule. If, during the proceeding, a party chooses to appear pro se (without counsel), the Proposed Rule would no longer apply. Before it can be used, all arbitrators and all parties must agree to the use of direct communication during the Initial Prehearing Conference or during a later conference or hearing. 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. Parties may not orally communicate with any of the arbitrators outside the presence of all parties.

The Proposed Rule provides that either an arbitrator or a party may rescind his or her agreement at any time after giving written notice to the other arbitrators and the parties. Materials must be sent at the same time and in the same manner to all parties and the Director of Arbitration (through the assigned NASD staff member), and NASD staff must receive copies of any orders and decisions made as a result of direct communications among the parties and the arbitrators.<sup>7</sup>

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<sup>6</sup> See letter from Jean Feeney, Vice President and Chief Counsel, Dispute Resolution, NASD, to Katherine England, Assistant Director, Division of Market Regulation, SEC (June 29, 2004).

<sup>7</sup> Parties may send materials by regular mail, overnight courier, facsimile or e-mail. All the arbitrators and parties must have facsimile or e-mail capability before such a delivery method may be used.

### III. Summary of Comments

The Commission received two comments regarding the proposed rule change.<sup>8</sup> Both commenters were supportive.<sup>9</sup> One commenter, which states that its member attorneys represent public investors in disputes with broker-dealers, supports the proposal, noting that its members have generally found direct communication with arbitrators to be helpful.<sup>10</sup> The other commenter observed that the Proposed Rule would expedite and simplify the [arbitration] process.<sup>11</sup>

### IV. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities association.<sup>12</sup> The Commission finds that the proposal is consistent with the requirements of

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The Proposed Rule contains a provision stating that materials more than fifteen pages long shall be sent to the Director only by mail or courier, to avoid tying up busy fax machines and printers. Arbitrators (or parties) with similar concerns could include a similar provision as to themselves in the direct communication order. NASD will prepare a template for direct communication orders to guide the arbitrators and parties in considering these issues.

<sup>8</sup> As was discussed in the Notice of Proposed Rule Change published in the Federal Register on May 19, 2004, the Proposed Rule is modeled on a pilot project conducted by the Chicago Office of NASD Dispute Resolution. See Securities Exchange Act Release No. 49688 (May 12, 2004), 69 FR 28966.

<sup>9</sup> See supra note 5.

<sup>10</sup> PIABA Letter (“PIABA supports the proposed rule change.”).

<sup>11</sup> Davidson E-mail (“I am in favor of the proposed rule. I believe it will expedite and simplify the process.”).

<sup>12</sup> In approving the proposal, the Commission has considered the Proposed Rule’s impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

Section 15A(b)(6) of the Act,<sup>13</sup> which requires that the rules of a registered national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principals of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

Specifically, the Commission believes that the Proposed Rule will protect investors and the public interest by expediting the arbitration process and giving parties more control over their arbitration cases. In addition, the proposal will help promote just and equitable principals of trade by permitting parties to more quickly and easily resolve their disputes.

Significantly, the Proposed Rule has a number of safeguards that will prevent its abuse and protect the rights of both parties and arbitrators. First, all parties and arbitrators must agree to the use of direct communications during the Initial Prehearing Conference or at a later hearing or conference before direct communications can be used. Second, any party or arbitrator may terminate the use of direct communications under the Proposed Rule after giving written notice to the other arbitrators and the other parties. Third, only parties that are represented by counsel may use direct communication with the arbitrators under the Proposed Rule. Fourth, if, during the proceeding, a party chooses to appear pro se, the Proposed Rule would no longer apply. Fifth, copies of all materials sent to arbitrators must also be sent at the same time and in the same manner to all parties and to the Director of Arbitration. Sixth, if materials are sent via facsimile or email, all arbitrators and parties must have facsimile or email capability before such a delivery method may be used. Finally, parties may not communicate orally with any of the arbitrators

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<sup>13</sup> 15 U.S.C. 78o-3(b)(6).

outside of the presence of all parties.

V. Amendment No. 2

In Amendment No. 2 to the Proposed Rule, NASD added language to the text of paragraph (h) of Proposed Rule 10334 in order to clarify that parties in an arbitration may not communicate orally with any of the arbitrators outside of the presence of all the parties.<sup>14</sup> The Commission finds good cause to approve Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. The Commission believes that Amendment No. 2 effects a technical change that does not raise substantive issues. Accordingly, the Commission believes that there is good cause, consistent with Section 19(b) of the Act,<sup>15</sup> to approve Amendment No. 2 on an accelerated basis.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2003-163 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

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<sup>14</sup> See supra note 6.

<sup>15</sup> 15 U.S.C. 78s(b).

All submissions should refer to File Number SR-NASD-2003-163. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to Amendment No. 2 that are filed with the Commission, and all written communications relating to Amendment No. 2 between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD 2003-163 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

## VII. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>16</sup> that the proposed rule change (SR-NASD-2003-163) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>16</sup> 15 U.S.C. 78s(b)(2).

<sup>17</sup> 17 CFR 200.30-3(a)(12).