

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55038; File No. SR-NASD-2005-079)

January 3, 2007

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 4 to Revise Rule 10322 of the NASD Code of Arbitration Procedure Pertaining to Subpoenas and the Power to Direct Appearances

I. Introduction

On June 17, 2005, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or the “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to revise Rule 10322 of the NASD Code of Arbitration Procedure (the “Code”), which pertains to subpoenas and the power to direct appearances. On July 13, 2005, the Commission published for comment the proposed rule change in the Federal Register.³ The Commission received twelve comments on the proposal.⁴ On March 29, 2006, May 12, 2006, and July 7, 2006, NASD submitted Amendment Nos. 1, 2, and 3, respectively, to the proposed rule change. The Commission published the proposed rule change, as amended, for comment in the Federal Register on July

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 51981 (July 6, 2005), 70 FR 40411 (July 13, 2005).

⁴ Comment letters were submitted by Richard Skora, dated July 12, 2005; Seth E. Lipner, Deutsch & Lipner, dated July 13, 2005; Steve Buchwalter, Law Offices of Steve A. Buchwalter, P.C., dated July 13, 2005; Steven B. Caruso, Maddox Hargett & Caruso, P.C., dated July 19, 2005; Dennis M. Pape, dated July 20, 2005; Al Van Kampen, Rohde & Van Kampen PLLC, dated July 25, 2005; Phil Cutler, Cutler Nylander & Hayton, dated August 1, 2005; Avery B. Goodman, A.B. Goodman Law Firm, Ltd., dated August 1, 2005 and August 2, 2005; Jill Gross, Director, Barbara Black, Director, and Richard Downey, Student Intern, Pace Investor Rights Project, dated August 2, 2005; Tim Canning, dated August 3, 2005; and Rosemary J. Shockman, President, Public Investors Arbitration Bar Association, dated August 4, 2005.

18, 2006.⁵ The Commission received twenty-six comment letters on the proposal, as amended.⁶ On November 30, 2006, NASD submitted Amendment No. 4 to the proposed rule change.⁷ This notice and order solicits comments from interested persons on Amendment No. 4 and approves the proposal, as amended, on an accelerated basis. The text of the proposed rule change is available at www.nasd.com, at the principal offices of NASD, and at the Commission's Public Reference Room.

II. Description of the Proposed Rule Change

In the initial rule filing, NASD proposed to revise Rule 10322 of the Code to provide for a 10-day notice requirement before a party issues a subpoena to a non-party for pre-

⁵ See Securities Exchange Act Release No. 54134 (July 12, 2006), 71 FR 40762 (July 18, 2006).

⁶ Comment letters were submitted by Gary M. Berne, Stoll Stoll Berne Lokting & Shlachter P.C., dated April 13, 2006 ("Berne"); Robert S. Banks, Jr., President, Public Investors Arbitration Bar Association, dated April 28, 2006 ("PIABA 1"); Bryan Lantagne, Chair, Broker-Dealer Arbitration Project Group, North American Securities Administrators Association, Inc., dated May 1, 2006 ("NASAA"); Martin L. Feinberg, dated May 5, 2006 ("Feinberg 1"); Seth E. Lipner, Deutsch Lipner, dated July 17, 2006 ("Lipner 1"); Philip M. Aidikoff, Aidikoff, Uhl & Bakhtiari, dated July 19, 2006 ("Aidikoff"); Martin L. Feinberg, dated July 19, 2006 ("Feinberg 2"); Thomas C. Wagner, VanDeusen & Wagner LLC, dated July 19, 2006 ("Wagner 1"); Steven B. Caruso, Maddox Hargett Caruso, P.C., dated July 21, 2006 ("Caruso"); Joseph C. Korsak, dated July 21, 2006 ("Korsak"); Herbert E. Pounds, Jr., dated July 21, 2006 ("Pounds"); John Miller, dated July 21, 2006 ("Miller"); Richard M. Layne, Layne Lewis LLP, dated July 21, 2006 ("Layne"); Sarah G. Anderson, dated July 21, 2006 ("Anderson"); Jay Salamon, dated July 21, 2006 ("Salamon"); Steph D. M [sic], dated July 21, 2006 ("Steph M"); Thomas C. Wagner, VanDeusen Wagner LLC, dated July 21, 2006 ("Wagner 2"); W. Scott Greco, Greco & Greco, P.C., dated July 21, 2006 ("Greco"); Carl J. Carlson, Carlson & Dennett, P.S., dated July 24, 2006 ("Carlson"); Laurence S. Schultz, Driggers, Schultz & Herbst, P.C., dated July 28, 2006 ("Schultz"); Ryan P. Smith, Vice President, Wachovia Securities, dated August 7, 2006 ("Wachovia"); Robert S. Banks, Jr., President, Public Investors Arbitration Bar Association, dated August 14, 2006 ("PIABA 2"); Jim Parker, Johnson, Rial & Parker, P.C., dated September 7, 2006 ("Parker"); Alan S. Brodherson, Law Offices of Alan S. Brodherson, dated November 20, 2006 ("Brodherson"); Seth E. Lipner, Deutsch Lipner, dated December 6, 2006 ("Lipner 2"); and Steven B. Caruso, President, Public Investors Arbitration Bar Association, dated December 7, 2006 ("PIABA 3").

⁷ The PIABA 3 and Lipner 2 letters were received by the Commission after the submission of Amendment No. 4 by NASD. Both commenters noted NASD's submission of Amendment No. 4 and recommended expedited approval of the proposal, with one commenter stating "the proposed revisions will both protect public investors and represent a significant step toward reducing the discovery abuses that permeate the arbitration process." (PIABA 3).

hearing discovery.⁸ In addition, NASD proposed clarifying the requirements regarding the service of subpoenas by specifying that a party that issues a subpoena must serve a copy of the subpoena to all parties and the entity receiving the subpoena on the same day.

In Amendment No. 1, NASD proposed to allow only arbitrators to issue subpoenas for both parties and non-parties, whether for discovery or for appearance at a hearing. In Amendment No. 2, NASD clarified the process for issuing a subpoena to both parties and non-parties. In Amendment No. 3, NASD clarified that, in most cases, a public arbitrator will rule on all motions requesting a subpoena.⁹

In Amendment No. 4, NASD responded to comments on Amendment Nos. 1, 2, and 3 and amended the proposed rule change to authorize the arbitration panel to determine the amount of costs incurred as a result of subpoenaed documents and by whom such costs should be borne. NASD also amended the proposed rule change to provide that the party requesting the subpoena may respond to objections within 10 calendar days of receipt of the objections. In addition, NASD clarified that certain references to days are references to calendar days.

III. Summary of Comments Received and NASD Response

In Amendment No. 4, NASD responded to comments on the amended proposal.

Who Should Pay for Subpoenaed Documents

NASD noted that more than half of the comments discussed which party should be responsible for the costs associated with the production of documents obtained in response to

⁸ See infra note 3.

⁹ See infra note 5.

a subpoena.¹⁰ Specifically, NASD stated that commenters: (1) expressed the view that the proposal would inappropriately require a party requesting documents from another party to be responsible for the costs associated with the document production, (2) argued that the costs associated with the production of any documents, including subpoenaed documents, should be determined and assessed by the panel in its award, (3) stated that treating subpoenaed documents differently from other discovery-related documents could lead to gamesmanship, confusion, and delay in the discovery process, and (4) indicated that this aspect of the proposal would pose a considerable burden on public customers and could prevent them from adequately preparing their cases if they are unable to reimburse the other party for copies of subpoenaed documents.

NASD agreed that the panel should have the authority to determine the amount of costs incurred as a result of subpoenaed documents and by whom such costs should be borne. Therefore, NASD proposed in Amendment No. 4 to delete the following sentence from proposed Rule 10322(e): “The party requesting the documents shall be responsible for the reasonable costs associated with the production of the copies.” NASD noted that because Rules 10205(c) and 10332(c) of the Code already provide arbitrators with authority to make cost determinations, it is NASD’s belief that this issue does not need to be further addressed by the proposal.

Whether Counsel Should be Able to Issue Subpoenas

¹⁰ See Anderson, Carlson, Caruso, Feinberg 1 and 2, Greco, Korsak, Layne, Miller, PIABA 2, Pounds, Salamon, Schultz, Steph M, and Wagner 2.

NASD noted that four commenters objected to the proposal to limit the power to issue subpoenas to arbitrators.¹¹ Specifically, NASD stated commenters: (1) noted that they had not experienced any significant problems with the current rule (which also allows counsel of record to issue subpoenas as provided by law), and stated that there was no reason to revise the rule, (2) expressed the view that limiting to arbitrators the authority to issue subpoenas would result in additional delays, costs, and gamesmanship in the discovery process, and (3) speculated that arbitrators who tire of counsel making numerous requests for subpoenas may capriciously deny the issuance of a subpoena merely to limit the amount of time spent on discovery issues.

NASD disagreed with these comments, stating it believes that providing arbitrators with greater control over the issuance of subpoenas will help to protect investors, associated persons, and other parties from abuse in the discovery process. NASD also stated that the establishment of a uniform, nationwide rule will reduce potential confusion for parties and their counsel regarding whether they have the ability to issue subpoenas, minimize gamesmanship in the subpoena process, and make the rule easier to administer.

Which Arbitrators Should Have Authority to Decide Subpoena Requests

NASD noted that two commenters (1) stated that only public arbitrators should have the authority to decide subpoena requests and that non-public arbitrators should not be involved in resolving discovery issues in those cases where one of the parties is a public customer, and (2) suggested that, at the very least, a non-public arbitrator should be able to decide a subpoena request only if all parties agree.¹²

¹¹ See Berne, Broderson, Parker, and Wachovia.

¹² See NASAA and PIABA 1.

NASD stated that the rule, as proposed, is in accordance with the suggestions made by these commenters and affirmed that the arbitrator ruling on a motion requesting a subpoena will be a public arbitrator unless a customer previously consented to a non-standard panel composition.¹³

Necessity of Motions for Subpoenas

NASD noted that two commenters asserted that parties should not be required to include a motion as part of a subpoena request, and indicated that this would add unnecessary complexity and delay to the discovery process.¹⁴ NASD disagreed, stating it believes that requiring a motion would not place a significant burden on parties and may provide a benefit to the panel.

Automatic Exchange of Subpoenaed Documents

NASD noted that two commenters suggested revising the proposal to require or allow for the automatic exchange of documents received in response to all subpoenas.¹⁵ NASD disagreed, stating that another party may not want such documents or may not wish to be potentially responsible for the costs associated with the production of such documents. NASD also noted that the proposal does not limit the ability of the parties to agree to automatically exchange all documents received in response to subpoenas.

Time Frame for Ruling on Subpoena Requests

NASD noted that one commenter suggested revising the proposal to require the panel to rule on all subpoena motions within 10 days to ensure that parties are able to conduct

¹³ See Rule 10308(b)(1).

¹⁴ See Berne and PIABA 1.

¹⁵ See Feinberg 1 and 2, and Salamon.

discovery in a timely and orderly manner.¹⁶ NASD disagreed, stating that the proposal would require the panel to rule promptly on a motion for a subpoena. NASD also indicated it does not believe that it is appropriate to establish a specific time frame within which the panel must rule on a subpoena request, particularly because there may be occasions when a panel will need to consider several complex motions at the same time.

Clarifications to the Proposed Rule Change

NASD noted that two commenters suggested clarifying revisions to proposed Rule 10322(c).¹⁷ One commenter stated that the rule is potentially ambiguous regarding the time frame during which an arbitrator should rule on the issuance and scope of a subpoena.¹⁸ In this commenter's view the proposal could be read to mean that an arbitrator is required to rule promptly and not consider any objections that have been raised to a subpoena. The other commenter suggested that, to avoid confusion, the rule should contain a time period within which a party must respond to any objections to its proposed subpoena.¹⁹ This commenter also suggested amending paragraphs (c) and (e) of proposed Rule 10322 to clarify whether the time periods in those paragraphs are based on calendar or business days.

To reduce any potential ambiguities in the rule, NASD proposed in Amendment No. 4 to amend the proposed rule change to provide that the party that requested the subpoena

¹⁶ See Wachovia letter.

¹⁷ See Caruso and Feinberg 2.

¹⁸ See Feinberg 2.

¹⁹ See Caruso.

may respond to objections within 10 calendar days of receipt of the objections and to clarify certain references to days are references to calendar days.²⁰

Conforming the Proposal with the Federal Arbitration Act

NASD noted that one commenter stated that the proposed rule should be revised to conform to the Federal Arbitration Act (FAA), which the commenter states requires a majority of the arbitrators to sign a subpoena.²¹ NASD responded that because the proposal would allow only arbitrators to issue subpoenas, it would provide non-parties with more protection than current Rule 103222. NASD also stated it believes that subpoenas issued by a single arbitrator are valid and noted that it has received few, if any, complaints regarding the validity of such subpoenas from participants in the NASD forum.

NASD also noted that commenter expressed the view that the proposal, under the FAA, is unwieldy with respect to the service of subpoenas. The commenter stated that the FAA provides that an arbitration subpoena “shall be served in the same manner as subpoenas to appear and testify before the court.” The commenter asserted that federal courts have interpreted this provision to require the personal service of an arbitral subpoena. Consequently, the commenter contended that, under the FAA, the proposal would require personal service of all subpoenas issued in NASD’s forum.

In response, NASD pointed out that before a party may participate in NASD’s arbitral forum, it must submit a Uniform Submission Agreement in which the party agrees to abide

²⁰ NASD also noted that the pending revisions to the NASD Code of Arbitration Procedure for Customer Disputes and the NASD Code of Arbitration Procedure for Industry Disputes would clarify that the term “day” means calendar day, except as otherwise provided. See Securities Exchange Act Release Nos. 51856 (June 15, 2005) (SR-NASD-2003-158), 70 FR 36442 (June 23, 2005) and 51857 (June 15, 2005) (SR-NASD-2004-011), 70 FR 36430 (June 23, 2005).

²¹ See Feinberg 1 and 2.

by the Code.²² NASD stated that under the Code, service can be effectuated by a variety of methods, including mail, overnight mail service, hand delivery, and facsimile.²³ Citing Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, 489 U.S. 468 (1989), NASD also noted that the Supreme Court has found that the FAA does not prevent the enforcement of arbitration agreements that contain different rules than those set forth in the FAA. NASD indicated it believes that service under the proposal can be accomplished by any of the various methods provided for in the Code rather than personal service exclusively.

Issues Beyond the Scope of the Proposed Rule Change

Finally, NASD noted that two commenters raised issues that are beyond the scope of the proposed rule change. One commenter expressed views related to the composition of arbitration panels and the definition of public arbitrator.²⁴ The other commenter suggested revisions to the Code regarding the time period within which a panel must be appointed.²⁵

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 4, including whether Amendment No. 4 is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

²² The Uniform Submission Agreement provides, “The undersigned parties hereby submit the present matter in controversy, as set forth in the attached statement of claim, answers, and all related counterclaims and/or third-party claims which may be asserted, to arbitration in accordance with the Constitution, By-Laws, Rules, Regulations, and/or Code of Arbitration Procedure of the sponsoring organization.”

²³ See NASD Rule 10314(c).

²⁴ See NASAA.

²⁵ See Wachovia.

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>);
or
- Send e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2005-079 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2005-079. 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 the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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 Room. Copies of such filing also will be available for inspection and copying at the principal office of 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-2005-079 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Discussion and Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to NASD, and in particular, with the requirements of Section 15A(b)(6)²⁶ of the Exchange Act.²⁷ Section 15A(b)(6) requires, among other things, that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The Commission believes that the proposed rule change is designed to accomplish these ends by permitting only arbitrators to issue subpoenas and by making the arbitration subpoena process more orderly and efficient.

Accelerated Approval of Amendment No. 4

The Commission finds good cause for approving Amendment No. 4 to the proposed rule change prior to the thirtieth day after the amendment is published for comment in the Federal Register pursuant to Section 19(b)(2) of the Act. Amendment No. 4 amends the proposed rule change to authorize the arbitration panel to determine the amount of costs incurred as a result of subpoenaed documents and by whom such costs should be borne. Amendment No. 4 also provides that the party that requested the subpoena may respond to objections within 10 calendar days of receipt of the objections. In addition, Amendment No. 4 amends the proposed rule change to clarify that certain references to days are references to calendar days. The Commission anticipates that these changes will provide for greater clarity

²⁶ 15 U.S.C. 78o-3(b)(6).

²⁷ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

with respect to the subpoena process and will provide for a more equitable allocation of costs concerning subpoena documents. Accordingly, the Commission finds that accelerated approval of Amendment No. 4 is appropriate.

VI. Conclusions

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁸ that the proposed rule change, as amended (SR-NASD-2005-079), be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁹

Florence E. Harmon
Deputy Secretary

²⁸ 15 U.S.C. 78s(b)(2).

²⁹ 17 CFR 200.30-3(a)(12).