

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50714); File No. SR-NASD-2003-101)

November 22, 2004

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change, and Notice of Filing and Order Granting Accelerated Approval to Amendments No. 1 and 2 Thereto Relating to Time Limits for Submission of Claims in Arbitration

**I. Introduction**

On June 19, 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 (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Rule 10304 of the NASD Code of Arbitration Procedure (“Code”) to clarify, among other effects of the rule, that arbitration eligibility determinations are made by arbitrators.

The proposed rule change was published for comment in the Federal Register on August 1, 2003.<sup>3</sup> The Commission received eight comment letters on the proposal.<sup>4</sup> On September 23, 2003, NASD filed a response to the comment letters received as of that date and Amendment No.

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Release No. 34-48225 (July 7, 2002), 68 FR 45299 (August 1, 2003).

<sup>4</sup> See letters to Jonathan G. Katz, Secretary, Commission, from J. Pat Sadler, President, Public Investors Arbitration Bar Association, dated August 18, 2003 (“PIABA Letter”); Stephen G. Sneeringer, Senior Vice President and Counsel, A.G. Edwards & Sons, Inc., dated August 22, 2003 (“A.G. Edwards Letter”); Gregory M. Scanlon, Vice President & Senior Corporate Counsel, Charles Schwab & Co., Inc., dated August 26, 2003 (“Schwab Letter”); Herbert E. Pounds, Jr., Law Offices of Herbert E. Pounds, Jr., P.C., dated November 1, 2004 (“Pounds Letter”); James D. Keeney, P.A., dated November 8, 2004 (“Second Keeney Letter”); William S. Sheperd, Sheperd, Smith & Edwards, L.L.P., dated November 10, 2004 (“Sheperd Letter”); Rosemary J. Shockman, President, Public Investors Arbitration Bar Association, dated November 1, 2004 (“Second PIABA Letter”); and letter from James D. Keeney, P.A., to Mr. Robert Love, Division of Market Regulation (“Division”), Commission, dated July 17, 2003 (“Keeney Letter”).

1 to the proposed rule change.<sup>5</sup> On February 3, 2004, NASD filed Amendment No. 2 to the proposed rule change.<sup>6</sup> This order approves the proposed rule change, and issues notice of and grants accelerated approval to Amendments No. 1 and No. 2.

## II. Description of the Proposal

### A. Text of the Proposed Rule Change

NASD proposes to amend its rules governing arbitration to clarify and limit the effect of its six-year time limitation for the submission of claims. Below is the text of the proposed rule change. Proposed new language is italicized and proposed deletions are in [brackets].

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#### 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.

(b) Dismissal of a claim under this Rule does not prohibit a party from pursuing the claim in court. By requesting dismissal of a claim under this Rule, 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 claims without prejudice and may pursue all of the claims in court.

(c) This Rule shall not extend applicable statutes of limitations[, nor shall it apply

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<sup>5</sup> See Letter from Laura Gansler, Counsel, NASD Dispute Resolution, Inc., to Florence Harmon, Senior Special Counsel, Division, Commission, dated September 23, 2003, available at [http://www.nasdaq.com/rule\\_filings\\_index03.asp#03-101](http://www.nasdaq.com/rule_filings_index03.asp#03-101) (“Amendment No. 1”).

<sup>6</sup> See Letter from Laura Gansler, Counsel, NASD Dispute Resolution, Inc., to Catherine McGuire, Chief Counsel, Division, Commission, dated February 3, 2004, available at [http://www.nasdaq.com/rule\\_filings\\_index03.asp#03-101](http://www.nasdaq.com/rule_filings_index03.asp#03-101) (“Amendment No. 2”).

to any case which is directed to arbitration by a court of competent jurisdiction.] ; nor shall the six-year time limit on the submission of claims apply to any claim that is directed to arbitration by a court of competent jurisdiction upon request of a member or associated person.

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B. Description of the Proposed Rule Change

NASD has proposed to amend Rule 10304 of the Code to clarify certain of its effects, particularly in light of the ruling of the United States Supreme Court in Howsam v. Dean Witter Reynolds, Inc.<sup>7</sup> In Howsam, the Court held that the issue of whether a claim is ineligible for arbitration under Rule 10304 of the Code is presumptively a matter for arbitrators to decide. Rule 10304 of the Code provides that a claim is ineligible for arbitration in the NASD forum if six or more years have elapsed from the occurrence or event giving rise to the claim. Rule 10304 of the Code, however, currently does not state expressly whether the eligibility of a claim is determined by arbitrators or by the courts. In its proposal, NASD explained that under current NASD practice, arbitrators resolve questions concerning whether a particular claim falls within the six-year time limit, but noted that the issue has generated a significant amount of collateral litigation with differing results, leading to uncertainty and confusion among forum users until the Supreme Court's decision in Howsam.

NASD therefore has proposed several amendments to Rule 10304 of the Code. First, NASD proposes to amend Rule 10304 of the Code to state explicitly that eligibility determinations are made by the arbitrators. Second, NASD proposes to amend the provision in the current eligibility rule to provide that the rule does not apply to claims ordered to arbitration by a court at a member's or associated person's request. Finally, NASD proposes to amend Rule

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<sup>7</sup> 537 U.S. 79 (Dec. 10, 2002).

10304 of the Code to provide that by requesting dismissal of a claim on eligibility grounds in the NASD forum, the requesting party is agreeing that the party that filed the dismissed claim may withdraw all related claims without prejudice and may pursue all of the claims in court. Moreover, by a companion rule filing being approved today, Rule 10304 of the Code and all other NASD arbitration rules would be incorporated into predispute arbitration agreements governing arbitrations proceedings that take place in NASD forums.<sup>8</sup>

### **III. Summary of Comments and NASD's Response**

The Commission received eight comments on the proposal.<sup>9</sup> PIABA generally supported the proposed rule change as “far superior to the rule in its present form,” although PIABA would prefer elimination of Rule 10304 of the Code.<sup>10</sup> PIABA suggested amending the rule, however, to provide that motions to dismiss a claim under the rule be filed within 30 days of appointment of an arbitration panel.<sup>11</sup> NASD responded that arbitrators, rather than the Code, should set deadlines for raising and responding to eligibility challenges on a case-by-case basis, generally in Initial Prehearing Conferences, given the varying complexity of cases.<sup>12</sup>

Mr. Keeney objected to the proposed rule change, arguing that the current six-year eligibility rule should be eliminated entirely, on the basis that it is “hostile to investors.”<sup>13</sup> Mr. Keeney also took issue with the proposed amendment to allow parties whose claims are

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<sup>8</sup> See Release No. 34-50713.

<sup>9</sup> See note 4, supra.

<sup>10</sup> See PIABA Letter.

<sup>11</sup> Id.

<sup>12</sup> See Amendment No. 1. Due to a misplaced bracket in the original filing, NASD deleted the entire last sentence of Rule 10304(a) of the Code. Rather, NASD had intended to delete only the following text: “nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.” NASD corrected this typographical error in Amendment No. 1. In Amendment No. 2, this text was moved to Rule 10304(c) and further amended in response to certain comments.

<sup>13</sup> See Keeney Letter.

dismissed under Rule 10304 of the Code to withdraw any remaining related claims and pursue them in court, claiming that this provision forces claimants to choose between bifurcating or abandoning older claims, or pursuing the entire case in court.<sup>14</sup> NASD responded to these concerns, disagreeing that the rule is “hostile to investors” and, in contrast, stated that the purpose of the rule is to provide claimants with more choices with respect to where they can pursue related claims, a result that is in the best interest of investors.<sup>15</sup> Finally, Mr. Keeney objected to the elimination of the provision in Rule 10304 of the Code that the rule would not apply to claims ordered to arbitration by a court, on the basis that this would allow industry parties to “whipsaw” claimants between court and arbitration.<sup>16</sup> In response, NASD is proposing to amend the exemption, rather than delete it, to provide that the six-year time limit would not apply to claims ordered to arbitration by a court at a member’s or associated person’s request.<sup>17</sup>

Schwab also opposed the proposed rule change. Schwab contended that the anti-bifurcation provision would encourage claimants intentionally to include ineligible claims in their Statement of Claim, resulting in respondents having to choose between arbitrating stale claims, or seeking dismissal of an older claim based on eligibility while having to litigate remaining claims in court.<sup>18</sup> NASD acknowledged that there was a theoretical potential for abuse of this provision, but responded that the benefits of eliminating the issue of claimants

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<sup>14</sup> Id.

<sup>15</sup> See Amendment No. 1.

<sup>16</sup> See Keeney Letter.

<sup>17</sup> Mr. Keeney’s concern also would be addressed in part by SR-NASD-98-74, approved today in Release No. 34-50713, which would amend NASD Rule 3110 so that a predispute arbitration agreement would prohibit members from seeking to compel arbitration of some but not all of a customer’s court-filed claims, thus preventing members from forcing customers to litigate in two forums. NASD Rule 3110 also explicitly incorporates the rules of the arbitration forum in which the claim is filed into the predispute arbitration agreement. See supra n. 8.

<sup>18</sup> See Schwab Letter.

being forced to bifurcate claims (as under the current rule) outweighs this concern.<sup>19</sup> NASD also noted that the anti-bifurcation provision applies to related claims, and rejected Schwab’s assertion that the term “related claims” should be defined in the rule, maintaining that this determination is most properly made by arbitrators on a case-by-case basis.<sup>20</sup> In addition, Schwab noted that Rule 10304 of the Code does not expressly state that only a respondent may request dismissal of a claim based on eligibility, leading to the possibility that a claimant could request such a dismissal to pursue related claims in court.<sup>21</sup> NASD responded that this is not a practical concern because the rule change is not intended to apply to parties who move to dismiss their own claims.<sup>22</sup>

A.G. Edwards objected to the elimination of the portion of Rule 10304(a) of the Code that states that “This Rule shall not extend applicable statutes of limitations . . . .”<sup>23</sup> NASD responded by explaining that this comment resulted from a typographical error in the originally filed proposed rule change. NASD had intended to leave this phrase in Rule 10304(a) of the Code, while deleting only the text that followed: “nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.” A misplaced bracket made it appear as though NASD intended to delete the entire sentence.<sup>24</sup> NASD has corrected this error in Amendment No. 1 and, in Amendment No. 2, further amended this provision in response to Mr. Keeney’s comments, as discussed above.<sup>25</sup>

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<sup>19</sup> See Amendment No. 1.

<sup>20</sup> See Amendment No. 1.

<sup>21</sup> See Schwab Letter.

<sup>22</sup> See Amendment No. 1.

<sup>23</sup> See A.G. Edwards Letter.

<sup>24</sup> See Amendment No. 1; Amendment No. 2.

<sup>25</sup> Id.

Mr. Pounds, while not supportive of every aspect of the rule change, urged approval of the rule as soon as possible to prevent claimants from ending up without a forum in which to bring their claims.<sup>26</sup> In second comment letters, Mr. Keeney and PIABA urged a prompt resolution of this rule filing.<sup>27</sup> Mr. Sheperd similarly urged a prompt resolution of this rule filing.<sup>28</sup>

#### **IV. Discussion and Commission Findings**

After careful consideration, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association<sup>29</sup> and, in particular, the requirements of Section 15A of the Act<sup>30</sup> and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change, as amended, is consistent with Section 15A(b)(6) of the Act,<sup>31</sup> which requires, among other things, that the rules of an association 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.<sup>32</sup>

The Commission believes that the proposed rule is an appropriate response to the U.S. Supreme Court's holding in Howsam and clarifies Rule 10304 of the Code in a manner consistent with the Act. The specific amendments to Rule 10304 of the Code proposed by NASD – that questions of eligibility are to be resolved by the arbitration panel, that dismissal

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<sup>26</sup> See Pounds Letter.

<sup>27</sup> See Second Keeney Letter and Second PIABA Letter.

<sup>28</sup> See Sheperd letter.

<sup>29</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>30</sup> 15 U.S.C. 78q-3.

<sup>31</sup> 15 U.S.C. 78q-3(b)(6).

<sup>32</sup> Id.

under the rule will not preclude later claims in court, and that respondents may not force claimants to bifurcate their claims under the rule – provide needed guidance to parties arbitrating disputes in the NASD’s forum. The Commission believes that these amendments will provide certainty, reduce the cost and delay caused by collateral litigation, and streamline the NASD arbitration process.

Further, the Commission has carefully considered the suggestions and concerns submitted by commenters and has concluded that NASD has responded appropriately to them. In response to PIABA’s suggestion for a 30-day deadline to file a motion to dismiss under Rule 10304 of the Code, the Commission finds consistent with the Act the NASD’s position that arbitrators, rather than the Code, should set deadlines for raising and responding to eligibility challenges on a case-by-case basis.

The Commission also finds consistent with the Act the NASD’s position allowing parties whose claims are dismissed under Rule 10304 of the Code to withdraw any remaining related claims and to pursue all of the claims in court. Both Mr. Keeney and Schwab have objected to this provision of Rule 10304 of the Code for different reasons. Mr. Keeney has asserted that this provision would force claimants to choose between bifurcating or abandoning older claims, or pursuing the entire case in court. Schwab has asserted that this provision may result in respondents having to choose between arbitrating stale claims, or seeking dismissal of an older claim based on eligibility while having to litigate remaining claims in court. While claimants would have to address statute of limitations issues if their claims are ineligible for arbitration, and respondents would have to address possible bifurcation if they request dismissal under Rule 10304 of the Code, the Commission finds that Rule 10304 of the Code, as proposed, is consistent with the Act. The Commission observes that the term “related claims”



is intended to be interpreted broadly, given the purposes of the rule and the parallel language in a companion rule filing approved today.<sup>33</sup>

The Commission also finds that the proposed amendment of the Rule's provision that the six year time limit does not pertain to claims ordered to arbitration by a court at a member's or associated person's request is consistent with the Act. The provision limits the potential litigation strategies that could impede the resolution of disputes and would address the concern that industry parties could force claimants to litigate in two forums. Moreover, the Commission also notes that pursuant to the companion filing approved today, the specific requirements of this and other provisions of the Code explicitly would be incorporated into the parties' predispute arbitration agreement<sup>34</sup> and would be given effect under applicable law.

The Commission finds good cause for accelerating approval of Amendment Nos. 1 and 2 prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. Amendment No. 1 merely corrects a typographical error. Amendment No. 2, as noted above, amends Rule 10304(c), so that concerns of claimants or industry parties abusing Rule 10304, as amended, are addressed appropriately. Furthermore, concurrent approval of Amendment Nos. 1 and 2 will enable NASD to announce promptly the final rules, in conjunction with those being approved today in the companion filing, which changes would incorporate Rule 10304, as amended, into any predispute arbitration agreement governing proceedings held in a NASD forum. Concurrent approval of Amendment Nos. 1 and 2 and SR-NASD-2003-101 with the companion rule filing will lessen member confusion as to the final requirements of both rule

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<sup>33</sup> See supra n. 8.

<sup>34</sup> Id.

filings, allow their effective dates to be the same, and thereby permit members to make the necessary changes to comply with them in a timely fashion.<sup>35</sup>

## **V. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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-2003-101 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.

All submissions should refer to File Number SR-NASD-2003-101. 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

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<sup>35</sup> The Commission further notes that both rule filings and amendments thereto have been available since their respective filing dates on [www.nasdaq.com](http://www.nasdaq.com).

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-2003-101 and should be submitted on or before

[insert date 21 days from publication in the Federal Register].

## **VI. Conclusion**

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>36</sup> that the proposed rule change (File No. SR-NASD-2003-101) be, and it hereby is, approved and Amendment Nos. 1 and 2 are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>37</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>36</sup> 15 U.S.C. 78s(b)(2).

<sup>37</sup> 17 CFR 200.30-3(a)(12).