August 26, 2003

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

RE: Release No. 34-48225/File No. SR-NASD-2003-101
Amendment to Rule 10304 of the NASD Code of Arbitration Procedure Governing Time Limits for Submission of Claims in Arbitration

Dear Mr. Katz:

Charles Schwab & Co., Inc. ("Schwab") welcomes the opportunity to comment on SR-NASD-2003-101, the NASD's proposed Amendment to Rule 10304 of the NASD Code of Arbitration Procedure which governs the time limits for the submission of claims in arbitration ("the Proposed Rule"). Schwab recognizes that any rule regarding time limits for the submission of claims in arbitration affects the interests of several different parties, including public investors, NASD member firms and their associated persons, and the NASD's own Dispute Resolution subsidiary. Mindful of these multiple, and sometimes competing interests, Schwab submits its comments with the intention of contributing to the development of a fair and balanced rule on this important subject.

The Proposed Rule has three distinct elements:

(1) it once-and-for-all establishes that arbitrators, not courts, will resolve six-year "eligibility" claims under Rule 10304 of the NASD Code of Arbitration Procedure, consistent with the recent decision in *Howsam v. Dean Witter Reynolds, Inc*. (2002) 537 U.S. 79;

(2) it clarifies that a dismissal under Rule 10304 does not prevent a party from subsequently filing the dismissed claim(s) in court, thereby resolving any confusion that the "election of remedies" doctrine prevents such a subsequent action; and

(3) it adds a new subsection to Rule 10304 which provides that "[b]y 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."

The purpose of Schwab's comments is to express its concerns about the third element of the Proposed Rule. While the Proposed Rule states that the new portion of the rule regarding the dismissal of "remaining related claims" will "provide significant protection against involuntary bifurcation of claims" (Proposed Rule, p. 2), Schwab believes that in practice any such protection will be far outweighed by other negative consequences, including:

- The confusion created for parties and arbitrators by the Proposed Rule's "remaining related claims" language. The Proposed Rule gives no indication as to what those words might mean or what claims they might encompass. If those words are intended to mean only those claims that are inextricably or integrally linked to the claims being dismissed, the Proposed Rule should be modified to make that clear.

- If, on the other hand, the "remaining related claims" language is intended to mean all claims brought by a particular customer, then the Proposed Rule could strongly discourage Respondents from filing Rule 10304 motions. In that case, instead of severing *only* the ineligible claims from the arbitration, as has been the practice in the past, the Proposed Rule would require the requesting party to agree to have *all* of the claims dismissed from the arbitration and to litigate *all* of the claims in court. That would be an extremely high price for Respondents to pay simply to exercise their right under the Rule 10304 to have *ineligible* claims dismissed.

- For these reasons, Claimants could be motivated by the Proposed Rule to include both eligible and ineligible claims in their Statements of Claim, in order to force a Respondent into this difficult situation. If a Respondent successfully moves to dismiss ineligible claims, it could potentially have to litigate the other "remaining related claims" in court. If a Respondent chooses not to move to dismiss the ineligible claims, because of the uncertainty regarding the "related claims" language, it will be forced to arbitrate claims that are (or used to be) ineligible for arbitration under the NASD's own Code of Arbitration Procedure.

- The Proposed Rule undermines the arbitration agreements that the vast majority of member firms have with their customers, because it potentially could require that the parties litigate *all* of their disputes in court, not just those that are ineligible for arbitration. In addition, depending on how the "related claims" language is interpreted, the Proposed Rule could result in more claims being forced out of arbitration and into the court system.

I. The Phrase "Related Claims" Should Be Defined

The most significant problem with the Proposed Rule is that it requires a party moving under Rule 10304 to agree that "the party that filed the dismissed claim may withdraw any *remaining related claims* without prejudice and may pursue all of the claims in court" (emphasis added), without any guidance to parties or arbitrators as to what "remaining related claims" means. Does this phrase mean all claims filed by the customer (i.e. related to the customer), or only those that are somehow logically or rationally related to the claim being dismissed? If the former, then the "related claims" language of the Proposed Rule will open a gaping hole in the arbitration agreements between member firms and their customers. If the latter, the NASD needs to provide some guidance as to what, exactly, a "related claim" is.

This ambiguity could cause significant confusion in arbitration. Say, for example, that in 2003 a customer were to sue his/her brokerage firm for two separate transactions that occurred five years apart: a purchase and sale of Enron in 1995 and a purchase and sale of WorldCom in 2000. Without more complicating facts, it seems logical that these two trades would not be "related claims" for purposes of the Proposed Rule. Thus, the firm could presumably move to dismiss the Enron trade without concern that the WorldCom trade would also be dismissed as a "related claim."

Other fact patterns may be more common and less clear-cut. Consider the same customer and the same trades as above, except now both stocks are still held long in the account and both trades were solicited by the same broker the customer has worked with since 1995. In the 2003 arbitration, the customer asserts a variety of claims relating to his/her account, including the alleged unsuitability of his/her portfolio, including the Enron and WorldCom positions.

Are these claims "related claims"? Unfortunately, the Proposed Rule offers no guidance to the participants of the arbitration process who will be faced with these questions. The issue of whether claims are "related" is inevitably subjective in nature and, as currently drafted, the Proposed Rule creates the possibility that Claimants will be able to avoid the arbitration process entirely because all of the claims may be deemed to be related simply because they involve the same account or were handled by the same broker. The Proposed Rule's silence on this issue will lead to severe confusion and will undoubtedly require the parties to expend significant resources to brief and argue this issue to the panel.

II. The Proposed Rule Could Discourage the Use of Rule 10304 Motions And Could Create An Incentive For Claimants To File Ineligible Claims

If, on the other hand, the phrase "remaining related claims" is intended (or interpreted by arbitrators) to mean all claims by a particular customer, the Proposed Rule will have different, but equally negative consequences on the arbitration process. Faced with the new requirement that they must agree to dismiss "any remaining related claims" in order to have the ineligible claims dismissed from arbitration, many Respondents will simply choose not to bring a Rule 10304 motion at all. Forcing this Hobson's choice upon Respondents is patently unfair because it effectively eviscerates the arbitration agreements they have with their customers, and would have the negative effect of forcing more member firms and customers into the state and federal courts to resolve their disputes. In these instances, the principal advantage of arbitration – namely, that it is a more economical and efficient dispute resolution mechanism than court – will be lost.

For Claimants, the Proposed Rule as currently drafted provides potentially dangerous incentives to file arbitration claims that include both eligible and ineligible claims, with the goal, or at least the result, of forcing Respondents into the situation described above. It is no secret that many Claimants and their counsel would prefer to have their claims resolved in court rather than in arbitration, and it is easy to see how the Proposed Rule could encourage Claimants to file claims that would attempt to take advantage of the "either-or" nature of the Proposed Rule.

Putting aside the strong feelings that both Claimants and Respondents have about the arbitration process, the arbitration agreements that govern their disputes are part of their contracts and are entitled to be enforced to the fullest extent possible. As a matter of basic contract law, it is well-accepted that when a particular provision of a contract is found to be unenforceable, that provision should be severed and the remaining portions of the contract should be enforced, to the fullest extent possible. By analogy, then, those disputes that are ineligible for arbitration should be severed from the arbitration, and the parties should arbitrate all of the remaining, eligible claims. That is what the parties previously agreed to, and that is what their contract contemplates. However, by giving no indication of what a "related claim" is, the Proposed Rule could prompt a whole new area of debate for parties and arbitrators regarding exactly what those words mean.

III. The Potential Bifurcation of Claims Does Not Justify This Rule Change

The primary justification for the new part of the Proposed Rule dealing with "remaining related claims" is that it will "provide significant protection against involuntary bifurcation of claims, but will continue to allow arbitrators to decide questions of eligibility under the Rule." (Proposed Rule, p. 5.) What is not stated in the Proposed Rule is that it could significantly limit – depending on what "related claims" means – a Respondent's ability to have ineligible claims removed from the arbitration process.

The new portion of the rule that requires a party requesting dismissal to agree to dismiss all "remaining related claims" is unnecessary, vaguely worded and should be eliminated from the Proposed Rule. To date, Rule 10304 has worked effectively to remove ineligible claims from the arbitration process, without any requirement that a moving party must also agree to dismiss other claims as well. To Schwab's knowledge, most of the collateral litigation referenced in the Proposed Rule concerned the eligibility issues now conclusively settled by *Howsam*, and the "election of remedies" issue discussed in the Proposed Rule. The other proposed changes to the rule resolve both of these issues, and Schwab supports those changes.[1]

The bifurcation problem referenced by the NASD, on the other hand, is not one that justifies a significant change to the arbitration process. Previously, claims dismissed under Rule 10304 generally faced strong statute of limitation defenses *if* they were subsequently pursued in court. Thus, while the parties in those cases could potentially find themselves litigating in two different forums, a party is not required to bring the dismissed claims in court, and the issues being litigated in court would be limited to only those claims that were more than six years old and were susceptible to a statute of limitation defense. Thus, the resulting collateral litigation would not, in most cases, be the kind of full-blown, time-consuming litigation that has led the NASD, Congress and the Supreme Court to strongly support the arbitration process.

This scenario should be contrasted with the potential outcome under the Proposed Rule – depending on how "related claims" is interpreted - where the ineligible claims *and* other "related claims" could be pursued in court after a successful 10304 motion. In this instance, both parties will litigate the 10304 motion with the arbitration panel and then start the entire litigation process over in court for both the eligible and ineligible claims. For those "related claims" that were dismissed but may not be susceptible to a statute of limitations defense, both parties will expend all of the resources that are required in state and federal court litigation. Not only is such a result contrary to the federal judicial policy of enforcing arbitration agreements, but it also undermines the Proposed Rule's suggestion that it will "reduce the cost and delay caused by collateral litigation, and streamline the administration of arbitrations in NASD's forum." (Proposed Rule, p.

[1]In addition, Schwab believes the Proposed Rule should be modified to make clear that it will apply only if the 10304 motion is brought by a Respondent. As recently observed in the Securities Arbitration Commentator Arbitration Alert (2003-31), the Proposed Rule "appears to be triggered only by a request for an ineligibility ruling by a Respondent, but a plausible reading would allow the Panel to rule on its own or, even, pursuant to the Claimant's motion." Theoretically, the Proposed Rule might cause Claimants or arbitrators to make 10304 motions which then could have the unintended result of forcing the entire case into litigation. While the comments herein assume that Rule 10304 motions can only be brought by Respondents, Schwab nonetheless believes this should be expressly stated in the final rule.

5.) In reality, the Proposed Rule could have the negative effect of *increasing* the cost and delay – to Claimants and Respondents alike - associated with state and federal court litigation.

Thank you for considering Schwab's comments on this important issue. If you would like any additional information, please call me at (415) 636-5010.

Very truly yours,

Gregory M. Scanlon
Vice President & Senior Corporate Counsel
Charles Schwab & Co., Inc.

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