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July 13, 2005

Jonathan G. Katz
Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-9303

Re: File No. SR-NASD-2003-158
Proposed NASD Code of Arbitration
Procedure for Customer Disputes

Dear Mr. Katz:

The Arbitration and Litigation Committee of the Securities Industry Association ("SIA")[1] appreciates the opportunity to offer comments about the Proposed NASD Code of Arbitration Procedure for Customer Disputes (the "Proposed Customer Code" or the "Proposed Code").

As a preliminary matter, SIA generally supports the Proposed Customer Code and applauds the efforts of NASD Dispute Resolution, Inc. ("NASD Dispute Resolution") in drafting it. Viewed in its entirety, the Proposed Customer Code significantly improves the existing NASD Code of Arbitration Procedure (the "Existing Code"). NASD Dispute Resolution has substantially met its goals of simplifying the language in the Existing Code and improving the organization of the Existing Code.

While strongly supportive of the Proposed Code as a whole, we would like to offer some constructive comments on areas where it could be improved. Some of the proposed rules significantly change the powers of arbitrators, while other proposed rules have undesirable consequences, whether intended or not. SIA believes that some rules should

[1] The Securities Industry Association brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. At its core: Commitment to Clarity, a commitment to openness and understanding as the guiding principles for all interactions between investors and the firms that serve them. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated an estimated $227.5 billion in domestic revenue and $305 billion in global revenues. More information about SIA is available at: www.sia.com.

be significantly revised, while other rules should be amended to eliminate undesirable consequences, improve clarity and ensure fairness. SIA's comments and suggestions are organized by Proposed Rule in the balance of this letter.

Proposed Rule 12200. Arbitration Under An Arbitration Agreement or the Rules of the NASD

The existing rule and the Proposed Rule permit arbitration if arbitration is requested "by the customer." The Proposed Rule should clarify that arbitration is permitted if "requested by the customer of the member." This modification will eliminate the occasional attempts by customers to demand arbitration of disputes against firms with which the customer has not had an account or other relationship, and will eliminate collateral litigation relating to those situations.

Proposed Rule 12212. Sanctions.

Proposed Rule 12212 grants arbitrators broad authority to impose sanctions but does not contain procedural safeguards or substantive standards. By granting broad authority with little or no guidance, the Proposed Rule increases the risk that arbitrators will impose onerous and inappropriate sanctions on member firms and public customers. The lack of procedural and substantive standards also creates the risk that sanctions requests will become a routine part of arbitration practice to the detriment of the goals of cost-effective and efficient resolution of customer claims.

Proposed Rule 12212(a) provides: "The panel may sanction a party for failure to comply with any provision in the Code, or any order of the panel or a single arbitrator authorized to act on behalf of the panel." Subpart (a) also provides a non-exhaustive list of possible sanctions. Subpart (c) authorizes the panel to dismiss a claim, defense or arbitration with prejudice "as a sanction for material and intentional failure to comply with an order of the panel if prior warnings or sanctions have proven ineffective. Proposed Rule 12212 suffers from the following deficiencies:

- Subparts (a) and (c) permit arbitrators to impose sanctions without notice or an opportunity to be heard.

- Subpart (a) does not contain standards for the imposition of sanctions.

- Subpart (a) greatly expands the type of conduct for which arbitrators can impose sanctions.

As written, the Proposed Rule grants the arbitrators unfettered discretion to sanction a party, without notice, for any violation of the Code or an order. Under subpart (a), arbitrators can impose a sanction without giving consideration to whether the alleged violation was intentional, material or *de minimus*. For example, Proposed Rule 12212(a) permits the arbitrators to sanction a claimant or a respondent for the inadvertent failure to

submit a Uniform Submission Agreement (as required by Proposed Rules 12302 and 12303). Under the Proposed Rule as written, the arbitrators could assess a monetary fine or even preclude a party from presenting evidence for that rule violation.

The deficiencies in Proposed Rule 12212 should be remedied by: Requiring notice and an opportunity to be heard; establishing substantive standards for the imposition of sanctions; and limiting sanctions to violations of orders (as opposed to any provision of the Proposed Customer Code).

Notice and Opportunity to Be Heard. Proposed Rule 12212 should require notice to the party against whom sanctions are sought. A party seeking sanctions should be required to file a written motion. Consistent with the requirement in Proposed Rule 12503(b) regarding motions, the opposing party should be allowed a minimum of ten days from receipt of the motion to respond. If the arbitrators are considering sanctions without a motion by a party, they should be required to notify the parties in writing and afford the party against whom they are considering the sanction a minimum of ten days notice from receipt of the notice to respond. The party against whom sanctions are sought should be entitled to a prehearing conference pursuant to Proposed Rule 12501, and that party should be able to require the entire panel to hear and decide the motion.

While arbitration does not, and should not, offer the same panoply of procedural protections as judicial actions, arbitrations must be "fundamentally fair," and notice and an opportunity to be heard are two requisites of fundamental fairness. *See, e.g., Bowles Financial Group v. Stifel, Nicolaus & Co.*, 22 F.3d 1010, 1012-1013 (10th Cir. 1994). To ensure that arbitration affords fundamental fairness to both customers and member firms, notice and hearing requirements should be added to Proposed Rule 12212. These requirements are not onerous and are based on the procedures proposed by NASD Dispute Resolution for other motions in Proposed Rule 12503. Moreover, these requirements are consistent with the view that SIA has expressed against "creeping litigiousness" because orderly procedures will: eliminate disputes about the proper method for seeking sanctions; reduce the prospect that sanctions practice will undermine the efficiency and cost-effectiveness of arbitration that would result if sanctions practice were to become a routine part of almost every arbitration proceeding; and, reduce the likelihood of costly post-arbitration challenges to sanction awards.

Substantive Standards. Proposed Rule 12212(a) does not establish any standard or threshold for the imposition of sanctions. As written, Proposed Rule 12212(a) permits arbitrators to impose sanctions for *any* failure to comply with *any* provision of the Code or an order, even if the failure to comply was unintentional, justified or *de minimis*.

In contrast to Proposed Rule 12212(a), Existing Rule 10305(b) and Proposed Rule 12212(c) contain standards for awarding sanctions. Existing Rule 10305(b) provides that, "The arbitrators may dismiss a claim, defense or proceeding with prejudice as a sanction for willful and intentional material failure to comply with an order of the arbitrator(s) if lesser sanctions have proven ineffective." Proposed Rule 12212(c)

replaces Existing Rule 10305(b) and contains similar language; it would authorize the sanction of dismissal with prejudice, but only for "material and intentional failure to comply with an order of the panel if prior warnings or sanctions have proven ineffective."

Proposed Rule 12212(a) should be revised and should include a standard similar to the standard in Existing Rule 10305(b) and Proposed Rule 12212(c). Proposed Rule 12212(a) should be amended to read: "The panel may sanction a party for *material and intentional* failure to comply with [] any order of the panel or single arbitrator authorized to act on behalf of the panel, *unless the party demonstrates that it acted in good faith or shows substantial justification for its failure to comply*. (Brackets indicate deleted language[2] and italics indicate proposed new language.) The willfulness requirement will properly prevent arbitrators from imposing sanctions for negligence and mistakes. The materiality requirement will preclude sanctions for *de minimus* noncompliance. The good faith or substantial justification language will excuse a party from noncompliance with an order in a situation in which it is impossible to comply.[3]

Sanctions Should Be Limited to Violations of Prior Orders. Proposed Rule 12212(a) greatly expands arbitrators' authority to award sanctions. Under existing practice, sanctions are limited to violations of *orders*. Existing Rule 10305 permits dismissal as a sanction, but only for "willful and intentional material failure to comply with an *order* of the arbitrator(s) if lesser sanctions have proven ineffective." (Emphasis added.) The *Discovery Guide* permits sanctions "if a party fails to produce documents or information required by a *written order*. . . ." *Discovery Guide*, Section VIII (Emphasis added). Proposed Rule 12212(a) significantly expands the type of conduct that can be sanctioned by permitting the panel to sanction a party for failure to comply with "any provision of the Code."

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[2] SIA suggests the deletion of the phrase that permits sanctions for any violation of the Code. This proposed deletion is discussed in the next section, "*Sanctions Should Be Limited to Violations of Prior Orders*."

[3] The substantial justification language is taken from the current *Discovery Guide*. *Discovery Guide*, Section VIII. The language precludes a sanction if a party cannot comply with an order for a good reason. For example, a panel might issue an order to a member firm requiring it to produce all confirmations for the entire time the customer's account was open, or an order to a customer to produce tax returns for the entire time the account was open. If the customer had an account with the member for a long period of time, the member may no longer have all the confirmations and the customer may no longer have all the tax returns. Both the member and the customer may not be able to fully comply with the order. The member's and the customer's non-compliance would be substantially justified and the panel would not be able to sanction the non-compliance.

There is no sound reason to expand current practice. The primary means for enforcing compliance with the Code should be an order to comply. Sanctions should not be the remedy of first resort for every failure to comply with any provision of the Code, particularly since failures to comply can be unintentional, immaterial or *de minimus*. Compliance should be achieved in the first instance by arbitrator order; with sanctions used as a remedy for failure to comply with orders.

As under current practice, the Proposed Customer Code should reserve sanctions for violations of orders. To conform Proposed Rule 12212(a) with current practice, the phrase "with any provision of the Code" should be deleted.

Subsection (c) Should Have Procedural Requirements and Should Not Expand Current Practice. Proposed Rule 12212(c) authorizes dismissal of a claim, defense or arbitration with prejudice "as a sanction for a material and intentional failure to comply with an order of the panel if prior *warnings* or sanctions have proven ineffective." (Emphasis added.)

Subsection (c) does not have a notice requirement to afford the offending party an opportunity to be heard; it potentially allows a panel to dismiss a claim with prejudice without any prior notice. Subpart (c) should be amended in the same manner as subpart (a) to provide for notice and an opportunity to be heard.

The term "warnings" should be deleted from subpart (c). It is not a defined term and introduces unnecessary ambiguity.

Proposed Rule 12308. Loss of Defenses Due to Untimely or Incomplete Answer.

Proposed Rule 12308(a) permits a panel, upon motion, to bar a respondent from presenting facts or defenses for failure to timely answer any "claim." Proposed Rule 12100(c) defines "claim" as "an allegation or request for relief." Proposed Rule 12308 thus permits a panel to preclude a respondent from presenting "any defenses or facts at the hearing" if the respondent failed to answer any allegation.

Proposed Rule 12308(a) should permit an order barring defenses only when a respondent fails to timely answer a statement of claim, a counterclaim, a cross-claim or a third-party claim. (*See* Proposed Rule 12000 (f), (g), (t) and (u).) As written, however, the rule potentially imposes a severe penalty for failure to answer any allegation, regardless of its materiality or the party's ability to investigate and respond to the allegation by the time the answer is due.

The potentially severe (and likely unintended) consequences of Proposed Rule 12308(a) should be eliminated be revising the rule to read: "If a party fails to answer a statement of claim, cross-claim, counterclaim or third-party claim within the time period specified in the Code, the panel may, upon motion, bar that party from presenting any defenses or

facts at the hearing, unless the time to answer was extended in accordance with the Code. The party may also be subject to default proceedings under Rule 12801."

Proposed Rule 12308(b) should be revised in the same manner. Proposed Rule 12308(b) should read: "If a party answers a statement of claim, cross-claim, counterclaim or third-party claim that alleges specific facts and contentions with a general denial, or fails to include defenses of relevant facts in its answer that were known to it at the time the answer was filed, the panel may bar that party from presenting the omitted defenses or facts at the hearing."

These proposed revisions fulfill the goals of requiring both timely and thorough answers, without penalizing a party that has failed to respond to every allegation in a pleading, including boilerplate allegations.

Proposed Rule 12312. Multiple Claimants

Proposed Rule 12313. Multiple Respondents

Proposed Rules 12312 and 12313 substantively change the requirements for multi-party actions. The Comments of NASD Dispute Resolution do not offer any explanation for the change in the requirements and the change has unpredictable consequences. While SIA agrees that the requirements for multiple claimants and multiple respondents are properly separated into two rules, the Proposed Code should retain the requirements in Existing Rule 10314(d).

Existing Rule 10314(d)(1) is based on Federal Rule of Civil Procedures 20, "Permissive Joinder of Parties," and tracks the language of that Rule almost verbatim. The redrafting process, however, has substantively changed the criteria for joinder. Joinder of Parties under former Rule 10314(d)(1) required that two criteria need be satisfied:

1. The parties' claim must have arisen out of the same transaction or occurrence or series of transactions or occurrences; *and*,

2. The claims must contain common questions of law or fact.

The language related to asserting "relief jointly or severally" was not an alternative requirement to the "same transactions or occurrences" requirement but, rather, clarified that the relief sought on the same transactions by the various claimants could be either joint or several.

Because the purpose and consequences of the Proposed Rules are unclear, the Proposed Code should split the current rule into two rules but retain the existing substantive standard.

Proposed Rule 12404. Striking and Ranking Arbitrators

Proposed Rule 12404 does not address a common problem. The lists of proposed arbitrators often include proposed arbitrators with direct and serious conflicts that preclude their appointment as arbitrators (a "disqualifying conflict"). For example, it is not uncommon for a member firm to receive a list of proposed arbitrators that includes a lawyer who has brought a claim against the member firm or an expert who has testified against the member firm. SIA believes that public customers have experienced similar problems. For example, SIA believes that NASD has sent public customers a list of proposed arbitrators that includes an expert who has testified for the member firm involved in the case. Under the Proposed Rule, a party who receives such a list must use one of its five strikes to eliminate an arbitrator with a disqualifying conflict.

This problem is detrimental to both member firms and customers. When a party receives a list that includes an arbitrator with a disqualifying conflict, the party must use one of its five peremptory strikes and is effectively required to select from six instead of seven proposed arbitrators. To eliminate this problem, the rule should include a procedure for replacing arbitrators who have disqualifying conflicts before the parties are required to submit their rankings.

Proposed Rule 12409. Arbitrator Recusal

Proposed Rule 12409 permits parties to ask an arbitrator to recuse himself or herself "for good cause" and states that the request is "decided by the arbitrator who is the subject of the request."

Proposed Rule 12409 should be modified to eliminate an abuse that has occurred in some arbitrations. SIA is aware of situations in which a party has asked an arbitrator (or even an entire panel) to recuse himself or herself based solely on the arbitrator's ruling on a discovery dispute or other matter decided by the arbitrator prior to the hearing on the merits. Proposed Rule 12409 should include language to preclude this type of "arbitrator shopping" by adding a provision that: "A ruling adverse to the party requesting a recusal does not constitute good cause."

Proposed Rule 12410. Removal of Arbitrator by Director

Subpart (a)(1) provides that the Director will grant a request to remove an arbitrator if (among other criteria), the arbitrator "has a direct or indirect interest in the outcome of the arbitration." The term "indirect" interest is vague and ambiguous and should be deleted.

Subpart (a)(1) maintains the existing rule that "Close questions regarding challenges to an arbitrator by a customer under this Rule will be resolved in favor of the customer." The rule perpetuates a double-standard for resolving requests to remove an arbitrator: Requests made by customers are given a higher degree of deference. There is no

justification to continue the double-standard. Issues of arbitrator bias should be resolved by the same standard. The integrity of the process is damaged by a rule that affords greater protection against arbitrator bias to only one party.

The Proposed Rule should apply the same standard to all parties. It should provide that "All inferences regarding challenges to an arbitrator under this Rule will be resolved in favor of the party making the challenge".

Proposed Rule 12503. Motions

Oral Motions. Subpart (a)(1) permits a party to make any motion orally. The provision for oral motions allows a party to request, and the arbitrators to grant, relief without adequate notice and an opportunity to be heard.

The requirement that every motion, including an oral motion, "must include a description of the efforts made by the moving party to resolve the matter before making the motion" does not mitigate the risks associated with the broad endorsement of oral motions. For example, the Proposed Rule permits a party to orally request an order to compel discovery responses and to impose sanctions during a prehearing conference, as long as the party attempted to resolve the matter the prior day. In short, Proposed Rule 12503(a) invites motions made on inadequate notice without an adequate opportunity to respond.

The Proposed Rule's broad endorsement of oral motions also is inconsistent with other provisions of subparts (a) and (b), which require written notice and an opportunity to respond in writing.

SIA acknowledges that oral motions can be appropriate and even necessary under some circumstances. But oral motions should be the exception, not the rule. Oral motions should be limited to matters that could not have been anticipated and require immediate consideration. The party opposing an oral motion ordinarily should be afforded ten days to respond to the motion, unless there is good cause for deciding the motion on shorter time.

Entire Panel. Subpart (c)(3) states that "Discovery-related motions are decided by one arbitrator, generally the chairperson. The arbitrator may refer the motion to the full panel, on his or her own initiative, or at the request of a party," but the arbitrator need not honor a party request. In contrast, the arbitrator must refer motions relating to privilege to the full panel at the request of a party.

This distinction is unwarranted. Discovery motions often involve important issues, including issues that can impose substantial burdens and costs on a party. Parties should be entitled to require the full panel to hear and decide any discovery-related motion.

Proposed Rule 12504. Motions To Decide Claims Before a Hearing on the Merits

Subpart (a) provides that, "Except as provided in Rule 12206 [regarding the six-year eligibility rule], motions to decide a claim before a hearing are discouraged and may only be granted in extraordinary circumstances." The subpart improperly discourages dispositive motions and improperly imposes an extraordinary circumstances requirement.

The Code should neither encourage nor discourage dispositive motions. There are many situations in which dispositive motions are appropriate yet the circumstances may not be "extraordinary." Examples include stale claims that are barred by the statute of limitations; claims asserted against parties who had no involvement in the dispute; and cases in which the facts are not in dispute. In addition, claimants sometimes include clearing firms as respondents based solely on their role as clearing firms, despite compelling authority that clearing firms generally have no liability for the conduct of introducing firms.[4] The "extraordinary circumstances" language, combined with the Code's discouragement of dispositive motions, could be interpreted by panels to deny relief in cases where dismissal prior to the hearing on the merits is appropriate and the denial of relief unfairly imposes the unwarranted costs of discovery and a hearing on the merits on respondents.

By requiring hearings on the merits in all but "extraordinary circumstances," the Proposed Rule is inconsistent with the objective of efficient and cost-effective proceedings. The requirement will require both firms and individual respondents to unfairly bear the burdens – financial and otherwise – of participating in cases through a hearing on the merits. Subsection (a) should be deleted from Proposed Rule 12504.

Proposed Rule 12507. Other Discovery Requests

In conjunction with the Proposed Customer Code, NASD Dispute Resolution intends to amend the *Discovery Guide*. The proposed amendments include the deletion of the

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[4] See, e.g., *Carlson v. Bear, Stearns & Co.*, 906 F.2d 315 (7th Cir. 1990); *Flickinger v. Harold C. Brown & Co.*, 947 F.2d 595, 599 (2nd Cir. 1991); *Antinoph v. Laverell Reynolds Sec., Inc.*, 703 F. Supp. 1185, 1136, 1189 (E.D. Pa. 1989); *Goldberber v. Bear, Stearns & Co.* [2000-2001 Transfer Binder] *Fed. Sec. L. Rep.* (CCH) P91,287 (S.D.N.Y. Dec. 28, 2000); *Mars v. Wedbush Morgan Securities, Inc.*, 283 Cal. Rptr. 238 (Ct. App. 1991); *Riggs v. Schappell*, 939 F. Supp. 321 (D.N.J. 1996); *Ross v. Bolton,* 904 F.2d 819 (2d Cir. 1990); *Cacciola v. Kochcapital, Inc.*, 1997 WL 407867 (Wash. App. Jul. 1997); *Cromer Finance Ltd. v. Berger*, 137 F. Supp. 2d 452 (S.D.N.Y. 2001); *Connolly v. Havens*, 763 F. Supp. 6, 10 (S.D.N.Y. 1991); *Petersen v. Sec. Settlement Corp.*, 277 Cal. Rptr. 468, 473 (Ct. App. 1991); *Edwards & Hanly v. Wells Fargo Sec. Clearance Corp.*, 602 F.2d 478, 484 (2d Cir. 1979).

current Section V regarding "Information Request." That section currently defines and limits information requests. Section V states:

> Like requests for documents, parties may serve requests for information pursuant to Rule 10321(b). Requests for information are generally limited to identification of individuals, entities, and time periods related to the dispute; such requests should be reasonable in number and not require exhaustive answers or fact finding. Standard interrogatories, as utilized in state and federal courts, are generally not permitted in arbitration.

Section V strikes the correct balance between the parties' need for information and the objectives of an expeditious and cost-effective system for the resolution of customer disputes. The policy established by Section V should not be changed and Section V should not be eliminated from the *Discovery Guide*.

Proposed Rule 12508. Objecting to Discovery; Waiver of Objection

Proposed Rule 12508(a) requires a party who is objecting to a discovery request to "specifically identify which *document* or *requested information* it is objecting to and why." (Emphasis added.) The subpart should require an objecting party to specify the *document request* or *information request* that it is objecting to and why. As written, the subpart imposes the burden on parties to identify the documents and information to which they are objecting. For example, if a party objects that the request is overbroad, burdensome and unduly expensive to comply with, the subpart requires the party to nonetheless incur the expense of locating the documents or information and then identify the document of information in the objections. Similarly, if a party objects that the request seeks confidential and private information, the party is nonetheless required to identify the confidential and private information.

Proposed Rule 12508(b) provides that "Any objection not made within the required time is waived unless the panel determines that the party had substantial justification for failing to make the objection within the required time." The subpart unnecessarily requires the parties to anticipate every possible objection or face the penalty of waiver. The subpart thus encourages objections as a protective measure. Read in conjunction with Proposed Rule 12511, which authorizes sanctions for frivolous objections, the subpart unnecessarily requires parties to balance the risk of waiver against the risk of sanctions. Proposed Rule 12508(b) should be eliminated.

Proposed Rule 12511. Discovery Sanctions

Like Proposed Rule 12212(a), subpart (a) of Proposed Rule 12511 substantially broadens the type of conduct that arbitrators can sanction by permitting sanctions for violation of the Code, as opposed to violations of orders. By doing so, the Proposed Rule expands current practice. The Existing Code does not expressly authorize discovery sanctions.

The *Discovery Guide* suggests sanctions only "if [a] party fails to produce documents or information required by a *written order*, unless the panel finds that there is 'substantial justification.'"

The scope of discovery sanctions should not be expanded to violations of the Code. Compliance with Code provisions regarding discovery should be compelled in the first instance by a panel order. Sanctions should be reserved for non-compliance with panel orders.

Expanding discovery sanctions to violations of the code will likely make motion practice regarding discovery more contentious and more expensive. The Proposed Code permits customers and members to object to document and information requests. Proposed Rules 12506 - 12508. Objections to discovery are often the result of legitimate disputes about the propriety and scope of discovery requests. These disputes are properly resolved by motions to compel production. The Proposed Rule as drafted, however, invites the parties to include a request for sanctions in every motion to compel, even when the positions of both parties to the dispute are reasonable. Sanctions requests will become an unnecessary but routine part of discovery disputes, increasing both the costs imposed on the parties and the burdens imposed on the arbitrators who must decide the motions.

Proposed Rule 12513. Authority of Panel to Direct Appearances of Associated Person Witnesses and Production of Documents Without Subpoenas

Proposed Rule 12513 gives panels the power to order the appearance of associated persons, and Proposed Rule 12100(a) and (p) extends the definition as associated person to *former* associated persons. Proposed Rule 12513 thus purports to give panels the authority to order former associated persons to attend an arbitration hearing.

Proposed Rule 12513 is impractical, as panels have no means to enforce an order compelling the attendance of a former associated person. Proposed Rule 12513 should be limited to current associated persons. The attendance of former associated persons should be compelled by subpoena.

Proposed Rule 12601. Postponement of Hearings

Proposed Rule 12601 permits postponement of a hearing by agreement of the parties. On occasion, arbitrators have attempted to thwart the agreement of the parties to postpone an arbitration and compel the parties to proceed. To eliminate this possibility, Proposed Rule 12601 should provide that a hearing must be postponed by agreement of the parties and may be postponed under the other listed circumstances.

Former Associated Persons

SIA has a concern about Proposed Rule 12100, subparts (a) and (p), which extend the definition of "associated person," "associated person of a member" and "person

associated with a member" to *former* associated persons. Read in conjunction with Proposed Rule 12200, the Proposed Code exercises jurisdiction over former associated persons in perpetuity. SIA is unsure of the basis for this exercise of jurisdiction. For example, the by-laws of the National Association of Securities Dealers ("NASD") permit jurisdiction over former associated persons for a finite time period with respect to regulatory matters. (NASD By-Laws, Art. V, Sec. 4.) SIA has not found a corresponding by-law for NASD Dispute Resolution that permits lifelong jurisdiction over former associated persons.

Other Matters

SIA has identified several other issues regarding the Proposed Code that are more technical in nature. They are discussed in Attachment 1.

Conclusion

Thank you for giving the Arbitration and Litigation Committee of SIA the opportunity to comment on the Proposed Code. As noted at the outset, we believe that the Proposed Code overall is a very positive step, and we believe that with our suggestions it will go even further to simplify the Existing Code and keep the arbitration process as fair and efficient as possible, to the benefit of all market participants.

If you have any questions about this letter please contact the undersigned, our outside counsel on this matter, Robert Ericson of Bingham McCutchen (213-680-6798 or robert.ericson@bingham.com), or the Committee's staff advisor, George Kramer (202-216-2000 or gkramer@sia.com).

Very truly yours

Edward G. Turan
Chair, Arbitration and Litigation Committee

cc: Linda D. Fienberg, President, NASD Dispute Resolution
George H. Friedman, Executive Vice President, NASD Dispute Resolution
Catherine McGuire, Chief Counsel, Division of Market Regulation, SEC
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ATTACHMENT 1

TECHNICAL COMMENTS OF THE ARBITRATION AND LITIGATION COMMITTEE OF THE SECURITIES INDUSTRY ASSOCIATION ABOUT THE PROPOSED NASD CODE OF ARBITRATION PROCEDURE FOR CUSTOMER DISPUTES

Proposed Rule 12301. Service on Persons Currently Associated with a Member

If both a member and a person currently associated with a member are named as respondents in the same arbitration, Proposed Rule 12301 provides that "service on the person associated with the member may be made on the member or directly on the associated person. If service is made on the member, the member must serve the associated person, even if the member will not be representing the associated person in the arbitration." Nothing in the language of the rule limits its use to the Director, or limits its use to initial pleadings. The Proposed Rule creates confusion. For example, in a case where a member and a current associated person are respondents and are separately represented, the Proposed Rule as written would allow the claimant to serve only the member; the member would then have to serve the associated person. The Proposed Rule would simply delay service of the associated person.

SIA submits that the Proposed Rule is intended to apply, or in any event should apply, only to the service of initial pleadings. This modification can be achieved by making this rule an additional subpart of Rule 12302 regarding "Filing an Initial Statement of Claim." Alternatively, Proposed Rule 12301 should be re-written to make it available only to the Director for service of statements of claim.

Proposed Rule 12310. Answering Amended Claims

Under each of three different scenarios, the Proposed Rule allows a respondent 20 days to answer an amended statement of claim. Under each scenario, however, the 20-day period is calculated differently. To provide uniformity and fairness to respondents, each 20-day period should be calculated from respondent's receipt of the amended statement of claim.

- Subpart (c) governs the situation where a claim is amended after a panel has been appointed. Under this circumstance, the respondent has 20 days from its receipt of notice that the panel has granted the motion to amend the claim. In light of Proposed Rule 12309(b), the respondent would already have possession of the amended claim and would have a full 20 days to prepare and serve an amended answer. This is the appropriate time period.

- Subpart (a) deals with the situation in which a claim is amended before the answer is served. Under this circumstance, the Proposed Rule extends the respondent's original time to answer by 20 days. If a claimant files an amended statement of claim on or immediately before the original deadline for respondent's answer, and serves the amended statement of claim by mail, a respondent could have substantially less than 20 days to prepare an amended answer. To provide adequate time to respond, and to provide consistency within the rule, subpart (a) should be amended to read: "If a claim is amended before it has answered, the respondent has 20 days from the time respondent receives the amended claim to file and answer.

- Subpart (b) addresses the circumstance where the claim is amended after it has been answered but before a panel has been appointed. Under this circumstance, the Proposed Rule provides respondent 20 days from the time the amended claim is served to serve an amended answer. Since service can be accomplished by mail, in practice a respondent could have substantially less

than 20 days to file an amended answer. For fairness and consistency, subpart (b) should be amended to read: "If a claim is amended after it has been answered, but before a panel has been appointed, the respondent has 20 days from the time the amended claim is received to serve an amended answer."

Proposed Rule 12600. Required Hearings

Proposed Rule 12504. Motions to Decide Claims Before a Hearing on the Merits

These proposed rules are inconsistent. Rule 12504 permits cases to be dismissed without a hearing. Rule 12600 lists the circumstances in which hearings will not be held, but does not list cases can be dismissed without a hearing under Rule 12504. Subpart (a) of Rule 12600 should be amended to include dismissal pursuant to Rule 12504 as an additional exception to the requirement that hearings will be held.