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BY E-MAIL

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

Re: Comment: File No. SR-NASD-2005-079
Amendments to NASD Arbitration Code 10322 - Subpoenas

Dear Mr. Katz:

I write to comment on SR-NASD-2005-079, a revision to Rule 10322 of the NASD Code of Arbitration Procedure.

In my comment of July 19, 2006, I pointed out that some of the provisions of the new rule are either inconsistent with the Federal Arbitration Act ("FAA") or are rendered unwieldy because they require personal service of certain documents on parties. As I demonstrate below, NASD's November 30, 2006 response relies, in my opinion, on a mistaken view of the law, and the rule should be changed to conform with the FAA. I have reproduced below the relevant portions of my July 19 comment and NASD's November 30 response. My current comment begins on page 6.

Relevant Portion of Feinberg's July 19, 2006 Comment

1. The Proposed Rule is Inconsistent With the FAA Regarding Who Signs the Subpoena

Section 7 of the FAA provides, in part,

> The arbitrators selected . . . or a majority of them, may summon in writing any person to attend before them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case. . . . **Said summons shall issue in the name of**

> **the arbitrator or arbitrators, or a majority of them, and <u>shall be signed by the arbitrators, or a majority of them</u>,** . . . .

9 U.S.C.A. § 7[1] (emphasis added). Thus, at least a majority of the arbitrators must sign all subpoenas issued pursuant to the FAA.

Proposed Rule 10322(c) provides in relevant part "The arbitrator responsible for deciding discovery-related motions shall rule promptly on the issuance and scope of the subpoena . . . ." This implies that only one arbitrator need sign the subpoena. While this may be the case when only one arbitrator presides over the arbitration, it is not the case when three arbitrators preside.

The FAA provides third parties certain protections that parties cannot limit merely by creating a rule. One of the protections requires that a majority of the arbitrators sign the subpoena. Proposed Rule 10322 should conform to the FAA's requirements. Otherwise, arbitration panels will issue what they think are valid subpoenas (with the signature of only one arbitrator), and third-party recipients can legitimately ignore them.

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[1] Section 7 of the FAA provides:

> The arbitrators selected either as prescribed in this title [*9 USCS §§ 1* et seq.] or otherwise, or a majority of them, may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case. The fees for such attendance shall be the same as the fees of witnesses before masters of the United States courts. Said summons shall issue in the name of the arbitrator or arbitrators, or a majority of them, and shall be signed by the arbitrators, or a majority of them, and shall be directed to the said person and shall be served in the same manner as subpoenas to appear and testify before the court; if any person or persons so summoned to testify shall refuse or neglect to obey said summons, upon petition the United States district court for the district in which such arbitrators, or a majority of them, are sitting may compel the attendance of such person or persons before said arbitrator or arbitrators, or punish said person or persons for contempt in the same manner provided by law for securing the attendance of witnesses or their punishment for neglect or refusal to attend in the courts of the United States.

2. The Proposed Rule is Unwieldy

a. Receipt of the issued subpoena by all parties

Proposed Rule 10322(d) provides "If the arbitrator issues a subpoena, the party that requested the subpoena **must serve the subpoena at the same time and in the same manner on all parties and, if applicable, on any non-party receiving the subpoena**." (Emphasis added)

This provision may require that the subpoenaing party serve the other parties with copies of the subpoena by hand and in person. This cannot be the result NASD intended.

Section 7 of the FAA provides in relevant part that the arbitration subpoena "shall be served in the same manner as subpoenas to appear and testify before the court . . . ." The governing rule – Rule 45(b)(1) of the Federal Rules of Civil Procedure – provides in relevant part: "Service of a subpoena upon a person named therein shall be made by delivering a copy thereof to such person . . . ."

The courts have generally interpreted this provision of Rule 45 to mean that personal service of the subpoena is required.[2] Thus, pursuant to the FAA and Rule

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[2] We cite the rule of the vast majority of courts. However, not all courts agree, a condition that in itself can lead to unnecessary motion practice during the arbitration. *See, e.g., FTC v. Compagnie de Saint-Gobain-Pont-a Mousson*, 636 F.2d 1300, 1312–13 (D.C. Cir. 1980); *Harrison v. Prather*, 404 F.2d 267, 273 (5th Cir. 1968); *Klockner Namasco Holdings Corp v. Daly Access.com, Inc.*, 211 F.R.D. 685, 687 (N.D. Ga. 2002) (citing cases); *Agran v. City of New York*, No. 95 Civ. 2170 (JFK), 1997 U.S. Dist. LEXIS 2577, at *3 (S.D.N.Y. 1997) (weight of authority requires personal service; the court does not have authority to sanction alternative service); *Khachikian v. BASF Corp.*, No. 91-CV-573, 1994 WL 860702, at *1, 1994 U.S. Dist. LEXIS 2881, at *2 (N.D.N.Y. Mar. 4, 1994); *Conanicut Investment Co. v. Coopers & Lybrand (In re Deposition Subpoena Directed to Smith)*, 126 F.RD. 461, 462 (E.D.N.Y. 1989) (personal service required; "the court has no discretion to permit alternative service when a party has difficulty effecting service"); *In re Johnson & Johnson*, 59 F.R.D. 174, 177 (D. Del. 1973). *Contra Hall v. Sullivan*, 229 F.R.D. 501, 503 (D.Md. 2005) (acknowledging that the majority of courts require personal service but adopting the position of the minority); *Ultradent Products v. Hayman,* No. M8-85 (RPP), 2002 U.S. Dist. LEXIS 18000 (S.D.N.Y. Sept. 24, 2002) (subpoena served on corporation's registered agent or by certified mail satisfies Rule 45); *Catskill Development, L.L.C. v. Park Place Entertainment Corp.*, 206 F.R.D. 78, 84 n.5 (S.D.N.Y. 2002) ("substitute service at the [witness's] offices followed by mailing

45, a subpoena issued by the arbitrators must be served by personal service (i.e. by hand) on the subpoenaed party. Proposed Rule 10322 would, therefore, also require the subpoenaing party to serve copies of the subpoena to the other parties by hand.

This is expensive, unwieldy, and undoubtedly not what NASD had in mind when it drafted this provision.[3]

We suggest that the NASD Director of Arbitration send the issued subpoena to all parties at the same time and in the same manner (for example, first class mail), instead of sending the issued subpoena only to the party that requested the subpoena. The Director serves all parties at the same time and in the same manner with all other communications between the arbitrators and the parties. Subpoenas should not be an exception.

If the parties and arbitrators are able to communicate directly with each other pursuant to NASD Arbitration Rule 10334, then the arbitrators should send

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properly labeled copies [of subpoena] to the same address" is sufficient) (citing *King v. Crown Plastering Corp.*); *First City, Texas-Houston, N.A. v. Rafidain Bank*, 197 F.R.D. 250, 255 (S.D.N.Y. 2000) (Service on the witness's agent to accept service of process and its counsel of record); *Cordius Trust v. Kummerfeld*, No. 99 Civ. 3200 (DLC), 1999 U.S. Dist. LEXIS 19980 (S.D.N.Y. Dec. 29, 1999); (after repeated attempts at personal service, certified mail allowed); *Windsor v. Martindale*, 175 F.R.D. 665, 669–70 (D. Colo. 1997) (allowing service by certified mail by the U.S. Marshal's service; not allowing service by plaintiff by regular mail); *King v. Crown Plastering Corp.*, 170 F.R.D. 355, 356 (E.D.N.Y. 1997) (hand delivery of subpoena not required "so long as service is made in a manner that reasonably insures actual receipt of the subpoena by the witness"; allowing combination of hand delivery and mail delivery to residence of subpoenaed person to constitute proper service under Rule 45); *First Nationwide Bank v. Shur (In re Shur)*, 184 B.R. 640, 642–44 (Bankr. E.D.N.Y. 1995) (rejecting the majority rule) ("We therefore hold that the only limitation upon service under rule 45 is that the procedure employed be reasonably calculated to give the nonparty actual notice of the proceedings and an opportunity to be heard.") (citing *Doe v. Hersemann*, 155 F.R.D. 630 (N.D. Ind. 1994) (certified mail)); *Hinds v. Bodie*, No. 84 Civ. 4450, 1988 U.S. Dist. LEXIS 14437, 1988 WL 33123 (E.D.N.Y. 1988) (alternative form of service permitted after unsuccessful attempts at personal service).

[3] It is true that the parties may agree to receive service by some other less costly method, but some parties may not agree to this procedure.

copies of the issued subpoena to all parties at the same time and in the same manner. At the arbitrators' option, the arbitrators can send the subpoena to the NASD Director of Arbitration for distribution to all the parties.

NASD November 30, 2007 Response

One commenter stated that the proposed rule should be revised to conform to the Federal Arbitration Act (FAA).[4] This commenter noted that the proposal is inconsistent with the FAA, because the FAA requires that at least a majority of the arbitrators on a panel sign a subpoena, whereas the proposed rule change allows for only one arbitrator to sign a subpoena. This commenter argued that, by allowing only one arbitrator to sign a subpoena, the proposed rule inappropriately attempts to remove protections that are granted to non-parties by the FAA.

NASD respectfully disagrees with this commenter. NASD notes that the proposal provides non-parties with more protection than current Rule 10322 as it allows only arbitrators to issue subpoenas. As previously noted, the current rule allows any counsel of record the power of the subpoena process as provided by law. Limiting the power of the subpoena process to neutral arbitrators helps to protect non-parties from abusive or harassing subpoenas that could otherwise be issued by attorneys. NASD believes that subpoenas issued by a single arbitrator are valid and notes that it has received few, if any, complaints regarding the validity of such subpoenas from participants in the NASD forum.

This commenter also expressed the view that the proposal, under the FAA, is unwieldy with respect to the service of subpoenas. Specifically, the commenter stated in his letters 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 the proposal, under the FAA, would require personal service of all subpoenas issued in NASD's forum.

Once again, NASD respectfully disagrees with this commenter. Before a party may participate in NASD's arbitral forum, it is required to submit a Uniform Submission Agreement in which the party agrees to abide by NASD's

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[4] See Feinberg 1 and 2 letters.

Code of Arbitration Procedure.[5] Under the Code, service can be effectuated by a variety of methods, including mail, overnight mail service, hand delivery, and facsimile.[6] The United States 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. Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, 489 U.S. 468 (1989). In fact, the Supreme Court noted that:

> Indeed, such a result would be quite inimical to the FAA's primary purpose of ensuring that private agreements to arbitrate are enforced according to their terms. Arbitration under the Act is a matter of consent, not coercion, and the parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted.

Volt Information Sciences, 489 U. S. at 479 (citation omitted). As such, NASD 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.

DISCUSSION

Point 1

My first point was that the FAA requires a majority of arbitrators to sign a subpoena and that this requirement protects non-parties[7]. NASD's response is that

1. the new rule "provides non-parties with more protection than current Rule 10322 as it allows only arbitrators to issue subpoenas[;]"

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[5] 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."

[6] See NASD Rule 10314(c).

[7] This comment does not address issues that may arise if the non-party is a third-party beneficiary of the arbitration agreement or otherwise associated with one of the parties.

2. "NASD believes that subpoenas issued by a single arbitrator are valid[;]" and

3. "[NASD] has received few, if any, complaints regarding the validity of such subpoenas from participants in the NASD forum."

I address each point seriatim. First, the fact that the new rule provides non-parties with more protection than does current Rule 10322 does not justify failure to comply entirely with the FAA. While NASD should be commended for conforming its rule with that portion of the FAA that permits only arbitrators to sign subpoenas, it does not justify non-conformance with that portion of the FAA that protects non-parties by requiring that arbitrator-issued subpoenas be signed by a majority.

Second, it may be true that NASD believes that subpoenas issued by a single arbitrator are valid, but such subpoenas are valid only if one arbitrator will decide the case. The plain language of the statute requires that a majority of the arbitrators sign the subpoena, and NASD has offered no authority to the contrary. NASD's mere *ipse dixit* is not enough to amend the United States Code.

Finally, NASD supports its position by saying that no one participating in the NASD forum has complained. The fact that only person took the time to complain that NASD's rule does not comply with the FAA does not change the fact that NASD's rule does not comply with the FAA.

NASD's entire argument seems to rely on the unexpressed proposition that the parties to an arbitration can agree to do pretty much whatever they want in the arbitration.[8] While this is true with respect to the parties' relationship with each other, it is not true with respect to the parties' relationship with non-parties. Non-parties are governed by statute, not solely by the parties' agreement. And if a statute provides non-parties with certain protections, non-parties cannot supersede those protections by contract.

As the United States Court of Appeals for the Third Circuit correctly observed: "An arbitrator's authority over parties that are not contractually bound by the arbitration agreement is strictly limited to that granted by the Federal Arbitration Act." *Hay Group, Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404, 406 (3d Cir. 2004) (Alito, J.) (citing *Legion Ins. Co. v. John Hancock Mut. Life Ins. Co. (In re Arbitration), 2001 U.S. Dist. LEXIS 15911, No. 01-162, 2001 WL 1159852,* at *3 (E.D. Pa. Sept. 5, 2001) ("It is clear, and undisputed, that the cited statute is the only source of the authority for the validity and enforceability of the arbitrators' subpoena [over a nonparty]"))

Similarly, the United States District Court for the Southern District of New York recognized, "Because the parties to a contract cannot bind nonparties, they certainly cannot grant such authority to an arbitrator. Thus, an arbitrator's power over nonparties derives solely from

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[8] NASD expressly applies this theory in response to my second point.

the FAA." *Integrity Ins. Co., in Liquidation, v. American Centennial Ins. Co., 885 F. Supp. 69, 71 (S.D.N.Y. 1995)* (cited with approval in *Hay Group, Inc.*, 360 F.3d at 406).

Therefore, even though the parties – through NASD rules – grant one arbitrator the authority to subpoena a non-party, this grant of authority is a nullity. "An arbitrator's power over nonparties derives solely from the FAA," and the FAA requires a majority of the arbitrators to sign a subpoena.

The United States Court of Appeals for the Second Circuit agrees. *See National Broadcasting Co. v. Bear Stearns & Co.*, 165 F.3d 184, 186-187 (2d Cir. 1999) ("Ordinarily, because commercial arbitration is a creature of contract, only the parties to the arbitration contract are bound to participate. . . . If discovery were to be obtained from the Third Parties – none of which was a party to the arbitration agreement at issue here – the authority to compel their participation would have to be found in a source other than the parties' arbitration agreement." (citations omitted)) (interpreting statutes to determine whether third parties were obligated to comply with a subpoena issued in connection with an international arbitration). *See also Comsat Corp. v. National Science Foundation*, 190 F.3d 269, 275 (4th Cir. 1999) ("The subpoena powers of an arbitrator are limited to those created by the express provisions of the FAA.") (finding that the FAA does not authorize arbitrators to subpoena non-parties for discovery.)

Thus, the courts recognize that statute– and statute alone – determines the rights and obligations of non-parties, not contracts entered into by parties to an arbitration. Accordingly, NASD's rule should be amended to protect non-parties to the same extent the FAA protects non-parties, that is, by requiring that a majority of the arbitrators sign the subpoena.

Point 2

In my second point, I said that because the FAA requires personal service of a subpoena, the NASD rule requires personal service of a copy of the subpoena on the parties. I also said that this does not violate the FAA, but it makes arbitration practice at the NASD unwieldy. NASD responds that under the authority of *Volt* the parties have a right to serve the subpoena in a variety of ways because NASD's arbitration code permits it. In other words, NASD says that the parties can – and have – agreed to serve subpoenas on non-parties in a manner other than the FAA-required personal service and under *Volt* the parties can do this.[9]

But as discussed above, the parties cannot agree to supersede the protections the FAA provides to third parties. *See Hay Group, Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404, 406

[9] NASD's response is not clear. NASD may mean that non-parties must be served in conformance with the FAA, that is by personal service, and parties can be served by any of the methods allowed by its other rules. But if NASD means that, Rule 10322(d) would not expressly require that the parties be served with the subpoena in the same manner as non-parties are served.

(3d Cir. 2004) (Alito, J.); *Comsat Corp. v. National Science Foundation*, 190 F.3d 269, 275 (4th Cir. 1999); *National Broadcasting Co. v. Bear Stearns & Co.*, 165 F.3d 184, 186-187 (2d Cir. 1999); *Legion Ins. Co. v. John Hancock Mut. Life Ins. Co. (In re Arbitration), No. 01-162, 2001 U.S. Dist. LEXIS 15911, 2001 WL 1159852,* at *3 (E.D. Pa. Sept. 5, 2001); *Integrity Ins. Co., in Liquidation, v. American Centennial Ins. Co., 885 F. Supp. 69, 71 (S.D.N.Y. 1995).*

The FAA protects third parties by requiring that third parties be served personally. Therefore, the rule as currently drafted requires that parties serve non-parties with subpoenas personally and serve each other with copies of subpoenas personally. If NASD intends that parties be served differently, it should draft the rule differently.

Volt is not to the contrary. In *Volt* the United States Supreme Court determined the rights and obligations of the **parties** in light of an agreement entered into by the **parties**. The Supreme Court decided nothing about the rights and obligations of non-parties in light of the FAA, much less the rights and obligations of non-parties in light of someone else's arbitration agreement.

NASD has not cited, and – as far as we can tell – cannot cite a single case where a court found that the obligations of a subpoenaed non-party were defined solely by the provisions of an arbitration agreement.[10]

Under NASD's apparent view of *Volt*, parties can impose almost anything they want to impose on non-parties as long as the parties agree to it. Thus, in NASD's view not only can the parties (1) agree to authorize only one arbitrator to sign a subpoena and (2) agree that service of a subpoena on a non-party be by non-personal means, even though the FAA requires both, but the

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[10] In one case we found , the arbitration agreement permitted each party to depose one fact witness. In court, one of the parties to the arbitration agreement complained that she was at a disadvantage, because she needed to depose a non-party, and the FAA did not permit her to depose non-parties. The court acknowledged that the arbitration agreement allowed her to depose one fact witness and the court also agreed with her that pursuant to the FAA the fact witness could not be a non-party. At no time did the court even entertain the idea that the arbitration agreement superseded the FAA, and that she could depose a non-party. *Guyden v. Aetna Inc.*, 3:05cv1652 (WWE), 2006 U.S. Dist. LEXIS 73353 at *18 (D. Conn. Sept. 25, 2006) ("Ample authority supports plaintiff's concern with regard to the arbitrator's lack of subpoena power [to obtain discovery from a non-party]. . . .Although plaintiff may be precluded from taking depositions of non-party witnesses, she may obtain necessary information through a pre-merits hearing before the arbitrator." (citations omitted))

Thus, despite the fact that the parties agreed in their arbitration agreement that a party can take a deposition, the court recognized that the FAA supersedes the parties' arbitration agreement in regard to the rights of non-parties.

parties can also agree to deny witness fees and travel expenses to subpoenaed non-party witnesses, even though the FAA requires both.[11] Indeed, under NASD's theory, the parties may agree among themselves that subpoenaed non-party witnesses must pay the parties a special fee for the "privilege" of testifying at the parties' arbitration.

This is, of course, nonsense.

Parties cannot unilaterally impose their will on non-parties in contravention of statute. *See Integrity Ins. Co., in Liquidation, v. American Centennial Ins. Co., 885 F. Supp. 69, 71 (S.D.N.Y. 1995)* ("Because the parties to a contract cannot bind nonparties, they certainly cannot grant such authority to an arbitrator. Thus, an arbitrator's power over nonparties derives solely from the FAA.")

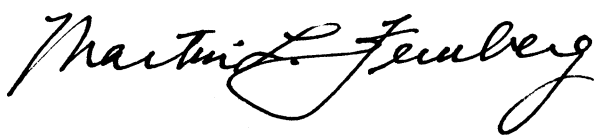
The FAA protects non-parties in at least two ways. First, it requires that a majority of the arbitrators sign subpoenas, and second, it requires - according to the majority of courts - that non-parties be served with subpoenas personally.

NASD has cited no legal authority supporting its proposition that private parties to an arbitration can - merely by agreement - impose their will on non-parties in contravention of statute.

Accordingly, we request that NASD's rules be modified.

Thank you for the opportunity to comment. If you have any questions, please contact me.

Very truly yours,



c.c.: Jean I. Feeney, Esq., Vice President and General Counsel, NASD Dispute Resolution
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[11] This theoretical agreement need not be part of NASD's rules. The parties can agree during the arbitration or in their arbitration agreement to deny witnesses fees and expenses.