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August 23, 2006

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U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

**RE: File No. SR-NASD-2005-094 – Response to Comments on Proposed Rule Change to Amend Rule 10308 of the NASD Code of Arbitration Procedure Relating to the Classification of Arbitrators**

Dear Ms. Gonzalez:

NASD hereby submits its response to comments received by the Securities and Exchange Commission (“Commission” or “SEC”) to SR-NASD-2005-094, a proposal to amend Rule 10308 of the NASD Code of Arbitration Procedure (“Code”) relating to the classification of arbitrators. The proposed rule change and Amendment No. 1 thereto were published for comment in the Federal Register on August 30, 2005.<sup>1</sup> The Commission received 65 letters in response to the proposed rule change.<sup>2</sup>

Two commenters expressed support for the proposal and believed that the changes would improve the definition of the terms “non-public arbitrator” and “public arbitrator” as set forth in NASD Rules 10308(a)(4) and (a)(5), respectively.<sup>3</sup> Fifteen commenters expressed support for the proposal, but believed that it does not go far enough to ensure that arbitrators do not have ties to the securities industry.<sup>4</sup> These commenters suggested that further changes be made to other NASD rules, including

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<sup>1</sup> Securities Exchange Act Release No. 52332 (August 24, 2005); 70 FR 51395 (August 30, 2005).

<sup>2</sup> See Exhibit A for a list of comment letters received.

<sup>3</sup> See Kaufman and Gross Letters.

<sup>4</sup> See Barnes, Galvin, Canning, Gard, Chasen, Rosenberg, Greco, Arbuckle, Salamon, Lopez, Willner, Layne, Pounds, Shockman, and Lipner Letters.

those pertaining to the composition of panels and the classification of arbitrators.<sup>5</sup> One commenter indicated that he did not “object to the proposal” and believed that the industry arbitrator on the panel must be retained since the proposal will result in arbitrators being further removed from the securities industry.<sup>6</sup>

Several commenters stated that non-public arbitrators should be eliminated from arbitration panels.<sup>7</sup> These commenters indicated that the presence of a non-public arbitrator on an arbitration panel results in the appearance of bias, if not actual bias, against customers who bring arbitration claims. The commenters believed that only public arbitrators should serve on arbitration panels to ensure that NASD’s forum is fair for all parties.

While NASD takes note of the suggestion that the non-public arbitrator should be eliminated from arbitration panels, NASD believes that the suggestion is beyond the scope of the current rule proposal. Specifically, the rules that are the subject of the current proposal involve the classification of arbitrators and not the composition of arbitration panels. Any revision to rules other than those specifically filed with the Commission would be contrary to the requirements of the federal securities laws.<sup>8</sup>

One commenter suggested that the New York Stock Exchange’s (“NYSE”) arbitrator classification proposal<sup>9</sup> should be harmonized with NASD’s proposal.<sup>10</sup> This commenter asserted that the NASD and NYSE proposals contain different definitions for the terms “immediate family member” and “public arbitrator” (with respect to control relationships). This commenter believed that such differences between the NASD and NYSE proposals create confusion for claimants as well as counsel and arbitrators that practice in both forums.

NASD respectfully disagrees with this commenter and does not believe that the rules of the NASD and NYSE need to be identical with respect to the classification of arbitrators. NASD drafted the current proposal to ensure that individuals with significant ties to the securities industry do not serve as public arbitrators by excluding individuals

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<sup>5</sup> These suggestions are addressed in detail below.

<sup>6</sup> See Hochman Letter.

<sup>7</sup> See Levenstein, Greenberg, Heiner, Barnes, Stanley, Ledbetter, Brannan, Langenbacher, Parker, Seiler, Greenman, Gillis, Davis, Harrison, Perkins, Ostwald, Bernstein, Galvin, Torngren, Mihalek, Landsman, Gard, Brewer, Hudson, Lea, Friedberg, Chasen, Doner, Graham, Speyer, Stoltmann, Van Kampen, Goldstein, Greco, Estell, Port, Arbuckle, Feldman, Salamon, Lopez, Willner, Layne, Miller, Pounds, Lipner, and Batterman Letters.

<sup>8</sup> See 15 U.S.C. 78s(b)(1).

<sup>9</sup> Securities Exchange Act Release No. 52314 (August 22, 2005), 70 FR 51104 (August 29, 2005).

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

who work for, or are officers or directors of, an entity that controls, is controlled by, or is under common control with, a broker/dealer, or who have a spouse or immediate family member who works for, or is an officer or director of, an entity that is in such a control relationship with a broker/dealer. NASD believes that its version of the rule, including the definition of immediate family member, best ensures that individuals with significant ties to the industry do not serve as public arbitrators. Furthermore, NASD notes that its rules pertaining to the classification of arbitrators already differ from the NYSE's rules. Both NASD and NYSE have rules stating that arbitrators who are professionals and who have devoted 20 percent or more of their work in the last two years to clients who are associated with the securities industry may not be classified as public arbitrators.<sup>11</sup> NASD also excludes from the definition of public arbitrator any attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the prior two years from any persons or entities associated with the securities industry;<sup>12</sup> the NYSE's arbitrator classification rules do not contain a similar provision.

Several commenters suggested that the definition of the term "public arbitrator" be revised with respect to professionals who have a connection with the securities industry. Some commenters stated that any attorney, accountant or other professional who has, or whose firm has, represented securities industry members at any time during the prior five years should not be considered a public arbitrator.<sup>13</sup> Other commenters believed that any attorney, accountant or other professional who has, or whose firm has, represented or has other ties with any securities industry members should not be classified as a public arbitrator.<sup>14</sup> One commenter asserted that any person whose firm has derived any revenue from the securities industry in the past five years should not be allowed to serve as a public arbitrator.<sup>15</sup> Finally, one commenter stated that any individual who has worked in, or been associated with, the securities industry for more than five years should be precluded from being considered a public arbitrator.<sup>16</sup>

NASD respectfully disagrees with these commenters and believes that the current definition of "public arbitrator," taken together with the proposed change, will properly exclude those individuals who have significant ties to the securities industry. In this

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<sup>11</sup> NASD Rule 10308 (a)(4)(C) and NYSE Rule 607(a)(2)(iv).

<sup>12</sup> NASD Rule 10308(a)(5)(A)(iv).

<sup>13</sup> See Evans, Barnes, Doss, Tornngren, Mihalek, Goodman, Lea, Savage, Chasen, Van Kampen, Goldstein, Fynes, Salamon, Caruso, and Shockman Letters.

<sup>14</sup> See Bernstein, Pederson, Greenman, Perkins, Bernstein, Galvin, Gard, Silver, Brewer, Friedberg, Speyer, Estell, Austin, Feldman, Lopez, Kruske, Layne, Pounds, Schultz, Lipner, and Batterman Letters.

<sup>15</sup> See Caruso Letter.

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

regard, NASD notes that the following individuals, among others, already are prohibited from serving as a public arbitrator:

- Individuals who have been associated with the securities industry during the past five years;
- Individuals who have spent a total of 20 years or more in the securities industry;
- Individuals who are professionals who have devoted 20 percent or more of their work in the last two years to clients who are associated with the securities industry; and
- Individuals who are the spouse or immediate family member of a person who is associated with the securities industry.

Furthermore, as mentioned above, NASD has taken the additional step to exclude from the definition of public arbitrator any attorney, accountant, or other professional whose firm derived 10 percent or more of its annual revenue in the past two years from any persons or entities associated with the securities industry. NASD believes that its revised definition of public arbitrator eliminates persons with actual bias, as well as persons who could reasonably be perceived as being biased, from serving as public arbitrators while at the same time maintaining a large and diversified arbitrator pool.

Lastly, NASD notes that several commenters raised issues that do not have any connection to the rule proposal. These issues included: the transparency of arbitrator deliberations;<sup>17</sup> various proposals to improve the overall arbitration process;<sup>18</sup> making securities arbitration voluntary;<sup>19</sup> the failure of arbitration panels to enforce state securities laws;<sup>20</sup> revisions to the arbitrator selection process;<sup>21</sup> and the inconsistency of arbitration awards.<sup>22</sup> While NASD takes note of these comments, it will not respond to them herein since they are beyond the scope of the rule proposal.

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<sup>17</sup> See Greenberg Letter.

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

<sup>19</sup> See Mihalek and Willner Letters.

<sup>20</sup> See Mihalek Letter.

<sup>21</sup> See Rosenberg and Arbuckle Letters.

<sup>22</sup> See Rosenberg Letter.

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NASD believes that the foregoing fully responds to the issues raised by the commenters to the rule filing. Please feel free to call me at (202) 728-8273 if you have any questions or wish to discuss this further

Sincerely,

John D. Nachmann

**Exhibit A**

1. Richard H. Levenstein, Kramer, Sopko & Levenstein, P.A., February 1, 2006 (“Levenstein Letter”)
2. Greenberg, Law Offices of Les Greenberg, October 9, 2005 (“Greenberg Letter”)
3. Bradford D. Kaufman, Greenberg Traurig, October 7, 2005 (“Kaufman Letter”)
4. Jonathan L. Hochman, Schindler Cohen & Hochman LLP, September 30, 2005 (“Hochman Letter”)
5. Jonathan W. Evans, Jonathan W. Evans & Associates, September 21, 2005 (“Evans Letter”)
6. Scot Bernstein, September 21, 2005 (“Bernstein Letter”)
7. John W. Barnes, September 21, 2005 (“Barnes Letter”)
8. L. Jerome Stanley, September 20, 2005 (“Stanley Letter”)
9. Dale Ledbetter, Adorno & Yoss, September 20, 2005 (“Ledbetter Letter”)
10. Randall R. Heiner, September 20, 2005 (“Heiner Letter”)
11. Sam T. Brannan, Page Perry, LLC, September 20, 2005 (“Brannan Letter”)
12. Jason R. Doss, Page Perry, LLC, September 20, 2005 (“Doss Letter”)
13. William B. Langenbacher, September 20, 2005 (“Langenbacher Letter”)
14. Steve Parker, Page Perry, LLC, September 20, 2005 (“Parker Letter”)
15. Jeffrey D. Pederson, September 20, 2005 (“Pederson Letter”)
16. Martin Seiler, September 20, 2005 (“Seiler Letter”)
17. Brian M. Greenman, September 20, 2005 (“Greenman Letter”)
18. Teresa M. Gillis, Shustak Jalil & Heller, September 20, 2005 (“Gillis Letter”)
19. William F. Davis, September 20, 2005 (“Davis Letter”)
20. David Harrison, Spivak & Harrison LLP, September 20, 2005 (“Harrison Letter”)

21. Susan N. Perkins, September 20, 2005 (“Perkins Letter”)
22. Mitchell S. Ostwald, Law Offices of Mitchell S. Ostwald, September 20, 2005 (“Ostwald Letter”)
23. Scot D. Bernstein, Law Offices of Scot D. Bernstein, September 20, 2005 (“Bernstein Letter”)
24. William F. Galvin, Commonwealth of Massachusetts, September 20, 2005 (“Galvin Letter”)
25. William P. Torngren, Law Offices of William P. Torngren, September 20, 2005 (“Torngren Letter”)
26. Charles C. Mihalek and Steven M. McCauley, Charles C. Mihalek, P.S.C., September 20, 2005 (“Mihalek Letter”)
27. Timothy A. Canning, September 20, 2005 (“Canning Letter”)
28. Laurence M. Landsman, Block & Landsman, September 20, 2005 (“Landsman Letter”)
29. Steven J. Gard, Gard Smiley Bishop & Dovin LLP, September 20, 2005 (“Gard Letter”)
30. Scott L. Silver, Blum & Silver, P.A., September 20, 2005 (“Silver Letter”)
31. G. Mark Brewer, Brewer Carlson, LLP, September 20, 2005 (“Brewer Letter”)
32. John D. Hudson, September 20, 2005 (“Hudson Letter”)
33. Joel A. Goodman, Kalju Nekvasil, Stephen Krosschell, and Jennifer Newsom, Goodman & Nekvasil, P.A., September 20, 2005 (“Goodman Letter”)
34. Jill I. Gross, Barbara Black, and Per Jebsen, Pace Investor Rights Project, September 20, 2005 (“Gross Letter”)
35. Royal B. Lea, III, Bingham & Lea, and Randall A. Pulman, Pulman, Bresnahan & Pullen, LLP, September 19, 2005 (“Lea Letter”)
36. Richard P. Ryder, Securities Arbitration Commentator, Inc., September 19, 2005 (“Ryder Letter”)

37. Alan C. Friedberg, Pendleton, Friedberg, Wilson & Hennessey, P.C., September 19, 2005 (“Friedberg Letter”)
38. Robert K. Savage, Savage Law Firm, P.A., September 19, 2005 (“Savage Letter”)
39. Michael Chasen, September 19, 2005 (“Chasen Letter”)
40. Adam S. Doner, September 19, 2005 (“Doner Letter”)
41. Jan Graham, Graham Law Offices, September 19, 2005 (“Graham Letter”)
42. Frederick W. Rosenberg, September 19, 2005 (“Rosenberg Letter”)
43. Debra G. Speyer, Law Offices of Debra G. Speyer, September 19, 2005 (“Speyer Letter”)
44. Andrew Stoltmann, Stoltmann Law Offices, P.C., September 19, 2005 (“Stoltmann Letter”)
45. Al Van Kampen, Rohde & Van Kampen PLLC, September 19, 2005 (“Van Kampen Letter”)
46. Eliot Goldstein, September 19, 2005 (“Goldstein Letter”)
47. W. Scott Greco, Greco & Greco, P.C., September 18, 2005 (“Greco Letter”)
48. Barry D. Estell, September 18, 2005 (“Estell Letter”)
49. Charles W. Austin, Jr., C. W. Austin, Jr. P.C., September 17, 2005 (“Austin Letter”)
50. Robert C. Port, Cohen Goldstein Port & Gottlieb, LLP, September 16, 2005 (“Port Letter”)
51. Kurt Arbuckle, September 16, 2005 (“Arbuckle Letter”)
52. Bill Fynes, September 15, 2005 (“Fynes Letter”)
53. Jeffrey A. Feldman, September 15, 2005 (“Feldman Letter”)
54. Jay H. Salamon, Hermann, Cahn & Schneider LLP, September 14, 2005 (“Salamon Letter”)
55. Steven B. Caruso, Maddox Hargett & Caruso, P.C., September 14, 2005 (“Caruso Letter”)

56. Jorge A. Lopez, Law Offices of Jorge A. Lopez, P.A., September 14, 2005 (“Lopez Letter”)
57. Michael J. Willner, Miller Faucher and Cafferty LLP, September 13, 2005 (“Willner Letter”)
58. Jeffrey S. Kruske, Law Office of Jeffrey S. Kruske, P.A., September 13, 2005 (“Kruske Letter”)
59. Richard M. Layne, Layne Lewis, LLP, September 13, 2005 (“Layne Letter”)
60. John Miller, Law Office of John J. Miller, P.C., September 13, 2005 (“Miller Letter”)
61. Herb Pounds, September 13, 2005 (“Pounds Letter”)
62. Laurence S. Schultz; Driggers, Schultz & Herbst, September 12, 2005 (“Schultz Letter”)
63. Rosemary J. Shockman, Public Investors Arbitration Bar Association, September 9, 2005 (“Shockman Letter”)
64. Seth E. Lipner, Baruch College and Deutsch & Lipner, September 8, 2005 (“Lipner Letter”)
65. Scott I. Batterman, Clay Chapman Crumpton Iwamura & Pulice, August 30, 2005 (“Batterman Letter”)