

The Neutral Corner

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Rule Updates

In July 2001, the Securities and Exchange Commission (SEC) approved the NASD Dispute Resolution proposal that simplifies and clarifies for parties, arbitrators, and staff the fee-related provisions of National Association of Securities Dealers, Inc. (NASD®) Rules 10306, 10319, and 10328.

The proposal amends NASD Rule 10306 to provide that, when parties settle their dispute, any outstanding fees will be divided equally among all of the remaining parties, if the parties do not have an agreement on the allocation of fees. If the arbitrators previously ordered one or more parties to pay certain fees, those fees will not be considered to be outstanding and will not be subject to NASD Rule 10306. The *Initial Prehearing Conference Script* and *Order* have been revised to alert parties and arbitrators to this amendment.

The proposal also amends NASD Rule 10319 to provide that an adjournment fee is required only if and when the arbitrators grant a

requested adjournment. In addition, the amendment conforms adjournment fee amounts to the fee schedule that became effective in March 1999.

Finally, the amendment provides that, under NASD Rule 10328, if a new or amended pleading increases the amount in dispute, all filing fees, hearing session deposits, member surcharges, and member process fees will be recalculated based on the new or amended amount in dispute.

In October 2001, the SEC also approved an NASD Dispute Resolution proposal that increases NASD Rule 10333 member surcharges and process fees. These increases will help fund the development and implementation of a new computer system that will greatly enhance case administration and defray inflationary cost increases.

According to *NASD Notice to Members 01-70*, the preceding amendments became effective on November 19, 2001. To view this *Notice*, and the SEC orders approving these changes, visit the NASD Dispute Resolution

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In October 2001, the SEC published for public comment additional amendments to NASD Rule 10335 Injunctions. See the July 2000 edition of *The Neutral Corner (TNC)* for information on key changes to this Rule. To view *TNC* online, go to the NASD Dispute Resolution Web Site at www.nasdr.com and click on Resources for Neutrals, Education & Guidance, and then *The Neutral Corner*.

Messages From The Editor

Promotions

Effective October 28, 2001, Rick Berry was promoted to Director of Case Administration. Rick earned this promotion by demonstrating exceptional leadership and vision in the Los Angeles Dispute Resolution Office under the direction of Western Regional Director Judith Hale Norris. In this newly created position, Rick assumes responsibility for coordinating NASD Dispute Resolution case administration functions nationwide and ensuring a uniform and high-quality system for all of our forum users. Rick performs these functions out of the New York Dispute Resolution Office.

Also, effective January 1, 2002, NASD Dispute Resolution staff members Liz Clancy, Jean Feeney, and Judy Norris will be promoted to Associate Vice President.

Liz Clancy joined NASD Dispute Resolution in February 1997 as Regional Director for the Northeast Region. Liz manages the arbitration and mediation staff in New York and Washington, DC. Prior to joining the NASD, she was General Counsel for the Coffee, Sugar & Cocoa Exchange. Liz received her J.D. from Fordham University School of Law.

Jean Feeney joined the NASD in 1977 as a law clerk while attending the George

Washington University Law School, and worked in the NASD and NASD Regulation Offices of General Counsel. Recently, Jean has concentrated on dispute resolution issues, being named Special Advisor to NASD Dispute Resolution President Linda D. Fienberg in January 2000, and Chief Counsel in April 2001. Jean presents issues to the National Arbitration and Mediation Committee and the NASD Dispute Resolution Board, manages the rule approval process, and advises staff and the public on rule interpretations.

Judith Hale Norris, Director of NASD Dispute Resolution's Western Region, joined the NASD in 1986 with substantial court management experience as Chief Staff Counsel for the United States Court of Appeals for the District of Columbia Circuit and the United States Court of Appeals for the First Circuit. In addition to her management responsibilities for the Los Angeles and San Francisco Offices, she is an active participant in the development and integration of new rules and procedures, including the *Discovery Guide*.

Please join NASD Dispute Resolution in congratulating everyone.

Statistical Brief—Arbitration Statistics Through The End of October 2001

Filings

2001 through October: 5,661
2000 through October: 4,646
1999 through October: 4,730

Close-Outs

2001 through October: 4,591
2000 through October: 4,497
1999 through October: 3,843

Rule Updates, from page 1

Web Site at www.nasdaq.com and click on Rules & Procedures, and then *NASD Notices to Members*.

In June 2001, NASD Dispute Resolution filed with the SEC a proposal to amend NASD Rules 10308 and 10313. The proposal requires that, in single arbitrator customer cases that are not processed under NASD Rule 10302 (*i.e.*, simplified public customer arbitrations decided exclusively on the filed pleadings or additional documentation), the arbitrators appearing on the Neutral List Selection System (NLSS) lists are required to have served on at least two cases resulting in awards. The proposal also permits parties to agree to deviate from NLSS by specifying their own arbitrators or arbitrator selection criteria. Lastly, the proposal requires additional NLSS arbitrator lists when the initial lists do not result in sufficient arbitrators to complete a panel,

or when an appointed arbitrator is disqualified or unavailable to serve.

In August 2001, NASD Dispute Resolution also filed with the SEC a new arbitration rule proposal that permits claimants who are represented by counsel with the option of serving arbitration claims directly on respondents.

To view the above proposals, visit the NASD Dispute Resolution Web Site's Rule Filings Web Page at www.nasdaq.com by clicking on Rules & Procedures, then Rule Filings and Guidance.

Correction To June 2001 Edition Of The Neutral Corner—*The approved amendment to NASD Rule 10301 that prohibits any terminated, suspended, barred, or otherwise defunct NASD member firm from enforcing predispute arbitration agreements with their customers to arbitrate at the NASD applies to all claims served on or after June 11, 2001—not on or after June 11, 2000.*

What's New On Our Web Site—www.nasdaq.com

NASD Dispute Resolution continues to update its Web Site (www.nasdaq.com). We also have enclosed with this edition the following documents referenced below: *NASD Notice to Members 01-36*, *NASD Notice to Members 01-65*, *'Top Ten' Ways To Be A Better Arbitrator*, *'Top Ten' Standards Of Good Practice At Arbitration Hearings*.

Arbitrator's Reference Guide: *The Arbitrator's Reference Guide*, compiled by NASD Dispute Resolution as a guide for NASD arbitrators, has been updated. To view this document on our Web Site, click on Resources for Neutrals, Education & Guidance, and *Arbitrator's Reference Guide*.

'Top Ten' Ways To Be A Better Arbitrator: *'Top Ten' Ways To Be A Better Arbitrator*, compiled

by NASD Dispute Resolution, is a guide for NASD arbitrators. To view this document online, click on Resources for Neutrals, Education & Guidance, and *'Top Ten' Ways To Be A Better Arbitrator*.

'Top Ten' Standards Of Good Practice At Arbitration Hearings: *'Top Ten' Standards Of Good Practice At Arbitration Hearings*, compiled by NASD Dispute Resolution, is a guide for hearing participants. To view this document online, click on Resources for Parties, Case-Related Guidance, and then *'Top Ten' Standards Of Good Practice*.

NASD Notice to Members 01-36: In this *Notice*, NASD Regulation requested comments from NASD member firms, associated persons, investors, and other interested parties on a

proposal to adopt IM-2110-7. The proposed Interpretative Material provides that it will be inconsistent with just and equitable principles of trade for an NASD member or a person associated with a member to take any action that interferes with a customer's ability to transfer his or her account.

NASD Notice to Members 01-65: In this Notice, NASD Regulation requested comments from NASD member firms, associated persons,

investors, and other interested parties on proposed standards and procedures that it believes should be met and followed before it executes any expungement of customer dispute information from the Central Registration Depository (CRD) system.

To view *Notices to Members* on our Web Site, click on Rules & Procedures, and then *NASD Notices to Members*.

Expungements

This article provides the current practice of NASD Regulation in honoring arbitration awards that direct the expungement of information from the Central Registration Depository (CRD) system. It also discusses arbitrator orders to expunge termination information contained in the Uniform Termination Notice For Securities Industry Registration (Form U-5). Lastly, the article references recent NASD Regulation efforts to develop appropriate steps that should be taken before it executes any directive to expunge *customer dispute information*.

Current Practice

In January 1999, after consultation with the North American Securities Administrators Association (NASAA), NASD Regulation imposed a moratorium on arbitrator-ordered expungements. NASD Regulation announced the moratorium in *NASD Notice to Members 99-09*. Under the moratorium, which is still in effect, NASD Regulation will not expunge information from the CRD system based on a directive contained in *any* arbitration award, unless the award has been confirmed by a court of law.

However, there is one exception to the moratorium. NASD Regulation continues to

expunge information from the CRD system based on expungement directives contained in *intra-industry* awards that involve associated persons and firms, provided the arbitrators awarded such relief based on the defamatory nature of the information ordered expunged. In this regard, *NASD Notice to Members 99-54* advises arbitrators that they "...must clearly state in the 'Award' section of the award that they are ordering the expungement relief based on the defamatory nature of the information in the CRD system." Later, this article refers to the new expungement proposals contained in *NASD Notice to Members 01-65*. When you review this Notice, please be aware that NASD Regulation is not proposing any changes to this limited *intra-industry* exception to the court confirmation requirement.

All three referenced *Notices* are available on the NASD Dispute Resolution Web Site (click on Rules & Procedures, then *NASD Notices to Members*). See the November 1999 edition of *The Neutral Corner (TNC)* for more on the current practice relating to arbitrator-ordered expungements. To view *TNC* issues online, go to the NASD Dispute Resolution Web Site, click on Resources for Neutrals, Education & Guidance, then *The Neutral Corner*.

Reason For Termination

If, after a hearing on the merits involving an *intra-industry* dispute between an NASD member firm and an associated person, arbitrators decide to order CRD to expunge or delete the reason for termination contained in the associated person's Form U-5, CRD will carry out this directive provided the award meets two requirements. First, as mentioned earlier, the award must state that the information is ordered expunged because it is defamatory in nature. In addition, the award must follow Form U-5 by (1) identifying the new reason for termination (*i.e.*, deceased, voluntary, permitted to resign, discharged, or other) and (2) providing an accompanying explanation when Form U-5 requires one. The reasons for termination that require an explanation in Form U-5 are: "permitted to resign," "discharged," or "other." If the reason for termination is "voluntary" or "deceased," no explanation is required. To view Form U-5 online, visit the NASD Regulation Web Site at www.nasdr.com (go to Standard Forms menu item on the top right of the Home Page).

The preceding requirements also apply to such intra-industry expungement directives contained in simplified or paper case awards (awards based exclusively on the filed pleadings and additional documentary submissions) and in stipulated or consent awards.

For example, assume that an associated person was terminated by a member firm and the original reason for termination stated in the Form U-5 was "discharged." Assume also that the original explanation for the discharge stated in the Form U-5 was "kept client money in violation of firm policy." If the arbitrators conclude that the reason for termination and the accompanying explanation are defamatory in nature and should be expunged or deleted, they must state this in the award. In addition, the arbitrators must provide the new reason for termination in the award.

If the arbitrators believe the new reason for termination should be "permitted to resign," they must say so explicitly in the award. They also must provide an explanation for this new reason in the award because Form U-5 requires one for this particular type of termination. Otherwise, CRD is not authorized to carry out the arbitrator order to delete the original reason for termination and the accompanying explanation in Form U-5.

If the arbitrators in the above example believe the new reason for termination should be "voluntary," they must state this in the award. However, in this case, CRD is authorized to carry out the expungement directive without any explanation for this new reason for termination in the award because Form U-5 does not require one for "voluntary" terminations.

Arbitrators who decide to expunge a reason for termination and an accompanying explanation contained in a Form U-5 because they are defamatory should *avoid* the use of award language that directs a respondent member firm or CRD to *amend* such reason or explanation because Form U-5 prohibits such amendments. Instead, arbitrators should use specific award language that: directs CRD to expunge the reason for termination and the explanation because they are defamatory; states a new reason for termination; and provides an explanation for the new termination reason when Form U-5 requires one.

Customer Dispute Information

The most recent NASD discussion of expungements is contained in *NASD Notice to Members 01-65*, a copy of which is enclosed with this edition. The primary focus of the *Notice* is the proposal of appropriate standards and procedures that NASD Regulation believes should be met and followed before it will execute *any judicial or arbitrator-ordered* expungement of *customer dispute information* from the CRD system.

The *Notice* explains that *customer dispute information* includes arbitration claims, customer

complaints, or court filings, as well as arbitration awards or court judgments that may result from allegations that an NASD member firm or its associated persons has engaged in some form of misconduct.

As you review the *Notice*, please be aware that NASD Regulation proposes to continue to require that a court must confirm any arbitration award that orders the expungement of customer dispute information before it executes the expungement directive. Future editions of this newsletter will inform you of important developments on this subject.

Arbitrator Alert

NASD Dispute Resolution arbitrators often ask why they are not asked to serve more frequently. Arbitrators who haven't served in some time often erroneously assume that they have been removed from the roster through some unidentified fault of their own. In most instances, that isn't the case. *If you received this newsletter, you are on our roster of arbitrators eligible for selection to cases.*

In November 1998, NASD Dispute Resolution implemented the Neutral List Selection System (NLSS) for selecting arbitrators on panels. It was a direct result of recommendations of the NASD Arbitration Task Force (Task Force) led by former SEC Chairman David S. Ruder. In its report, the Task Force recommended that the NASD adopt a list selection process that would give the parties the ability to select the arbitrators who would decide their cases.

Under the previous system of selecting arbitrators, the Director of Arbitration appointed the arbitrators without submission of lists to the parties. Using NLSS, arbitrator lists are generated

and qualified and available arbitrators are rotated through the system. Each party receives a list of proposed arbitrators and strikes or ranks the listed arbitrators according to his/her preference. Once the parties have completed numerically ranking the arbitrators provided by NLSS, the NASD Dispute Resolution staff again utilizes NLSS to consolidate and align the parties' preferences. Arbitrators are then appointed according to the consolidated rankings. The ranking process in the list selection method allows the parties to have a substantial role in determining the ultimate composition of the arbitration panel.

In many instances, arbitrators are listed for service more frequently than they realize. However, because parties are free to strike potential arbitrators from the lists, and because cases often settle prior to arbitrator appointment, arbitrators are called to serve less frequently than they are listed.

NASD Dispute Resolution understands the desire of some panelists to serve on a more frequent basis. For this reason, we try to maintain

a roster size that is reflective of the number of cases filed in each hearing location. We do this by routinely examining our panel and case filing

statistics and by evaluating arbitrator performance. Our goal is to provide the best possible panel to the parties using our forum.

NASD Discovery Guide Survey

In June of this year, NASD Dispute Resolution analyzed the results of a survey aimed at measuring the effectiveness of the *NASD Discovery Guide (Guide)*. The purpose of the survey was to assist NASD Dispute Resolution in its ongoing effort to facilitate discovery improvements in the arbitration process. This article highlights the positive conclusions of the *NASD Dispute Resolution Discovery Guide Survey (Survey)*.

The primary goal of the *Guide*, implemented in 1999, is to simplify the exchange of essential documents among parties in *customer* arbitrations without staff or arbitrator intervention. To help accomplish this goal, the *Guide* contains 14 document production lists. Two lists set forth the documents that member firms, persons associated with member firms, and customers should produce in *every* case, unless the arbitrators agree with an objection to their production. The other 12 lists set forth the additional documents that members, associated persons, and customers should produce based upon the *specific claims asserted*, unless the arbitrators uphold an objection to their production.

The *Guide* and NASD Rule 10321 encourage parties to reach agreement on documentary production. The *Guide* is available on the NASD Dispute Resolution Web Site at www.nasdadr.com by clicking on Resources For Neutrals. To view the NASD Code of Arbitration Procedure on our Web Site, click on Rules and Procedures.

The *Survey* resulted in a 53 percent return rate, having been sent to 197 frequent arbitration filers and experienced arbitrators, with a total of 104 responses. Nearly all participants, 96 percent, indicated that they had been actively involved in three or more NASD arbitrations within the last 18 months.

As noted earlier, the representatives and arbitrators who filed responses expressed favorable views of the *Guide*. Some of those views are set forth below.

Since these encouraging results are preliminary in nature, NASD Dispute Resolution will continue to study the usefulness of the *Guide*. To obtain a copy of the *Survey*, visit the NASD Dispute Resolution Web Site at www.nasdadr.com.

- ➔ 84% of the participants indicated that they did *not* want the *Guide* discontinued
- ➔ 54% of the participants indicated that since the *Guide* was implemented, the discovery process has improved
- ➔ 49% of the participants indicated that since the *Guide* was implemented, arbitrators have resolved discovery disputes more quickly
- ➔ 33% of the participants indicated that since the *Guide* was implemented, the number of discovery motions has lessened

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