

# The Neutral Corner

JUNE 2002

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## National Adjudicatory Council Affirms Sanctions

The NASD National Adjudicatory Council (NAC)\* recently upheld sanctions against a member firm for not complying with an arbitrator directive, and stated:

***Reducing the sanctions...would undermine the authority of arbitrators to conduct hearings. We strongly support an arbitrator's authority under Arbitration Rule 10322 to order the production of any document in a party's control, and we disapprove of a party that participates in arbitration but seeks to reserve for itself the option to disobey rulings issued by an arbitrator.***

Two claimants initiated an NASD arbitration against Josephthal & Co. Inc. (Josephthal), an NASD member firm. The arbitrators rendered an award in favor of the claimants and Josephthal paid the award in full.

However, during the course of the evidentiary hearings, the claimants requested that the arbitrators order Josephthal to produce a memorandum that had been prepared by the law firm of Morgan, Lewis & Bockius (Morgan memorandum). Josephthal objected to producing the Morgan memorandum based on attorney-client privilege. The arbitrators issued a letter ruling that required Josephthal to produce the document.

Josephthal then filed a motion asking the arbitrators to reconsider the order to produce. During oral argument before the arbitrators, Josephthal objected to a proposal that the Morgan memorandum be submitted to the arbitration panel for a private or *in camera* inspection. Josephthal asserted that if it submitted the document for arbitrator inspection it might waive any attorney-client privilege as to the document. The arbitrators ordered Josephthal to produce the document for *in camera* review by the panel. Josephthal declined to produce the document as ordered. This refusal prevented the arbitrators from making a ruling on the attorney-client privilege.

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### ***Arbitrator Survey***

We thank the 3,370 neutrals who participated in the *Arbitrator Survey* on the Web-Based Case Administration System that NASD Dispute Resolution plans to implement in 2003. The results of the *Survey* can be seen on page 11 of this publication.

Asked to comment on the *Survey* results, Executive Vice President George Friedman said: "We're delighted with the results. Over a quarter of NASD Dispute Resolution's arbitrators responded to the questionnaire. The results validate our assumption that our arbitrators are willing and able to operate in an online environment, and will use the new Case Management Solutions computer system we will roll out next year."

### ***New Publication Schedule***

Effective immediately, this newsletter will be published every other month. Every other edition of *The Neutral Corner (TNC)* will be Web-based only—meaning there will be no print version. Therefore, the August 2002 edition will be a Web-only edition; the October 2002 edition will be a hard-copy and Web edition; and the December 2002 edition will be a Web-only edition, etc.

To know when a *TNC* edition is posted on our Web Site, we suggest that all of our neutrals complete the Dispute Resolution E-Mail Subscription form by visiting our Web Site Home Page at [www.nasdadr.com](http://www.nasdadr.com) and clicking on E-Mail Subscription.

### ***A New Look for Our Newsletter and NASD***

As you can see, NASD now has a new logo as part of an overall 'rebranding' effort. All of our publications and Web Sites now carry a new 'look and feel' reflecting a unified identity for NASD.

### ***Editor's Note***

*In addition to your comments, feedback, or questions on the material presented in this publication and other arbitration and mediation issues, The Neutral Corner invites readers to submit articles on important issues of law and procedure relating to mediation, arbitration, or other alternative dispute resolution processes. Please send your article to Tom Wynn, Editor, The Neutral Corner, NASD Dispute Resolution, 125 Broad Street, 36th Floor, NY, NY 10004. Call the Editor at (212) 858-4392 for editorial guidelines.*

### ***Arbitration Statistics through the End of May 2002***

#### **Arbitration Filings through May**

2002:	3,122
2001:	2,803
2000:	2,207

#### **Closed Arbitration Cases through May**

2002:	2,484
2001:	2,141
2000:	2,185

### ***National Adjudicatory Council Affirms Sanctions***

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After the award was rendered, the arbitrators referred the Josephthal refusal to produce to NASD Regulation for appropriate action. On April 18, 2001, an NASD Regulation hearing panel (hearing panel) held that Josephthal violated NASD Conduct Rule 2110 because it failed to comply with the NASD arbitration panel order to produce the Morgan memorandum for the panel's *in camera* review. As a result, the hearing panel imposed sanctions against Josephthal in the form of a censure and \$10,000 fine.

Josephthal appealed the decision of the hearing panel, and the NASD Department of Enforcement cross-appealed from the same decision. On May 6, 2002, the NAC affirmed the hearing panel's decision in every respect, adding that it was not necessary to find that Josephthal had acted in bad faith to conclude that it violated NASD Rule 2110. Read this significant NAC decision (Complaint No. CAF000015) on our Web Site at [www.nasdadr.com](http://www.nasdadr.com).

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\* The National Adjudicatory Council (NAC) is an NASD committee that hears appeals and calls for review of disciplinary matters; acts on applications in statutory disqualification and membership proceedings; acts on certain disciplinary settlement proposals; and acts in other proceedings in the NASD Code of Procedure. The NAC also advises NASD staff and the Board on enforcement policy and proposed rules relating to the business and sales practices of NASD members and associated persons.

### **Explaining the Neutral List Selection System**

*This article responds to arbitrator requests to clarify the operation of the Neutral List Selection System (NLSS).*

NASD Dispute Resolution implemented NLSS in November 1998. It was created to allow parties to select arbitrators from lists generated by an automated system.

NLSS generates lists by sorting and searching for arbitrators according to four primary factors: public or non-public classification; geographic hearing location; rotation; and conflict of interest. If a party requests that the lists include arbitrators with specific subject-matter expertise/experience, NLSS adds this factor when it sorts and searches for arbitrators to be placed on the lists.

NLSS also was designed to help ensure that all available arbitrators in each hearing location are provided with an equal chance to appear on the lists sent to the parties. Newly approved arbitrators are moved to the top of the rotation for inclusion on a list. If a new arbitrator appears on a list, but is not appointed to the panel for that case, he/she will move back into the general rotation with all other arbitrators in that hearing location.

Existing differences among arbitrators, such as readily apparent conflicts with the parties, and party requests for specific arbitrator expertise or experience can affect the strict rotation. Although NLSS was designed to present all available

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### *Explaining NLSS*

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arbitrators to the parties on a regular basis, not every arbitrator appears on the same number of lists each year.

When parties receive the NLSS arbitrator lists, they can strike any listed arbitrator and rank those remaining in order of preference. After the lists are returned to the staff, NLSS consolidates the party rankings. Arbitrators are contacted and requested to serve on a matter according to these consolidated party rankings. If a full panel cannot be constituted from the ranked arbitrators, the staff will request that NLSS supply them with additional arbitrators to contact to complete the panel.

Parties may agree that one of the appointed arbitrators will act as the Chairperson of the panel. If the parties do not agree on the Chairperson, the staff will select the highest ranked public arbitrator as the Chairperson.

## Single Arbitrator Pilot Program

On May 15, 2002, NASD Dispute Resolution allowed NASD Rule 10336 to expire by its terms because very few eligible cases participated in the single arbitrator pilot program. The cases that have been filed under this pilot program will be processed to conclusion.

## NASD Arbitrator and Mediator Disclosure Reports

As of May 2002, NASD Arbitrator and Mediator Disclosure Reports will include the city/state/country of the neutral's primary address. This information will be located between the Mediator Name and the Employment/Education Section in the Mediator Disclosure Report and between the Arbitrator Name and the Skills Section in the Arbitrator Disclosure Report.

## Arbitrator Expertise

Recently, NASD Dispute Resolution and the NAMC advisory group improved the arbitrator selection process by making important changes in regard to arbitrator expertise or experience.

In January of this year, this forum sent arbitrators a questionnaire requesting that they select codes that indicate their securities expertise and provide a written explanation for each selection. Arbitrators were provided with sample explanations and asked to base their selections and explanations on their business, securities, or employment experience. Arbitrator records were updated upon receipt of the completed questionnaires. Failure to respond or provide the required basis for the selected expertise resulted in the removal of securities expertise codes from the arbitrator's profile.

To help ensure complete and accurate reporting of arbitrator skills or experience, NASD Dispute Resolution and the NAMC also made changes to the list of securities issues for which arbitrators may claim expertise. The former

securities expertise and product lists were consolidated; some of the issues contained on the lists were deleted; and other issues were added or clarified. These changes were contained in the recent questionnaire.

See the revised expertise lists in the Arbitrator Application on our Web Site at [www.nasdadr.com/recruit.asp](http://www.nasdadr.com/recruit.asp) under How To Become An Arbitrator.

To afford all parties full knowledge of the arbitrator selection process, this forum now requires any party who requests arbitrators with specific expertise to inform all other parties of the request. Since a request of this nature becomes another component of arbitrator selection under NLSS, staff will not enter the request in NLSS, unless all parties are advised of it.

## Replacing Presiding Arbitrators

In March 2002, the Securities and Exchange Commission (SEC) announced its immediate approval of an amendment to NASD Rule 10313. NASD Dispute Resolution implemented the amendment in April 2002.

According to the rule change, when any arbitrator is disqualified, resigns, dies, refuses, or is otherwise unable to continue serving on a three-person panel, NASD will replace him/her immediately; and notify the parties of the vacancy and a new arbitrator. Unless all parties notify NASD of their agreement to proceed with the remaining arbitrators within five business days of the notification of the vacancy and replacement, the case proceeds with the three arbitrators.

Under the former rule, when a vacancy occurred on a panel, the arbitration continued with the remaining arbitrators. If any party objected to continuing the case with the remaining arbitrators within five days of notice of the panel vacancy, then a replacement arbitrator was appointed to the panel.

The amendment improves the procedure for replacing arbitrators on a three-person panel after the first hearing begins, but before the arbitrators render an award, by conforming the rule to what is most often the parties' preference. In this regard NASD staff indicated that, in almost all cases, parties object to continuing the arbitration with the remaining arbitrators. Consequently, the new procedure saves the parties time and lessens the administrative burden by providing a replacement arbitrator as soon as there is a vacancy on a three-person panel.

To view the SEC approval order (File No. SR-NASD-2002-38), visit our Web Site's Rule Approvals Web Page at [www.nasdaq.com/app\\_orders\\_index.asp](http://www.nasdaq.com/app_orders_index.asp).

## A Note on the Expertise Verification Project from the Director of Neutral Management

As the Director of Neutral Management, I gladly take this opportunity to thank our respected roster of neutrals, the majority of whom so cooperatively responded to our mass mailing regarding arbitrator experience/expertise.

As you will recall, we contacted each arbitrator earlier this year requesting that they clarify—in writing—their reasons for listing specific areas of experience/expertise on their individual arbitrator disclosure reports. This project was initiated on the recommendation of various constituent groups, and was undertaken after more than a year of discussion and review with the National Arbitration and Mediation Committee (NAMC). This group, composed of practitioners, industry members, and neutrals, is the primary sounding board for NASD Dispute Resolution policy and rule change initiatives.

The quality of the arbitration process rests ultimately on the quality of the arbitrators serving in the forum. In keeping with this concept, the Committee's goal was to ensure that arbitrators selected by parties based on their area of experience/expertise do, in fact, possess the special qualifications indicated on their disclosure reports.

The response to our mailing was tremendous, with nearly 5,000 updates received through the end of May. The Department of Neutral Management is working hard to update the data by June 30, 2002. Arbitrators who did not reply to our mailing remain on our roster, but we have removed from their disclosure reports any specific area of experience/expertise.

Once again, thank you for your cooperation and for your continued support of our process.

**Barbara L. Brady**

*Director, Neutral Management*

## Claim Eligibility

Three years ago, NASD requested that the SEC simultaneously approve the eligibility, punitive damages, and predispute arbitration agreement rule proposals (File Nos. SR-NASD 97-44, SR-NASD 97-47, and SR-NASD 98-74, respectively). However, in March 2002, this forum requested that the SEC separately approve the rule filing governing the eligibility of claims (Amendment No. 7 to the proposed eligibility rule change). As a result of this most recent request, in April 2002, the SEC published for public comment the proposal to amend the claim eligibility provisions of NASD Rule 10304.

Although the proposal retains the existing six-year eligibility rule, it contains significant changes. For example, it considers all filed claims eligible unless their eligibility is challenged. It also includes specific procedures for challenging claim eligibility; and authorizes the Arbitration Director to make final eligibility decisions based upon transaction and non-transaction dates. Finally, the proposal includes conforming amendments to NASD Rules 10324 and 10307.

To view Amendment No. 7 requesting separate SEC approval of the proposed eligibility rule changes and the April 2002 SEC *Federal Register* Notice, visit the NASD Dispute Resolution Rule Filings Web Page at [www.nasdadr.com](http://www.nasdadr.com) by clicking on Rules & Procedures, then Rule Filings and Guidance.

## Default Procedures

In May 2002, the SEC published for public comment the proposal to amend NASD Rule 10314 to provide expedited default procedures.

The default procedures may be elected by all claimants against a suspended or terminated NASD member firm or an associated person that does not answer or participate in a proceeding. If all claimants elect to use the default procedures, the arbitration will proceed with a single arbitrator who will decide the matter based on the filed claim and any additional documentary material (File No. SR-NASD 2002-15).

To view the May SEC *Federal Register* Notice, visit the NASD Dispute Resolution Rule Filings Web Page at [www.nasdadr.com](http://www.nasdadr.com) by clicking on Rules & Procedures, then Rule Filings and Guidance.



## Question & Answer

### On Arbitrator Removal from the NASD Roster

#### QUESTION:

*I've just learned that a former colleague on an arbitration panel was removed from your roster. I didn't want to pry into his situation, but it made me wonder under what circumstances would an arbitrator be removed from the roster?*

#### ANSWER:

Arbitrators may be removed from the NASD roster of arbitrators for a variety of reasons. An arbitrator may be temporarily or permanently removed for any of the reasons articulated in the *Criteria for Temporary and Permanent Removal*, ([http://www.nasdr.com/arb\\_ref\\_guide.asp](http://www.nasdr.com/arb_ref_guide.asp)) a copy of which is sent to every arbitrator upon appointment to a case. For example, given the criteria, an arbitrator may be temporarily removed for being "the subject of, or a party to, a pending investment civil action or arbitration claim initiated by a customer." One of the several reasons for permanent removal under the criteria includes "misstatement or failure to disclose material information in the arbitrator profile."

In addition to removal pursuant to the *Criteria for Temporary and Permanent Removal*, arbitrators also may be removed for displaying a demeanor or temperament unsuitable for members of our roster. Since arbitrators are evaluated by their peers, the parties, and the staff, reports of inappropriate behavior are provided in a variety of ways.

Examples of inappropriate behavior that might result in an arbitrator's removal from the roster include:

- ★ Failing to be impartial, both in appearance and in fact
- ★ Being rude to parties, counsel, and/or staff
- ★ Being inflexible, especially with regard to mutual requests from parties
- ★ Causing repeated and routine scheduling problems
- ★ Not being prepared for conferences and hearings
- ★ An unwillingness to abide by the Code of Arbitration Procedure
- ★ Infraction of the Code of Ethics for Arbitrators in Commercial Disputes

In recent months, NASD also has removed inactive arbitrators from its roster for failing to attend its mandatory basic training program within a "reasonable" period of time. "Reasonable" is currently defined as within five years from the date the arbitrator was accepted to the roster.

No one has the "right" to be an arbitrator and NASD strives to maintain a roster of arbitrators of the highest quality and integrity. Accordingly, reports citing any one of the above examples may result in our summarily — and confidentially — dismissing an arbitrator from our roster without notice or appeal. In doing so, we preserve the integrity of our entire roster, which benefits the parties and the many other outstanding arbitrators who remain.

## Pleading Standards

In May 2002, NASD Dispute Resolution filed with the SEC a proposal to conform the specificity of answer requirements to the minimum claim requirements of NASD Rule 10314. This will permit the filing of answers that specify relevant facts and available defenses according to the submitted claims (File No. SR-NASD-2002-62).

To view this rule proposal, visit the NASD Dispute Resolution Rule Filings Web Page at [www.nasdradr.com](http://www.nasdradr.com) by clicking on Rules & Procedures, then Rule Filings and Guidance.

## NASD Institute for Professional Development

The NASD Institute for Professional Development was created to provide quality educational programs for financial services industry professionals and regulators and to enhance understanding between the industry and its regulators. Dispute Resolution neutrals may find the subject matter to be helpful.

The 120-hour Certificate Program is designed to distinguish and prepare participants as leaders in the financial services industry. It provides an academic environment for the discussion, understanding, and possible resolution of problems faced by regulators and industry professionals.

The Certificate Program can be completed over a three-year period and has three required components: Phase I and Phase III (which are week-long sessions), and an Ethics program. Phase II can be completed through a combination of the following: NASD Institute Two-Day Symposia, Phase II Week-Long Program, or NASD Institute-approved courses provided by other third parties. You are not required to be a certificate candidate to take any NASD Institute courses.

If you would like to learn more about the NASD Institute for Professional Development, visit [www.nasd-institute.com](http://www.nasd-institute.com).

## Arbitrator Survey Results

Following are the results of a recent survey conducted by NASD Dispute Resolution regarding Web-based case administration and e-mail readiness. This survey is for information gathering only and does not infer a specific decision.

### 1. Do you have an e-mail address?

Yes	3136	(93%)
No	234	(7%)

### 2. Would you be willing to use e-mail and other electronic communication (e.g., the Internet) for routine case communication with NASD?

Yes	2832	(84%)
No	190	(6%)
Not Sure	348	(10%)

### 3. How often do you use the Web?

Every day	2165	(64%)
Several times a week	729	(22%)
Once a week	179	(5%)
Monthly	102	(3%)
Never	195	(6%)

### 4. Would you be willing to use a Web-based system to track the status (i.e., view pleadings, obtain hearing schedules, etc.) of cases to which you are assigned?

Yes	2647	(79%)
No	219	(6%)
Not Sure	504	(15%)

### 5. Project ahead to three years from now (i.e., 2005). If NASD Dispute Resolution required NASD arbitrators to communicate with us by e-mail, or through another electronic format, would you be willing to remain on the roster? (Your answer here is not binding.)

Yes	3075	(91%)
No	46	(1%)
Not Sure	249	(8%)

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## Directory

**Linda D. Fienberg**  
President, NASD Dispute Resolution

**George H. Friedman**  
Executive Vice President  
NASD Dispute Resolution

**Jean Feeney**  
Associate Vice President & Chief Counsel

**Dorothy Popp**  
Associate Vice President, Operations

**Kenneth L. Andrichik**  
Vice President, Mediation and  
Business Strategies

**Barbara L. Brady**  
Director, Neutral Management

**Richard Berry**  
Director, Case Administration

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**Elizabeth R. Clancy**  
Associate Vice President, Northeast  
Region

**Judith Hale Norris**  
Associate Vice President, Western Region

**Rose Schindler**  
Regional Director, Southeast Region

## NASD Dispute Resolution Offices

**Northeast Region**  
125 Broad Street, 36th Floor  
New York, NY 10004-2193  
(212) 858-4400  
Fax: (212) 509-9041

1735 K Street, NW  
Washington, DC 20006  
(202) 728-8958  
Fax: (202) 728-6952

**Western Region**  
300 S. Grand Avenue, Suite 900  
Los Angeles, CA 90071  
(213) 613-2680  
Fax: (213) 613-2677

**Southeast Region**  
Boca Center Tower 1  
5200 Town Center Circle, Suite 400  
Boca Raton, FL 33486  
(561) 416-0277  
Fax: (561) 416-2267

**Midwest Region**  
10 S. LaSalle Street, Suite 1110  
Chicago, IL 60603-1002  
(312) 899-4440  
Fax: (312) 236-9239