

**Phlx Memo No. 555-08**

**RC No: NASD- 2007-21**

**MEMORANDUM**

To: Members and Member Organizations

From: Legal Department

Date: March 18, 2008

Re: NASD Code of Arbitration  
SR-NASD-2007-21 Order Approving a Proposed Rule Change To Amend  
the Definition of Public Arbitrator

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Pursuant to Phlx Rule 950, Section 44, the Exchange has outsourced its arbitration and mediation program to NASD Dispute Resolution. The purpose of this memo is to update you as to proposed amendments to the NASD Code of Arbitration Procedure.

On March 12, 2007, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. (n/k/a FINRA Dispute Resolution, Inc.) filed with the Securities and Exchange Commission ("Commission") a proposed rule change to amend the definition of "public arbitrator" in the NASD's Code of Arbitration Procedure for Customer Disputes ("Customer Code") and Code of Arbitration Procedure for Industry Disputes ("Industry Code"). The proposed rule change was published for comment in the Federal Register on July 17, 2007. On March 13, 2008 the Commission approved the proposed rule change. The Commission believes that the proposed rule change meets this standard by removing from the pool of public arbitrators those individuals whose firms receive a significant amount of compensation for service on matters closely related to those that arbitrators consider during arbitration proceedings.

NASD Dispute Resolution proposes to amend the Code of Arbitration Procedure for Customer Disputes ("Customer Code"), and the Code of Arbitration Procedure for Industry Disputes ("Industry Code") to amend the definition of public arbitrator to add an annual revenue limitation.

NASD has taken numerous steps in recent years to ensure the integrity and neutrality of its arbitrator roster by addressing classification of arbitrators. For example, in August 2003, NASD proposed changes to Rules 10308 and 10312 of the Code of Arbitration Procedure ("Code") to modify the definitions of public and non-public

arbitrators to further prevent individuals with significant ties to the securities industry from serving as public arbitrators.

NASD also had pending at the Commission a 2003 proposal to amend the Code to reorganize the rules into the Customer Code, the Industry Code, and a separate code for mediation. The final provisions of this proposal were approved by the Commission on January 24, 2007, and became effective on April 16, 2007. Several of the substantive changes to the Customer and Industry Codes will affect the classification of arbitrators and how they are selected for panels.

Despite these many initiatives amending the arbitrator classification rules, some users of the forum continue to voice concerns about individuals serving as public arbitrators when they have business relationships with entities that derive income from broker-dealers. The concern is that, for example, an arbitrator classified as public might work for a very large law firm that derived less than 10% of its annual revenue from broker-dealer clients, but still receives a large dollar amount of such revenue. The concern focused primarily on the law firm's defense of action (in arbitration or litigation) by customers of broker-dealers, and not on representing broker-dealers in underwriting or other activities. Therefore, those concerned with the amount of annual revenue recommended that there be an annual dollar limitation of \$ 50,000 on revenue from broker-dealers relating to customer disputes with a brokerage firm or associated person concerning an investment account.

NASD supports these recommendations and is, therefore, proposing to amend the definition of public arbitrator in Rule 12100(u) of the Customer Code and Rule 13100(u) of the Industry Code to add a provision that would prevent an attorney, accountant, or other professional from being classified as a public arbitrator, if the person's firm derived \$ 50,000 or more in annual revenue in the past two years from professional services rendered to any persons or entities listed in Rule 12100(p)(1) of the Customer Code or Rule 13100(p)(1) of the Industry Code relating to any customer disputes concerning an investment account or transaction, including but not limited to, law firm fees, accounting firm fees, and consulting fees.

NASD believes the proposed amendment, in conjunction with the existing 10 percent revenue limitation, will further improve NASD's public arbitrator roster by ensuring that arbitrators whose firms receive a significant amount of compensation from any persons or entities associated with or engaged in the securities, commodities, or futures business are removed from the public roster.

The text of the proposed rule change is available on NASD's Web site (<http://www.nasd.com>), at NASD's principal office, and at the Commission's Public Reference Room.

If you have any questions regarding this proposed rule change, or would like a complete copy of this proposed filing, or further questions regarding the NASD Dispute Resolution Process, please click on the NASD Dispute Resolution website at

[www.nasdadr.com](http://www.nasdadr.com). If you need additional help, please contact Scott Donnini at (215) 496-5358.