

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52009; File No. SR-NASD-2005-032]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto, to Provide Written Explanations in Arbitration Awards Upon the Request of Customers, or of Associated Persons in Industry Controversies

July 11, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 15, 2005, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. On April 14, 2005, and July 7, 2005, NASD filed Amendment Nos. 1 and 2, respectively, to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

NASD is proposing to amend the NASD Code of Arbitration Procedure ("Code") to provide written explanations in arbitration awards upon the request of customers, or of associated persons in industry controversies. The proposed rule change consists of amendments to NASD IM-10104 and NASD Rules 10214, 10321, 10330, and 10332. 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.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed

rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The purpose of the proposed rule change is to amend the Code of Arbitration Procedure (Code) to provide written explanations in arbitration awards upon the request of customers, or of associated persons in industry controversies.

Currently, Rule 10330(e) of the Code requires only that arbitration awards contain the names of the parties and counsel; a summary of the issues; the damages and other relief requested and awarded; a statement of any other issues resolved; the names of the arbitrators; the dates the claim was filed and the award rendered; the location, number, and dates of hearing sessions; and the signatures of the arbitrators concurring in the award.<sup>4</sup> Arbitrators may also include the rationale underlying their decision in the award, but they currently are not required to do so<sup>5</sup> and, therefore, usually do not provide one.<sup>6</sup>

Arbitration parties occasionally raise the issue of the lack of written explanations or opinions in arbitration awards. Specifically, customers and associated persons who lose in arbitration (or consider their recovery insufficient) often request written explanations or opinions from the arbitrators. Since these requests are usually made after the awards are issued, arbitrators are unlikely to provide them because they were not advised in advance that they would be writing an explained award and do not want to undermine their award. The lack of reasoning or explanations in awards is one of the most common complaints of non-prevailing participants in NASD's arbitration forum.

In order to increase investor confidence in the fairness of the NASD arbitration process, NASD is proposing

<sup>4</sup> Pursuant to Rule 10214, awards in intra-industry cases involving employment discrimination claims also shall include "a statement regarding the disposition of any statutory claim(s)."

<sup>5</sup> NASD is proposing to codify this policy in Rule 10330(i).

<sup>6</sup> The United States Supreme Court has found that there is no general requirement for an arbitrator to explain the reasons for an award. *Wilko v. Swan*, 346 U.S. 427 (1953).

to amend the Code to allow customers or associated persons in industry controversies to require an explained decision.<sup>7</sup> An explained decision will constitute a fact-based award that states the reason(s) each alleged cause of action was granted or denied and will address all claims involved in the case, whether brought by the party requesting the explained decision or another party.<sup>8</sup> The inclusion of legal authorities or damage calculations, however, will not be required in an explained decision in order to limit the additional costs and processing time associated with explained decisions. Specifically, requiring the inclusion of legal authorities and damage calculations would significantly increase the processing time of awards because it would result in the drafting of complex and lengthy judicial-type decisions. This, in turn, would require the payment of considerably more honoraria to arbitrators. NASD believes that requiring only the fact-based reasons underlying an award in explained decisions will provide customers and associated persons with the information that they desire while at the same time maintaining the speed and efficiency of arbitration.<sup>9</sup>

Although customers, and associated persons in industry controversies, will be able to require the issuance of explained decisions, NASD members will not have the ability to do so. Limiting the parties that can require an explained decision in this manner will protect customers and associated persons, because they alone will determine whether to request an explained decision while bearing in mind the potential costs and the prospect that a reviewing court might find grounds in the explanation to vacate the award.<sup>10</sup> Furthermore,

<sup>7</sup> A customer or associated person may require an explained decision regardless of whether he or she is the claimant or respondent in the arbitration.

<sup>8</sup> While Rule 10323 provides that arbitrators shall determine the materiality and relevance of any evidence proffered, NASD intends that, as with current arbitration awards, explained decisions will have no precedential value in other cases. Thus, arbitrators will not be required to follow any findings or determinations that are set forth in prior explained decisions. In order to ensure that users of the forum are aware of the non-precedential nature of explained awards, NASD plans to revise the template for all awards to include the following sentence: "If the arbitrators have provided an explanation of their decision in this award, the explanation is for the information of the parties only and is not precedential in nature."

<sup>9</sup> NASD estimates that arbitrators will be able to render explained decisions within the 30 business day timeframe currently set forth in Rule 10330(d).

<sup>10</sup> See, e.g., *Dawahare v. Spencer*, 210 F.3d 666, 669 (6th Cir. 2000) ("Arbitrators are not required to explain their decisions. If they choose not to do so,

Continued

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 replaced the original rule filing in its entirety. Amendment No. 2 represented a partial amendment, and its changes have been incorporated into this Notice.

providing member firms with the ability to request explained decisions could result in conflicts between co-respondents who may disagree on whether to request a decision. NASD members will be able to request that a panel issue an explained decision but, unlike those situations involving customers and associated persons, the arbitrator(s) will not be required to comply with the request.

However, no parties will be able to require explained decisions in two types of arbitration proceedings. The first is simplified arbitrations that are decided solely upon the pleadings and evidence filed by the parties, as described in Rules 10203 and 10302.<sup>11</sup> The second is arbitrations that are conducted under the default procedures provided for in Rule 10314(e). Explained decisions would not be appropriate in either of these situations due to the abbreviated nature of these arbitration proceedings.

Under the proposed rule, an eligible party that wishes to require an explained decision must make his or her request at least 20 calendar days prior to the first scheduled hearing date. This is the same time frame for the parties to exchange documents and lists of the witnesses that they intend to present at the hearing, which is set forth in Rule 10321(c). NASD believes that this time frame provides eligible parties with a sufficient opportunity to determine whether they would like to request an explained decision and also allows arbitrators adequate notice that a case will require an explained decision. Any requests for an explained decision that are made after the deadline, including any post-award requests, would be granted only where the arbitrators agree to provide them after reviewing all the parties' arguments on the issue.

Since cases involving an explained decision will require additional time and effort on the part of arbitrators, the proposed rule provides each arbitrator with an additional \$200 honorarium for cases in which an explained decision is required under Rule 10330(j). The panel will allocate \$100 of each arbitrator's honorarium to the parties as part of the final award, along with the other allocable fees. NASD will pay the other \$100 of each arbitrator's honorarium in order to help defray the costs associated with explained decisions. In order to avoid any potential conflict of interest, the arbitrator(s) will not receive the additional \$200 honorarium if the panel

issues an explained decision that is not required by Rule 10330(j).<sup>12</sup> Specifically, NASD does not want to provide a financial incentive for arbitrators to write an explained decision when they are not required to do so.

## 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that allowing customers and associated persons in industry disputes to request explained decisions will enhance investor confidence in the fairness of NASD's arbitration forum.

### (B) Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

### (C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments were neither solicited nor received.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing,

including whether the proposed rule change, as amended, is consistent with the Act. In particular, the Commission solicits comment on the deadline for requesting explained decisions under the proposed rule change. Should customers and associated persons be permitted to require an explained decision if the request is made after the time for the pre-hearing exchange of documents and witness lists under NASD Rule 10321(c)?

In addition, the Commission solicits comment on explained decisions in simplified cases decided without a hearing. Should customers and associated persons in those arbitrations also have the ability to require arbitrators to provide explained decisions?

Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2005-032 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-9303.

All submissions should refer to File Number SR-NASD-2005-032. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, Station Place, 100 F Street, NE., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from

it is all but impossible to determine whether they acted with manifest disregard of the law.") (citation omitted).

<sup>11</sup> An eligible party may require an explained decision if there is a hearing in a simplified arbitration proceeding.

<sup>12</sup> For example, the arbitrator(s) will not receive the additional \$200 honorarium for writing an explained decision in response to an NASD member's request or a request made by a customer or associated person after the deadline set forth in Rule 10321(c)(2).

submissions. You should submit only information that you wish to make available publicly. All submissions should refer to the File Number SR-NASD-2005-032 and should be submitted on or before August 5, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

Jill M. Peterson,

Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51999; File No. SR-NYSE-2004-69]

### Self-Regulatory Organizations; New York Stock Exchange, Inc.; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto To Establish Rules for the Trading of Unlisted Debt Securities on the Exchange's Automated Bond System

July 8, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 3, 2004, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NYSE. On March 15, 2005, the NYSE filed Amendment No.1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The NYSE proposes Exchange Rules 1400 and 1401 relating to the trading of unlisted debt securities on its

Automated Bond System® ("ABS"). The text of the proposed rule change, as amended, is available on NYSE's Web site (<http://www.nyse.com>), at the NYSE's principal office, and at the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the NYSE included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it had received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

On May 26, 2005, separately from this rule proposal, the Exchange submitted a letter (the "2005 Exemptive Request Letter") to the Commission requesting that the Commission, pursuant to Section 36 of the Act,<sup>4</sup> issue an exemption from Section 12(a) of the Act<sup>5</sup> that would permit NYSE members and member organizations to trade certain debt securities on ABS that are not registered under Section 12(b) of the Act.<sup>6</sup> Section 12(a) provides in relevant part that it shall be unlawful for any "member, broker, or dealer to effect any transaction in any security (other than an exempted security) on a national securities exchange unless a registration is effective as to such security for such exchange." The Exchange requested that this exemption be granted in connection with debt securities that satisfy the following conditions:

(a) The issuer of the debt securities registered the offer and sale of that class of debt securities under the Securities Act of 1933 ("1933 Act");<sup>7</sup>

(b) The issuer of the debt securities or the issuer's parent, if the issuer is a wholly owned subsidiary, has at least one class of common or preferred equity securities registered under Section 12(b) of the Act and listed on the NYSE; and

(c) The transfer agent for the debt securities is registered under Section 17A of the Act.<sup>8</sup>

In the 2005 Exemptive Request Letter, the NYSE stated that it would take or has taken the following steps in connection with the exemptive request:

(a) The NYSE would provide definitions of "listed" debt securities and "traded" debt securities on the ABS log-on screen and on the NYSE's Web site;

(b) The NYSE would distinguish between "listed" debt securities and "traded" debt securities on ABS and on the NYSE Web site's bond issue directory;<sup>9</sup>

(c) The NYSE would directly provide each member organization and each listed company notification via letter and/or e-mail prior to the date that trading of the debt securities commences on ABS to clarify the distinction between "listed" debt securities and "traded" debt securities and to provide notification that eligible listed debt securities would be delisted and, instead, traded on ABS;

(d) The NYSE would issue a press release upon launch of this initiative stating that "listed" debt securities trade along side "traded" debt securities on ABS; and

(e) The NYSE has contracted with Xcitek, LLC ("Xcitek"), a third-party bond issue tracking service, for the provision of information prior to the date that action on the NYSE's exemption request is taken by the Commission.

Xcitek's tracking service provides the NYSE a customized on-line reference for corporate actions relevant to bonds, including:

- Notification of calls (redemptions) of traded bonds;
- Notification of tender offers for traded bonds;
- Notice of defaults in payment of interest on traded bonds;
- Notice of consent solicitations for traded bonds; and
- Notice of corporate actions for traded bonds (includes tender offers,

<sup>8</sup> 15 U.S.C. 78q-1.

<sup>9</sup> The NYSE would distinguish debt securities "listed" on ABS from those "traded" on ABS on the three different screens used to view the market and through which orders may be entered: (1) the book showing all the orders in a particular security; (2) the summary book showing aggregate interest at each price in a particular security; and (3) the display of the best bid/offer, price range, and calculated accrued interest in a particular security. As would be clearly noted on the ABS log-on screen, "listed" debt securities would be identified by a letter or symbol, and "traded" debt securities would be identifiable due to the absence of such letter or symbol. The location of the indicator would be the same on all three screens.

<sup>13</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1, which replaced and superseded the original filing in its entirety, restated the scope of the NYSE's requested exemption, described in Section II(A)(1), below; provided the name of the tracking service, Xcitek, that would provide the NYSE a customized on-line reference for corporate actions relevant to bonds; provided additional discussion of the definition of "Debt Securities" under proposed NYSE Rule 1400; described additional scenarios in proposed NYSE Rule 1401 under which the Exchange would suspend trading on ABS of unlisted Debt Securities; and discussed the effect that the proposed rule change would have on existing NYSE Rule 396.

<sup>4</sup> 15 U.S.C. 78mm.

<sup>5</sup> 15 U.S.C. 78l(a).

<sup>6</sup> 15 U.S.C. 78l(b).

<sup>7</sup> 15 U.S.C. 77a et seq.