

**Securities Industry Association**

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October 3, 1996

Linda D. Fienberg
Executive Vice President
NASD Regulation, Inc.
1735 K Street, N.W., 4th Fl.
Washington, D.C. 20006-1500

Re: Eligibility Rule

Dear Linda:

This is a comment on your memo to the Members of the Securities Industry Conference on Arbitration dated August 28, 1996. On behalf of the SIA Arbitration Subcommittee of the Litigation Committee I wish to ask you to reconsider the position taken in that memorandum. I ask this because of the following reasons:

- The interpretation is contrary to the agreement between the parties to the arbitration.
- The interpretation is contrary to the intention of the rule and its uniform interpretation since its adoption.
- Since this constitutes a new interpretation of an existing rule, before it can become effective it must be submitted to the SEC for approval.
- This interpretation will increase the necessity to petition courts to resolve the question of arbitrability.
- This interpretation is contrary to the law as interpreted by five U.S. Circuit Courts.

Each of the above will be explained more fully below. I request that this interpretation be withdrawn and that the NASDR move forward quickly to adopt the recent SICA amendment which will resolve all of the ambiguities in the current rule.

1. The interpretation is contrary to the agreement between the parties to the arbitration --
In instances where there is an arbitration agreement between the parties, they have agreed to arbitrate all disputes in accordance with the rules of the NASD. Rule 15 of the NASD states that controversies which are older than six years are not eligible for arbitration, therefore, parties have not agreed to arbitrate matters which are older than six years. The current interpretation of this rule ignores the agreement between the parties and submits ineligible matters to arbitrators for decisions. It is basic arbitration law that arbitrators derive their authority solely from the underlying agreement to arbitrate. Therefore, under the typical brokerage arbitration agreement, arbitrators do not have the authority to decide the question of the arbitrability of matters which are older than six years.

To put it another way, the parties have not agreed to submit questions of arbitrability based on the eligibility rule to the arbitrators. I call your attention to the case of **Kaplan et al. v. First Options of Chicago, Inc.**² This case stands for the proposition that if parties did not agree to submit a question of arbitrability to the arbitrators, then it is the courts which must decide this question. Justice Breyer in the **Kaplan** opinion, relying on **AT&T Technologies v. Communication Workers**² and other Supreme Court opinions, concludes "-- arbitration is simply a matter of contract between the parties; it is a way to resolve those disputes -- but only those disputes -- that the parties have agreed to submit to arbitration." In arbitrations based on agreements to arbitrate under NASD rules the parties have agreed not to submit disputes older than six years to arbitration.

The same logic applies when there is no agreement between the parties and the authority of the arbitrators is based on the by-laws and rules of the NASD. A member of the NASD agrees to abide by its rules. The arbitration rules require the member to arbitrate in accordance with the Code which says matters over six years are ineligible for arbitration; therefore, the member in joining the NASD has only agreed to arbitrate matters which are under six years old.

2. The interpretation is contrary to the intention of the rule and its uniform interpretation since its adoption -- The eligibility rule was part of the original NASD Arbitration Code adopted in 1968. Its purpose is to keep out of arbitration old, stale disputes. It was understood by the staff and by participants that the staff made the determination under the rule and there was no intention to block a party from pursuing ineligible matters in court. It was universally understood that there was no equitable tolling of this eligibility requirement; the only tolling of the eligibility requirement in Section 15 appears in Section 18 of the NASD Code whereby the six year time limitation does not run for the period of time during which a court of competent jurisdiction retains jurisdiction over the subject matter.

In 1980 when SICA promulgated its Uniform Code it adopted the NASD eligibility rule. All SROs uniformly interpreted the Section much as stated above. In the beginning there was little ambiguity since most disputes related to specific trades and administration of the rule was reasonably simple. As time went on, however, complexities and ambiguities arose. Courts interpreted the arbitration agreement coupled with the eligibility rule as an election of remedies and forbade complainants from going to court if a matter had been declared ineligible for arbitration. Next came claims of fraudulent concealment coupled with claims of fraud or suitability at the time a security had been purchased. This made for a more complex decision on the part of the arbitration staffs and pointed out the need to clarify the ambiguities which were now apparent in the original rule. SICA adopted an amended version in the early 90s. However, during the 19(b) process with the SEC, the simple straightforward approach of SICA was changed with the final product being too complex and far more ambiguous than the original rule. This version was withdrawn. SICA recently adopted a new version of the eligibility rule which again is straightforward and easy to administer. I urge the NASDR to adopt this new amended version in order to remove all of the ambiguities and complications which have arisen through the years.

The current interpretation defeats the whole purpose of the eligibility rule. It is also contrary to the consistent interpretation of the eligibility rule since its inception in 1968. The whole purpose of the rule is to keep stale matters away from the arbitrators and out of arbitration. The current

interpretation does just the opposite.

3. Since this constitutes a new interpretation of an existing rule, before it can become effective it must be submitted to the SEC for approval -- The current interpretation changes the historic way in which the eligibility rule has been enforced by both the NASD and other SROs. New interpretations of rules which materially alter the manner in which SROs administer a rule require SEC approval before they can become effective. Rule 19b-4 states that with a few stated exceptions, none of which apply to the current situation, interpretations of SRO rules are considered rule changes for purposes of 19b filings. Until and unless the new interpretation is approved by the SEC, it is requested the NASD continue to administer Rule 15 as it always has.

4. This interpretation will increase the necessity to petition courts to resolve the question of arbitrability -- Referring ineligible matters to arbitrators does not confer on the arbitrators the authority needed for them to function legally. Any action they may take is voidable. To avoid the cost and necessity of preparing for and actually attending an arbitration whose decisions will eventually be vacated, parties will resort to the courts at the beginning of the arbitration. Out of necessity, to avoid arbitrating a matter which never was eligible for arbitration and cannot be made so, parties will use the most efficient and cost effective methods. Petitioning the courts is the obvious choice and this would conflict with the NASD's stated purpose to avoid ancillary litigation. This would be a great hardship on all parties to arbitrations since most recently the use of courts to avoid the necessity to arbitrate ineligible claims has been decreasing. Quite obviously, if the SICA recent amendment to the eligibility rule is adopted access to the court for this purpose will disappear entirely.

5. This interpretation is contrary to the law as interpreted by five U.S. Circuit Courts -- In five U. S. Circuit Courts of Appeal, there are decisions which state that the question of eligibility under Section 15 of the NASD Arbitration Code is a questions for the courts and not for arbitrators.³ In five other circuits, courts have permitted the arbitrators to decide this issue on usually two theories -- (1) that Section 15 is a procedural rule or (2) Section 35 of the NASD Code which grants to the arbitrators the ability to interpret the arbitration rules permits arbitrators to interpret the eligibility rule. I think it can be shown by a reading of the Supreme Court decisions that these two theories are clearly erroneous. Section 15 poses the questions of arbitrability. The question that courts must decide is the same one in the **Kaplan** case which is "Is there an agreement to arbitrate?" The Supreme Court has consistently held that all questions of arbitrability should be decided by the courts and not by the arbitrators. It would seem apparent that if this conflict between the Circuits were to be presented to the Supreme Court, it would rule precisely as it did in the **Kaplan** and **AT&T** cases which is contrary to the current interpretation of the NASDR.

Conclusion

It is respectfully requested that the interpretation given in the memorandum dated August 28, 1996 be withdrawn so that parties are not thrust into a situation of resolving this issue through petitions in the court. The best solution to the current ambiguity concerning Section 15 is to adopt the SICA amendment so that the ambiguities are removed and parties can proceed with certainty and efficiency.

Very truly yours,

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CC:

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Members, NASDR Arbitration Comm.

Members, SICA

Footnotes:

¹ 115 S.Ct. 1920 (1995).

² 475 U.S. 643, 649 (1986).

³ Edward D. Jones & Co. v. Sorrells 957 F.2d 509 (7th Cir. 1992).PaineWebber Inc. v. Hartmann 921 F.2d 507 (3rd Cir. 1990).Roney & Co. v. Kassab 981 F.2d 894 (6th Cir. 1990).Cogswell v. Merrill Lynch 78 F.3d 474 (10th Cir. 1996).Merrill Lynch v. Cohen 62 F.3d 381 (11th Cir. 1995).