

Applicability of Disclosure Requirements to New and Existing Account Agreements

Members would be required to add the new disclosure requirements to all new customer account agreements containing predispute arbitration agreements as of the effective date of the rule. The proposed rule does not require members to replace existing agreements with current customers.

Incorporation of Arbitration Forum Rules

Paragraph (f)(1)(G) would provide that the rules of the arbitration forum in which a claim is brought, and any amendments thereto, shall be incorporated into the agreement. The purpose of this provision is to ensure that the rules of a forum apply to cases brought in that forum, and to avoid having to execute new agreements each time a forum changes its rules. For example, if a customer filed a complaint in an NASD arbitration forum, NASD's arbitration rules would apply in all respects to the agreement.

Requirement That Members Provide Copies of Customer Agreements and Information Regarding Arbitration Forums to Customers Upon Request

In some cases, customers have complained that they have not been able to obtain copies of the predispute arbitration agreements they have signed from members in a timely manner, and that they had unequal access to information about the respective rules of the arbitration forums in which claims may be filed under a given agreement. Under the proposed amendments, paragraph (f)(3)(A) would require that, within ten days of receiving a request, members must provide a customer with a copy of any predispute arbitration agreement clause or agreement that the customer had signed, or inform the customer that the member does not have a copy of the agreement. In addition, paragraph (f)(3)(B) would require that, upon request of a customer, a member must provide the customer with the names of, and information on how to contact or obtain the rules of, all arbitration forums in which a claim may be filed under the agreement.

Restrictions on Provisions That Limit Rights and Remedies

Much of the criticism of predispute arbitration agreements has focused on the use of choice-of-law provisions. A choice-of-law provision specifies that the law of a certain state will govern disputes arising out of an agreement. In some cases, the law of a state might limit the availability of certain

remedies, such as punitive damages, or the ability of a customer to bring a claim. For example, previously under New York law, courts could award punitive damages, but arbitrators could not. A customer who agreed to arbitrate disputes under New York law could inadvertently forfeit the ability to obtain punitive damages that might have been available in court. (New York law on this subject has begun to shift in favor of arbitrators being able to award punitive damages.) Customers have argued that it is unfair for members to include provisions in predispute arbitration agreements that limit the availability of remedies, particularly when the effects of the provisions are not explained in the agreement.

Currently, Rule 3110(f) prohibits any choice-of-law provision that limits or contradicts the rules of any SRO, or that limits the ability of a party to file any claim in arbitration or of arbitrators to make any award. However, the application of this provision has not always been consistent or clear. In addition, some investors have expressed concern that choice-of-law provisions select arbitrary jurisdictions that have no relationship to the customer or the transaction at issue.

To address these concerns, paragraph (f)(4) of the Rule would be amended to clarify the prohibition against provisions that limit rights or remedies, including provisions that would circumvent the eligibility rule. The amended rule would also state that no choice-of-law provision would be enforceable unless there is a significant contact or relationship between the law selected and either the transaction at issue or one or more of the parties.

In response to the **Federal Register** publication of SR-NASD-98-74 in November, 1999,¹⁰ two commenters expressed the view that the laws of the state in which the customer resides should apply in arbitration disputes.¹¹ NASD believes that it should not dictate to the parties of a predispute arbitration agreement the law that would govern their agreement. NASD believes the approach taken by the proposed rule change effectively balances the rights of parties to contractually agree on the law that will govern their disputes with the concerns expressed by customers regarding choice-of-law provisions in predispute arbitration agreements.

Non-Bifurcation Provision

NASD is proposing to amend Rule 3110(f) to include a provision prohibiting members from seeking to

compel arbitration of some but not all of a customer's court-filed claims, in order to prevent members from forcing customers to litigate in two forums when they filed a complaint in court that contained both eligible and ineligible claims.¹² Therefore, NASD is proposing to add a new paragraph (f)(5) to Rule 3110 that would require members seeking to compel arbitration of claims filed in court to agree to arbitrate all of the claims contained in the court-filed complaint, even if some of the claims would be ineligible for arbitration under the eligibility rule. The purpose of these provisions in Rule 3110(f) is to give the customer control over whether claims are bifurcated.

Effective Date Provisions

The proposed amendments to Rule 3110(f) would require various changes to the customer agreements used by member firms. In order to provide enough time for firms to modify customer agreements, NASD has determined that this rule filing, if approved, should take effect 90 days after publication of a *Notice to Members* announcing Commission approval of the proposed rule change. NASD would issue the Notice to Members within 60 days of receiving Commission approval.

The proposed amendments to Rule 3110(f) would also provide that agreements signed before the effective date of the Rule as amended would be subject to the provisions of 3110(f) in effect at the time the agreement was signed.

Restriction of Rule to Customer Account Agreements

Some members of NASD's National Arbitration and Mediation Committee expressed concern that the rule, which currently applies to all predispute arbitration clauses in any agreement between member firms and customers, could be construed to apply to agreements between a member firm and large institutional clients with whom they had face-to-face negotiations over the terms of the agreement. To address this concern, the rule would be amended to clarify that it only applies

¹² In June 2003, NASD filed proposed amendments to Rule 10304 relating to time limits for the submission of claims to arbitration. The proposed rule change seeks to amend Rule 10304 to provide that by requesting dismissal of a claim on eligibility grounds in the NASD forum, the requesting party is agreeing that the claimant may withdraw all related claims without prejudice and may pursue all of the claims in court. The proposed provision seeks to protect parties against involuntary bifurcation of claims. The filing is currently pending with the Commission. See Securities Exchange Act Release No. 48225 (July 25, 2003), 68 FR 45299 (August 1, 2003) (SR-NASD-2003-101).

¹⁰ See *supra* note.

¹¹ See Estell Letter and Miller Letter, *supra* note.