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THE NEW NASD ARBITRATOR SELECTION PROCESS - NLSS

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For many of you who have been arbitrators for years and who have never sat on a panel, much less been called to sit on a panel, get out your seat cushions! Few who have worked extensively in securities arbitration over the last 10 years would argue that the previous system the NASD used for picking arbitrators was anything other than archaic and, even, unfair. I am an arbitrator, and there are hundreds of individuals like myself who have not only never sat on an arbitration panel, but have never been called to sit on a panel.

On the other hand, we are all aware of arbitrators who have sat on 20 arbitration panels or more, which leaves one wondering about the number of panels to which they were appointed. It was much easier for the NASD to select arbitrators whom they knew would pass muster with the securities industry and thereby conserve critical staff time (rather than spending it appointing replacement arbitrators). Many among the Claimants' bar believe this tendency led to the selection of arbitrators who were anesthetized to wrongdoing and who dared not award punitive damages — lest they never sit again.

The new NASD arbitrator selection process is in place and many of you have already been involved with the new criteria. If the new selection process is properly carried out in accordance with the guidelines, many of the complaints that participants in the process have had with the system should be dramatically reduced and a more fair and even-keeled arbitration should result. Rick Ryder's excellent article in the September issue of Securities Arbitration Commentator (SAC) details much of the process.

During Fall 1998, Arbitrator Registration Packages were sent to all NASD arbitrators so that the NASD arbitrator list would be current, updated and meet the new guidelines. My research and subsequent conversations with the NASD now have me very excited about the new process. As a securities expert with a fairly heavy case load, I have also had numerous opportunities in the last few months to discuss with other arbitration participants the concerns and questions the new process has created. The following are some nuances in the new rules that I think are important for those of you who practice securities arbitration.

The Neutral List Selection System (NLSS) is the computerized system that has been in place since November 1998 to select NASD arbitrators. Presumably, the NASD staff will no longer have discretion to make such selections. Although the computer selection process has been called "random," it is

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potentially biased against that side's case.

Ceratinly, it behooves counsel to exercise "due diligence" in examining the backgrounds and past voting records of the nominated arbitrators. Yet, one item should keep attorneys from readily striking all or many arbitrators on the list. If a three-member panel is not in place after the parties strike the original list, then the NASD, again using the NLSS system, appoints the remaining needed panel members. At this juncture, there are no peremptory strikes! You are basically stuck with the appointments, absent a valid challenge for cause.

In addition, when the staff makes the appointment, certain arbitrators are screened from the available choices. The Arbitrator Registration Package, Note #2, states that the Office of Dispute Resolution (ODR) staff may generally not appoint an arbitrator who has answered "yes" to questions #5, 6, and 10 on his questionnaire. Those questions are paraphrased as follows:

5. Are you retired from engaging in any securities-related industries?

6. Are you an attorney, accountant, or other professional who has devoted 20% or more of your professional work, in the last two years, to clients who are engaged in any securities-related industries?

10. Are you an attorney, accountant, or other professional who has devoted 50% or more of your professional or business activities, within the last two years, to representing or advising public customers in matters relating to disputed securities or commodity transactions or similar matters?

Now the prescreening is documented and sanctioned! It's hard for Claimants to cry "foul" when the screen eliminates a higher percentage of candidates on the industry side than the percentage on the Claimant's side. Arguably, though, it is the industry side that will benefit from an implementation of the screen. Those who believe that so-called career arbitrators consistently rule for the securities industry will find that such veterans are not screened out and may easily appear on the ODR appointment list.

A defense attorney who subscribes to this oft-held belief need only strike all of the arbitrators on the initial list, and he thereby ensures that the old system will rear its ugly head, sans the peremptory strike. He should be careful, though, because, given the rotational element in the NLSS staff selection procedure, he could be stuck with the arbitrator who has awarded punitive damages.

One thing is certain: the pool from which the computer draws should be a much larger pool and we can expect to see a greater number of unfamiliar arbitrator names on the NLSS lists. I encourage parties not to be "strike crazy." Consensus on marginally acceptable candidates to both sides will do more to assure a capable Panel than gamesmanship. For both sides to persist in striking all nominees will basically foster a return to the old system — a dice roll; only now the peremptory strike is unavailable.

The ODR selection process, which results when a combination of strikes makes an incomplete panel, can work for or against either side. Some have said that it would have been better to have limited the strikes on the initial go-round. If attorneys could strike only two from the industry list and only three from the non-industry list, you would guarantee a panel every time, thereby eliminating the need for the ODR selection process and its attendant pre-screening. NYSE Arbitration offers something of this kind, a "SICA model" option, as a consensual alternative, but at ODR, it now remains for counsel to demonstrate whether the NASD's insistence on a free-strike system, with its emphasis on complete party discretion, will actually work.

Another screening performed by the NLSS system relates to disclosed conflicts of interest. Under Rule 10308 (4), Preparation of Lists, the computerized NLSS will screen for two types of arbitrator conflicts: (1) when the arbitrator currently has an account with the Respondent brokerage firm, and (2) when the arbitrator, as an expert or attorney, is currently working on a case for or against the Respondent brokerage firm or the claimant. The key word here is "current." NLSSS, by itself, will not screen an attorney or expert from the list selection process just because of some conflict in the past.

To augment the conflict-screening process, whenever the NLSS selects a group of arbitrators, the ODR staff will also perform a manual check for conflicts before the potential arbitrator goes on the list. One might worry that this

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actually rotational. What the computer is supposed to do is pick the next person on the arbitrator rolls who is a willing arbitrator for that geographic location and possibly an arbitrator with a particular expertise.

One of the most interesting items in the Arbitrator Registration Package was the one page that asks the arbitrator to check off categories indicating his/her expertise in various securities-related fields. If parties indicate that they seek arbitrators with specific expertise/experience, then the NLSS will presumably use this expertise/experience page for that purpose. However, my inquiries indicate that the NASD has no process in place to ensure that anyone who indicates he or she has a particular expertise/experience, in fact, has it.

The more boxes you check, the more likely you are to rotate to the top of the NLSS rotational list. So, those who see this new process as an excellent opportunity to sit on more arbitration panels will likely be liberal with their check marks. For that reason, practitioners should keep in mind, when requesting that arbitrators have a particular expertise, they can also ask how many of the people in that geographical region have that expertise.

Armed with that information, the party should then consider requesting that a certain number - from 1 to 15 - have the particular expertise. If the party requests a particular expertise, but does not specify a number, the computer will default to a majority number which for a 15 people list, would be eight. Once the list of candidates is provided, you have the right to request additional information to assure the claimed expertise is, in fact, satisfactory for the needs of the case. The respondent will receive an "Arbitrator Expertise Sheet" with the Statement of Claim. The claimant will receive the "Arbitrator Expertise Sheet" after the respondent's Answer is served. This will be a helpful reminder, but there is no need to wait for the form to arrive before stating your preferences.

At first blush, the new system would appear palatable to those Claimant attorneys who pressed for this change. They can expect to see arbitrators on the initial list whose names have never graced NASD paper before. However, the same system that opens the arbitration door to you, in the same breath, could slam it shut. Each party has unlimited challenges to the original list. If both sides assume that each arbitrator generally falls into one camp or the other - the industry camp or the claimant camp - then what may happen is that each camp will strike all or many of the arbitrators in the other camp. Each side may reason that there is no downside to striking any arbitrators perceived as

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could lead to the old "screening" and "favoritism" of the past, but whenever the ODR staff strikes a person for a conflict, they are, I have been told, required to issue a written reason explaining why.

Since the NLSS screens for current conflicts, followed by the ODR which checks for more subtle conflicts, challenges for cause, though allowed, will be a rare occurrence. A party would have to be aware of some special information not found on an arbitrator's disclosure sheet or in his awards, to be able to raise a challenge for cause.

If in the striking process by the parties, what is left are all industry arbitrators or all public arbitrators, the NASD will not appoint the remaining candidates as the panel. The ODR staff will go to the computer for the selection of the missing arbitrator, i.e. industry or public. To the extent there are additional arbitrators in the local area available for appointment, the staff will fashion a list comprised of those mutually selected by the parties with those whom the staff has selected for appointment.

If an arbitrator must be selected from outside the geographic area for a particular hearing, the arbitrator must have marked that he is willing to pay his own expenses to travel outside his area. Second, this arbitrator must be picked by the NLSS computer system in rotational order. This is a major plus of the new system. Under the old system, there was a group of "Darth Vader" arbitrators who, in the view of many Claimants' advocates, were handpicked to fly across the country to fill a void. Because they were late appointees, they were not able to be readily challenged. These arbitrators were often perceived as a death knell to Claimants. Though the vast majority of arbitrators are fair, conscientious individuals, the new selection system will certainly make the system more fair.

If the discovery process is any indication, getting two opposing attorneys to agree on anything is nearly impossible. With that said, it would greatly benefit both sides to try to communicate and compromise whenever they can after they receive their NLSS list. Keep in mind that, even if the joint striking leaves three remaining arbitrators, there is a chance that one or more of these arbitrators might not be able to serve for various reasons, such as extended vacation, health problems, etc. Even if both parties choose not to confer with each other on determining their respective selections, it is a good strategy for each party to send a copy, after the response deadline, of its final selection to the opposing party. Both sides then benefit from being able to monitor the NASD staff to make sure they are following your request and complying with the new system.

There is one policy of the NASD's NLSS with which I disagree. Once the parties have struck and ranked the arbitrator list, the NASD staff then commences to contact those arbitrators who are highest ranked. The policy is that if the NASD cannot make contact with these individuals within 48 hours the NASD removes them from the list and moves lower on the list or, alternatively, appoints arbitrators. 48 hours is just far too short a time period. We all want to speed along the process, but to remove arbitrators when we finally have a meeting of the minds is too much of an injustice to both sides. How many times have you been unable to return a phone call for 48 hours? I would suggest that seven business days should be the minimum.

Once the NASD staff has received the selection list back from the parties and has confirmed that the selected arbitrators are available, the parties are notified of the panel. It is at this point that the parties are given 15 days to choose which of the three panel members they wish to be the chairperson. The chairperson must be mutually agreed upon by both parties, which requires them to communicate with each other. If the parties cannot agree on a chairman within 15 days, the NASD staff chooses the chairman. The ODR staff will pick the highest ranking public arbitrator, omitting any arbitrators who are attorneys, accountants, or professionals who devote 50% of their time assisting claimants.

The parties should endeavor to agree on a chairman who meets their mutual preferences and needs. Otherwise, the chairman may turn out to be the least experienced arbitrator or a non-attorney arbitrator, a result which may not please either side. There are no criteria that the chairman must meet, so if the parties desire, they could choose a chairman who has no experience as an arbitrator or who has never received chairperson training. When you are ranking your initial selection list, keep in mind that if the NASD staff is forced to pick the chairman, it is done by ranking, so be thinking potential chairperson, as you rank.

Once the panel is in place, all hearings and decision-making will automatically include all three arbitrators. This differs from past procedure where the Chairman may have been the sole decision maker, at least on procedural issues. The parties are free to agree, however, that the Chairman or any other single arbitrator will preside over a prehearing conference. If discovery conferences will be necessary, the parties will find that it is both less expensive and more expeditious to agree, early on, that a single arbitrator will hear these issues.

The question has been asked whether the new NASD arbitrator selection system has any flexibility, as in the new NYSE arbitrator selection system. The answer generally is that the NASD is flexible to the wishes of the parties, but only when the parties have set forth their agreement in writing and prior to implementation of the NLSS system. For example, if both parties

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write the NASD prior to the appointment of arbitrators that they prefer an entire public or entire industry panel. the NASD will most likely bow to those wishes.

When the NLSS list of arbitrators is sent to the parties, as in the past, it will include a full disclosure of each arbitrator on the list. Also as in the past, a party can request a full copy of the prior arbitration awards for each arbitrator. You can have all the awards for the past year or any five awards for free. Any additional awards are $5.00 each, up to a maximum cost of $70.00. You have 20 days in which to return your rankings to the NASD. If you are planning on requesting full awards, you had better get your request in early because the NASD is not likely to extend your 20 days just because you were late in requesting awards.

If you are waiting by the phone to be called as an arbitrator, keep in mind the initial ranking was done by your arbitrator number, not alphabetically. Also, arbitration dates are no longer of importance under the new NLSS, meaning that general availability will no longer be a factor that favors the retired or less busy candidate. Now arbitrators are selected and then parties, together with the panel, pick dates that work for all concerned during the preliminary hearing.

If an individual is selected by the NLSS and appears on the original list or is later selected under the ODR staff selection procedure, that arbitrator will go to the bottom of the list —period! It does not matter if you were struck from the list by either side, if the case settled, or if the case concluded. Once you are put on the list, your name then moves to the bottom of the rotational pile. Otherwise, like when an arbitrator is stricken by the computer because he has a conflict, fails to meet an expertise request, or is manually conflicted out for a conflict by the ODR staff, the arbitrator returns to the rotation and stays at the top of the list.

This is good, because there will now be a record of how often each arbitrator is put on a list. I assume that now that the NASD is computerizing the entire arbitrator selection process, this computerization will also allow a review and scrutiny of the process. PIABA and the SIA should petition and demand that the NASD regularly publish or make available a statistical report showing by geographic region when each arbitrator was selected by the computer, how many times he was selected, and what the net result was. Individual arbitrators should also have the right to obtain a printout of the arbitrator selection history in their geographic area. Then, we can all feel comfortable that the system is running fairly and that suspicions of behind-closed-doors-deals have no foundation under the new system.