

Treasury securities as the underlying instrument.<sup>8</sup> Currently, repurchase agreement transactions constitute the majority of the transactions cleared by DCC.

As a part of its temporary registration, DCC was granted a temporary exemption from the requirements of Section 17A(b)(3)(C),<sup>9</sup> which requires that the rules of a clearing agency assure the fair representation of its shareholders or members and participants in the selection of its directors and administration of its affairs. While Commission staff and DCC staff have had ongoing discussions on DCC's proposed method of complying with Section 17A(b)(3)(C), the Commission believes that the issue of DCC's compliance with the fair representation requirements should be completely resolved before DCC receives permanent registration as a clearing agency under Section 17A(b) of the Act.<sup>10</sup>

In light of DCC's past performance, the Commission believes that DCC complies with the statutory prerequisites for registration as a clearing agency contained in Section 17A(b)(3) of the Act except for the fair representation requirement discussed above.<sup>11</sup> Therefore, the Commission believes that DCC should continue to be registered on a temporary basis. Comments received during DCC's temporary registration will be considered in determining whether DCC should receive permanent registration as a clearing agency.

Interested persons are invited to submit written data, views, and arguments concerning the foregoing application. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Copies of the application and all written comments will be available for inspection and copying at the Commission's Public Reference Room 450 Fifth Street, NW., Washington, DC 20549. All submissions should refer to the File No. 600-24 and should be submitted by July 29, 1998.

It is therefore ordered, pursuant to Section 19(a) of the Act, that DCC's registration as a clearing agency (File No. 600-24) be and hereby is temporarily approved through July 31, 1999.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 98-17234 Filed 6-26-98; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40109; File No. SR-NASD-97-77]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change Relating to the Arbitration of Employment Discrimination Claims

June 22, 1998.

#### I. Introduction

On October 17, 1997, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), by and through its wholly owned subsidiary NASD Regulation, submitted to the Securities and Exchange Commission ("Commission"), 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> a proposed rule change to amend Rule 10201 of the NASD's Code of Arbitration Procedure ("Code") to remove the requirement to arbitrate statutory claims of employment discrimination.

Notice of the proposed rule change, together with the substance of the proposal, was published for comment in Securities Exchange Act Release No. 39421 (December 10, 1997), 62 FR 66164 (December 17, 1997). Nine comment letters were received on the proposal.<sup>3</sup> NASD Regulation

<sup>12</sup> 17 CFR 200.30-3(a)(16).

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

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

<sup>3</sup> Letter from Dennis C. Vacco, Attorney General of the State of New York ("Attorney General"), to Jonathan G. Katz, Secretary, Commission, dated December 17, 1997 ("Attorney General Letter"); Gilbert F. Casellas, Chairman, U.S. Equal Employment Opportunity Commission ("EEOC"), to Secretary, Commission, ("EEOC Letter"); Jeffrey L. Liddle, Liddle & Robinson, L.L.P., to Secretary, Commission, dated January 2, 1998 ("Liddle Letter"); W. Hardy Callcott, Vice President and Deputy General Counsel, Charles Schwab ("Schwab"), to Jonathan G. Katz, Secretary, Commission, dated January 6, 1997 [sic] ("Schwab Letter"); William J. Fitzpatrick, Attorney, to Secretary, Commission, dated January 8, 1997 [sic] ("Fitzpatrick Letter"); Stuart J. Kaswell, Senior Vice President and General Counsel, Securities Industry Association ("SIA"), to Jonathan G. Katz, Secretary, Commission, dated January 13, 1998 ("SIA Letter"); Helen Norton, Director, Equal Opportunity Programs, Women's Legal Defense Fund ("WLDF"), to Jonathan G. Katz, Secretary, Commission, dated January 7, 1998 ("WLDF Letter"); Cliff Palefsky,

subsequently filed Amendment No. 2 to the proposed rule filing on April 15, 1998.<sup>4</sup>

#### II. Description

The proposed rule change will modify the current requirement that associated persons arbitrate all disputes arising out of their employment or termination of employment with a member broker/dealer. The proposed rule provides that associated persons are no longer required, solely by virtue of their association or their registration with the NASD, to arbitrate claims of statutory employment discrimination. Associated persons still will be required to arbitrate other employment-related claims, as well as any business-related claims involving investors or other persons.

#### Background

The requirement for associated persons to register with the NASD arises from Section 15A(g)(3)(B) of the Act, which provides that the NASD may "require a natural person associated with a member, or any class of such natural persons, to be registered with the association in accordance with procedures so established [by the rules of the association]." The registration requirement for associated persons who effect securities transactions was made mandatory by Rule 15b7-1 under the Act in 1993.<sup>5</sup> The NASD, other self-regulatory organizations ("SROs"), and

Chair, Securities Industry Arbitration Committee, National Employment Lawyers Association ("NELA"), to Secretary, Commission, dated January 6, 1998 ("NELA Letter"); and George A. Schieren, Senior Vice President and General Counsel, Merrill Lynch, to Jonathan G. Katz, Secretary, Commission, dated January 16, 1998 ("Merrill Letter").

<sup>4</sup> Letter from Jean I. Feeney, Attorney, NASD Regulation, to Katherine A. England, Assistant Director, Market Regulation, Commission, dated April 14, 1998. Amendment No. 2 amends the language of the proposed rule change in Section 10201(b) of the code to state "A claim alleging employment discrimination, *including a sexual harassment claim*, [or sexual harassment] in violation of a statute is not required to be arbitrated." Amendment No. 2 also amends the effective date of the proposed rule change to January 1, 1999. In addition, Amendment No. 2 responds to the comment letters.

<sup>5</sup> 17 CFR 240.15b7-1. The rule provides as follows:

No registered broker or dealer shall effect any transaction in, or induce the purchase or sale of, any security unless any natural person associated with such broker or dealer who effects or is involved in effecting such transaction is registered or approved in accordance with the standards of training, experience, competence, and other qualification standards (including but not limited to submitting and maintaining all required forms, paying all required fees, and passing any required examinations) established by the rules of any national securities exchange or national securities association of which such broker or dealer is a member or under the rules of the Municipal Securities Rulemaking Board (if it is subject to the rules of that organization).

<sup>8</sup> Securities Exchange Act Release No. 36367 (October 13, 1995), 60 FR 54095.

<sup>9</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>10</sup> 15 U.S.C. 78q-1(b).

<sup>11</sup> 15 U.S.C. 78q-1(b)(3).

state regulatory authorities require all applicants for registration as persons associated with a broker/dealer (registered representatives, assistant representatives or principals) to complete and sign the Form U-4, the "Uniform Application for Securities Industry Registration or Transfer."<sup>6</sup> Form U-4 requires registered persons to submit to arbitration any claim that is eligible under the rules of the organizations with which they register (as indicated in Item 10 of the Form U-4).<sup>7</sup> thus, the Form U-4 incorporates by reference the rule of the SRO with which the individual is to be registered. NASD Rule 10101 provides as follows:

The Code of Arbitration Procedure is prescribed \* \* \* for the arbitration of any dispute, claim, or controversy arising out of or in connection with the business of any member of the Association, or arising out of the employment or termination of employment of associated person(s) with any member, with the exception of disputes involving the insurance business of any member which is also an insurance company \* \* \* between or among members and associated persons \* \* \*.

For industry and clearing controversies, Rule 10201 requires that all matters eligible under Rule 10101 be submitted to arbitration at the request of any member or associated person.<sup>8</sup> Rules 10101 and 10201 were amended in 1993 to include the language relating to disputes "arising out of the employment or termination of employment" of an associated person.<sup>9</sup> This language was

added in order to clarify that employment disputes were required to be arbitrated, since a California court had held that the Code of Arbitration Procedure did not cover such disputes, but only covered disputes arising out of or in connection with business transactions.<sup>10</sup>

Over the past several years, employees have raised several challenges to the mandatory arbitration of employment discrimination disputes. In 1991, the Supreme Court established the framework for considering the issues raised by such challenges in *Gilmer v. Interstate/Johnson Lane Corp.*<sup>11</sup> In *Gilmer*, which involved a person registered with the New York Stock Exchange, the Court examined numerous challenges to the adequacy of arbitration procedures raised by the registered representative and found that none was sufficient to prevent the Court from enforcing the representative's agreement, pursuant to his signing of the Form U-4, to arbitrate his federal age discrimination claim. The Court held that Mr. Gilmer had not met his burden of showing that Congress intended to preclude arbitration of claims under the Age Discrimination in Employment Act ("ADEA") of 1967.<sup>12</sup>

sex, or race discrimination, or relating to sexual harassment, were subject to the arbitration requirement.

<sup>10</sup> *Higgins v. Superior Court of Los Angeles County*, No. B057028 (Cal. App. Oct. 8, 1991), review denied and decision ordered not officially published, 1 Cal. Rptr. 2d 57 (1992). The state court noted the difference between the NYSE rule (at issue in the Supreme Court's *Gilmer* decision, discussed below), which refers to disputes arising out of the employment or termination of employment of an associated person, and the NASD rule, which at the time did not contain the phrase relating to employment. A federal court reached the same conclusion while the rule change was pending approval. *Farrand v. Lutheran Bhd.*, 993 F.2d 1253 (7th Cir. 1993). The Association stated in its rule filing that the amendment was a clarification of existing intent rather than a new policy; some courts accepted this view, while other courts interpreted the rule amendment as a change in policy. See *Kuehner v. Dickinson & Company*, 84 F.3d 316, 320 n.1 (9th Cir. 1996) (describing splits in the Seventh, Tenth and Eleventh Circuits on this issue).

<sup>11</sup> 500 U.S. 20 (1991). Those challenges included contentions that anti-discrimination laws are designed to further important social policies that should be addressed in a public forum, that arbitration panels may be biased, that discovery is more limited in arbitration than in court, that arbitrators often do not issue written opinions, that arbitration procedures do not provide for broad equitable relief and class actions, and that there is unequal bargaining power between employers and employees. The Court noted the most of these contentions were generalized attacks on arbitration that had been rejected in prior Supreme Court decisions. *Id.* at 30.

<sup>12</sup> *Id.* at 35. The Court cited its earlier holding that, "So long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." 500

Subsequent to the *Gilmer* decision, several courts have declined to find a Constitutional or statutory bar to enforcement of the agreement to arbitrate contained in the Form U-4. Indeed, they have extended the reasoning of *Gilmer* to cover disputes arising under Title VII of the Civil Rights Act of 1964,<sup>13</sup> the Americans with Disabilities Act,<sup>14</sup> and state statutes of a similar nature.<sup>15</sup> Courts also have extended the application of *Gilmer* to the NASD, since its rules are similar to the NYSE rule at issue *Gilmer*.<sup>16</sup> The Commission notes, however, that the U.S. Court of Appeals for the Ninth Circuit, in *Duffield v. Robertson Stephens & Co.*, 1998 U.S. App. Lexis 9284 (9th cir. 1998), recently held that Item 10 of Form U-4, incorporating the current mandatory provision of Rule 10101 and 10201, is unenforceable as applied to Title VII claims.

Registered persons and others have continued to question the policy of requiring the arbitration of statutory discrimination claims.<sup>17</sup> In February of 1997, three members of Congress wrote to the SEC and questioned the authority of the NASD and other SROs to require arbitration of statutory discrimination claims in employment disputes through an associated person's signing of the Form U-4.<sup>18</sup> Legislation was introduced that year in both the House and Senate<sup>19</sup> that would prohibit employers and employees from entering into predispute arbitration agreements concerning claims of unlawful employment discrimination.<sup>20</sup>

U.S. at 28, quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985).

<sup>13</sup> See, e.g., *Alford v. Dean Witter Reynolds, Inc.*, 939 F.2d 229 (5th Cir. 1991); *Cremin v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 957 F. Supp. 1460 (N.D.Ill. 1997). But see *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 1998 U.S. Dist. Lexis 877 (D.Mass. 1998).

<sup>14</sup> See, e.g., *Austin v. Owens-Brockway Glass Container, Inc.*, 78 F.3d 875, 881 (4th Cir.), cert. denied, 117 S. Ct. 432 (1996).

<sup>15</sup> See, e.g., *Kaliden v. Shearson Lehman Hutton, Inc.*, 789 F. Supp. 179, 180 (W.D. Pa. 1991).

<sup>16</sup> See, e.g., *Metz v. Merrill Lynch Pierce, Fenner & Smith, Inc.*, 39 F.3d 1482, 1488 (10th Cir. 1994).

<sup>17</sup> See, e.g., Commission on Future of Worker-Management Relations ("Dunlop Commission"), *Report and Recommendations* 33 n.15 (1994); Equal Employment Opportunity Commission, *Policy Statement on Mandatory Binding Arbitration of Employment Discrimination Disputes as a Condition of Employment* n.2 (1997).

<sup>18</sup> Letter from Representatives Edward J. Markey, Anna G. Eshoo, and Jesse L. Jackson, Jr., to Arthur Levitt, Chairman, SEC (February 3, 1997). The Commission's Division of Market Regulation determined that there was no clear answer and suggested that the SROs should address the issue in the first instance.

<sup>19</sup> H.R. 983 and S. 63, 105th Cong. (1997).

<sup>20</sup> Under the proposed legislation, the parties could agree, after a dispute arose, whether to resolve it by arbitration or by court proceedings.

<sup>6</sup> The Form U-4 was adopted effective October 1, 1975.

<sup>7</sup> The relevant language on the Form U-4 states:

I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the organizations indicated in Item 10 as may be amended from time to time and that any arbitration award rendered against me may be entered as a judgment in any court of competent jurisdiction.

From page 4 of the Form U-4 as revised in November 1991. A new version of the Form U-4 was approved by the Commission on July 5, 1996. Securities Exchange Act Release No. 37407 (July 5, 1996), 61 FR 36595 (July 11, 1996). Use of the revised form has been deferred pending related changes to the Central Registration Depository ("CRD"). Securities Exchange Act Release No. 37994 (November 27, 1996), 61 FR 64549 (December 5, 1996). The substance of the quoted language was not changed in the revision.

<sup>8</sup> As one court explained, "Section 1 [now Rule 10101] defines the general universe of issues that may be arbitrated, and Section 8 [now Rule 10201] describes a subset of that universe that must be arbitrated under the Code." *Armijo v. Prudential Ins. Co. of Am.*, 72 F.3d 793, 798 (10th Cir. 1995).

<sup>9</sup> Securities Exchange Act Release No. 32802 (August 25, 1993), 58 FR 45932 (August 31, 1993). In its order approving this change and a related change in the composition of arbitration panels to hear employment disputes, the Commission recognized that claims based on allegations of age,

### *Details of the Proposed Rule Change*

Paragraph (a) of the proposed rule adds a prefatory phrase indicating that the requirement to arbitrate employment disputes contains an exception, set forth in paragraph (b).

New paragraph (b) provides that claims alleging employment discrimination, including sexual harassment, in violation of a statute are not required to be arbitrated by NASD rules.<sup>21</sup> This means that such claims may be filed in the appropriate court, if the employee chooses to do so and is not under an enforceable predispute obligation to arbitrate the dispute. An employee also may agree to arbitrate after a dispute arises.<sup>22</sup>

Paragraph (b) applies only to claims alleging employment discrimination, including sexual harassment,<sup>23</sup> in violation of a statute.<sup>24</sup> Paragraph (b) does not apply to causes of action created solely by judicial precedents or to other causes of action under state or federal law, which remain subject to mandatory arbitration under paragraph (a).<sup>25</sup>

Paragraph (c) of the proposed rule is former paragraph (b), which is unchanged except for the renumbering.

### *Effective Date*

The NASD originally requested that the proposed rule become effective one year from the date of Commission approval. However, the NASD is now asking that the proposed rule change become effective on January 1, 1999.<sup>26</sup> NASD Regulation states that the rule change will apply to claims filed on or

after the effective date of the rule change.<sup>27</sup> NASD Regulation states that this method is the one most commonly used with regard to changes to the Code and is the most efficient to administer.

### **III. Summary of Comments**

The Commission received nine comment letters on the proposed rule change. Six commenters supported the proposed rule change, with recommended modifications. Three commenters opposed the proposed rule change.<sup>28</sup> The comment letters focused on three main issues: (1) whether the rule will lead to the bifurcation of claims in arbitration and in court; (2) whether the one-year delayed effective date was appropriate; and (3) whether the rule should be amended to permit only post-dispute agreements to arbitrate. NASD Regulation responded to the comment letters.<sup>29</sup>

### *Overview of the Proposed Rule Change*

Many of those who support the proposed rule change do so because they believe employment discrimination claims do not belong in arbitration. The EEOC, for example, applauded the proposal as a "first step" toward bringing the securities industry into harmony with the intent of federal anti-discrimination statutes. The WLDF asserted that it will help protect important civil rights. NELA argued that the NASD does not have the jurisdiction to compel the waiver of fundamental statutory rights and remedies as a condition of employment, and that statutory claims of this sort do not belong in the present arbitration system. The New York Attorney General supported the proposed rule change, maintaining that industry arbitrators lack training and experience relating to interpreting and applying employment discrimination law.

One commenter opposed the proposed rule change, contending that it is against public policy, is contrary to case law and federal legislation encouraging the use of arbitration, ignores the concerns of courts,<sup>30</sup> and undermines a long history of a system of SRO arbitration of employment matters without any empirical evidence of a problem.<sup>31</sup> Similarly, Schwab stated

that although it is willing to resolve statutory discrimination claims in court, because arbitration is the preferable forum, it does not support the proposed rule change in its current form. In Schwab's view, arbitration is fundamentally fair as a dispute resolution process and the NASD should address any concerns by working to improve the process, not by removing some classes of cases from the process.<sup>32</sup> On the other hand, one commenter opposed the proposed rule change as not going far enough. He maintained that the Commission should prohibit arbitration of all employment claims in any instance.<sup>33</sup>

NASD Regulation responded that its arbitration forum is fair and that it provides many benefits to employees as well as to members, and that the proposed rule change does not in any way indicate a lack of confidence in the current arbitration system.

### *Comments Concerning Bifurcation of Claims*

Several letters voiced concerns that, as presently drafted, the rule presents the possibility that claimants will be required to pursue different claims in different forums. A number of commenters asserted that the proposal should be expanded to cover all common law claims concerning employment-related matters,<sup>34</sup> such as wrongful termination, defamation, negligent supervision, invasion of privacy, tortious interference with economic opportunity, and intentional infliction of emotional distress.<sup>35</sup> Those commenters argued that since the proposed rule change allows the statutory discrimination claims to be brought in court, while requiring employees to bring the common law and all other statutory claims in arbitration, it will result in the separation of claims that are often joined together and based

employment discrimination claims and employees actually do better in arbitration than in overcrowded court systems.

<sup>32</sup> Schwab noted that the NASD did state its intent to provide increased training in employment related issues to arbitrators and to assign arbitrators based on their subject-matter expertise.

<sup>33</sup> Liddle Letter. He stated that the decision to exclude statutory employment claims from mandatory arbitration reflects the NASD's view that its arbitration process is not suited to handle resolution of these claims because it is fundamentally unfair and does not afford a claimant with an employment claim a full and fair opportunity to vindicate his or her rights.

<sup>34</sup> Attorney General Letter; Liddle Letter. Another commenter stated that the proposed rule change should be expanded to cover all statutory employment rights, including those under ERISA, the Family and Medical Leave Act, and other laws. WLDF Letter.

<sup>35</sup> Attorney General Letter.

<sup>21</sup> See Amendment No. 2, *supra* note 4.

<sup>22</sup> A report by the NASD's Arbitration Policy Task Force ("Task Force Report") observed that arbitration of employment-related disputes offers advantages in terms of speed and cost, and that arbitration's essentially equitable approach to dispute resolution is fully capable of vindicating the important public rights expressed in anti-discrimination statutes. Task Force Report at 119. Therefore, the NASD expects that many employees will continue to file their discrimination claims in arbitration if the proposed rule becomes effective, and the NASD states that it intends to make further enhancements to its arbitration forum to make it even more attractive to parties. Firms and their employees who agree to arbitrate discrimination claims may agree to use any arbitration forum.

<sup>23</sup> Sexual harassment has been held to be a form of sex discrimination, and thus a violation of Title VII. *Meritor Savings Bank v. Vinson*, 477 U.S. 57, 64 (1986).

<sup>24</sup> The NASD intends the term "statute" to be interpreted broadly, as defined in *Black's Law Dictionary* 1410 (6th Ed. 1990): "A formal written enactment of a legislative body, whether federal, state, city, or county."

<sup>25</sup> Such judicially created causes of action might include, for example, claims alleging "wrongful discharge" without any accompanying claim of discrimination on account of age, sex, race, or other status protected by a specific law.

<sup>26</sup> See Amendment No. 2, *supra* note 4.

<sup>27</sup> Accordingly, under the proposal, on January 1, 1999, claims may be filed in court for past conduct if they are within the applicable statutes of limitation and other statutory requirements and no other predispute arbitration agreements apply.

<sup>28</sup> Liddle Letter; Fitzpatrick Letter; Schwab Letter.

<sup>29</sup> See Amendment No. 2, *supra* note 4.

<sup>30</sup> Fitzpatrick Letter.

<sup>31</sup> *Id.* the SIA also noted that critics of the arbitration process have not offered any empirical data to support a claim that SRO arbitration is not a fair forum for employees to resolve statutory

on the same alleged facts.<sup>36</sup> In their view, such bifurcation of the statutory and common law claims could create a financial burden on employees<sup>37</sup> and members or member firms,<sup>38</sup> delay the resolution of claims,<sup>39</sup> and cause scheduling and discovery disputes.<sup>40</sup> Several commenters also voiced concerns about the possible res judicata or collateral estoppel effects of the arbitration on the court proceeding.<sup>41</sup>

NASD Regulation responded that the proposed rule change is an exception to a long-standing rule requiring the arbitration of disputes between members and associated persons and that the interest groups who expressed their concerns focused on federal anti-discrimination legislation, not on common law claims or other federal laws. In addition, NASD Regulation stated it will continue to observe developments in this area (as will the Commission).

#### *Comments Concerning the Effective Date*

Several commenters recommended that the proposal become effective earlier than one year after Commission approval.<sup>42</sup> Several commenters suggested immediate effectiveness,<sup>43</sup> while one suggested effectiveness three months after Commission approval.<sup>44</sup> The EEOC was of the view that the rule should be effective immediately upon Commission approval because securities industry employees should not be locked into an agreement that conflicts

with the principles underlying the anti-discrimination laws. The EEOC was not persuaded otherwise by the NASD's justification that a one-year delay will allow it to improve its arbitral forum<sup>45</sup> and stated that the NASD can still pursue those steps notwithstanding an immediate effective date. The EEOC stated that existing deficiencies in the arbitral process militate against delaying the effective date. The EEOC was concerned that the year delay will allow firms time to implement their own mandatory arbitration agreements to replace the requirement eliminated by the NASD. Similarly, NELA's view is that the real purpose of the waiting period is to allow member firms time to implement their own mandatory arbitration requirements in employee contracts in order to circumvent the positive benefits of the rule change. The WLDF objected to the one-year waiting period because it argued that victims of sexual harassment and other forms of illegal discrimination will continue to be denied important safeguards, while NELA opposed the one year waiting period as being inconsistent with the purpose and spirit of the proposal and stated it would be unconscionable to keep in place for a year a system that is "admittedly inadequate" for the resolution of statutory discrimination claims.

On the other hand, the SIA and Merrill Lynch supported the one-year phase in period.<sup>46</sup> The SIA stated that employees and firms need time to consider what agreements they may wish to enter into with each other and that firms need time to consider and implement the changes. The SIA also noted that the NASD intends to use the year to enhance the quality of its arbitration programs, to increase the level of confidence that employees have in the fairness of the NASD arbitration forum, and to work with other regulators to consider whether other change in the industry registration process are warranted. The SIA argued that the proposal does not need to be implemented immediately to protect employee rights because (1) the Supreme Court has stated that parties who agree to arbitrate their claims do not forgo any substantive statutory rights, and (2) it is not true that

arbitration is improper and unfair to employees. Similarly, Merrill Lynch supported a one-year waiting period because, in its view, arbitration is not unfair, as found by the Supreme Court in *Gilmer*, and employees fare better in SRO arbitration than in court. Merrill Lynch stated that because the proposed rule change represents a significant change in industry practice, other SROs (who have not followed the NASD's lead in this area) and the industry need time to resolve the issues created by the new rule.<sup>47</sup>

NASD Regulation responded that the publicity that has surrounded the proposed rule has always included the fact that the rule would take effect one year after Commission approval, so firms and employees have not been on notice that they should act more quickly. NASD Regulation also stated that making the rule change effective shortly after Commission approval would be problematic because other SROs that require arbitration of employee/employer disputes may wish to amend their rules to be consistent with the NASD and this process could take several months. Nonetheless, the NASD stated that it understands the desirability of a definitive effective date and moved the effective date to January 1, 1999. In the view of NASD Regulation, this date gives other SROs, members and employees sufficient time to take action to respond to the rule.

With regard to the significance of the effective date, NASD Regulation stated that the rule change will apply to claims filed on or after the effective date of the rule change. NASD Regulation asserted that this method is the one most commonly used with regard to changes to the Code and is the most efficient to administer, as it does not involve subsidiary determinations as to the dates of other transactions.

#### *Comments Concerning Voluntary Post-Dispute Agreements*

Several commenters argue that pre-dispute agreements to arbitrate should not be allowed because they are never truly voluntary,<sup>48</sup> because of the

<sup>36</sup> Attorney General Letter; Liddle Letter; Schwab Letter; Fitzpatrick Letter.

<sup>37</sup> Liddle Letter.

<sup>38</sup> Schwab Letter. Schwab noted that the court case and arbitration case might occur in different states, requiring different lawyers and further increasing the costs of final resolution.

<sup>39</sup> Attorney General Letter; Liddle Letter; Schwab Letter.

<sup>40</sup> Schwab Letter. In addition, Schwab observed that parties may file pretextual claims in court to gain the advantage of more liberal discovery in court than in arbitration, or that multiple proceedings may result in orders that conflict with one another. Schwab argued that, because it is more likely that arbitrations and investigations will now occur at the same time because the arbitration necessarily will not resolve the discrimination claims, the proposal creates the potential for conflict between investigations by the EEOC or comparable state or local agencies, and arbitrations. Schwab also maintained that parties to arbitration would then subpoena the investigatory files and submit the information to the arbitration panel, who are likely to misunderstand the information in those files, which may be gathered without due process or significant input from the parties involved. Schwab suggested that EEOC and comparable state investigative files should not be subject to discovery or admissible as evidence in arbitration.

<sup>41</sup> Liddle Letter; Schwab Letter.

<sup>42</sup> Attorney General Letter; EEOC Letter; WLDF Letter; NELA Letter.

<sup>43</sup> EEOC Letter; WLDF Letter; NELA Letter.

<sup>44</sup> Attorney General Letter.

<sup>45</sup> The NASD stated that it intended to improve the arbitration process to ensure procedural adequacy and to safeguard employee rights, including providing for greater disclosure to employees of the effect of signing the Form U-4, the features of arbitration, and their rights under the proposed rule.

<sup>46</sup> Fitzpatrick, who oppose the proposed rule change, nevertheless supported the one-year period in the event the Commission approves the proposed rule change.

<sup>47</sup> Schwab requested that the NASD and the Commission clarify precisely how the one-year effective date is intended to operate. Schwab questioned whether the proposed rule change will apply to any court case filed more than a year form the approval of the proposal (which could encourage people to wait to file a case), or whether it will apply only to employees who sign the Form U-4 after one year has passed (which would result in different employees having different rights in incidents occurring at the same time).

<sup>48</sup> Attorney General Letter; EEOC Letter. The Attorney General further stated that opposition to pre-dispute arbitration agreements is widespread, including some members of Congress, the EEOC, and the Commission on the Future of Worker-

unequal bargaining power of employers and employees,<sup>49</sup> and because they are contrary to the fundamental principles reflected in this nation's anti-discrimination laws.<sup>50</sup> These commenters argued that the Commission should only allow agreements that are truly voluntary and that are entered into after a dispute has arisen.<sup>51</sup> In addition, one commenter supported voluntary post-dispute agreements to arbitrate employment disputes only to the extent that such agreements preserve the substantive protections and remedies afforded by statute, and argued that the NASD should amend its proposal to include such protections.<sup>52</sup>

The NASD Regulation stated it considered the above issues and does not take a position on the desirability of private arbitration agreements between members and their employees, but instead simply determined to remove from its rules the mandatory requirement as to claims of statutory employment discrimination.

#### IV. Discussion

Under the Act, SROs, like the NASD, are assigned rulemaking and enforcement responsibilities to perform their role in regulating the securities industry for the protection of investors and other related purposes. Pursuant to Section 19(b)(2) of the Act, the Commission is required to approve a rule change of an SRO like the NASD if it determines that the proposal is consistent with applicable statutory standards.<sup>53</sup> These standards include Section 15A(b)(6) of the Act, which provides that the NASD's rules must be designed to, among other things, "promote just and equitable principles of trade;" and "protect investors and the public interest." Section 15A(b)(6) also provides that the NASD's rules may not

be designed to "regulate \* \* \* matters not related to the purposes of the [Exchange Act] or the administration of the [NASD]."

By changing its rule, the NASD will no longer require associated persons, solely by virtue of their association or registration with the NASD, to arbitrate claims of statutory employment discrimination. NASD's proposal is consistent with the applicable statutory standards.<sup>54</sup> The statutory employment anti-discrimination provisions reflect an express intention by legislators that employees receive special protection from discriminatory conduct by employers. Such statutory rights are an important part of this country's efforts to prevent discrimination. It is reasonable for the NASD to determine that in this unique area, it will not, as a self-regulatory organization, require arbitration.

With respect to the bifurcation issue raised by the commenters, the Supreme Court, in *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 217 (1985), acknowledge the appropriateness of bifurcation between federal statutory and pendant state law claims.

With respect to the issue raised by commenters of whether the rule should be effective immediately or have a delayed effective date, notwithstanding this rule change by the NASD, other SROs continue to have rules that will require employees of their members to arbitrate statutory discrimination claims. The NASD's decision to move the effective date from one year after approval of the proposed rule change to January 1, 1999 is a reasonable compromise. The January 1, 1999 date will permit other SROs to change their rules as the NASD has done, so that employees of member firms of other SROs will not be required to arbitrate these claims.

With respect to other comments that suggested that the NASD should enact other rules concerning employer/employee arbitration agreements or extend this rule to other causes of action, these issues are left to the NASD to consider in the first instance.

In approving this rule, the Commission notes that it has considered the proposed rule's effects upon efficiency, competition, and capital formation.<sup>55</sup>

Amendment No. 2 is a technical amendment; it changes the rule language to clarify that sexual harassment is a form of sex discrimination prohibited under Title VII (as well as certain state statutes).

This change will make it clear to the securities industry that sexual harassment claims are encompassed within the term "employment discrimination" claims. In addition, as discussed more fully above, Amendment No. 2 also amends the effective date of the proposal to an earlier date, while at the same time still allowing enough time for members and member firms to consider and implement the changes.<sup>56</sup>

#### V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>57</sup> that the proposed rule change, as amended, (SR-NASD-97-77) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>58</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 98-17150 Filed 6-26-98; 8:45 am]

BILLING CODE 8010-01-M

#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40108; File No. SR-PCX-98-14]

#### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 To Extend the Supervisory Specialist Pilot Program

June 22, 1998.

#### I. Background

On March 3, 1998, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") a proposed rule change pursuant to Section 19(b)(2) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> to establish a temporary, 90-day, Supervisory Specialist Pilot Program ("Program").<sup>3</sup>

<sup>56</sup> Because Amendment No. 2 is technical in nature, it is not subject to a notice and comment requirement.

<sup>57</sup> 15 U.S.C. 78s(b)(2).

<sup>58</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> Also on March 3, 1998, the PCX filed proposed rule change SR-PCX-98-13 ("Companion filing"), requesting the Commission to approve a one-year pilot of the Program. See Securities Exchange Act Release No. 39825 (April 1, 1998), 63 FR 17250. The Companion filing originally was to become effective at the expiration of the temporary, 90-day Program. On March 12, 1998 the PCX filed Amendment No. 1 to the proposed rule change. See Letter from Michael D. Pierson, Senior Attorney, Regulatory Policy, PCX, to Marc McKayle, Attorney, Division of Market Regulation ("Division"), Commission

Continued

Management Relations ("Dunlop Commission"). Legislation was introduced in the House and the Senate that would prohibit parties from entering into agreements to resolve employment discrimination claims unless they voluntarily enter into them after such claims arise.

<sup>49</sup> Attorney General Letter.

<sup>50</sup> EEOC Letter.

<sup>51</sup> Attorney General Letter; EEOC Letter; Liddle Letter.

<sup>52</sup> Attorney General Letter. NASD Regulation responded that the content of private arbitration agreements is not germane to the proposed rule change, which simply removes the arbitration requirement imposed through the signing of the Form U-4 from the NASD's rules.

<sup>53</sup> The Commission oversees the arbitration programs of the SROs, like the NASD, through inspections of the SRO facilities and the review of SRO arbitration rules. Inspections are conducted to identify areas where procedures should be strengthened, and to encourage remedial steps either through changes in administration or through the development of rule changes.

<sup>54</sup> 15 U.S.C. 78o-3(b)(6).

<sup>55</sup> 15 U.S.C. 78c(f).