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California Duels With NYSE, NASD

State's New Arbitration Rules Spur Protests About Stringency And Usurpation of Authority

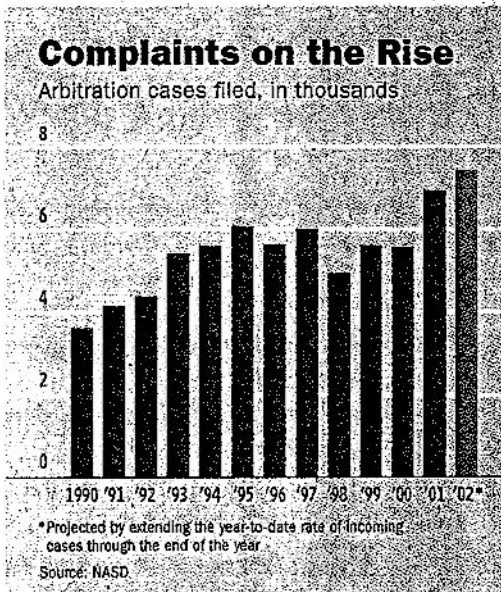
By SUSANNE CRAIG

AT THE HEIGHT OF the tech boom, Joe and Janet Janssens say they took the advice of their Salomon Smith Barney broker and plowed much of their life savings, including money earmarked for their dream home, into technology stocks.

Today, the couple says they have lost \$276,000—nearly a third of their portfolio—and their plans to build that home on a 3-acre lot in Santa Ynez, Calif., are on hold. Their attempts to bring an arbitration claim against the financial powerhouse are also in limbo thanks to an increasingly bitter dispute being played out in California between that state and two of Wall Street's most powerful organizations.

"We are very frustrated," says Mrs. Janssens, 69 years old. "It's like putting your life on hold at the end of your life."

On July 1, California passed legislation with new ethics policies for all arbitrators in the state, aimed at forcing greater disclosure for a range of arbitration forums, including medical malpractice claims,



employment disputes and securities arbitration.

The New York Stock Exchange and the National Association of Securities Dealers, however, have refused to play by the new rules, saying they are unnecessarily stringent and usurp NYSE and NASD authority. The dispute has caused a backlog

of at least 500 cases in a state that generates almost 15% of the country's securities arbitration hearings. The two organizations, which oversee some 7,000 securities arbitration cases heard nationwide each year, have launched a joint lawsuit against California, saying nothing short of a full exemption from the law will satisfy them.

"If California wins, it could set a dangerous precedent," says Linda Fienberg, president of NASD's dispute-resolution program.

At issue: the increased information California is demanding that arbitrators reveal about their financial and professional relationships. An array of additional facts, not just about an arbitrator's immediate family, but also including some extended family members, as well as an arbitrator's past relationships with other lawyers involved in an arbitration hearing, must now be disclosed.

"Before our law went into effect there was a concern that arbitrators were not disclosing conflict that may have affected their impartiality," says the California Senate Judiciary Committee's chief counsel, Gene Wong. "It was a system in need of an overhaul and that is what we did. It certainly isn't our goal to set national rules."

Still, some legal experts believe those standards could become the national model if the NYSE and NASD are forced to comply with the California rules, and the case is being closely watched. A hearing on the NYSE and NASD's request for relief

Please Turn to Page C14, Column 5

California Fights NYSE, NASD

Continued From Page C1

from the bill is scheduled for Sept. 24 a U.S. District Court in San Francisco.

The Public Investors Arbitration Bar Association, a national lawyers' group that has pushed for greater disclosure in the past, supports the California rules. "The California rules are not perfect but provide a solid framework for what should be applied nationally," says the association's president, Phil Aidikoff. "And if the NASD and NYSE lose their case, these rules could very well end up being the national standard."

Although arbitration cases like the Janssens' can be heard in another state as long as both parties to the arbitration agree, plaintiffs lawyers are reluctant to do so. "Many of my clients are elderly and I am not going to ask them to head to Nevada to get justice," says Mr. Aidikoff whose firm represents Mr. and Mrs. Janssens. The firm has filed a lawsuit against the NASD, claiming the association has breached its contract with investors by refusing to appoint arbitration panels in California. Other plaintiffs lawyers say more legal action is almost certain.

Salomon, a unit of Citigroup Inc. didn't return calls for comment.

The clash is the latest between states and national organizations involving Wall Street. In recent months New York Attorney General Eliot Spitzer has taken on several large securities firms, alleging conflicts of interest between their research and investment-banking divisions, an area once thought to be the domain of the Securities and Exchange Commission. In May, to settle the New York probe into research analysts' conflicts, Merrill Lynch & Co. agreed to pay \$100 million and change how it monitors and pays its stock analysts.

This time, what is at stake is the way complaints by brokerage-firm customers are handled. The NYSE and NASD say their disclosure rules are more than adequate in rooting out conflict.

A brokerage-house customer with a complaint is almost guaranteed to end up in arbitration, as brokerage contracts gen-

erally require that investor beefs be handled that way. The NASD, which regulates brokerage firms, handles roughly 90% of cases that go through that process—NYSE takes the rest. Securities arbitration panels consist of three people, one selected by the industry and two from the public.

Under current NYSE/NASD rules, arbitrators are required to disclose any past "financial business, professional, family, social or other relationship" that will affect their impartiality. They also must reveal any relationships that they have had with any party or its counsel, or with any witness.

The California rules are much more detailed in their definition of what might constitute a conflict. For instance, not only are arbitrators specifically asked to disclose personal relationships they might have with parties to the arbitration or with lawyers on either side, they also must reveal relationships that their family members might have had. The requirement that applies to extended family is not as onerous, but some may disqualify an arbitrator. An arbitrator must disclose, for example, if he or she is the trustee of a trust fund for an extended family member, and at what firm the account is held.

Potential arbitrators also have to answer questions about testimony they have given as expert witnesses and consulting assignments they have accepted, and whether any attorney in an arbitration has appeared before them previously. As well, arbitrators can't accept gifts or prospective employment from a party to the arbitration while serving as an arbitrator.

The NYSE and NASD feel the California rules are simply too onerous and will dissuade arbitrators from serving. They say the arbitration system they oversee is national in scope and one state should not be allowed to hijack their rule-making process.

"What are we going to do, move the capital of the country from Washington to Sacramento?" asks Robert Clemente, the NYSE's director of arbitration. "What about Kansas or Wyoming? They probably think more clearly out there because the air is cleaner."

Ms. Fienberg says NASD arbitrators make about \$400 a day, compared with as much as \$1,000 or more in some other arbitrations. The California rules, she says, will require arbitrators to invest countless hours of their own time just to track the information the state is asking for.

Attorney Cary Lapidus, also a former member of the NASD's national arbitration and mediation committee, says because the NASD is denying investors a forum to hear their complaints, there is now some question as to whether brokerage contracts can be enforced.

"They are denying customers a forum," he says. "Right now everyone is waiting to see what happens on Sept. 24, but more legal action is bound to happen if this continues."

Recent Stock-Listing Changes

NEW YORK—Among recent stock-listing changes on the New York Stock Exchange, Gray Communications Systems Inc. is changing its name to Gray Television Inc. Its Class A and Class B shares trade under symbols GTNA and GTN, respectively. BlackRock North American Government Income Trust Inc. is changing its name to BlackRock Income Opportunity Trust Inc. using the same symbol, BNA. Valmont Industries Inc., previously traded on the Nasdaq Stock Market, is now trading on the New York Stock Exchange under a new symbol, VMI. Lionbridge Technologies Inc., previously traded on the Nasdaq Stock Market, is now trading on the Nasdaq SmallCap Market using the same symbol, LIOX.