

SECURITIES WEEK

An exclusive report on events and people in the securities and futures industry

FORMER ARBITRATORS ALLEGE REMOVAL FROM NASD LISTS FOR POLITICAL REASONS, NEVER INFORMED

Joe Lynch, a former arbitrator, only found out he had been removed from the NASD's arbitration pool a year after the actual delisting occurred. And Lynch, of Hatboro, Penn., figured that out, with little help from the NASD, only after he started making inquiries after the stream of arbs coming his way—which had once been significant—dried up.

At the time he was stricken from the pool, July 2001, he had been a panel member of the Holubowich vs. BSC (Bear Stearns) arbitration, he said.

But, he said, no one from the NASD ever notified him he was removed, so he continued to serve on that panel and the others he was already on. As far as he knew nothing had changed. So Lynch was no longer officially qualified to sit on an NASD arbitration panel, even as he sat on several.

"I had a number of cases I was on, but they didn't take me

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CBOT AND MINORITY MEMBERS REACH AGREEMENT, OPENING WAY FOR RESTRUCTURING EXCHANGE

The Chicago Board of Trade has settled the lawsuit brought by certain minority members against full members of the exchange, casting off the last obstacle towards demutualizing into a for-profit corporation.

The dispute was over what percentage of exchange ownership would go to the exchange's Associate, GIM, IDEM and COM members.

Under the terms of a memorandum of understanding approved by the exchange's board, 78% of equity ownership would go to the full members and about 22% to minority members.

The minority members would also receive protection of their current trading rights, and future benefits to their dues and transaction fees.

The court must approve the final terms of the settlement.

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NASD DISCOVERY ABUSE PLANS SEEN BY SOME AS NOT ADDRESSING REAL CAUSE OF PROBLEM

NASD enforcement's recent plans to ensure discovery rules are followed are seen by some industry observers as missing the real problem, which is that arbitrators are either unable or unwilling to enforce the codes already on the books. And those arbitrators that do put firms to the test are eventually moved out of sitting on arbitrations all together, some say.

The NASD's actions, reported by Dow Jones Newswires last week, said the SRO plans to "conclude several cases in the next six months alleging that brokerage firms abused discovery procedures during arbitrations." The article added the NASD wouldn't comment on whether the cases would involve settlements with firms or charges against the firms.

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SEC APPROVES PHLX DEMUTUALIZATION AS PCX MEMBERS OK PLAN OF THEIR OWN

The Philadelphia Stock Exchange will now operate as a share-based corporation after the SEC last week approved the exchange's demutualization.

With the Phlx's demutualization off its plate, the SEC will soon be considering another as the Pacific Exchange's seat owners overwhelmingly approved a demutualization plan on Thursday.

The SEC approval makes the Phlx the first floor-based U.S. stock exchange to demutualize. The all-electronic International Securities Exchange is already demutualized, and the Chicago Mercantile Exchange has gone even further by offering shares to the public.

"This is an historic moment for the Phlx," said Sandy Frucher, Phlx chairman and CEO. "We are now primed to move aggressively to capitalize on our

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arbitrators basically fall asleep during arbitrations and this guy is not one of them."

Frumento agreed that Sturtevant came off as a passive chairman. He added that this was an unusually contentious panel where the three arbitrators spent large amounts of time arguing amongst themselves, with Lynch encroaching on "the chairman's prerogatives."

Ultimately the arbitration went in favor of Bear Stearns, Frumento said, which surprised him, as he thought he had argued the case well enough to at least win something for Holubowich. He said Lynch came to him later and said he had received a call from Sturtevant implying that if he didn't side with him he wouldn't be able to arbitrate again. Lynch repeated this story and said he was officially stricken from the roles the same day he received the call. Sturtevant could not be reached to comment on this specific matter on Friday.

"It was an intimidating thing," Lynch said.

Allan Fedor, partner at Fedor & Fedor in Largo, Fla., is another former arbitrator stricken from the roles without being told.

"I think it might be more prevalent than a lot of people know," he said. Fedor first sat on an NASD arbitration panel in 1987, but hasn't gotten many calls recently. And he really doesn't know why he was removed.

He suspects it involves a case with what he called a "no-name" firm where he sat on a panel on a substitute basis.

"If this were thoroughly researched by the SEC, as opposed to the NASD, there would be an uproar," he said. "Sort of like excluding jurors. Like they used to do many years ago, to keep blacks off."

Fedor only found out he was gone when, a year ago, he tried to update his profile, although officially he's on "inactive status."

"What's this new status?" he asked. "It's not in the code anywhere that I'm aware of."

Barry Estell, an attorney in Kansas City, Mo., had been an arbitrator until 1990 when he was removed for being a "known claimant's" lawyer, even though he had not been to law school. He says he is officially an arbitrator again today, although he never gets called.

"(Former NASD arbitration chair) Debra Masuchi, before the current administration took over, claimed the absolute right to purge anyone that was obviously unacceptable," he said. "What was never answered was, obviously unacceptable to whom?"

Estell too was never told he was removed.

In response to questions about Masuchi, Lynch's claims, Fedor's claims, and requests to speak to Brady, an NASD spokeswoman replied: "First, Debbie Masuchi left NASD quite some time ago in early 1998. On your other questions—we do not comment on the specifics of arbitrations."

Estell backed up Lynch's claims that politically reliable arbitrators are appointed over and over, and flown, expenses paid, to all the arbitrations they can handle.

"They have a favored few who are politically reliable," he

said. "They spare no expense in lavishing cases on them, sending them where they want to go."

Another former arbitrator, who wished to remain anonymous, said he also was stricken from the roles while still serving on several panels, as had happened to Lynch. Like Lynch he never found out why. He said when he questioned Brady about it she said he could continue to sit on the rest of the cases.

He remembers thinking: "What the hell is the head of the NASD telling me?"

He said he contacted the NASD after this and said he has a canon of ethics that have to be disclosed to his present panels if there is a conflict; in this case that he was stricken from further duty. He said the NASD didn't want him to reveal in his ongoing arbitrations that he had been stricken from the roles.

"Brady sends a henchman that said you can either resign or get kicked off completely, and (we'll) never let you back in," he said. "I said I have to disclose to all panels that I've been taken off the roster. So Brady's henchman says I have to resign every case."

Frumento said that when Lynch was booted without any due process it undermined the entire credibility of NASD arbitration.

"You can't have faith in the process if arbitrators don't have some degree of tenure, if they can be willy-nilly thrown off panels because other arbitrators don't like them," he said. "The fact that the NASD has the power to do this and does it without notice and procedural right, really does undermine the credibility of the arbitration process... If an arbitrator is essentially a judge you can't remove judges if you don't like them."

Frumento also believes it wrong not to assign cases to arbitrators simply because you don't like how they decide other cases. "What kind of impartiality is that? Worse, the NASD has vested power in the hands of a staff attorney, a single person, who has the power to strike someone from the roles. There are no rules or regulations, that power can be used arbitrarily."—DS

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But to Allan Fedor, partner at Fedor & Fedor, in Largo, Fla., the system is currently set up to promote arbitrators that don't hold firms to the fire when it comes to producing documents.

"The system really fosters weak arbitrators," he said. "If arbitrators are strong, and make sanction awards, say for discovery abuses, they're afraid they're not going to get called back. It's a system of exclusion."

Fedor added that there is huge discovery abuse by firms now, the worst he's seen in over a decade. "It's in almost every case I have. They're drawing a line in the sand with every

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change, the source added.

Nandapurkar was brought in to the CME by James McNulty, who stepped down as the exchange's chief executive last year, replaced by current CEO Craig Donohue.

"Whenever someone comes into an exchange, they bring in people with them, and by the same token, when that person leaves, the people they brought in tend to leave," said the source close to the CME.

Sources speculated that Nandapurkar may have lost some power when McNulty left the CME, and that he may have felt shut out.

Another source echoed the first, saying: "When you lose the guy who brought you in, you find another place to play."

CME member Jack Bouroudjian, of Spike Trading, said he didn't think Nandapurkar's hire would be a significant factor in Eurex US's success.

"Anecdotally, it's difficult to migrate liquidity from one exchange to another. That will be the challenge for Eurex US. But the end result [of the contest] will be a more efficient marketplace."

As CEO, Nandapurkar will be appointed to Eurex US's board of directors. In addition, Joseph Murphy of Refco will join Eurex US's board, representing independent clearing firms. The week before, Kaushik Amin of Lehman Brothers, Bradford Levy of Goldman Sachs, and Jeffrey Jennings of Morgan Stanley, were appointed to the board.

Uwe Velten, a spokesman for Eurex, said Nandapurkar would start at Eurex US this week. Nandapurkar is a "perfect fit" for Eurex US, and vice-versa, Velten said. He has experience in information technology, trading, and business development—"everything that is needed" by Eurex US.—SR

CME'S DONOHUE HIGHLIGHTS CLEARING LINK IN EXCHANGE'S GROWTH STRATEGY

The Chicago Mercantile Exchange's stock price jumped to \$86.80 last Thursday as the exchange set a new volume record in foreign exchange trading on its Globex electronic platform.

The CME is the leading futures exchange in the U.S. and the only one so far to go public.

The exchange is poised for more growth, according to its new CEO Craig Donohue, and a significant part of its strategy is the Common Clearing Link it recently launched to clear all the Chicago Board of Trade's contracts at the CME's clearinghouse.

"We've all seen the media wring its hands over the loss of Chicago's largest bank," Donohue told members of the Futures Industry Association's Chicago Division last Thursday, "Yet, very little attention has been paid to the fact that Chicago is home to the CME clearinghouse—which is now far and

away the largest derivatives clearing facility in the world."

The clearinghouse holds more than \$38 billion in collateral and handles between \$1.5 and \$6 billion a day in settlements, Donohue said.

"Every major benchmark financial futures instrument is now cleared in a single facility," Donohue said, "unlike the European futures markets." This results in real capital and performance bond reductions of \$1.6 billion to market users, he said.

As a result of the link, the exchange expects to clear more than a billion contracts this year, Donohue said.

Many in the industry regard the Link as the best move the Chicago exchanges could have made in their efforts to win the war against Eurex US, the Eurex subsidiary that plans to launch in February offering identical contracts to CBOT's Treasury products—and perhaps eventually some of the CME's products as well.

Donohue described the night of January 1, 2004, when exchange staff worked through the night to launch the Clearing Link, as "absolutely the most boring event I ever have experienced in my 15 years in the futures industry."

The "flawless" launch of the Link was in part a tribute to the support and cooperation of many in the FIA, Donohue added.

"We succeeded in doing what most thought was impossible: getting the Chicago futures exchange to work together for the benefit of our clearing firms and customers."

Volume at the exchange is up from 900,000 contracts a day three years ago to 2.5 million per day in 2003. Almost 50% of the exchange's volume is done electronically on Globex.

CME is also number one in notional value and open interest.—SR

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case."

In a Notice to Parties issued by the NASD January 16 the SRO explains that it is at least partly attempting to get arbitrators up to snuff: "NASD will be reminding arbitrators about what they can do to manage the discovery process effectively, including what sanctions are available when parties violate either NASD rules or arbitrator orders. Among other things, NASD is creating a new discovery 'mini-course' that will be offered to all arbitrators online in the first quarter of 2004."

Jenice Malecki, a securities attorney in New York, said that while the NASD is on the right path she's unsure of whether this would have any effect on day-to-day operations.

"Notices to members about discovery are issued frequently,