



RULE
ADOPTION
NOTICE

RAN-04-54
November 29, 2004

**TO: All OTP Holders and OTP Firms
ETP Holders and Sponsored Participants**

FROM: Department of Regulatory Policy

**SUBJECT: Arbitrator Classification, Challenges and Disclosure
(File No. SR-PCX-2004-80)**

On August 16, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission a proposal to amend the PCX Options and PCX Equities arbitration rules relating to arbitrator classification, challenges, and disclosure. The Exchange filed Amendment No. 1 to the proposed rule change on October 1, 2004. The Commission approved the proposed rule change on November 22, 2004.

The following is the text of the rule change. Questions regarding this bulletin may be directed to Tania J.C. Blanford at (415) 393-4107.

EXHIBIT A
Text of the Proposed Rule Change:¹

**Rules of the
Pacific Exchange, Inc.**

**Rule 12
Arbitration**

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Designation of Number of Arbitrators

Rule 12.8(a) – (b) – No change.

(c) An arbitrator will be deemed as a non-public arbitrator, or being from the securities industry, if he or she:

¹ New text is underscored; deleted text is in brackets.

(i)[1.] is a person associated with an OTP Firm, OTP Holder, [or] broker/dealer, government securities broker, government securities dealer, municipal securities dealer or registered investment advisor, is registered under the Commodity Exchange Act, a member of a commodities exchange or a registered futures association; or associated with a person or firm registered under the Commodity Exchange Act; or

(ii)[2.] has been associated with any of the above within the past five (5) [three (3)] years, or

(iii)[3.] is retired from, or spent a substantial part of a career, engaging in any of the business activities listed [any of the above] in subsection (i), or

(iv)[4.] is an attorney, accountant or other professional who devoted twenty (20) percent or more of his or her professional work effort to securities industry clients within the last two (2) years.

(d) An arbitrator will be deemed as a public arbitrator if he or she: [An arbitrator who is not from the securities industry shall be deemed a public arbitrator. A person will not be classified as a public arbitrator if he or she has a spouse or other member of the household who is a person associated with a registered broker, dealer, municipal securities dealer, government securities broker, government securities dealer or investment advisor]

(i) is not engaged in the conduct or activities described in subsection (c)(i)-(iv);

(ii) was not engaged in the conduct or activities described in subsections (c)(i)-(iv) for a total of twenty (20) years or more;

(iii) is not an investment adviser;

(iv) is not an attorney, accountant, or other professional whose firm derived ten (10) percent or more of its annual revenue in the past two (2) years from any persons or entities listed in subsections (c)(i)-(iv);

(v) is not the spouse, parent, stepparent, child, or stepchild, or a member of the household of a person who is engaged in the conduct or activities described in subsections (c)(i)-(iv);

(vi) is not a person who receives financial support of more than 50 percent of his or her annual income from a person engaged in the conduct or activities described in subsections (c)(i)-(iv);

(vii) and is not a person who is claimed as a dependent for federal income tax purposes by a person engaged in the conduct or activities described in subsections (c)(i)-(iv).

(e) – (g) – No change.

Notice of Selection of Arbitrators

Rule 12.9. The Director of Arbitration shall inform the parties of the arbitrators' names and employment histories for the past ten (10) years, as well as information disclosed pursuant to Section 11 of this Rule at least eight (8) business days prior to the date fixed for the first hearing session. A party may make further inquiry of the Director of Arbitration concerning an arbitrator's background. In the event that any arbitrator after appointment and prior to the first hearing session, should resign, die, withdraw, be disqualified or otherwise be unable to perform as an arbitrator, the Director of Arbitration shall appoint a replacement arbitrator to fill any vacancy. The Director of Arbitration will grant a party's request to disqualify an arbitrator if it is reasonable to infer, based on information known at the time of request, that the arbitrator is biased, lacks impartiality, or has an interest in the outcome of the arbitration. The interest or bias must be direct, definite, and capable of reasonable demonstration, rather than remote or speculative. The Director of Arbitration shall inform the parties of the name and employment history of the arbitrator for the past ten (10) years, as well as information disclosed pursuant to Section 11, as soon as possible. A party may make further inquiry of the Director of Arbitration concerning the background of the replacement arbitrator and, within the time remaining prior to the first hearing session, or the five (5) day period provided under Section 10, whichever is shorter, may exercise its right to challenge the replacement arbitrator as provided under Section 10.

Peremptory Challenge

Rule 12.10. In any arbitration proceeding, each party shall have the right to one peremptory challenge. In arbitrations where there are multiple Claimants, Respondents and/or Third Party Respondents, the Claimants shall have one peremptory challenge, the Respondents shall have one peremptory challenge and the Third Party Respondents shall have one peremptory challenge, unless the Director of Arbitration determines that the interests of justice would best be served by awarding additional peremptory challenges. Unless extended by the Director of Arbitration, a party wishing to exercise a peremptory challenge must do so by notifying the Director of Arbitration in writing within five (5) business days of notification of the identity of the persons named to the panel. There shall be unlimited challenges for cause.

In cases involving public customers, any close questions regarding arbitrator classification or challenges for cause brought by a customer will be resolved in favor of the customer.

Disclosures Required of Arbitrators

Rule 12.11 Each arbitrator shall be required to disclose to the Director of Arbitration any circumstances which might preclude such arbitrator from rendering any objective and impartial determination. Each arbitrator shall disclose:

(i)[(1)] any direct or indirect financial or personal interest in the outcome of the arbitration;

(ii)[(2)] any existing or past financial, business, professional, family or social relationships that are likely to affect impartiality or that might reasonable create an appearance of partiality or bias. Persons requested to serve as arbitrators must [should] disclose any such relationships which they personally have with any party or its counsel, or with any individual whom they have been told will be a witness. They must [should] also disclose any such relationship involving members of their families or their current employers, partners, or business associates.

(b) persons who are requested to accept appointment as arbitrators must [should] make a reasonable effort to inform themselves of any interests or relationships described in subsection (a) above.

(c) – (d) – No change.

(e) The Director of Arbitration will grant a party's request to disqualify an arbitrator if it is reasonable to infer, based on information known at the time of request, that the arbitrator is biased, lacks impartiality, or has an interest in the outcome of the arbitration. The interest or bias must be direct, definite, and capable of reasonable demonstration, rather than remote or speculative.

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**Rules of
PCX Equities, Inc.**

**Rule 12
Arbitration**

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Designation of Number of Arbitrators

Rule 12.9(a) – (b) – No change.

(c) An arbitrator will be deemed as a non-public arbitrator, or being from the securities industry, if he or she:

(i)[1.] is a person associated with an ETP Holder, [or] broker/dealer, government securities broker, government securities dealer, municipal securities dealer or registered investment advisor, is registered under the Commodity Exchange Act, a member of a commodities exchange or a registered futures association; or associated with a person or firm registered under the Commodity Exchange Act; or

(ii)[2.] has been associated with any of the above within the past five (5) [three (3)] years, or

(iii)[3.] is retired from, or spent a substantial part of a career, engaging in any of the business activities listed [any of the above] in subsection (i), or

(iv)[4.] is an attorney, accountant or other professional who devoted twenty (20) percent or more of his or her professional work effort to securities industry clients within the last two (2) years.

(d) An arbitrator will be deemed as a public arbitrator if he or she: [An arbitrator who is not from the securities industry shall be deemed a public arbitrator. A person will not be classified as a public arbitrator if he or she has a spouse or other member of the household who is a person associated with a registered broker, dealer, municipal securities dealer, government securities broker, government securities dealer or investment advisor]

(i) is not engaged in the conduct or activities described in subsection (c)(i)-(iv);

(ii) was not engaged in the conduct or activities described in subsections (c)(i)-(iv) for a total of twenty (20) years or more;

(iii) is not an investment adviser;

(iv) is not an attorney, accountant, or other professional whose firm derived ten (10) percent or more of its annual revenue in the past two (2) years from any persons or entities listed in subsections (c)(i)-(iv);

(v) is not the spouse, parent, stepparent, child, or stepchild, or a member of the household of a person who is engaged in the conduct or activities described in subsections (c)(i)-(iv);

(vi) is not a person who receives financial support of more than fifty (50) percent of his or her annual income from a person engaged in the conduct or activities described in subsections (c)(i)-(iv);

(vii) and is not a person who is claimed as a dependent for federal income tax purposes by a person engaged in the conduct or activities described in subsections (c)(i)-(iv).

(e) – (g) – No change.

Notice of Selection of Arbitrators

Rule 12.10. The Director of Arbitration shall inform the parties of the arbitrators' names and employment histories for the past ten (10) years, as well as information disclosed pursuant to Rule 12.12 at least eight (8) business days prior to the date fixed for the first hearing session. A party may make further inquiry of the Director of Arbitration concerning an arbitrator's background.

In the event that any arbitrator after appointment and prior to the first hearing session, should resign, die, withdraw, be disqualified or otherwise be unable to perform as an arbitrator, the Director of Arbitration shall appoint a replacement arbitrator to fill any vacancy. The Director of Arbitration will grant a party's request to disqualify an arbitrator if it is reasonable to infer, based on information known at the time of request, that the arbitrator is biased, lacks impartiality, or has an interest in the outcome of the arbitration. The interest or bias must be direct, definite, and capable of reasonable demonstration, rather than remote or speculative. The Director of Arbitration shall inform the parties of the name and employment history of the arbitrator for the past ten (10) years, as well as information disclosed pursuant to Rule 12.12, as soon as possible.

A party may make further inquiry of the Director of Arbitration concerning the background of the replacement arbitrator and, within the time remaining prior to the first hearing session, or the five (5) day period provided under Rule 12.11, whichever is shorter, may exercise its right to challenge the replacement arbitrator as provided under Rule 12.11.

Peremptory Challenge

Rule 12.11. In any arbitration proceeding, each party shall have the right to one peremptory challenge. In arbitrations where there are multiple Claimants, Respondents and/or

Third Party Respondents, the Claimants shall have one peremptory challenge, the Respondents shall have one peremptory challenge and the Third Party Respondents shall have one peremptory challenge, unless the Director of Arbitration determines that the interests of justice would best be served by awarding additional peremptory challenges.

Unless extended by the Director of Arbitration, a party wishing to exercise a peremptory challenge must do so by notifying the Director of Arbitration in writing within five (5) business days of notification of the identity of the persons named to the panel. There shall be unlimited challenges for cause.

In cases involving public customers, any close questions regarding arbitrator classification or challenges for cause brought by a customer will be resolved in favor of the customer.

Disclosures Required of Arbitrators

Rule 12.12(a) Each arbitrator shall be required to disclose to the Director of Arbitration any circumstances which might preclude such arbitrator from rendering any objective and impartial determination. Each arbitrator shall disclose:

(i)[(1)] any direct or indirect financial or personal interest in the outcome of the arbitration;

(ii)[(2)] any existing or past financial, business, professional, family or social relationships that are likely to affect impartiality or that might reasonable create an appearance of partiality or bias. Persons requested to serve as arbitrators must [should] disclose any such relationships which they personally have with any party or its counsel, or with any individual whom they have been told will be a witness. They must [should] also disclose any such relationship involving members of their families or their current employers, partners, or business associates.

(b) persons who are requested to accept appointment as arbitrators must [should] make a reasonable effort to inform themselves of any interests or relationships described in subsection (a) above.

(c) – (d) – No change.

(e) The Director of Arbitration will grant a party’s request to disqualify an arbitrator if it is reasonable to infer, based on information known at the time of request, that the arbitrator is biased, lacks impartiality, or has an interest in the outcome of the arbitration. The interest or bias must be direct, definite, and capable of reasonable demonstration, rather than remote or speculative.