

Proposed Rule Change by National Association of Securities Dealers
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial <input checked="" type="checkbox"/>	Amendment <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) <input checked="" type="checkbox"/>	Section 19(b)(3)(A) <input type="checkbox"/>	Section 19(b)(3)(B) <input type="checkbox"/>
			Rule		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action <input type="checkbox"/>	Date Expires <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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Description
Provide a brief description of the proposed rule change (limit 250 characters).

The proposed rule change amends the proposed Code of Arbitration Procedure for Customer Disputes and the proposed Code of Arbitration Procedure for Industry Disputes and the NASD Code of Arbitration Procedure to address representation of parties in arbitration and mediation.

Contact Information
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name	<input type="text" value="Mignon"/>	Last Name	<input type="text" value="McLemore"/>
Title	<input type="text" value="Assistant Chief Counsel, NASD Dispute Resolution"/>		
E-mail	<input type="text" value="mignon.mclemore@nasd.com"/>		
Telephone	<input type="text" value="(202) 728-8151"/>	Fax	<input type="text" value="(301) 527-4752"/>

Signature
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date	<input type="text" value="09/14/2006"/>
By	<input type="text" value="Jean I. Feeney"/>
	(Name)
	<input type="text" value="Vice President and Chief Counsel, NASD Dispute Resolution"/>
	(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. (“NASD Dispute Resolution”), is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend the proposed Code of Arbitration Procedure for Customer Disputes (“Customer Code”), the proposed Code of Arbitration Procedure for Industry Disputes (“Industry Code”), and the NASD Code of Arbitration Procedure (“Code”) to address representation of parties in arbitration and mediation.¹ Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * *

Customer Code

12208. Representation of Parties

(a) Representation by a Party

Parties may represent themselves in an arbitration held in a United States hearing location. A member of a partnership may represent the partnership; and a bona fide officer of a corporation, trust, or association may represent the corporation, trust, or association.

(b) Representation by an Attorney

At any stage of an arbitration proceeding held in a United States hearing location, [All] all parties shall have the right to be represented by [counsel during any stage of an arbitration] an attorney at law in good standing and admitted to practice before the Supreme Court of the United States or the highest court of any state of the United States,

¹ The proposed rule change would amend the new NASD Code of Mediation Procedure, which was approved on October 31, 2005, and became effective on January 30, 2006. See Securities Exchange Act Rel. No. 34-52705 (Oct. 31, 2005); 70 FR 67525 (Nov. 7, 2005) (SR-NASD-2004-013). It is included currently in the Code, but will be renumbered once the Customer and Industry Codes are approved by the Commission.

the District of Columbia, or any commonwealth, territory, or possession of the United States.

(c) Representation by Others

Parties may be represented in an arbitration by a person who is not an attorney, unless:

- state law prohibits such representation, or
- the person is currently suspended or barred from the securities industry in any capacity, or
- the person is an attorney who is currently suspended or disbarred from the practice of law.

(d) Qualifications of Representative

Issues regarding the qualifications of a person to represent a party in arbitration are governed by applicable law and may be determined by an appropriate court or other regulatory agency. In the absence of a court order, the arbitration proceeding shall not be stayed or otherwise delayed pending resolution of such issues.

Industry Code

13208. Representation of Parties

(a) Representation by a Party

Parties may represent themselves in an arbitration held in a United States hearing location. A member of a partnership may represent the partnership; and a bona fide officer of a corporation, trust, or association may represent the corporation, trust, or association.

(b) Representation by an Attorney

At any stage of an arbitration proceeding held in a United States hearing location, [All] all parties shall have the right to be represented by [counsel during any stage of an arbitration] an attorney at law in good standing and admitted to practice before the Supreme Court of the United States or the highest court of any state of the United States, the District of Columbia, or any commonwealth, territory, or possession of the United States.

(c) Representation by Others

Parties may be represented in an arbitration by a person who is not an attorney, unless:

- state law prohibits such representation, or
- the person is currently suspended or barred from the securities industry in any capacity, or

- the person is an attorney who is currently suspended or disbarred from the practice of law.

(d) Qualifications of Representative

Issues regarding the qualifications of a person to represent a party in arbitration are governed by applicable law and may be determined by an appropriate court or other regulatory agency. In the absence of a court order, the arbitration proceeding shall not be stayed or otherwise delayed pending resolution of such issues.

* * *

Code of Arbitration Procedure

10407. Representation of Parties

(a) Representation by Party

Parties may represent themselves in mediation held in a United States hearing location. A member of a partnership may represent the partnership; and a bona fide officer of a corporation, trust, or association may represent the corporation, trust, or association.

(b) Representation by an Attorney

At any stage of a mediation proceeding held in a United States hearing location, all parties shall have the right to be represented by an attorney at law in good standing and admitted to practice before the Supreme Court of the United States or the highest court of any state of the United States, the District of Columbia, or any commonwealth, territory, or possession of the United States.

(c) Representation by Others

Parties may be represented in mediation by a person who is not an attorney, unless:

- state law prohibits such representation, or
- the person is currently suspended or barred from the securities industry in any capacity, or
- the person is an attorney who is currently suspended or disbarred from the practice of law.

(d) Qualifications of Representatives

Issues regarding the qualifications of a person to represent a party in mediation are governed by applicable law and may be determined by an appropriate court or other regulatory agency. In the absence of a court order, the mediation proceeding shall not be delayed pending resolution of such issues.

[10407] 10408. Mediator Selection

(a) – (d) No change.

[10408] 10409. Limitation on Liability

No change.

[10409] 10410. Mediation Ground Rules

(a) – (g) No change.

[10410] 10411. Mediation Fees

(a) – (c) No change.

* * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change to amend Rule 12208 of the Customer Code and Rule 13208 of the Industry Code, and to adopt a new Rule 14106 of the Mediation Code was approved by the Board of Directors of NASD Dispute Resolution at its meeting on July 19, 2006 which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Regulation have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by the NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on July 20, 2006.

No other action by the NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

The NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

(b) Questions regarding this rule filing may be directed to Mignon McLemore, Assistant Chief Counsel, NASD Dispute Resolution at (202) 728-8151.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

a) Purpose

Background

NASD Dispute Resolution believes a rule is needed to clarify the issue of representation of parties in dispute resolution. Under the current Code, Rule 10316 states that all parties shall have the right to representation by counsel at any stage of the proceedings. The rule does not provide any guidance on the kind of representatives who are permitted to practice in the NASD dispute resolution forum; nor does it provide guidance on the qualifications those representatives must have to participate in the forum. Moreover, Rule 10316 does not address a growing trend in American jurisprudence, the multi-jurisdictional practice of law.

The multi-jurisdictional practice of law occurs when attorneys, licensed in one United States (U.S.) jurisdiction, practice law in a jurisdiction in which they are not licensed. In the area of dispute resolution, for example, it is common for an attorney licensed to practice law in one state to represent a client in a dispute resolution proceeding in another state in which the attorney is not licensed. Although this practice

is common, it can be a violation of state unauthorized practice of law provisions. Until recently, most states had taken no action against this practice. However, recent case law developments suggest that states are reconsidering this position. For example, two state courts have found that an out-of-state attorney providing representation in an arbitration or mediation proceeding is engaging in the practice of law, and that it is a violation of the state's unauthorized practice of law statute to participate in such a proceeding without being licensed in that jurisdiction.²

In light of these developments and the trend toward multi-jurisdictional practice, the American Bar Association (ABA) amended its Model Rule of Professional Conduct 5.5 (Rule 5.5) so that those attorneys representing a client in a dispute resolution proceeding in a United States jurisdiction where they are not licensed could participate in the dispute resolution proceeding in that jurisdiction without violating the state's unauthorized practice of law rules.³ While Rule 5.5 establishes a new standard for certain types of legal activity, it can be enforced only if the states adopt it into their laws. Some states have adopted either Rule 5.5 or a similar version of the rule.⁴ Other states have

² See Birbrower, Montalbano, Condo & Frank v. Superior Court, 949 P.2d 1 (Cal. 1998); see also Florida Bar v. Rapoport, 845 So. 2d 874, 2003 Fla. LEXIS 250 (Fla. 2003).

³ Model Rule 5.5, as amended, would allow a United States lawyer, admitted in one United States jurisdiction, to engage in certain types of legal activity in another United States jurisdiction where he is not licensed to practice, without being deemed to be engaging in the unauthorized practice of law. For purposes of the dispute resolution forum, Model Rule 5.5, as amended, states, in relevant part, that a lawyer may provide legal services on a temporary basis in an out-of-state jurisdiction that are in or reasonably related to a pending or potential arbitration, mediation, or other alternative dispute resolution proceeding in the jurisdiction or another jurisdiction, if the services arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice and are not services for which the forum requires *pro hac vice* admission. This rule is sometimes referred to as the temporary practice rule.

⁴ Twenty-seven states have either adopted Rule 5.5 or a similar version of the rule or currently have a temporary practice rule in effect. American Bar Association, *Charts on State Adoption of MJP Proposals* (visited Aug. 23, 2006) <http://www.abanet.org/cpr/mjp/state_adoption.html>.

adopted a temporary practice rule that, like Rule 5.5, allows an attorney not licensed in a state to provide certain types of legal services in the state on a limited basis.⁵

As a result of these developments and the lack of guidance under the Code, NASD developed a proposal to address the issues raised in dispute resolution by the multi-jurisdictional practice of law and to provide guidance to parties and representatives on the qualifications necessary to represent a party in NASD's dispute resolution forum.

Proposal Relating to Representation in Arbitration and Mediation

On February 9, 2005, NASD filed a proposed rule change with the Commission to address attorney representation in arbitration and mediation.⁶ The proposed rule change would have:

- Allowed parties to represent themselves in an arbitration or mediation;
- Allowed parties to be represented by an attorney at law admitted to practice before a U.S. jurisdiction at any stage of the proceeding; and
- Deferred to the states any issues regarding qualifications of a person to represent a party.

NASD amended the attorney representation proposal on July 8, 2005 to clarify that the proposal was intended to address the issue of multi-jurisdictional practice of law by attorneys, and not intended to address the issue of representation by non-attorneys in arbitration or mediation proceedings.⁷

⁵ The laws of Michigan and Virginia specifically authorize occasional or incidental practice by out-of-state lawyers. See Mich. Comp. Law Ann. sec. 600.916 and Va. State Bar Rule, Pt. 6, sec. 1(C).

⁶ See File No. SR-NASD-2005-023.

⁷ Id. at Amendment No. 1.

The attorney representation proposal was published in the Federal Register on July 21, 2005.⁸ The SEC received fifteen comments on the proposal. The comments focused on two issues: whether the rule should preempt state law regarding attorney licensing, and whether the rule should prohibit non-attorneys from practicing in NASD's forum. The comments and NASD's response are discussed below.

Based on the comments received on the attorney representation proposal, as amended, NASD recognized that the proposal may have been ambiguous. NASD did not intend to change current practice in the forum regarding representation of parties by non-attorneys; nor did it intend to preempt state law on the issue of attorney licensing. Because the comments indicated that these positions were unclear, NASD has withdrawn the attorney representation proposal, and is filing a new proposed rule change to address representation of parties in arbitration and mediation.

Representation of Parties in Arbitration and Mediation

NASD is proposing to amend Rules 12208 and 13208 of the Customer and Industry Codes, respectively, and to adopt a new Rule 10407 of the Code to clarify that: (1) parties may represent themselves; (2) parties may be represented by an attorney, provided certain criteria are met; (3) parties may be represented in an arbitration or mediation by a person who is not an attorney, unless state law prohibits such representation or the person is currently suspended or barred from the securities industry in any capacity or is an attorney who is currently suspended or disbarred from the

⁸ See Securities Exchange Act Rel. No. 34-52045 (July 15, 2005); 70 FR 42123 (July 21, 2005) (File No. SR-NASD-2005-023).

practice of law; and (4) issues regarding qualifications of a representative are governed by applicable law.

First, the proposed rule change states explicitly what is currently the case, that parties may represent themselves in arbitration.

Second, the proposed rule change states that if a party chooses to be represented by an attorney, the attorney must be licensed to practice in a U.S. jurisdiction and be in good standing in that jurisdiction. NASD believes that requiring an attorney to be licensed in a U.S. jurisdiction and to be in good standing in that jurisdiction will protect investors by prohibiting individuals who have been suspended or disbarred from the practice of law from representing parties in the NASD forum. Further, the requirement that an attorney must be licensed to practice in a U.S. jurisdiction sets a standard of practice for the arbitration forum that is consistent with the other rules and proceedings of NASD. Rule 9141(b) of the NASD Code of Procedure states, in relevant part, that a person may be represented in any disciplinary proceeding by an attorney at law admitted to practice before the highest court of any state of the United States, the District of Columbia, or any commonwealth, territory, or possession of the United States.⁹ The SEC also has a similar practice rule. Rule 102(b) of the SEC Rules of Practice states that, in

⁹ This rule has been enforced in NASD Enforcement proceedings. In two similar cases, a respondent's answer was stricken from the record because the respondent's representative had not indicated that he was a licensed attorney. See NASDR Office of the Hearing Officers, OHO Order 97-15 (C01970032) (visited Aug. 24, 2006) <http://www.nasd.com/web/groups/enforcement/documents/oho_disciplinary_orders/nasdw_007839.pdf> ; see also OHO Order 98-10 (C10970176) (visited Aug. 24, 2006) <http://www.nasd.com/web/groups/enforcement/documents/oho_disciplinary_orders/nasdw_007695.pdf>.

any proceeding, a person may be represented by an attorney at law admitted to practice before the Supreme Court of the United States or the highest court of any State.¹⁰

Third, the proposed rule change addresses the representation of parties by non-attorneys in the NASD forum. Under the proposed rule change, parties may be represented in an arbitration or mediation by a person who is not an attorney, unless state law prohibits such representation or the person is currently suspended or barred from the securities industry in any capacity or is an attorney who is currently suspended or disbarred from the practice of law.

NASD understands that it may be difficult for investors with claims of less than \$100,000 to retain an attorney on a contingency-fee basis, because the attorney may believe that the attorney's share of the award might be too small to justify the effort. In these circumstances, NASD believes that investors should be able to seek other assistance to resolve their arbitration or mediation claims for a reasonable fee.¹¹ At the same time, NASD believes that such non-attorney representatives should not be persons who have been found by a regulatory body to be unfit to represent clients or to conduct securities business with the public. Thus, to protect investors, the rule would prohibit non-attorney representatives who are currently suspended or barred from the securities industry, or attorneys who are currently suspended or disbarred from the practice of law, from

¹⁰ See SEC Rules of Practice, 17 C.F.R. §201.102(b) (2004).

¹¹ As at present, the proposed rule would allow a relative, friend or associate to represent or assist an elderly or disabled person with his or her arbitration or mediation. In addition, law school securities arbitration clinics can provide investors with affordable, legal representation. A securities arbitration clinic can help an investor who has a smaller claim but is unable to hire an attorney, provided the investor qualifies for assistance. See *How to Find an Attorney* (for more information on clinic locations and eligibility requirements) (visited Sept. 13, 2006) <<http://www.nasd.com/ArbitrationMediation/StartanArbitrationorMediation/HowtoFindanAttorney/index.htm>>.

representing parties in the NASD dispute resolution forum. While NASD remains concerned about some aspects of non-attorney representation, NASD does not wish to prohibit investors from retaining a non-attorney representative if that person is the only affordable representation available, and the requirements of the proposed rule are met.

Last, the proposed rule change would allow attorneys to represent a client in an NASD arbitration or mediation held in any U.S. hearing location, regardless of the jurisdiction in which the attorneys are licensed. The attorneys' qualifications to represent clients in a jurisdiction in which they are not licensed would be subject to the applicable law of that jurisdiction. The proposed rule change is not intended to preempt a state from deciding that an out-of-state attorney may have violated a state's unauthorized practice of law provision by representing a party in an NASD dispute resolution proceeding. It is intended, however, to reflect current practice in the forum, which, based on experience, indicates that the outcome of a dispute resolution proceeding depends more on the level of knowledge, training and skill of the attorneys, rather than the jurisdiction from which the attorneys received their license to practice.

b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change balances the needs of investors to have access to representation in small cases with NASD's responsibility to protect investors, the integrity of its forum, and the public interest.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received by NASD. The SEC received fifteen comments on the attorney representation proposal that was published for comment on July 21, 2005.¹² The comments focused on two issues: whether the rule should preempt state law regarding attorney licensing, and whether the rule should prohibit non-attorneys from practicing in NASD's forum.

With respect to the state preemption issue, one group of commenters supported the provision of the rule that stated that state law should control whether attorneys may participate in arbitrations in a state in which they are not licensed.¹³ These commenters were concerned that representatives should be licensed, legal practitioners, who are

¹² Comment letters were submitted by Timothy A. Canning, Esq., Law Offices of Timothy A. Canning, dated August 10, 2005 ("Canning I Letter"); Albert A. Rapoport, Esq., dated June 20, 2005 ("Rapoport Letter"); Joseph C. Korsak, Esq., Law Office of Joseph C. Korsak, dated July 22, 2005 ("Korsak Letter"); Michael Firestein, Esq. and Navid Yadegar, Esq., Proskauer Rose LLP, dated August 1, 2005 ("Firestein Letter"); Rodney J. Heggy, Esq., Heggy & Associates, LLC, dated August 4, 2005 ("Heggy Letter"); Richard L. Sacks, Securities Arbitration Consultant, dated August 9, 2005 ("Sacks Letter"); Rosemary Shockman, President, Public Investors Arbitration Bar Association, dated August 9, 2005 ("PIABA Letter"); Joseph O'Donnell, dated August 10, 2005 ("O'Donnell Letter"); Irwin G. Stein, dated August 10, 2005 ("Stein Letter"); Montgomery G. Griffin, Esq., Securities Arbitration Offices of Montgomery G. Griffin, dated August 10, 2005 ("Griffin Letter"); Timothy A. Canning, Esq., Law Offices of Timothy A. Canning, dated August 10, 2005 ("Canning II Letter"); Kevin P. Takacs, CCO, Dominion Investor Services, Inc., dated August 11, 2005 ("Takacs Letter"); Jill I. Gross, Director of Advocacy and Barbara Black, Director of Research, Pace Investor Rights Project, dated August 11, 2005 ("PACE Letter"); and Stephen C. Krosschell, Esq., Goodman & Nekvasil, P.A., dated August 11, 2005 ("Krosschell Letter"). The letter received from Marie W. Hayes, dated March 25, 2005, does not comment on the proposed rule change.

¹³ See PACE Letter, Heggy Letter, Firestein Letter, Rapoport Letter and PIABA Letter.

regulated and have demonstrated a minimum level of competence required to represent clients. Another group of commenters opposed the provision of the proposal that would allow state law to control attorney-licensure issues.¹⁴ These commenters contended that the provision could result in delays in arbitration proceedings as party representatives make the qualifications of an out-of-state representative the focus of the proceedings.

Other commenters speculated as to whether the proposal would prohibit, in effect, non-attorneys from practicing in NASD's forum. One group of these commenters contended that the proposal should address non-attorney representation and should allow non-attorneys to practice in the forum.¹⁵ These commenters argued that the proposal attempts to deny investors access to qualified non-attorney representatives who have securities industry experience and are willing to accept cases that are too small to enable investors to retain a securities attorney. The other commenters contended that the proposal should prohibit compensated non-attorney representation in securities arbitration, because the lack of legal training makes non-attorneys less knowledgeable or competent to deal fully with the laws and issues that arise in an arbitration proceeding.¹⁶

Based on the disparate comments received on the proposal, NASD recognized that the proposal may not have been clear. NASD did not intend to change current practice in the forum regarding representation of parties by non-attorneys; nor did it intend to preempt state law on the issue of attorney licensing. Because the comments

¹⁴ See Krosschell Letter, Canning I & II Letters, Stein Letter, Sacks Letter, and Korsak Letter.

¹⁵ See Takacs Letter, Griffin Letter, Stein Letter, Sacks Letter, Rapoport Letter, and O'Donnell Letter.

¹⁶ See PACE Letter, Heggy Letter, Firestein Letter, Korsak Letter and PIABA Letter.

indicated that these positions were unclear, NASD has withdrawn the attorney representation proposal and is filing this new proposal to replace it.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

SECURITIES AND EXCHANGE COMMISSION

Release No. 34-_____; File No. SR-NASD-2006-109

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Representation of Parties in Arbitration and Mediation

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that the National Association of Securities Dealers, Inc. (“NASD”), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. (“NASD Dispute Resolution”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) on September 14, 2006, the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Dispute Resolution. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD Dispute Resolution is proposing to amend the proposed Code of Arbitration Procedure for Customer Disputes (“Customer Code”), the proposed Code of Arbitration Procedure for Industry Disputes (“Industry Code”), and the NASD Code of Arbitration Procedure (“Code”) to address representation of parties in arbitration and mediation.³ Below

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The proposed rule change would amend the new NASD Code of Mediation Procedure, which was approved on October 31, 2005, and became effective on January 30, 2006. See Securities Exchange Act Rel. No. 34-

is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * * *

Customer Code

12208. Representation of Parties

(a) Representation by a Party

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(b) Representation by an Attorney

At any stage of an arbitration proceeding held in a United States hearing location, [All] all parties shall have the right to be represented by [counsel during any stage of an arbitration] an attorney at law in good standing and admitted to practice before the Supreme Court of the United States or the highest court of any state of the United States, the District of Columbia, or any commonwealth, territory, or possession of the United States.

(c) Representation by Others

Parties may be represented in an arbitration by a person who is not an attorney, unless:

- state law prohibits such representation, or
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- the person is an attorney who is currently suspended or disbarred from the practice of law.

(d) Qualifications of Representative

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- the person is an attorney who is currently suspended or disbarred from the practice of law.

(d) Qualifications of Representative

Issues regarding the qualifications of a person to represent a party in arbitration are governed by applicable law and may be determined by an appropriate court or other regulatory agency. In the absence of a court order, the arbitration proceeding shall not be stayed or otherwise delayed pending resolution of such issues.

* * *

Code of Arbitration Procedure**10407. Representation of Parties****(a) Representation by Party**

Parties may represent themselves in mediation held in a United States hearing location. A member of a partnership may represent the partnership; and a bona fide officer of a corporation, trust, or association may represent the corporation, trust, or association.

(b) Representation by an Attorney

At any stage of a mediation proceeding held in a United States hearing location, all parties shall have the right to be represented by an attorney at law in good standing and admitted to practice before the Supreme Court of the United States or the highest court of any state of the United States, the District of Columbia, or any commonwealth, territory, or possession of the United States.

(c) Representation by Others

Parties may be represented in mediation by a person who is not an attorney, unless:

- state law prohibits such representation, or
- the person is currently suspended or barred from the securities industry in any capacity, or
- the person is an attorney who is currently suspended or disbarred from the practice of law.

(d) Qualifications of Representatives

Issues regarding the qualifications of a person to represent a party in mediation are governed by applicable law and may be determined by an appropriate court or other regulatory agency. In the absence of a court order, the mediation proceeding shall not be delayed pending resolution of such issues.

[10407] 10408. Mediator Selection

(a) – (d) No change.

[10408] 10409. Limitation on Liability

No change.

[10409] 10410. Mediation Ground Rules

(a) – (g) No change.

[10410] 10411. Mediation Fees

(a) – (c) No change.

* * * *

II. **SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE**

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

- (A) **Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

(a) Purpose

Background

NASD Dispute Resolution believes a rule is needed to clarify the issue of representation of parties in dispute resolution. Under the current Code, Rule 10316 states that all parties shall have the right to representation by counsel at any stage of the proceedings. The rule does not provide any guidance on the kind of representatives who are permitted to practice in the NASD dispute resolution forum; nor does it provide guidance on the qualifications those representatives must have to participate in the forum. Moreover, Rule 10316 does not address a growing trend in American jurisprudence, the multi-jurisdictional practice of law.

The multi-jurisdictional practice of law occurs when attorneys, licensed in one United States (U.S.) jurisdiction, practice law in a jurisdiction in which they are not licensed. In the area of dispute resolution, for example, it is common for an attorney licensed to practice law in one state to represent a client in a dispute resolution proceeding in another state in which the attorney is not licensed. Although this practice is common, it can be a violation of state unauthorized practice of law provisions. Until recently, most states had taken no action against this practice. However, recent case law developments suggest that states are reconsidering this position. For example, two state courts have found that an out-of-state attorney providing representation in an arbitration or mediation proceeding is engaging in the practice of law, and that it is a violation of the state's unauthorized practice of law statute to participate in such a proceeding without being licensed in that jurisdiction.⁴

⁴ See Birbrower, Montalbano, Condo & Frank v. Superior Court, 949 P.2d 1 (Cal. 1998); see also Florida Bar v. Rapoport, 845 So. 2d 874, 2003 Fla. LEXIS 250 (Fla. 2003).

In light of these developments and the trend toward multi-jurisdictional practice, the American Bar Association (ABA) amended its Model Rule of Professional Conduct 5.5 (Rule 5.5) so that those attorneys representing a client in a dispute resolution proceeding in a United States jurisdiction where they are not licensed could participate in the dispute resolution proceeding in that jurisdiction without violating the state's unauthorized practice of law rules.⁵ While Rule 5.5 establishes a new standard for certain types of legal activity, it can be enforced only if the states adopt it into their laws. Some states have adopted either Rule 5.5 or a similar version of the rule.⁶ Other states have adopted a temporary practice rule that, like Rule 5.5, allows an attorney not licensed in a state to provide certain types of legal services in the state on a limited basis.⁷

As a result of these developments and the lack of guidance under the Code, NASD developed a proposal to address the issues raised in dispute resolution by the multi-jurisdictional practice of law and to provide guidance to parties and representatives on the qualifications necessary to represent a party in NASD's dispute resolution forum.

⁵ Model Rule 5.5, as amended, would allow a United States lawyer, admitted in one United States jurisdiction, to engage in certain types of legal activity in another United States jurisdiction where he is not licensed to practice, without being deemed to be engaging in the unauthorized practice of law. For purposes of the dispute resolution forum, Model Rule 5.5, as amended, states, in relevant part, that a lawyer may provide legal services on a temporary basis in an out-of-state jurisdiction that are in or reasonably related to a pending or potential arbitration, mediation, or other alternative dispute resolution proceeding in the jurisdiction or another jurisdiction, if the services arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice and are not services for which the forum requires *pro hac vice* admission. This rule is sometimes referred to as the temporary practice rule.

⁶ Twenty-seven states have either adopted Rule 5.5 or a similar version of the rule or currently have a temporary practice rule in effect. American Bar Association, *Charts on State Adoption of MJP Proposals* (visited Aug. 23, 2006) <[http://http://www.abanet.org/cpr/mjp/state_adoption.html](http://www.abanet.org/cpr/mjp/state_adoption.html)>.

⁷ The laws of Michigan and Virginia specifically authorize occasional or incidental practice by out-of-state lawyers. See Mich. Comp. Law Ann. sec. 600.916 and Va. State Bar Rule, Pt. 6, sec. 1(C).

Proposal Relating to Representation in Arbitration and Mediation

On February 9, 2005, NASD filed a proposed rule change with the Commission to address attorney representation in arbitration and mediation.⁸ The proposed rule change would have:

- Allowed parties to represent themselves in an arbitration or mediation;
- Allowed parties to be represented by an attorney at law admitted to practice before a U.S. jurisdiction at any stage of the proceeding; and
- Deferred to the states any issues regarding qualifications of a person to represent a party.

NASD amended the attorney representation proposal on July 8, 2005 to clarify that the proposal was intended to address the issue of multi-jurisdictional practice of law by attorneys, and not intended to address the issue of representation by non-attorneys in arbitration or mediation proceedings.⁹

The attorney representation proposal was published in the Federal Register on July 21, 2005.¹⁰ The SEC received fifteen comments on the proposal. The comments focused on two issues: whether the rule should preempt state law regarding attorney licensing, and whether the rule should prohibit non-attorneys from practicing in NASD's forum. The comments and NASD's response are discussed below.

Based on the comments received on the attorney representation proposal, as amended, NASD recognized that the proposal may have been ambiguous. NASD did not intend to

⁸ See File No. SR-NASD-2005-023.

⁹ Id. at Amendment No. 1.

¹⁰ See Securities Exchange Act Rel. No. 34-52045 (July 15, 2005); 70 FR 42123 (July 21, 2005) (File No. SR-NASD-2005-023).

change current practice in the forum regarding representation of parties by non-attorneys; nor did it intend to preempt state law on the issue of attorney licensing. Because the comments indicated that these positions were unclear, NASD has withdrawn the attorney representation proposal, and is filing a new proposed rule change to address representation of parties in arbitration and mediation.

Representation of Parties in Arbitration and Mediation

NASD is proposing to amend Rules 12208 and 13208 of the Customer and Industry Codes, respectively, and to adopt a new Rule 10407 of the Code to clarify that: (1) parties may represent themselves; (2) parties may be represented by an attorney, provided certain criteria are met; (3) parties may be represented in an arbitration or mediation by a person who is not an attorney, unless state law prohibits such representation or the person is currently suspended or barred from the securities industry in any capacity or is an attorney who is currently suspended or disbarred from the practice of law; and (4) issues regarding qualifications of a representative are governed by applicable law.

First, the proposed rule change states explicitly what is currently the case, that parties may represent themselves in arbitration.

Second, the proposed rule change states that if a party chooses to be represented by an attorney, the attorney must be licensed to practice in a U.S. jurisdiction and be in good standing in that jurisdiction. NASD believes that requiring an attorney to be licensed in a U.S. jurisdiction and to be in good standing in that jurisdiction will protect investors by prohibiting individuals who have been suspended or disbarred from the practice of law from representing parties in the NASD forum. Further, the requirement that an attorney must be licensed to practice in a U.S. jurisdiction sets a standard of practice for the arbitration forum

that is consistent with the other rules and proceedings of NASD. Rule 9141(b) of the NASD Code of Procedure states, in relevant part, that a person may be represented in any disciplinary proceeding by an attorney at law admitted to practice before the highest court of any state of the United States, the District of Columbia, or any commonwealth, territory, or possession of the United States.¹¹ The SEC also has a similar practice rule. Rule 102(b) of the SEC Rules of Practice states that, in any proceeding, a person may be represented by an attorney at law admitted to practice before the Supreme Court of the United States or the highest court of any State.¹²

Third, the proposed rule change addresses the representation of parties by non-attorneys in the NASD forum. Under the proposed rule change, parties may be represented in an arbitration or mediation by a person who is not an attorney, unless state law prohibits such representation or the person is currently suspended or barred from the securities industry in any capacity or is an attorney who is currently suspended or disbarred from the practice of law.

NASD understands that it may be difficult for investors with claims of less than \$100,000 to retain an attorney on a contingency-fee basis, because the attorney may believe that the attorney's share of the award might be too small to justify the effort. In these circumstances, NASD believes that investors should be able to seek other assistance to

¹¹ This rule has been enforced in NASD Enforcement proceedings. In two similar cases, a respondent's answer was stricken from the record because the respondent's representative had not indicated that he was a licensed attorney. See NASDR Office of the Hearing Officers, OHO Order 97-15 (C01970032) (visited Aug. 24, 2006) <http://www.nasd.com/web/groups/enforcement/documents/oho_disciplinary_orders/nasdw_007839.pdf> ; see also OHO Order 98-10 (C10970176) (visited Aug. 24, 2006) <http://www.nasd.com/web/groups/enforcement/documents/oho_disciplinary_orders/nasdw_007695.pdf>.

¹² See SEC Rules of Practice, 17 C.F.R. §201.102(b) (2004).

resolve their arbitration or mediation claims for a reasonable fee.¹³ At the same time, NASD believes that such non-attorney representatives should not be persons who have been found by a regulatory body to be unfit to represent clients or to conduct securities business with the public. Thus, to protect investors, the rule would prohibit non-attorney representatives who are currently suspended or barred from the securities industry, or attorneys who are currently suspended or disbarred from the practice of law, from representing parties in the NASD dispute resolution forum. While NASD remains concerned about some aspects of non-attorney representation, NASD does not wish to prohibit investors from retaining a non-attorney representative if that person is the only affordable representation available, and the requirements of the proposed rule are met.

Last, the proposed rule change would allow attorneys to represent a client in an NASD arbitration or mediation held in any U.S. hearing location, regardless of the jurisdiction in which the attorneys are licensed. The attorneys' qualifications to represent clients in a jurisdiction in which they are not licensed would be subject to the applicable law of that jurisdiction. The proposed rule change is not intended to preempt a state from deciding that an out-of-state attorney may have violated a state's unauthorized practice of law provision by representing a party in an NASD dispute resolution proceeding. It is intended, however, to reflect current practice in the forum, which, based on experience, indicates that the outcome of a dispute resolution proceeding depends more on the level of

¹³ As at present, the proposed rule would allow a relative, friend or associate to represent or assist an elderly or disabled person with his or her arbitration or mediation. In addition, law school securities arbitration clinics can provide investors with affordable, legal representation. A securities arbitration clinic can help an investor who has a smaller claim but is unable to hire an attorney, provided the investor qualifies for assistance. *See How to Find an Attorney* (for more information on clinic locations and eligibility requirements) (visited Sept. 13, 2006) <<http://www.nasd.com/ArbitrationMediation/StartanArbitrationorMediation/HowtoFindanAttorney/index.htm>>.

knowledge, training and skill of the attorneys, rather than the jurisdiction from which the attorneys received their license to practice.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rule change balances the needs of investors to have access to representation in small cases with NASD's responsibility to protect investors, the integrity of its forum, and the public interest.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received by NASD. The SEC received fifteen comments on the attorney representation proposal that was published for comment on July 21, 2005.¹⁴ The comments focused on two issues: whether the rule should preempt state

¹⁴ Comment letters were submitted by Timothy A. Canning, Esq., Law Offices of Timothy A. Canning, dated August 10, 2005 ("Canning I Letter"); Albert A. Rapoport, Esq., dated June 20, 2005 ("Rapoport Letter"); Joseph C. Korsak, Esq., Law Office of Joseph C. Korsak, dated July 22, 2005 ("Korsak Letter"); Michael Firestein, Esq. and Navid Yadegar, Esq., Proskauer Rose LLP, dated August 1, 2005 ("Firestein Letter"); Rodney J. Heggy, Esq., Heggy & Associates, LLC, dated August 4, 2005 ("Heggy Letter"); Richard L. Sacks, Securities Arbitration Consultant, dated August 9, 2005 ("Sacks Letter"); Rosemary Shockman, President, Public Investors Arbitration Bar Association, dated August 9, 2005 ("PIABA Letter"); Joseph O'Donnell, dated August 10, 2005 ("O'Donnell Letter"); Irwin G. Stein, dated August 10, 2005 ("Stein Letter"); Montgomery G. Griffin, Esq., Securities Arbitration Offices of Montgomery G. Griffin, dated August 10, 2005 ("Griffin

law regarding attorney licensing, and whether the rule should prohibit non-attorneys from practicing in NASD's forum.

With respect to the state preemption issue, one group of commenters supported the provision of the rule that stated that state law should control whether attorneys may participate in arbitrations in a state in which they are not licensed.¹⁵ These commenters were concerned that representatives should be licensed, legal practitioners, who are regulated and have demonstrated a minimum level of competence required to represent clients. Another group of commenters opposed the provision of the proposal that would allow state law to control attorney-licensure issues.¹⁶ These commenters contended that the provision could result in delays in arbitration proceedings as party representatives make the qualifications of an out-of-state representative the focus of the proceedings.

Other commenters speculated as to whether the proposal would prohibit, in effect, non-attorneys from practicing in NASD's forum. One group of these commenters contended that the proposal should address non-attorney representation and should allow non-attorneys to practice in the forum.¹⁷ These commenters argued that the proposal attempts to deny investors access to qualified non-attorney representatives who have securities industry experience and are willing to accept cases that are too small to enable investors to retain a securities attorney. The other commenters contended that the proposal should prohibit

Letter"); Timothy A. Canning, Esq., Law Offices of Timothy A. Canning, dated August 10, 2005 ("Canning II Letter"); Kevin P. Takacs, CCO, Dominion Investor Services, Inc., dated August 11, 2005 ("Takacs Letter"); Jill I. Gross, Director of Advocacy and Barbara Black, Director of Research, Pace Investor Rights Project, dated August 11, 2005 ("PACE Letter"); and Stephen C. Krossschell, Esq., Goodman & Nekvasil, P.A., dated August 11, 2005 ("Krossschell Letter"). The letter received from Marie W. Hayes, dated March 25, 2005, does not comment on the proposed rule change.

¹⁵ See PACE Letter, Heggy Letter, Firestein Letter, Rapoport Letter and PIABA Letter.

¹⁶ See Krossschell Letter, Canning I & II Letters, Stein Letter, Sacks Letter, and Korsak Letter.

¹⁷ See Takacs Letter, Griffin Letter, Stein Letter, Sacks Letter, Rapoport Letter, and O'Donnell Letter.

compensated non-attorney representation in securities arbitration, because the lack of legal training makes non-attorneys less knowledgeable or competent to deal fully with the laws and issues that arise in an arbitration proceeding.¹⁸

Based on the disparate comments received on the proposal, NASD recognized that the proposal may not have been clear. NASD did not intend to change current practice in the forum regarding representation of parties by non-attorneys; nor did it intend to preempt state law on the issue of attorney licensing. Because the comments indicated that these positions were unclear, NASD has withdrawn the attorney representation proposal and is filing this new proposal to replace it.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

¹⁸ See PACE Letter, Heggy Letter, Firestein Letter, Korsak Letter and PIABA Letter.

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASD-2006-109 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2006-109. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the principal office of NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to the File Number SR-NASD-2006-109 and should be submitted on or before [insert date 21 days from publication in the Federal

Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁹

Jonathan G. Katz
Secretary

Action as set forth or recommended herein
APPROVED pursuant to authority delegated by
the Commission under Public Law 87-592.

For the Division of Market Regulation

by: _____

(DATE)

¹⁹

17 CFR 200.30-3(a)(12).