

September 20, 2002

Florence Harmon
Senior Special Counsel
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: File No. SR-NASD-2002-126 – Pilot amendment to IM-10100 of the Code of Arbitration Procedure to require industry parties in arbitration to waive application of contested California arbitrator disclosure standards, upon the request of customers or associated persons with claims of statutory employment discrimination; accelerated effectiveness requested

Dear Ms. Harmon:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the Federal Register release.

If you have any questions, please contact Jean I. Feeney, Associate Vice President and Chief Counsel, NASD Dispute Resolution, at (202) 728-6959; e-mail jean.feeney@nasd.com. The fax number is (202) 728-8833.

Very truly yours,

Barbara Z. Sweeney
Senior Vice President
and Corporate Secretary

Enclosures

File No. SR-NASD-2002-126
Consists of 24 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

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”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to amend IM-10100 of the NASD Code of Arbitration Procedure (“Code”) to require industry parties in arbitration to waive application of contested California arbitrator disclosure standards, upon the request of customers or, in industry cases, of associated persons with claims of statutory employment discrimination, for a six-month pilot period. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * *

IM-10100. Failure to Act Under Provisions of Code of Arbitration Procedure

It may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member or a person associated with a member to:

(a) – (e) No change.

(f) fail to waive the California Rules of Court, Division VI of the Appendix, entitled, “Ethics Standards for Neutral Arbitrators in Contractual Arbitration” (the “California Standards”), if all the parties in the case who are customers have waived application of the California Standards in that case; or

(g) fail to waive the California Standards, if all the parties in the case who are associated persons with a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute have waived application of the California Standards in that case.

(Remainder unchanged.)

* * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Governors of NASD at a meeting of its Executive Committee on September 11, 2002, which authorized the filing of the rule change with the SEC. 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 NASD Rules without recourse to the membership for approval. Section 4(a) of Article IX of the NASD By-Laws permits the NASD Board to appoint an Executive Committee to exercise all the powers and authority of the Board in the management of the business and affairs of the NASD between meetings of the Board. NASD requests that the rule change become effective on September 30, 2002, for a six-month pilot period.

(b) Questions regarding this rule filing may be directed to Jean I. Feeney, Associate Vice President and Chief Counsel, NASD Dispute Resolution, at (202) 728-6959.

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

Purpose

NASD's foremost interest is to serve investors who bring their claims to the NASD by providing a fair, efficient arbitration forum at a modest cost. To this end, NASD spent several months

trying to resolve the issues created by the recent California Rules of Court, Division VI of the Appendix, entitled, “Ethics Standards for Neutral Arbitrators in Contractual Arbitration” (the “California Standards”), which are described in more detail below. Only as a last resort, when it became clear that NASD could not resolve these issues consistent with providing a fair and efficient national forum, did NASD, along with the New York Stock Exchange (“NYSE”), conclude that NASD should cease appointing arbitrators in California and institute litigation¹.

NASD and NYSE have filed a joint complaint in federal court for declaratory relief² in which they contend the California Standards cannot lawfully be applied to NASD and NYSE (both registered as self-regulatory organizations (SROs) with the SEC under the Securities Exchange Act of 1934) and their arbitrators because the California Standards are preempted by federal law and are inapplicable to SROs under state law.³ Pursuant to the parties’ agreement, the

¹ See Motion for Declaratory Judgment, NASD Dispute Resolution, Inc. and New York Stock Exchange, Inc. v. Judicial Council of California, filed in the United States District Court for the Northern District of California, No. C 02 3486 SBA (July 22, 2002), available on the NASD Web site at: http://www.nasdaq.com/pdf-text/072202_ca_complaint.pdf.

² As noted above, NASD and NYSE filed a lawsuit on July 22, 2002, seeking a declaratory judgment that the Standards that went into effect in California on July 1, 2002 do not apply to arbitrations conducted by NASD or the NYSE as a matter of federal law. The suit has three legal bases: that securities regulation is part of a pervasive system of federal regulation and state efforts to regulate SRO-administered arbitration are impermissible; that California’s rules are preempted by the Federal Arbitration Act, as interpreted by the United States Supreme Court; and that the California rules improperly expanded on the definition of neutral arbitrator as provided in California statutory law. The parties to the litigation have entered into a stipulation for the court to adjudicate the case on an expedited basis.

³ On September 18, 2002, the SEC filed a friend of the court (“amicus curiae”) brief in which it contended that the California Standards conflict with and thus are preempted by the Commission’s regulation of SRO arbitration under the Act. Brief of the Securities and Exchange Commission, Amicus Curiae, in Support of Plaintiffs’ Motion for Declaratory Judgment, NASD

court directed expedited proceedings. While waiting for the court's guidance on this issue, NASD and NYSE announced that they were temporarily postponing the appointment of arbitrators for new arbitration cases in California until their concerns over the new rules governing the arbitration process in that state were addressed. Since appointments stopped on July 1, 2002, approximately five hundred NASD and NYSE California cases have been affected. In an effort to keep cases moving, NASD and NYSE have offered California parties several alternatives, enumerated below.

On September 5, 2002, the Chairmen of NASD and NYSE received a request from Harvey L. Pitt, Chairman of the SEC, to further expedite processing of arbitration claims involving California parties.⁴ In response, NASD Chairman Robert R. Glauber responded that NASD would work closely with SEC staff to develop interim steps to process California cases.⁵ Having done so, NASD now proposes implementation on an accelerated basis of a six-month pilot amendment to IM-10100 that will require all parties that are member firms or associated persons to waive the California Standards if all the parties in the case who are customers or associated persons with a statutory employment discrimination claim⁶ have waived application of the California Standards in that case. Under such a waiver, the case would proceed in California

dispute Resolution, Inc. and New York Stock Exchange, Inc. v. Judicial Council of California, No. C 02 3486 SBA (N.D. Cal.). The brief is available on the SEC Web site at: <http://www.sec.gov/litigation/briefs/nasddispute.pdf>.

⁴ Chairman Pitt's letter is attached as Exhibit 2.

⁵ Mr. Glauber's letter is attached as Exhibit 3.

⁶ The amendment will require members to waive the Standards not only at the request of customers, but also in industry cases in which the parties who are associated persons with claims of statutory employment discrimination have waived, since such claims already are subject to special procedures in arbitration (see Rule 10201(b) and the Rule 10210 Series).

under the existing NASD Code, which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest.

NASD will notify parties (and their representatives, if any) who currently are awaiting the appointment of arbitrators in California of the terms of this new rule upon its approval by the Commission, and will provide them with the waiver forms.

Background

On July 1, California introduced new rules governing the arbitration process in that state. The rules were designed to address conflicts of interest in private arbitration forums that are not part of a federal regulatory system overseen on a uniform, national basis by the SEC. The conflicts that the new rules are designed to correct do not exist in the NASD and NYSE not-for-profit, highly regulated dispute resolution programs. The SEC staff strongly supported this view in its July 1, 2002 letter to the leadership of the California Legislature.

The California Standards put extreme and unnecessary disclosure burdens on individuals who serve on NASD arbitration panels and already meet stringent disclosure rules. The extensive record-keeping requirements for arbitrators, coupled with potential liability for even inadvertent violations of the California Standards, led NASD to conclude that, if NASD were required to implement the California rules, investors and other parties would be saddled with higher costs, a less efficient and streamlined process, and a much smaller arbitrator roster from which to select the panelists who will decide their cases. Under the California Standards, even inadvertent non-disclosure of immaterial relationships is a basis for removal of an arbitrator and vacatur of an award. The California Standards remove from the alternative dispute resolution administrator the

power to decided contested challenges to arbitrators, instead vesting this authority unilaterally in any party to the arbitration. As currently drafted, the California Standards would allow a party unilaterally to challenge and remove one arbitrator after another, thus destroying any notion of arbitral finality and closure. Accordingly, both NASD and NYSE filed extensive comments when the rules were proposed in February 2002, followed by meetings between NASD and NYSE officials and Judicial Council and Legislative staff. Despite these efforts, the California Standards were promulgated without addressing the fundamental concerns expressed by NASD and the NYSE. As a result, both forums announced in July 2002 that they were postponing the appointment of arbitrators for new arbitration cases in California until this matter could be resolved.

Measures Previously Implemented

NASD has taken several steps to help investors deal with the delay in California cases. Specifically, NASD announced that it would provide venue changes for arbitration cases and absorb the extra administrative costs associated with the change of venue, use non-California arbitrators when appropriate, and waive its administrative fees for NASD-sponsored mediations. To accommodate cases being heard outside of California, NASD added Reno, Nevada as a new hearing location to the existing sites in Portland, Oregon; Seattle, Washington; Phoenix, Arizona; and Las Vegas, Nevada. On September 3, 2002, NASD further enhanced the venue selection for investors by announcing that cases would be moved outside of California at the request of an investor member firm acquiescence is no longer required.

To educate parties about these measures, NASD posted on its Web site specific guidance announcing and elaborating on these steps. Importantly, NASD also advised that investors who believe they have disputes with their brokers should not delay in filing their cases with an SRO forum because of statutes of limitations. NASD also advised that NASD is still processing California cases as they are filed up to the point of sending out lists of arbitrators (or appointing arbitrators, in cases that had already passed the list selection stage). NASD announced that the 660 California cases that had already been paneled prior to July 1, 2002 would continue in the normal course.

Finally, to accommodate investors with exigent circumstances (e.g., elderly investors or investors with infirmities), NASD has paneled cases at the request of the investor or the investor's representative in situations where both the investor and the broker/dealer have agreed in writing to waive the California standards.

Proposed Rule Change

In its ongoing efforts to accommodate California parties in its forum, NASD is taking additional steps to resume paneling of California cases while the litigation continues. The proposed rule will require industry parties to waive the California Standards in all cases in which all the parties in the case who are customers (or, in industry cases, who are associated persons with claims of statutory employment discrimination) agree to waive application of the Standards. Under such a waiver, the case would proceed in California under the existing NASD Code, which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest.

Starting immediately, NASD will resume issuing lists of proposed arbitrators in California cases from which the parties select their panels under the current Neutral List Selection System (NLSS). Once the proposed rule is effective, NASD will send letters to investors and associated persons with claims of statutory employment discrimination, giving them the option of waiving the California Standards and providing them with waiver forms. NASD is taking steps to inform investors of how they can move their arbitration cases forward under this situation. NASD staff members have spoken with numerous investors and other parties, and their representatives, and will continue to do so, as well as sending written material and posting information to its Web site.

At the same time, NASD will notify industry parties in all pending California cases that they must waive the California Standards where the investor agrees to a waiver (or associated person, in the circumstances described above). Industry parties in such cases will be required to execute waiver agreements; however, their failure to do so will not stop the cases from moving forward and the failure to sign as required by the proposed rule change will be referred for disciplinary action.

Where all parties waive the California Standards as provided in the proposed rule change, NASD will immediately commence the arbitrator appointment process using the NASD Code of Arbitration Procedure guidelines regarding arbitrator disclosure, and not the California Standards. This opportunity will apply to those cases where NASD is ready to appoint arbitrators based on lists already executed by the parties, and those cases where there is a vacancy in a previously appointed panel.

NASD requests that the rule change become effective on September 30, 2002, for a six-month pilot period.⁷

(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 expediting the appointment of arbitrators under the proposed waiver, at the request of customers and associated persons with claims of statutory employment discrimination, will allow those parties to exercise their contractual rights to proceed in arbitration in California, notwithstanding the confusion caused by the disputed California Standards.

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.

⁷If the outcome of the lawsuit is that the California Standards do not apply to NASD arbitration, waivers would no longer be necessary. Cases in which arbitrators were appointed pursuant to waivers would continue to their conclusion. If the lawsuit has not concluded at the expiration of the six-month pilot period, NASD may request an extension.

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)

NASD requests the Commission to find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after its publication in the Federal Register. Because NASD believes that this action is necessary for the protection of investors to resolve the backlog created by confusion over the new California Standards, and that accelerated approval will benefit parties who wish to pursue their cases in arbitration under the NASD Code of Arbitration Procedure, NASD requests the Commission to accelerate the effectiveness of the proposed rule change prior to the 30th day after its publication in the Federal Register.

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.
2. Letter from Harvey L. Pitt, Chairman of the Commission to Robert R. Glauber, Chairman of NASD and Richard Grasso, Chairman of NYSE (September 5, 2002)
3. Letter from Robert R. Glauber to Harvey L. Pitt (September 6, 2002).

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD

BY: _____
Barbara Z. Sweeney, Senior Vice President and
Corporate Secretary

Date: September 20, 2002

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-

; File No. SR-NASD-2002-126)

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by National Association of Securities Dealers, Inc. to require industry parties in arbitration to waive application of contested California arbitrator disclosure standards, upon the request of customers and associated persons with claims of statutory employment discrimination, for a six-month pilot period

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 on _____, the National Association of Securities Dealers, Inc. (“NASD”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

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

NASD is proposing to amend IM-10100 to require industry parties in arbitration to waive application of contested California arbitrator disclosure standards, upon the request of customers (and, in industry cases, upon the request of associated persons with claims of statutory employment discrimination), for a six-month pilot period.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

* * *

IM-10100. Failure to Act Under Provisions of Code of Arbitration Procedure

It may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member or a person associated with a member to:

(a) – (e) No change.

(f) fail to waive the California Rules of Court, Division VI of the Appendix, entitled, “Ethics Standards for Neutral Arbitrators in Contractual Arbitration” (the “California Standards”), if all the parties in the case who are customers have waived application of the California Standards in that case; or

(g) fail to waive the California Standards, if all the parties in the case who are associated persons with a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute have waived application of the California Standards in that case.

(Remainder unchanged.)

* * *

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

NASD's foremost interest is to serve investors who bring their claims to the NASD by providing a fair, efficient arbitration forum at a modest cost. To this end, NASD spent several months trying to resolve the issues created by the recent California Rules of Court, Division VI of the Appendix, entitled, "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" (the "California Standards"), which are described in more detail below. Only as a last resort, when it became clear that NASD could not resolve these issues consistent with providing a fair and efficient national forum, did NASD, along with the New York Stock Exchange ("NYSE"), conclude that NASD should cease appointing arbitrators in California and institute litigation.³

³ See Motion for Declaratory Judgment, NASD Dispute Resolution, Inc. and New York Stock Exchange, Inc. v. Judicial Council of California, filed in the United States District Court

NASD and NYSE have filed a joint complaint in federal court for declaratory relief⁴ in which they contend the California Standards cannot lawfully be applied to NASD and NYSE (both registered as self-regulatory organizations (SROs) with the SEC under the Securities Exchange Act of 1934) and their arbitrators because the California Standards are preempted by federal law and are inapplicable to SROs under state law.⁵ Pursuant to the parties' agreement, the court directed expedited proceedings.

While waiting for the court's guidance on this issue, NASD and NYSE announced that they were temporarily postponing the appointment of arbitrators for new arbitration cases in California until their concerns over the new rules governing the arbitration process in that state were addressed. Since appointments stopped on July 1, 2002, approximately five hundred NASD and NYSE California cases have been affected. In an effort to keep cases

for the Northern District of California, No. C 02 3486 SBA (July 22, 2002), available on the NASD Web site at: http://www.nasdaq.com/pdf-text/072202_ca_complaint.pdf.

⁴ As noted above, NASD and NYSE filed a lawsuit on July 22, 2002, seeking a declaratory judgment that the Standards that went into effect in California on July 1, 2002 do not apply to arbitrations conducted by NASD or the NYSE as a matter of federal law. The suit has three legal bases: that securities regulation is part of a pervasive system of federal regulation and state efforts to regulate SRO-administered arbitration are impermissible; that California's rules are preempted by the Federal Arbitration Act, as interpreted by the United States Supreme Court; and that the California rules improperly expanded on the definition of neutral arbitrator as provided in California statutory law. The parties to the litigation have entered into a stipulation for the court to adjudicate the case on an expedited basis.

⁵ On September 18, 2002, the SEC filed a friend of the court ("amicus curiae") brief in which it contended that the California Standards conflict with and thus are preempted by the Commission's regulation of SRO arbitration under the Act. Brief of the Securities and Exchange Commission, Amicus Curiae, in Support of Plaintiffs' Motion for Declaratory Judgment, NASD dispute Resolution, Inc. and New York Stock Exchange, Inc. v. Judicial Council of California, No. C 02 3486 SBA (N.D. Cal.). The brief is available on the SEC Web site at: <http://www.sec.gov/litigation/briefs/nasddispute.pdf>.

moving, NASD and NYSE have offered California parties several alternatives, enumerated below.

On September 5, 2002, the Chairmen of NASD and NYSE received a request from Harvey L. Pitt, Chairman of the SEC, to further expedite processing of arbitration claims involving California parties.⁶ In response, NASD Chairman Robert R. Glauber responded that NASD would work closely with SEC staff to develop interim steps to process California cases.⁷ Having done so, NASD now proposes implementation on an accelerated basis of a six-month pilot amendment to IM-10100 that will require all parties that are member firms or associated persons to waive the California Standards if all the parties in the case who are customers or associated persons with a statutory employment discrimination claim⁸ have waived application of the California Standards in that case. Under such a waiver, the case would proceed in California under the existing NASD Code, which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest.

NASD will notify parties (and their representatives, if any) who currently are awaiting the appointment of arbitrators in California of the terms of this new rule upon its approval by the Commission, and will provide them with the waiver forms.

⁶ Chairman Pitt's letter is attached as Exhibit 2.

⁷ Mr. Glauber's letter is attached as Exhibit 3.

⁸ The amendment will require members to waive the Standards not only at the request of customers, but also in industry cases in which the parties who are associated persons with claims of statutory employment discrimination have waived, since such claims already are subject to special procedures in arbitration (see Rule 10201(b) and the Rule 10210 Series).

Background

On July 1, California introduced new rules governing the arbitration process in that state. The rules were designed to address conflicts of interest in private arbitration forums that are not part of a federal regulatory system overseen on a uniform, national basis by the SEC. The conflicts that the new rules are designed to correct do not exist in the NASD and NYSE not-for-profit, highly regulated dispute resolution programs. The SEC staff strongly supported this view in its July 1, 2002 letter to the leadership of the California Legislature.

The California Standards put extreme and unnecessary disclosure burdens on individuals who serve on NASD arbitration panels and already meet stringent disclosure rules. The extensive record-keeping requirements for arbitrators, coupled with potential liability for even inadvertent violations of the California Standards, led NASD to conclude that, if NASD were required to implement the California rules, investors and other parties would be saddled with higher costs, a less efficient and streamlined process, and a much smaller arbitrator roster from which to select the panelists who will decide their cases. Under the California Standards, even inadvertent non-disclosure of immaterial relationships is a basis for removal of an arbitrator and vacatur of an award. The California Standards remove from the alternative dispute resolution administrator the power to decide contested challenges to arbitrators, instead vesting this authority unilaterally in any party to the arbitration. As currently drafted, the California Standards would allow a party unilaterally to challenge and remove one arbitrator after another, thus destroying any notion of arbitral finality and closure.

Accordingly, both NASD and NYSE filed extensive comments when the rules were proposed in February 2002, followed by meetings between NASD and NYSE officials and Judicial

Council and Legislative staff. Despite these efforts, the California Standards were promulgated without addressing the fundamental concerns expressed by NASD and the NYSE. As a result, both forums announced in July 2002 that they were postponing the appointment of arbitrators for new arbitration cases in California until this matter could be resolved.

Measures Previously Implemented

NASD has taken several steps to help investors deal with the delay in California cases. Specifically, NASD announced that it would provide venue changes for arbitration cases and absorb the extra administrative costs associated with the change of venue, use non-California arbitrators when appropriate, and waive its administrative fees for NASD-sponsored mediations. To accommodate cases being heard outside of California, NASD added Reno, Nevada as a new hearing location to the existing sites in Portland, Oregon; Seattle, Washington; Phoenix, Arizona; and Las Vegas, Nevada. On September 3, 2002, NASD further enhanced the venue selection for investors by announcing that cases would be moved outside of California at the request of an investor; member firm acquiescence is no longer required.

To educate parties about these measures, NASD posted on its Web site specific guidance announcing and elaborating on these steps. Importantly, NASD also advised that investors who believe they have disputes with their brokers should not delay in filing their cases with an SRO forum because of statutes of limitations. NASD also advised that NASD is still processing California cases as they are filed up to the point of sending out lists of arbitrators (or appointing arbitrators, in cases that had already passed the list selection

stage). NASD announced that the 660 California cases that had already been paneled prior to July 1, 2002 would continue in the normal course.

Finally, to accommodate investors with exigent circumstances (e.g., elderly investors or investors with infirmities), NASD has paneled cases at the request of the investor or the investor's representative in situations where both the investor and the broker/dealer have agreed in writing to waive the California standards.

Proposed Rule Change

In its ongoing efforts to accommodate California parties in its forum, NASD is taking additional steps to resume paneling of California cases while the litigation continues. The proposed rule will require industry parties to waive the California Standards in all cases in which all the parties in the case who are customers (or, in industry cases, who are associated persons with claims of statutory employment discrimination) agree to waive application of the Standards. Under such a waiver, the case would proceed in California under the existing NASD Code, which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest.

Starting immediately, NASD will resume issuing lists of proposed arbitrators in California cases from which the parties select their panels under the current Neutral List Selection System (NLSS). Once the proposed rule is effective, NASD will send letters to investors and associated persons with claims of statutory employment discrimination, giving them the option of waiving the California Standards and providing them with waiver forms. NASD is taking steps to inform investors of how they can move their arbitration cases forward under this situation. NASD staff members have spoken with numerous investors and

other parties, and their representatives, and will continue to do so, as well as sending written material and posting information to its Web site.

At the same time, NASD will notify industry parties in all pending California cases that they must waive the California Standards where the investor agrees to a waiver (or associated person, in the circumstances described above). Industry parties in such cases will be required to execute waiver agreements; however, their failure to do so will not stop the cases from moving forward and the failure to sign as required by the proposed rule change will be referred for disciplinary action.

Where all parties waive the California Standards as provided in the proposed rule change, NASD will immediately commence the arbitrator appointment process using the NASD Code of Arbitration Procedure guidelines regarding arbitrator disclosure, and not the California Standards. This opportunity will apply to those cases where NASD is ready to appoint arbitrators based on lists already executed by the parties, and those cases where there is a vacancy in a previously appointed panel.

NASD requests that the rule change become effective on September 30, 2002, for a six-month pilot period.⁹

(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

⁹ If the outcome of the lawsuit is that the California Standards do not apply to NASD arbitration, waivers would no longer be necessary. Cases in which arbitrators were appointed pursuant to waivers would continue to their conclusion. If the lawsuit has not concluded at the expiration of the six-month pilot period, NASD may request an extension.

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 expediting the appointment of arbitrators under the proposed waiver, at the request of customers (and, in industry cases, associated persons with claims of statutory employment discrimination), will allow those parties to exercise their contractual rights to proceed in arbitration in California, notwithstanding the confusion caused by the disputed California Standards.

(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.

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

NASD has requested that the Commission find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the NASD and, in particular, the requirements of Section 15A and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in that accelerated approval is necessary

for the protection of investors to resolve the backlog created by confusion over the new California Standards and will benefit parties who wish to pursue their cases in arbitration under the NASD Code of Arbitration Procedure.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Jonathan G. Katz
Secretary