

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49452; File No. SR-NASD-2004-040]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Extend, for an Additional Six-Month Period, a Pilot Rule Regarding Waiver of California Arbitrator Disclosure Standards

March 19, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19-4 thereunder,<sup>2</sup> notice is hereby given that on March 5, 2004, 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 and II below, which Items have been prepared by NASD. NASD has designated the proposed rule change as constituting a "non-controversial" rule change pursuant to Rule 19b-4(f)(6) under the Act,<sup>3</sup> which renders the proposal effective upon receipt of this filing by the Commission. 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 is proposing to extend the pilot rule in IM-10100(f) of the NASD Code of Arbitration Procedure, which requires industry parties in arbitration to waive application of contested California arbitrator disclosure standards, upon the request of customers, and associated persons with claims against other industry parties, for a six-month period.

#### 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. The 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

##### 1. Purpose

Effective July 1, 2002, the California Judicial Council adopted a set of rules, "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" ("California Standards"),<sup>4</sup> which contain extensive disclosure requirements for arbitrators. 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 California Standards imposed disclosure requirements on arbitrators that conflict with the disclosure rules of NASD and the New York Stock Exchange ("NYSE"). Because NASD could not both administer its arbitration program in accordance with its own rules and comply with the new California Standards at the same time, NASD initially suspended the appointment of arbitrators in cases in California, but offered parties several options for pursuing their cases.<sup>5</sup>

NASD and NYSE filed a lawsuit in federal district court seeking a declaratory judgment that the California Standards are inapplicable to arbitration forums sponsored by self-regulatory organizations ("SROs").<sup>6</sup> That litigation is currently pending on appeal. Since then, other lawsuits relating to the application of the California Standards to SRO-sponsored arbitration have been filed, some of which are still pending.

To allow arbitrations to proceed in California while the litigation was pending, NASD implemented a pilot rule to require all industry parties (member firms and associated persons) to waive application of the California Standards to the case, if all the parties in the case who are customers, or associated persons with claims against industry parties, have done so.<sup>7</sup> In such

cases, the arbitration proceeds under the NASD Code of Arbitration Procedure, which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest.<sup>8</sup>

The pilot rule, which was originally approved for six months on September 26, 2002, has been extended and is now due to expire on March 31, 2004. Because the pending litigation regarding the California Standards is unlikely to be resolved by March 31, 2004, NASD requests that the effectiveness of the pilot rule be extended through September 30, 2004, in order to prevent NASD from having to suspend administration of cases covered by the pilot rule.

##### 2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>9</sup> which requires, among other things, that NASD'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 waiver rule, at the request of customers and associated persons with claims against industry respondents 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.

industry respondents. In July 2003, NASD expanded the scope of the pilot rule to include all claims by associated persons against another associated person or a member. At the same time, the rule was amended to provide that when a customer, or an associated person with a claim against a member or another associated person, agrees to waive the application of the California Standards, all respondents that are members or associated persons will be deemed to have waived the application of the standards as well. The July 2003 amendment also clarified that the pilot rule applies to terminated members and associated persons. See Securities Exchange Act Rel. No. 48187 (July 16, 2003), 68 FR 43553 (July 23, 2003) (File No. SR-NASD-2003-106).

<sup>8</sup> The NYSE has a similar rule; Rule 600(g).

<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

<sup>4</sup> California Rules of Court, Division VI of the Appendix.

<sup>5</sup> These measures included providing venue changes for arbitration cases, using non-California arbitrators when appropriate, and waiving administrative fees for NASD-sponsored mediations.

<sup>6</sup> 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.nasdadr.com/pdf-text/072202\\_ca\\_complaint.pdf](http://www.nasdadr.com/pdf-text/072202_ca_complaint.pdf).

<sup>7</sup> Originally, the pilot rule only applied to claims by customers, or by associated persons asserting a statutory employment discrimination claim against a member, and required a written waiver by the

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

*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 designated the proposed rule change as one that: (i) Does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. Therefore, the foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>10</sup> and Rule 19b-4(f)(6) thereunder.<sup>11</sup> At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate the rule change if it appears to the Commission that the action is necessary or appropriate in the public interest, for the protection of investors, or would otherwise further the purposes of the Act.

Pursuant to Rule 19b-4(f)(6)(iii) under the Act,<sup>12</sup> the proposal may not become operative for 30 days after the date of its filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, and the self-regulatory organization must file notice of its intent to file the proposed rule change at least five business days beforehand. NASD has requested that the Commission waive the five-day pre-filing requirement and the 30-day operative delay so that the proposed rule change will become immediately effective upon filing.

The Commission believes that waiving the five-day pre-filing provision and the 30-day operative delay is consistent with the protection of investors and the public interest.<sup>13</sup> Waiving the pre-filing requirement and accelerating the operative date will merely extend a pilot program that is designed to provide investors, and associated persons with claims against industry respondents, with a mechanism to resolve their disputes. During the period of this extension, the Commission and NASD will continue to

monitor the status of the previously discussed litigation. For these reasons, the Commission designates the proposed rule change as effective and operative on March 31, 2004.

**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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments should be submitted electronically at the following e-mail address: *rule-comments@sec.gov*. All comment letters should refer to File No. SR-NASD-2004-040. 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, comments should be sent in hard copy or by e-mail but not by both methods. 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 be submitted by April 21, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-49458; File No. SR-NQLX-2004-02]

**Self-Regulatory Organization; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by NQLX LLC To Amend Its Rule 419 Relating to Block Trades**

March 23, 2004.

Pursuant to section 19(b)(7) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-7 under the Act,<sup>2</sup> notice is hereby given that on March 4, 2004, NQLX LLC ("NQLX") filed with the Securities and Exchange Commission ("Commission") the proposed rule changes described in Items I, II, and III below, which Items have been prepared by NQLX. On March 16, 2004, NQLX filed an amendment to the proposed rule changes.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule changes, as amended, from interested persons. On March 3, 2004, NQLX filed the proposed rule changes with the Commodity Futures Trading Commission ("CFTC"), together with a written certification under section 5c(c) of the Commodity Exchange Act<sup>4</sup> ("CEA") in which NQLX indicated that the effective date of the proposed rule changes would be March 4, 2004.

**I. Self-Regulatory Organization's Description of the Proposed Rule Change**

NQLX is proposing changes to its Rule 419 to explicitly permit orders for block trades at the Daily Settlement Price for the Exchange Contract, at the fair value<sup>5</sup> derived from that day's last sale price of the security underlying the Security Futures Contract, or at the fair value of the Security Futures Contract derived from the volume weighted average price ("VWAP")<sup>6</sup> of

<sup>1</sup> 15 U.S.C. 78s(b)(7).

<sup>2</sup> 17 CFR 240.19b-7.

<sup>3</sup> See letter from Robert Ledvora, Executive Vice President and Chief Financial Officer, NQLX, to the Office of Market Supervision, Division of Market Regulation ("Division"), Commission, dated March 16, 2004 ("Amendment No. 1").

<sup>4</sup> 7 U.S.C. 7a-2(c).

<sup>5</sup> The fair value of a security future is the current security price plus the interest rate cost of carry to the future's expiration minus the value of the expected dividend. Transaction costs make this an inexact number. Therefore, the fair value must be represented as an approximation.

<sup>6</sup> "Volume Weighted Average Price" means the average price of a security over an agreed upon time segment computed by multiplying the price per share of each transaction by the number of shares

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<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>11</sup> 17 CFR 240.19b-4(f)(6).

<sup>12</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>13</sup> For purposes of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> 17 CFR 200.30-3(a)(12).