

October 31, 2003

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-2003-163** - Voluntary Direct Communication Between Parties and Arbitrators

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, 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

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” 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 the Code of Arbitration Procedure (“Code”) to permit parties in an arbitration to communicate directly with the arbitrators if all parties and arbitrators agree, and to establish guidelines for such direct communication. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * *

10334. Direct Communication Between Parties and Arbitrators

(a) This rule provides procedures under which parties and arbitrators may communicate directly.

(b) Only parties that are represented by counsel may use direct communication under this Rule. If, during the proceeding, a party chooses to appear pro se (without counsel), this Rule shall no longer apply.

(c) All arbitrators and all parties must agree to the use of direct communication during the Initial Prehearing Conference or a later conference or hearing before it can be used.

(d) Parties may send the arbitrators only items that are listed in an order.

(e) Parties may send items by regular mail, overnight courier, facsimile, or email. All the arbitrators and parties must have facsimile or email capability before such a delivery method may be used.

(f) Copies of all materials sent to arbitrators must also be sent at the same time and in the same manner to all parties and the Director. Materials that exceed 15 pages, however, shall be sent to the Director only by regular mail or overnight courier.

(g) The Director must receive copies of any orders and decisions made as a result of direct communications among the parties and the arbitrators.

(h) Parties may not communicate orally with the arbitrators outside the presence of all parties.

(i) Any party or arbitrator may terminate the direct communication order at any time, after giving written notice to the other arbitrators and the parties.

* * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Dispute Resolution at its meeting on July 30, 2003, 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 31, 2003. 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.

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 Jean I. Feeney, 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

(a) Purpose

NASD proposes a rule that would permit direct communication with the arbitrators where all parties and arbitrators agree. The rule also would establish guidelines for direct communication.

Background

Under normal procedures, parties may exchange certain documents among themselves (such as those relating to discovery), but must address all communications intended for the arbitrators to NASD staff, who then forward the communications to the arbitrators. If the communication includes a motion or similar request, staff members customarily solicit a response from the other parties before forwarding the motion or request. Similarly, the arbitrators transmit their orders and any other communications through the staff.

In response to a recommendation of the NASD National Arbitration and Mediation Committee, the Chicago Office of NASD Dispute Resolution began a pilot project in June 2001 to determine whether direct communication between parties and arbitrators would enhance the arbitration process. The Chicago Office developed the parameters governing whether a case

would be eligible for inclusion in the pilot and changed the script used by the panel chairperson at the Initial Prehearing Conference (“IPHC”) on those cases. A modified IPHC Order also was given to the panel chairperson to memorialize all direct communication matters agreed to by the parties and the arbitrators.

In total, 839 cases were eligible for inclusion in the project. Of these cases, parties and arbitrators in 255 cases (30%) participated in the program. At the end of the one-year pilot period, staff formulated a survey for those arbitrators and party representatives who participated in the pilot project. NASD Dispute Resolution sent out 850 surveys and obtained 268 responses (32%). Although attempts were made to limit duplication, certain arbitrators and party representatives who participated in more than one eligible case in the pilot might have sent in multiple survey responses.

Of the responses NASD received, 193 came from arbitrators and 75 from party representatives. Overall, 73% of party representatives and 69% of the arbitrators who responded to the survey favored continuing direct communication with the arbitrators. Favorable comments reflected the opinion that direct communication expedited the arbitration process and was more convenient than the normal method of communicating through staff.

In light of the success of the Chicago pilot, NASD has developed a nationwide rule that would permit direct communication with the arbitrators where all parties and arbitrators agree. The rule also would establish guidelines for direct communication.

Proposed Rule Change

The proposed rule is based largely on procedures used in the Chicago pilot, with a few changes to reflect staff’s experience with the pilot and to provide for possible issues that might occur in a larger-scale application of the rule. Only parties that are represented by counsel may

use direct communication under the proposed rule. If, during the proceeding, a party chooses to appear pro se (without counsel), the rule will no longer apply. All arbitrators and all parties must agree to the use of direct communication before it can be used. The scope of direct communication will be set forth in an arbitrator order, and parties may send the arbitrators only the types of items that are listed in the order.

The proposed rule provides that either an arbitrator or a party may rescind his or her agreement at any time if direct communication is no longer working well. Materials must be sent at the same time and in the same manner to all parties and the Director (through the assigned staff member), and staff must receive copies of any orders and decisions made as a result of direct communications among the parties and the arbitrators. As requested by staff, however, the rule contains a provision stating that materials more than 15 pages long shall be sent to the Director only by mail or courier, to avoid tying up busy fax machines and printers. Arbitrators (or parties) with similar concerns could include a similar provision as to themselves in the direct communication order. NASD will prepare a template for direct communication orders to guide the arbitrators and parties in considering these issues.

(b) Statutory Basis

NASD Dispute Resolution 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. The NASD believes that permitting direct communication with the arbitrators where all parties and arbitrators agree, and where specific guidelines are followed, will protect investors and

the public interest by expediting the arbitration process and giving parties more control over their arbitration cases.

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

NASD Dispute Resolution 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.

6. Extension of Time Period for Commission Action

NASD Dispute Resolution 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.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Dispute Resolution 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: October 31, 2003

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-

; File No. SR-NASD-2003-163)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Voluntary Direct Communication Between Parties and Arbitrators

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”), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. (“NASD Dispute Resolution”) 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 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 a new rule of the National Association of Securities Dealers, Inc. (“NASD” or “Association”), to permit parties in an arbitration to communicate directly with the arbitrators if all parties and arbitrators agree, and to establish guidelines for such direct communication. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * *

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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(h) Parties may not communicate orally with the arbitrators outside the presence of all parties.

(i) Any party or arbitrator may terminate the direct communication order at any time, after giving written notice to the other arbitrators and the parties.

* * *

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 Dispute Resolution 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 Dispute Resolution 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

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Background

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arbitration process. The Chicago Office developed the parameters governing whether a case would be eligible for inclusion in the pilot and changed the script used by the panel chairperson at the Initial Prehearing Conference (“IPHC”) on those cases. A modified IPHC Order also was given to the panel chairperson to memorialize all direct communication matters agreed to by the parties and the arbitrators.

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occur in a larger-scale application of the rule. Only parties that are represented by counsel may use direct communication under the proposed rule. If, during the proceeding, a party chooses to appear pro se (without counsel), the rule will no longer apply. All arbitrators and all parties must agree to the use of direct communication before it can be used. The scope of direct communication will be set forth in an arbitrator order, and parties may send the arbitrators only the types of items that are listed in the order.

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(b) Statutory Basis

NASD Dispute Resolution 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. The NASD believes that permitting direct communication with the arbitrators where all parties and arbitrators agree, and where specific guidelines are followed, will protect investors and

the public interest by expediting the arbitration process and giving parties more control over their arbitration cases.

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

NASD Dispute Resolution 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

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. 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].

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

Jonathan G. Katz
Secretary