

January 2, 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: **SR-NASD-2003-001 – Refund of Member Surcharges in Arbitration**

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 Laura Gansler, Counsel, NASD Dispute Resolution, Inc., at (202) 728-8275; e-mail laura.gansler@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-2003-001
Consists of 13 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”), 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 Rule 10333(a) of the NASD Code of Arbitration Procedure (“Code”) to provide that, in certain circumstances, NASD will refund the member surcharge paid by a member firm named as a party to an arbitration proceeding (or where its employee/former employee has been named as a party). Below is the text of the proposed rule change.

Proposed new language is underlined; proposed deletions are in brackets.

* * *

Code of Arbitration Procedure

* * *

10333. Member Surcharge and Process Fees

(a) Member Surcharge

(1) Each member that is named as a party to an arbitration proceeding, whether in a Claim, Counterclaim, Cross-Claim or Third-Party Claim, shall be assessed a [non-refundable] surcharge pursuant to the schedule below when the Director of Arbitration perfects service of the claim naming the member on any party to the proceeding.

(2) For each associated person who is named, the surcharge shall be assessed against the member or members that employed the associated person at the time of the

events which gave rise to the dispute, claim or controversy. No member shall be assessed more than a single surcharge in any arbitration proceeding.

(3) The surcharge shall not be chargeable to any other party under Rules 10332(c) and 10205(c) of the Code. The Director will refund the surcharge paid by a member in an arbitration filed by a customer if the arbitration panel: (A) denies all of the customer's claims against the member or associated person; and (B) allocates all forum fees assessed pursuant to Rule 10332(c) against the customer. The Director may also refund or cancel the member surcharge in extraordinary circumstances.

(Remainder of rule 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 Directors of NASD Dispute Resolution at its meeting on November 20, 2002, 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 NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on November 21, 2002. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of NASD By-Laws permits the NASD Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

NASD will implement the proposed rule change on January 13, 2003, and will announce the implementation in a Notice to Members to be published no later than 60 days following Commission notice of the effective date of the proposed rule change.

(b) Questions regarding this rule filing may be directed to Laura Gansler, Counsel, NASD Dispute Resolution, at (202) 728-8275.

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

(a) Purpose

Rule 10332(c) of the Code requires that the arbitrators, in their awards, shall determine the amount chargeable to the parties as forum fees and shall determine who shall pay such forum fees. Generally such fees are divided among the parties, but the arbitrators may, in their discretion, allocate all forum fees against the claimant or the respondent.

Rule 10333(a) of the Code requires that each member that is named as a party in an arbitration, or that employed an associated person who is named as a party at the time of the events that gave rise to the dispute, must pay a surcharge. The amount of the surcharge is based on the amount asserted by the claimant to be in dispute. The member surcharge is non-refundable and, unlike forum fees, may not be allocated among the other parties, regardless of the outcome of the arbitration. As a result, member firms must pay the surcharge, which is typically higher than filing fees or forum fees, even when the arbitrators deny a customer's claim and allocate all forum fees against the customer.

To mitigate the impact of arbitration fees on member firms in such cases, NASD is amending Rule 10333(a) to provide that it will refund the member surcharge paid by each member firm named as a party (or where its employee/former employee has been named as a

party) in an arbitration filed by a customer in which the arbitration panel: (1) denies all of the customer's claims; and (2) allocates all of the forum fees against the customer. In cases with more than one customer claimant, NASD will not refund the surcharge unless the arbitration panel denies all of the customers' claims and allocates all of the forum fees against one or more of the customer claimants.

In addition, from time to time, a refund of the member surcharge may be warranted in extraordinary circumstances that do not meet the criteria described above. For example, occasionally a customer mistakenly names a member firm as a respondent, and later withdraws the claim as to that particular member firm. The Code as currently written would prohibit any refund or cancellation of the surcharge in such a case. To give NASD more flexibility in addressing such cases, NASD is further amending Rule 10333(a) to provide that the Director of Dispute Resolution, in his or her discretion, may cancel or refund member surcharges in extraordinary circumstances when he or she determines that retention of the surcharge would be inappropriate.

This rule change applies only to member surcharges under Rule 10333(a) and does not affect any other fee or surcharge required under the Code. The rule change will apply to all claims filed on or after January 13, 2003.

(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 rule change will enhance the fairness of the NASD arbitration forum for member firms, particularly small member firms.

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.

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)

The proposed rule change is effective upon filing pursuant to Section 19(b)(3)(A) of the Act and paragraph (f)(2) of Rule 19b-4 thereunder, in that the proposed rule change establishes or changes a due, fee, or other charge. NASD proposes to implement the proposed rule on January 13, 2003.

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 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: January 2, 2003

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-

; File No. SR-NASD-2003-001)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Refunds of Member Surcharges in Arbitration

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. NASD has designated the proposed rule change as “establishing or changing a due, fee or other charge” under Section 19(b)(3)(A)(ii) of the Act³ and paragraph (f)(2) of Rule 19b-4 thereunder⁴, 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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(ii).

⁴ 17 CFR § 240.19b-4(f)(2)

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

NASD is proposing to amend Rule 10333(a) of the NASD Code of Arbitration Procedure to provide that, in certain circumstances, NASD will refund the member surcharge paid by a member firm named as a party to an arbitration proceeding (or where its employee/former employee has been named as a party). Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * *

Code of Arbitration Procedure

* * *

10333. Member Surcharge and Process Fees

(a) Member Surcharge

(1) Each member that is named as a party to an arbitration proceeding, whether in a Claim, Counterclaim, Cross-Claim or Third-Party Claim, shall be assessed a [non-refundable] surcharge pursuant to the schedule below when the Director of Arbitration perfects service of the claim naming the member on any party to the proceeding.

(2) For each associated person who is named, the surcharge shall be assessed against the member or members that employed the associated person at the time of the events which gave rise to the dispute, claim or controversy. No member shall be assessed more than a single surcharge in any arbitration proceeding.

(3) The surcharge shall not be chargeable to any other party under Rules 10332(c) and 10205(c) of the Code. The Director will refund the surcharge paid by a

member in an arbitration filed by a customer if the arbitration panel: (A) denies all of the customer's claims against the member or associated person; and (B) allocates all forum fees assessed pursuant to Rule 10332(c) against the customer. The Director may also refund or cancel the member surcharge in extraordinary circumstances.
(Remainder of rule 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

Rule 10332(c) of the Code requires that the arbitrators, in their awards, shall determine the amount chargeable to the parties as forum fees and shall determine who shall pay such forum fees. Generally such fees are divided among the parties, but the arbitrators may, in their discretion, allocate all forum fees against the claimant or the respondent.

Rule 10333(a) of the Code requires that each member that is named as a party in an arbitration, or that employed an associated person who is named as a party at the time of the events that gave rise to the dispute, must pay a surcharge. The amount of the surcharge is based on the amount asserted by the claimant to be in dispute. The member surcharge is non-

refundable and, unlike forum fees, may not be allocated among the other parties, regardless of the outcome of the arbitration. As a result, member firms must pay the surcharge, which is typically higher than filing fees or forum fees, even when the arbitrators deny a customer's claim and allocate all forum fees against the customer.

To mitigate the impact of arbitration fees on member firms in such cases, NASD is amending Rule 10333(a) to provide that it will refund the member surcharge paid by each member firm named as a party (or where its employee/former employee has been named as a party) in an arbitration filed by a customer in which the arbitration panel: (1) denies all of the customer's claims; and (2) allocates all of the forum fees against the customer. In cases with more than one customer claimant, NASD will not refund the surcharge unless the arbitration panel denies all of the customers' claims and allocates all of the forum fees against one or more of the customer claimants.

In addition, from time to time, a refund of the member surcharge may be warranted in extraordinary circumstances that do not meet the criteria described above. For example, occasionally a customer mistakenly names a member firm as a respondent, and later withdraws the claim as to that particular member firm. The Code as currently written would prohibit any refund or cancellation of the surcharge in such a case. To give NASD more flexibility in addressing such cases, NASD is further amending Rule 10333(a) to provide that the Director of Dispute Resolution, in his or her discretion, may cancel or refund member surcharges in extraordinary circumstances when he or she determines that retention of the surcharge would be inappropriate.

This rule change applies only to member surcharges under Rule 10333(a) and does not affect any other fee required under the Code. The rule change will apply to all claims filed on or after January 13, 2003.

(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 rule change will enhance the fairness of the NASD arbitration forum for member firms, particularly small member firms.

(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

The proposed rule change has been filed by NASD as establishing or changing a due, fee, or other charge imposed by the self-regulatory organization. Consequently, it has

become effective pursuant to Section 19(b)(3)(A) of the Act⁵ and paragraph (f)(2) of Rule 19b-4 thereunder.⁶

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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 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].

⁵ 15 U.S.C. 78s(b)(3)(A)(ii)

⁶ 17 CFR § 240.19b-4(f)(6)

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

Jonathan G. Katz
Secretary