

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>20</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50447; File No. SR-NASD-2004-126]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding Waiver of California Arbitrator Disclosure Standards

September 24, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 19, 2004, 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 ("Commission") the proposed rule change as described in Items I, II, and III, below, which NASD has prepared. NASD has designated the proposed rule change as constituting a "non-controversial" rule change under paragraph (f)(6) of Rule 19b-4 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 ("Code"), relating to the California waiver program, until March 31, 2005. NASD is not proposing any textual changes to the By-Laws or Rules of NASD.

#### 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

##### 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. According to NASD, 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. NASD states that the California Standards impose 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.

<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.nasdaq.com/pdf-text/072202\\_ca\\_complaint.pdf](http://www.nasdaq.com/pdf-text/072202_ca_complaint.pdf). The Commission notes that a more thorough discussion of the litigation history of this issue can be found in SR-NYSE-2004-50.

To allow arbitrations to proceed in California while the litigation is 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, associated persons with claims against industry parties, member firms with claims against other member firms, or member firms with claims against associated persons that relate exclusively to promissory notes, 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,<sup>9</sup> has been extended and is now due to expire on September 30, 2004.<sup>10</sup> Because NASD believes the pending litigation regarding the California Standards is unlikely to be resolved by September 30, 2004, NASD requests that the effectiveness of the pilot rule be extended through March 31, 2005, 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

<sup>7</sup> Originally, the pilot rule applied only to claims by customers, or by associated persons asserting a statutory employment discrimination claim against a member, and required a written waiver by the 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 Release No. 48187 (July 16, 2003), 68 FR 43553 (July 23, 2003) (SR-NASD-2003-106). In October 2003, NASD again expanded the scope of the pilot rule to include claims filed by members against other members and to claims filed by members against associated persons that relate exclusively to promissory notes. See Securities Exchange Act Release No. 48711 (October 29, 2003), 68 FR 62490 (November 4, 2003) (SR-NASD-2003-153).

<sup>8</sup> NASD states that the NYSE has a similar rule, NYSE Rule 600(g).

<sup>9</sup> See Securities Exchange Act Release No. 46562 (September 26, 2002), 67 FR 62085 (October 3, 2002) (SR-NASD-2002-126).

<sup>10</sup> See Securities Exchange Act Release No. 49452 (March 19, 2004), 69 FR 17010 (March 31, 2004) (SR-NASD-2004-040).

<sup>20</sup> 17 CFR 200.30-3(a)(12).

<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.

of Section 15A(b)(6) of the Act,<sup>11</sup> which requires, among other things, that the 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 proposed waiver, at the request of customers, associated persons with claims against industry parties, member firms with claims against other member firms, or member firms with claims against associated persons that relate exclusively to promissory notes, will allow those parties to exercise their contractual rights to proceed in arbitration in California, notwithstanding the conflict between the disputed California Standards and the NASD rules.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The NASD does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the Act.

#### *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. NASD provided the Commission with written notice of its intent to file the proposed rule change at least five days prior to the filing date. Therefore, the foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>12</sup> and Rule 19b-4(f)(6) thereunder.<sup>13</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>14</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 30-day operative delay so that the proposed rule change will become immediately effective upon filing.<sup>15</sup>

The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest.<sup>16</sup> 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 September 30, 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. Comments may be submitted by any of the following methods:

#### *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](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2004-126 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-126. This file

<sup>14</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>15</sup> Telephone Conversation between John Nachmann, Counsel, NASD Dispute Resolution, Inc. and Elizabeth MacDonald, Attorney Adviser, Division of Market Regulation, September 23, 2004

<sup>16</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).

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 in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the 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 File Number SR-NASD-2004-126 and should be submitted on or before October 21, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-50446; File No. SR-NASD-2004-121]

### **Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the National Association of Securities Dealers, Inc. To Include Failures to Timely Submit Amendments to Form U5 in its Minor Rule Violation Plan**

September 24, 2004.

#### **I. Introduction**

On August 11, 2004, the National Association of Securities Dealers, Inc. ("NASD"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> filed with the Securities and Exchange

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

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

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

<sup>11</sup> 15 U.S.C. 78o-3(b)(6).

<sup>12</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>13</sup> 17 CFR 240.19b-4(f)(6).