

OMB APPROVAL

OMB Number: 3235-0045
Expires: June 30, 2007
Estimated average burden
hours per response.....38

Page 1 of 16

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - 2004 - 180

Amendment No.

Proposed Rule Change by National Association of Securities Dealers

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

Initial ☒ Amendment ☐ Withdrawal ☐

Section 19(b)(2) ☒Section 19(b)(3)(A) ☐Section 19(b)(3)(B) ☐

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Pilot ☐ Extension of Time Period
for Commission Action ☐ Date Expires

Exhibit 2 Sent As Paper Document
☐

Exhibit 3 Sent As Paper Document
☐

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Proposed rule change to extend the pilot rule in IM-10100(f) of the NASD Code of Arbitration Procedure relating to the California waiver program until September 30, 2005.

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name
Title
E-mail
Telephone Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date

By
(Name)

Vice President and Chief Counsel, Dispute Resolution

(Title)

NOTE: Clicking the button at right will digitally sign and lock
this form. A digital signature is as legally binding as a physical
signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EDFS website.

Form 19b-4 Information

Add

Remove

View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

Add

Remove

View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add

Remove

View

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit Sent As Paper Document

☐

Exhibit 3 - Form, Report, or Questionnaire

Add

Remove

View

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit Sent As Paper Document

☐

Exhibit 4 - Marked Copies

Add

Remove

View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add

Remove

View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add

Remove

View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange 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 extend the pilot rule in IM-10100(f) of the NASD Code of Arbitration Procedure (“Code”) relating to the California waiver program until September 30, 2005. NASD is not proposing any textual changes to the By-Laws or Rules of NASD.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the NASD Dispute Resolution Board of Directors at its meeting on November 17, 2004, which authorized the filing of the rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Regulatory Policy and Oversight 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 November 18, 2004. 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 amendments to NASD Rules without recourse to the membership for

approval.

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

(a) Purpose

Effective July 1, 2002, the California Judicial Council (“Judicial Council”) adopted a set of rules, “Ethics Standards for Neutral Arbitrators in Contractual Arbitration” (“California Standards”),¹ 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.²

In July 2002, NASD and the 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”).³ On November 12, 2002,

¹ California Rules of Court, Division VI of the Appendix.

² These measures included providing venue changes for arbitration cases, using non-California arbitrators when appropriate, and waiving administrative fees for NASD-sponsored mediations.

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 for the Northern District of California, No. C 02 3486 SBA (July 22, 2002), available on the NASD Web site at: http://www.nasd.com/stellent/groups/med_arb/documents/mediation_arbitration/nasdw_009557.pdf.

the United States District Court for the Northern District of California dismissed the case on Eleventh Amendment grounds. In December 2002, NASD and the NYSE filed a Notice of Appeal to the United States Court of Appeals for the Ninth Circuit. This appeal is currently stayed pending a decision in *Credit Suisse First Boston Corp. v. Grunwald*, No. C 02-2051 SBA (N.D. Cal. March 31, 2003), which is discussed below.

In another case before the United States District Court for the Northern District of California regarding the applicability of the California Standards to NASD arbitrations, Judge Jeremy Fogel denied the plaintiff's motion to vacate an order compelling arbitration.⁴ In his April 2003 decision, Judge Fogel concluded that the application of the California Standards to the NYSE and other SROs, such as NASD, is preempted by the Exchange Act and by the Federal Arbitration Act ("FAA"). The *Mayo* decision was not appealed.

The applicability of the California Standards to SRO arbitrations was again addressed by the United States District Court for the Northern District of California in *Grunwald*. The court found that the California Standards could not apply to SRO-appointed arbitrators because such arbitrators did not fall within the definition of "neutral arbitrators" that is set forth in the California Code of Civil Procedure. Consequently, the court concluded that the Judicial Council had exceeded its authority in drafting the California Standards and thus declared them void. The *Grunwald* decision has been appealed to the United States Court of Appeals for the Ninth Circuit. Although the appeal has been briefed and argued, the Ninth Circuit has not yet issued a decision.

⁴ *Mayo v. Dean Witter Reynolds, Inc.*, 258 F. Supp. 2d 1097 (N.D. Cal. 2003).

In *Jevne v. The Superior Court of Los Angeles County*, 6 Cal. Rptr. 3d 542, 113 Cal. App. 4th 486 (2d Dist. 2003), the California Court of Appeal, Second District found that the Judicial Council had not exceeded its authority in drafting the California Standards and that the standards are not preempted by the FAA. The court did find, however, that the California Standards are preempted by the Exchange Act. On March 17, 2004, the California Supreme Court granted review in *Jevne*. Although the case has been fully briefed, oral arguments have not yet been scheduled.

To allow arbitrations to proceed in California while the litigation regarding the applicability of the California Standards to SRO arbitrations 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, 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.⁵ In such cases, the arbitration proceeds under the NASD Code of Arbitration Procedure,

⁵ 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 Rel. No. 48187 (July 16, 2003), 68 FR 43553 (July 23, 2003) (File No. 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 Rel. No. 48711 (October 29, 2003), 68 FR 62490 (November 4, 2003) (File No. SR-NASD-2003-153).

which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest.⁶

The pilot rule, which was originally approved for six months on September 26, 2002,⁷ has been extended and is now due to expire on March 31, 2005.⁸ Because the pending litigation regarding the California Standards is unlikely to be resolved by March 31, 2005, NASD requests that the effectiveness of the pilot rule be extended through September 30, 2005, in order to prevent NASD from having to suspend administration of cases covered by the pilot rule.

(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. 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

⁶ The NYSE has a similar rule, Rule 600(g).

⁷ See Securities Exchange Act Rel. No. 46562 (September 26, 2002), 67 FR 62085 (October 3, 2002) (File No. SR-NASD-2002-126).

⁸ See Securities Exchange Act Rel. No. 50447 (September 24, 2004), 69 FR 58567 (September 30, 2004) (File No. SR-NASD-2004-126).

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.

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)**

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.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-2004-180)

SELF-REGULATORY ORGANIZATIONS

Proposed Rule Change by National Association of Securities Dealers, Inc.
Relating to Waiver of California Arbitrator Disclosure Standards

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange 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.

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 September 30, 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 (“Judicial Council”) adopted a set of rules, “Ethics Standards for Neutral Arbitrators in Contractual Arbitration” (“California Standards”),³ 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.⁴

³ California Rules of Court, Division VI of the Appendix.

⁴ These measures included providing venue changes for arbitration cases, using non-California arbitrators when appropriate, and waiving administrative fees for NASD-sponsored mediations.

In July 2002, NASD and the 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”).⁵ On November 12, 2002, the United States District Court for the Northern District of California dismissed the case on Eleventh Amendment grounds. In December 2002, NASD and the NYSE filed a Notice of Appeal to the United States Court of Appeals for the Ninth Circuit. This appeal is currently stayed pending a decision in *Credit Suisse First Boston Corp. v. Grunwald*, No. C 02-2051 SBA (N.D. Cal. March 31, 2003), which is discussed below.

In another case before the United States District Court for the Northern District of California regarding the applicability of the California Standards to NASD arbitrations, Judge Jeremy Fogel denied the plaintiff’s motion to vacate an order compelling arbitration.⁶ In his April 2003 decision, Judge Fogel concluded that the application of the California Standards to the NYSE and other SROs, such as NASD, is preempted by the Exchange Act and by the Federal Arbitration Act (“FAA”). The *Mayo* decision was not appealed.

The applicability of the California Standards to SRO arbitrations was again addressed by the United States District Court for the Northern District of California in *Grunwald*. The court found that the California Standards could not apply to SRO-appointed arbitrators because such arbitrators did not fall within the definition of “neutral

⁵ 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.nasd.com/stellent/groups/med_arb/documents/mediation_arbitration/nasdw_009557.pdf.

⁶ *Mayo v. Dean Witter Reynolds, Inc.*, 258 F. Supp. 2d 1097 (N.D. Cal. 2003).

arbitrators” that is set forth in the California Code of Civil Procedure. Consequently, the court concluded that the Judicial Council had exceeded its authority in drafting the California Standards and thus declared them void. The *Grunwald* decision has been appealed to the United States Court of Appeals for the Ninth Circuit. Although the appeal has been briefed and argued, the Ninth Circuit has not yet issued a decision.

In *Jevne v. The Superior Court of Los Angeles County*, 6 Cal. Rptr. 3d 542, 113 Cal. App. 4th 486 (2d Dist. 2003), the California Court of Appeal, Second District found that the Judicial Council had not exceeded its authority in drafting the California Standards and that the standards are not preempted by the FAA. The court did find, however, that the California Standards are preempted by the Exchange Act. On March 17, 2004, the California Supreme Court granted review in *Jevne*. Although the case has been fully briefed, oral arguments have not yet been scheduled.

To allow arbitrations to proceed in California while the litigation regarding the applicability of the California Standards to SRO arbitrations 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, 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.⁷ In

⁷ 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

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.⁸

The pilot rule, which was originally approved for six months on September 26, 2002,⁹ has been extended and is now due to expire on March 31, 2005.¹⁰ Because the pending litigation regarding the California Standards is unlikely to be resolved by March 31, 2005, NASD requests that the effectiveness of the pilot rule be extended through September 30, 2005, in order to prevent NASD from having to suspend administration of cases covered by the pilot rule.

2. 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. NASD believes that expediting the appointment of arbitrators under the proposed waiver, at the request of customers, associated persons

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). 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 Rel. No. 48711 (October 29, 2003), 68 FR 62490 (November 4, 2003) (File No. SR-NASD-2003-153).

⁸ The NYSE has a similar rule, Rule 600(g).

⁹ See Securities Exchange Act Rel. No. 46562 (September 26, 2002), 67 FR 62085 (October 3, 2002) (File No. SR-NASD-2002-126).

¹⁰ See Securities Exchange Act Rel. No. 50447 (September 24, 2004), 69 FR 58567 (September 30, 2004) (File No. SR-NASD-2004-126).

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 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

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, 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. Please include File Number SR-NASD-2004-180 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-2004-180. 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, 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 at the principal office of 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 the File Number SR-NASD-2004-180 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland
Deputy Secretary

¹¹ 17 CFR 200.30-3(a)(12).