

OMB APPROVAL

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

File No. SR - 2005 - 070

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 rescind the pilot rule in IM-10100(f) of the NASD Code of Arbitration Procedure relating to the waiver of the California Ethics Standards for Neutral Arbitrators in Contractual Arbitration.

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, NASD 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

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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

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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

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Exhibit Sent As Paper Document

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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 3 - Form, Report, or Questionnaire

Add

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Exhibit Sent As Paper Document

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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 4 - Marked Copies

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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

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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

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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 (“Exchange Act” or “Securities 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 rescind the pilot rule in IM-10100(f) of the NASD Code of Arbitration Procedure relating to the waiver of the California Ethics Standards for Neutral Arbitrators in Contractual Arbitration.

Below is the text of the proposed rule change.¹ Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

IM-10100. Failure to Act Under Provisions of Code of Arbitration Procedure

It may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member or a person associated with a member to:

(a) through (e) No change

[(f) fail to waive the California Rules of Court, Division VI of the Appendix, entitled, "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" (the "California Standards"), if application of the California Standards has been waived by all parties to the dispute who are:

(1) customers with a claim against a member or an associated person;

¹ Corresponding changes reflecting the proposed rule change will be made to the NASD Code of Arbitration Procedure for Customer Disputes filed on October 15, 2003, and amended on January 3, 2005, January 19, 2005, and April 8, 2005 (SR-NASD-2003-158); and the NASD Code of Arbitration Procedure for Industry Disputes filed on January 16, 2004, and amended on February 26, 2004, January 3, 2005, and April 8, 2005 (SR-NASD-2004-011).

(2) associated persons with a claim against a member or an associated person;

(3) members with a claim against another member; or

(4) members with a claim against an associated person that relates exclusively to a promissory note.

Written waiver by such parties shall constitute and operate as a waiver for all member firms or associated persons against whom the claim has been filed.

This rule applies to claims brought in California against all member firms and associated persons, including terminated or otherwise inactive member firms or associated persons.]

Remainder 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 Governors of NASD on a mail vote of its Executive Committee on May 25, 2005, 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. 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. Section 4(a) of Article IX of the NASD By-Laws permits the NASD Board to appoint an Executive Committee to exercise all the powers and authority of the Board in the management of the business and affairs of the NASD between meetings of the Board.

(b) Questions regarding this rule filing may be directed to John D. Nachmann, Counsel, NASD Dispute Resolution, at (202) 728-8273.

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

(a) Purpose

The purpose of the proposed rule change is to rescind the pilot rule in IM-10100(f) of the NASD Code of Arbitration Procedure (“Code”) relating to the waiver of the California Ethics Standards for Neutral Arbitrators in Contractual Arbitration (“Pilot Rule”).

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”),² which contain extensive disclosure and disqualification requirements for arbitrators. The California Standards imposed disclosure and disqualification requirements on arbitrators that conflict with the disclosure and disqualification 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

² California Rules of Court, Division VI of the Appendix.

offered parties several options for pursuing their cases.³

In September 2002, NASD implemented a pilot rule providing that if parties to an arbitration who are customers (or, in certain circumstances, associated persons) waived application of the California Standards to their arbitration proceeding, then the firm would be required to waive the application of the California Standards.⁴ Under such a waiver, the arbitration proceeds under the existing NASD Code, which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest. In those cases where a waiver of the California Standards is not received, the appointment of arbitrators is temporarily postponed unless the parties agree to proceed in a non-California venue.

NASD also commenced litigation or became involved in a number of suits challenging the California Standards. On March 1, 2005, the United States Court of Appeals for the Ninth Circuit issued its decision in *Credit Suisse First Boston Corp. v. Grunwald*.⁵ The Ninth Circuit held that the Securities Exchange Act preempts application of the California Standards to NASD arbitrations. On May 23, 2005, the

³ These measures included providing venue changes for arbitration cases, using non-California arbitrators when appropriate, and waiving administrative fees for NASD-sponsored mediations.

⁴ This rule has been expanded on several occasions. 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 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. Securities Exchange Act Release No. 48187 (July 16, 2003), 68 FR 43553 (July 23, 2003). On October 6, 2003, the rule was further amended to include claims by members against other members, and claims by members against associated persons that relate exclusively to promissory notes. Securities Exchange Act Release No. 48711 (October 29, 2003), 68 FR 62490 (November 4, 2003).

⁵ 400 F.3d 1119 (9th Cir. 2005).

Supreme Court of California also held that the Exchange Act preempts application of the California Standards to NASD-administered arbitrations.⁶

The Pilot Rule was originally approved for six months in September 2002.⁷ It was subsequently extended on several occasions and is now due to expire on September 30, 2005.⁸ NASD has determined that the Pilot Rule should be rescinded prior to September 30, 2005, as it is no longer necessary. Specifically, with the recent decisions in *Grunwald* and *Jevne*, both the Ninth Circuit Court of Appeals and the California Supreme Court have found that the Exchange Act preempts the application of the California Standards to arbitrators in the NASD forum. Consequently, NASD believes that it can once again appoint arbitrators in California cases without requiring a waiver of the California Standards.

(b) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Exchange Act, 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. Specifically, rescinding the Pilot Rule will benefit all users of the forum as it will allow NASD to process those arbitration cases that have not been paneled because the necessary waivers of the California Standards have not been received.

⁶ *Jevne v. The Superior Court of Los Angeles County*, S121532 (CA Sup. Ct. May 23, 2005).

⁷ See Securities Exchange Act Release No. 46562 (September 26, 2002), 67 FR 62085 (October 3, 2002).

⁸ See Securities Exchange Act Release No. 51213 (February 16, 2005), 70 FR 8862 (February 23, 2005).

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 Exchange 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 Exchange Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

NASD requests the Commission to find good cause pursuant to Section 19(b)(2) of the Exchange Act for approving the proposed rule change prior to the 30th day after its publication in the Federal Register. NASD believes that good cause exists to accelerate approval of the proposed rule change, because it will allow NASD to commence as quickly as administratively possible the processing of those arbitration cases that have been held in abeyance because the necessary waivers to the California Standards have not been received. NASD anticipates that it will be able to begin processing such cases once the Commission approves the proposed rule change. Therefore, NASD requests that the Commission accelerate the effectiveness of the proposed rule change prior to the 30th day after its publication in the Federal Register.

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-2005-070)

SELF-REGULATORY ORGANIZATIONS

Proposed Rule Change by National Association of Securities Dealers, Inc. to Rescind the Pilot Rule in IM-10100(f) of the NASD Code of Arbitration Procedure Relating to the Waiver of the California Ethics Standards for Neutral Arbitrators in Contractual Arbitration

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Securities Exchange Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 31, 2005, the National Association of Securities Dealers, Inc. (“NASD” or “Association”) 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 rescind the pilot rule in IM-10100(f) of the NASD Code of Arbitration Procedure relating to the waiver of the California Ethics Standards for Neutral Arbitrators in Contractual Arbitration.

Below is the text of the proposed rule change.³ Proposed new language is

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Corresponding changes reflecting the proposed rule change will be made to the NASD Code of Arbitration Procedure for Customer Disputes filed on October 15, 2003, and amended on January 3, 2005, January 19, 2005, and April 8, 2005 (SR-NASD-2003-158); and the NASD Code of Arbitration Procedure for Industry Disputes filed on January 16, 2004, and amended on February 26, 2004, January 3, 2005, and April 8, 2005 (SR-NASD-2004-011).

underlined; proposed deletions are in brackets.

* * * * *

IM-10100. Failure to Act Under Provisions of Code of Arbitration Procedure

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[(f) fail to waive the California Rules of Court, Division VI of the Appendix, entitled, "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" (the "California Standards"), if application of the California Standards has been waived by all parties to the dispute who are:

(1) customers with a claim against a member or an associated person;

(2) associated persons with a claim against a member or an associated person;

(3) members with a claim against another member; or

(4) members with a claim against an associated person that relates exclusively to a promissory note.

Written waiver by such parties shall constitute and operate as a waiver for all member firms or associated persons against whom the claim has been filed.

This rule applies to claims brought in California against all member firms and associated persons, including terminated or otherwise inactive member firms or associated persons.]

Remainder 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

1. Purpose

The purpose of the proposed rule change is to rescind the pilot rule in IM-10100(f) of the NASD Code of Arbitration Procedure (“Code”) relating to the waiver of the California Ethics Standards for Neutral Arbitrators in Contractual Arbitration (“Pilot Rule”).

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”),⁴ which contain extensive disclosure and disqualification requirements for arbitrators. The California Standards imposed disclosure and disqualification requirements on arbitrators that conflict with the disclosure and disqualification 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

⁴ California Rules of Court, Division VI of the Appendix.

time, NASD initially suspended the appointment of arbitrators in cases in California, but offered parties several options for pursuing their cases.⁵

In September 2002, NASD implemented a pilot rule providing that if parties to an arbitration who are customers (or, in certain circumstances, associated persons) waived application of the California Standards to their arbitration proceeding, then the firm would be required to waive the application of the California Standards.⁶ Under such a waiver, the arbitration proceeds under the existing NASD Code, which already contains extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest. In those cases where a waiver of the California Standards is not received, the appointment of arbitrators is temporarily postponed unless the parties agree to proceed in a non-California venue.

NASD also commenced litigation or became involved in a number of suits challenging the California Standards. On March 1, 2005, the United States Court of Appeals for the Ninth Circuit issued its decision in *Credit Suisse First Boston Corp. v. Grunwald*.⁷ The Ninth Circuit held that the Securities Exchange Act preempts

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⁶ This rule has been expanded on several occasions. 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 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. Securities Exchange Act Release No. 48187 (July 16, 2003), 68 FR 43553 (July 23, 2003). On October 6, 2003, the rule was further amended to include claims by members against other members, and claims by members against associated persons that relate exclusively to promissory notes. Securities Exchange Act Release No. 48711 (October 29, 2003), 68 FR 62490 (November 4, 2003).

⁷ 400 F.3d 1119 (9th Cir. 2005).

application of the California Standards to NASD arbitrations. On May 23, 2005, the Supreme Court of California also held that the Exchange Act preempts application of the California Standards to NASD-administered arbitrations.⁸

The Pilot Rule was originally approved for six months in September 2002.⁹ It was subsequently extended on several occasions and is now due to expire on September 30, 2005.¹⁰ NASD has determined that the Pilot Rule should be rescinded prior to September 30, 2005, as it is no longer necessary. Specifically, with the recent decisions in *Grunwald* and *Jevne*, both the Ninth Circuit Court of Appeals and the California Supreme Court have found that the Exchange Act preempts the application of the California Standards to arbitrators in the NASD forum. Consequently, NASD believes that it can once again appoint arbitrators in California cases without requiring a waiver of the California Standards.

2. Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Exchange Act, 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. Specifically, rescinding the Pilot Rule will benefit all users of the forum as it will allow NASD to process those arbitration cases that have not been paneled because the necessary waivers of the California Standards have

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⁹ See Securities Exchange Act Release No. 46562 (September 26, 2002), 67 FR 62085 (October 3, 2002).

¹⁰ See Securities Exchange Act Release No. 51213 (February 16, 2005), 70 FR 8862 (February 23, 2005).

not been received.

(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**

NASD has requested that the Commission find good cause pursuant to Section 19(b)(2) of the Act for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to NASD and, in particular, the requirements of Section 15A of the Act and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in that accelerated approval will benefit NASD members and the investing public.

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-2005-070 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-2005-070. 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-2005-070 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

Action as set forth or recommended herein
APPROVED pursuant to authority delegated by
the Commission under Public Law 87-592.

For the Division of Market Regulation

by: _____

(DATE)

¹¹ 17 CFR 200.30-3(a)(12).