Subject: Rule Change Notice – Changes to NASD Arbitration Rules

Pursuant to ISE Rule 1800, which in part states that the NASD’s Code of Arbitration shall govern ISE arbitrations, this Regulatory Information Circular informs Members of proposed rule changes to the NASD Code of Arbitration published by the Securities and Exchange Commission, attached.

- In the June 20, 2005 Federal Register, the Commission published notice of filing and order granting accelerated approval of a proposed rule change (SR-NASD-2005-070) by NASD to rescind the pilot rule in IM-10100(f) of the NASD Code of Arbitration Procedure. The pilot rule required all industry parties (member firms and associated persons) in arbitration to waive application of California arbitrator disclosure standards 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. (Securities Exchange Act Release No. 34-51825 (June 13, 2005))


A copy of each notice is attached for reference.
SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51825; File No. SR-NASD-2005-070]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 Thereto Relating to Rescinding 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

June 13, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 19b-4 thereunder, notice is hereby given that on May 31, 2005 and on June 8, 2005 (Amendment No. 1), 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 and is approving the proposal on an accelerated basis.

1. 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. Proposed new language is italicized; proposed deletions are in brackets.

* * * * * * *


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 (c) No change

(d) Fail to honor an award, or comply with a written and executed settlement agreement, obtained in connection with an arbitration submitted for disposition pursuant to the procedures specified by the National Association of Securities Dealers, Inc.

(e) Fail to comply with a written and executed settlement agreement, obtained in connection with a mediation submitted for disposition pursuant to the procedures specified by the National Association of Securities Dealers, Inc. or

(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

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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 III 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"), 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 offered parties several options for pursuing their cases.

2. Statutory Basis

3. Effectiveness Date

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

* These measures included providing venue changes for arbitration cases, using non-California arbitrators when appropriate, and waiving administrative fees for NASD-sponsored mediations.
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. 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. The Ninth Circuit held that the Exchange Act preempts 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.

The Pilot Rule was originally approved for six months in September 2002. It was subsequently extended on several occasions and is now due to expire on September 30, 2005. 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 paused because the necessary waivers of the California Standards have 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 Exchange Act, as amended.

(C) Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Exchange 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);
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2005-070 on the subject line.

Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–0003.

All submissions should refer to File Number SR-NASDAQ-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). 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, 100 F Street, NE., Washington, DC 20549. Copies of such filings also will be available for inspection and copying at the principal offices 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 the File Number SR-NASDAQ-2005-070 and should be submitted on or before July 11, 2005.

IV. Commission’s Findings and Order Granting Accelerated Approval of Proposed Rule Change

The Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder, applicable to a self-regulatory organization. In particular, the Commission finds that the proposed rule change is consistent with 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

Notes:
10 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 affected 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.
11 See Exchange Act Release No. 41877 (July 16, 2003), 68 FR 42282 (July 22, 2003). In October 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 transactions with customers.
12 Jevne v. The Superior Court of Los Angeles County, S121532 (CA Sup. Ct. May 23, 2005).
general, to protect investors and the public interest. The Commission notes that rescinding the Pilot Rule will benefit all users of the forum as it will allow NASD to process those arbitration cases that have not proceeded because the necessary waivers of the California Standards have not been received.

After careful consideration, the Commission finds good cause, pursuant to Section 19(b)(2) of the Exchange Act, for approving the proposed rule change prior to the thirtieth day after the date of publication of notice in the Federal Register. In recent decisions in Granwald 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 arbitrations in the NASD forum. Consequently, the Commission believes that the NASD can once again appoint arbitrators in California cases without requiring a waiver of the California Standards. Accordingly, the Commission believes that there is good cause, consistent with Section 15A(b)(6) of the Exchange Act, to approve the proposal on an accelerated basis.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act, that the proposed rule change (SR–NASD–2005–070) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.\textsuperscript{12}

Margaret H. McFarland, Deputy Secretary.

[FR Doc. E5–3151 Filed 6–17–05; 8:45 am]

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\textsuperscript{3} Amendment No. 1 replaced and superseded the original filing in its entirety.


\textsuperscript{6} Amendment No. 2 replaced and superseded the original filing in its entirety. In addition, NYSE also responded to the three comment letters in Amendment No. 2.

\textsuperscript{7} Amendment No. 3 replaced and superseded the original filing in its entirety.

\textsuperscript{8} NYSE submitted Amendment No. 4 to the proposed rule change.

\textsuperscript{9} NYSE submitted Amendment No. 5 to the proposed rule change.

\textsuperscript{10} NYSE submitted Amendment No. 6 to the proposed rule change.

\textsuperscript{11} NYSE submitted Amendment No. 7 to the proposed rule change.

\textsuperscript{12} NYSE submitted Amendment No. 8 to the proposed rule change.

\textsuperscript{13} NYSE submitted Amendment No. 9 to the proposed rule change.

\textsuperscript{14} NYSE submitted Amendment No. 10 to the proposed rule change.

\textsuperscript{15} NYSE submitted Amendment No. 11 to the proposed rule change.

\textsuperscript{16} NYSE submitted Amendment No. 12 to the proposed rule change.

\textsuperscript{17} NYSE submitted Amendment No. 13 to the proposed rule change.

\textsuperscript{18} NYSE submitted Amendment No. 14 to the proposed rule change.

\textsuperscript{19} NYSE submitted Amendment No. 15 to the proposed rule change.

\textsuperscript{20} NYSE submitted Amendment No. 16 to the proposed rule change.

\textsuperscript{21} NYSE submitted Amendment No. 17 to the proposed rule change.

\textsuperscript{22} NYSE submitted Amendment No. 18 to the proposed rule change.

\textsuperscript{23} NYSE submitted Amendment No. 19 to the proposed rule change.

\textsuperscript{24} NYSE submitted Amendment No. 20 to the proposed rule change.

\textsuperscript{25} NYSE submitted Amendment No. 21 to the proposed rule change.

\textsuperscript{26} NYSE submitted Amendment No. 22 to the proposed rule change.

\textsuperscript{27} NYSE submitted Amendment No. 23 to the proposed rule change.

\textsuperscript{28} NYSE submitted Amendment No. 24 to the proposed rule change.

\textsuperscript{29} NYSE submitted Amendment No. 25 to the proposed rule change.

\textsuperscript{30} NYSE submitted Amendment No. 26 to the proposed rule change.

\textsuperscript{31} NYSE submitted Amendment No. 27 to the proposed rule change.

\textsuperscript{32} NYSE submitted Amendment No. 28 to the proposed rule change.

\textsuperscript{33} NYSE submitted Amendment No. 29 to the proposed rule change.

\textsuperscript{34} NYSE submitted Amendment No. 30 to the proposed rule change.

\textsuperscript{35} NYSE submitted Amendment No. 31 to the proposed rule change.

\textsuperscript{36} NYSE submitted Amendment No. 32 to the proposed rule change.

\textsuperscript{37} NYSE submitted Amendment No. 33 to the proposed rule change.

\textsuperscript{38} NYSE submitted Amendment No. 34 to the proposed rule change.

\textsuperscript{39} NYSE submitted Amendment No. 35 to the proposed rule change.

\textsuperscript{40} NYSE submitted Amendment No. 36 to the proposed rule change.

\textsuperscript{41} NYSE submitted Amendment No. 37 to the proposed rule change.

\textsuperscript{42} NYSE submitted Amendment No. 38 to the proposed rule change.

\textsuperscript{43} NYSE submitted Amendment No. 39 to the proposed rule change.
For the Commission, by the Division of Market Regulation, pursuant to delegated authority.23
Margaret H. McFarland,
Deputy Secretary.
[FR Doc. E5–3266 Filed 6–22–05; 8:45 am]
BILLING CODE 6010–01–P

SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto to Amend NASD Arbitration Rules for Mediation Proceedings

June 15, 2005.

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 January 23, 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 (“SEC” or “Commission”), and amended on January 3, 2005 and April 8, 2005, 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 is proposing to amend the NASD Code of Arbitration Procedure (“Code”) to reorganize the current rules, simplify the language, codify current practices, and implement several substantive changes. NASD is proposing to reorganize its current dispute resolution rules (Rules 10000 et seq.) into three separate procedural codes: The NASD Code of Arbitration Procedure for Customer Disputes (“Customer Code”); the NASD Code of Arbitration Procedure for Industry Disputes (“Industry Code”); and the NASD Code of Mediation Procedure (“Mediation Code”). The three new codes will replace the current NASD Code in its entirety.

This rule filing contains the proposed Mediation Code, the text of which is available on the NASD Web site at http://www.nasdaq.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_0090039:ssSourceNodeId=801.3 Also available at the same URL are a chart comparing the current mediation rules and the proposed Mediation Code and an old-to-new conversion guide.

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 has 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

This rule filing is part of a comprehensive plan to reorganize and simplify the NASD Code of Arbitration Procedure. Specifically, NASD is proposing to reorganize its dispute resolution rules in a more logical, user-friendly way, including creating separate Codes for customer and industry arbitrations, and for mediations. At the same time, it is proposing to rewrite the three Codes using plain English, in accordance with the Commission’s plain English guidelines. Although NASD is also proposing to implement several substantive rule changes to its arbitration rules, as described in the Customer and Industry Code rule filings, NASD is not proposing any substantive changes to the current rules governing mediations.

Reorganization

One of the most frequent criticisms of the current Code is that it is poorly organized. Parties, particularly infrequent users of the forum, have difficulty finding the rules they are looking for, because the rules are not presented in a logical order. The


The proposed Customer Code and the proposed Industry Code have been filed separately with the Commission as SR–NASD–2003–158 and SR–NASD–2004–011, respectively.
confusion is compounded by the fact that certain rules in the Code apply only to customer cases, some apply only to industry cases, and still others apply to both types of disputes. In addition, the current Code contains the NASD mediation rules, despite the fact that many matters are submitted directly to mediation, and do not arise out of an arbitration proceeding.

To address these concerns, NASD is proposing to divide the current Code into three separate Codes: The Customer Code, the Industry Code, and the Mediation Code. NASD believes that maintaining separate Codes will make it easier for parties to find the rules that apply to their disputes, particularly for parties to disputes that are submitted directly to mediation. NASD will maintain electronic versions of each code on its Web site, http://www.nasd.com, and will make paper copies available upon request.

In keeping with the current NASD rule numbering system, each of the three codes will be numbered in the thousands, and major sections will be numbered in the hundreds. Individual rules within those sections will be numbered in the tens (or ones, if necessary). The current method for numbering and lettering paragraphs within individual rules will remain unchanged. The Customer Code will use the Rule 12000 series, the Industry Code will use the Rule 15000 series, and the Mediation Code will use the Rule 14000 series, all of which are also currently unused. NASD will reserve the Rule 10000 series, which is currently used for NASD’s dispute resolution rules, for future use.

Plain English

In 1998, the SEC launched an initiative to encourage issuers and self-regulatory organizations (“SROs”) to use “plain English” in disclosure documents and other materials used by investors. At that time, the SEC published a “Plain English Handbook,” to provide guidance to issuers and SROs in drafting such materials. The Plain English Handbook recommended using shorter, more common words; breaking long rules into shorter ones; using the active voice whenever possible; and using easy-to-read formatting, such as bullet points. NASD has implemented these guidelines wherever possible in revising the proposed Mediation Code, as well as the proposed Customer and Industry Codes.

Proposed Definitions Rule

NASD is also proposing to add a comprehensive definitions rule to the Mediation Code (proposed Rule 14100). This rule would include definitions of terms used throughout the proposed Mediation Code. NASD believes that this rule will provide useful clarification for parties and mediators.

No Substantive Changes

The proposed rule change would establish a separate Mediation Code, and would shorten and simplify NASD’s current mediation rules in a manner consistent with the proposed Customer and Industry Codes. However, with the exception of adding a definitions rule, as described above, NASD is not proposing any substantive changes to its current rules governing mediations.

(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 NASD’s rules 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 proposed rule change will protect the public interest by making its mediation rules easier to find, and by making the mediation process more accessible to parties.

(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, as amended, is consistent with the Act. In particular, the Commission solicits comments on whether the proposed rule change provides for mediation procedures that are fair to investors in customer disputes and to associated persons in industry disputes. 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--013 on the subject line.

Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549--9303.

All submissions should refer to File Number SR--NASD--2004--013. The 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 in the Commission’s Public Reference Section, 100 F Street, NE., Washington, DC 20549. Copies of such filing will also 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 SR--2004--013 and should be submitted on or before July 14, 2005.
amendments to the Code as described herein. This rule filing contains the proposed Customer Code, the text of which is available on the NASD Web site at http://www.nasd.com/web/ideplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_000360&ssSourceNodeid=802. A chart comparing the current Code and the proposed Customer Code, as well as an old-to-new conversion guide, are also available at the same URL.

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 has 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

In 1998, the SEC launched an initiative to encourage issuers and self-regulatory organizations (“SROs”) to use “plain English” in disclosure documents and other materials used by investors. Because the Code is used by investors, including investors who appear pro se in the NASD forum, NASD undertook to rewrite the current Code in “plain English.” Over time, the goals of the plain English initiative expanded beyond simplifying the language and sentence structure of the rules in the Code to include:

- Reorganizing the Code in a more logical, user-friendly way, including creating separate Codes for customer and industry arbitrations, and for mediations; and
- Implementing several substantive rule changes, including codifying several common practices, to provide more guidance to parties and arbitrators.

The proposed Industry Code and proposed Mediation Code have been filed separately with the Commission as SR–NASD–2004–011 and SR–NASD–2004–013, respectively.

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Reorganization

One of the most frequent criticisms of the current Code is that it is poorly organized. Parties, particularly infrequent users of the forum, have difficulty finding the rules they are looking for, because the rules are not presented in a logical order. The confusion is compounded by the fact that certain rules in the Code apply only to customer cases, some apply only to industry cases, and still others apply to...
both types of disputes. In addition, the current Code contains the NASD mediation rules, despite the fact that many matters are submitted directly to mediation, and do not arise out of an arbitration proceeding.

To address these concerns, NASD is proposing to divide the current Code into three separate Codes: The Customer Code, the Industry Code, and the Mediation Code. Although many of the rules in the Customer and Industry Codes will be identical, NASD believes that maintaining separate arbitration codes will eliminate confusion regarding which rules are applicable to which disputes. NASD also believes that maintaining a separate Mediation Code will be particularly useful to parties submitting matters directly to mediation. NASD will maintain electronic versions of each code on its Web site, http://www.nasd.com, and will make paper copies available upon request.

In keeping with the current NASD rule numbering system, each code will be numbered in the thousands, and major sections will be numbered in the hundreds. Individual rules within those sections will be numbered in the tens (or ones, if necessary). The current method for numbering and lettering paragraphs within individual rules will remain unchanged. For example, the Customer Code will use the Rule 12000 series, which is currently unused. The Industry Code will use the Rule 13000 series, and the Mediation Code will use the Rule 14000 series, both of which are also currently unused. NASD will reserve the Rule 10000 series, which is currently used for NASD’s dispute resolution rules, for future use.

To make it easier to find specific rules, the Customer Code will be divided into the following nine parts, which are intended to approximate the chronological order of a typical arbitration:

- Part I (Rule 12100 et seq.) contains definitions, as well as other rules relating to the organization and authority of the forum;
- Part II (Rule 12200 et seq.) contains general arbitration rules, including what claims are subject to arbitration in the NASD forum;
- Part III (Rule 12300 et seq.) contains rules explaining how to initiate a claim, how to respond to a claim, how to amend claims, and when claims may be combined and separated;
- Part IV (12400 et seq.) contains rules relating to the appointment, authority and removal of arbitrators;
- Part V (Rules 12500 et seq.) contains rules governing the prehearing process, including proposed new rules relating to motions and discovery;
- Part VI (Rules 12600 et seq.) contains rules relating to hearings;
- Part VII (Rules 12700 et seq.) contains rules relating to the dismissal, withdrawal, or settlement of claims;
- Part VIII (Rules 12800 et seq.) contains rules relating to simplified (small cases) arbitrations and default proceedings; and
- Part IX (Rules 12900 et seq.) contains rules relating to fees and awards.

Description of Other Changes

In addition to simplifying and reorganizing the Code, the proposed rule change includes several other changes to the Customer Code that are intended to make the NASD arbitration process as simple, uniform and transparent as possible. Some of the proposed changes codify or clarify current NASD practice. Others are substantive changes that are intended to provide guidance to parties, resolve open questions, or streamline or standardize the administration of NASD arbitrations. Only proposed substantive changes are discussed in detail below. Any proposed changes to the Code that are not discussed are intended to be nonsubstantive revisions. The proposed changes are discussed below, in the order that they appear in the Customer Code.

Agreement of the Parties (Proposed Rule 12105)

Both the current Code and proposed Customer Code permit parties to an arbitration to agree to modify certain provisions, such as the number of arbitrators on a panel, or the time to respond to a pleading. Occasionally, all active parties to an arbitration agree to modify a provision, but an inactive party does not respond to notices or participate in the decision. Under a literal reading of the current Code, the active parties to the arbitration would not be able to agree to the modification, even though the inactive party was not participating in the arbitration. This can cause unnecessary delay and frustration for the active parties. NASD believes that the nonappearance of an inactive party should not prevent active parties to an arbitration from exercising control over the arbitration process. To address this concern, proposed Rule 12105 would provide that, when the Code allows the parties to an arbitration to modify a provision of the Code, or a decision of the Director or the panel, the agreement of all named parties is required, unless the Director or panel determines that a party is inactive in the arbitration or has failed to respond after adequate notice has been given.

Use of the Forum (Proposed Rule 12203)

Currently, Rule 10301(b) provides that the Director of Arbitration, upon approval of the National Arbitration and Mediation Committee (“NAMC”) or its Executive Committee, may decline the use of the NASD arbitration forum if the “dispute, claim, or controversy is not a proper subject matter for arbitration.”

Occasionally, situations arise in which the Director believes that it is in the best interest of the forum to deny use of the forum for reasons other than subject matter. For example, the current rule does not specifically permit the Director to deny the forum when NASD has reason to believe that a party would present a security risk to the forum or to other parties. Furthermore, the requirement that the Director must first obtain approval of either the NAMC or its Executive Committee, is burdensome and time-consuming, making it difficult for the Director or the forum to respond appropriately in emergency situations.

To address this concern, proposed Rule 12203(a) would provide that the Director may decline to permit the use of the NASD arbitration forum if the Director determines that, given the purposes of NASD and the intent of the Code, the subject matter of the dispute is inappropriate, or that accepting the matter would pose a risk to the health or safety of parties or their representatives, arbitrators or NASD staff. In addition, the provision requiring approval of the NAMC or its Executive Committee would be deleted. However, to ensure that the authority to deny the forum could not be delegated by the Director, the rule would provide that only the Director or the President of NASD Dispute Resolution may exercise the Director’s authority under the rule. NASD believes that this rule change will give the Director limited, but crucial, flexibility to protect the integrity and the security of the NASD forum.

Shareholder Derivative Actions (Proposed Rule 12205)

Currently, the Code does not specifically address whether shareholder derivative actions may be arbitrated at NASD. Such claims are not eligible for arbitration at NASD because, by definition, they involve corporate governance disputes that do not arise out of or in connection with the business of a member firm or an associated person. Nonetheless, the question arises from time to time,
occasionally after a claimant has filed a statement of claim.

Proposed Rule 12205, which is consistent with New York Stock Exchange Rule 600(e), would clarify that shareholder derivative actions are not eligible for arbitration at NASD. NASD believes that the inclusion of this rule would help avoid confusion, provide guidance to parties, and conserve resources expended when parties seek to arbitrate such matters at NASD.

Extensions of Deadlines (Proposed Rule 12207)

Currently, Rule 10314(b)(5) provides that deadlines established by the Code for filing or serving pleadings may be extended by the Director, or with the consent of the initial claimant. This provision does not provide guidance with respect to the extension of other deadlines established by the Code, or by the panel or Director, and can also cause confusion with respect to responsive pleadings filed by the initial claimant. The current rule also provides that extensions of time for filing an answer are disfavored and will only be granted in extraordinary circumstances.

To eliminate confusion, and to provide more comprehensive guidance regarding when and under what circumstances deadlines may be extended, proposed Rule 12207 would provide that the parties may agree in writing to extend or modify any deadline for serving an answer; returning arbitrator or chairperson lists; responding to motions; or exchanging documents or witness lists. If the parties agree to extend or modify a deadline, the proposed rule would require that they notify the Director of the new deadline in writing. The proposed rule would also provide that the panel may extend or modify any deadline listed above, or any other deadline set by the panel, either on its own initiative or upon motion of a party. Finally, the rule would provide that the Director may modify or extend any deadline or time period (1) set by the Code for good cause, or (2) set by the panel in extraordinary circumstances. Although good cause is a lower standard than extraordinary circumstances, which refers to unexpected and uncontrollable events such as weather-related or security emergencies, good cause is not a negligible standard. In the context of the proposed rule, the good cause requirement means that extensions of Code deadlines by the Director are generally disfavored, and that the Director must take into account the effect of the extension on all parties before granting such a request.

Ex Parte Communications (Proposed Rule 12210)

The current Code does not address ex parte communications. To provide additional guidance to arbitrators and parties, and to further ensure the integrity of the NASD arbitration process, the revised Code would include proposed Rule 12210 expressly to prohibit ex parte communications between parties and arbitrators, except as provided in proposed Rule 12211. The proposed rule is based on general ex parte rules applicable in court proceedings, and reflects current NASD practice. The NASD Arbitrators’ Manual and NASD arbitrator training materials direct arbitrators to avoid ex parte communications with parties, and arbitrators receive training on how and why to do so. Materials provided to parties also advise parties to avoid ex parte communications with arbitrators. For example, NASD’s “Top Ten” Standards Of Good Practice At Arbitration Hearings (available on NASD’s Web site, http://www.nasd.com), states that participants in NASD arbitrations “should not engage in conversation with arbitrators in the absence of the other party(ies).”

Sanctions (Proposed Rule 12212)

Currently, Rule 10305(b), governing the dismissal of proceedings, provides that the “arbitrators may dismiss a claim, defense, or proceeding with prejudice as a sanction for willful and intentional material failure to comply with an order of the arbitrator(s) if lesser sanctions have proven ineffective.” In addition, the NASD Discovery Guide states that “[t]he panel has wide discretion to address noncompliance with discovery orders. For example, the panel may make an adverse inference against a party or assess adjournment fees, forum fees, costs and expenses, and/or attorneys’ fees caused by noncompliance.” Proposed Rule 12212 would codify the sanction options available to arbitrators that are described in the Discovery Guide, and extend them beyond the discovery context to apply to non-compliance with any provision of the Code, or order of the panel or a single arbitrator authorized to act on behalf of the panel. The proposed rule would also allow the panel to dismiss a claim, defense, or arbitration under the same conditions as they may currently, although it would use the term “prior” rather than “lesser” sanctions, in order to avoid potential confusion regarding whether a prior sanction was “lesser” or “greater.” NASD believes that this rule change will encourage parties to comply with both the Code and with orders of the panel, and will also clarify the authority of arbitrators to ensure the fair and efficient administration of arbitration proceedings when parties fail to do so.

Hearing Locations (Proposed Rule 12213)

NASD currently maintains more than 55 designated hearing locations for NASD arbitrations and mediations. Generally, when a claim is filed in a case involving a customer, NASD selects the hearing location that is closest to where the customer lived at the time the events giving rise to the dispute arose. To make the arbitration process more transparent, proposed Rule 12213 would codify this practice. The use of the term “generally” reflects that fact that while the default location is the one closest to where the customer lived at the time the dispute arose, the Director does have discretion to select another location that would be more appropriate or less burdensome to the parties given the specific facts of the case. For example, if the customer lived in California at the time the dispute arose, but has since moved to New York, and the firm does business in New York, the Director could select New York as the hearing location.

The proposed rule would also clarify that before arbitrator lists are sent to the parties under Rule 12403, the parties may agree in writing to a different hearing location other than the one selected by the Director, and that the Director may change the hearing location upon motion of a party. NASD believes that the proposed rule will provide useful guidance to parties about where their arbitration will take place, which may be particularly helpful to investors who may be considering filing a claim in arbitration.

Time to Answer Counterclaims and Cross Claims (Proposed Rules 12304 and 12305)

Currently, Rule 10314 provides that claimants have only 10 days to answer a counterclaim, but a respondent answering a cross claim has 20 days to file an answer to the cross claim, even if the respondent has already answered the initial claim. This discrepancy can cause delay in the proceedings. NASD believes that parties who have already
filed or served a pleading should have the same amount of time to respond to subsequent pleadings. NASD also believes that 10 days is insufficient, while 45 days is too long. NASD believes that 20 calendar days is the appropriate amount of time for parties to respond to both counter and cross claims.

Therefore, proposed Rule 12304 would extend the time that a claimant has to file a response to a counterclaim from 10 to 20 days from receipt of the counterclaim. In addition, proposed Rule 12305 would shorten the time that a respondent has to respond to a cross claim from 45 days to 20 days from the date that the respondent’s answer to the statement of claim is due, or from the receipt of the cross claim.

**Deficient Claims (Proposed Rule 12307)**

Under current NASD practice, if a claimant files a deficient, or incomplete, claim, NASD will notify the claimant, and the claimant is given 30 days to correct the deficiency. If the deficiency is not corrected within that time, the claim is dismissed without prejudice. Reasons for deficiencies include failure to include required information in the statement of claim, failure to pay required fees, and failure to properly execute the NASD Uniform Submission Agreement.

NASD’s practice with respect to deficiencies is consistent with the Arbitration Procedures published by the Securities Industry Conference on Arbitration (“SICA”). However, the current Code does not expressly address what constitutes a deficiency, or explain the process for identifying and correcting deficiencies. Proposed Rule 12307 would codify NASD’s deficiency practice. Specifically, it would provide that the Director will not serve a deficient, or incomplete, claim, and will enumerate the most common types of deficiencies. The proposed rule would also provide that the Director will notify the claimant in writing if the claim is deficient. If all deficiencies are not corrected within 30 calendar days from the time the claim is received, notice, the Director will close the case without serving the claim, and will not refund any filing fees paid by the claimant. The proposed rule would also make clear that the same standards apply to deficient counterclaims, cross claims and third party claims served directly by parties, and would prohibit arbitrators from considering such claims unless the deficiencies were corrected within the time allowed. NASD believes that including the deficiency standards and practice in the Code will provide useful guidance to parties, and will reduce delay in NASD arbitrations by reducing the number of deficient claims.

**Amending Pleadings to Add Parties (Proposed Rule 12309)**

Under the current Code, parties may amend their pleadings at any time prior to the appointment of the arbitration panel. After panel appointment, parties must obtain approval of the arbitrators before amending a pleading. If a party is added to an arbitration proceeding before the Director has consolidated the other parties’ arbitrator rankings under current Rule 10308, the Director will send the arbitrator lists to the newly-added party, and the newly-added party may participate in the arbitrator selection process. However, if a party amends a pleading to add a new party to the proceeding between the time that the Director consolidates the arbitrator lists and the time the panel is appointed, the newly-added party is not allowed to participate in the arbitrator selection process, or to object to being added to the arbitration.

To address this issue, which has been the subject of concern among some users of the forum, proposed Rule 12309 would provide that no party may amend a pleading to add a party during the time between the date that ranked arbitrator lists are due to the Director and the panel is appointed. Proposed Rule 12309(c) would provide that the party to be added after panel appointment must be given an opportunity to be heard before the panel decides the motion to amend. This change will ensure that a party added to an arbitration by amendment either will be able to participate in the arbitrator selection process, or will have the opportunity to object to being added to the proceeding.

**Time to Answer Amended Pleadings (Proposed Rule 12310)**

Currently, Rule 10328 provides that parties have 10 business days to answer an amended pleading. Other rules in the current Code refer to calendar days. In the interest of uniformity, proposed Rule 12310(h) defines the term “day” to mean calendar day. To reflect this definition, proposed Rule 12310 would give parties 20 calendar days, rather than 10 business days, to respond to amended pleadings. Although this represents a slight extension of time, it is consistent with the time to respond to counterclaims and cross claims under proposed Rule 12304 and 12305. Because standardizing time frames is part of NASD’s plain English initiative, NASD believes that 20 calendar days is an appropriate time period for responding to amended pleadings.

**Neutral List Selection System and Arbitrator Rosters (Proposed Rule 12400)**

Currently, NASD maintains a roster of public and non-public arbitrators. Depending on the amount in dispute, an arbitration panel in a customer dispute will consist either of one public arbitrator, or two public arbitrators and one non-public arbitrator. Parties in three-arbitrator cases receive two lists: one of non-public arbitrators and one of public arbitrators. The lists are generated by the Neutral List Selection System (“NLSS”). NASD’s computerized system for generating lists of arbitrators from NASD’s rosters of arbitrators for the selected hearing location. By a process of striking and ranking the listed arbitrators, the parties select one non-public and two public arbitrators from the lists generated by NLSS. Once the panel is appointed, the parties jointly select the chairperson from the panel, or, if the parties do not agree, the Director appoints the highest-ranked public arbitrator on the panel to serve as chairperson.6

Although NASD provides voluntary chairperson training to its arbitrators, arbitrators who serve as chairperson are not currently required to have chairperson training, to have any particular experience, or to meet any other specific criteria beyond the requirements for serving as an arbitrator. Over the years, one of the most frequent suggestions for improving the quality and efficiency of NASD arbitrations is to ensure that chairpersons, who play a vital role in the administration of cases, have some degree of arbitrator experience and training.

NASD agrees that requiring trained and experienced chairpersons would significantly enhance the quality of its arbitration forum. However, NASD also believes that the criteria or training requirements should not prevent public arbitrators of any professional or educational background from qualifying to serve as chairpersons of panels in customer cases.

To address these concerns, the proposed Customer Code would require that NASD create and maintain a third roster of public arbitrators who are qualified to serve as chairpersons. In three-arbitrator cases, parties would receive three lists of arbitrators: A non-public list, a public list and a public chair-qualified list. The parties would select the chairperson from the chair-qualified list in the same manner and at the same time that they select the other members of the panel. In single-

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6 NASD estimates that parties agree on a chairperson only about 20% of the time.
arbitrator cases, the arbitrator would be selected from a list of public chair-
qualified arbitrators, unless the parties agreed otherwise.

Under proposed Rule 12400, public arbitrators would be eligible for the
chairperson roster if they have completed chairperson training
provided by NASD, or have substantially equivalent training or
experience, and either:
- Have a law degree and are a
  member of a bar of at least one
  jurisdiction and have served as an
  arbitrator through award on at least two
  arbitrations administered by a SRO in
  which hearings were held; or
- Have served as an arbitrator through
  award on at least three arbitrations
  administered by an SRO in which
  hearings were held.

Substantially equivalent training or experience would include service as a
judge or administrative hearing officer, chairperson training offered by another
recognized dispute resolution forum, or the like. Decisions regarding whether
particular training or experience other than NASD chairperson training would
qualify under this provision would be in the sole discretion of the Director.

NASD believes that these criteria strike the appropriate balance between
ensuring that arbitrators who serve as chairpersons or single arbitrators have the
requisite experience to fairly and efficiently administer their cases, and
allowing arbitrators of all professional backgrounds to qualify as chairpersons.
Public arbitrators who qualify under these criteria will be placed on the
chairperson roster only if they agree to serve as chairpersons; otherwise, they
will remain on the general public arbitrator roster. To avoid duplication of
names on the lists sent to parties, arbitrators who are on the chairperson
roster will not be on the general public arbitrator roster.

Number of Arbitrators (Proposed Rule 12401)

Under current Rule 10308(b), if the
amount of a claim is $25,000 or less, the
arbitration panel consists of one public
arbitrator, unless that arbitrator requests
a three-arbitrator panel. If the claim is
more than $25,000 but not more than
$50,000, the panel consists of one
public arbitrator unless either that
arbitrator, or any party in its initial
pleading, requests a three-arbitrator panel.
Claims of more than $50,000 are
heard by a three-arbitrator panel.

7 NLSS would generate arbitrator names from the
NASD rosters on a random, rather than rotational,
basis. Changes to NLSS were primarily driven by
computer programming requirements. See Exchange
Act Rel. No. 51339 (Mar. 9, 2005), 70 FR 12763
(Mar. 15, 2005) [Order Approving Proposed Rule
Change and Amendment No. 1 Thereto by NASD
Relating to the Random Selection of Arbitrators by
NLSS]; Exchange Act Rel. No. 51083 (Jan. 26, 2005),
70 FR 5497 (Feb. 2, 2005) [Notice of Filing and
Order Granting Accelerated Approval of Proposed
Rule Change and Amendment No. 1 Thereto
Relating to the Random Selection of Arbitrators by
NLSS].

8 See, e.g., Flocsynth, Inc. v. Pickholz, 759 F.2d
171, 174 (2d Cir. 1984); ANR Coal Co. v. Gigentrix of
1999); Consolidation Coal Co. v. Local 1649,
United Mine Workers of Am., 48 F.3d 125, 127–130
(4th Cir. 1995); Jansen v. Halliburton Co., 2002 U.S.
Dist. LEXIS 19706, 10–16 (E.D. La. 2002); Iependi
A. Prosad, M.D., Inc. v. Investors Assoc., Inc., 82 F.
Supp. 2d 365, 370, 8 (D. N.J. 2000); Arix, Inc.

that is currently in Rule 10327 has been
included in proposed Rule 12406.

Arbitrator Recusal (Proposed Rule
12409)

Under current NASD practice, parties
may request that an arbitrator recuse
himself or herself from the panel at any
time. However, the current Code does
not address arbitrator recusal. To
provide guidance to parties, proposed
Rule 12409 would provide that any
party may ask an arbitrator to recuse
himself or herself from the panel for
good cause. The proposed rule would
also clarify that requests for arbitrator
recusal are decided by the arbitrator
who is the subject of the request. Some
users of the forum believe that recusal
requests should be made to the full
panel. Courts have held, however, that
recusal decisions are within the
discretion of the individual arbitrator,
and therefore, tend to uphold these
decisions on appeal. However, the
Director may continue to remove
arbitrators for cause under proposed
Rule 12410 on the same grounds as
those under current Rules 10308(d),
10312(d) and 10313.

Replacement of Arbitrators (Proposed
Rule 12411)

Under the current Code, the
provisions regarding replacement of
arbitrators are found in Rules
10308(d)(3) and 10313, which contain
numerous cross-references to other
rules. Proposed Rule 12411 would
consolidate the various current rules.

The proposed rule also would extend
the option of electing to proceed with
only the remaining arbitrators to all
stages of the proceeding, and eliminate
the 5-day limit on electing that option
contained in current Rule 10313. NASD
believes that parties should have the
right to decide jointly to proceed with
only the remaining arbitrators regardless
of when the replacement occurs, and
that the parties should be able to elect
that option up until the time the
replacement arbitrator is appointed.
Otherwise, proposed Rule 12411 does
not contain any substantive changes from
the current rules upon which it is
based.
Determinations of Arbitration Panel (Proposed Rule 12414)

Under the current Code, Rule 10325 requires that all rule and determinations of the panel be made by a majority of the arbitrators. Proposed Rule 12414 would provide that all rule and determinations of the panel must be made by a majority of the arbitrators, unless the parties agree, or the Code or applicable law provides otherwise. The proposed rule reflects that under the Code, and applicable law, some decisions of the panel may be made by a single member of a three-arbitrator panel. For example, Proposed Rule 12503 provides that some motions may be decided by a single arbitrator. Also, applicable law may permit a single arbitrator to issue a subpoena.

Initial Prehearing Conferences (Proposed Rule 12500)

Proposed Rule 12500 would codify the portion of the NASD Discovery Guide relating to initial prehearing conferences (“IPHCs”). Since the adoption of the Discovery Guide in 1999, IPHCs have been standard practice in NASD arbitrations. The IPHC gives the panel and the parties an opportunity to organize the management of the case, set a discovery cut-off date, identify and establish a schedule for potential motions, schedule hearing dates, determine whether mediation is desirable, and resolve many other preliminary issues. Users of the forum have found the IPHC to be a valuable tool in managing the administration of arbitrations. NASD believes that the proposed rule, which provides that an IPHC will be held in every case unless the parties jointly agree on certain scheduling and other enumerated issues in advance, will provide valuable guidance to parties and arbitrators about the role of IPHCs in NASD arbitrations.

Recording Prehearing Conferences (Proposed Rule 12502)

Currently the Code is silent with respect to whether and under what circumstances a prehearing conference will be tape-recorded. Proposed Rule 12502 would provide that prehearing conferences are generally not tape-recorded as a matter of course (with the exception of prehearing conferences to decide dispositive motions, discussed below). However, the rule would permit the panel to decide to tape-record a prehearing conference on its own initiative, or at the request of a party. The rule would also provide that, if the prehearing conference is tape-recorded, the Director will provide a copy of the tape to any party upon request, for a nominal fee. The rule does not specify the fee because the fee may vary slightly depending on the rates charged by NASD’s telephone service provider, which normally makes the initial recording of telephonic hearing sessions. The current fee is $15 per tape. (Because NASD must arrange in advance to have telephonic hearing sessions taped, NASD will instruct arbitrators that they should notify NASD at least 24 hours in advance when they decide that a prehearing conference should be taped.)

Motions (Proposed Rule 12503)

Although motions are increasingly common in arbitration, the current Code does not refer to motions or provide any guidance with respect to motions practice. As a result, motions practice lacks uniformity, and parties and arbitrators alike are often unsure how motions should be made, responded to or decided. To provide guidance to parties and arbitrators, and to standardize motions practice in the NASD forum, proposed Rule 12503 would establish procedures and deadlines for making, responding to and deciding motions.

Some users of the forum have expressed the concern that adopting a motions practice rule will encourage more motions. Although NASD understands this concern, NASD believes that motions have already become an inescapable part of most arbitrations. Therefore, NASD believes that the Code should provide as much guidance about motions as possible to parties, particularly infrequent users of the forum. However, in an effort to deter unnecessary motions, the rule would require that, before making a motion, a party must make an effort to resolve the matter that is the subject of the motion with the other parties. The rule would also require that every motion, whether written or oral, include a description of the efforts made by the moving party to resolve the matter before making the motion.

Another common concern about adopting a motions practice rule is that it will detract from the informal nature of arbitration. To address this concern, the rule would make clear that most motions may be made either orally or in writing, and that written motions need not take any particular form.

Paragraph (c) of the proposed rule would outline who decides what motions. Paragraph (c)(1) provides that motions relating to the use of the forum under proposed Rule 12203 and removal of an arbitrator under proposed Rule 12410 are decided by the Director, because these motions are filed and decided before a panel has been appointed. Paragraph (c)(2) would provide that motions relating to combining or separating claims or arbitrations, or changing the hearing location, are decided by the Director before a panel is appointed, and by the panel after the panel is appointed. Paragraph (c)(3) provides that discovery-related motions are decided by one arbitrator, generally the chairperson. This provision reflects that while the chairperson is usually the person to decide such motions, the chairperson may not always be available, and the parties or the Director may decide to refer the matter to one of the other arbitrators. The provision also states that the arbitrator who initially hears a discovery-related motion may refer such motions to the full panel, either at his or her own initiative or at the request of a party. The arbitrator must refer motions relating to issues of privilege to the full panel at the request of a party. Paragraph (c)(4) provides that motions relating to arbitrator recusal are decided by the arbitrator who is the subject of the motion, as provided by proposed Rule 12409. Finally, the rule provides that all other motions not covered in the preceding paragraphs of the rule are decided by the full panel, unless the Code provides or the parties agree otherwise.

Motions to Decide Claims Before a Hearing on the Merits (Proposed Rule 12504)

Another recurring question in NASD arbitrations is whether, and to what extent, arbitrators have the authority to decide dispositive motions before a hearing on the merits. In its Follow-up Report on Matters Relating to Securities Arbitration, the General Accounting Office (“GAO”) noted that while NASD’s arbitration rules do not specifically provide for dispositive motions, case law generally supports the authority of arbitrators to grant motions to dismiss claims prior to the hearing on the merits. Because the Code provides no guidance with respect to this question, arbitrator decisions with respect to it lack uniformity.

Generally, NASD believes that parties have the right to a hearing in arbitration. However, NASD also acknowledges that in certain extraordinary circumstances, it would be unfair to require a party to proceed to a hearing. Specifically, the proposed rule would:

- Provide that, except for motions relating to the eligibility of claims under

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the Code’s six year time limit, motions that would resolve a claim before a hearing on the merits are discouraged, and may only be granted in extraordinary circumstances;

• Require that a prehearing conference before the full panel must be held to discuss the motion before the panel could grant it; and

• Allow the panel to issue sanctions against a party for making a dispositive motion in bad faith.

NASD believes that this rule proposal, which was developed over several years with input from industry and public members of the NAMC, will provide necessary guidance to parties and arbitrators, and make the administration of arbitrations more uniform and transparent. NASD believes that the rule strikes the appropriate balance between allowing the dismissal of claims in limited, extraordinary circumstances and reinforcing the general principle that parties are entitled to a hearing in arbitration.

Discovery (Proposed Rules 12505—12511)

One of the most frequent comments made by users of the NASD forum is that the discovery procedures outlined in NASD’s Discovery Guide are routinely ignored, resulting in significant delay and the frequent need for arbitrator intervention in the discovery process. This is partly due to the fact that the Discovery Guide establishes guidelines rather than mandatory procedures. To address these concerns, proposed Rules 12505—12511 would codify the discovery procedures currently outlined in the NASD Discovery Guide, with certain substantive changes. The proposed Code would not contain the actual Document Production Lists, which would remain in the Discovery Guide, but it would make clear that either producing or objecting to documents on applicable lists, as well as other documents requested by parties, is mandatory. The proposed rules also would extend the time parties have to respond to Document Production Lists and other discovery requests from 30 to 60 days, but would also provide more serious consequences when parties fail to respond, or when parties frivolously object to requests to produce documents or information. In addition, proposed Rule 12512 would codify the sanctions provisions of the Discovery Guide, clarifying the authority of arbitrators to sanction parties for non-compliance with discovery rules or orders of the panel. NASD believes that, collectively, these changes will significantly minimize the number of discovery disputes in NASD arbitrations.

Because much of what is currently contained in the Discovery Guide would be incorporated into the Code, the Discovery Guide would be amended to include only the remaining information, including the Document Production Lists themselves. The proposed and amended Discovery Guide is available at http://www.nasd.com/web/idcplg?IdcService=SS_GETlowbar;PAGE&ssDocName=NASDW_009306&ssSourceNodelD=802.

Subpoenas (Proposed Rule 12512)

Current Rule 10322 provides that the arbitrators and any counsel of record to the proceeding shall have the power of the subpoena process as provided by law, and that all parties must be given a copy of a subpoena upon its issuance. The rule also provides that parties shall produce documents and make witnesses available to each other to the fullest extent possible without resort to the subpoena process.

Proposed Rule 12512 is substantially identical to the current rule Code, but would also require that if a subpoena is issued, the issuing party must send copies to all other parties at the same time and in the same manner as the party that issued the subpoena. This modification is intended to ensure that parties receive notice of the subpoena in a timely manner.

Exchange of Documents and Witness Lists (Proposed Rule 12514)

Current Rule 10321(d) requires that at least 20 days before a hearing on the merits is scheduled to begin, all parties must exchange copies of all documents in their possession that they intend to present at the hearing, and must identify all witnesses they intend to present at the hearing. As a practical matter, many of the documents will already have been exchanged through discovery. Users of the forum have advised NASD that this rule would be less burdensome, and more useful, if it were amended to require only that parties exchange all documents they intend to use at the hearing that have not previously been exchanged. The proposed rule would make this change and would increase the consequences of failing to comply with this requirement. Under the current rule, the panel may exclude evidence not exchanged in a timely manner. Proposed Rule 12514 would create a presumption that parties could not use any documents at the hearing that were not exchanged, or call any witnesses at the hearing who were not identified, within the time provided by the rule, unless the panel determines that good cause exists. The proposed rule specifically provides that good cause includes the need to use documents or call witnesses for rebuttal or impeachment purposes based on developments at the hearing.

Postponements (Proposed Rule 12601)

In the proposed Code, hearing adjournments are referred to as hearing postponements, for plain English purposes. Paragraph (a) of proposed Rule 12601 has been amended to provide that the panel may not grant requests to postpone a hearing that are made within 10 days of a scheduled hearing session unless the panel determines that good cause exists. This provision is intended to reduce the number of last minute requests for postponements, a practice that many users of the forum believe results in unnecessary delay and unfairness to parties.

Paragraph (b) of the proposed rule provides that, except as otherwise provided, a postponement fee equal to the applicable hearing session fee, as set forth in Proposed Rule 12902, will be charged for each postponement agreed to by the parties, or granted upon request of one or more parties. Therefore, the fee would no longer increase for a second or subsequent request by the same party. This change is intended to simplify the rule and to avoid confusion when one party requesting a postponement has made a previous request, but one or more of the other parties requesting the same postponement have not made previous requests.

The proposed rule also gives the panel the authority to allocate the postponement fees among non-requesting parties if the panel determines that the non-requesting party caused or contributed to the need for the postponement.

Withdrawing Claims (Proposed Rule 12702)

The current Code does not contain any guidance with respect to withdrawing claims. This occasionally causes confusion, particularly with respect to the consequences of withdrawing a claim at a particular stage in an arbitration. To provide guidance to parties, proposed Rule 12702 would provide that before a claim has been answered by a party, a claimant may withdraw the claim against that party with or without prejudice. However, after a claim has been answered by a party, a claimant may only withdraw its claim against that party with prejudice, unless the panel decides, or the claimant and that
party agree, otherwise. NASD believes that the proposed rule strikes the appropriate balance between allowing claimants to withdraw their claims without prejudice before a respondent has expended significant resources responding to the claim, and protecting the respondent from having to respond to the same claim multiple times.

**Simplified Arbitration Rule (Proposed Rule 12800)**

The simplified arbitration rule would be significantly shortened. Currently, in addition to the procedures that are unique to simplified arbitrations, Rule 10302 repeats some, but not all, of the general provisions that apply to both regular and simplified cases. The proposed rule would include only those provisions that are unique to simplified cases.

The proposed rule would eliminate the current provisions establishing the special time limits or deadlines for pleadings in simplified cases, and the time limits would now be the same as those in regular cases. Frequent users of the forum report that the time limits in simplified cases are routinely extended under the current rule. To provide better guidance to parties, NASD believes that the Code should reflect that, in practice, the time to answer in simplified cases is typically the same as it is in regular cases.

Under proposed Rule 12800, the single arbitrator would be selected from the chairperson roster, unless the parties agree in writing otherwise. The single arbitrator would not be able to request a three-arbitrator panel, and the arbitrator would no longer have the option of dismissing without prejudice a counterclaim or other responsive pleading that increased the amount in dispute above the simplified case threshold. If a pleading increased the amount in dispute above the threshold, the case would be administered under the regular provisions of the Code. If an arbitrator has been appointed, that arbitrator will remain on the panel. If a three-arbitrator panel is required, the remaining arbitrators will be appointed by the Director. The proposed rule would also eliminate the ability of the single arbitrator to require a hearing. However, a hearing would still be held upon the customer’s request.

NASD believes that these changes will make the simplified arbitration rule easier for parties to understand, and will also streamline and simplify the administration of small claims in the NASD forum.

**Fees (Proposed Rules 12900—12903)**

One of the most frequent criticisms of the current Code is that the fee schedules are difficult to understand, particularly with respect to what claimants must pay at the time of filing. Currently, claimants must pay a non-refundable filing fee, and an initial hearing session deposit that may be refundable under certain circumstances. In addition, parties also must pay hearing session fees for each hearing session. Although the filing fee and the initial hearing session deposit are both due upon filing, they are presented in the Code as separate fees, making it hard for some parties to understand the total amount due upon filing. To address this issue, and to make the fee schedules easier to read, the fee schedules have been revised in two significant ways.

First, the filing fee and the hearing session deposit have been combined into one single fee that is paid when a claim is filed. With two exceptions, described below, the amounts paid by claimants would not change. Although what is now the refundable hearing session deposit would no longer be paid separately, an amount equal to the current hearing session deposit or a portion thereof may be refunded if NASD receives notice that the case has been settled more than 10 calendar days prior to the hearing on the merits. (Under the current Code, the initial hearing session deposit may be refunded if NASD receives, prior to 8 days before the hearing on the merits, notice that the case has been settled; this has been changed to 10 days as part of the overall effort to standardize the time frames in the Code.) The consolidation of the filing fee and the hearing session deposit is intended to make it easier for claimants to understand how much they have to pay when they file a claim and what, if any, portion of that fee may be refunded.

Second, several sets of brackets in the filing fee schedule would be condensed. Currently, there are 14 separate fee brackets in the customer filing fee schedule. Some of the fees for different brackets are the same; others are separated by amounts ranging from $25–$100. The result is a schedule that is confusing and difficult to read. To simplify the schedule, the customer filing fee brackets would be reorganized as follows: The $25,000–$30,000 bracket ($800) and the $30,000–$50,000 bracket ($825) would be combined, and the filing fee for the new bracket would be $800; and the $1 million–$3 million bracket ($1,700), the $3 million–$5 million bracket ($1,800), the $5 million–$10 million bracket ($1,800) and the over $10 million bracket ($1,800) would be combined, and the filing fee for the new bracket would be $1,800.

The proposed changes would not result in an increase in the total amount of fees paid by customers or associated persons when filing a claim, except that for claims of $30,000 to $50,000, the customer’s overall filing fees would decrease by $50, and for claims of $1 million to $3 million, the customer’s overall filing fees would increase by $100. Corresponding changes would be made to the member filing fee schedule.

NASD believes that these changes will greatly simplify the fee schedule, eliminate three repetitive high and brackets, and align the brackets in the filing fee schedule with the brackets in the member filing fee and surcharge schedules.

(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 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 the proposed Customer Code will protect investors and the public interest by making the arbitration process more transparent for parties, providing useful guidance to parties, arbitrators and staff, and helping to standardize and streamline the administration of NASD arbitrations. If the proposed Code is approved, NASD will offer training on the new Code to arbitrators, users of the forum, and staff.

(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
be direct, definite, and capable of reasonable demonstration, rather than remote or speculative, and close questions regarding challenges to an arbitrator by a customer would be resolved in favor of the customer.\footnote{12}{Id.}

Where the Uniform Code differs from the Proposed NASD Rules with respect to appointment of arbitrators by the Director, which alternative is preferable? Why?

2. **Subpoenas:** Section 23(c)(1) of the Uniform Code provides that arbitrators and any counsel of record may issue subpoenas as provided by law, and that parties will produce witnesses and present proof at the hearing whenever possible without using subpoenas.\footnote{13}{Section 23(c) of the Uniform Code provides as follows:}

Subpoenas.

(c) Subpoenas.

(1) Arbitrators and any counsel of record may issue subpoenas as provided by law. The party who requests or issues a subpoena must send a copy of the request or subpoena to all parties and the entity receiving the subpoena in a manner that is reasonably expected to cause the request or subpoena to be delivered to all parties and the entity receiving the subpoena on the same day. The parties will produce witnesses and present proof at the hearing whenever possible without using subpoenas.

(2) No subpoena seeking discovery shall be issued to or served upon non-parties to an arbitration unless at least 10 days prior to the issuance or service of the subpoena, the party seeking to issue or serve the subpoena sends notice of intention to serve the subpoena, together with a copy of the subpoena, to all parties to the arbitration.

(3) In the event a party receiving such a notice objects to the scope or propriety of the subpoena, that party shall, within the 10 days prior to the issuance or service of the subpoena, file with the Director, with copies to all other parties, written objections. The party seeking to issue or serve the subpoena may respond thereto. The arbitrator appointed pursuant to this Code shall rule promptly on the issuance and scope of the subpoena.

(4) If in the event an objection to a subpoena is filed under paragraph (c)(3), the subpoena may only be issued or served prior to the arbitrator’s ruling if the party seeking to issue or serve the subpoena advises the subpoenaed party of the existence of the objection at the time the subpoena is served, and instructs the subpoenaed party that it should preserve the subpoenaed documents, but not deliver them until a ruling is made by the arbitrator.

(5) Rule 23(c)(2) and (3) do not apply to subpoenas addressed to parties or non-parties to appear at a hearing before the arbitrators.

(6) The arbitrator[s] shall have the power to quash or limit the scope of any subpoena.

10 Section 17(d) of the Uniform Code provides as follows:

(d) Appointment of Arbitrators.

The Director shall appoint one or more arbitrators for the panel from the SRO’s pool of arbitrators if:
• the parties do not agree on a complete panel;
• acceptable arbitrators are unable to serve; or
• arbitrators cannot be found from the lists for any other reason.

In the event the Director’s appointment becomes necessary, then each side will be given one peremptory strike per case.

11 Proposed NASD Rule 12410(a)(1).

Where Section 23 of the Uniform Code and Proposed NASD Rule 12512 differ, which alternative is preferable? Why?

**B. Nonsubstantive Changes:** Are any changes that are intended to be nonsubstantive actually substantive changes? If so, why are they substantive, and how will they affect the arbitration process or the rights of the parties? Are these proposed changes preferable to their counterparts in the current Code, or vice versa?

**C. Proposed Rule 12105, Agreement of the Parties:** This proposed rule provides that if the Code permits the parties to modify a provision of the Code, or a decision of the Director or the panel, the written agreement of all named parties is required for such a modification. If the Director or the panel determines that a named party is inactive in the arbitration, or has failed to respond after adequate notice has been given, however, the Director or the panel may determine that the written agreement of that party to such modification is not required while the party is inactive or non-responsive.

Is it sufficiently clear what an inactive party is? If not, how could the proposed rule be clarified?

**D. Proposed Rule 12400, Neutral List Selection System and Arbitrator Rosters:** This proposed rule provides that NASD would maintain three separate rosters of arbitrators: one of non-public arbitrators, one of public arbitrators, and one of arbitrators who are eligible to serve as chairpersons. Under Proposed Rule 12400(c), chairpersons must be public arbitrators in customer disputes. NASD has stated that public arbitrators who qualify to be chairpersons will be placed on the chairperson roster only if they agree to serve as chairpersons; otherwise, they will remain on the
prevail are the problems of respondents (1) expending significant resources to respond to a claim that is later withdrawn, or (2) having to respond to the same claim multiple times? Are there other ways to address these competing concerns? Would the proposed rule unnecessarily deter claimants from filing claims? Would the proposed rule encourage respondents to increase the amount in controversy in the arbitration, and therefore the fees that the parties may have to bear? Should the proposed rule exclude arbitrations involving $25,000 or less, i.e., those to which Proposed Rule 12800, Simplified Arbitrations, apply?

H. Proposed Rule 12800, Simplified Arbitrations: This proposed rule provides that all provisions of the Code apply to simplified arbitrations, unless otherwise provided under proposed rule 12800. This means that the time within which parties must answer a statement of claim in simplified arbitrations is 45 days, as in regular arbitrations. Should this time be shortened for simplified arbitrations, as they are meant to be more expedient than regular arbitrations? If so, what would be an appropriate amount of time? 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-2003-158 on the subject line.

Paper Comments
- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–9303.

All submissions should refer to File Number SR-NASD-2003-158. The 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 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 Section, 100 F Street, NE., Washington, DC 20549. Copies of such filing will also 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 SR-NASD-2003-158 and should be submitted on or before July 14, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30–36(e)(12).
Margaret H. McFarland, Deputy Secretary.
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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–51863; File No. SR–NYSE–
2005–02]

Self-Regulatory Organizations; New York Stock Exchange, Inc., Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2 and 3 Relating to Amendments to Exchange Rule 607

June 16, 2005.
Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"), and Rule 19b–4 thereunder, notice is hereby given that on January 4, 2005, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed amendments to its arbitration rules as described in Items I, II and III below, which items have been prepared by the NYSE. On May 12, 2005, the NYSE filed Amendment No. 1 to the proposed rule change ("Amendment No. 1"). On May 13, 2005, the NYSE filed Amendment No. 2 to the proposed rule change ("Amendment No. 2"). On June 16, 2005, the NYSE filed Amendment No. 3 to the proposed rule change (Amendment No. 3).

4 Amendment No. 1 was filed and withdrawn by the NYSE on May 12, 2005.
5 See Amendment No. 2, Amendment No. 2 supplemented the initial filing.
6 See Amendment No. 3, Amendment No. 3 supplemented the initial filing and modified certain statements in Amendment No. 2.