

August 24, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change Relating to Motions to Decide Claims Before a Hearing on the Merits

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 the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. (“NASD Dispute Resolution”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) on July 21, 2006, 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 new Rule 12504 and new Rule 13504 of the NASD Code of Arbitration Procedure to address motions to decide claims before a hearing on the merits (“dispositive motions”). Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * *

12504. Motions to Decide Claims Before a Hearing on the Merits

(a) Except as provided in Rule 12206, motions to decide a claim before a hearing are discouraged and may only be granted in extraordinary circumstances.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

(b) Motions under this rule must be made in writing. Unless the parties agree or the panel determines otherwise, motions under this rule must be served at least 60 days before a scheduled hearing, and parties have 45 days to respond to the motion.

(c) Motions under this rule will be decided by the full panel. The panel may not grant a motion under this rule unless a prehearing conference on the motion is held, or waived by the parties. Prehearing conferences to consider motions under this rule will be tape-recorded.

(d) The panel may issue sanctions under Rule 12212 if it determines that a party filed a motion under this rule in bad faith.

* * *

13504. Motions to Decide Claims Before a Hearing on the Merits

(a) Except as provided in Rule 13206, motions to decide a claim before a hearing are discouraged and may only be granted in extraordinary circumstances.

(b) Motions under this rule must be made in writing. Unless the parties agree or the panel determines otherwise, motions under this rule must be served at least 60 days before a scheduled hearing, and parties have 45 days to respond to the motion.

(c) Motions under this rule will be decided by the full panel. The panel may not grant a motion under this rule unless a prehearing conference on the motion is held, or waived by the parties. Prehearing conferences to consider motions under this rule will be tape-recorded.

(d) The panel may issue sanctions under Rule 13212 if it determines that a party filed a motion under this rule in bad faith.

* * *

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

(a) Background

NASD has filed a series of proposed rule changes with the SEC to amend the NASD Code of Arbitration Procedure (“current Code”). The proposed rule changes would revise the current Code language in accordance with the SEC’s Plain English initiative, codify current practices, implement several substantive changes, and reorganize the current Code into three separate procedural codes: one relating to customer disputes (“Customer Code”), one relating to industry disputes (“Industry Code”), and one relating to mediations (“Mediation Code,” and collectively with the Customer and Industry Codes, the “Code Rewrite”). Proposed Rules 12504 and 13504 initially were proposed as part of the Code Rewrite.

On June 23, 2005, the SEC published the Code Rewrite for comment in the Federal Register.³ The SEC received 51 comment letters on the Customer Code, one comment letter on the Industry Code, and one comment letter on the Mediation Code.⁴

³ See Securities Exchange Act Rel. No. 51856 (Jun. 15, 2005); 70 FR 36442 (Jun. 23, 2005) (Customer Code); Securities Exchange Act Rel. No. 51857 (Jun. 15, 2005); 70 FR 36430 (Jun.

On May 4, 2006, NASD filed a Response to Comments and Amendment No. 5 (“Amendment”) to address the commenters’ concerns with the Customer Code.⁵ The Amendment summarized the commenters’ concerns and, where appropriate, responded to their concerns by proposing to clarify the meaning of some of the rules and to explain arbitration procedure under some of the proposed rules. The Amendment also requested that the proposal be approved on an accelerated basis.

NASD posted the Amendment on its Web site shortly after it was filed. As of July 19, 2006, the SEC had received 105 comment letters opposing some aspects of the Amendment, and asking the SEC to deny NASD’s request for accelerated approval.⁶ Several of the 105 comment letters objected to the Amendment because it proposed to include in the narrative section of the rule filing additional guidance relating to proposed rules 12504 and 13504, including examples of “extraordinary circumstances” in which a dispositive motion could be granted.

23, 2005) (Industry Code); and Securities Exchange Act Rel. No. 51855 (Jun. 15, 2005); 70 FR 36440 (Jun. 23, 2005) (Mediation Code).

⁴ The SEC approved the Mediation Code on October 31, 2005, and it became effective on January 30, 2006. See Securities Exchange Act Rel. No. 52705 (Oct. 31, 2005); 70 FR 67525 (Nov. 7, 2005) (SR-NASD-2004-013).

⁵ See Reorganization and Revision of NASD Rules Relating to Customer Disputes (visited Aug. 2, 2006)

<http://www.nasd.com/RulesRegulation/RuleFilings/2003RuleFilings/NASDW_009306>. A similar amendment was filed to address the comment letter on the Industry Code. See Reorganization and Revision of NASD Arbitration Rules Relating to Industry Disputes (visited Aug. 2, 2006)

<http://www.nasd.com/RulesRegulation/RuleFilings/2004RuleFilings/NASDW_009295>.

While none of the 51 commenters addressed specifically the Industry Code, many of the issues raised apply to the Industry Code, because the two codes contain similar rules and procedures. Thus, based on these comments, NASD made similar changes to the Industry Code, where applicable.

⁶ See Comments on NASD File No. SR-NASD-2003-158, Notice of Filing of Proposed Rule Change and Amendments Nos. 1, 2, 3, and 4 Thereto to Amend NASD Arbitration Rules for Customer Disputes (visited Jul. 19, 2006)

<<http://www.sec.gov/rules/sro/nasd/nasd2003158.shtml>>.

(b) Comments Received on the Description of Proposed Rules 12504 and 13504

NASD states that, based on some of the 51 comment letters received on the Customer Code⁷ and meetings with various constituents, it initially believed that the term “extraordinary circumstances” needed to be explained to clarify when Proposed Rules 12504 and 13504 would apply, and to provide more guidance to arbitrators on the standards to use when deciding a dispositive motion. NASD states that it raised this issue with its public and industry constituents and suggested that they develop language jointly to explain the term “extraordinary circumstances.” NASD was unable to obtain consensus among its constituents. Thus, NASD proposed to insert the following narrative language in the Dispositive Motions section of the rule filing:

For purposes of this rule, if a party demonstrates affirmatively the legal defenses of, for example, accord and satisfaction, arbitration and award, settlement and release, or the running of an applicable statute of repose, the panel may consider these defenses to be extraordinary circumstances. In such cases, the panel may dismiss the arbitration claim before a hearing on the merits if the panel finds that there are no material facts in dispute concerning the defense raised, and there are no determinations of credibility to be made concerning the evidence presented.

The proposed narrative language has engendered substantial controversy. Of the 105 comment letters received on the Amendment, 22 specifically opposed the proposed narrative language. In general, these commenters contended that the proposed narrative language encourages, rather than discourages, the making of dispositive motions. The commenters also argued that the proposed language could increase investors’ costs in defending against these types of motions, and could result in a loss of the major benefits of the arbitration process – cost effectiveness and expediency.

⁷ The comment letter received on the Industry Code did not address dispositive motions.

As noted, NASD has been unable to obtain a consensus among its constituents as to what constitutes “extraordinary circumstances” for purposes of Proposed Rules 12504 and 13504. Therefore, NASD is re-filing the original text of Proposed Rules 12504 and 13504 and the associated narrative language separately from the Customer and Industry Codes, but without the above narrative language that was proposed in the Amendment. NASD believes that addressing these provisions separately will give the public additional time to provide its input without delaying the Commission’s review and final action on the remaining provisions of the Customer and Industry Codes.

(c) Proposed Rules 12504 and 13504: Motions to Dismiss a Claim Before a Hearing on the Merits

One recurring question in NASD arbitrations is whether, and to what extent, arbitrators should 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.⁸

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. Thus, the proposed rules would:

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

⁸ U.S. General Accounting Office, Follow-up Report on Matters Relating to Securities Arbitration (April 11, 2003). GAO has since been renamed Government Accountability Office.

- 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.

(2) Statutory Basis

NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD believes that the proposed rules will provide some guidelines for arbitrators and users of the forum concerning dispositive motions practice and will, thereby, make administration of arbitrations more uniform and transparent.

(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

NASD did not solicit written comments. Comments received by the Commission prior to this filing are discussed above.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. In particular, the Commission solicits comment on whether the proposed rule change provides for arbitration procedures that are fair and consistent with the protection of investors for the resolution of their disputes. In addition, the Commission solicits comment on the questions included below.

- (A) Need for a Dispositive Motions Rule: NASD has stated that, because the current Code provides no guidance with respect to whether arbitrators have the authority to grant dispositive motions, arbitrator decisions with respect to these motions lack uniformity. Should the current Code, or the Customer and Industry Codes, if adopted, contain a dispositive motions rule? Is the absence or presence of such

a rule detrimental to the arbitration process, and if so, how? Assuming that arbitrator decisions with respect to dispositive motions lack uniformity, are there ways, other than through the proposed rule, to address this issue? Commenters are specifically invited to share quantifiable costs and benefits that they believe may result should the Commission approve or disapprove the proposed rules.

(B) Proposed Rules: NASD believes that Proposed Rules 12504 and 13504 strike the appropriate balance between the parties' right to have a hearing and the authority of arbitrators to dismiss claims in limited, extraordinary circumstances. Do the proposed rules strike an appropriate balance, or would they tend to favor one party over another?

(C) Explanatory Language Regarding "Extraordinary Circumstances": In connection with Proposed Rules 12504 and 13504, as initially filed with the Code Rewrite, some commenters stated that the absence of a definition for "extraordinary circumstances" would promote, rather than limit, abusive litigation tactics in arbitration.⁹ Others stated that the "extraordinary circumstances" standard is too vague,¹⁰ and/or recommended that the term be defined or described in the Code Rewrite.¹¹ As described in Section II.A.1.b, above, NASD proposed in Amendment No. 5 to provide explanatory language in the narrative portion of the

⁹ See, e.g., Letter from Jeff Sonn, Esq., Sonn & Erez (Jul. 14, 2005) ("Sonn letter"); Letter from Steven A. Stolle, Rohde & Van Kampen PLLC (Jul. 8, 2005); Letter from Rebecca Davis, Esquire, Tate, Lazarini & Beall, PLC (Jul. 14, 2005); and Letter from Mark A. Tepper (Jul. 14, 2005).

¹⁰ See, e.g., Letter from Barry D. Estell (May 15, 2006) and Letter from Daniel A. Ball, Selzer Gurvitch Rabin & Obecny, Chtd. (July 14, 2005).

¹¹ See, e.g., Letter from Tim Canning, Law Offices of Timothy A. Canning (Jul. 14, 2005); Letter from Scott C. Ilgenfritz (Jul. 14, 2005); Letter from Richard A. Karoly, Vice President and Senior Corporate Counsel, Charles Schwab & Co., Inc. (Jul. 14, 2005); and Sonn Letter.

Code Rewrite filing to clarify the rule language. Since Amendment No. 5 was filed, some commenters have opposed providing examples of “extraordinary circumstances” if the rule is approved.¹² Should additional guidance be provided for what constitutes “extraordinary circumstances”? Why or why not? If so, what type of additional guidance would be beneficial? Should a term other than “extraordinary circumstances” be used? If so, what would be a more useful term?

- (D) Standard of Pleading: Some commenters have expressed concerns about dispositive motions being granted when statements of claim do not meet pleading requirements under civil procedure rules. NASD Rule 10314, however, requires only that the statement of claim specify “the relevant facts and the remedies sought.”¹³ Should the proposed rule provide additional guidance in the context of dispositive motions concerning the relevant pleading standard in NASD arbitration?
- (E) Authority of Arbitrators to Limit Filing of Dispositive Motions: The proposed rules provide that dispositive motions are “discouraged.” One commenter suggested that the arbitration panel be given the authority to manage the arbitration proceeding by denying leave to make dispositive motions. Should NASD grant arbitrators this authority in the proposed rule?

¹² See, e.g., Letter from David E. Robbins, Kaufmann, Feiner, Yamin, Gildin & Robbins LLP (May 29, 2006) and Letter from Robert S. Banks, Jr., Public Investors Arbitration Bar Association (May 26, 2006).

¹³ See Letters from Jill I. Gross and Barbara Black, Directors of Advocacy, Pace Investor Rights Project (Jul. 14, 2005 and Jun. 6, 2006) (“Pace Letters”) and Letter from Brian Lantagne, Chair, NASAA Broker-Dealer Arbitration Project Group (Jul. 19, 2006) (“NASAA Letter”).

- (F) Additional Suggestions: Are there other ways in which the proposed rule could balance cost effectiveness and efficiency with the general principle that parties are entitled to a hearing in arbitration?

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-2006-088 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASD-2006-088. 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-NASD-2006-088 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Nancy M. Morris
Secretary

¹⁴ 17 CFR 200.30-3(a)(12).