

of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change that would delete an interpretation of CHX Article XX, Rule 7 that prohibits specialists from disseminating automatically-generated quotations that are more than \$.10 away from the Intermarket Trading System best bid or offer. On November 26, 2003, CHX filed Amendment No. 1 to the proposed rule change.³ The **Federal Register** published the proposed rule change, as amended, for comment on December 31, 2003.⁴ The Commission received no comments on the proposal.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁵ In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁶ which requires, among other things, that an exchange's rules be designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The CHX has represented that, following the securities industry's transition to decimal pricing, the consolidated quotations in the national securities markets flicker significantly throughout the trading day. Consequently, the quotations generated by CHX's auto-quote functionality flicker significantly during the trading day, resulting in significant, costly quotation traffic. Given that the Consolidated Quotation Association is now charging participants based on their capacity requirements, CHX wants to eliminate any unnecessary use of capacity. The Commission notes that, since automatic executions are required to be executed at the national best bid or offer in effect at the time the order is received or better, the proposed change should not

have any negative effect on execution prices.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁷ that the proposed rule change, as amended, (SR-CHX-2003-17) be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49183; File No. SR-NYSE-2002-32]

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change and Amendment Nos. 1, 2, 3, and 4 To Incorporate Interpretive Material to Several NYSE Rules

February 4, 2004.

I. Introduction

On August 12, 2002, the New York Stock Exchange ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to incorporate interpretive material to several existing NYSE Rules. On March 11, 2003, the Exchange filed Amendment No. 1 to the proposed rule change.³ On May 21, 2003, the Exchange filed Amendment No. 2 to the proposed rule change.⁴

On June 9, 2003, the proposed rule change, as amended by Amendment Nos. 1 and 2, was published for comment in the **Federal Register**.⁵ The Commission received no comments on the proposed rule change, as amended. On June 11, 2003, the NYSE filed Amendment No. 3 to the proposed rule

change.⁶ On January 29, 2004, the NYSE filed Amendment No. 4 to the proposed rule change.⁷ This order approves the proposed rule change, as amended.

II. Description of the Proposed Rule Change

The NYSE filed the proposed rule change to codify long-standing interpretive material to several NYSE rules and to respond to recommendations made by an independent consultant retained by the NYSE.⁸

A. NYSE Rule 72

NYSE Rule 72 delineates the basic rule governing the priority and precedence of bids and offers at the same price on the Exchange. NYSE Rule 72(b) provides that certain types of agency cross transactions at a given price receive priority over pre-existing bids or offers at that price. The Exchange proposes to add a sentence to NYSE Rule 72(b) to clarify that a broker whose cross is broken up because another member has provided price improvement must follow the crossing procedures of NYSE Rule 76 before completing the balance of the cross.

The Exchange is also proposing to add an example to NYSE Rule 72(b) to illustrate its interpretation that a sale "clears the floor," meaning all bids and offers not satisfied in a given transaction are deemed to be simultaneously re-entered and on parity with each other.

B. NYSE Rule 75

The Exchange is proposing to codify formally in NYSE Rule 75 its long-standing practice that Floor disputes involving \$10,000 or more, or questioned trades, can be referred for resolution to a panel of three Floor Governors, Senior Floor Officials, or

⁶ See letter from Mary Yeager, Assistant Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division, Commission, dated June 10, 2003 ("Amendment No. 3"). In Amendment No. 3, the Exchange added the phrase "or rejected" to a sentence within NYSE Rule 91.10 to clarify that transactions that are not rejected are deemed to be accepted for the purposes of NYSE Rule 91.10. This sentence now reads that "[t]ransactions which are not then confirmed or rejected in accordance with the procedures above are deemed to have been accepted." This is a technical amendment and is not subject to notice and comment.

⁷ See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division, Commission, dated January 29, 2004 ("Amendment No. 4"). In Amendment No. 4, the Exchange provided the Commission with examples of different scenarios for confirming principal transactions under NYSE Rule 91.10. This is a technical amendment and is not subject to notice and comment.

⁸ See *In the Matter of New York Stock Exchange, Inc.*, 70 S.E.C. Docket 106, Securities Exchange Act Release No. 41574 (June 29, 1999), Administrative Proceeding File No. 3-9925.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Kathleen M. Boege, Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated November 25, 2003 ("Amendment No. 1"). In Amendment No. 1, the Exchange expanded its discussion regarding the consequences of the proposed rule change, and also clarified that the proposed rule change was filed pursuant to Section 19(b)(2) of the Act. 15 U.S.C. 78s(b)(2).

⁴ See Securities Exchange Act Release No. 48982 (December 23, 2003), 68 FR 75674.

⁵ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁶ 15 U.S.C. 78f(b)(5).

⁷ 15 U.S.C. 78s(b)(2).

⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Mary Yeager, Assistant Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 10, 2003 ("Amendment No. 1").

⁴ See letter from Darla C. Stuckey, Corporate Secretary, NYSE to Nancy J. Sanow, Assistant Director, Division, Commission, dated May 20, 2003 ("Amendment No. 2").

⁵ See Securities Exchange Act Release No. 47961 (June 2, 2003), 68 FR 34453.

Executive Floor Officials, or any combination thereof if the parties to the dispute so agree. The proposed rule change further provides that members may, as an alternative, resolve such disputes through the arbitration procedures established under the Exchange's Constitution and Rules.

C. NYSE Rule 91

NYSE Rule 91.10 addresses the procedures a member follows to confirm a transaction involving another member who has elected to take or supply for his own account the securities named in an order entrusted to him. The Exchange is proposing to amend NYSE Rule 91.10 to make clear in the rule that only a member may confirm a transaction in the situations covered by the rule. The Exchange is also proposing to add a sentence to the Rule to clarify that transactions that are not confirmed or rejected are deemed to have been accepted.⁹ In addition, the Exchange proposes to amend NYSE Rule 91.10 to provide that a member receiving a report of execution of a transaction where another member acted as principal triggers the member's unconditional right to reject the trade as soon as practicable, given the prevailing circumstances. Furthermore, the Exchange is amending NYSE Rule 91.10 to clarify that disputes as to whether there was sufficient time to reject the trade would be resolved under NYSE Rule 75.

The Exchange provided several examples of situations involving confirmation of a principal trade by a specialist¹⁰ and whether the member took timely action. Under Rule 91.10, three different scenarios can occur in situations involving confirmation of a principal trade by a specialist. First, the broker can determine to take no action, in which case the transaction with the specialist would be deemed confirmed/accepted under NYSE Rule 91.10 since "transactions which are not then confirmed or rejected * * * are deemed to have been accepted." Second, the broker could determine to go to the specialist's post as soon as practicable under the prevailing circumstances to confirm the transaction by initialing the memorandum record of the specialist which shows the details of the trade and

to return it to the specialist. Third, the broker could determine to go to the specialist's post as soon as practicable under the prevailing circumstances to reject the trade.

What is reasonable for a floor broker in taking timely action under NYSE Rule 91.10 depends on his location on the trading floor in relation to where the specialist's post is located, how busy he is, how timely the customer was in relaying his instructions to confirm/reject/do nothing, as well as prevailing market conditions. Any disagreement about whether a member or member organization took timely action in rejecting a trade or about whether a transaction was properly deemed to have been accepted under NYSE Rule 91.10 would be resolved in accordance with NYSE Rule 75, which gives the final determination to a Floor Official. If called upon to resolve such a dispute, a Floor Official would be expected to weigh the factors noted above. Any resolution of the dispute would, of necessity, depend on the unique facts of each particular situation. A Floor broker who received a report of execution within one minute of a trade, was located in close proximity to the trading post, and who took no action upon receiving the execution report, might, in the judgment of a Floor Official, be precluded from rejecting a trade after a period that could be as brief as several minutes, if the Floor Official concluded that the broker had not acted as soon as practicable under the circumstances. Conversely, a broker who did not receive an execution report until 10 or 15 minutes after the trade, and was actively executing orders in another trading room, might be deemed to have acted as soon as practicable in rejecting a trade after a period of a half hour or more, depending on the Floor Official's assessment of the reasonableness of the broker's actions.

The Exchange is also proposing to amend NYSE Rule 91.20 to replace the term "should" with "must," to reflect the mandatory nature of the procedures outlined, pertaining to principal transactions effected against orders in a specialist's possession.

The Exchange proposes to add NYSE Rule 91.50 regarding the rejection of specialist's principal transactions. The proposed rule states that if there is a continued pattern of rejections of a specialist's principal transactions, a Floor Official may be called upon to require the broker to review his actions. If a customer gives a continued pattern of rejection instructions to a Floor broker to reject any trade where the specialist acted as principal, a Floor Official would be able to review the

appropriateness of the continued pattern of rejections by the broker, to make sure he is representing his customer as fiduciary and not giving the specialist, in effect, a kind of conditional order that is not recognized under Exchange rules. If a continued pattern of rejections does occur because the customer will not accept executions with the specialist as contra party, the Floor broker should represent the order himself or herself to ensure appropriate representation of the order in accordance with the broker's fiduciary responsibility to the customer. The proposed NYSE Rule 91.50 clarifies, however, that neither the Floor Official's review of a broker's actions, nor the characterization of an order as a conditional order compromises the unconditional right of a broker to reject any trade where the specialist trades as principal. The proposed rule further provides that a broker's exercise of his right to reject a trade will not trigger a disciplinary action against the broker.

D. NYSE Rule 95

The Exchange is proposing to add material to NYSE Rule 95(a) making clear that members may not create an order or a material term of an order, but must receive an order from off the Floor which includes all the material terms of an order, regardless of how familiar they are with a customer's strategy.

E. NYSE Rule 115A

NYSE Rule 115A provides, among other matters, procedures for members to confirm transactions on openings. The Exchange is proposing to add to NYSE Rule 115A an intra-rule cross-reference to make clear that while a broker should confirm a transaction as promptly as possible, the specialist is not responsible for losses 30 minutes after the opening.

F. NYSE Rule 116

The Exchange is proposing three changes to NYSE Rule 116. First, the Exchange proposes to amend NYSE Rule 116.20 to state directly a prohibition against a Floor broker "stopping" stock. Second, the Exchange is proposing to amend NYSE Rule 116.30(3)(a) to make clear that a specialist should "stop" an order in a minimum variation market only when there is an imbalance in the quotation suggesting the likelihood of price improvement for the "stopped" order. And third, the Exchange is proposing to add to NYSE Rule 116.40 a cross-reference to NYSE Rule 123C, which codifies the Exchange's procedures regarding execution of market-on-close and limit-on-close orders.

⁹ See Amendment No. 3, *supra* note 6.

¹⁰ See Amendment No. 4, *supra* note 7. The Exchange also confirmed that the scenarios provided by the Exchange regarding principal trades by a specialist would also apply to members involved in a principal transaction with any Exchange member. Telephone conversation between Donald Siemer, Director of Rule Development, Market Surveillance Division, NYSE, and Terri Evans, Assistant Director, Division, Commission on February 3, 2004.

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹¹ Specifically, the Commission believes the proposed rule change, as amended, is consistent with section 6(b)(5) of the Act,¹² which requires among other things, that the rules of the Exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and in general to protect investors and the public interest.

The Commission believes that the proposed rule change codifies current practices on the Exchange and existing interpretations of NYSE rules and is responsive to recommendations made by an independent consultant retained by the Exchange.¹³ The Commission also believes that the proposed rule change should clarify Exchange members' rights and obligations under certain rules such as a broker having to recross a clean agency cross when there has been price improvement, a member's ability to resolve certain disputes involving a monetary difference of \$10,000 or more by a panel or through arbitration, a member's requirement to receive all material terms of an order from the member's customer off the floor of the Exchange, a specialist's responsibility for losses incurred by other members because of an opening transaction, and the conditions for stopping stock.

Moreover, the Commission believes the proposed rule change will clarify the process by which a member can confirm or reject a transaction involving another member who has elected to take or supply for his own account the security named in an order entrusted to him.¹⁴ The Commission notes that several of the changes to NYSE Rule 91 codify the NYSE's prior interpretation of this rule. As a result, the Commission believes that codification of these interpretations will add greater transparency to the NYSE's rules. Further, the Commission notes that the proposed changes to NYSE Rule 91 aim to maintain a degree

¹¹ The Commission has considered the proposed rules' impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78f(b)(5).

¹³ See *supra* note 8.

¹⁴ The Commission notes that Exchange members should assure that any agency issues are addressed by their respective customer agreements.

of flexibility in the rule to accommodate various situations occurring during the trading day.

With respect to the changes proposed for NYSE Rule 91.50, the Commission notes that a Floor Official's review of a broker's continued pattern of rejections of a specialist's principal transactions in no way compromises the unconditional right of a broker to reject any trade where the specialist trades as principal. Furthermore, the Commission notes that the proposed rule provides that no disciplinary process would be triggered by the broker exercising his or her right to reject a trade.

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-NYSE-2002-32), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49176; File No. SR-PCX-2003-59]

Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Granting Approval to a Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. To Amend Its Rules Governing Market-Maker Obligations on the Archipelago Exchange

February 3, 2004.

On October 21, 2003, the Pacific Exchange, Inc. ("PCX" or "Exchange"), through its wholly-owned subsidiary PCX Equities, Inc. ("PCXE"), filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its rules governing Market Maker obligations on the Archipelago Exchange ("ArcaEx"), the equities trading facility of PCXE. The PCX filed Amendment No. 1 to the proposal on December 2, 2003.³ The proposed rule change, as amended, was

¹⁵ 15 U.S.C. 78s(b)(2).

¹⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaces the originally filed Form 19b-4 in its entirety.

published for comment in the **Federal Register** on December 29, 2003.⁴ The Commission received no comment letters on the proposal. This order approves the proposed rule change, as amended.

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange⁵ and, in particular, the requirements of Section 6 of the Act⁶ and the rules and regulations thereunder. Specifically, the Commission believes that the proposed rule change is consistent with Section 6(b),⁷ which, among other things, requires that the PCX's rules be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission notes that the PCX's restrictions on Market Makers requiring them to become odd-lot dealers and to maintain cleanup orders in the securities in which they maintain a market currently impose a competitive barrier vis-à-vis other market centers in attracting Market Maker participation on ArcaEx because competing market centers do not impose such requirements.⁸ The Commission notes that the Exchange believes that eliminating the aforementioned requirements will facilitate additional Market Maker participation on ArcaEx and will further enhance order interaction, provide greater depth in liquidity, and foster price competition. Moreover, the Exchange believes that the elimination of such requirements will place ArcaEx on a level playing field with other market centers and allow ArcaEx to fairly compete for Market Maker,⁹ and that the impact on the system from removing these requirements for Market Makers would be minimal on the ArcaEx.

⁴ See Securities Exchange Act Release No. 48928 (December 16, 2003), 68 Fr 75010 (December 29, 2003).

⁵ In approving this proposed rule change, the Commission notes that it has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁶ 15 U.S.C. 78f.

⁷ 15 U.S.C. 78f(b).

⁸ See e.g., NASD Rules 4611 and 4612.

⁹ See note 4, *supra*.