

or otherwise in furtherance of the purposes of the Act.¹⁹

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. 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-NSX-2006-13 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-NSX-2006-13. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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 File Number SR-NSX-2006-13 and should

¹⁹ 15 U.S.C. 78s(b)(3)(C). For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposal, the Commission considers the period to commence on November 17, 2006, the date on which the Exchange submitted Amendment No. 1.

be submitted on or before December 27, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Nancy M. Morris,
Secretary.

[FR Doc. E6-20628 Filed 12-5-06; 8:45 am]

BILLING CODE 8011-01-P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54820; File No. SR-NYSE-2006-65]

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Granting Approval of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 5 Thereto Relating to Exchange Rules Governing Certain Definitions, Systemic Processing of Certain Orders, and the Implementation Schedule of the NYSE Hybrid Market

November 27, 2006.

I. Introduction

On August 23, 2006, the New York Stock Exchange LLC ("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 amend certain aspects of its Hybrid Market. On September 11, 2006, September 15, 2006, and September 26, 2006, the Exchange filed Amendment Nos. 1, 2, and 3 respectively. The proposed rule change, as amended, was published for comment in the **Federal Register** on September 29, 2006.³ On November 2, 2006, the Exchange filed Amendment No. 5 to the proposed rule change.⁴ The Commission received

²⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 54520 (September 27, 2006), 71 FR 57590. On November 1, 2006, the Exchange filed Amendment No. 4 to the proposed rule change and subsequently withdrew Amendment No. 4 on November 2, 2006 due to inaccurate exhibits.

⁴ See Partial Amendment dated November 2, 2006 ("Amendment No. 5"). In Amendment No. 5, the Exchange: (1) Removed from Amendment No. 3 an incorrect exhibit of the proposed rule text; (2) reconciled the current rule text of the definition of an IOC Order as modified by a prior proposed rule change that designated Regulation NMS-compliant IOC orders; (3) corrected typographical errors in proposed NYSE Rules 60(e) and NYSE Rule 123F(b)(ii); (4) replaced the term "NYSE Bonds" with the term "Automated Bond System" in its

three comment letters from two commenters on the proposal.⁵ On November 2, 2006, the Exchange filed a response to the comment letters.⁶

This order approves the proposed rule change, as amended by Amendment Nos. 1, 2 and 3, and grants accelerated approval to Amendment No. 5. The Commission is also providing notice and soliciting comments on Amendment No. 5.

II. Description of Proposal

On March 22, 2006, the Commission approved NYSE's proposal to establish a Hybrid Market.⁷ In this proposed rule change, the Exchange proposes to amend certain Hybrid Market rules and other NYSE rules to reflect their operation in the Hybrid Market.

A. Order Types

1. Auto Ex Order

The Exchange proposes to amend its definition of Auto Ex Order to clarify that an Auto Ex Order is an order that initiates an automatic execution immediately upon entry into Exchange systems.⁸ Accordingly, the Exchange also proposes to delete elected stop, stop limit orders, and CAP-DI orders from the Auto Ex Order definition as these orders do not initiate an automatic execution upon their entry on the Exchange. Further, the Exchange proposes to clarify that "non-auto-ex" orders, *i.e.*, those orders that do not initiate an automatic execution immediately upon entry into NYSE systems, would participate in automatic executions in accordance with the rules governing their operation. Finally, the Exchange proposes to amend NYSE Rules 1000-1004 to replace the term "auto ex" with the words "automatically executing" to reflect that such rules govern all automatic executions, not just those involving an Auto Ex Order.

2. Market Orders

The current definition of an Auto Ex Order in NYSE Rule 13 includes a

rules; and (5) specified in NYSE Rule 1000 that the liquidity replenishment point ("LRP") value would be calculated every 30 seconds. See also Securities Exchange Act Release No. 54611 (October 16, 2006), 71 FR 62143 (October 23, 2006).

⁵ See Letters from George Rutherford, Consultant, dated September 10, 2006 ("Rutherford Letter I") and November 16, 2006 ("Rutherford Letter II"), and Junius W. Peake, Monfort Distinguished Professor Emeritus of Finance, Greeley, Colorado, dated October 3, 2006 ("Peake Letter").

⁶ See Letter from Mary Yeager, Secretary, NYSE, to Nancy M. Morris, Secretary, Commission, dated November 2, 2006 ("Response to Comments").

⁷ See Securities Exchange Act Release No. 53539, 71 FR 16353 (March 31, 2006) ("Hybrid Market Order").

⁸ See proposed NYSE Rule 13 ("Auto Ex Order").

“market order designated for automatic execution.” The Exchange proposes to treat all market orders as Auto Ex Orders unless specifically designated to be handled in the auction market as Auction Market Orders. A market order, therefore, would no longer need to be designated for automatic execution.

3. Maximum Size

In the Hybrid Market, NYSE eliminated the size limitation for Auto Ex Orders. NYSE systems, however, have a maximum order capacity of 3,000,000 shares. Therefore, NYSE proposes to gradually increase the size of orders that may be entered for automatic execution to a maximum of 3,000,000 shares.⁹ The Exchange proposes to phase in the maximum order size eligibility for automatic executions, beginning with a maximum size of 1,000,000 shares. The Exchange also proposes to move the maximum order size limitation for automatic executions to NYSE Rule 1000.¹⁰

4. Immediate or Cancel (“IOC”) Order

In the Hybrid Market, the Exchange created two types of IOC orders.¹¹ The first type is an IOC order that complies with Regulation NMS (“Reg. NMS”).¹² A Reg. NMS IOC order would *not* be routed during an Exchange execution to satisfy better priced protected bids or offers¹³ displayed by other market centers; rather, a Reg. NMS IOC order would be cancelled, as soon as its ability to receive an execution on the Exchange ends. The second type of IOC order, an NYSE IOC order, would route during a sweep to other markets to satisfy better priced protected bids or offers and would cancel only when it is no longer able to receive an execution.

The Exchange proposes to amend the definition of an NYSE IOC order to clarify that Exchange systems would accept NYSE IOC orders for participation in the re-opening trade after a trading halt.¹⁴ Specifically, NYSE IOC orders received during a trading halt would be systemically maintained in order of their receipt for execution upon the re-opening of the halted security. If an NYSE IOC order is not executed as part of the re-opening trade, the order would be cancelled.

B. Sweeps

As approved in the Hybrid Market Order, an incoming Auto Ex Order of a size larger than the Exchange best bid or offer (“BBO”) would receive an execution at two prices—the BBO price and the “clean-up” price.¹⁵ The Exchange proposes to allow an automatically executing order to trade with all interest in the Display Book system at each successive price outside of the Exchange BBO.¹⁶ As proposed, an automatically executing order would trade with the Exchange BBO and at each successive price until the order is filled, its limit price (if any) is reached, an LRP is reached, or, in the case of a Reg. NMS IOC order, trading at a particular price on the Exchange would require cancellation because the order cannot be routed to another market center.¹⁷

During a sweep, floor broker e-Quotes trade on parity with orders in the Book at the clean-up price, but only to the extent of the size the floor broker designated as displayable should the price become the NYSE BBO.¹⁸ The size that would have been placed in reserve would yield to orders in the Book.¹⁹ The Exchange proposes to eliminate this distinction and allow all floor broker agency interest to trade on parity, once the order with priority has been satisfied, with orders in the Book at each successive price during a sweep.

The Exchange also proposes to clarify how and when CAP–DI orders would participate in sweeps. Specifically, CAP–DI orders on the same side as an automatically executing order would be elected at each execution price that is part of the sweep.²⁰ To the extent that the sweeping order has volume remaining to be executed, the elected CAP–DI orders would not participate in a transaction and would automatically and systemically be unelected.²¹ If, at the last execution price during a sweep, the sweeping order is filled or is otherwise unable to continue executing, and there is contra side volume remaining on the Display Book system or from contra-side elected CAP–DI orders, then the same-side CAP–DI orders may participate in the final transaction.²²

CAP–DI orders on the contra side of the sweeping order are also elected at each execution price that is part of the sweep and would participate at the electing price, if there is volume available from the sweeping order on the Display Book system or from CAP–DI orders on the same side of the market as the sweeping order.²³

C. Liquidity Replenishment Points

The Exchange proposes to delete the two types of LRPs it proposed to implement, and replace them with a single LRP. The proposed LRP would be calculated by adding and subtracting a value (determined by the Exchange) to the last sale price.²⁴ The LRP value would not change during the day, and the Exchange would disseminate the LRP value.²⁵ According to the Exchange, the LRP value would be based on an examination of trading data and would vary based on the security’s NYSE average daily volume (“ADV”), price, and volatility. The Exchange proposes a range of LRP values for securities with preset characteristics of ADV, price, and volatility.²⁶ The LRP would not be calculated until there is a trade on the Exchange in a particular security.²⁷ If a security opens on a quote, and there are no trades on the Exchange, the LRP value would not be set until there is a trade.

The LRP value would be calculated automatically throughout the day, as follows: (1) Every 30 seconds throughout the day; (2) after a manual trade by the specialist; and (3) when automatic executions resume after an LRP has been reached.²⁸

Further, the Exchange proposes to change when automatic executions and Autoquote would resume after an LRP has been reached. The Exchange proposes that automatic executions and Autoquote would resume as soon as possible after an LRP has been reached, but in no more than five to ten seconds, unless the residual is able to trade at a price beyond the LRP, and the price creates a locked or crossed market.²⁹ In such case, automatic executions would resume with a manual transaction.³⁰ Finally, the Exchange proposes to make

⁹ See proposed NYSE Rule 1000.

¹⁰ The Exchange had implemented similar language as part of an extended auto-ex pilot in Lucent. See Securities Exchange Act Release No. 53791 (May 11, 2006), 71 FR 28732 (May 17, 2006) (“Lucent Pilot”).

¹¹ See NYSE Rule 13.

¹² See Rule 600(b)(3), 17 CFR 242.600(b)(3).

¹³ A protected bid and offer is defined in Rule 600(b)(57) of Reg. NMS. See 17 CFR 242.600(b)(57).

¹⁴ See proposed NYSE Rule 13.

¹⁵ The “clean-up” price is the best price at which interest in the Display Book system can trade with an Auto Ex Order outside of the Exchange BBO. See NYSE Rule 1000(d)(iii).

¹⁶ See proposed NYSE Rule 1000(d)(iii).

¹⁷ See proposed NYSE Rule 1000(d)(ii)(C).

¹⁸ See NYSE Rule 70.20(d)(i).

¹⁹ See NYSE Rule 70.20(d)(ii).

²⁰ See proposed NYSE Rule 123A.30(a)(ii).

²¹ See proposed NYSE Rule 123A.30(a)(ii).

²² See proposed NYSE Rule 123A.30(a)(ii).

²³ See proposed NYSE Rule 123A.30(a)(iv).

²⁴ See proposed NYSE Rule 1000(a)(iv).

²⁵ See proposed NYSE Rule 1000(a)(iv).

²⁶ See proposed NYSE Rule 1000(a)(iv).

²⁷ See proposed NYSE Rule 1000(a)(iv).

²⁸ See proposed NYSE Rule 1000(a)(iv).

²⁹ See NYSE Rules 60(e)(ii) and 1000(b).

³⁰ See NYSE Rules 60(e)(ii) and 1000(b).

conforming changes to other Exchange rules.³¹

D. Stop Order and Stop Limit Order

The Exchange proposes to modify how stop orders are handled and processed on the Exchange. Specifically, the Exchange proposes that specialists would no longer have access to information about stop orders. In addition, the Exchange proposes to no longer accept stop limit orders.

1. Processing of Stop Orders

Currently, stop orders are entered on the Exchange primarily through SuperDOT³² and routed directly to the Display Book system, where they reside awaiting election. The specialist assigned to each security knows the prices at which stop orders would be elected and their sizes. Because the specialist has access to this information that is not available to other market participants, NYSE Rule 123A.40 requires that, in certain circumstances described below, the specialist must guarantee the execution of elected stop orders at the electing price.

The Exchange proposes to restrict the ability of specialists and their systems employing algorithms ("specialist algorithms") to view information regarding stop orders. Specialists would no longer view the electing price and size of stop orders, nor possess any unique information regarding stop orders. Stop orders would be maintained in a "blind file" in the sequence of their receipt. When a transaction on the Exchange results in the election of a stop order, the elected stop order would be sent as a market order to the Display Book system and the specialist algorithms, and would be handled in the same way as any other market order.

The Exchange also proposes to modify its opening and closing procedures to reflect that specialists would no longer have access to stop order volume that would be elected by the opening or closing transaction. Currently, the specialist calculates the opening price based in part on the stop order volume that would be elected by the opening trade.³³ On the close, the specialist calculates the closing price based in part on the stop order volume that would be elected and the volume of buy and sell market-at-the-close/limit-at-the-close

³¹ See proposed NYSE Rules 60(e)(C)(iii), 60(e)(C)(iv), 60(d)(i) and (ii), 72(j)(i) and (j)(ii), and 1000(c).

³² SuperDot is an electronic order-routing system used by NYSE member firms to send market and limit orders to the NYSE.

³³ See, e.g., NYSE Rule 123D.

("MOC/LOC")³⁴ orders that would be executed as a result of the closing price.³⁵

The Exchange proposes that at the open, the specialist or his or her trading assistants would indicate to Exchange system the price at which the specialist contemplates opening the stock. The Exchange system then would calculate the volume of shares available for execution on the open at that price, including stop orders that would be elected by an execution at such price. There would be no indication what, if any, portion of the total volume accounts for stop orders. There would only be one opening print and would include stop orders that are elected by the opening trade.

Similarly, prior to the close, the Exchange proposes that the specialist or his or her trading assistants would indicate to Exchange system the price at which the specialist is contemplating closing the stock. In turn, Exchange system would calculate the volume of shares executable on the close at that price, including stop order volume that would be elected by an execution at that price. There would be no indication what, if any, portion of the total volume accounts for stop orders. The unelected stop orders would only be included in the total volume of shares available to trade on the close five minutes prior to the close.

The Exchange proposes to add NYSE Rule 115A.10 and NYSE Rule 116.50 to prohibit specialists, trading assistants, and anyone on their behalf from using the opening and closing process in a manner designed to inappropriately discover information about unelected stop orders.³⁶

2. Elimination of Specialist's Guarantee and Floor Official Approval

Currently, NYSE Rule 123A.40 prohibits a specialist from making a transaction for his own account in a stock in which he is registered that would result in putting into effect any

³⁴ MOC order is a market order, which is to be executed in its entirety at the closing price, on the Exchange, of the stock named in the order, and if not so executed, is to be treated as cancelled. A LOC order is a limit order, which may or may not receive execution on the close depending on the closing price and depth of contra side interest. The term "at the close order" also includes a limit order that is entered for execution at the closing price, on the Exchange, of the stock named in the order, pursuant to such procedures as the Exchange may from time to time establish.

³⁵ See, e.g., NYSE Rule 116.40.

³⁶ The proposed opening and closing processes for stop order handling are not available intraday; therefore, during the trading day, it is not possible for these processes to be employed in a manner designed to inappropriately discover information about unelected stop orders.

stop orders he may have on his book. However, a specialist may be party to the election of a stop order only: (i) When his bid or offer has the effect of bettering the market, when he guarantees that the stop order will be executed at the same price as the electing sale, and with Floor Official approval if the transaction is more than 0.10 point away from the prior transaction; or (ii) when the specialist purchases or sells stock for his own account solely for the purpose of facilitating completion of a member's order at a single price, where the depth of the current bid or offer is not sufficient to do so. When the specialist is acting in this manner, he shall not be required to guarantee that the stop order will be executed at the same price as the electing sale. In addition, current NYSE Rule 13.30, which applies to stop orders in Investment Company units, requires a specialist to obtain Floor Official approval prior to making a bid or offer for its proprietary account that would elect a stop order and is more than 0.10 point away from the last sale.

Because specialists will no longer be privy to information about stop orders, the Exchange proposes to eliminate the requirement that specialists guarantee the execution price of stop orders elected by their trades and the requirement that they receive Floor Official approval for certain proprietary quotes and trades.

3. Floor Broker Stop Order Processing

Under the proposal, floor brokers would continue to be permitted to represent stop orders. However, the Exchange proposes that stop orders represented by floor brokers in the Crowd may not be included in e-Quote.³⁷

4. Elimination of Stop Limit Orders

Finally, the Exchange proposes to eliminate stop limit orders as an acceptable order type. The Exchange proposes to make conforming changes to other Exchange rules to reflect the elimination of stop limit orders.³⁸

E. Other Changes

1. Autoquote

Currently, when Autoquote is suspended due to a gap quote, NYSE Rule 60(e)(iv)(C) provides that Autoquote would continue to update the NYSE BBO in certain situations.³⁹ According to the Exchange, however, Autoquote does not continue to update

³⁷ See proposed NYSE Rule 70.20(a)(i).

³⁸ See proposed NYSE Rules 13, 118(2), 123(e)(7), 123(f), 132B(a)(9), 132B(b)(9), and 476A.

³⁹ See NYSE Rule 60(e)(iv)(c).

the BBO when NYSE has a gapped quote. Thus, the Exchange proposes to amend its rule to provide that when the NYSE quote is gapped, Autoquote would be suspended on both sides of the market.⁴⁰

2. Exchange Crossing Rule

The Exchange proposes to amend its Rule 76 to provide that it would not apply to automatic executions.⁴¹ Currently, when a member has an order to buy and an order to sell the same security, NYSE Rule 76 requires that the member offer such security at a price which is higher than his bid by the minimum variation before making a transaction with himself to enable the Crowd to trade with the order at such price. Since automatic executions cannot accommodate verbal Crowd participation, the Exchange proposes to specify that NYSE Rule 76 only applies to manual transactions.

3. High Priced Securities

The Exchange proposes to amend the definition of the price of high-priced securities, which are not eligible for automatic executions, as the closing price of a security, or if the security did not trade, the closing bid price of the security on the Exchange on the immediate previous trading day, that is \$1,000 or more.⁴² Currently, the Exchange considers securities with a closing price, or a closing bid price if the security did not trade, of \$300 or more as high-priced.

F. Hybrid Market Implementation Schedule

The Exchange is in the process of implementing Phase 3 of the Hybrid Market. The Exchange proposes to amend the Phase 3 implementation schedule⁴³ to add the following additional features:

- Elimination of Direct+ suspension when a better bid or offer is displayed by another market center;
- Implementation of sweeps (as redefined herein);
- Implementation of the LRP (as redefined herein); and
- Implementation of new stop order processing (as discussed herein).

Exchange Rule 1002 (“Availability of Automatic Execution Feature”) would be available for all stocks through the close upon implementation of Phase 3 of the Hybrid Market.

IV. Summary of Comments and NYSE’s Response

The Commission received three comment letters from two commenters on the proposed rule change,⁴⁴ and the Exchange filed the Response to Comments.⁴⁵ One commenter continued to reiterate his objections to the NYSE’s Hybrid Market,⁴⁶ many of which relate to aspects of the Hybrid Market that the Commission has already approved.⁴⁷ In the recent letters, the commenter raised objections to two aspects of the current proposal—the processing of stop orders and the proposed sweep methodology.

With regard to the proposed stop order processing, the commenter noted that the proposal to remove a specialist’s ability to see stop orders minimizes the specialist’s ability to improperly elect and then trade with stop orders. The commenter, however, believes that specialists have an exclusive ability to trade with elected stops in the Hybrid Market. The commenter believes that because the specialist algorithms will receive information about elected stops, which will be routed to the Display Book system as market orders, the specialists would also be provided with an opportunity to trade with these orders before other market participants. The commenter argues that the specialist’s ability to algorithmically trade with elected stop orders before other market participants would violate the specialist’s negative obligation. NYSE noted that the commenter’s belief was erroneous and that specialists do not have an exclusive ability to trade with elected stops.

The commenter also argues that the Exchange needs to discuss the proposed stop order processing with the elimination of the specialist guarantee in the context of the affirmative and negative obligations of the specialists. The commenter argues that the specialist guarantee provides a benefit to the market by minimizing price dislocation that may result from an influx of elected stop orders into the market. Absent the specialist guarantee, the elected stop orders may trade at a

price away from the last sale that may be precluded under current Exchange rules, which could add to market volatility. NYSE responded that the reason the specialist is required to guarantee the price of execution for certain elected stops is due to its access to information about the stop orders that would be executed by its proprietary trade. Since the specialists would no longer have access to electing price and size information for stop orders, the reason for the price guarantee would no longer exist and thus should be eliminated. The Exchange argued that eliminating the specialist’s knowledge of information about these orders would create a more even playing field for market participants in the Hybrid Market, and as the commenter has acknowledged, would reduce the possibility of the specialists having a trading advantage or a conflict of interest.

With respect to the sweeps, the commenter raises several issues. First, the commenter argues that the proposed sweep methodology is fundamentally unfair to orders in the Book because they must split executions with undisplayed e-Quotes. The commenter states that floor brokers are given a competitive advantage because they can enter their automated orders with full knowledge of limit orders in the Book, while public customers do not have similar knowledge about floor brokers’ agency interest outside the BBO. The commenter believes that this is unfair, as public customers are not provided an opportunity to set their limit orders taking into account interest in the floor broker agency interest files.

Second, the commenter argues that the Exchange’s parity rules are unfair to the Book because the commenter believes that each individual order represented in the floor broker agency interest file is entitled to a split.⁴⁸ Third, the commenter argues that the Book should be executed in price and time priority, and that non-displayed floor broker agency interest should be executed after displayed orders in the Book. The commenter argues that orders in the Book attract liquidity, and they should be executed ahead of non-displayed orders.⁴⁹

⁴⁴ See *supra* note 5. One commenter raised concerns with respect to floor brokers’ ability to enter discretionary instructions with regard to orders they represent. See Peake Letter. The Commission considered the issues raised by the commenter in its order approving the floor broker’s ability to enter discretionary instructions. See Securities Exchange Act Release No. 54577 (October 5, 2006), 71 FR 60208 (October 12, 2006) (“d-Quote Order”).

⁴⁵ See *supra* note 6.

⁴⁶ See Rutherford Letters I and II, *supra* note 5.

⁴⁷ For example, the commenter continues to object to specialists’ ability to trade in the Hybrid Market.

⁴⁸ The Commission notes that the commenter is unclear as to whether he believes that each individual order that is represented by a floor broker and placed in the agency interest file gets a split, or if the commenter believes that each individual floor broker agency interest file, that may include multiple customers, gets a split. Under NYSE’s Hybrid Market rules, the latter is the correct way parity splits are determined.

⁴⁹ The Commission notes that the commenter also argued that specialist interest should not be able to

⁴⁰ See proposed NYSE Rule 60(e)(iii)(c).

⁴¹ See proposed NYSE Rule 76.

⁴² See proposed NYSE Rule 1000(a)(vi).

⁴³ See Hybrid Market Order, *supra* note 7.

V. Discussion

After careful review and consideration of the comments, 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 and, in particular, with the requirements of Section 6(b) of the Act.⁵⁰ Specifically, the Commission finds that approval of the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act⁵¹ in that the proposal is 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 adoption of the Hybrid Market has fundamentally altered NYSE's market structure to a predominantly electronic market. As the Exchange continues to roll out the implementation phases of the Hybrid Market, it has also proposed changes to certain aspects of the Hybrid Market based on its experience and the various needs of its customers and members. As discussed more fully below, the Commission believes that the proposed changes to the Hybrid Market are consistent with the Act.

A. Changes to Order Types

The Exchange proposes to amend the following order types: (1) Auto Ex Orders; (2) market orders; (3) Auction Market Orders; and (4) IOC Orders. First, with respect to Auto Ex Orders, the Exchange proposes to clarify that Auto Ex Orders are orders that initiate automatic executions immediately upon arrival into Exchange systems. The Commission finds that this change clarifies NYSE's rule by specifying how the orders NYSE accepts will be handled. Second, the Exchange proposes to consider all market orders as Auto Ex Orders and therefore would no longer need to require that they be

trade on parity with floor broker agency interest. The commenter continues to argue that this is inconsistent with Section 11A of the Act and the specialist's negative obligation. The Commission approved this aspect of the Hybrid Market, and NYSE has not proposed to change the approved parity rule in the instant proposed rule change. See Hybrid Market Order, *supra* note 7.

⁵⁰ 15 U.S.C. 78f(b). In approving this proposal, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁵¹ 15 U.S.C. 78f(b)(5).

specifically designated for automatic execution. The Commission finds this change could enhance automated access to liquidity on the Exchange, and facilitate the efficient execution of market orders on the Exchange. As a result of the change to market orders, NYSE also proposes to add a definition for Auction Market Orders for those market orders that are to be handled in the auction market. The Commission finds that this change is consistent with the Act because it provides investors with the option to seek price improvement through these orders.

Third, the Exchange proposes to amend the definitions of IOC orders to identify Reg. NMS-compliant IOC orders and to amend the definition of an NYSE IOC order to clarify that Exchange systems will accept NYSE IOC orders for participation in the re-opening trade after a trading halt. The Commission finds that these changes are consistent with the Act because they clarify how these orders will be handled. Finally, the Exchange proposes to gradually increase its order size eligibility for automatic executions to a maximum size of 3,000,000 shares. The Commission finds that this proposal is consistent with the Act and reflects in NYSE's rules its systems limitations.

B. Sweeps

The Exchange proposes to allow an Auto Ex Order to trade with all interest in the Display Book system at each successive price outside of the Exchange BBO instead of receiving an execution at the BBO price and the clean up price. The Exchange also proposes to allow all floor broker agency interest to trade on parity with orders in the Book at each successive price during a sweep. Further, the Exchange clarified the participation of CAP-DI orders during a sweep.

One commenter objected to the floor broker's ability to trade on parity with the orders in the Book.⁵² Specifically, this commenter believed that non-displayed interest, such as the floor broker agency interest file, should yield to displayed orders in the Book. The commenter also believed that floor brokers have a competitive advantage over public customers because they can enter their agency interest with knowledge of orders in the Book, while public customers would not be aware of floor broker agency interest outside of the BBO.

The Commission notes that it has previously approved the Exchange's proposal to allow Auto Ex Orders to sweep the Display Book system in the

Hybrid Market Order. In the Hybrid Market Order, the Commission noted that NYSE's proposal to allow Auto Ex Orders to sweep the Display Book system was a significant expansion of the availability and speed of automatic executions on the Exchange and should facilitate more efficient transactions on the Exchange. The Commission continues to believe that these execution efficiencies could result in the Hybrid Market. The Exchange stated that its customers indicated that they would not utilize the sweep functionality as originally approved.⁵³ Accordingly, NYSE made the decision to amend its rule to allow incoming orders to trade at each price in the Display Book system. The Commission believes that the decision to make this change is consistent with the Act, and within the realm of business judgment typically left to individual markets.

With respect to a floor broker's ability to maintain non-displayed interest that is available for execution, the Commission notes that it has not required complete disclosure of all trading interest, and that it has previously permitted the use of undisplayed order types. For example, in the auction market, floor brokers may hold significant trading interest that is not broadly disclosed but is available for execution and participation in a transaction on the Exchange. The Commission found in the Hybrid Market Order that e-Quotes could trade on parity with orders in the Book consistent with the requirements of the Act.⁵⁴ While the Exchange now proposes, under the amended sweep functionality, to permit the full size of an e-Quote to trade on parity with orders in the Book at each successive price, the Commission continues to believe that NYSE's rules provide floor brokers with incentives to place liquidity in the Display Book system and effectively represent their customers' orders, and are consistent with the Act.⁵⁵

The commenter believes that e-Quotes should not be entitled to parity because floor brokers have the ability to change

⁵³ The Commission notes that commenters to the original Hybrid Market proposal raised this issue. See Hybrid Market Order, *supra* note 7.

⁵⁴ During a sweep in the current Hybrid Market, only e-Quotes that would be displayed if the price becomes the Exchange BBO would trade on parity with orders in the Book.

⁵⁵ Like in the auction market, each floor broker's e-Quote, which may reflect several customers' orders, would be considered one bidder/offeree, and the Book would likewise be considered one bidder/offeree. This aspect of NYSE's parity rule remains unchanged, and the Commission believes it continues to be consistent with the requirements of the Act.

⁵² See Rutherford Letters I and II, *supra* note 5.

the prices of their e-Quotes in response to information about orders in the Book, while public customers are not provided information about the floor brokers' interest outside the BBO. The Commission, however, notes that NYSE's proposal does not alter the information that is currently available to floor brokers or investors. Public customers entering limit orders have access to the same information as floor brokers regarding the Book, and can change their orders in response to that information. Floor brokers have information about their own customers' orders, as they always have had, but do not have information about other floor broker interest. Accordingly, the Commission does not believe that floor brokers have an inappropriate informational advantage.

The Commission believes that exchanges have a certain degree of flexibility to determine the methods of order interaction on their markets so long as the requirements of the Act are met. Floor brokers represent customers that are also providing liquidity for execution. Floor brokers' customers often do not want their orders disclosed and rely on floor brokers to use their judgment to represent their interest. As noted above, the Commission has not required disclosure of this liquidity outside the BBO, and, in the auction market, orders represented by floor brokers have been entitled to parity with orders in the Book. Accordingly, the Commission finds that NYSE's proposal to allow floor broker agency interest to trade on parity at each successive price with orders in the Book during a sweep is consistent with the requirements of the Act.

C. Stop Orders

Currently, the specialist acts as agent for stop orders and, as agent, has exclusive access to information about the election price and size of the stop orders. Because the specialist has exclusive access to this information, the Exchange requires the specialist, in certain situations, to guarantee the price of an elected stop order. The Exchange now proposes to modify the manner in which stop orders are handled and processed on NYSE by removing the specialist's access to information about stop orders, and eliminating the requirement that the specialist guarantee the stop order's election price in certain situations. In addition, NYSE proposes to eliminate the requirement that the specialist receive Floor Official approval of certain specialist proprietary trades that would elect stop orders. NYSE also proposes to modify its opening and closing procedures and

eliminate stop limit orders as an order type on the Exchange.

One commenter believed that, under the proposal, the specialist would have an exclusive ability to trade with elected stop orders since it would receive information about elected stop orders through the specialist algorithm prior to other market participants.⁵⁶ This belief is incorrect. Specialists in the Hybrid Market can only trade algorithmically in certain specified instances that are set forth in NYSE Rule 104. Under the proposal, specialists and the specialist algorithm would be restricted from viewing information regarding the stop orders. Stop orders would instead be maintained in a "blind file" in the sequence of their receipt, and, once elected, the elected stop order would be sent by the Exchange system as a market order to the Display Book system. Information about the market order also would be sent to the specialist algorithm. The market order would be handled in the same manner as previously approved for market orders in the Hybrid Market. Accordingly, in order to trade against an incoming market order, the specialist algorithm would have to: (1) Provide "additional specialist volume" to partially or completely fill the market order at the Exchange BBO; (2) match better bids and offers published by other market centers where automatic executions are immediately available; or (3) provide price improvement to the market order.⁵⁷

The commenter also argued that eliminating the guarantee implicates the specialist's affirmation obligation in that, without the specialist guarantee, elected stop orders could trade at a price away from the last sale and add to market volatility. The Commission finds it reasonable and appropriate that NYSE eliminate the specialist price guarantee when the specialist is a party to the

election of stop orders, since specialists would no longer have information regarding the electing price and size of stop orders. With respect to the commenter's concern that removing the specialist price guarantee would necessarily impact the specialist's affirmative obligations, NYSE explained that the specialist price guarantee was a requirement originally put in place due to the specialist's ability to view the electing price and sizes of all stop orders in a stock, information that is not available to other market participants. Requiring the specialist to guarantee the price at which these orders are executed removed any incentives for the specialist to effect proprietary trades that would inappropriately elect stop orders. Accordingly, the Exchange believes that, since the specialists would no longer have access to electing price and size information for stop orders under this proposal, the reason for the price guarantee would no longer exist and thus should be eliminated. The Commission notes that a specialist in the Hybrid Market remains obligated to comply with NYSE Rule 104.10, which includes the maintenance, in so far as reasonably practicable, of a fair and orderly market. Under NYSE Rule 104.10(2), in connection with the maintenance of a fair and orderly market, a specialist should engage to a reasonable degree under existing circumstances in dealings for its own account when lack of price continuity, lack of depth, or disparity between supply and demand exists or is reasonably to be anticipated. The elimination of the specialist guarantee for executing certain elected stops at the electing price would not alter this affirmation obligation.

The Commission also believes that eliminating the specialist's ability to view the prices at which stop orders would be elected and their sizes would minimize the specialist's unique informational advantage over other market participants with respect to stop orders. The Commission finds that the proposal would create a more level playing field for market participants in the Hybrid Market.

The Exchange has proposed a reasonable method by which specialists can continue to effectively open and close the market by allowing specialists to query the system, at discrete times, to determine the total number of shares available for execution (including stop orders) at a proposed opening or closing price. NYSE has proposed to specifically prohibit in its rules specialists, trading assistants, and anyone on their behalf from using the amended opening and closing process

⁵⁶ See Rutherford Letters I and II, *supra* note 5. In his second letter, the commenter stated that floor broker d-Quotes would not be able to trade against incoming market orders and that NYSE's rules provide that d-Quotes can only trade against published NYSE interest. The Commission notes that this statement is erroneous. NYSE Rule 70.25(b)(i) specifically states that "[a] [f]loor broker may set a discretionary price range within the Exchange best bid and offer that specifies the prices at which they are willing to trade. This discretion will be used, as necessary, to initiate or participate in a trade with an *incoming* order capable of trading at a price within the discretionary price range" (emphasis added). Accordingly, d-Quotes are capable of trading with incoming market orders, and specialists do not maintain an exclusive trading ability with incoming market orders.

⁵⁷ In order to provide price improvement, the specialist would have to be represented in the BBO in a significant size and would be required to provide a minimum amount of price improvement. See NYSE Rule 104(b).

in a manner designed to inappropriately discover information about unelected stop orders. The Commission believes that the Exchange's enforcement of this provision and surveillance for its compliance will provide investors with additional protection against any remaining potential trading abuses related to the election and execution of stop orders.

Similarly, because the specialist would no longer have access to information about stop orders, the Commission believes it is appropriate for NYSE to remove the requirement that the specialist obtain Floor Official approval prior to trading or making a bid or offer⁵⁸ for its proprietary account that would elect a stop order and is more than 0.10 point away from the last sale.

Finally, the Commission believes it is reasonable for NYSE to no longer accept the stop limit order type in Exchange systems given their infrequent use. Accordingly, the Commission finds it appropriate for NYSE to eliminate the definition and all references to stop limit orders from its rules.

D. Liquidity Replenishment Point

The Exchange proposes to replace the two types of LRP approved in the Hybrid Market Order—the sweep LRP and the momentum LRP—with a single LRP that would be calculated by adding and subtracting a value to the security's last sale price. NYSE proposes that the value would not change intraday and would be disseminated by the Exchange. The Exchange also proposes to change when Autoquote and automatic executions would resume after an LRP has been reached.

The Commission believes that the proposed LRP changes are within the realm of business judgments generally left to the discretion of individual markets. The Commission has previously approved the Exchange's use of LRPs in its Hybrid Market model.⁵⁹ The Commission believes that the proposal to change the calculation of the LRP is consistent with the requirements of the Act. By providing for a single LRP and simplifying its calculation, the Commission believes that the proposal may assist market participants in determining when automatic executions and Autoquote may be halted on the Exchange. The Commission also notes that the specific value ranges used to calculate the LRP have been incorporated into proposed NYSE Rule

1000(a)(iv) and that the LRP values will be disseminated by the Exchange.

E. Other Changes

Finally, the Exchange proposes to amend NYSE Rule 60 to indicate that Autoquote will not update the BBO when the quote has been gapped in accordance with Exchange procedures. The Commission notes that this proposed change to NYSE Rule 60 is consistent with NYSE Rule 79A.15 regarding gapped quotes. The purpose of a gapped quote is to provide public notice of an order imbalance and to minimize short-term price dislocation associated with such imbalance by allowing for entry of offsetting orders or the cancellation of orders on the side of the imbalance. The Commission has previously found that NYSE rules do not have to require that both sides of its quote be updated to reflect better priced limit orders when the quote is gapped.⁶⁰ The Commission continues to believe that it is consistent with the Act to disengage Autoquote when the quote is gapped to allow the specialist to disseminate an order imbalance.

The Exchange also proposes to make clear that the crossing requirements in NYSE Rule 76 would only apply to manual transactions. The Commission finds it appropriate for NYSE to amend this rule to exclude automatic executions since they cannot accommodate verbal Crowd participation.

Finally, the Exchange proposes to increase the dollar threshold for high-priced securities, which are not eligible for automatic executions, from \$300 to \$1,000. The Commission believes that increasing the dollar threshold for high-priced securities is consistent with the Act and could expand the eligibility of orders for automatic executions on the Exchange.

F. Hybrid Market Implementation Plan

The Exchange proposes to alter the Hybrid Market implementation plan to add additional features to Phase 3. Specifically, NYSE proposes to implement the amended sweeps and LRP, original planned for Phase 4, earlier in Phase 3. In addition, the Exchange proposes to implement in Phase 3 the new stop order processing and eliminate Direct+ suspension when a better bid or offer is displayed by another market center. NYSE also proposes that Exchange Rule 1002 be available for all stocks through the close upon implementation of Phase 3.

The Commission finds that the proposed changes to the Hybrid Market implementation plan are consistent with the Act. The Commission notes that it approved on a pilot basis for a limited number of securities the changes to the implementation plan, including the changes to NYSE rules proposed herein.⁶¹ The Exchange has represented that the implementation of Phase 3 has not incurred any significant problems to date.

VI. Accelerated Approval of Amendment No. 5

The Commission finds good cause to accelerate approval of the changes in Amendment No. 5, prior to the thirtieth day after the amendment is published for comment in the **Federal Register** pursuant to Section 19(b)(2) of the Act⁶² for the reasons discussed below. In Amendment No. 5, NYSE proposes to: (1) Remove from Amendment No. 3 an incorrect exhibit of the proposed rule text; (2) reconcile the current rule text of the definition of an IOC Order as modified by a prior proposed rule change that designated Reg. NMS-compliant IOC orders;⁶³ (3) correct typographical errors in proposed NYSE Rules 60(e) and 123F(b)(ii); (4) correct the term "NYSE Bonds" that was used in the prior amendments to designate the automated system in which bonds trade and replace it with "Automated Bond System" in order to reflect the current name of the system and existing NYSE rule text;⁶⁴ and (5) incorporate in NYSE Rule 1000 that the LRP value would be calculated every 30 seconds.

The Commission finds good cause to accelerate approval of NYSE's proposal to correct its exhibit of proposed rule text and the definition of an IOC Order, to make technical corrections in proposed NYSE Rules 60(e) and 123F(b)(ii), and to replace the term "NYSE Bonds" with "Automated Bond System" prior to the thirtieth day after publication in the **Federal Register** because it would accurately reflect NYSE's existing rule text and raises no new regulatory issues. In addition, the Commission finds good cause to accelerate approval of NYSE's proposal to incorporate in NYSE Rule 1000 the 30-second time period in which the LRP

⁶¹ See Securities Exchange Act Release Nos. 54578 (October 5, 2006), 71 FR 60216 (October 12, 2006) and 54675 (October 31, 2006), 71 FR 65019 (November 6, 2006).

⁶² 15 U.S.C. 78s(b)(2).

⁶³ See Securities Exchange Act Release No. 54611, *supra* note 4.

⁶⁴ See Securities Exchange Act Release No. 54615 (October 17, 2006), 71 FR 62338 (October 24, 2006) (pending proposed rule change to rename the automated system in which bonds would trade as "NYSE Bonds").

⁵⁸ Stop orders in ETFs may be elected by a quote. See NYSE Rule 13.30.

⁵⁹ See Hybrid Market Order, *supra* note 7.

⁶⁰ See Securities Exchange Act Release No. 39129 (September 25, 1997), 62 FR 51497 (October 1, 1997).

would be calculated because it would codify into NYSE's rules the manner in which the LRP would be determined and provide clarity and specificity to its operation.

VII. Solicitation of Comments on Amendment No. 5

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 5, including whether such amendment is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2006-65 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-NYSE-2006-65. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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 File Number SR-NYSE-2006-65 and should be submitted on or before December 27, 2006.

VIII. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁶⁵ that the proposed rule change (SR-NYSE-2006-65) and Amendment Nos. 1, 2, and 3, are approved and that Amendment No. 5 thereto is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁶⁶

Nancy M. Morris,

Secretary.

[FR Doc. E6-20619 Filed 12-5-06; 8:45 am]

BILLING CODE 8011-01-P

SMALL BUSINESS ADMINISTRATION

Emergence Capital Partners SBIC, L.P. License No. 09/79-0454; Notice Seeking Exemption Under Section 312 of the Small Business Investment Act, Conflicts of Interest

Notice is hereby given that Emergence Capital Partners SBIC, L.P., 160 Bovet Road, Suite 300, San Mateo, CA 94402, a Federal Licensee under the Small Business Investment Act of 1958, as amended ("the Act"), in connection with the financing of a small concern, has sought an exemption under section 312 of the Act and section 107.730, Financings Which Constitute Conflicts of Interest of the Small Business Administration ("SBA") Rules and Regulations (13 CFR 107.730). Emergence Capital Partners SBIC, L.P. proposes to provide equity/debt security financing to Ketera Technologies, Inc. ("Ketera"), 3965 Freedom Circle, 16th Floor, Santa Clara, CA 95054. The financing is contemplated for working capital and general corporate purposes.

The financing is brought within the purview of § 107.730(a)(1) of the Regulations because Emergence Capital Partners, L.P. and Emergence Capital Associates, L.P., all Associates of Emergence Capital Partners SBIC, L.P., own more than ten percent of Ketera, and therefore Ketera is considered an Associate of Emergence Capital Partners SBIC, L.P. as detailed in § 107.50 of the Regulations.

Notice is hereby given that any interested person may submit written comments on the transaction to the Associate Administrator for Investment, U.S. Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

⁶⁵15 U.S.C. 78s(b)(2).

⁶⁶17 CFR 200.30-3(a)(12).

Dated: November 9, 2006.

Harry S. Haskins,

Acting Associate Administrator for Investment.

[FR Doc. E6-20613 Filed 12-5-06; 8:45 am]

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SMALL BUSINESS ADMINISTRATION

Emergence Capital Partners SBIC, L.P.; License No. 09/79-0454; Notice Seeking Exemption Under Section 312 of the Small Business Investment Act, Conflicts of Interest

Notice is hereby given that Emergence Capital Partners SBIC, L.P., 160 Bovet Road, Suite 300, San Mateo, CA 94402, a Federal Licensee under the Small Business Investment Act of 1958, as amended ("the Act"), in connection with the financing of a small concern, has sought an exemption under Section 312 of the Act and Section 107.730, Financings which Constitute Conflicts of Interest of the Small Business Administration ("SBA") Rules and Regulations (13 CFR 107.730). Emergence Capital Partners SBIC, L.P. proposes to provide equity/debt security financing to Intacct Corporation. ("Intacct"), 125 S. Market Street, Suite 600, San Jose, CA 95113. The financing is contemplated to bridge the company's operations until either the round of equity is raised or a sale occurs.

The financing is brought within the purview of § 107.730(a)(1) of the Regulations because Emergence Capital Partners, L.P. and Emergence Capital Associates, L.P., all Associates of Emergence Capital Partners SBIC, L.P., own more than ten percent of Intacct, and therefore Intacct is considered an Associate of Emergence Capital Partners SBIC, L.P. as detailed in § 107.50 of the Regulations.

Notice is hereby given that any interested person may submit written comments on the transaction to the Associate Administrator for Investment, U.S. Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

Dated: November 9, 2006.

Jaime Guzmán-Fournier,

Associate Administrator for Investment.

[FR Doc. E6-20614 Filed 12-5-06; 8:45 am]

BILLING CODE 8025-01-P