

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 the filing will also be available for inspection and copying at the principal office of the ISE. All submissions should refer to SR-ISE-2002-16 and should be submitted by August 9, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 02-18222 Filed 7-18-02; 8:45 am]

BILLING CODE 8010-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46191; File No. SR-NYSE-2001-24]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto by the New York Stock Exchange, Inc. Amending Exchange Rule 97 Which Limits Member Trading Because of Block Positioning

July 12, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 17, 2001, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Exchange filed Amendment No. 1 to the proposed rule change on April 17, 2002.<sup>3</sup> The Exchange filed Amendment No. 2 to the proposed rule change on

June 28, 2002.<sup>4</sup> The Commission is publishing this notice, as amended by Amendment Nos. 1 and 2, 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

The Exchange proposes to amend NYSE Rule 97 (Limitation on Member Trading Because of Block Positioning) so that it applies only to transactions executed at or near the end of the trading day, and to provide exceptions to the rule for member organizations that establish the requisite internal information barriers and for certain hedging transactions.

The text of the proposed rule change appears below. New text is in italics; deletions are in brackets.

\* \* \* \* \*

#### Limitation on Members' Trading Because of Block Positioning

##### Rule 97

(a) When a member organization holds any part of a long position in a stock in [its trading] *a proprietary* account resulting from a block transaction it effected with a customer, such member organization may not effect *within twenty minutes of the close of trading on the Exchange a purchase on a "plus" tick in such stock at a price higher than the lowest price at which any block was acquired in a previous transaction on that day* [the following transactions] for any account in which it has a direct or indirect interest [for the remainder of the trading day on which it acquired such position.] *if the person responsible for the entry of such order to purchase such stock has knowledge of such block position.[:]*

*A member, allied member, or an employee of a member organization responsible for entering proprietary orders shall be presumed to have knowledge of a particular block position unless the member organization has implemented a reasonable system of internal policies and procedures to prevent the misuse of information about block positions by those responsible for entering such proprietary orders.*

[(i) A purchase on a "plus" tick if such purchase would result in a new daily high;

(ii) A purchase on a "plus" tick within one-half hour of the close;

(iii) A purchase on a "plus" tick at a price higher than the lowest price at which any block was acquired in a previous transaction on that day; or

(iv) A purchase on a "zero plus" tick of more than 50% of the stock offered at a price higher than the lowest price at which any block was acquired in a previous transaction on that day.]

For purposes of [the restrictions in subparagraphs (iii) and (iv) above] *this rule*, in the case where more than one block was acquired during the day, the lowest price of any such block will be the governing price.

(b) The provisions of paragraph (a) shall not apply to transactions made:

(1) For bona fide arbitrage or to engage in the purchase and sale, or sale and purchase of securities of companies involved in publicly announced merger, acquisition, consolidation, tender, etc.;

(2) To offset a transaction made in error;

(3) To facilitate the conversion of options;

(4) By specialists in the stocks in which they are registered;

(5) To facilitate the sale of a block of stock or a basket of stocks by a customer;

(6) To facilitate an existing customer's order for the purchase of a block of stock, or a specific stock within a basket of stocks, or a stock which is being added to or reweighted in an index, at or after the close of trading on the Exchange, provided that the facilitating transactions are recorded as such and the transactions in the aggregate do not exceed the number of shares required to facilitate the customer's order for such stock; [or]

(7) Due to a stock's addition to an index or an increase in a stock's weight in an index, provided that the transactions in the aggregate do not exceed the number of shares required to rebalance the index portfolio[.] *or;*

(8) *To hedge a position that is economically equivalent to a short stock position, provided that (i) the creation of the hedge, whether through one or more transactions, occurs so close in time to the completion of the transaction precipitating such hedge that the hedge is clearly related; (ii) the risk to be offset is the result of a position acquired in the course of facilitating a customer's order, and (iii) the size of the hedge is commensurate with the number of shares required to hedge such position when netted with any long position in the stock.*

*Supplementary Material:* No change.

<sup>7</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from Richard P. Bernard, Executive Vice President and General Counsel, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated April 16, 2002 ("Amendment No. 1"). In Amendment No. 1, the Exchange amended the proposed rule text to clarify which types of hedging transactions it would exclude from the restrictions of NYSE Rule 97.

<sup>4</sup> See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division, Commission, dated June 27, 2002 ("Amendment No. 2"). In Amendment No. 2, the Exchange amended the example in the Purpose section of the proposal to clarify the types of hedging transactions that would fall under the proposed exemption to NYSE Rule 97.

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

In its filing with the Commission, the Exchange 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. The Exchange 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

NYSE Rule 97 prohibits a member organization that holds any part of a long position in a stock in its trading account resulting from a block transaction it effected with a customer from purchasing, for an account in which it (*i.e.*, the block positioning firm) has a direct or indirect interest, additional shares of such stock on a "plus" or "zero plus" tick under certain conditions for the remainder of the trading day. NYSE Rule 97 defines a "block" as a quantity of stock having a market value of \$500,000 or more. Exceptions to the rule exist for transactions involving bona fide arbitrage or trading in companies involved in a publicly announced merger, acquisition, consolidation or tender offer; to offset error transactions; to facilitate the conversion of options; to allow specialty stock transactions by specialists; or to facilitate the sale of a block of stock to a customer.

The Exchange now proposes to amend NYSE Rule 97 in three significant respects. First, the Exchange proposes to amend NYSE Rule 97 to focus on transactions executed at or near the end of the trading day that could advantage a position acquired by a block positioner by being executed at a higher price than the lowest price at which a block was acquired during that day. As amended, NYSE Rule 97 would apply only during the last twenty minutes of the trading day, rather than, as under the current rule, the remainder of the trading day following acquisition of the block position. The Exchange believes that this approach is the same the Exchange applied, and the Commission approved, in other customer facilitation situations when a member organization may be positioning stock for its own

account.<sup>5</sup> The Exchange notes that while the proposed amendments to NYSE Rule 97 would limit the strict "tick" restriction to the most sensitive part of the trading day, members and member organizations remain subject to the anti-manipulative provisions of the Act at all times during the trading day.

Secondly, the Exchange proposes to provide that if a member organization establishes internal information barriers to shield a person entering proprietary orders in a stock from the knowledge that the firm has a block position in that stock, the restrictions in NYSE Rule 97 shall not apply to proprietary orders entered by such person. The Exchange believes that this is similar to the approach taken with respect to NYSE Rule 92, which provides that the proscriptions against trading ahead of customer orders shall not apply if internal information barriers shield a person entering a proprietary order from knowledge of any particular customer order executable at the same price.

Paragraph (b) of NYSE Rule 97 provides exceptions to the rule for purchases involving bona fide arbitrage or trading in companies involved in a publicly announced merger, acquisition, consolidation or tender offer; to offset error transactions; to facilitate the conversion of options; for transactions by specialists in their specialty stocks; to facilitate the sale of a block of stock or a basket of stocks by a customer; to facilitate an existing customer order for the purchase of a block of stock or a stock in a basket of stocks or a stock being added to or reweighted in an index at or after the close of trading on the Exchange provided certain conditions are met; or to increase a proprietary position in a stock which is being added to, or being increased in the weight of, a publicly disseminated index, provided that the transactions in the aggregate do not exceed the number of shares required to rebalance the portfolios.

The Exchange also proposes an additional exception for purchases which offset all or part of the market risk of a position that is economically equivalent to a short position in the stock, provided that such position was established as the result of facilitating a customer's order and the creation of the hedge, whether through one or more transactions, occurs so close in time to the completion of the transaction precipitating such hedge that the hedge is clearly related. Examples of positions that, according to the Exchange, would be deemed to be economically

equivalent to a short position in the stock include a long put option or a short position in a call option, warrant, right or convertible or exchangeable securities. The number of shares purchased to hedge the short position must be commensurate with the number of shares required to hedge such position when it is netted with any long position in the stock.

For example, on July 1, a member organization, in order to facilitate a customer,<sup>6</sup> sold short to that customer a security which is convertible into 100,000 shares of common stock. Thereafter, it facilitates a block transaction for another customer by buying 40,000 shares of the same common stock for the member organization's proprietary account. Within 20 minutes of the close on the same day, it seeks to hedge its remaining short exposure in the convertible security by buying 60,000 shares of the common stock. Since the member organization has acquired a long facilitation position (*i.e.*, the 40,000 share purchase), it must now calculate whether it is long for purposes of NYSE Rule 97, as amended. If it determines that it is not long, but rather short, it would fall within the proposed exception to NYSE Rule 97, as amended, for hedging a short position since the hedge being created offsets the risk of a position acquired in the course of facilitating a customer's order and the hedge is "clearly related" to the completion of the transaction precipitating the hedge<sup>7</sup> (the short position).

If, on the other hand, the firm determines it is long for purposes of NYSE Rule 97, the firm would not be able to effect within twenty minutes of the close of trading on the Exchange a purchase on a "plus" tick in the security

<sup>6</sup> Telephone conversation between Jeff Rosenstock, Senior Special Counsel, NYSE, and Ira Brandriss, Special Counsel, Division, Commission, and Christopher Solgan, Law Clerk, Division, Commission, on July 2, 2002.

<sup>7</sup> A hedge is deemed to be "clearly related" to the transaction precipitating the hedge if either the first or last transaction comprising the hedge is executed on the same trade date as the transaction that precipitates such hedge. Thus, the initiation of the hedge should be reasonably proximate to the transaction precipitating the hedge, but the member organization is not strictly required to complete the hedge on the same date as the precipitating transaction. The Exchange intends the hedge exemption to be construed narrowly and that the hedge transaction will be proximate in time to the precipitating transaction. See SR-NYSE-94-34, Amendment No. 6 (March 9, 2001), approved in Securities Exchange Act Release No. 44139 (March 30, 2001), 66 FR 18339 (April 6, 2001). For a more complete discussion, see Amendment No. 6 to SR-NYSE-94-34, which also described several interpretive issues which had arisen with respect to the amendment of NYSE Rule 92.

<sup>5</sup> See Securities Exchange Act Release No. 35837 (June 12, 1995), 60 FR 31749 (June 16, 1995).

at a price higher than the lowest price at which any block was acquired in a previous transaction on July 1, provided that the person responsible for the entry of such order to purchase the security had knowledge of the block position.<sup>8</sup>

The Exchange also proposes to replace the term "trading account" in paragraph (a) of NYSE Rule 97 with "proprietary account" so as to clarify that NYSE Rule 97's restrictions may apply regardless of where the long facilitation position is placed, e.g., a facilitation account or a trading account.

#### (2) Statutory Basis

The Exchange believes that the basis for the proposed rule change is the requirement under Section 6(b)(5) of the Act<sup>9</sup> that an exchange have rules that are designed to promote just and equitable principles of trade, 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.

#### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

#### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

The Exchange has neither solicited nor received written comments on the proposed rule change.

#### 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 Exchange consents, the Commission will:

A. By order approve such proposed rule change; or

<sup>8</sup> Under the proposed language to NYSE Rule 97, "a member, allied member, or an employee of a member organization responsible for entering proprietary orders shall be presumed to have knowledge of a particular block position unless the member organization has implemented a reasonable system of internal policies and procedures to prevent the misuse of information about block positions by those responsible for entering such proprietary orders."

<sup>9</sup> 15 U.S.C. 78f(b)(5).

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 filings will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-NYSE-2001-24 and should be submitted by August 9, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 02-18223 Filed 7-18-02; 8:45 am]

**BILLING CODE 8010-01-P**

#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46190; File No. SR-PCX-2002-33]

#### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc., To Revise the Process for Designating Arbitrators for Member-to-Member Disputes

July 11, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 30, 2002, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and

<sup>10</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

III below, which Items have been prepared by the Exchange. 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

The PCX proposes to amend PCX Rule 12.8(e) to revise the process for designating arbitrators for member-to-member disputes. Text in brackets indicates material to be deleted, and text in italics indicates material to be added.

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#### Pacific Exchange, Inc., Rules of The Board of Governors

##### Rule 12

##### Arbitration

##### Designation of [Number of] Arbitrators

Rule 12.8(a)-(d)—No change.  
(e) Member Controversies. [(1)] In all arbitration matters not involving public customers[,] *and where the matter in controversy involves an amount that is \$30,000 or less (exclusive of interest and costs), the Director of Arbitration [shall] will appoint an arbitration panel composed of one securities industry arbitrator unless the parties request and mutually agree to the appointment of a public arbitrator* [assign the matter to a panel consisting of members of the Arbitration Committee]. *If the amount involved in the controversy exceeds \$30,000 (exclusive of interest and costs), the Director of Arbitration will appoint an arbitration panel composed of three or five arbitrators from the securities industry unless the parties request and mutually agree to a different panel composition.* [Such] [m]Members of the arbitration panel *will* [shall] not be affiliated with any of the parties to the controversy or have any interest in the matter to be heard. [For controversies involving an amount of \$10,000 or less, the panel shall consist of one (1) member. For all other controversies, the panel shall consist of three (3) members.]

Commentary:

.01—No change.

(f)—No change.

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

In its filing with the Commission, the PCX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed