

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

ISE Rule 720 gives the Exchange authority to bust or adjust trades that result from an obvious error. The rule contains objective standards regarding the definition of an "obvious error," the circumstances under which a trade should be adjusted or busted, and the price to which a trade should be adjusted if adjustment is appropriate. The Rule currently defines an obvious error based upon the market conditions and the difference between the execution price and the "theoretical price" of the options series. To be an obvious error, the difference in execution and theoretical price must be the greater of \$0.50 or two times the allowable spread in regular market conditions (three times the allowable spread in "fast market" conditions).

The current rule does not directly consider the price at which the particular options series is trading in determining whether there has been an obvious error (although the allowable spread does increase as an option's price increases). The ISE represents that in administering the Rule, it has found that (1) the price of an option is a significant factor in determining when there is an obvious error; and (2) a pricing error in an options series trading at less than \$3.00 can often be significant even if it does not meet the current \$0.50 minimum requirement. The Exchange thus proposes that the standard for determining the existence of an obvious error for options series trading at less than \$3.00 be whether the difference between the execution price and the theoretical price is at least \$0.25.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>3</sup> in general, and furthers the objectives of Section 6(b)(5)<sup>4</sup> in particular, in that it is 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 for 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 did not solicit or receive 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

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-ISE-2001-34 and should be submitted by May 22, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-45818; File No. SR-NASD-2002-15]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Situations in Which a Suspended, Terminated, or Otherwise Defunct Member or Associated Person Fails To Answer or Participate in an Arbitration Proceeding**

April 24, 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 February 1, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, NASD Dispute Resolution, Inc. ("NASD Dispute Resolution"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Dispute Resolution. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

NASD Dispute Resolution is proposing to amend Rule 10314 of the NASD Code of Arbitration Procedure ("Code") to provide default procedures for situations in which a suspended, terminated, or otherwise defunct member or associated person fails to answer or participate in an arbitration proceeding, and the claimant nevertheless elects to pursue arbitration. Below is the text of the proposed rule change. Proposed new language is in *italics*.

\* \* \* \* \*

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

<sup>4</sup> 15 U.S.C. 78f(b)(5).

**Code of Arbitration Procedure****10314. Initiation of Proceedings**

Except as otherwise provided herein, an arbitration proceeding under this Code shall be instituted as follows:

- (a) Statement of Claim Unchanged.
- (b) Answer—Defenses, Counterclaims, and/or Cross-Claims
  - (1) Unchanged.
  - (2) (A)–(B) Unchanged.
  - (C) A Respondent, Responding Claimant, Cross-Claimant, Cross-Respondent, or Third-Party Respondent who fails to file an Answer within 45 calendar days from receipt of service of a Claim, unless the time to answer has been extended pursuant to subparagraph (5), below, may, in the discretion of the arbitrators, be barred from presenting any matter, arguments, or defenses at the hearing. *Such a party may also be subject to default procedures as provided in paragraph (e) below.*
  - (3)–(4) Unchanged.
  - (5) Unchanged.
  - (c)–(d) Unchanged.
  - (e) Default Procedures
    - (1) *A Respondent, Cross-Respondent, or Third-Party Respondent that fails to file an Answer within 45 calendar days from receipt of service of a Claim, unless the time to answer has been extended pursuant to paragraph (b)(5), may be subject to default procedures, as provided in this paragraph, if it is:*
      - (A) *a member whose membership has been terminated, suspended, canceled, or revoked;*
      - (B) *a member that has been expelled from the NASD;*
      - (C) *a member that is otherwise defunct; or*
      - (D) *an associated person whose registration is terminated, revoked, or suspended.*
    - (2) *If all Claimants elect to use these default procedures, the Claimant(s) shall notify the Director in writing and shall send a copy of such notification to all other parties at the same time and in the same manner as the notification was sent to the Director.*
    - (3) *If the case meets the requirements for proceeding under default procedures, the Director shall notify all parties.*
    - (4) *The Director shall appoint a single arbitrator pursuant to Rule 10308 to consider the Statement of Claim and other documents presented by the Claimant(s). The arbitrator may request additional information from the Claimant(s) before rendering an award. No hearing shall be held, and the default award shall have no effect on any non-defaulting party.*

*(5) The Claimant(s) may not amend the claim to increase the relief requested after the Director has notified the parties that the claim will proceed under default procedures.*

*(6) An arbitrator may not make an award based solely on the non-appearance of a party. The party who appears must present a sufficient basis to support the making of an award in that party's favor. The arbitrator may not award damages in an amount greater than the damages requested in the Statement of Claim, and may not award any other relief that was not requested in the Statement of Claim.*

*(7) If the Respondent files an Answer after the Director has notified the parties that the claim will proceed under default procedures but before an award has been rendered, the proceedings under this paragraph shall be terminated and the case will proceed under the regular procedures.*

\* \* \* \* \*

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

In its filing with the Commission, NASD Dispute Resolution included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD Dispute Resolution 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**

NASD Dispute Resolution proposes to amend Rule 10314 of the Code to provide default procedures for situations in which a suspended, terminated, or otherwise defunct member or associated person (collectively referred to in this rule filing as "defunct") fails to answer or participate in an arbitration proceeding, and the claimant nevertheless elects to pursue arbitration. The procedures are designed to make it easier for claimants to obtain an award against a defunct party, which award can then be enforced in court.

The United States General Accounting Office ("GAO") issued a report in June 2000 expressing concern over the number of unpaid arbitration awards issued in connection with arbitration

proceedings in the securities industry arbitration forums, and making several recommendations for improvements.<sup>3</sup> The GAO Report observed that most of the unpaid awards resulted from broker/dealers that were no longer in business.<sup>4</sup> In a letter to the GAO on May 25, 2000, the NASD committed to undertake several initiatives to address the issue of unpaid awards.<sup>5</sup> The NASD Dispute Resolution believes that the proposed rule change will complete its implementation of all initiatives.

The GAO initiatives are listed below with a description as to the actions already taken. The last item is the proposed rule change.

*Require member firms and associated persons to notify NASD Dispute Resolution when they have satisfied an award.*

NASD Dispute Resolution issued Notice to Members 00–55, effective September 18, 2000, which requires members to certify that they have paid or otherwise complied with an award against them or their associated persons within 30 days after service of the award. Beginning September 18, 2000, NASD Dispute Resolution has been sending two new letters when awards are served. One letter is sent only to members and associated persons against whom an award has been rendered. It requires members to inform NASD Dispute Resolution whether they or their associated persons have paid awards against them. Associated persons who have changed members since the complaint was filed are required to notify NASD Dispute Resolution directly.<sup>6</sup> NASD Dispute Resolution begins the suspension process if the 30-day period has passed and there has been no notice that the member or associated person has paid the award.

*Request in the award service letter that claimants notify NASD Dispute Resolution if the award has not been paid within an established number of days of service.*

Notice to Members 00–55 also invites claimants to inform NASD Dispute

<sup>3</sup> The report is entitled, "Securities Arbitration: Actions Needed to Address Problem of Unpaid Awards," Report No. GAO/GGD–00–115 (June 15, 2000) ("GAO Report"). The report is available online at [www.gao.gov](http://www.gao.gov).

<sup>4</sup> See the GAO Report at page 8.

<sup>5</sup> The letter is reprinted in the GAO Report at page 66.

<sup>6</sup> The respondent may also provide a justification for non-payment; for example, that the parties have agreed to installment payments; that the award has been modified or vacated by a court; that a motion to vacate or modify the award has been timely filed with a court of competent jurisdiction and such motion has not been denied by that court; that there is a pending bankruptcy petition; or that the award has been discharged in bankruptcy.

Resolution if their awards against members or associated persons have not been paid, so that the non-summary suspension process can begin. The second letter implemented on September 18, 2000 is sent to all parties with service of their award. It restates the requirement to pay awards within 30 days of service, and requests parties who have prevailed against a member or associated person to inform NASD Dispute Resolution if their award has not been paid.

*Propose to the NASD Board and to the Commission a rule amendment that a firm that has been terminated, suspended, or barred from the NASD, or that is otherwise defunct, cannot enforce a predispute arbitration agreement against a customer in the NASD forum.*

The Boards of NASD Dispute Resolution and the NASD approved this proposal at their meetings on December 6 and 7, 2000. The Commission approved the rule change on April 6, 2001.<sup>7</sup> Notice to Members 01-29, announcing the Commission's approval, was published on May 10, 2001, and the rule change was effective for all claims served on or after June 11, 2001.

*Advise claimants in writing of the status of a firm or associated person (e.g., terminated, out of business, bankrupt) so they can evaluate whether to continue with arbitration.*

This procedure was implemented on June 11, 2001, in connection with the previous item.

*Propose to the NASD Board and to the Commission a rule amendment to provide streamlined default proceedings where the terminated or defunct member or associated person does not answer or appear, but the claimant affirmatively elects to pursue arbitration.*

This is the present proposed rule change. It would provide an expedited default procedure for certain cases in which a respondent is an associated person whose registration is terminated, revoked, or suspended; a member whose membership has been terminated, suspended, canceled, or revoked; a member that has been expelled from the NASD; or a member that is otherwise defunct. If a defunct respondent fails to answer the claim in a timely manner, the claimant may elect to proceed under optional default procedures as to that respondent. If there are several claimants, all must agree to use default procedures. The default procedures may be used against one or more defunct

respondents while the rest of the initial arbitration proceeds against any remaining respondents.<sup>8</sup>

If the claimant opts to use default procedures, the case will proceed with a single arbitrator without a hearing. Under the default procedures, the arbitrator will make an award based upon the Statement of Claim and any other material submitted by the claimant. The arbitrator may request additional information from the claimant before rendering an award. In keeping with the streamlined nature of the procedures, neither the claimant nor the single arbitrator will have the option to ask that two additional arbitrators be appointed to decide the case (as is sometimes done in other single-arbitrator cases).

The procedures have several provisions to safeguard the integrity of the process and discourage abuses:

- The claimant may not amend the claim to increase the relief requested after the staff has notified the parties that the claim will proceed under default procedures.
- An arbitrator may not make an award based solely on the non-appearance of a party. The party who appears must present a sufficient basis to support the making of an award in that party's favor.
- The arbitrator may not award damages in an amount greater than the damages requested in the Statement of Claim, and may not award any other relief that was not requested in the Statement of Claim.

The proposed rule provides, however, that the default award will have no effect on the non-defaulting parties. The proposed rule would apply to all types of claimants, whether they are customers, associated persons, or member firm claimants, that are bringing a claim against a suspended or terminated member or associated person. In line with the GAO's recommendations, the proposal is designed to make it easier to obtain an award against any defunct member or associated person.

Finally, if a respondent thought to be defunct belatedly files an answer or otherwise begins to participate after the staff has notified the parties that the claim will proceed under default procedures but before an award has been rendered, the default procedures will be suspended, and the case will proceed under the regular procedures.

<sup>8</sup> If a case is to be bifurcated and handled under two different procedures, regular and default, each proceeding will be assigned a separate case number to avoid confusion. Proposed NASD Rule 10314(e) provides that the default award will have no effect on any non-defaulting party.

## 2 Statutory Basis

NASD Dispute Resolution believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act<sup>9</sup> which requires, among other things, that the Association's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Dispute Resolution believes that the proposed rule change will protect investors and the public interest by making it faster and less expensive for investors and other claimants to obtain awards against defunct members and associated persons, which awards can then be enforced in court and through the NASD suspension process, while containing several provisions to safeguard the integrity of the process and discourage abuses.

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

NASD Dispute Resolution 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*

No written comments were solicited or received with respect to 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 NASD Dispute Resolution consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the

<sup>7</sup> Securities Exchange Act Release No. 44158 (April 6, 2001), 66 FR 19267 (April 13, 2001) (File No. SR-NASD-01-08).

<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

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 filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2002-15 and should be submitted by May 22, 2002.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45813; File No. SR-NASD-2002-55]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Minimum Life of Directed Orders in Nasdaq's SuperMontage System and the Minimum Life of SelectNet Orders

April 24, 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 April 18, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), 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 Nasdaq. 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 NASD proposes to: (1) establish a minimum life of five seconds for Directed Orders in Nasdaq's future Order Display and Collector Facility ("NNMS" or "SuperMontage"), and (2) reduce from ten seconds to five seconds the minimum time period before an order entered into Nasdaq's SelectNet system may be cancelled by the entering party. If approved, Nasdaq will implement both rule changes on July 1, 2002.

Proposed new language is *italicized*; proposed deletions are in [brackets].

\* \* \* \* \*

#### 4706. Order Entry Parameters

(a) No Change.

(b) Directed Orders: A participant may enter a Directed Order into the NNMS to access a specific Attributable Quote/Order displayed in the Nasdaq Quotation Montage, subject to the following conditions and requirements:

(1) through (3) No Change.

(4) *a Directed Order entered into the system may not be cancelled until a minimum of five seconds has elapsed after the time of entry. This five second time period shall be measured by NNMS.*

\* \* \* \* \*

#### 4720. SelectNet Service

(a) Cancellation of a SelectNet Order

No member shall cancel or attempt to cancel an order, whether preferenced to a specific market maker or electronic communications network, or broadcast to all available members, until a minimum time period of [ten] *five* seconds has expired after the order to be canceled was entered. Such [ten] *five* second time period, shall be measured by the Nasdaq processing system processing the SelectNet order.

(b) through (c) No Change.

\* \* \* \* \*

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

In its filing with the Commission, Nasdaq 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. Nasdaq 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

As part of its ongoing analysis of its current and future trading systems, Nasdaq continuously reviews system functionality and rules with a view to constant improvement. As a result of this review, and in consultation with industry professionals, Nasdaq has determined to: (1) establish a five-second minimum life for Directed Orders in SuperMontage, and (2) reduce from ten seconds to five seconds the minimum time period before an order entered into SelectNet may be cancelled by the entering party. Because the SuperMontage Directed Order Process will utilize an enhanced version of the current SelectNet system, Nasdaq is jointly proposing these rule changes because it believes that the rules must become effective simultaneously to ensure uniformity of minimum order life parameters across both systems during the phase-in period.<sup>3</sup>

#### a. Creation of Five-Second Minimum Life for Directed Orders in SuperMontage

Directed Orders are orders at any price that have been specifically dispatched to a particular market participant by the sender through the SuperMontage's Directed Order Process. Recipients of Directed Orders have an option to elect to receive such orders as either liability orders with which they must interact consistent with the Commission's Firm Quote Rule,<sup>4</sup> or as non-liability orders that create no obligation to respond by the recipient under the Commission's Firm Quote Rule, and instead may serve as the basis for negotiating a trade.

The minimum life of a Directed Order is the shortest period of time that a Directed Order must remain active and available for a response before an entering party may cancel it. Currently, there is no minimum life for Directed Orders in SuperMontage. Directed Orders may be cancelled immediately after entry, well before a recipient has

<sup>3</sup> Nasdaq intends to introduce SuperMontage through a phased roll-out process where limited numbers of securities will transition to trading in the new SuperMontage environment under new rules, while the remainder will continue to trade in Nasdaq's current environment. Nasdaq represents that, during this transition, both SuperMontage and SelectNet will continue to operate, and a single uniform minimum order cancellation time parameter will be needed governing both systems.

<sup>4</sup> See Rule 11Ac1-1 under the Act, 17 CFR 240.11Ac1-1.

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

<sup>11</sup> 15 U.S.C. 78s(b)(1).

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