

Rule 477, OMB Control No. 3235-0550, SEC File No. 270-493.

Notice is hereby given that, pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Securities and Exchange Commission ("Commission") has submitted to the Office of Management and Budget requests for extension of the previously approved collections of information discussed below.

Rule 155 under the Securities Act provides safe harbors for a registered offering following an abandoned private offering, or a private offering following an abandoned registered offering, without integrating the registered and private offering in either case. Rule 155 requires any prospectus filed as a part of a registration statement after a private offering to include disclosure regarding abandonment of the private offering. Similarly, the rule requires an issuer to provide each offeree in a private offering following an abandoned registered offering with: (1) Information concerning withdrawal of the registration statement; (2) the fact that the private offering is unregistered; and (3) the legal implications of the offering's unregistered status. The likely respondents will be companies. All information submitted to the Commission is available to the public for review. Companies only need to satisfy the Rule 155 information requirements if they wish to avail themselves of the rule's safe harbors. The Rule 155 information is required only on occasion. It is estimated that 600 issuers will file Rule 155 submissions annually at an estimated 4 hours per response. Also, it is estimated that 50% of the 2,400 total annual burden hours (1200 burden hours) would be prepared by the company. We estimate that the company's outside counsel would prepare the other 1,200 burden hours.

Rule 477 under the Securities Act sets forth procedures for withdrawing a registration statement or any amendment or exhibits thereto. The Rule provides that if a registrant applies in anticipation of reliance on Rule 155's registered-to-private safe harbor, the registrant must state in the withdrawal application that the registrant plans to undertake a subsequent private offering in reliance on the rule. Without this statement, the Commission would not be able to monitor issuers' reliance on and compliance with Rule 155(c). The likely respondents will be companies. All information submitted to the Commission under Rule 477 is available to the public for review. Information provided under Rule 477 is mandatory.

The information is required on occasion. It is estimated that 300 issuers will file Rule 477 submissions annually at an estimated one-hour per response for a total annual burden of 300 hours.

Finally, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Written comments regarding the above information should be directed to the following persons: (i) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10102, New Executive Office Building, Washington, DC 20503; and (ii) Michael E. Bartell, Associate Executive Director, Office of Information Technology, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Comments must be submitted to OMB within 30 days of this notice.

Dated: May 30, 2001.

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 01-14330 Filed 6-6-01; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44376; File No. SR-ISE-00-19]

Self Regulatory Organizations; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 Thereto by the International Securities Exchange LLC Adopting an Obvious Error Rule

June 1, 2001.

I. Introduction

On November 20, 2000, the International Securities Exchange LLC ("ISE" or "Exchange"), submitted to 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 give the ISE the authority to bust or adjust trades that result from clearly erroneous orders or quotations.

The proposed rule change was published for comment in the **Federal Register** on January 18, 2001.³ One comment letter was received on the

proposal.⁴ On May 30, 2001, the ISE submitted Amendment No. 1 to the proposed rule change to the Commission.⁵ This Order approves the proposed rule change. In addition, the Commission is issuing notice of, granting accelerated approval to, and soliciting comments on, Amendment No. 1 to the proposed rule change.

II. Description of the Proposal

The Exchange proposes to adopt new ISE Rule 720, as amended, that would allow it to either adjust or bust a transaction in circumstances where a member or its customer has made an error and the price of the execution is "obviously" not correct. The proposed rule contains objective standards regarding when a transaction was clearly the result of an "obvious error," under what circumstances a trade would be adjusted or busted, and to what price a trade would be adjusted if adjustment were appropriate under the circumstances.

Under proposed ISE Rule 720, when a member believes that it has participated in a transaction that was the result of an obvious error, it must notify ISE Market Control within a specified time of the execution. The proposed rule requires Exchange market makers, who are continuously monitoring their transactions on the ISE, to notify ISE Market Control within five minutes of an execution. The proposed rule allows Electronic Access Members ("EAMs"), who may handle customer orders on multiple exchanges simultaneously and who may need to contact customers for instruction, up to twenty minutes to notify ISE Market Control. Absent unusual circumstances, ISE Market Control would not grant relief unless notification is made within the prescribed time periods.⁶

⁴ This comment letter is more fully discussed below in Section III, Comment and Response. See Letter from George Brunelle, Brunelle & Hadjicow, to Jonathan G. Katz, Secretary, Commission, dated February 6, 2001 ("Brunelle Letter").

⁵ Letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Susie Cho, Division of Market Regulation ("Division"), Commission, dated May 29, 2001 ("Amendment No. 1"). In Amendment No. 1, the ISE proposed to change the composition of the Obvious Error Panel to comprise two Electronic Access Members and two members that are market makers on the Exchange. The ISE also amended the proposed rule change to state that the ISE Market Control, not the Obvious Error Panel, would determine the theoretical price of an option where there are no quotes to be relied on for comparison purposes. Finally, the ISE clarified its procedures for appeal of a decision by ISE Market Control to the Obvious Error Panel.

⁶ The provision permitting ISE Market Control to grant relief in "unusual circumstances" is intended primarily to encompass situations where EAMs and market-makers might make a request a few minutes

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 43830 (January 10, 2001), 66 FR 4880 (January 18, 2001).

ISE Market Control would determine whether there was an obvious error according to the following objective criteria: (1) An obvious error would be deemed to have occurred during normal market conditions when the execution price of a transaction is higher or lower than the theoretical price⁷ for the series by an amount equal to at least two times the maximum bid/ask spread allowed for the option, so long as such amount is 50 cents or more; and (2) an obvious error would be deemed to have occurred during fast market conditions when the execution price of a transaction is higher or lower than the theoretical price for the series by an amount equal to at least three times the maximum bid/ask spread allowed for the option, so long as such amount is 50 cents or more.

If it is determined that a transaction is the result of an obvious error, ISE Market Control will take one of the following actions: (1) Where each party to the transaction is an Exchange market maker, the execution price of the transaction would be adjusted unless both parties agree to bust the trade; or (2) where at least one party to the obvious error is not a market maker on the Exchange, the trade would be busted unless both parties agree to adjust the price of the transaction. The default action would be taken unless agreement is reached within ten minutes in the case where both parties are Exchange market makers, and within thirty minutes where at least one party is not an Exchange market maker. Upon taking final action, Market Control would be required to promptly notify both parties to the trade.

Where an adjustment is made to a transaction price, the adjusted price would be determined by objective criteria. The adjusted price would be equal to the theoretical price of the option in the case where the erroneous price is displayed in the market and subsequently executed by quotes or orders that did not exist in the system at the time the price was entered.

outside the set time limits, if they have a legitimate reason for the delay. According to the ISE, one such situation would be, for example, if a firm's system was down and after trying to fix it, the firm finds an obvious error among the orders that have queued up. On the other hand, EAMs and market makers who fail to make a timely request because they failed to monitor their trades would not be granted relief. Telephone conversation between Katherine Simmons, Vice President and Associate General Counsel, ISE, and Susie Cho, Special Counsel, Division, Commission, on May 29, 2001.

⁷ The theoretical price of an option in the case of an erroneous bid (offer) is the last bid (offer), just prior to the trade, found on the exchange that has the most liquidity in that option other than the ISE. If there are no quotes for comparison purposes, the theoretical price will be determined by ISE Market Control.

Proposed ISE Rule 720 further specifies that the Exchange must designate a least ten market maker representatives and at least ten EAM representatives to ISE to be called upon to serve on an Obvious Error Panel, as needed.⁸ The Obvious Error Panel would be comprised of four members. Two of the representatives must be directly engaged in market making activity and two of the representatives must be employed by an EAM. Proposed ISE Rule 720 provides that an Obvious Error Panel would have the authority to, upon request by a party to a potential obvious error, review whether ISE Market Control used the correct theoretical price and whether an adjustment was made at the correct price. A request for a review must be made in writing within thirty minutes after a party receives verbal notification of a final determination by ISE Market Control, except that if notification is made after 3:30 p.m. Eastern time, either party would have until 9:30 a.m. Eastern time the next trading day to request review. The Obvious Error Panel would be permitted to overturn or modify an action taken by ISE Market Control upon agreement by a majority of the panel representatives; if the Obvious Error Panel vote were split 2–2, then the decision of ISE Market Control would stand.⁹ All determinations by an Obvious Error Panel will be made on the same day as the transaction in question, or the next trading day in the case where a request is properly made after 3:30 p.m. on the day of the transaction or where the request is properly made the next trading day. The determination of the Obvious Error Panel would be final.

III. Comment and Response

A. Comment Letter

The Commission received one comment letter regarding the proposal.¹⁰ Overall, the commenter believed that the proposed rule would unfairly injure public investors, would damage the public options markets and would subvert the Commission's newly amended Quote Rule.¹¹

Specifically, the commenter argued that the concept of "theoretical price" is arbitrary.¹² The commenter believed that the proposed rule change ignores the fact that many different theoretical

pricing formulae exist and their application by different parties to the same trading situations can produce widely divergent calculations of the theoretical price.¹³ The commenter also stated that even in situations where the ISE recognizes that the theoretical price is not objectively determinable, the ISE had proposed to allow an Obvious Error Panel comprised entirely of market makers to determine the theoretical price without third-party oversight.¹⁴

The commenter also objected that the limitation on the composition of the Obvious Error Panel to market makers would tend to create opportunities for reciprocity and would constitute, in itself, a conflict of interest.¹⁵ The commenter worried that the proposal would give members an incentive and opportunity to take unfair advantage of the public by manipulating the "obvious error" process to entice public investors into trading at prices deliberately set in excess of the maximum bid/ask limits.¹⁶ The commenter stated that the proposal contains no mechanism for disclosing to public investors the facts underlying a decision to cancel one of their trades, nor any procedure for appealing from such a decision to an impartial tribunal.¹⁷ Finally, the commenter argued that the proposal would unfairly impose losses from obvious error trades only on the public investor and not on market makers who commit "obvious" trading errors.¹⁸

B. ISE Response

The ISE responded by stating that the protection afforded by the proposal is applied equally to all market participants, whether they are market makers entering quotations or investors entering limit orders.¹⁹ The ISE later submitted Amendment No. 1 to the proposal.²⁰

In response to the commenter's argument that the proposal would violate the Commission's Quote Rule, the ISE argued that its proposal is consistent with the Quote Rule, because it is narrowly crafted to apply in a fair and even-handed manner only in cases where any objective person would agree that the error was obvious.²¹ The ISE stated that there is no support for the

¹³ *Id.*

¹⁴ *Id.* at 5.

¹⁵ *Id.*

¹⁶ *Id.* at 6.

¹⁷ *Id.*

¹⁸ *Id.* at 6–7.

¹⁹ Letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Jonathan G. Katz, Secretary, Commission, dated February 27, 2001 ("ISE Response").

²⁰ See Amendment No. 1, *supra* note 5.

²¹ ISE Response, *supra* note 19 at 3.

⁸ Under proposed Supplementary Material .05 to ISE Rule 720, in no case would an Obvious Error Panel include a person related to a party to the obvious error in question.

⁹ See Amendment No. 1, *supra* note 5.

¹⁰ Brunelle Letter, *supra* note 4.

¹¹ Rule 11Ac1–1, 17 CFR 240.11 Ac1–1.

¹² Brunelle Letter, *supra* note 4 at 4.

argument that trades done at a price obviously in error must stand, citing rules from other self-regulatory organizations ("SROs")²² that permit SRO staff to adjust or bust clearly erroneous trades.²³ The ISE also disputed the commenter's assertion that the proposal would allow the ISE to cancel trades on the basis of a formula that the public could not calculate or verify. The ISE stated that its proposal provides specific objective criteria that the Exchange will use to determine if a quotation is erroneous and notes that the ISE spread requirements are described in ISE Rule 803.²⁴

Responding to the commenter's arguments regarding the arbitrariness of the theoretical price determination and potential conflicts of interest for the Obvious Error Panel, the ISE states that the proposal specifies exactly the prices to be used in determining whether a trade is an "obvious error," *i.e.*, the quotation in the most liquid market for the option. Where there is no available quote, the ISE has proposed to amend its proposal to state that ISE Market Control, not an Obvious Error Panel comprised solely of market makers, will determine the theoretical price.²⁵ In addition, the composition of the Obvious Error Panel has been proposed to be altered by Amendment No. 1 so that it would consist of both market maker members and EAMs and it will review ISE staff decisions made under the proposed rule.²⁶ The ISE notes that this is a limited function in which pricing and trading expertise is needed and that the proposal explicitly prohibits market makers from ruling on any matter involving their own firms.²⁷ Moreover, the Obvious Error Panel would have no involvement in the initial review of a trade and would only provide a forum for an appeal.²⁸ The ISE also adds that in any trade involving a customer, the proposal explicitly provides that the ISE would bust any customer trade that is obviously in error unless the customer agrees to adjust the price.²⁹

Responding to the commenter's concern of market maker manipulation under the proposal, the ISE commented that the Exchange is charged with the responsibility to engage in active surveillance of its markets and to

discipline members who violate its rules or the federal securities laws.³⁰ The ISE noted that ISE Market Control would easily detect the commenter's example of manipulation, since the market maker must seek ISE staff involvement to "correct" trades.³¹ The ISE also stated that the Exchange posts both its rules and its rule proposals on its Internet web site for anyone to review.³²

Finally, the ISE challenged the commenter's argument that the proposal would allow market makers to avoid losses and transfer risks to public customers. The ISE stated that the proposal would provide all market participants with notice that trades clearly out-of-line with the market—subject to clear, objective standards—would not stand.³³ The proposal, instead of permitting arbitrageurs to exploit a clear mistake in the market, would reasonably allocate the risk in this type of situation in a manner that protects customers while not unfairly harming market makers who attempt to provide investors with deep and liquid markets.³⁴

C. Amendment No. 1

Amendment No. 1 would alter the proposal in several aspects. In Amendment No. 1, the ISE revised the composition of the Obvious Error Panel to comprise two Electronic Access Members and two members that are market makers on the Exchange.³⁵ The ISE also amended the proposed rule change to state that the ISE Market Control, not the Obvious Error Panel, would determine the theoretical price of an option where there are no quotes for comparison purposes.³⁶ Finally, the ISE clarified its procedures for appealing an ISE staff decision to the Obvious Error Panel.³⁷ Proposed ISE Rule 720, as amended by Amendment No. 1, follows. Additions are italicized.

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Rule 720. Obvious Errors

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(b) *Definition of Theoretical Price. For purposes of this Rule only, the Theoretical Price of an option is:*

(1) *if the series is traded on at least one other options exchange, the last bid or offer, just prior to the trade, found on the exchange that has the most liquidity in that option as provided in Supplementary Material .02 below; or*

(2) *if there are no quotes for comparison purposes, as determined by designated personnel in the Exchange's market control center ("Market Control").*

* * * * *

(d) *Obvious Error Procedure. Designated personnel in the Exchange's market control center ("Market Control") shall administer the application of this Rule as follows:*

(1) *Notification. If a market maker on the Exchange believes that it participated in a transaction that was the result of an Obvious Error, it must notify Market Control within five (5) minutes of the execution. If an Electronic Access Member believes an order it executed on the Exchange was the result of an Obvious Error, it must notify Market Control within twenty (20) minutes of the execution. Absent unusual circumstances, Market Control will not grant relief under this Rule unless notification is made within the prescribed time periods.*

(2) *Adjust or Bust. Market Control will determine whether there was an Obvious Error as defined above. If it is determined that an Obvious Error has occurred, Market Control shall take one of the following actions: (i) where each party to the transaction is a market maker on the Exchange, the execution price of the transaction will be adjusted unless both parties agree to bust the trade within ten (10) minutes of being notified by Market Control of the Obvious Error; or (ii) where at least one party to the Obvious Error is not a market maker on the Exchange, the trade will be busted unless both parties agree to adjust the price of the transaction within thirty (30) minutes of being notified by Market Control of the Obvious Error. Upon taking final action, Market Control shall promptly notify both parties to the trade.*

(e) *Obvious Error Panel.*

(1) *Composition. An Obvious Error Panel will be comprised of representatives from four (4) Members. Two (2) of the representatives must be directly engaged in market making activity and two (2) of the representatives must be employed by an Electronic Access Member.*

(2) *Request for Review. If a party affected by a determination made under this Rule so requests within the time permitted below, the Obvious Error Panel will review decisions made by Market Control under this Rule, including whether an Obvious Error occurred, whether the correct Theoretical Price was used, and whether an adjustment was made at the correct price. A party may also request that the Obvious Error Panel provide relief under this Rule in cases where the party failed to provide the notification required in paragraph(d)(1) and Market Control declined to grant an extension, but unusual circumstances must merit special consideration. A request for review must be made in writing within thirty (30) minutes after a party receives verbal notification of a final determination by Market Control under this Rule, except that if notification is made after 3:30 p.m. Eastern Time, either party has until 9:30 a.m. Eastern Time the next trading day to request review. The Obvious Error Panel shall review the facts and render a decision on the day of the transaction, or the next trade day in the case where a request*

²² Rule 11890 of the National Association of Securities Dealers, Inc. ("NASD"); Rule 75 of the New York Stock Exchange, Inc. ("NYSE").

²³ ISE Response, *supra* note 19 at 2.

²⁴ *Id.* at 3.

²⁵ See Amendment No. 1, *supra* note 5.

²⁶ *Id.*

²⁷ ISE Response, *supra* note 19 at 5.

²⁸ See Amendment No. 1, *supra* note 5.

²⁹ ISE Response, *supra* note 19 at 4.

³⁰ ISE Response, *supra* note 19 at 6.

³¹ *Id.*

³² *Id.*

³³ *Id.* at 7.

³⁴ *Id.*

³⁵ Amendment No. 1, *supra* note 5.

³⁶ *Id.*

³⁷ *Id.*

is properly made after 3:30 on the day of the transaction or where the request is properly made the next trade day.

(3) *Panel Decision.* The Obvious Error Panel may overturn or modify an action taken by Market Control under this Rule upon agreement by a majority of the Panel representatives. All determinations by the Obvious Error Panel shall constitute final Exchange action on the matter at issue.

Supplementary Material to Rule 720

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.03 The price to which a transaction is adjusted under paragraph (c)(2) above will be as follows: (i) the bid price from the exchange providing the most volume for the option will be used with respect to an erroneous offer price entered on the Exchange, and (ii) the offer price from the exchange providing the most volume for the option will be used with respect to an erroneous bid price entered on the Exchange. If there are no quotes for comparison purposes, the adjustment price will be determined by Market Control.

* * * * *

.05 To qualify as a representative of an Electronic Access Member on an Obvious Error Panel, a person must (i) be employed by a Member whose revenues from options market making activity do not exceed ten percent (10%) of its total revenues; or (ii) have as his or her primary responsibility the handling of Public Customer orders or supervisory responsibility over persons with such responsibility, and not have any responsibilities with respect to market making activities.

.06 The Exchange shall designate at least ten (10) market maker representatives and at least ten (10) Electronic Access representatives to be called upon to serve on Obvious Error Panels as needed. In no case shall an Obvious Error Panel include a person related to a party to the trade in question. To the extent reasonably possible, the Exchange shall call upon the designated representatives to participate on an Obvious Error Panel on an equally frequent basis.

.07 All determinations made by the Exchange, Market Control or an obvious Error Panel under this Rule shall be rendered without prejudice as to the rights of the parties to the transaction to submit a dispute to arbitration.

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IV. Discussion

The Commission has reviewed the ISE's proposed rule change and finds, for the reasons set forth below, that the proposal is consistent with the requirements of section 6 of the Act³⁸ and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission believes the proposal is consistent with section 6(b)(5) of the Act,³⁹ because it promotes just and equitable principles of trade, removes impediments to and perfects the

mechanism of a free and open market and a national market system, and protects investors and the public interest, by providing objective standards for the ISE to use in correcting executions made as a result of an obvious error and procedures by which ISE staff decisions may be appealed.⁴⁰

The Commission believes that the proposal is a reasonable means by which the Exchange might allocate the costs of obvious error trades. The proposal reasonably balances the concern that one market participant may receive a wind-fall at the expense of another market participant who made an obvious error, with the expectation that market participants not be permitted to reconsider poor trading decisions.

In addition, by providing objective standards for resolving disputes involving obvious errors, the proposal should enhance the proper functioning of the markets. When an obvious error has been made and publicly reported, it is important that the ISE correct these obvious errors as quickly as possible using procedures that are clearly outlined. Thus, for any trade involving a customer, the proposal explicitly provides that the ISE will bust any customer trade that is obviously in error unless the customer agrees to adjust the price. The proposal further delineates and appeals process to the Obvious Error Panel and provides a specified time period in which an appeal can be made. The composition of the Obvious Error Panel will provide for the equal representation of both EAMs and market makers. Moreover, if there is no majority consensus among the panel, the decision of ISE Market Control will stand. In addition, where a panel member is an EAM from a firm that engages in both public customer business and market making activity, the ISE expects that the firm will have information barriers in place to ensure against any inappropriate sharing of information between the public customer side and the market making side of the firm.⁴¹

The Commission finds good cause for approving Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice in the **Federal Register**. In Amendment No. 1, the ISE proposes to change the composition of the Obvious Error Panel to comprise two

Electronic Access Members and two members that are market makers on the Exchange. The ISE also amended the proposed rule change to state that the ISE Market Control, not the Obvious Error Panel, would determine the theoretical price of an option where there are no quotes for comparison purposes. As the changes to the proposal set forth in Amendment No. 1 are directly responsive to the concerns raised by the commenter, the Commission finds that, consistent with section 19(b)(2) of the Act,⁴² good cause exists for approving Amendment No. 1 on an accelerated basis. Accelerated approval of Amendment No. 1 will allow the ISE to expeditiously implement the obvious error procedures set forth in the proposal.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether the proposed amendment 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-00-19 and should be submitted by June 28, 2001.

VI. Conclusion

It Is Therefore Ordered, pursuant to section 19(b)(2) of the Act,⁴³ that the proposed rule change (SR-ISE-00-19), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴⁴

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 01-14332 Filed 6-6-01; 8:45 am]

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⁴⁰ In approving the proposal, the Commission has considered the rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴¹ Telephone conversation between Katherine Simmons, Vice President and Associate General Counsel, ISE, and Susie Cho, Special Counsel, Division, Commission, on May 25, 2001.

⁴² 15 U.S.C. 78s(b)(2).

⁴³ 15 U.S.C. 78s(b)(2).

⁴⁴ 17 CFR 200.30-3(a)(12).

³⁸ 15 U.S.C. 78f.

³⁹ 15 U.S.C. 78f(b)(5).