

any comments it received on the proposed rule change. The test 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

Images and sounds from the Trading Floor are a powerful symbol of the Amex and a valuable asset. The recording of images, sound or data on the Trading Floor also may disrupt the conduct of business. Thus, for example, when recording is allowed on the Trading Floor (as in the Media Booth), the Exchange takes precautions to ensure that trading is not disturbed.

To protect the Amex, the Exchange is proposing that any person that wishes to record images, sound or data on the Trading Floor must first receive written permission from the Exchange to do so. Such permission may be granted on such terms and conditions as the Exchange deems appropriate. The Exchange believes that the proposed rule change is desirable to protect both the Exchange's rights and its interests in ensuring the orderly conduct of business.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act,<sup>4</sup> in general, and section 6(b)(5) of the Act,<sup>5</sup> in particular, which requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

*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 purpose 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

(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 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 Exchange. All submissions should refer to File No. SR-AMEX-2001-56 and should be submitted by February 22, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-45341; File No. SR-CBOE-00-42]

**Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc. Eliminating the Obligation of Designated Primary Market Makers to Accord Priority to Non-Public Customer Orders**

January 25, 2002.

**I. Introduction**

On August 29, 2000, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities Exchange Commission ("SEC" or "Commission"), 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> a proposed rule change to eliminate the obligation of Designated Primary Market Makers ("DPMs") to accord priority to non-public customers over the DPMs' principal transactions. The proposed rule change was published for comment in the **Federal Register** on December 4, 2001.<sup>3</sup> The Commission received no comments on the proposal. On January 8, 2002, the CBOE submitted Amendment No. 1 to the proposed rule change.<sup>4</sup> On January 16, 2002, the CBOE submitted Amendment No. 2 to the proposed rule change.<sup>5</sup> This order approves the proposal, as amended by Amendment No. 2. The Commission also solicits comment on Amendment No. 2 from interested persons.

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

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

<sup>3</sup> See Securities Exchange Act Release No. 45013 (November 26, 2001), 66 FR 63083.

<sup>4</sup> See letter from Steve Youhn, Legal Department, CBOE to Kelly Riley, Senior Special Counsel, Division of Market Regulation ("Division"), Commission, dated January 7, 2002 ("Amendment No. 1"). In Amendment No. 1, the CBOE proposed a definition of "public customer orders."

<sup>5</sup> See letter from Steve Youhn, Legal Department, CBOE to Kelly Riley, Senior Special Counsel, Division, Commission, dated January 14, 2002 ("Amendment No. 2"). In Amendment NO. 2 CBOE proposed to define the term "public customer" in proposed Interpretation .03 of CBOE Rule 8.85. Amendment No. 2 supersedes and replaces Amendment No. 1 in its entirety. Telephone conversation between Steven Youhn, Legal Division, CBOE, and Kelly Riley, Senior Special Counsel, Division, Commission, on January 14, 2002. On January 18, 2002, CBOE consented to an extension of time for Commission action until January 25, 2002. See letter from Steve Youhn, Legal Department, CBOE, to Kelly Riley, Senior Special Counsel, Division, Commission, dated January 18, 2002.

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

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

<sup>6</sup> 17 CFR 200.30-3(a)(12).

## II. Description of the Proposal

The CBOE proposes to amend CBOE Rule 8.85 (DPM Obligations) regarding the obligations of DPMs to represent orders. Currently, CBOE Rule 8.85(b)(iii) requires a DPM to accord priority to any order, that the DPM represents as agent over the DPM's principal transactions, unless the customer who placed the order has consented to not being accorded such priority. The CBOE proposes to amend CBOE Rule 8.85(b)(iii) to require DPMs to accord priority only to public customer orders. In Amendment No. 2 the CBOE proposes to add Interpretation .03 to CBOE Rule 8.85 to define a public customer order as not including any order in which a member, non-member participant in a joint venture with a member, or any non-member broker dealer has an interest. Accordingly, CBOE proposes to exclude these orders from a DPM's obligation under Exchange rules to accord priority.

## III. Commission Findings and Order Granting Accelerated Approval of the Proposed Rule Change

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>6</sup> The Commission's approval of CBOE's proposal to amend its Rule 8.85 to eliminate a DPM's obligation, *pursuant to CBOE rules*, to accord priority under all circumstances to certain orders is based solely on its determination that this proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange. The Commission is making no determination as to whether a DPM's failure to accord priority to non-public customer orders, when the DPM is acting as an agent, is consistent with the federal securities laws or any other applicable law. Accordingly, the Commission's approval of CBOE's proposal does not affect a DPM's fiduciary obligations under federal securities laws or agency law principles when it acts as an agent.<sup>7</sup>

<sup>6</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>7</sup> Pursuant to agency law principles, a DPM that acts as agent for any customer has an obligation to act solely for the benefit of the customer in all matters connected with the customer's order, *see* Restatement (Second) of Agency § 387 (1958), and not compete with the customer concerning the customer's order unless the customer understands its agent is to compete, *see* Restatement (Second) of Agency § 393 (1958). *See also In re E.F. Hutton & Company*, Securities Exchange Act Release No.

Currently, by requiring DPMs to accord priority to all customer orders pursuant to its Rule 8.85, unless the customer who placed the order has consented to not being accorded such priority, the CBOE creates an obligation on DPMs under Exchange rules in addition to the DPM's obligations under Federal securities laws and agency law. Accordingly, the result of CBOE's proposal is to no longer make a DPM's failure to accord priority to non-public customer orders for which it acts as agent a CBOE rule violation. The CBOE's proposal, however, does not affect a DPM's obligations to orders for which it acts as agent under Federal securities laws or any other applicable laws.

The Commission found in its Manning Decision that broker-dealers owe a fiduciary duty to their limit order customers not to trade ahead of these orders unless the customer knows of the firm's limit order policy.<sup>8</sup> After the Commission issued its Manning Decision, the NASD filed a proposed rule change stating that a member firm would not be deemed to violate NASD Rules of Fair Practice if it provides to customers a statement setting forth the circumstances in which the firm accepts limit orders and the policies and procedures the firm follows in handling these orders.<sup>9</sup> As part of this filing, the NASD proposed model disclosure language to be used by firms whose policy was not to grant priority to customer limit orders over the member's own proprietary trading.

This proposal was never approved by the Commission and was withdrawn by the NASD at the time it submitted a proposed rule change to prohibit member firms from trading ahead of their customers' limit orders in their market making capacity.<sup>10</sup> In approving this subsequent NASD proposal, the Commission expressed concern that the prohibition did not extend to trading ahead of limit orders of other firms' customers that had been sent to the market maker for execution.<sup>11</sup> Shortly thereafter, the Commission proposed its

25887 (July 6, 1988) ("Manning Decision"). In its opinion, the Commission noted that "absent disclosure and a contrary agreement a fiduciary cannot compete with his beneficiary with respect to the subject matter of their relationship \* \* \*".

<sup>8</sup> *See supra* note 7.

<sup>9</sup> *See* Securities Exchange Act Release No. 26824 (May 15, 1989), 54 FR 22046 (May 22, 1989).

<sup>10</sup> *See* Securities Exchange Act Release No. 33697 (March 1, 1994), 59 FR 45 (March 8, 1994) ("Manning I").

<sup>11</sup> *See* Securities Exchange Act Release No. 34279 (June 29, 1994), 59 FR 34883 (July 7, 1994). *See also* Division of Market Regulation, SEC, Market 2000: An Examination of Current Equity Market Developments, V-8 (1994).

own rule to prohibit any market maker in Nasdaq National Market securities from trading ahead of the orders of other firms' customers sent to it for execution.<sup>12</sup>

Shortly after the Commission's publication of its proposal, the NASD filed a proposed rule change to prohibit its member firms from trading ahead of the orders of other firms' customers, which the Commission approved.<sup>13</sup> In its approval order of Manning II, the Commission also noted that:

"In a typical agency relationship, disclosure often is relied upon as an adequate means of resolving a conflict of interest between an agent and its principal. *Cite omitted*. Investors enjoy greater protection under the federal securities laws, however, than that afforded by common law; a general common law remedy of disclosure does not always suffice.<sup>14</sup> A stricter duty may be imposed where, as here, the principles are investors and the agents control access to the trading market."

While the NASD's limit order protections only extend to non-broker-dealer customers, the Commission questioned why the provisions of the rule should not be extended to limit orders placed by other broker-dealers, including options specialists and registered options traders. Further, the Commission specifically noted that it expected the NASD to consider extending the scope of limit order protections to orders of options specialists and market makers.<sup>15</sup>

More recently, the Commission approved a New York Stock Exchange ("NYSE") proposal to prohibit NYSE members from trading along with their customers except in limited circumstances.<sup>16</sup> NYSE Rule 92 significantly restricts NYSE members'

<sup>12</sup> *See* Securities Exchange Act Release No. 34753 (September 29, 1994), 59 FR 50867 (October 6, 1994). The Commission's proposal was never adopted.

<sup>13</sup> *See* Securities Exchange Act Release No. 35751 (May 22, 1995), 60 FR 27997 (May 26, 1995) ("Manning II").

<sup>14</sup> *See e.g., Herman & MacLean v. Huddleston*, 459 U.S. 375, 389 (1983) ("An important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common law protection by establishing higher standards of conduct in the securities industry.")

<sup>15</sup> *See* Manning II, *supra* note 12.

<sup>16</sup> *See* Securities Exchange Act Release No. 44139 (March 30, 2001), 66 FR 18339 (April 6, 2001). Specifically, members are only permitted to enter certain types of proprietary orders, such as liquidating positions in proprietary facilitation accounts, bona fide hedges, bona fide arbitrages and risk arbitrages, while representing a customer's order that could be executed at the same price, so long as the order is not for an individual investor and the customer has given express permission, which must include an understanding of the relative price and size of the allocated execution reports.

ability to enter orders to buy or sell NYSE-listed securities for any account in which such member is interested, if the person responsible for the entry of such order has knowledge of any particular unexecuted customer order to buy or sell the same security that could be executed at the same price. In its approval order, the Commission noted that proprietary trading exceptions "did not minimize the importance of a broker-dealers' duty to their customers, which requires broker-dealers to place investors' interests before their own. On the contrary," the Commission continued, "member and member organizations remain obligated to consider their customers' interest in every customer transaction."<sup>17</sup>

#### *Amendment No. 2*

The Commission finds good cause, consistent with Section 19(b)(2) of the Act,<sup>18</sup> to approve Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. The Commission notes that the notice that was published in the **Federal Register**<sup>19</sup> discussed CBOE's intent to define "public customer orders." Therefore, the CBOE's proposed definition was subject to notice and comment. Accordingly, the Commission believes good cause exists, pursuant to Sections 6(b)(5) and 19(b) of the Act<sup>20</sup> to accelerate approval of Amendment No. 2 to the proposed rule change.

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 2, including whether it 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 filing will also be

available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-00-42 and should be submitted by February 22, 2002.

#### **V. Conclusion**

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>21</sup> that the proposed rule change (SR-CBOE-00-42) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>22</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-45337; File No. SR-ISE-2002-02]

#### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the International Securities Exchange LLC, Relating to an Extension of the Interim Intermarket Linkage Program**

January 25, 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 January 16, 2002, the International Securities Exchange LLC ("Exchange" or "ISE") 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 the ISE. The Exchange filed this proposal under section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. 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 ISE is proposing to extend the effective date of its rules providing for an "interim linkage" from January 31, 2001 to the earlier of: January 31, 2003;

or the complete implementation of the permanent intermarket linkage in the options market.<sup>5</sup>

#### **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 ISE 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 ISE 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

On January 30, 2001, the Commission approved rules of the ISE permitting the ISE to implement an "interim linkage" with the other options exchanges.<sup>6</sup> The interim linkage utilizes existing order types to permit market makers on each of the exchanges to send orders to their counterparts on the other exchanges. Interim linkage orders are treated as "customer" orders upon receipt on an exchange and, thus, are eligible for automatic execution and similar processing efficiencies.

The options exchanges implemented the interim linkage pending completion of a permanent linkage. That linkage will provide enhanced connectivity between the markets and will have additional rules and mechanisms to help investors achieve best execution of their orders. While work continues on the permanent linkage, the ISE currently does not believe that it will be implemented until late this year. At the same time, the ISE's interim linkage rules will expire on January 31, 2002. ISE believes that the interim linkage has worked well and that it will benefit investors to continue operation of this linkage pending completion of the permanent linkage. The purpose of the proposed rule change is to extend the effectiveness of these rules until the full implementation of the permanent linkage or January 31, 2003, whichever comes first.

<sup>5</sup> The Commission approved the Plan for the Purpose of Creating and Operating an Intermarket Options Linkage ("Linkage Plan") in July 2000. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000).

<sup>6</sup> Securities Exchange Act Release No. 43904 (January 30, 2001), 66 FR 9112 (February 6, 2001) (File No. SR-ISE-00-15).

<sup>17</sup> See *supra* note 16.

<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> See *supra* note 3.

<sup>20</sup> 15 U.S.C. 78f(b)(5) and 15 U.S.C. 78s(b).

<sup>21</sup> 15 U.S.C. 78s(b)(2).

<sup>22</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. 78s(b)(3)(A).

<sup>4</sup> CFR 240.19b-4(f)(6). The ISE requested that the Commission waive the 30-day operative delay. The ISE provided the Commission with notice of its intention to file this proposal on January 14, 2002.