

limiting the exposure of order senders to potential inferior execution in a volatile market. In addition, the Commission finds that establishing a five-second minimum life period for both Directed Orders in SuperMontage and for SelectNet orders should help to provide clarity and uniformity of minimum order life parameters across both systems during the phase-in period.<sup>9</sup> Nasdaq expects to implement both rule changes on July 1, 2002.

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (SR-NASD-2002-55) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority,<sup>11</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46025; File No. SR-NASD-2002-70]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. Regarding Replacement Hearing Officers' Authority to Participate in Hearing Panel Decisions

June 4, 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 31, 2002, the National Association of Securities Dealers, Inc. ("NASD"), through its wholly owned subsidiary, NASD Regulation, Inc. ("NASD Regulation"), 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 Regulation. NASD Regulation filed the proposal pursuant to 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.<sup>5</sup> 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 Regulation proposes to amend NASD Procedural Rules 9231 and 9233 to clarify a replacement Hearing Officer's authority when he or she is appointed after a hearing has begun or been concluded. The text of the proposed rule is below. Proposed new language is in italics.

9231. Appointment by the Chief Hearing Officer of Hearing Panel or Extended Hearing Panel *or Replacement Hearing Officer*

(a) No Change.

(b) Hearing Panel.

The Hearing Panel shall be composed of a Hearing Officer and two Panelists, except as provided in *paragraph (e) and in Rule 9234 (a), (c), (d), or (e)*. The Hearing Officer shall serve as the chair of the Hearing Panel. Each Panelist shall be associated with a member of the Association or retired therefrom.

(1) through (2) No Change.

(c) through (d) No Change.

(e) *Appointment of Replacement Hearing Officer.*

*In the event that a Hearing Officer withdraws, is incapacitated, or otherwise is unable to continue service after being appointed, the Chief Hearing Officer shall appoint a replacement Hearing Officer. To ensure fairness to the parties and expedite completion of the proceeding when a replacement Hearing Officer is appointed after the hearing has commenced, the replacement Hearing Officer has discretion to exercise the following powers:*

(1) *Allow the Hearing Panelists to resolve the issues in the proceeding and issue a decision without the participation of the replacement Hearing Officer in the decision. The replacement Hearing Officer may advise the Hearing Panelists regarding legal issues, and shall exercise the powers of the Hearing Officer under Rule 9235(a), including preparing and signing the*

*decision on behalf of the Hearing Panel, in accordance with Rule 9268; or*

(2) *Certify familiarity with the record and participate in the resolution of the issues in the case and in the issuance of the decision. In exercising this power, the replacement Hearing Officer may recall any witness before the Hearing Panel.*

\* \* \* \* \*

9233. Hearing Panel or Extended Hearing Panel: Recusal and Disqualification of Hearing Officers

(a) Recusal, Withdrawal of Hearing Officer.

If at any time a Hearing Officer determines that he or she has a conflict of interest or bias or circumstances otherwise exist where his or her fairness might reasonably be questioned, the Hearing Officer shall notify the Chief Hearing Officer and the Chief Hearing Officer shall issue and serve on the Parties a notice stating that the Hearing Officer has withdrawn from the matter. In the event that a Hearing Officer withdraws, is incapacitated, or otherwise is unable to continue service after being appointed, the Chief Hearing Officer shall appoint a replacement Hearing Officer. *In such a case, the replacement Hearing Officer shall proceed according to Rule 9231(e).*

(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, NASD Regulation included statements concerning the purpose of and basis for its proposal and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in Item IV below. NASD Regulation 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

The proposed amendments clarify a replacement Hearing Officer's authority when he or she is appointed after a hearing has begun or been concluded. For various reasons, Hearing Officers are sometimes unable to finish hearings and participate in the issuance of decisions. NASD Code of Procedure Rule 9233 provides that the Chief Hearing Officer shall appoint a replacement Hearing

<sup>9</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 to govern both systems.

<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</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> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> NASD Regulation asked the Commission to waive the 30-day operative delay. 17 CFR 240.19b-4(f)(6).

Officer. The rule does not, however, delineate the replacement Hearing Officer's powers when he or she is appointed after a hearing has begun or been concluded. The proposed amendments to Rules 9231 and 9233 clarify a replacement Hearing Officer's authority in such situations.<sup>6</sup>

In part, the proposed amendments respond to an ambiguity in the current rules that was highlighted by the National Adjudicatory Council's ("NAC") recent decision in *U.S. Rica Financial, Inc.*, Complaint No. C01000003 (NAC Oct. 26, 2001). In that case, the Hearing Officer designated as a member of the Hearing Panel left the NASD after the record in the matter had closed but before a decision had been issued. A replacement Hearing Officer was then appointed, and the decision was issued. The decision made clear that the replacement Hearing Officer had not taken part in the decision, which reflected the determinations of the remaining two members of the Hearing Panel. On appeal, the NAC remanded the matter for a rehearing based on the current rules' ambiguity in such a situation.

The proposed amendments would allow, in appropriate cases, the remaining Hearing Panelists to resolve the issues in the proceeding and issue a decision without the participation of the replacement Hearing Officer in the decision. In that scenario, the replacement Hearing Officer may advise the Hearing Panelists regarding legal issues and prepare and sign the decision on behalf of the Hearing Panel.<sup>7</sup> The amendments, however, also would allow the replacement Hearing Officer the discretion to participate in the resolution of the issues in the case and in the issuance of the decision if he or she certifies familiarity with the record.<sup>8</sup>

<sup>6</sup> NASD Regulation notes that the Chief Hearing Officer will promptly notify the parties of the appointment of the replacement Hearing Officer. In general, the parties also should be provided an opportunity to comment on the manner in which the matter should proceed.

<sup>7</sup> Industry representatives have always had a central role in bringing their securities industry expertise to bear on the NASD's disciplinary process. The NASD procedural rules recognize that role by providing that industry representatives shall constitute a majority of each hearing panel. The current amendments also recognize that central role by making clear that, under paragraph (e)(1) of Rule 9231, the remaining Hearing Panel members may, in appropriate circumstances, decide the case and issue the decision with the assistance of the replacement Hearing Officer regarding legal issues and drafting of the decision.

<sup>8</sup> To certify familiarity with the record, the replacement Hearing Officer must read and consider all relevant portions of the record. NASD Regulation anticipates that, in most cases, certification will be made by written order signed by the replacement Hearing Officer (although

In exercising this power, the replacement Hearing Officer could recall any witness before the Hearing Panel.<sup>9</sup> The proposed amendments would provide a replacement Hearing Officer with discretion, and thus flexibility, to deal with various situations. That discretion, of course, is not unfettered, as the NAC and the Commission could reverse a replacement Hearing Officer determination based on an abuse of discretion.<sup>10</sup>

## 2. Statutory Basis

NASD Regulation believes that the proposal is consistent with the provisions of sections 15A(b)(6)<sup>11</sup> and 15A(b)(8)<sup>12</sup> of the Act. Section 15A(b)(6) of the Act requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect

certification could be made by written correspondence or oral representation transcribed by a court reporter).

<sup>9</sup> If the replacement Hearing Officer determines to proceed under paragraph (e)(2) of Rule 9231, he or she normally should afford the parties an opportunity to suggest which, if any, witnesses they believe should be recalled. Although the decision to recall witnesses is left to the sound discretion of the replacement Hearing Officer, if the replacement Hearing Officer determines not to recall any witnesses, he or she must have sufficient confidence in the existing record to be able to resolve the case on a fair and reasoned basis.

NASD Regulation recognizes that a witness who is recalled might be unavailable or, if available, might change his or her previous testimony. These potential complications, however, are not unique to the proposed amendments, and hearing panels and courts have a long tradition of dealing with these types of situations. If the replacement Hearing Officer who proceeds under Rule 9231(e)(2) directs that a witness who testified at the hearing be recalled, the party who sponsored the witness will be responsible for producing the witness or establishing that the witness is unavailable. If the party fails to do so, the Hearing Panel may disregard the prior testimony. Where a witness is shown to be unavailable, the replacement Hearing Officer would have to rely on the transcripts of the witness's testimony. Where an available witness is recalled but testifies differently during the subsequent hearing, the parties may impeach the witness with his or her prior inconsistent statement(s). The trier of fact would then take those inconsistencies into account when determining how much weight, if any, to give to the witness's testimony.

<sup>10</sup> For example, depending on the facts and circumstances of the particular case, a replacement Hearing Officer who proceeds under Rule 9231(e)(2) likely would abuse his or her discretion by refusing to recall a witness whose testimony he or she had not heard where such testimony is material and disputed and where the witness is available to testify without undue burden. Conversely, a replacement Hearing Officer likely would not abuse his or her discretion by relying on evidence heard by a predecessor Hearing Officer when the particular testimony is undisputed or immaterial or when a witness has become unavailable.

<sup>11</sup> 15 U.S.C. 78o-3(b)(6).

<sup>12</sup> 15 U.S.C. 78o-3(b)(8).

investors and the public interest. Section 15A(b)(8) states, in pertinent part, that the NASD's rules must provide a fair procedure for the disciplining of members and persons associated with members.

NASD Regulation believes the proposed rule change clarifies NASD Procedural Rules 9231 and 9233 with regard to a replacement Hearing Officer's authority to participate in a Hearing Panel's decision. Under the current rules, when a Hearing Officer withdraws, is incapacitated, or otherwise is unable to continue service, the Chief Hearing Officer appoints a replacement Hearing Officer under Rule 9233. That rule, however, presently does not describe the powers of a replacement Hearing Officer who is appointed after a hearing has begun or been concluded. By clarifying replacement Hearing Officers' powers in such situations, NASD Regulation believes the proposed rule change promotes the fair and efficient resolution of disciplinary cases and thus furthers the purposes of the Act.

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

NASD Regulation does not believe that the proposed rule change will result in 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

Written comments were neither solicited nor received.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not:

- (i) Significantly affect the protection of investors or the public interest;
- (ii) Impose any significant burden on competition; and

(iii) Become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to section 19(b)(3)(A) of the Act<sup>13</sup> and Rule 19b-4(f)(6) thereunder.<sup>14</sup> At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors,

<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> 17 CFR 240.19b-4(f)(6).

or otherwise in furtherance of the purposes of the Act.

NASD Regulation has requested that the Commission waive the 30-day operative delay. The Commission finds good cause to waive the 30-day operative delay because such designation is consistent with the protection of investors and the public interest. Acceleration of the operative date will ensure that the clarifying amendments outlined in this proposed rule change are not needlessly delayed. For these reasons, the Commission finds good cause to waive the 30-day operative waiting period.<sup>15</sup>

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal 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 NASD. All submissions should refer to file number SR-NASD-2002-70 and should be submitted by July 1, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45997; File No. SR-NASD-2002-58]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by National Association of Securities Dealers, Inc. Relating to Temporary Approval of the Primex Auction System®

May 29, 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 30, 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 ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. Nasdaq filed Amendment No. 1 with the Commission on May 28, 2002.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.<sup>4</sup>

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

Nasdaq proposes to continue operating Nasdaq's application of the Primex Auction System® ("Primex" or "System"). The System began operating as a Pilot Trading System on December 17, 2001, pursuant to Rule 19b-5 of the Act.<sup>5</sup> Pursuant to paragraph (f) of Rule 19b-5 of the Act,<sup>6</sup> Nasdaq is filing this proposed rule change effective immediately so that it can continue

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

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

<sup>3</sup> See letter from Peter R. Geraghty, Associate Vice President and Associate General Counsel, Nasdaq, to Katherine England, Assistant Director, Division of Market Regulation, Commission, dated May 1, 2002 ("Amendment No. 1"). In Amendment No. 1, Nasdaq removed language under NASD Rule 5013(c)(2) that was inadvertently included in its initial filing. Nasdaq originally removed this language in Amendment No. 1 to Nasdaq's Form PILOT filing for Primex.

<sup>4</sup> This proposed rule change, absent Amendment No. 1, was previously published in the **Federal Register**. See Securities Exchange Act Release No. 45982 (May 23, 2002). However, the Commission notes that although Amendment No. 1 is dated May 1, 2002, the Commission did not receive Amendment No. 1 until May 28, 2002, after publication of the initial proposed rule change. The Commission now publishes the proposed rule change, as amended by Amendment No. 1, for public comment.

<sup>5</sup> 17 CFR 240.19b-5.

<sup>6</sup> 17 CFR 240.19b-5(f).

operating the System until the Commission grants permanent approval. Nasdaq has filed a companion proposed rule change which seeks permanent approval of Primex.<sup>7</sup> The proposed rule language contained in the companion filing and set forth below is identical and is the same language that governs use of the System today.

5010. NASDAQ Application of the PRIMEX AUCTION SYSTEM®

5011. Definitions

For purposes of this Rule Series, unless the context requires otherwise:

(a) "Application" or "Nasdaq Application" as used in this Rule Series, and "Nasdaq Application of the Primex Auction System" as used throughout the NASD Rules means the voluntary Nasdaq trading service facility that permits NASD member firms, among other things, to submit orders in Primex Eligible Securities to be exposed to a Crowd of Participants in an anonymous, electronic auction format for the purpose of obtaining an execution for their own account or the account of a customer; to have required reports of any resulting trades automatically disseminated to the public and the industry; and to "lock in" these trades as necessary by sending both sides to the applicable clearing agency designated by the Participants involved for clearance and settlement, all in accordance with this Rule Series and other applicable rules and policies of Nasdaq.

(b) "Primex Auction System Participant," "Participant," or "Participant Firm" means a broker-dealer registered with the NASD that, when authorized, can access and participate in the Application for its customers or its own account, consistent with this Rule Series. Participants access the Application through one or more Subscribers associated with that Participant within the Application.

(c) "Subscriber" means a user associated with a Participant who, when authorized, can access and participate in the Application on behalf of that Participant, consistent with this Rule Series. A user also can access and participate directly in the Application on its own behalf, but in the name of a Participant, subject to a sponsored arrangement with that Participant, and consistent with these Rules.

(d) "Firm Administrator" means a Subscriber who, for a particular Participant, is authorized among other things to: (1) monitor and control access

<sup>7</sup> See Securities Exchange Act Release No. 45983 (May 23, 2002) (publishing SR-NASD-2002-60 for notice and comment).

<sup>15</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>16</sup> 17 CFR 200.30-3(a)(12).