

notes that the other options exchanges currently permit BD orders to access their automatic execution systems and the Commission believes that this proposed rule change could enhance competition for BD orders in the options markets.

At any time within 60 days of the filing of such 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, or otherwise in furtherance of the purposes of the Exchange Act.

**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 CBOE. All submissions should refer to File No. SR-CBOE-2002-56 and should be submitted by November 1, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>19</sup> 17 CFR 200.30-3(a)(12).

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-46600; File No. SR-CBOE-2002-39]

**Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the Chicago Board Options Exchange, Inc. To Make Certain Changes Pertaining to the Enforcement of Trading Conduct and Decorum Policies**

October 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 July 15, 2002, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") 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 CBOE. On August 30, 2002, CBOE submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> On September 17, 2002, CBOE submitted Amendment No. 2 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend CBOE Rule 6.20(c) (Admission to and Conduct on the Trading Floor—Fines Imposed by Floor Officials) to authorize two Floor Officials, in consultation with a designated senior executive officer of the Exchange, to summarily exclude a member or person associated with a

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

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

<sup>3</sup> See Form 19b-4 received on August 30, 2002 ("Amendment No. 1"). Amendment No. 1 replaced the original filing in its entirety. In Amendment No. 1, the Exchange clarified that not all Class A offenses qualified the offender for summary exclusion, explained why three types of offenses previously set forth as "Violations of Trading Conduct and Decorum Policies" had been omitted from the proposed list of such violations, clarified that the "rolling look back" period used to determine the appropriate fine for Firm Quote violations will be 24 months, and cross-referenced the appeal procedure for the imposition of fines for minor rule violations.

<sup>4</sup> See letter from Christopher R. Hill, Attorney II, Legal Division, CBOE, to Nancy Sanow, Division of Market Regulation ("Division"), Commission, dated September 16, 2002 ("Amendment No. 2"). In Amendment No. 2, the Exchange underlined the entire subsection of Exhibit B to Amendment No. 2 labeled "Class A Offenses" to reflect that it is new text, and added the offense "Trading in the Aisle" to the subsection of Exhibit B to Amendment No. 2 labeled "Class B Offenses."

member from the Exchange premises for not longer than the remainder of the trading day for any violation of the Exchange's trading conduct and decorum policies that is classified as a Class A offense, except for those Class A offenses specified by Exchange Regulatory Circulars as not qualifying the offender for summary exclusion. The Exchange also proposes to amend CBOE Rule 17.50(g)(6) (Imposition of Fines for Minor Rules Violations—Violations of Trading Conduct and Decorum Policies) to reflect the incorporation into the fine policies of specified higher fine levels for "subsequent" offenses. Finally, the Exchange proposes to issue a new Regulatory Circular setting forth the fines that may be imposed under CBOE Rule 17.50 for violations of CBOE Rule 6.20. The proposed Regulatory Circular also sets forth those violations that may qualify the offender for summary expulsion. Below is the text of the proposed rule change. Proposed new language is italicized; deletions are in brackets.

\* \* \* \* \*

**CHAPTER VI—Doing Business on the Exchange Floor**

*Section B: Member Activities on the Floor*

\* \* \* \* \*

Admission to and Conduct on the Trading Floor; Member Education  
RULE 6.20.

- (a) No Change.
- (b) No Change.
- (c) Fines Imposed by Floor Officials.

The Exchange shall periodically issue fine schedules setting forth which violations of the Exchange's trading conduct and decorum policies are subject to fines pursuant to CBOE Rule 17.50 and the specific dollar amounts of such fines. Floor Officials may (i) fine members and persons employed by or associated with members pursuant to CBOE Rule 17.50 for trading conduct and decorum violations which are subject to fine under such fine schedule, (ii) direct members and persons employed by or associated with members to act or cease to act in a manner to ensure compliance with Exchange Rules and accepted and established standards of trading conduct and decorum and/or (iii) refer violations of the foregoing to the Business Conduct Committee for disciplinary action pursuant to Chapter XVII of the Rules. *In addition, two Floor Officials in consultation with a designated senior executive officer of the Exchange, may summarily exclude a member or person*

associated with a member from the Exchange premises for not longer than the remainder of the trading day for any violation of the Exchange's trading conduct and decorum policies that is classified as a Class A offense, except for those Class A offenses specified by Exchange Regulatory Circulars as not qualifying the offender for summary exclusion. Any action taken by Floor Officials under this paragraph (c) shall not preclude additional disciplinary action by the Business Conduct Committee under Chapter XVII of the Rules. Any application or interpretation of Rules, and any decision to impose a fine under this paragraph (c), shall be agreed upon by at least two Floor Officials. Floor Officials shall file with the Exchange a written report of any action taken pursuant to authority specifically granted them by the Rules and of any interpretation of the Rules.

(d) No Change.

(e) No Change.

\* \* \* Interpretations and Policies:

.01-.09 No Change.

.10 Where a member or person associated with a member is summarily excluded from the trading floor pursuant to Rule 6.20(c), that member or associated person shall have the right to request reinstatement from Floor Officials after a sufficient "cooling-off" period has elapsed. If, in the judgment of two Floor Officials, the member or associated person no longer poses an immediate threat to the safety of persons or property, the member or

associated person shall be permitted to return to the trading floor.

\* \* \* \* \*

**CHAPTER XVII—Discipline**

**RULE 17.50. Imposition of Fines for Minor Rule Violations**

(a)–(f) No Change.

(g) The following is a list of the rule violations subject to, and the applicable fines that may be imposed by the Exchange pursuant to, this Rule:

(1) No Change.

(2) No Change.

(3) No Change.

(4) No Change.

(5) No change.

(6) Violations of Trading Conduct and Decorum Policies. (Rule 6.20)

The Exchange's trading conduct and decorum policies shall be distributed to the membership periodically and shall set forth the specific dollar amounts that may be imposed as a fine hereunder with respect to any violations of those policies. If warranted under the circumstances in the view of two floor officials, the fine authorized under those policies for a second, [or]third or subsequent offense may be imposed for a first offense and the fine authorized for a third or subsequent offense may be imposed for a second offense.

\* \* \* \* \*

(The following Regulatory Circular will supersede and replace RG98-123)

02- Violations of Trading Conduct and Decorum Policies

Date: , 2002

To: Exchange Members and Associated Persons of Member Organizations  
From: Floor Officials Committee

The purpose of this circular is to advise members and their personnel of the provisions of Exchange Rule 17.50, Imposition of Fines for Minor Rule Violations, as they relate to violations of the Exchange's trading conduct and decorum policies under Exchange Rule 6.20, Admission to and Conduct on the Trading Floor.

(1) The Rule. Rule 17.50(g)(6) provides for the imposition of fines for violations of the Exchange's trading conduct and decorum policies under Rule 6.20. The following schedule identifies certain conduct deemed to violate those policies and lists the applicable fines that may be imposed for such violations by the Exchange under Rule 17.50(g)(6). Please be advised that Rule 17.50(g)(6) enables the Exchange, if warranted under the circumstances, to impose for a first offense the fine authorized for a second, third or subsequent offense; to impose for a second offense the fine authorized for a third or subsequent offense; and to impose for a third offense the fine authorized for a subsequent offense.

(2) Two Floor Officials may impose a summary fine in a rolling twelve month period (except for firm quote violations, which will be assessed using a 24-month look back period) not to exceed \$5,000 for violative conduct classified as a Class A offense within the following ranges:

1st Offense	2nd Offense	3rd Offense	Subsequent Offenses
\$500 to \$1,500 .....	\$1,000 to \$3,000 .....	\$2,000 to \$5,000 .....	\$3,500 to \$5,000

(3) Two Floor Officials may impose a summary fine in a rolling twelve month period not to exceed \$2500.00 for

violative conduct classified as a Class B offense within the following ranges:

1st Offense	2nd Offense	Subsequent Offenses
\$100 to \$500 .....	\$500 to \$1,000 .....	\$1,000 to \$2,500

**TRADING CONDUCT AND DECORUM VIOLATIONS**

**Class A Offenses:**

- Physical Violence (Shoving, Fighting)
- Unbusinesslike Conduct
- Harassment (as set forth in Exchange Rule 4.19)
- Failure to Abide by a Floor Official Determination
- Property Damage (plus repair or replacement costs)

• Enabling/Assisting Suspended Member or Associated Person to Gain Improper Access to Floor

- Failure to Supervise a Visitor
- Failure to Attend Exchange Mandated Educational Training ‡
- Effecting or Attempting to Effect a Transaction with No Public Outcry ‡
- Violation of Rule 8.51 (Firm Quote)<sup>5</sup> ‡

<sup>5</sup> In any Rolling Twenty-Four Month "Look-Back" Period.

‡ Does not qualify the offender for summary exclusion pursuant to Exchange Rule 6.20(c).

**Class B Offenses:**

- Abusive Language
- Abusing Exchange Property (no damage)
- Dress Code Violation
- Failure to Display I.D.
- Food or Drink on Floor
- Gaining or Enabling Improper Access to Floor

- Improper Use of Runners' Aisle
- Smoking in Unauthorized Areas
- Running
- Impermissible Use of Member

#### Phones

- Visitor Badge Returned Late or Not Returned
- Failure of Market-Maker to Respond to Request for Market by Order Book Official or to Bid or Offer within Ranges Specified by Rule 8.7(b)
- DPM Failure to Activate or Deactivate RAES

(2) *Floor Officials. Fines under Rule 17.50(g)(6) may be imposed upon the determination of two Floor Officials that the person fined has committed any of the 4 trading conduct and decorum violations enumerated in the fine schedule above. Any application or interpretation of the Rules relating to conduct on Exchange premises shall be agreed upon by at least two Floor Officials. Floor Officials shall file with the Exchange a written report of any action taken pursuant to authority specifically granted them by the Rules and of any interpretation of the Rules.*

(3) *Persons Subject to Fine. The Exchange may impose the preceding fines against either or both of the following: (a) the individual responsible for the subject violation and/or (b) if such individual is employed by or associated with a member, the member and/or any supervisory personnel of the member that failed to adequately supervise such individual to ensure compliance with Exchange rules. Any member or supervisory person who is fined more than one (1) time in any twelve month period for failure to supervise shall be subject to the fines specified above for second offenses, third offenses and subsequent offenses, regardless of the number of offenses committed by the individual subject to fine for the underlying violation.*

(4) *Right to Contest Fines. Any person against whom a fine is imposed pursuant to Rule 17.50(g)(6) may contest that fine. Specifically, fines imposed under Rule 17.50(g)(6) that do not exceed \$2,500 may be contested before the Appeals Committee in accordance with the provisions of Rule 17.50(d), and fines imposed under Rule 17.50(g)(6) that exceed \$2,500 may be contested before the Business Conduct Committee in accordance with the provisions of Rule 17.50(c). Persons wishing to contest such fines must comply with the deadlines and all other requirements set forth in Rule 17.50(d) or Rule 17.50(c), as applicable. Please be advised that if a fine imposed under Rule 17.50(g)(6) is contested and the reviewing body finds that the person fined committed the rule violation(s)*

*alleged, the reviewing body may impose any one or more of the disciplinary sanctions authorized by the Exchange's Constitution and Rules, including but not limited to a higher fine than the fine imposed pursuant to Rule 17.50(g)(6). In addition, if a person contests a fine imposed under Rule 17.50(g)(6) and the fine is upheld by the reviewing body, the reviewing body will impose a forum fee against the person in the amount of \$100 if the reviewing body's determination was reached without a hearing, or in the amount of \$300 if a hearing was conducted.*

(5) *Additional Floor Official Action. In addition to, or instead of, issuing a fine pursuant to Rule 17.50(g)(6), Rule 6.20(c) provides that Floor Officials may direct members and their associated persons to act or cease to act in a manner to ensure compliance with Exchange Rules and accepted and established standards of trading conduct and decorum and/or refer violations of the foregoing to the Business Conduct Committee for disciplinary action pursuant to Chapter XVII of the Rules. Furthermore, any action taken by Floor Officials under Rules 17.50(g)(6) and 6.20(c) does not preclude additional disciplinary action by the Business Conduct Committee under Chapter XVII. In addition, as set forth in Rule 6.20(c), two Floor Officials in consultation with a designated senior executive officer of the Exchange, may summarily exclude a member or person associated with a member from the Exchange premises for not longer than the remainder of the trading day for any violation of the Exchange's trading conduct and decorum policies that is classified as a Class A offense.*

*Any questions in connection with this circular should be directed to Andrew Spiwak of the Legal Division at (312) 786-7483 or to Rod Ely of the Trading Floor Liaison Group at (312) 786-7794.*

(RG98-123, Revised)

\* \* \* \* \*

## **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 CBOE 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 CBOE 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

#### *Temporary Exclusion*

The Exchange proposes to amend CBOE Rule 6.20(c) (Admission to and Conduct on the Trading Floor—Fines Imposed by Floor Officials) to authorize two Floor Officials, in consultation with a designated senior executive officer of the Exchange, to summarily exclude a member or person associated with a member from the Exchange premises for not longer than the remainder of the trading day for any violation of the Exchange's trading conduct and decorum policies that is classified as a Class A offense, except for those Class A offenses specified by Exchange Regulatory Circulars as not qualifying the offender for summary exclusion.

Class A offenses are the most serious offenses against trading conduct and decorum policies, including but not limited to violations such as physical violence (e.g., shoving or fighting), unbusinesslike conduct,<sup>6</sup> harassment, failure to abide by a floor official determination, or property damage. Most Class A offenses affect the safety or security of personnel and/or property on the Exchange in ways that may be ameliorated by temporarily excluding the offender from Exchange premises. The Exchange also proposes that members be summarily excluded from Exchange premises for enabling or assisting a suspended member or associated person to gain improper access to the floor, and failing to supervise a visitor. As specified in the proposed Regulatory Circular, the Exchange currently proposes to distinguish three Class A offenses as not qualifying the offender for summary exclusion. These are (1) Failure to Attend Exchange Mandated Educational Training; (2) Effecting or Attempting to Effect a Transaction with No Public Outcry; and (3) Violation of CBOE Rule 8.51 (Firm Quote). These offenses are so categorized because unlike the other Class A offenses, they do not raise significant issues of safety or security at the Exchange.

The Exchange believes that it is important for Floor Officials, in consultation with a designated senior Exchange executive, to have the

<sup>6</sup>In general, "unbusinesslike conduct" is conduct, other than harassment, that disrupts trading. Telephone call between Christopher R. Hill, Attorney II, Legal Division, CBOE, and Jennifer Lewis, Attorney, Division, Commission, on September 30, 2002.

authority to temporarily exclude certain such violators from the Exchange premises, in order to be able to defuse volatile situations, safeguard trading floor personnel and facilities, and minimize disruptions to the maintenance of fair and orderly markets. The proposed rule will enable an excluded 5 member or associated person to request reinstatement to the Trading Floor from Floor Officials after a sufficient "cooling off period" has elapsed.

The Exchange represents that this part of its proposal is closely patterned on Article XII, Rule 3(c) of the Rules of the Chicago Stock Exchange.

#### *Penalties for Violations of Trading Conduct and Decorum Policies*

The Exchange also proposes to amend CBOE Rule 17.50(g)(6) (Imposition of Fines for Minor Rules Violations—Violations of Trading Conduct and Decorum Policies) to reflect the incorporation into the fine policies of specified higher fine levels for "subsequent" offenses. For example, the amended provision would enable the imposition of the fine authorized for a Class A "subsequent" offense to be imposed for a first, second or third Class A offense, if such is deemed warranted under the circumstances in the view of two floor officials.<sup>7</sup> The Exchange believes this update will help Exchange officials safeguard people, property, and fair and orderly markets at the Exchange by enabling them to impose fine levels for violations of Trading and Decorum Policies that are most appropriate to the circumstances of particular offenses.

#### *Regulatory Circular*

The Exchange proposes to issue a new Regulatory Circular to update and replace Regulatory Circular RG 98-123, and classify trading conduct and decorum offenses as either Class A or Class B offenses. The Exchange believes the schedule of offenses is consistent with the recently revised Minor Rule Violation Plan.<sup>8</sup>

The Exchange notes that it has added the violation "DPM Failure to Activate or Deactivate RAES" to the new proposed regulatory circular in order to encourage DPM's to comply with their obligations under Exchange Rule 6.8 (RAES Operations).<sup>9</sup>

<sup>7</sup> The amended provision would also enable the imposition of the fine authorized for a Class B "subsequent" offense to be imposed for a first or second Class B offense, if such is deemed warranted under the circumstances in the view of two floor officials.

<sup>8</sup> See Securities Exchange Act Release No. 45571 (March 15, 2002), 67 FR 13382 (March 22, 2002).

<sup>9</sup> Telephone call between Christopher R. Hill, Attorney II, Legal Division, CBOE, and Jennifer

The Exchange notes the following reasons why three types of offenses previously set forth as "Violations of Trading Conduct and Decorum Policies" in RG-98-123 are omitted from the list of such violations in the new proposed regulatory circular. First, "Disruptive Announcements of Stock Prints" are no longer a focus of regulatory concern due to technological advances that have changed and improved the dissemination of such information. Second, "Failure to Abide by Floor Official Request for Information," has been omitted because it is now deemed to be included within the broader offense entitled "Failure to Abide by Floor Official Determination." Finally, "Book Priority Violations" are no longer included in the list of Trading Conduct and Decorum violations because under a recent Exchange rule change approved by the SEC, (Securities Exchange Act Release No. 34-45571, 67 FR 13382 (March 15, 2002), approving SR-CBOE-2001-71), such violations are now addressed separately in CBOE Rule 17.50(g)(5).

The Exchange also proposes that as set forth in the first footnote of the proposed regulatory circular, the "rolling look back" period used to determine the appropriate fine for Firm Quote violations will be 24 months.<sup>10</sup>

Finally, the Exchange notes that the appeal procedure for the imposition of fines for minor rule violations as set forth in CBOE Rule 17.50(d)(1) is described in paragraph (4) in the proposed draft regulatory circular.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>11</sup> in general, and furthers the objectives of Sections 6(b)(5)<sup>12</sup> and 6(b)(7)<sup>13</sup> of the Act, in particular, because the proposed rule change will refine and enhance the Exchange's Minor Rule Violation Plan to make it more efficient and effective. The Exchange believes the proposed rule change is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to transactions in securities, to protect investors and the public interest, and enhances the effectiveness and fairness of the Exchange's disciplinary procedures.

Lewis, Attorney, Division, Commission, on October 3, 2002.

<sup>10</sup> See note 5 *supra*.

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

<sup>12</sup> 15 U.S.C. 78f(b)(5).

<sup>13</sup> 15 U.S.C. 78f(b)(7).

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

The CBOE does not believe that the proposed rule change will impose a burden on competition that is not necessary or appropriate in furtherance of 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 CBOE 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, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of CBOE.

All submissions should refer to File No. SR-CBOE-2002-39 and should be submitted by November 1, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

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

[FR Doc. 02-26019 Filed 10-10-02; 8:45 am]

BILLING CODE 8010-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46599; File No. SR-CSE-2002-04]

### Self-Regulatory Organizations; Notice of Filing of Amendment Nos. 1 and 2 to a Proposed Rule Change by the Cincinnati Stock Exchange, Inc. Relating to the Introduction of Order Delivery and Automated Response

October 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 April 22, 2002, the Cincinnati Stock Exchange, Inc. ("CSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change. The proposed rule change was published for comment in the **Federal Register** on May 10, 2002.<sup>3</sup> On September 13, 2002, the CSE filed Amendment No. 1 to the proposed rule change<sup>4</sup> and on September 17, 2002, filed Amendment No. 2 to the proposed rule change.<sup>5</sup> Amendment Nos. 1 and 2 are described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on Amendment Nos. 1 and 2 to the proposed rule change from interested persons.

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

As discussed in the Initial Notice, the Exchange proposed to amend CSE Rule 11.9, National Securities Trading System ("NSTS" or "System"), to modify CSE's execution functionality from a process of automatically matching and executing like-priced

displayed orders and quotes to an optional process of delivering orders to quoting CSE members and requiring automated responses from such members back to the CSE System.<sup>6</sup> The Exchange filed Amendment No. 1 to delete proposed rule language in Paragraph 11.9(i)(2)(a) regarding price/time and agency/principal priorities, which was inadvertently included in the original proposal. The Exchange filed Amendment No. 2 to expand the proposed order delivery and automated response alternative to all securities traded through the Exchange's NSTS, rather than simply Nasdaq National Market Securities. In addition, Amendment No. 2 made certain non-substantive grammatical changes. The text of the proposed rule change, incorporating Amendment Nos. 1 and 2, is set forth below in its entirety. Proposed new language is in italics; proposed deletions are in brackets.

\* \* \* \* \*

#### Chapter XI

##### Trading Rules

##### Rule 11.9(i)

The System [shall automatically match and execute like-priced orders, bids and offers in accordance with the price-time and agency/principal priorities set forth in Rule 11.9(l) and (m).] *offers two modes of order interaction selected by members:*

(1) *If automatic execution is selected, the System shall match and execute like-priced orders, bids and offers on an order by order basis only at the specific instruction of Users, including Designated Dealers.*

(2) *If order delivery and automated response is selected, the System will deliver contra-side orders against displayed orders and quotations on an order by order basis and only at the specific instruction of Users, including Designated Dealers. To be eligible for order delivery service, Users must*

<sup>6</sup> In the Initial Notice, reference was made to a defined term, the CSE Over-the-Counter Unlisted Trading Privileges System ("CSE OTC-UTP System"). This reference created ambiguity, because the term CSE OTC-UTP System is defined in and ostensibly created by a pending CSE rule filing (File No. SR-CSE-2001-04) that has been published in the **Federal Register** for comment, but has not been approved by the Commission. See Securities Exchange Act Release No. 45405 (February 6, 2002), 67 FR 6558 (February 12, 2002). Because of this ambiguity and because of the lack of need for such a defined term in the instant proposal, the Exchange requested that the Commission remove the defined term, CSE OTC-UTP System, from the purpose section of the instant proposal. Telephone discussion between Jeffrey, T. Brown, Vice President, Regulation and General Counsel, CSE, and Katherine England, Assistant Director, and Christopher B. Stone, Attorney Advisor, Division, Commission (October 3, 2002).

*demonstrate to Exchange examiners that the User's system can automatically process the inbound order and respond appropriately within 1 second.*

\* \* \* \* \*

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

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change, as amended. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

##### 1. Purpose

As discussed in the Initial Notice and Amendment Nos. 1 and 2, the purpose of the proposed rule change is to increase the flexibility of CSE execution systems to accommodate member needs. Specifically, CSE proposes to modify CSE's execution functionality within the CSE System from a process of automatically matching and executing like-priced displayed orders and quotes to an optional process of delivering orders to quoting CSE members and requiring automated responses from such members back to the CSE System. CSE is proposing this modification to facilitate a diverse membership base while promoting a fair and orderly market. CSE members that operate as electronic communications networks ("ECNs")<sup>7</sup> or alternative trading systems ("ATSs") subject to SEC Regulation ATS,<sup>8</sup> as well as members that act as Designated Dealers or specialists on CSE will have the option of selecting the type of centralized execution system that best fits their business model.

In an order delivery and automated response system, a member's quotation or displayed order will be held in the CSE System, and when a contra-side order is received in the CSE System, CSE will immediately forward the order

<sup>7</sup> ECNs are defined in SEC Rule 11Ac1-1(a)(8), 17 CFR 240.11Ac1-1(a)(8), as any electronic system that widely disseminates to third parties orders entered therein by an exchange market maker or OTC market maker, and permits such orders to be executed against in whole or in part.

<sup>8</sup> 17 CFR 242.300-303.

<sup>14</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 45873 (May 3, 2002), 67 FR 31856 ("Initial Notice"). No comments have been received on the proposal.

<sup>4</sup> See letter from Jennifer M. Lamie, CSE, to Katherine England, Assistant Director, Division of Market Regulation ("Division"), Commission (September 12, 2002) ("Amendment No. 1").

<sup>5</sup> See letter from Jennifer M. Lamie, CSE, to Katherine England, Assistant Director, Division, Commission (September 16, 2002) ("Amendment No. 2").