

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**

Nasdaq has delayed until January 1, 2003, the implementation of certain fee changes for the Nasdaq Testing Facility ("NTF") established by SR-NASD-2002-72<sup>5</sup> and SR-NASD-2002-73.<sup>6</sup> There is no proposed rule language.

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

In its filing with the Commission, Nasdaq included statements concerning the purpose of and basis for 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. Nasdaq has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

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

The purpose of the proposed rule change is to notify the Commission and other interested parties of the delay until January 1, 2003, of the implementation of certain fee changes for the NTF. The fee changes were established by SR-NASD-2002-72 and SR-NASD-2002-73. In those filings, Nasdaq, among other things, amended rule 7050(d)(1) to apply the hourly testing fees for use of the NTF to testing of Nasdaq Workstation II ("NWII") application programming interface ("API") and market data vendor feeds. The hourly testing fees had formerly applied only to testing of computer-to-computer interfaces ("CTCI").<sup>7</sup> Under the filings, the fee change was effective and to be implemented upon filing for members and upon Commission approval for non-members. However, Nasdaq delayed implementation of the testing fees for NWII API because of delays in the availability of a system that could accurately record the time

<sup>5</sup> Securities Exchange Act Release No. 46065 (June 12, 2002), 67 FR 41556 (June 18, 2002)(SR-NASD-2002-72)(immediately effective fees for members).

<sup>6</sup> Securities Exchange Act Release No. 46234 (July 19, 2002), 67 FR 48693 (July 25, 2002)(SR-NASD-2002-73)(approval of fees for non-members).

<sup>7</sup> Prior to the amendments, the rule had also made reference to testing of "digital interface (DIS/CHPS)," a technology that is not currently in use by Nasdaq. These references were deleted.

spent by a particular NTF user in testing NWII API. This delay has now been addressed, and Nasdaq implemented the fee for NWII API testing as of January 1, 2003. Prior to that time, Nasdaq has made the NTF available for testing of NWII API without charge, and Nasdaq has notified users of the NTF as to the implementation of the testing fees. All other aspects of SR-NASD-2002-72 and SR-NASD-2002-73 were implemented as of the effective dates of those filings.

#### *Statutory Basis*

Nasdaq believes that the proposed rule change is consistent with the provisions of section 15A of the Act,<sup>8</sup> in general, and with section 15A(b)(5) of the Act,<sup>9</sup> in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers, and other persons using any facility or system which the NASD operates or controls.

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

Nasdaq 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, as amended.

#### *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**

The foregoing proposal has become effective pursuant to section 19(b)(3)(A)(i) of the Act,<sup>10</sup> and rule 19b-4(f)(1)<sup>11</sup> thereunder, in that it constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. 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, or otherwise in furtherance of the purposes of the Act.

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

Interested persons are invited to submit written data, views, and arguments concerning the foregoing,

<sup>8</sup> 15 U.S.C. 78o-3.

<sup>9</sup> 15 U.S.C. 78o-3(b)(5).

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A)(i).

<sup>11</sup> 17 CFR 240.19b-4(f)(1).

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-2003-06 and should be submitted by February 19, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-47233; File No. SR-NASD-2002-127]

### **Self Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change and Amendment No. 1 Thereto Amending Rule 11890 Concerning Clearly Erroneous Transactions**

January 22, 2003.

#### **I. Introduction**

On September 24, 2002, the National Association of Securities Dealers, Inc., through its subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("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 amend NASD rule 11890, which provides Nasdaq with authority to nullify or modify transactions. On November 1, 2002, Nasdaq filed Amendment No. 1 that entirely replaced

<sup>12</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.

the original rule filing.<sup>3</sup> The proposed rule change, as amended, was published for comment in the **Federal Register** on December 9, 2002.<sup>4</sup> The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

## II. Description of the Proposal

Nasdaq proposes to amend NASD rule 11890, which provides Nasdaq with the authority to nullify or modify transactions.

### *a. Review of Transactions Pursuant to Complaint of Market Participant*

Under NASD rule 11890, Nasdaq has the authority to receive petitions from market participants requesting that designated officers of Nasdaq review the terms of a transaction and nullify or modify it if the transaction is found to be clearly erroneous. Among other things, NASD rule 11890, as amended by this proposal, will explicitly limit Nasdaq's purview to transactions arising out of the use or operation of Nasdaq execution or communication systems and explicitly require that the parties to a reviewable transaction be readily identifiable by Nasdaq through its systems. Amended NASD rule 11980 will also clarify, in part, that it covers transactions entered into by a member of a UTP exchange through a Nasdaq execution system. Thus, the rule will cover transactions executed between a Nasdaq member and a member of a UTP exchange that had agreed to accept automatic executions through SuperSOES or SuperMontage, but will not cover transactions where the UTP exchange merely posted a quote and was accessible only via telephone. The amended rule would also clarify that information submitted by parties to Nasdaq must be received by Nasdaq within the time frames specified in the rule.

### *b. Review of Transactions on Nasdaq's Own Motion*

Nasdaq proposes to amend NASD rule 11890 to state that Nasdaq's authority to review transactions based upon its own motion may be exercised in the event of extraordinary market conditions or other circumstances in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors

and the public interest. Amended NASD rule 11890 will also clarify that Nasdaq's authority to review transactions based upon its own motion may be applied to any transaction arising out of or reported through a Nasdaq quotation, execution, communication, or trade reporting system, including transactions entered into by a member of a UTP exchange through a Nasdaq execution system (but excluding transactions entered into through, or reported to, a UTP exchange).

Additionally, the proposed rule change will amend the time frame for action to require that the Nasdaq officer, either the Nasdaq President or Executive Vice President designated by the President, on Nasdaq's own motion, act, except in extraordinary circumstances, no later than 3 p.m. on the next trading day. Finally, Nasdaq is adding interpretative material after the rule to provide that it shall be considered conduct inconsistent with just and equitable principles of trade for a member to refuse to take action that is necessary to effectuate a final decision of a Nasdaq officer or the Market Operations Review Committee ("MORC").

### *c. Review by the Market Operations Review Committee*

NASD rule 11890 governs review by the MORC, a standing committee composed of representatives of member firms as well as "non-industry" representatives. Persons seeking to appeal a determination by Nasdaq must submit their appeal within the time parameters specified by the rule. Both parties are then given the opportunity to submit supporting arguments in writing, and the matter is submitted to the MORC for a determination. Nasdaq proposes, however, that an officer empowered to review transactions on Nasdaq's own motion (*i.e.*, the President or an Executive Vice President) may determine that the number of transactions affected by a decision to break or modify trades on Nasdaq's own motion is such that the decision must be accorded immediate finality in order to maintain a fair and orderly market and to protect investors and the public interest.

### *d. Communications Between Nasdaq and Market Participants*

Amended NASD rule 11890 will describe in greater detail the parameters for communications between Nasdaq and market participants. Specifically, the proposal will provide that materials submitted to Nasdaq or the MORC must be submitted via facsimile machine and

must be received within the time parameters specified by the rule. However, if requested, Nasdaq staff may authorize submission of materials via electronic mail on a case-by-case basis.<sup>5</sup> Materials shall be deemed received at the time indicated by a facsimile machine or computer that receives the materials. Nasdaq reserves the right to reject or accept material that is not received within the time parameters specified by the rule.

Nasdaq will provide notice of determinations under the rule via facsimile machine, electronic mail, or telephone (including voicemail). However, in cases where an officer nullifies or modifies a large number of transactions pursuant to Nasdaq's authority to act on its own motion, individual notice may not be practicable. In that case, Nasdaq may provide notice to market participants via the Nasdaq Workstation II Service, a press release, or any other method reasonably expected to provide rapid notice to many market participants.

## III. Discussion

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 association,<sup>6</sup> and in particular, the requirements of section 15A(b)(6) of the Act,<sup>7</sup> which, among other things, requires that the association's rules 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. Specifically, the Commission believes that Nasdaq's proposal may clarify the scope of Nasdaq's authority to review erroneous transactions and the procedural aspects of reviewing such transactions.

Nasdaq proposes to delineate, in part, the conditions under which Nasdaq will consider petitions by market participants to review transactions. Proposed NASD rule 11890 explicitly

<sup>5</sup> For example, if a party wishes to submit, pursuant to subparagraph (a)(2)(A) of the amended rule, a large document containing supporting information, it may be preferable to submit the document via electronic mail. Electronic mail may be used only when specifically authorized by Nasdaq staff, however, because it is impossible to control the delivery time of electronic mail.

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

<sup>3</sup> See letter from Mary M. Dunbar, Vice President and Deputy General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated November 1, 2002.

<sup>4</sup> See Securities Exchange Act Release No. 46939 (December 3, 2002), 67 FR 72994 (December 9, 2002) (SR-NASD-2002-127).

limits its purview to transactions arising out of the use or operation of Nasdaq execution or communication systems and explicitly requires that the parties to a reviewable transaction be readily identifiable by Nasdaq through its systems. The Commission believes that the amended rule better reflects Nasdaq's interpretation of the scope of its rule. Nasdaq has represented that in the past it has declined to adjudicate petitions on the grounds that the transaction would be more appropriately reviewed by the market center on which it was executed. Therefore, the Commission believes that the proposed rule change clarifies the application and operation of the rule for market participants.

Nasdaq also proposes to amend NASD rule 11890 to state that Nasdaq's authority to review transactions based upon its own motion may be exercised in the event of extraordinary market conditions or other circumstances in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest. The Commission believes that the proposal clarifies Nasdaq's authority to nullify or modify transactions on its own motion and provides Nasdaq with the flexibility to address a variety of extraordinary market conditions expeditiously. The Commission notes that Nasdaq expects to assert its authority primarily in circumstances where the disruption or malfunction of a system resulted in the execution of trades with obvious errors, such as a price substantially unrelated to the inside market. Nasdaq has also represented that it will not attempt to break or modify trades entered into through, or reported to, a UTP exchange. Nasdaq will endeavor to coordinate its actions with other market centers to achieve consistent treatment of trades outside Nasdaq's jurisdiction.

Regarding the review of Nasdaq determinations by the MORC, Nasdaq proposes that an officer empowered to review transactions on Nasdaq's own motion (*i.e.*, the President or an Executive Vice President) may determine that the number of transactions affected by a decision to break or modify trades on Nasdaq's own motion is such that the decision must be accorded immediate finality in order to maintain a fair and orderly market and to protect investors and the public interest. The Commission believes that Nasdaq's proposal is reasonable and that the market may be well served by the finality it provides. Furthermore, Nasdaq has represented, and the Commission expects, that Nasdaq would

use this authority only on rare occasions. For example, Nasdaq believes that there may be circumstances in which review by the MORC of a large number of trades would be impractical and could expose market participants to unacceptable levels of risk.<sup>8</sup>

Finally, Nasdaq proposes to describe in greater detail the parameters for communications between Nasdaq and market participants. The Commission believes that the proposal may clarify procedural aspects of the process of reviewing transactions and therefore promote the fair and efficient resolution of disputes.

#### IV. Conclusion

For the reasons discussed above, the Commission finds that the proposal, as amended, is consistent with the Act and the rules and regulations thereunder. It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>9</sup> that the proposed rule change (SR-NASD-2002-127), as amended, be and hereby is approved.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47223; File No. SR-PCX-2002-75]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc., Through Its Subsidiary PCX Equities, Inc., Relating to New Order Types and To Amend PCXE Rule 7.37

January 21, 2003.

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 December 9, 2002, the Pacific Exchange, Inc. ("PCX" or "Exchange"), through its subsidiary, PCX Equities, Inc. ("PCXE"),

<sup>8</sup> For example, Nasdaq believes that if an erroneously priced order or quote causes a large number of transactions to occur at prices far in excess of a security's true value and if a decision is made to break all of the affected trades, some sellers may appeal the decision to break the trades. If a market participant is a party to trades on both sides of the market, and some remain broken while others are appealed and reinstated, it will suffer losses that arise solely from the inconsistent treatment of its trades.

<sup>9</sup> 15 U.S.C. 78s(b)(2).

<sup>10</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.

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 PCX. On January 15, 2003, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</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 PCX, through its wholly owned subsidiary, PCXE, proposes to amend its rules governing the Archipelago Exchange, the equities trading facility of PCXE, by: (1) Adopting several new order types to accommodate the trading of securities listed on the Nasdaq Stock Market, Inc., on an unlisted trading privileges ("UTP") basis; (2) amending PCXE rule 7.37 to provide for a limited exemption from the trade-through restrictions for some of these new order types; (3) amending certain provisions of the Working Order Process to reflect the unique operational requirements of two proposed order types; and (4) making several minor technical rule changes to conform to the Nasdaq UTP Plan, which extends UTP to Nasdaq SmallCap securities. The text of the proposed rule change follows:

Additions are *italicized*; deletions are in [brackets].

PCX Equities, Inc.

Rule 1 Definitions

Rule 1.1(a)-(z)—No change.

#### Nasdaq[/NM] Security

(aa) The term "Nasdaq[/NM] Security" shall mean any security (i) designated as *an eligible* [national market system] security pursuant to the "*Nasdaq Unlisted Trading Privileges Plan*", as amended, [NASD's "National Market System Securities Designation Plan with respect to Nasdaq Securities,"] filed with and approved by the Commission pursuant to SEC rule 11Aa2-1 under the Exchange Act and (ii) that is either listed on the Corporation pursuant to rule 5 or as to which unlisted trading privileges have been granted pursuant to section 12(f) of the Exchange Act.

Rule 1.1 (bb)-(hh)—No change.

#### OTC/UTP Plan

(ii) The term "OTC/UTP Plan" shall mean the Nasdaq *Unlisted Trading*

<sup>3</sup> In Amendment No. 1, the Exchange submitted a new form 19b-4, which replaced the original filing in its entirety.