

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49941; File No. SR-Amex-2003-39)

June 29, 2004

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment Nos. 1, 2, 3, and 4 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 5 to a Proposed Rule Change by the American Stock Exchange LLC to Adopt a Clearly Erroneous Transaction Rule and Half-Point Error Guarantee for Trades in Nasdaq National Market Securities

I. Introduction

On April 30, 2003, the American Stock Exchange LLC (“Amex” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt a “clearly erroneous” transaction rule and “half-point error guarantee” for trades in Nasdaq National Market securities. On October 15, 2003, Amex submitted Amendment No. 1 to the proposed rule change.³ Amex submitted Amendment No. 2 to the proposed rule change on November 21, 2003.⁴ Amex submitted Amendment No. 3 to the proposed rule change on December 10, 2003.⁵ Amex submitted Amendment No. 4 to the proposed rule change on

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter from William Floyd Jones, Associate General Counsel, Amex, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated October 14, 2003 (“Amendment No. 1”).

⁴ See Letter from William Floyd Jones, Associate General Counsel, Amex, to Nancy J. Sanow, Assistant Director, Division, Commission, dated November 20, 2003 (“Amendment No. 2”).

⁵ See Letter from William Floyd Jones, Associate General Counsel, Amex, to Nancy J. Sanow, Assistant Director, Division, Commission, dated December 9, 2003 (“Amendment No. 3”).

February 2, 2004.⁶ The proposed rule change, as amended, was published for comment in the Federal Register on March 3, 2004.⁷ The Commission received no comments on the proposal.

On May 17, 2004, Amex submitted Amendment No. 5 to the proposed rule change.⁸ This order approves the proposed rule change, as amended by Amendment Nos. 1, 2, 3, and 4; solicits comments on Amendment No. 5 from interested persons; and grants accelerated approval to Amendment No. 5 to the proposed rule change.

II. Description of the Proposal

The Exchange is proposing new Amex Rule 118(l) that would provide it with authority to break or revise trades in Nasdaq National Market securities occurring on the Exchange.

Proposed Amex Rule 118(l) would be substantively similar to NASD Rule 11890. Like NASD Rule 11890(a), proposed Amex Rule 118(l) would set forth the circumstances in which trades can be broken or revised at the request of a member who is part of a trade or at the motion of the self-regulatory organization itself. In the former case, any member who seeks review of a trade in a Nasdaq National Market security must submit the matter to an Amex Floor Official⁹ and

⁶ See Letter from William Floyd Jones, Associate General Counsel, Amex, to Nancy J. Sanow, Assistant Director, Division, Commission, dated January 30, 2004 (“Amendment No. 4”).

⁷ See Securities Exchange Act Release No. 49319 (February 25, 2004), 69 FR 10081.

⁸ See Letter from William Floyd Jones, Associate General Counsel, Amex, to Nancy J. Sanow, Assistant Director, Division, Commission, dated May 14, 2004 (“Amendment No. 5”). See also *infra* Section III.

⁹ Floor Officials are deemed to be Officers of the Exchange. See Amex Rule 22(c). Floor Officials are generally responsible for the supervision of operations the Exchange Floor. There are four classifications of Floor Official. In ascending order of responsibility, these classifications are: (1) Floor Official, (2) Exchange Official, (3) Senior Floor Official, and (4) Senior Supervisory Officer. The Vice Chairman of the Exchange is a Floor Governor and serves as the Senior Supervisory Officer. Governors of the Exchange that spend a significant amount of time on the Floor are Senior Floor Officials.

deliver a written complaint to the Service Desk within 30 minutes of the trade. Upon such delivery, the complainant would have up to 30 minutes to submit any supporting written information necessary for a review of the trade. The other member that was part of the trade would have up to 30 minutes after being notified of the complaint to submit information. Either 30-minute period could be extended at the discretion of the Floor Official.

The Floor Official would be required to review the trade and make a ruling unless both members involved agreed to withdraw the application for review before the Floor Official made the ruling. The Floor Official would be required to review the trade "with a view toward maintaining a fair and orderly market and the protection of investors and the public interest."¹⁰ If the Floor Official determined that the trade was "clearly erroneous," he or she would be required to: (1) nullify the trade; or (2) modify one or more terms of the trade. In the latter case, the Floor Official would be required to adjust the price and/or size of the trade "to achieve an equitable rectification of the error that would place the parties . . . in the same position, or as close as possible to the same position, as they would have been in had the error not occurred."¹¹ Under Amex Rule 118(l)(i), a trade would be "clearly erroneous" if "there is an obvious error in any term, such as price, number of shares or the unit of trading, or identification of the security."

Similar to NASD Rule 11890(b), proposed Amex Rule 118(l)(iii) would permit an Exchange Floor Governor¹² to break or revise a trade in a Nasdaq National Market security on

Numerous provisions of the Exchange's rules specifically call for Floor Official involvement in the Exchange's operations.

¹⁰ See Proposed Amex Rule 118(l)(i).

¹¹ Id.

¹² Four members of the Board of Governors are designated as "Floor Governors" under Section 1 of Amex Rule 9011. Floor Governors are members of the Amex Board of Governors who spend a substantial part of their time on the floor of the Exchange.

his or her own motion. A Floor Governor could exercise this authority in the following circumstances:

- a disruption or malfunction in the use or operation of any facility of the Exchange;
- a disruption or malfunction in the use or operation of any facility of Nasdaq that results in the nullification or modification of trades on Nasdaq; or
- extraordinary market conditions or other circumstances in which nullification or adjustment of a trade may be necessary for the maintenance of a fair and orderly market or for the protection of investors and the public interest.

Before a Floor Governor could exercise this authority, the Exchange must have received confirmation from NASD or Nasdaq that there was a disruption or malfunction in the Nasdaq market that resulted in the nullification or modification of trades in that market. A Floor Governor acting pursuant to proposed Amex Rule 118(l)(iii) could nullify or modify a trade if he or she determined that the trade was "clearly erroneous" or such action was "necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest." A Floor Governor acting under the proposed rule, in the absence of extraordinary circumstances, would be required to take action within 30 minutes of the detection of the transaction, but in no event later than 3:00 p.m. Eastern Time on the next trading day following the date of the trade at issue.

A member could seek review of a Floor Official's ruling pursuant to proposed Amex Rule 118(l)(i) and (ii) or of a Floor Governor's ruling pursuant to proposed Amex Rule 118(l)(iii). Such a review would follow the procedures set forth in Amex Rule 22(d) and Commentary .02 to Amex Rule 22.

The Exchange also has proposed new Amex Rule 118(m) that would establish a "half-point error guarantee" for trades in Nasdaq National Market securities occurring on the Exchange. Proposed Amex Rule 118(m) would state that Amex Rule 129¹³ would not apply to orders for Nasdaq National Market securities of 1,000 shares or less received by a specialist through the Exchange's electronic order routing system. As to such orders, proposed Amex Rule 118(m) would apply instead. Amex has stated that this rule would allow small investors to rely upon reports of executions where the report is within \$0.50 of the execution price. Proposed Amex Rule 118(m) is substantively identical to New York Stock Exchange ("NYSE") Rule 123B(b)(2).

Finally, the Exchange is proposing new Amex Rule 118(n), stating that members and member organizations may share in losses in a customer's account when the member or member organization determines that the member or firm was responsible for the loss. Amex Rule 118(n) is substantively similar to NYSE Rule 352.

III. Amendment No. 5

¹³ Amex Rule 129 states: "The price at which an order is executed shall be binding notwithstanding the fact that an erroneous report in respect thereto may have been rendered. A report shall not be binding if an order was not actually executed but was in error reported to have been executed; however, an order which was executed, but in error reported as not executed, shall be binding; provided, however, when a member who is on the Floor reports in good faith the execution of an order entrusted to him by another member or member organization and the other party to that transaction does not know it, the member or member organization to whom such report was rendered and the member broker who made the report shall treat the transaction as made for the account of the member who made the report, or the account of his member organization, if the price and size of the transaction were within the price and volume of transactions in the security at the time that the member who made the report believed he had executed the order. A detailed memorandum of each such transaction shall be prepared and filed with the Exchange by the member assuming the transaction."

In Amendment No. 5, the Exchange revised the text of proposed Amex Rule 118(l) to specify that a member seeking to have a trade reviewed by a Floor Official must deliver a written complaint to the Service Desk "and to the other member(s) who were part of the trade." In addition, Amex replaced the term "party" with the term "member" throughout the rule text. The text of Amendment No. 5 is available at the Commission's Public Reference Room and at the principal office of the Exchange.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 5 to the proposed rule change, including whether Amendment No. 5 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Amex-2003-39 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-Amex-2003-39. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Amex-2003-39 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. 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 exchange. In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹⁴ which requires 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 for a free and open market and a national market system, and, in general, to protect investors and the public interest.¹⁵ New Amex Rule 118(l) will set forth formal procedures to be followed by an Exchange member that seeks to have a trade nullified or revised or by an Amex Floor Governor who seeks to nullify or revise trades on his or her own motion. The Commission believes that it

¹⁴ 15 U.S.C. 78f(b)(5).

¹⁵ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

is proper for trade nullification and revision procedures to be codified and thus made transparent.

The new rule also sets forth a procedure for the appeal of a determination made by an Exchange Floor Official or Floor Governor pursuant to Amex Rule 118(l). The Commission believes that the existence of such a procedure should help ensure that the rule is exercised in a fair and reasonable manner.

In addition, the Commission believes that Amex Rule 118(m), offering a "half-point error guarantee," is reasonable and consistent with the Act. In approving an amendment to the NYSE rule (NYSE Rule 123B(b)(2)) on which Amex Rule 118(m) is based, the Commission stated that this guarantee protects customers "since the specialist absorbs any price difference below one-half a point."¹⁶

Finally, the Commission believes that Amex Rule 118(n) is consistent with the Act because it allows a member to share in customer losses that were caused in whole or in part by the member's action or inaction.

Pursuant to Section 19(b)(2) of the Act,¹⁷ the Commission finds good cause for approving Amendment No. 5 to the proposed rule change prior to the thirtieth day after the amendment is published for comment in the Federal Register. The Commission notes that no comments were received in response to the initial notice. Because Amendment No. 5 makes only minor changes to the rule text that do not alter the substance of the proposal, the Commission believes that no purpose would be served by delaying approval of Amendment No. 5 until the completion of another notice-and-comment period. Accordingly, the Commission finds good cause for

¹⁶ Securities Exchange Act Release No. 25145 (November 20, 1987), 52 FR 45699, n.4 (December 1, 1987) (approving SR-NYSE-87-29).

¹⁷ 15 U.S.C. 78s(b)(2).

accelerating approval of Amendment No. 5 to the proposed rule change.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁸ that the proposed rule change (SR-Amex-2003-39) and Amendment Nos. 1, 2, 3, and 4 are approved, and that Amendment No. 5 is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁹

Margaret H. McFarland
Deputy Secretary

¹⁸ 15 U.S.C. 78s(b)(2).

¹⁹ 17 CFR 200.30-3(a)(12).