For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[9]

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–51048; File No. SR–NYSE–2004–70]**

## Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. To Amend Exchange Rule 104 to Require Specialists To Yield Orally-Consummated Proprietary Trades to Later-Arriving System Orders

January 18, 2005.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on December 13, 2004, the New York Stock Exchange, Inc. (''NYSE'' 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 Exchange. On January 7, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.[3] 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 NYSE Rule 104, Dealings by Specialists, to require that in transactions between a specialist and a contra order that have been orally agreed to but not yet reported, the specialist must yield to any system orders that enter the specialist's book and can take the specialist's position in the orally-consummated transaction.

The text of the proposed amendments is set forth below. Italics indicate additions.

**Rule 104**

*Dealings by Specialists*

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Supplementary Material

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*Functions of Specialists*

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*(11)(i) Notwithstanding the ability of a specialist to trade for his or her dealer account, dealer transactions by a specialist that have not yet been reported by the specialist must yield to any order or orders received through an Exchange order delivery system after the oral commitment to transact, provided that such order or orders are capable of trading in place of the specialist in the consummated transaction.*

*(ii) The provisions of subparagraph (i) above shall not apply if the specialist's trade for his or her dealer account:*

(a) *Is to correct an error on a previously reported transaction;*

(b) *Is executed in satisfaction of the specialist's obligation to give up a trade to an agency order;*

(c) *Is a non-regular way trade between the specialist and a Crowd broker;*

(d) *Is the result of the election of ''stop'' orders as required in Rule 123A.40;*

(e) *Is in connection with the execution of ''stop'' orders or CAP orders executed as part of the opening of trading;*

(f) *Participates on the closing transaction in a security to offset a market-at-the-close and/or limit-at-the-close order imbalance; or*

(g) *Is a report of principal participation on a commitment sent to another market center through the ITS system.*

*(iii) Transactions by a specialist pursuant to subparagraph (ii) above must be documented and reported to the Exchange in such manner and within such time as the Exchange shall designate.*

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### 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. 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

The Exchange proposes to amend NYSE Rule 104 to provide that where a specialist has completed, but not yet reported, a transaction as principal with an order in the book or in the crowd, the specialist must yield to any order received through SuperDOT® that could take the specialist's place in the unreported principal transaction.

Exchange rules provide that specialists must always yield to customer orders on the book when trading in the specialist's specialty securities for the dealer account. When no other interest is present on the book, specialists may trade for their own account with interests represented on the book or by a broker in the crowd; in such situations, the specialist may trade either fully or in parity with other contra interests represented in the crowd, as the case may be. The Exchange proposes to amend NYSE Rule 104.10 to include new section (11) to require that, notwithstanding the ability of a specialist to trade as principal with either a system order or a broker in the crowd, if a marketable order arrives on the book before the report of the specialist's trade as principal is completed, the specialist must yield to such order. Where the specialist is required to yield, the customer whose order entered the book would be reported as the contra party for the trade instead of the specialist.

The proposed rule would provide seven limited exceptions, representing situations in which it would continue to be appropriate for the specialist to act as principal, notwithstanding the presence of a new customer order on the book. These exceptions are:

(1) Corrections of bona fide specialist errors;

(2) Trading in satisfaction of the specialist's obligation to give up a trade to an agency order;

(3) Reports of non-regular-way principal-to-crowd transactions;

(4) Principal participation on stop order electing transactions;

(5) Principal participation in connection with opening transactions;

(6) Closing transactions involving market-on-close (''MOC'') imbalances; and

(7) Report of principal participation on a commitment sent to another market

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[9] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Form 19b–4 dated January 7, 2004 (''Amendment No. 1''). In Amendment No. 1, the NYSE changed the basis under which the proposed rule change was filed from section 19(b)(3) of the Act to section 19(b)(2) of the Act.

through the Intermarket Trading System (''ITS'').

These exceptions are discussed in more detail below:

1. Corrections of Bona Fide Specialist Errors: These are cases where a specialist has to issue corrected reports that include dealer participation via the Display Book® to correct a previously executed and reported transaction. Such corrections could involve the price, volume, or names involved in a transaction. If an executable system order is on the same side as the dealer participation necessary to correct the error, this would trigger the Display Book's® ''P'' indicator (preventing the specialist from participating as dealer ahead of executable system orders). In this situation, the specialist would be permitted to use the ''Prin Ahead'' override feature, provided that the specialist placed the notation ''Error'' in the Display Book's® free-form comment field. The specialist would be required to adequately document the error on the firm's books and records.

2. Trading in satisfaction of the specialist's obligation to give up a trade to an agency order: These are cases where Exchange rules require the specialist to give up a trade to an agency order after the initial trade has been reported and the specialist cannot substitute the agency customer's name, such as where a customer requests to participate on a trade previously executed by the specialist as principal on a non-regular way basis. When reporting such substituted trades, the specialist would have to participate as dealer in order to unwind his own participation in the initial transaction. If an executable system order is on the same side as the dealer participation necessary to effect the substitution, this would trigger the Display Book's® ''P'' indicator. In this situation, the specialist would be permitted to use the ''Prin Ahead'' override feature to complete the substitute transaction. The specialist would be required to document the substitution trade in the Display Book's® free-form comment field.

3. Reports of non-regular-way principal-to-crowd transactions: These are cases where a crowd broker represents a non-regular-way settlement order (*e.g.*, cash basis, next day, and sellers option) and the specialist is willing to trade with that order at a price at which there are regular way settlement customer orders on the same side on the Display Book®. The ''Prin Ahead'' override feature may be used by the specialist to effect the non-regular way transaction, provided, however, that the specialist may be required to give up the trade to an agency order if the customer indicates its willingness to participate on the same terms as the specialist.

4. Principal participation on stop order electing transactions: These are cases where the specialist participation in an electing transaction requires the guarantee of the same price to the elected stop order(s), the specialist bases the price on the total volume of both transactions, and the specialist effects both transactions contemporaneously and at the same price. Exchange rules require the specialist to report the transaction that elects the stop orders independently from the transaction that fills the stop orders. Orders may arrive on the Display Book® between the time the specialist reports the electing trade and the fill for the stop transaction, which would trigger the ''P'' indicator. In connection with the transaction filling the stop order, the specialist would be permitted to use the ''Prin Ahead'' override feature. The specialist would be required to document the dealer participation by placing a stop order comment in the Display Book's® free-form comment field.

5. Principal participation in connection with opening transactions: These are cases where the specialist participates as dealer in connection with stop orders and convert-and-parity (''CAP'') orders [4] that are included in the specialist's calculation of the opening price, elected by the opening crossing trade, and executed substantially contemporaneously with the opening transaction at the opening cross price, but that are reported separately from the report of the opening transaction. Orders may arrive on the Display Book® between the time the specialist reports the opening trade and the fill for the elected stop transaction, which would trigger the ''P'' indicator. In connection with the transaction filling the stop order at the opening, the specialist would be permitted to use the ''Prin Ahead'' override feature. The specialist would be required to document the dealer participation by placing a stop order comment in the Display Book's® free-form comment field.

6. Closing transactions involving MOC imbalances: These are cases where the specialist participates on the closing transaction to offset a market-on-close/limit-on-close order imbalance. The situation may arise if unexecuted market orders entered just prior to the close are assigned to the paired-off portion of the closing trades. When the specialist reports dealer participation to offset an imbalance on the first print of the closing (as required by Exchange rules) and there are market orders on the same side assigned to the paired off portion, which is the second print of the close, the ''P'' indicator would be triggered. In this instance, the specialist would be permitted to use the ''Prin Ahead'' override feature. The specialist would be required to document the dealer participation by indicating ''MOC'' in the Display Book's® free-form comment field.

7. Report of principal participation on a commitment sent to another market through the ITS System: These are cases where the specialist has indicated dealer interest to trade on a regional exchange and has sent a commitment to trade. It may take a regional exchange up to 30 seconds to execute and report the transaction. However, before the specialist can report the trade to the position minder system via the Display Book®, customer orders on the same side at the same or a better price may have been received, which would trigger the ''P'' indicator when the specialist attempts to report the ITS trade. In such cases, the specialist would be permitted to use the ''Prin Ahead'' override feature. The specialist would be required to document the situation.

The Exchange believes that the amendment is designed to further ensure that public orders receive executions in the Exchange market against other public orders to the greatest extent possible.

2. Statutory Basis

The Exchange believes that the proposal, as amended, is consistent with section 6(b)(5) of the Act,[5] which requires that an exchange have rules that are designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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.

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

The Exchange believes that the proposal would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

[4] CAP orders are orders in which the specialist may convert all or part of an unelected portion of a percentage order, and may trade on parity with the elected or converted portions of the order, as long as the specialist is not holding orders at the same price that do not grant parity.

[5] 15 U.S.C. 78f(b)(5).

*C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

The Exchange has neither solicited nor received written comments on the proposed rule change.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. 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 e-mail to *rule-comments@sec.gov*. Please include File Number SR–NYSE–2004–70 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–NYSE–2004–70. 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the NYSE. 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–NYSE–2004–70 and should be submitted on or before February 18, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[6]

**Margaret H. McFarland,**

*Deputy Secretary.*

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[6] 17 CFR 200.30–3(a)(12).

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–51051; File No. SR–PCX–2004–58]**

## Self-Regulatory Organizations; the Pacific Exchange, Inc.; Order Approving Proposed Rule Change and Amendment No. 2 Thereto by the Pacific Exchange, Inc., Relating to the Exchange's Rules Under Its Minor Rule Plan and Recommended Fine Schedule

January 18, 2005.

On December 2, 2004, the Pacific Exchange, Inc., (''PCX'' 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 amend PCX Rule 10.12 to add new provisions (h)(45) and (k)(i)45. These provisions amend the PCX Minor Rule Plan (''MRP'') and Recommended Fine Schedule (''RFS'') to add the failure to maintain adequate procedures and controls to monitor and supervise the entry of electronic orders by Users [3] to prevent the prohibited practices set forth in PCX Rules 6.87(d) and 6.90(e).[4] The proposed rule change was published for comment in the **Federal Register** on December 17, 2004.[5] On January 3, 2005, PCX filed Amendment No. 1 to the proposal. On January 4, 2005, PCX withdrew Amendment No. 1 and filed Amendment No. 2 to the proposal.[6] The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange,[7] and, in particular, the requirements of section 6(b)(5) of the Act,[8] in that it is designed to promote just and equitable principles of trade, facilitate transactions in securities, 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. The Commission also finds that the proposal is consistent with section 6(b)(6) of the Act,[9] which requires that members and persons associated with members be appropriately disciplined for violations of Exchange rules, and section 6(b)(7) of the Act,[10] which requires that members and persons associated with members are provided a fair procedures for disciplinary procedure.

In approving this proposal, the Commission in no way minimizes the importance of compliance with these rules, and all other rules subject to the imposition of fines under the MRP. The Commission believes that the violation of any self-regulatory organization's rules, as well as Commission rules, is a serious matter. However, in an effort to provide the Exchange with greater flexibility in addressing certain violations, the MRP provides a reasonable means to address rule violations that do not rise to the level of requiring formal disciplinary

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Pursuant to PCX Rule 6.87(a)(2), ''User'' means any person or firm that obtains electronic access to Auto-Ex (defined in PCX Rule 6.87(a)(1)) through an Order Entry Firm (defined in PCX Rule 6.87(a)(3)). Pursuant to PCX Rule 6.90(c)(1), ''User'' means any person or broker-dealer that obtains electronic access to PCX Plus (defined in PCX Rule 6.90(a)) through an Order Entry Firm (defined in PCX Rule 6.90(c)(2)).

[4] PCX Rules 6.87(c)(4) and 6.90(d)(3) require Order Entry Firms to maintain such controls and procedures.

[5] *See* Securities Exchange Act Release No. 50830 (December 9, 2004), 69 FR 75581 (December 17, 2004) (''Notice'').

[6] In Amendment No. 2, PCX proposes to correct a typographical error in the proposed rule text by changing footnote 1 to tie to PCX Rule 10.12(k)(i) instead of to PCX Rule 10.12(k). Amendment No. 2 is a technical amendment, and, therefore, not subject to notice and comment.

[7] 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).

[8] 15 U.S.C. 78f(b)(5).

[9] 15 U.S.C. 78f(b)(6).

[10] 15 U.S.C. 78f(b)(7).