

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46881; File No. SR-PCX-2002-71]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Pacific Exchange, Inc. To Require Industry Parties in Arbitration To Waive Application of Contested California Arbitrator Disclosure Standards, Upon the Request of Customers and Associated Persons With Claims of Statutory Employment Discrimination, for a Six-Month Pilot Period

November 21, 2002.

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 November 7, 2002, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as 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 the proposed rule change from interested persons. For the reasons described below, the Commission is granting accelerated approval to the proposed rule change.

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

PCX and PCX Equities, Inc. ("PCXE") are proposing a rule change to amend their rules to require industry parties in arbitration to waive application of contested California arbitrator disclosure standards upon the request of customers or, in industry cases, upon the request of associated persons with claims of statutory employment discrimination, for a six-month pilot period from November 21, 2002 to May 22, 2003.³ Below is the text of the proposed rule change. Proposed new language is *italicized*, deleted text is in [brackets].

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Rules of the Board of Governors of the Pacific Exchange, Inc.

Rule 12 Arbitration

Matters Subject to Arbitration

Rule 12.1(a)-(g)—No change.

Commentary:

.01—No change.

.02—It may be deemed conduct inconsistent with just and equitable principles of trade for a member, a member organization or a person associated with a member or member organization to fail to submit to arbitration on demand under the provisions of this Rule[,]; or to fail to waive the California Rules of Court, Division VI of the Appendix, entitled "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" (the "California Standards"), if all the parties in the case who are customers have waived application of the California Standards in that case; or to fail to waive the California Standards if all associated persons with a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute have waived application of the California Standards in that case; or to fail to appear or to provide any document in his or its possession or control as directed pursuant to the provisions of this Rule; or to fail to honor an award of arbitrators properly rendered pursuant to the provisions of this Rule where a timely motion has not been made to vacate or modify such award pursuant to applicable law.

.03—No change.

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PCX Equities, Inc.

Rule 12 Arbitration

Matters Subject to Arbitration

Rule 12.1—No change.

Rule 12.2 (a)-(g)—No change.

(h) It may be deemed conduct inconsistent with just and equitable principles of trade for an ETP Holder or a person associated with an ETP Holder to fail to submit to arbitration on demand under the provisions of this Rule[,]; or to fail to waive the California Rules of Court, Division VI of the Appendix, entitled "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" (the "California Standards"), if all the parties in the case who are customers have waived application of the California Standards in that case; or to fail to waive the California Standards if all associated persons with a claim alleging employment discrimination, including a sexual harassment claim, in violation of a statute have waived application of the California Standards in that case; or to fail to appear or to provide any document in his or her or its possession or control as directed pursuant to the provisions of this Rule or to fail to

honor an award of arbitrators properly rendered pursuant to the provisions of this Rule where a timely motion has not been made to vacate or modify such award pursuant to applicable law.

(i)-(j)—No change.

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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 PCX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change.⁴ The text of these statements may be examined at the places specified in Item III below. PCX 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 states that it makes every effort to provide investors who bring their claims to PCX with a fair, efficient, and economical arbitration forum. In July 2002, the California Rules of Court, Division VI of the Appendix, entitled, "Ethics Standards of Neutral Arbitrations in Contractual Arbitration" (the "California Standards") became effective (further described below). Prior to the enactment of the California Standards, the Exchange states that it, along with the National Association of Securities Dealers, Inc. ("NASD") and the New York Stock Exchange ("NYSE", and collectively with PCX and NASD, the "Exchanges"), made several efforts to raise their concerns about the California Standards with the California Judicial Council and Legislative staff. The Exchange states that these attempts did not meet with any success, and the California Standards became effective without addressing the Exchanges' concerns. Since then, PCX has been attempting to develop an appropriate process by which it can appoint arbitrators in California.

NASD and NYSE filed a joint complaint in federal court for declaratory relief (the "Complaint") in which they contend that the California Standards cannot lawfully be applied to NASD and NYSE, because the California Standards are preempted by federal law

⁴ The discussion in this section represents the Exchange's views on the situation in California and does not in any way represent a Commission position on this issue.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Telephone conversation between Betsy James, Assistant General Counsel, PCX, and Andrew Shipe, Special Counsel, Division of Market Regulation, SEC, November 21, 2002.

and are inapplicable to self-regulatory organizations ("SROs") under state law.⁵ On September 18, 2002, the Commission moved to appear in the case as a friend of the court and submitted a brief in which it contended that the California Standards conflict with and thus are preempted by the Commission's regulation of SRO arbitration under the Act and by the Federal Arbitration Act.⁶ On November 12, 2002, the district court dismissed the case on the ground that the defendants were immune from suit under the Eleventh Amendment of the Constitution.

While waiting for the court's guidance on this issue, NASD and NYSE announced that they were temporarily postponing the appointment of arbitrators for new arbitrations in California. While PCX has not joined in the Complaint to date, PCX concurs with NASD's and NYSE's position in this matter, as well as the Commission's as set forth in its friend of the court brief, and believes that the court's decision could be applicable to PCX also. PCX has therefore been reluctant to appoint arbitrators pending the court's decision.

On September 5, 2002, Harvey L. Pitt, Chairman of the Commission, sent a letter to NASD and NYSE requesting them to explore ways to expedite processing of arbitration claims involving California parties.⁷ In response, NASD proposed the implementation of a six-month amendment to its rules, requiring all parties that are member firms or associated persons to waive the California Standards if all the parties in the case who are customers or associated persons with a statutory employment discrimination claim have waived the California Standards in that case. This Rule Filing was published in the **Federal Register** on October 3, 2002, and the Commission granted accelerated

approval.⁸ In the interest of continuing to provide investors with an arbitral forum in California, and of being responsive to the Commission's desire that the Exchanges offer some alternatives to parties pending resolution of the applicability of the California Standards to the Exchanges, PCX proposes an amendment to its Rules substantially similar to NASD's.

Background Regarding the California Standards

The California Standards became effective July 1, 2002. They are intended to address potential conflicts of interest that could exist in private arbitration forums. The Exchanges' arbitration forums, however, are part of a federal regulatory system overseen on a uniform basis by the Commission. The conflicts that the California Standards are designed to address do not exist in the Exchanges' arbitration forums, which are highly regulated dispute resolution programs. The Commission Staff sent a letter on July 1, 2002, requesting that the arbitration programs administered by the SROs be exempted from the California Standards.

The California Standards place excessive and unnecessary disclosure burdens on persons who would serve on PCX arbitration panels and who already must meet PCX's stringent disclosure requirements. The extensive record-keeping requirements, and the potential liability for even inadvertent violations of the California Standards, led PCX to conclude that if PCX were required to implement the California Standards, PCX arbitrations would be more time consuming, more costly, and there would be less arbitrators willing to be members of PCX's arbitrator pool. The California Standards would permit a party to require the removal of an arbitrator for disclosing even an immaterial relationship. An arbitrator's inadvertent failure to disclose even an immaterial relationship could also result in the removal of the arbitrator, or the vacatur of an award. The alternative dispute resolution administrator would no longer have the power to decide contested challenges to arbitrators under the California Standards. Instead, the parties would have unilateral authority to require removal of arbitrators based on disclosures under the California Standards, whether the disclosures were material or not.

NASD and NYSE filed extensive comments when the California Standards were proposed in February

2002, and followed up with meetings with the Judicial Council and Legislative staff, some of which PCX also attended. PCX also filed a letter with the Judicial Council concurring with the positions taken by NASD and NYSE and objecting to the application of the California Standards to PCX's arbitration program. Despite this, the California Standards were implemented without addressing the basic concerns of the Exchanges. NYSE and NASD formally announced in July 2002, that they were postponing appointment of arbitrators in California until this matter was resolved. PCX has been attempting to determine how it can panel arbitrations in this environment. PCX is concerned that any attempt to seat arbitrators pursuant to the California Standards would result in: (a) the potential for limitless objections to arbitrators based on potentially immaterial disclosures required under the California Standards, (b) unacceptable risk of liability to arbitrators and PCX, (c) the likelihood that PCX's arbitrator pool would decrease dramatically due to the costs associated with the required record-keeping and the risk of liability, and (d) an overall increase in the cost of arbitrations to the parties due to all of these factors.

Proposed Rule Change

PCX states that it has a strong desire to accommodate parties to arbitration in California in this uncertain environment. PCX reviewed NASD's proposed rule change that would require industry parties to waive the California Standards in all cases in which all the parties in the case who are customers (or in industry cases, who are associated persons with claims of statutory employment discrimination) agree to waive the application of the California Standards. PCX states that implementation of a similar rule change would be an acceptable temporary way to allow PCX to continue to provide arbitration, pending a more permanent solution. Pursuant to the waiver permitted by this Rule change, the matter would proceed under the existing PCX Arbitration Rules, which already contain extensive disclosure requirements and provisions for challenging arbitrators with potential conflicts of interest.

Once the proposed rule filing is effective, PCX will notify investors and associated persons with claims of statutory employment discrimination, giving them the option of waiving the California Standards and providing them with waiver forms. PCX staff will also speak with investors and other

⁵ See Motion for Declaratory Judgment, NASD Dispute Resolution, Inc. and New York Stock Exchange, Inc., v. Judicial Council of California, filed in the United States District Court for the Northern District of California, No. C 02 3486 SBA (July 22, 2002), available on the NASD Web site at: www.nasdadr.com/pdf-text/072202_ca_complaint.pdf.

⁶ See Brief of the Securities and Exchange Commission, Amicus Curiae, in Support of Plaintiffs' Motion for Declaratory Judgment, NASD Dispute Resolution, Inc. and New York Stock Exchange, Inc., v. Judicial Council of California. The brief is available on the Commission Web site at: www.sec.gov/litigation/briefs/nasddispute.pdf.

⁷ See letter from Chairman Pitt to Robert R. Glauber, Chairman and CEO of NASD, and Richard Grasso, Chairman and CEO of NYSE, dated September 5, 2002.

⁸ See Securities Exchange Act Release No. 34-46562 (September 26, 2002), 67 FR 62085 (SR-NASD-2002-126).

parties to explain this process, and will endeavor to provide additional information on its website.

At the same time, PCX will notify industry parties in all pending California cases that they must waive the California Standards if the investor agrees to a waiver (or associated person, in the circumstances described above). Industry parties in such cases will be required to execute waiver agreements. However, their failure to do so will not stop the cases from moving forward.⁹ An industry party's failure to sign the waiver as required by the proposed rule change will be referred for disciplinary action.

If all parties waive the California Standards as permitted by the proposed Rule change, PCX will immediately commence the arbitrator appointment process using the PCX Rules regarding arbitrator disclosures, and not the California Standards.

PCX requests that this Rule change become effective immediately, for a six-month pilot period. If the outcome of NASD's and NYSE's lawsuit is that the California Standards do not apply to SROs, the waivers will no longer be necessary. Cases that had already been empanelled pursuant to a waiver would continue to conclusion with the existing panel. If the lawsuit has not concluded by the expiration of the initial six-month period, PCX may request an extension.

2. Statutory Basis

PCX believes that this proposal is consistent with section 6(b)¹⁰ of the Act, in general, and furthers the objectives of section 6(b)(5),¹¹ in particular, in that it is designed to facilitate transactions in securities; to prevent fraudulent and manipulative acts and practices; 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. PCX believes that expediting the appointment of arbitrators under the proposed waiver, at the request of customers and associated persons with

claims of statutory employment discrimination, will allow those parties to exercise their contractual rights to proceed in arbitration in California, notwithstanding the confusion and uncertainty caused by the California Standards.

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

PCX does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments on the proposed rule change were neither solicited nor received.

III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR-PCX-2002-71 and should be submitted by December 20, 2002.

IV. Commission's Findings and Order Granting Accelerated Approval of the Proposed Rule Change

After careful review, 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, and, in particular, the requirements of section 6 of the Act.¹² Specifically, the Commission finds that the proposal is consistent

with section 6(b)(5) of the Act, which requires that the rules of a national securities exchange be designed to promote just and equitable principles of trade, as well as to remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest.¹³ The Commission further finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice thereof in the **Federal Register**. Accelerated approval is necessary to protect investors in that the rules are designed to help address the backlog of cases created by the confusion over the new California Standards, are designed to provide them with a mechanism to help resolve their disputes with broker-dealers in a more expedited manner, and are designed to help ensure the certainty and finality of arbitration awards. Additionally, the proposed rule change will become effective as a pilot program for six months, from November 21, 2002 to May 22, 2003, during which time the Commission and the Exchange will monitor the status of the previously discussed litigation.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-PCX-2002-71) is hereby approved on an accelerated basis through May 22, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46874; File No. SR-Phlx-2002-64]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. To Change the Exchange's Calculation of Transaction Charges From a Value-Based System to a Share-Based System

November 21, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934

⁹In these situations, PCX will treat the industry parties as having waived the California standards. Telephone conversation between Peter Bloom, Director of Policy Development, PCX, and Andrew Shipe, Division of Market Regulation, SEC, November 21, 2002.

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(5).

¹² In approving the proposal, the Commission has considered the rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹³ 15 U.S.C. 78f(b)(5).

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).