

two Document Production Lists be "pruned" to avoid placing an unreasonable burden on the parties. In this regard, if production of a particular document or class of documents called for under an applicable Document Production List is unduly burdensome to a party, that party may object to production on that or any other grounds. The arbitrator(s) retains the ability to modify any request in order to protect against discovery abuses. Furthermore, there is nothing in the Discovery Guide that prevents a party from asking for additional documents such as those suggested by some commenters. We recognize the commenters' intentions to improve the Discovery Guide and the discovery process in general. However, the Discovery Guide reflects a compromise, which was obtained after a long period of negotiation, between various interests of the drafters. For each item that one commenter thought would be burdensome for a customer, another commenter believed a different item would be burdensome to a firm. As adopted, the Discovery Guide will benefit arbitrators and parties in handling document production.

One commenter suggests that parties produce a privilege log to identify documents not produced as a result of the assertion of a privilege. NASD Rule IM-10100 states that "[i]t may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member of * * * fail to appear or to produce any document in his possession or control as directed pursuant to provisions of the NASD Code of Arbitration Procedure * * *". All parties should act in good faith and carefully consider the relevant case law when asserting a privilege, and arbitrators should consider whether a privilege log is necessary to help facilitate the discovery process.⁴⁵ It is expected that the NASD Regulation will take appropriate action against members and registered persons who do not act in good faith or otherwise violate IM-10100.

The Discovery Guide will streamline the discovery process. By creating lists of documents that should be produced in all customer arbitrations as well as particular types of cases, the Discovery Guide will help expedite the discovery process and reduce the number of discovery disputes between parties, which in turn should help lower the

⁴⁵ The Commission agrees with several commenters that applicable privileges, which are usually a matter of state law, should not be specified in the Discovery Guide.

cost of the arbitration discovery process. Further, nothing in the Discovery Guide changes the burden of establishing or defending any aspect of a claim. When considered as a whole, the Discovery Guide provides useful guidance to parties and arbitrators in NASD-sponsored customer arbitrations.

In addition, the Commission finds that the proposal is consistent with the requirements of Section 15A of the Act⁴⁶ and the rules and regulations thereunder that govern the NASD.⁴⁷ In particular, the Commission finds that the proposal is consistent with Section 15A(b)(6) of the Act⁴⁸ which requires, among other things, that the rules of an association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination among customers, issuers, brokers, or dealers.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁴⁹ that the proposed rule change (SR-NASD-99-07), as amended, is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41820; File No. SR-NASD-99-35]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Definition of "Person Associated with a Member"

September 1, 1999.

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 August 3, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission

⁴⁶ 15 U.S.C. 78o-3.

⁴⁷ In addition, pursuant to Section 3(f) of the Act, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴⁸ 15 U.S.C. 78o-3(b)(6).

⁴⁹ 15 U.S.C. 78s(b)(2).

⁵⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared by the Association. The 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

The NASD is proposing to amend the definition of "person associated with a member" in the By-Laws of the NASD, NASD Regulation, Inc. ("NASD Regulation"), and The Nasdaq Stock Market, Inc. ("Nasdaq"). The text of the proposed rule change is set forth below. Additions are italicized and deletions are bracketed.

* * * * *

BY-LAWS OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

ARTICLE I DEFINITIONS

* * * * *

(ee) "person associated with a member" or "associated person of a member" means: (1) a natural person *who is registered or has applied for registration* under the Rules of the Association; [or] (2) a sole proprietor, partner, officer, director, or branch manager of a member, or [a] *other* natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the NASD under these By-Laws or the Rules of the Association; *or*³ (3) *for purposes of Rule 8210, any other person listed in Schedule A of Form BD of a member;*

* * * * *

The NASD proposes conforming changes to Article I(y) of the NASD Regulation By-Laws and Article I(r) of the Nasdaq By-Laws, respectively.

* * * * *

³ The NASD has approved the substitution of the word "or" in place of the word "and" in the proposed text here as it appeared in the NASD's original filing, to make clear that item (3) represents an alternative meaning of "associated person." Telephone conversation between Mary Dunbar, Associate General Counsel, NASD Regulation, and Gordon Fuller, Special Counsel, and Ira L. Brandriss, Attorney, Division of Market Regulation, Commission (August 11, 1999).

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 NASD 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 NASD 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 NASD proposes two amendments to the definition of "person associated with a member" in Article I of the NASD By-Laws, and conforming amendments to the NASD Regulation and Nasdaq By-Laws. The term is currently defined to include: (1) a natural person registered under the Rules of the Association; or (2) a sole proprietor, partner, officer, director, or branch manager of a member, or a natural person occupying a similar status or performing similar functions, or a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the NASD under the By-Laws or the Rules of the Association.

Two issues have arisen with respect to the definition. The first issue is whether the definition should be expanded to apply to certain owners of members. Currently, the definition only includes owners who are natural persons engaged in the member's investment banking or securities business and who have a direct or indirect "control" relationship with the member.⁴ While the NASD does not believe that the definition of associated person should include all owners and thereby subject them to all NASD rules, the NASD would like to amend the

⁴The By-Laws do not define the term "control." Form BD defines "control" as the "power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. Any person that * * * directly or indirectly has the right to vote 25% or more of a class of voting securities or has the power to sell or direct the sale of 25% or more of a class of voting securities; or * * * in the case of a partnership, has the right to receive upon dissolution, or has contributed 25% or more of the capital, is presumed to control that company."

definition with what it views as a modest and incremental expansion to give the staff authority to require the provision of information and testimony under Rule 8210 ("the Rule") from any person—including a natural person or corporate or other entity—who holds a five percent or greater interest in a member firm, regardless of whether they "control" the member firm or are actively engaged in its securities or investment banking business.

The NASD can identify such owners because members must list them in Schedule A of Form BD, which is filed with the NASD and the Commission. For example, if the member is a corporation, the member generally must list each shareholder that directly owns five percent or more of a class of a voting security of the member. If the member is a partnership, the member must list all general partners and those limited and special partners that have contributed, or have the right to receive upon dissolution, five percent or more of the partnership's capital. Members have a continuing obligation to update Schedule A.

The NASD is not recommending any change to the Rule itself, which is one for the staff's primary tools for carrying out its regulatory responsibilities. The Rule authorizes the staff, for the purpose of an investigation, complaint, examination, or proceeding authorized by the NASD By-Laws or rules, to require a member or associated person to provide information or testimony. The Rule also authorizes the staff to inspect and copy the books, records, and accounts of such member or person with respect to any matter involved in the investigation, complaint, examination, or proceeding. The proposed amendment to the definition of associated person would permit the staff to direct a Rule 8210 request to any owner—individual, corporate, partnership, trust, or otherwise—listed in Schedule A of Form BD, whether or not such owner controls the member firm. The NASD does not believe that it is necessary at this time to apply any other NASD rules to this group of owners or to amend Rule 8210; however, an owner who falls within the associated person definition but fails to comply with a Rule 8210 request may be disciplined by the NASD.

The second issue involves an anomaly between the By-Law definition of the term "person associated with a member" and a Form U-4, which is the application form for registration that must be signed by the prospective registered person. The Form U-4 states that by signing the Form, the applicant is subject to the jurisdiction of the

NASD and any state in which he is applying for registration. However, the current definition of "associated person" in the By-Laws does not address applicants for registration. The NASD proposes that the By-Law should be made expressly consistent with the Form U-4 in this respect.

Finally, the word "other" is inserted into subsection 2 of the definition to clarify that the subsection describes only natural persons.

The NASD proposes to make the rule change effective for all members within 45 days after Commission approval. The effective date will be announced at least 15 days in advance in a Notice To Members.

2. Statutory Basis

The NASD believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6)⁵ of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The NASD believes that the proposed rule change will help it obtain necessary information to conduct its regulatory investigations and proceedings and clarify its jurisdiction over applicants for registration.

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

The NASD 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.

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

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 self-regulatory organization consents, the Commission will:

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

⁵ 15 U.S.C. 78o-3(b)(6).

(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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 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 the filing will also be available for inspection and copying at the principal offices of the NASD. All submissions should refer to File No. SR-NASD-99-35 and should be submitted by October 1, 1999.

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

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41824; File No. SR-PCX-99-24]

Self-Regulatory Organizations; Notice of Filing of Amendment No. 2 and Order Granting Partial Accelerated Approval to a Proposed Rule Change by the Pacific Exchange, Inc. Relating to Automated Opening Rotations

September 1, 1999.

I. Introduction

On July 13, 1999, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") 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 related to automated opening rotations ("AOR"s). On August 4, 1999, the PCX filed with the Commission Amendment No. 1 to the proposal.³ Notice of the proposed rule change appeared in the **Federal Register** on August 30, 1999.⁴ On September 1, 1999, the PCX filed Amendment No. 2 to the proposal.⁵ The Commission is publishing this notice to solicit comments on Amendment No. 2. In addition, for the reasons discussed below, the Commission has determined to grant accelerated approval of PCX's request in Amendment No. 2 to implement automated opening rotations for 16 issues on a thirty day pilot basis.

II. Description of the Proposal

A. Introduction

The Exchange is proposing to adopt a new procedure to facilitate trading of option contracts during the opening rotation.⁶ Opening rotations are held promptly following the opening of the underlying security on the principal market where it is traded.⁷ Opening rotations are conducted by an Order Book Official ("OBO"), who is an Exchange employee.⁸ The PCX rules on opening rotations apply to both index and equity options contracts.⁹

In its initial filing, as amended by Amendment No. 1, the PCX proposed a new process that would allow the Exchange to conduct AORs. The Exchange proposed a procedure to allow the OBO to establish electronically a single price opening for executing eligible market and marketable limit orders in the POETS system. In the event of an imbalance, any remaining orders in the system that are eligible to be executed will be assigned to market makers participating on the Auto-Ex System. The new process involves three basic steps: first, the markets are

established; second, the opening rotation is automatically processed for the majority of series; and finally, any series with manual orders or compilation is opened manually, *i.e.*, pursuant to the current procedures for opening rotations.

More specifically, under the new AOR process, opening rotations on the PCX will occur in the following manner: Prior to the opening, the OBO will determine whether there are any orders in the trading crowd to be executed at the opening. Once the underlying security has opened, the OBO will request from the trading crowd bids and offers in the specific option issue. The trading crowd may determine that the posted bids and offers are accurate, or alternatively, may request by public outcry that certain quotes be modified.¹⁰ Once the bid and asking price in each series has been ascertained, the OBO and AOR system will identify all series that are eligible for the AOR and that can be opened immediately, and will also identify all series that are not eligible for the AOR. Those that are not eligible for the AOR must be opened manually.¹¹

B. Amendment No. 2

In Amendment No. 2, the PCX requests that the Commission grant accelerated approval of a thirty day pilot program ("Pilot") that would allow the Exchange to use automated openings for 16 issues during the pilot period. The 16 issues are Microsoft Corp. (MSQ), Compaq Computer Corp. (CPQ), Sun Microsystems, Inc. (SUQ), Applied Materials (AMAT), 3Com Corp. (THQ), Advanced Micro Devices (AMD), Tellabs, Inc. (TLAB), Schering-Plough Corp. (SGP), McKesson HBOC, Inc. (MCK), ALZA Corp. (AZA), R&B Falcon Corp. (FLC), First Union Corp. (FTU), NIKE, Inc. (Class B) (NKE), Newbridge Networks Corp. (NN), Data General

³ In Amendment No. 1, the Exchange further clarifies the operation of automated openings, provides rule text related to the new procedures, and justifies its request for accelerated approval. See letter from Michael D. Pierson, Director, Regulatory Policy, PCX, to Michael A. Walinskas, Associate Director, Division of Market Regulation ("Division"), SEC, dated August 3, 1999 ("Amendment No. 1").

⁴ See Securities Exchange Act Release No. 41774 (August 20, 1999), 64 FR 47210.

⁵ In Amendment No. 2, the Exchange provides additional details about the operation of automated openings and proposes limited use of such openings for certain issues on a pilot basis. See letter from Michael D. Pierson, Director, Regulatory Policy, PCX, to Richard Strasser, Assistant Director, Division, SEC, dated September 1, 1999 ("Amendment No. 2").

⁶ The Exchange intends to continue to employ the current (manual) procedures for closing rotations.

⁷ See PCX Rule 6.64, Comment .01(a).

⁸ See PCX Rules 6.51 and 6.64.

⁹ See PCX Rule 7.10.

¹⁰ Prior to an automated opening, the members of the trading crowd must establish a bid and offer for each series in a given issue. This occurs basically as follows: The OBO will first display a bid price and an offering price for a particular series. (These prices will have been established either by the Auto-Quote feature of POETS or by a manual process, *i.e.*, a member or members of the trading crowd will vocalize bids and offers that a Market Quote Terminal Operator will enter into the system and display on the overhead screen.) The OBO will then ask the crowd if the displayed prices are "all right" (or other words to that effect). There will then be a short window period when the displayed prices may be adjusted. While the trading crowd is establishing the market, any member may vocalize a bid or offer that improves the market, and the OBO will be required to update the market accordingly. See Amendment No. 1.

¹¹ For a more detailed description of the current and proposed processes, see Securities Exchange Act Release No. 41774 (August 20, 1999), 64 FR 47210 (August 30, 1999).

⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.