

measures for incorporation into Rule 103A.

Regarding the Intermarket Trading System ("ITS"), the Commission has stated its belief that the mature status of the ITS as a market structure facility warrants the incorporation of ITS turnaround and "trade-through" concerns into the NYSE's Rule 103A performance standards. The Exchange continues to believe that ITS matters are more appropriately addressed by means of the Exchange's regulatory process rather than through its performance measurement system, but will continue to study the matter.

## 2. Statutory Basis

The Exchange believes the basis under the Act for the proposed rule change is the requirement under Section 6(b)(5) that an exchange have rules that are designed to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest. The Exchange believes the proposed extension of Rule 103A is consistent with these objectives in that it will allow the Exchange to continue to administer the rule on an uninterrupted basis, fostering quality specialist performance.

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

The Exchange 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*

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 thirty-five 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 ninety 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

(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. 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. 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 6 U.S.C. § 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. SR-NYSE-96-22 and should be submitted by September 11, 1996.

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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[Release No. 34-37563; File No. SR-PSE-96-21]

### **Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change by the Pacific Stock Exchange, Inc., Relating to the Liability of the Exchange and Its Governors, Officers, and Agents**

August 14, 1996.

## I. Introduction

On June 17, 1996, the Pacific Stock Exchange, Inc. ("PSE" or "Exchange") submitted to 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 adopt new provisions pertaining to the liability of the Exchange and to amend an existing provision. Specifically, the PSE proposes to adopt: New Rule 13.2, which clarifies and broadens the

existing limitations on the Exchange's liability; new Rule 13.3, which prohibits members from instituting certain types of legal proceedings against Exchange officials; and new Rule 13.4, which provides for the recovery of the Exchange's defense costs in certain circumstances. In addition, the PSE proposes to amend Rule 6.59, to clarify its purposes and to provide a reference to the new provisions in Rule 13.

Notice of the proposed rule change appeared in the Federal Register on July 3, 1996.<sup>3</sup> No comments were received on the proposed rule change.<sup>4</sup> This order approves the PSE's proposal.

## II. Background and Description

### *A. Liability of Exchange*

The principal rule concerning Exchange liability is contained in Article VI, Section 6 of the PSE Constitution. Article VI, Section 6 provides that the Exchange is not liable to members for damages arising out of the use or enjoyment of Exchange facilities in the conduct of their business.

New Rule 13.2(a)<sup>5</sup> clarifies that, except as otherwise expressly provided in the rules of the Exchange, neither the Exchange nor its Governors, officers, committee members, employees, or agents shall be liable to members or their associated persons except where the Exchange's liability is attributable to willful misconduct, gross negligence, bad faith, fraud, or criminal acts. In addition, new Rule 13.2(a) clarifies that the limitation of the Exchange's liability includes interruption, failure or unavailability of Exchange facilities or services.

New Rule 13.2(a)<sup>6</sup> also adds language which limits the Exchange's liability for errors, omissions, or delays in calculating or disseminating various kinds of data relating to current or closing index values, reports of transactions or quotations for options or other securities, and further provides that the Exchange does not warrant the

<sup>3</sup> See Securities Exchange Act Release No. 37391 (July 1, 1996), 61 FR 36100 (July 9, 1996).

<sup>4</sup> The PSE submitted a letter regarding the enforceability of the proposed rules under state law. See letter from Rosemary A. MacGuiness, Senior Counsel, Director of Arbitration, PSE, to Glenn Barrentine, Branch Chief, Office of Market Supervision, Division of Market Regulation, Commission, dated August 7, 1996.

<sup>5</sup> The PSE notes that new Rule 13.2(a) is based on Chicago Stock Exchange ("CHX") Article I, Rule 18(a) and the proposed rule changes filed by the Chicago Board Options Exchange ("CBOE") to Rule 6.7(a). See Securities Exchange Act Release No. 36863 (February 20, 1996), 61 FR 7285 (February 27, 1996) (File No. SR-CBOE-96-02).

<sup>6</sup> The PSE notes that this language to new Rule 13.2(a) is based on CBOE Rule 24.12.

<sup>10</sup> 17 CFR 200.30-3(a)(912) (1994).

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

<sup>2</sup> 17 CFR 240.19b-4.

results obtained by any person or entity relying on data transmitted by or on behalf of the Exchange or any designated reporting authority. New Rule 13.2(a)<sup>7</sup> states that its provisions are in addition to, and do not limit, the provisions of the PSE Constitution, Article VI, Section 6. Lastly, paragraphs (b) and (c) of new Rule 13.2<sup>8</sup> describe the monetary limits on the Exchange's liability with respect to the Exchange's order routing systems, electronic book, and automatic execution systems.<sup>9</sup>

#### *B. Legal Proceedings Against Exchange Governors, Officers, Employees, or Agents*

New Rule 13.3<sup>10</sup> prohibits a member or associated person from instituting a lawsuit or any other type of legal proceeding against any Governor, officer, employee, agent, or other official of the Exchange or any of its subsidiaries based on actions taken or omitted to be taken while such person is acting on Exchange business or the business of any of its subsidiaries. Rule 13.3, however, does not apply where private rights of action under the federal securities laws exist, to appeals of disciplinary actions, to other actions by the Exchange as provided for in its rules, and, with respect to the Governors of the Exchange, to the extent such action or omission is inconsistent with the Exchange's Certificate of Incorporation.

The Exchange notes that new Rule 13.3 does not prohibit a member from suing the Exchange as a result of the actions of these individuals; rather it merely prohibits suits against the person in his or her individual capacity. According to the PSE, the purpose of disallowing lawsuits or other legal

proceedings against Exchange officials or agents when they are acting on Exchange business is to eliminate the potential exposure to personal liability of such persons which impairs their ability to perform their duties.

#### *C. Exchange's Costs of Defending Legal Proceedings*

New Rule 13.4<sup>11</sup> requires a member or associated person who fails to prevail in a lawsuit or other legal proceeding instituted by that person against the Exchange or other specified persons, and related to the business of the Exchange, to pay to the Exchange all reasonable expenses, including attorney's fees, incurred by the Exchange in its defense of such proceeding. The requirement would apply only where the costs exceed fifty thousand dollars (\$50,000).

According to the PSE, this provision is intended to discourage unfounded, vexatious litigation against the Exchange where the Exchange's costs are significant, without having an undue chilling effect on legitimate claims of members. The proposed rule would apply to lawsuits or other legal proceedings that might be instituted by members against the Exchange or to any of its Governors, officers, committee members, employees, or agents. This provision, however, would not apply to disciplinary actions, to administrative appeals of Exchange actions, or to any specific instance where the Board of Governors has granted a waiver of this rule.

#### *D. Liability of Exchange for Actions of Order Book Officials*

Current Rule 6.59 (a) and (g) are being amended for clarification purposes.<sup>12</sup> Rule 6.59 is also adding a reference to the new provisions in Rule 13.

### III. Discussion

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, with the requirements of Section 6(b)(5).<sup>13</sup> Specifically, the Commission believes that by limiting the liability of the Exchange and its Governors, officers, committee members, employees, and agents, by precluding certain types of

legal actions by members against such persons individually, and by discouraging frivolous lawsuits against the Exchange, the costs of the Exchange in responding to claims and lawsuits will be reduced, thereby permitting the resources of the Exchange to be better utilized for promoting just and equitable principles of trade and for protecting investors and the public interest.

#### *A. Liability of Exchange*

The Commission believes the rule change limiting the liability of the Exchange and its Governors, officers, committee members, employees, and agents, to situations attributable to willful misconduct, gross negligence, bad faith, fraud, or criminal acts, will adequately preserve members' right to pursue actions in circumstances where the Exchange and its officials should be held accountable, or where there has been a violation of the federal securities laws.

#### *B. Legal Proceedings Against Exchange Governors, Officers, Employees, or Agents*

The Commission believes that the rule change prohibiting members from instituting legal proceedings against Exchange officials should be approved. Specifically, the rule change prohibits members and associated persons from instituting lawsuits or any other legal proceedings against any Governor, officer, employee, agent, or other official of the Exchange or any subsidiary of the Exchange, for actions taken or omitted to be taken by these parties in connection with official business of the Exchange or any subsidiary. New Rule 13.3, however, does not impair members' ability to initiate legal action based upon violations of the federal securities laws for which a private right of action exists, appeals of disciplinary actions, other actions by the PSE as provided for in the Exchange's rules, and with respect to the Governors of the Exchange, to the extent such action or omission is inconsistent with the Exchange's Certificate of Incorporation. The Commission believes that new Rule 13.3 is consistent with the Act because it will help to ensure that the covered persons will be able to carry out their duties under the Act, and to enforce compliance with the Act and the rules thereunder, as well as the rules of the Exchange, without the threat of personal liability.

#### *C. Exchange's Cost of Defending Legal Proceedings*

The Commission believes that the rule change requiring members or associated persons who fail to prevail in a lawsuit

<sup>7</sup> The PSE notes that this aspect of new Rule 13.2(a) is based on CHX Article I, Rule 18(b).

<sup>8</sup> The PSE notes that new Rules 13.2 (b) and (c) are based on CBOE Rules 6.7 (b) and (c).

<sup>9</sup> Under new Rule 13.2(b), the PSE's liability with respect to the Exchange's order routing systems, electronic book, and automatic execution systems is limited to the larger of any recovery obtained by the Exchange under any applicable insurance or: (i) \$100,000 as to any claim or series of claims made by a single member on a single day; (ii) \$250,000 as to all claims by all members on any single trading day; and (iii) \$500,000 as to all claims, in the aggregate, by all members in any calendar month.

Under new Rule 13.2(c), if all of the claims arising out of the use of enjoyment of the facilities afforded by the Exchange cannot be fully satisfied because in the aggregate they exceed the applicable maximum amount of liability provided for in paragraph (b), the maximum amount will be allocated based on the proportion that each claim bears to the sum of the all such claims.

<sup>10</sup> The PSE notes that new Rule 13.3 is based on CHX Article I, Rule 17 and the proposed rule changes filed by the CBOE to Rule 6.7A. See Securities Exchange Act Release No. 36863, *supra* note 5.

<sup>11</sup> The PSE notes that new Rule 13.4 is based on CHX Article I, Rule 18(c) and the proposed rule changes filed by the CBOE to Rule 2.24. See Securities Exchange Act Release No. 36863, *supra* note 5.

<sup>12</sup> The PSE notes that the amendments are based on CBOE Rules 7.11(b)(1) and 7.11(e), respectively.

<sup>13</sup> 15 U.S.C. 78f(b)(5) (1988).

or other legal proceeding instituted by that person against the Exchange or other specified persons, and related to the business of the Exchange, to pay all reasonable expenses, including attorneys' fees; incurred by the PSE in its defense during such proceedings if such expenses exceed \$50,000, is consistent with Section 6(b)(4) of the Act.<sup>14</sup> Section 6(b)(4) requires that the rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members.

The Commission believes that because the funds to pay the legal expenses incurred by the Exchange in defending legal suits are generated, in part, by membership fees, the rule change reflects a reasonable business decision by the membership to shift the financial burden of litigation to the responsible member under certain circumstances. Moreover, as the Exchange's legal expenses must be reasonable and must accrue to at least \$50,000 before a member would be obligated to compensate the Exchange, the Commission believes that the rule change should not provide an undue disincentive to litigation, in so far as it will permit the discovery needed to assess the merits of members' cases.

The Commission also notes that new Rule 13.4 specifically excludes disciplinary actions brought by the Exchange, administrative appeals of Exchange actions, as well as any other specific instance where the Board of Governors grants a waiver of this rule. The Commission believes that this provision will ensure that members will be able to freely pursue their right to appeal any action brought by the Exchange for violations of its rules.<sup>15</sup>

#### *D. Liability of Exchange for Actions of Order Book Officials*

The Commission believes that because the PSE's proposal regarding the Exchange's order book officials clarifies the application of the rules governing Exchange liability, it should be approved.

#### **IV. Conclusion**

For the foregoing reasons, the Commission finds that the PSE's proposal to limit the liability of the Exchange and its directors, officers,

employees, and agents, to preclude certain types of legal actions by members against such persons individually, and to require members to pay the Exchange's costs of litigation under specified circumstances is consistent with the requirements of the Act and the rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>16</sup> that the proposed rule change (SR-PSE-96-21) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

Margaret H. McFarland,

*Deputy Secretary.*

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[Release No. 34-37570; File No. SR-PHILADEP-96-11]

#### **Self-Regulatory Organizations; The Philadelphia Depository Trust Company; Notice of Filing of a Proposed Rule Change Regarding the Destruction of Certain Expired Securities Certificates**

August 14, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on June 28, 1996, the Philadelphia Depository Trust Company ("Philadep") filed with the Securities and Exchange Commission ("Commission") the proposed rule change (File No. SR-PHILADEP-96-11) as described in Items I, II, and III below, which Items have been prepared primarily by Philadep. 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**

Philadep proposes to amend its rules to permit the destruction of expired securities certificates representing warrants or rights that have expired to be carried out under the supervision of Philadep's internal audit department.

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

In its filing with the Commission, Philadep included statements concerning the purpose of and basis for

the proposed rule change and discussed any comments that it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. Philadep has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.<sup>2</sup>

#### **(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 amend Rule 31 which governs the orderly destruction of securities certificates relating to expired warrants and rights.<sup>3</sup> Currently, Section (c) of Rule 31 requires that all securities to be destroyed pursuant to the rule must be forwarded to the rule department for destruction.<sup>4</sup> Under the proposed rule change, Philadep will be allowed to destroy the certificates in a designated area of Philadep under the supervision of the internal audit department instead of being required to destroy such certificates in the internal audit department itself.

Philadep believes the proposed rule change complies with Section 17A of the Act because it is contemplated to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions by providing an efficient administrative mechanism to destroy expired securities that presently and unnecessarily occupy critical space in Philadep's vault.

<sup>2</sup> The Commission has modified the text of the summaries submitted by Philadep.

<sup>3</sup> The procedures for the destruction of expired securities set forth in Rule 31 require Philadep to (i) contact the transfer agent or the issuer of the expired securities to verify that the respective warrants or rights have expired, (ii) obtain written confirmation from such transfer agent or issuer that the certificates representing such warrants or rights have expired (if there is no transfer agent, Philadep personnel must exercise all reasonable due diligence to confirm the expired nature of the respective certificates including consulting with the Philadep's legal department, internal audit department and senior management), (iii) notify its participants that in the judgment of the transfer agent, or other appropriate parties if a transfer agent does not exist, the securities certificates have expired, (iv) delete such securities positions from its participants' account on or after the thirtieth day following the date of such notice, and (v) appropriately mark the securities certificates and forward them to its internal audit department for destruction.

<sup>4</sup> Securities Exchange Act Release No. 35426 (February 28, 1995) [File No. SR-PHILADEP-94-05] (order approving proposed rule change authorizing Philadep to implement a program for the destruction of securities certificates relating to expired warrants and rights).

<sup>14</sup> 15 U.S.C. 78f(b)(4) (1988).

<sup>15</sup> The Commission notes that if the minimum amount in the fee provision were substantially lower it might have a more difficult time concluding that the provision was consistent with Section 6(b)(4). This is because such a lower threshold amount could be found to represent an inequitable allocation of fees to the disadvantage of certain members.

<sup>16</sup> 15 U.S.C. 78s(b)(2) (1988).

<sup>17</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. § 78s(b)(1) (1988).