

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. 34-42563; File No. SR-OCC-99-16]

Self Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change Relating to Exercises by Put Holders in a "Short Squeeze" Situation

March 22, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on November 2, 1999, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by OCC. 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 proposed rule change would amend Article VI, Section 19 to eliminate OCC's authority to prohibit exercises by put holders who would be unable to deliver the underlying stock in a short squeeze situation and, in lieu thereof, to give OCC the same authority to protect put holders as OCC already has to protect call holders.

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

In its filing with the Commission, OCC 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. OCC has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.²

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 Article VI, Section 19 of OCC's by-laws to eliminate OCC's authority to prohibit exercises by put holders who would be unable to deliver the underlying stock in a short squeeze situation and, in lieu thereof, to give OCC the same authority to protect put holders as OCC already has to protect call holders.

Currently, Article VI, Section 19 treats calls and puts differently in a short-squeeze situation. Section 19(a)(3) allows OCC to suspend the exercise settlement obligations of clearing members' assigned execution notice for their call option contracts until (i) OCC determines that there is no reasonable likelihood that a sufficient supply of the underlying security will become available, in which case OCC fixes a cash settlement price³ or (ii) OCC determines that there is a sufficient supply of the underlying security available, in which case OCC either fixes a new exercise settlement date or, if delivery would be inequitable, a cash settlement price.⁴

In contrast, Article VI, Section 19 does not currently give OCC discretion to protect the benefit of a put holder's bargain in a short squeeze situation. Instead, as it is currently written, Article VI, Section 19(a)(2) gives OCC the limited power to prohibit the exercise of put option contracts by clearing members who will be unable to deliver the underlying securities on the exercise settlement date due to the short squeeze.⁵ If OCC were to maintain such a prohibition through the option's expiration, a put holder who was unable to obtain the underlying stock would lose the benefit of the option even though the option is in the money.

Rather than allowing OCC to prohibit put exercises in a short squeeze

situation, the proposed language would allow OCC to treat puts in the same manner as calls by giving OCC the right to suspend settlement until it can determine whether the unavailability of the underlying stock would extend past the option expiration date and, upon making that determination, to take the appropriate action under Article VI, Section 19(b) or (c). Thus, the proposed change allows OCC to protect the benefit of the put holder's bargain and to treat puts and calls equally in a short squeeze situation.

Because the proposed rule change would affect the fundamental obligations of put writers, OCC is making it effective only on a prospective basis with respect to new series of options introduced after the latter of (i) approval of the rule change by the Commission or (ii) commencement of distribution of a new or amended Options Disclosure Documents or an Options Disclosure Document⁶ supplement disclosing the substance of the rule change.

Article XXIV, Section 5, which relates to buy-write options unitary derivatives (BOUNDS)⁷ is proposed to be amended so that it conforms to the proposed new language for Article VI, Section 19.

OCC believes that the proposed rule change is consistent with the purposes and requirements of Section 17A of the Act because the proposed rule change will facilitate the prompt and accurate clearance and settlement of securities transactions, foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, and, in general, protect investors and the public interest.

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

OCC does not believe that the proposed rule change would impose any burden on competition.

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

Written comments were not and are not intended to be solicited with respect to the proposed rule change, and none have been received.

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)

³ Article VI, Section 19(c) of OCC's by-laws.

⁴ Article VI, Section 19(b) of OCC's by-laws.

⁵ The asymmetrical treatment of puts and calls was first addressed in 1979, when OCC believed that a call holder who is fully prepared to perform his obligation (*i.e.*, pay the exercise price) should not be disadvantaged merely because his exercise happens to be randomly assigned to an uncovered writer. Securities Exchange Act Release No. 16014 (Aug. 3, 1979), 44 FR 47424, (Aug. 13, 1979). OCC now believes that it is inappropriate to render a put holder's contract valueless when circumstances beyond his control (often a bankruptcy filing or other event adversely affecting the value of the underlying stock and thus validating the put holder's market judgment) disable him from obtaining the underlying stock. Such a result would generally be perceived as unfair and the desirability of avoiding a perception of unfairness outweighs the somewhat legalistic basis for the present rule.

⁶ 17 CFR 200.30-3(a)(12).

⁷ 15 U.S.C. 78s(b)(1).

² The Commission has modified parts of these statements.

⁶ 17 CFR 240.9b-1.

⁷ Securities Exchange Act Release No. 36960 (Mar. 13, 1996), 61 FR 11458.

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 OCC consents, the Commission will:

(a) By order approve the 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. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of OCC. All submissions should refer to File No. SR-OCC-99-16 and should be submitted by April 19, 2000.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁸

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42557; File No. SR-PCX-98-30]

Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Granting Approval to Proposed Rule Change and Amendment No. 1 to the Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendments 2 and 3 to the Proposed Rule Change Relating to Telephone Use on the Options Floor

March 21, 2000.

I. Introduction

On June 26, 1998, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "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 codify the Exchange's procedures and restrictions regarding telephone use on the Options Trading Floor. On November 12, 1998, the Exchange filed Amendment No. 1 to the proposed rule change.³ The proposed rule change, including Amendment No. 1 was published for comment in the **Federal Register** on February 6, 1999.⁴ On August 4, 1999 and September 27, 1999, respectively, the Exchange filed Amendments 2⁵ and 3⁶ to the proposed rule change. No comments were received on the proposal. This order approves the proposal as amended.

II. Description of the Proposal

The purpose of this proposal is to establish rules and procedures for telephone use on the Options Floor. Proposed Rule 6.2(h) sets guidelines for the use of telephones by market makers,

Lead Market Makers ("LMMs"), floor brokers, clerks, and floor managers.

The PCX is proposing to establish a formal rule requiring that Members and Member Firms must register, prior to use, any new telephone to be used on the Options Floor. Proposed Rule 6.2(h)(1) states that each phone registered with the Exchange must be registered by category of user (market maker, LMM, floor broker, clerk, or manager). If there is a change in the category of any user, the phone must be re-registered with the Exchange. At the time of registration, Members and Member Firm representatives must sign a statement indicating that they are aware of and understand the rules governing the use of telephones on the Options Floor.

The proposed Rule further states that no Member or Member Firm may employ any alternative communication device, including but not limited to e-mail, on the Options Floor without the prior approval of the Options Floor Trading Committee.

Capacity and Functionality

Proposed Rule 6.2(h)(2) specifies the capacity and functionality permitted for the use of telephones on the Options Floor. The Rule states specifically that no wireless telephone used on the Options Floor may have an output greater than one watt and that no person on the Options Floor may use any device for the purpose of maintaining an open line of continuous communication whereby a person not located in the trading crowd may continuously monitor the activities in the trading crowd. This prohibition covers intercoms, walkie-talkies and any similar devices. The Rule does not permit speed-dialing features for Member phones.

The proposed Rule states specific guidelines for each category of user on the Options Floor, as follows:

Market Makers and LMMs

Proposed Rule 6.2(h)(3) states that market makers and LMMs may use their own cellular and cordless phones to place calls to any person at any location (whether on or off the Options Floor). The Rule also states that market makers and LMMs may use the pit rep and LMM telephones located at the trading posts only for the purpose of marketing option issues, responding to customer inquiries, or otherwise conducting Exchange business. No person other than a pit rep, market maker⁷ or an LMM may use the pit rep or LMM phones. This is to ensure that phones

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Robert Pacileo, Staff Attorney, Regulatory Policy, PCX, to David Sieradzki, Attorney, Division of Market Regulation, SEC, dated November 10, 1998 ("Amendment No. 1"). The substance of Amendment No. 1 is incorporated into this order.

⁴ Securities Exchange Act Release No. 41018 (February 3, 1999), 64 FR 7681.

⁵ See letter from Michael D. Pierson, Director, Regulatory Policy, PCX, to David Sieradzki, Special Counsel, Division of Market Regulation, SEC, dated August 3, 1999 ("Amendment No. 2"). In Amendment No. 2, the Exchange clarifies that subsections (d)-(g) of Rule 6.2 are reserved for future use.

⁶ See letter from Michael D. Pierson, Director, Regulatory Policy, PCX, to David Sieradzki, Special Counsel, Division of Market Regulation, SEC, dated September 24, 1999 ("Amendment No. 3"). In Amendment No. 3, the Exchange amends Rule 6.2(h)(6) to indicate that floor managers may not use the pit rep or LMM phones.

⁷ See Amendment No. 1, *supra* note 3.

⁸ 17 CFR 200.30-3(a)(12).