

notification to review the proposed Seat Transaction. Understanding that the Governance Member or Member Organization may need to act quickly in order to consummate a Seat Transaction, Article V.3(a) of the Seat Transaction Policy mandates the Special Committee to make all reasonable efforts to respond to the Governance Member or Member Organization rapidly and within a time frame requested by such person. The Seat Transaction Policy therefore anticipates that, in certain cases, the Special Committee will be asked to review a Seat Transaction within 24 hours of notification of the Board of Governors by the Governance Member or Member Organization. In any case, the Special Committee must either render a decision, conduct an interview with the Governance Member, or request additional information from the Governance Member within 15 business days from the time of request. If the Special Committee conducts an interview with the Governance Member or requests additional information from the Governance Member, than the Special Committee must render a decision within 30 business days from the later to occur of (i) the interview or, (ii) if further information is requested by the Special Committee, all requested information is supplied to the Special Committee; provided that a Governance Member may waive compliance with these deadlines.

Special Committee Procedures

Article V.4 of the Seat Transaction Policy requires the Special Committee to render a binding written decision to the Governance Member or Member Organization, as well as to the Board of Governors, regarding whether the proposed Seat Transaction complies with the Seat Transaction Policy. Articles V.3 and V.4 provide further procedures to be followed by the Special Committee in reviewing Seat Transactions. An aggrieved Governance Member or Member Organization may appeal decisions of the Special Committee to the Board of Governors consistent with Article XI of the Phlx By-Laws, by filing a written notice with the Secretary of the Exchange within thirty (30) days of the Special Committee's decision.

Proposed Articles V.3(d) and V.4 specify the remedies that the Special Committee may impose in the event it determines that a Governance Member or Member organization possess Material Confidential Information at the time of a Seat Transaction. These remedies include (i) prohibiting the Seat Transaction until such time as the Material Confidential Information is no

longer confidential; (ii) requiring that Material Confidential Information be disclosed to the other party, but only after a non-disclosure agreement between the parties is in place; and (iii) disallowing the Seat Transaction to proceed, but only during certain "window periods" established by the Special Committee.

Disciplinary Consequences

Under amended Phlx Rule 708, the Exchange proposes to provide notice to Governance Members and Member Organizations that the failure by any Governance Member or Member Organization to comply with the Seat Transaction Policy constitutes a violation of Phlx Rule 708, *Acts Detrimental to the Interest and Welfare of the Exchange*, and would thereby subject such Governance Member or Member Organization to disciplinary action by the Exchange pursuant to Phlx By-Laws 18-1 and 18-3.¹⁵ The Exchange states that Article V.3(b) of the Seat Transaction Policy makes clear that any determination by the Special Committee is for the sole benefit of the Exchange and is limited to the question whether a Governance Member or Member Organization's conduct complies with the Governance Member Code of Conduct. The Special Committee's decisions do not constitute legal advice and are not intended to affect the rights and obligations of Governance Members and Member Organizations under any applicable law or under any contract with third parties, including purchasers or sellers of Exchange Seats.

2. Statutory Basis

The Phlx believes that the proposed rule change, as amended, is consistent

¹⁵ The Exchange notes that conduct that violates the Seat Transaction Policy could also violate various laws and that no inference should be drawn that the Exchange's remedies for violative conduct are limited to disciplinary action under By-Laws 18-1 and 18-3. However, the Exchange notes that Seats have never been regarded as "securities" for purposes of the federal securities laws. Therefore, Seat Transactions would not be subject to the provisions of the federal securities laws prohibiting deceptive and manipulative practices "in connection with the sale of securities." (See, e.g., Section 10 of the Act, 15 U.S.C. 78j, and Rule 10b-5 under the Act, 17 CFR 240.10b-5.) See *Ferreri v. Goldberg Securities, Inc.*, 1989 WL 11073, 2-3 (E.D. Pa. 1989) ("it is the view of this Court that plaintiff's two [Seats] do not constitute 'securities'"); letter to Clifford Lefebvre, Esq., Baker, Nelson & Williams from John Heneghan, Deputy Chief Counsel, Office of the Chief Counsel, Commission dated March 12, 1973; letter to European Mercantile Exchange Limited from Brian Lynch, Attorney-Adviser, Division of Corporation Finance, Commission dated October 11, 1988; letter to American Stock Exchange—NASD from Michael Hyatte, Special Counsel, Division of Corporation Finance, Commission, dated July 10, 1998.

with the provisions of section 6 of the Act,¹⁶ in general, and in particular, with sections 6(b)(3) and 6(b)(5) of the Act,¹⁷ in that it is designed to regulate fairly and in the public interest the administration of the Exchange; with section 6(b)(5), in that it is designed to prevent fraudulent and manipulative acts and practices; and with section 6(b)(6), in that it is designed to appropriately discipline members for violation of the rules of the Exchange. Specifically, the Phlx believes that the Seat Transaction Policy, as specified in the Governance Members Code of Conduct, and Rule 708, as amended, should discourage fraudulent and manipulative acts and practices in connection with the purchase or sale of Exchange Seats by Governance Members, who owe a fiduciary duty to the Exchange and its members, and by Member Organizations, which are each prohibited from taking actions that are detrimental to the interests or welfare of the Exchange.

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

The Phlx does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were either solicited or 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 Phlx 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, as amended, is consistent with the Act. Persons making written submissions should file six copies

¹⁶ 15 U.S.C. 78f(b).

¹⁷ 15 U.S.C. 78f(b)(3) and (b)(5).