

transaction had been reported pursuant to an effective transaction reporting plan as defined in Rule 11Aa3-1 under the Exchange Act.<sup>17</sup> The proposed rule, therefore, would have shortened the mandatory waiting period (or "interval," as it is described in the UTP Act) for UTP in listed IPO securities from two trading days, as temporarily specified by amended Section 12(f),<sup>18</sup> to the time that it takes to effect and report the initial trade in the security on a listing exchange. The result of the proposed rule would have been to permit the regional exchanges to trade listed IPOs at essentially the same time as the primary listing exchange.

The Commission proposed a one-trade delay for UTP in listed IPOs because the Commission preliminarily believed that it was appropriate to minimize regulatory restraints on competition for trading listed IPO securities. In soliciting comments on proposed Rule 12f-2, however, the Commission noted a previous New York Stock Exchange ("NYSE") position that listed IPOs should be traded solely on the listing market for a "short" period of time to help ensure market efficiency immediately following the IPO.<sup>19</sup> The Commission also cited a report on the UTP Act by the House Committee on Energy and Commerce ("Committee"), in which the Committee directed the markets to provide the Commission with trading activity data on the effects of UTP in IPOs (including, for example, any volatility effects on the security), so that the Commission could determine whether the benefits of confining early trading in IPOs to one marketplace would be outweighed by the benefits of removing regulatory delays that inhibit competition among markets.<sup>20</sup>

The Commission solicited comments on these issues, specifically seeking comments on certain items that would be particularly useful to the Commission. These included identification and analysis of the potential harms and benefits that would result from either no waiting period, or from a longer waiting period than that proposed by the Commission. To the extent that commenters believed a waiting period would be appropriate, the Commission requested that they

provide data to illustrate the potential negative effects on the pricing of an IPO. The Commission also suggested that commenters might provide an analysis of the effects of the two-day waiting period temporarily in effect under the UTP Act. Finally, the Commission stated that it would be interested in receiving alternative proposed rules from commenters who believe that either no waiting period or a longer waiting period would be appropriate.

In addition, the Commission sought comment on whether any Commission action would be necessary under Section 12(f), as amended, in order to carry out the congressional objectives of linked markets as required by Section 11A(a)(1)(D).<sup>21</sup> Specifically, the Commission requested comment on whether changes should be made to the consolidated quotation, trade reporting, and order routing systems, now that exchanges and linking facilities will have less time to prepare for multiple exchange trading in the securities. The Commission expressed particular interest in receiving comments concerning any existing procedural delays that should be corrected by Commission action to ensure that the operation of amended Section 12(f) is not impeded.

#### B. Comments on Proposed Rule 12f-2

The Commission received a total of eight comment letters on proposed Rule 12f-2, five of which supported the proposed rule,<sup>22</sup> and three of which opposed the proposal.<sup>23</sup> Shortly prior to the publication of the proposed rules, the Commission also received a study from the Philadelphia Stock Exchange ("Phlx"), submitted on behalf of the Boston Stock Exchange, Inc., the Chicago Stock Exchange Inc., and the Pacific Stock Exchange Inc., concerning certain volume and pricing characteristics of listed IPOs.<sup>24</sup>

The Phlx Study shows high volume in IPOs during the early days of trading, particularly on the first and second day of trading. Based on this data, the Phlx Study states that a restriction on UTP in IPOs creates a substantial negative effect

on competition, both in relation to the listing exchange and OTC dealers.<sup>25</sup> The Phlx Study concludes that the Commission should adopt a rule for UTP in listed IPOs that would allow the regional exchanges to trade the securities on the first day of trading.

These competitive concerns were reiterated by the other comment letters supporting the proposed rule.<sup>26</sup> One regional exchange also states that it has listed IPOs simultaneously with the NYSE and has seen no adverse effect related to the dual listings.<sup>27</sup> This exchange argues that the NYSE has not been able to identify any adverse effects from the dual listing of IPOs. Another regional exchange states that, since the UTP Act reduced the waiting period to two days, there have been no instances of pricing disparities, inordinate volatility, or issuer complaints for securities traded by regional exchanges on the third trading day of IPOs, and no offering has been adversely affected by regional trading.<sup>28</sup>

The Commission received three comment letters, one from the NYSE and two from underwriters, expressing opposition to proposed Rule 12f-2.<sup>29</sup> These commenters believe that immediate regional exchange trading of IPOs would increase price volatility in the trading of IPO securities because the underwriters would not have sufficient time to ensure an orderly distribution of the securities. Two of the commenters argued that the temporary two-day delay should continue in place,<sup>30</sup> while the third commenter recommends at the very least a one-day trading delay.<sup>31</sup> Those proposing a two-day delay base their recommendation on data compiled by Lehman Brothers ("Lehman Study"), showing higher volatility in some Nasdaq IPOs than in selected NYSE IPOs. The two letters assert that this data demonstrates that dispersed initial trading of IPOs in the Nasdaq market is more volatile than initial centralized trading of IPOs.

The Commission received two comment letters from two regional exchanges in response to the comments opposing the proposed rule.<sup>32</sup> One of these commenters believes that National Market System procedures and practices are capable of providing effective

<sup>21</sup> Section 11A(a)(1)(D) of the Exchange Act provides:

The linking of all markets for qualified securities through communication and data processing facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors' orders, and contribute to best execution of such orders.

15 U.S.C. 78k-1(a)(1)(D).

<sup>22</sup> See BSE letter, Chx letter, PSE letter, Phlx response, and PSE response, *supra* note 4.

<sup>23</sup> See CS First Boston letter, Lehman letter, and NYSE letter, *supra* note 4.

<sup>24</sup> See Phlx Study, *supra* note 4.

<sup>25</sup> See *supra* note 9.

<sup>26</sup> See BSE letter, Chx letter, and PSE letter, *supra* note 4.

<sup>27</sup> See Chx letter, *supra* note 4.

<sup>28</sup> See PSE letter, *supra* note 4.

<sup>29</sup> See NYSE letter, CS First Boston letter, and Lehman letter, *supra* note 4.

<sup>30</sup> See NYSE letter and Lehman letter, *supra* note 4.

<sup>31</sup> See CS First Boston letter, *supra* note 4.

<sup>32</sup> PSE response and Phlx response, *supra* note 4.

<sup>17</sup> 17 CFR 240.11Aa3-1 (1991).

<sup>18</sup> See *supra* note 15.

<sup>19</sup> See Proposing Release, *supra* note 1, citing prepared testimony of Edward A. Kwalwasser, Executive Vice President, Regulation, New York Stock Exchange, UTP Hearing, *supra* note 12.

<sup>20</sup> See Proposing Release, *supra* note 1, citing H.R. Rep. No. 626, 103d Cong., 2d Sess. (1994). The Committee also identified the experience of third market trading in listed IPOs as relevant to this inquiry.