



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

March 16, 2004

Amy N. Kroll, Esquire
Foley & Lardner
Washington Harbour
3000 K Street, N.W., Suite 500
Washington, D.C. 20007-5143

Re: Rule 10a-1; Exemptive Relief under Short Sale Rule

Dear Ms. Kroll:

In your letter dated March 8, 2004, as supplemented by telephone conversations with the staff, you request exemptive relief regarding Rule 10a-1 under the Securities Exchange Act of 1934 (Exchange Act) for clients of Harborside Securities, L.L.C. (Harborside) that seek to execute short sale transactions that Harborside proposes to match prior to the opening of regular trading and execute after the close of regular trading at the volume-weighted average price (VWAP). This response is attached to the enclosed photocopy of your letter. By doing this, we avoid having to recite or summarize the facts set forth in your letter. Each defined term in this response has the same meaning as defined in your letter, unless otherwise noted.

Response:

Rule 3b-3 under the Exchange Act defines the term "short sale," and Rule 10a-1 governs short sales generally. Paragraph (a) of Rule 10a-1 applies to short sales of any exchange-listed security, if transactions in such security are reported pursuant to an "effective transaction reporting plan" (Listed Security). A short sale of a Listed Security may not be effected at a price either: (1) below the last reported price of a transaction reported in the consolidated transaction reporting system (minus tick); or (2) at the last reported price if that price is lower than the last reported different price (zero-minus tick).

Absent an exemption, short sales of Listed Securities effected by Harborside's clients on a VWAP basis must comply with paragraph (a)(1) of Rule 10a-1. The final execution price of such VWAP short sale transactions by Harborside's clients may be on a minus tick or a zero-minus tick with respect to the last sale in the consolidated transaction reporting system. Transactions under such circumstances in exchange-listed securities would not comply with Rule 10a-1. You state that the manner in which Harborside proposes to effect the proposed VWAP transactions should not give rise to any concerns with regard to possible short selling in an effort to manipulate or destabilize trading in any particular security. In particular, you note that the parties to each transaction will irrevocably agree to a transaction for which orders are matched before the opening of regular trading on the date of the transaction, and are executed after the close of regular trading at

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the volume-weighted average price (VWAP). Furthermore, the VWAP short sales agreed to before the opening of regular trading that are the subject of this letter will not be used as part of the VWAP calculation that day, and thus these transactions should not exert any downward pressure on the subject stock's price. These short sales will also be properly marked as "short exempt," and will be reported using a special VWAP trade modifier. Further, if one of the parties effected short sales in the market intraday, these short sales would be subject to Rule 10a-1.

Based upon your representations and the facts presented, but without necessarily concurring in your analysis, the Commission hereby grants an exemption from paragraph (a)(1) of Rule 10a-1 to permit short sale transactions in Listed Securities by Harborside's clients that have been guaranteed the VWAP by Harborside prior to the opening of regular trading, subject to the following conditions:

1. Persons relying on this exemption may not enter pre-arranged matching sale and purchase orders in the VWAP Match.
2. Transactions by persons relying on this exemption shall not be made for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.
3. Harborside's clients will be allowed to effect exempt short sale transactions in the VWAP match if the subject Listed Security qualifies as an "actively-traded security" or is one of the securities that comprise the S&P 500 Index.¹ Where the subject Listed Security is *not* an "actively-traded security" or a S&P 500 Index security, the proposed short sale transaction will be permitted only if it is conducted as part of a basket transaction of 20 or more securities in which the subject Listed Security does not comprise more than 5% of the value of the basket traded.
4. Harborside's clients will be allowed to effect exempt short sale transactions on a VWAP basis through Harborside with another broker-dealer as the contra side only if the total aggregate positions of Harborside's clients short sales being effected on a VWAP basis in the subject Listed Security with one or more such contra-parties does not exceed 10% of the subject Listed Security's relevant ADTV, as such term is defined in Regulation M.² (The

¹ For purposes of this exemption, actively-traded securities must have an average daily trading volume (ADTV) value of at least \$1 million and be issued by an issuer with a public float value of at least \$150 million. For purposes of this letter, ADTV shall be calculated in reference to the date on which the proposed VWAP short sale transaction is to take place. That is, the worldwide average daily trading volume during the two full calendar months immediately preceding the date of the proposed short sale or during any 60 consecutive calendar days ending within the 10 calendar days preceding the date of the proposed short sale.

² 17 CFR 242.100.

foregoing volume restriction will not apply to any exempt short sale transaction by a client where it is part of an agency cross transaction that Harborside effects between two of its clients.)

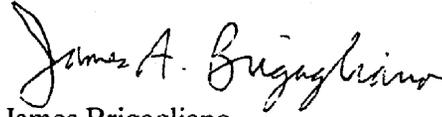
5. Harborside's clients will be allowed to effect exempt short sale transactions on a VWAP basis if the VWAP value of a Listed Security being sold short is determined in reference to transactions executed either in the consolidated marketplace or in the "primary market" for the Listed Security. To qualify as a "primary market," the referenced market must account for 75% or more of the Listed Security's ADTV. That is, the average daily trading volume reported by the referenced market during the two full calendar months immediately preceding the date of the proposed short sale or during any 60 consecutive calendar days ending within the 10 calendar days preceding the date of the proposed short sale must be equal to or greater than 75% of the worldwide average daily trading volume of the same security during the same relevant time period.
6. Harborside shall maintain and provide the Division of Market Regulation, upon request, separately retrievable written records pertaining to each exempt short sale transaction effected in the VWAP Match, including the date, time, security, price, size of each transaction, and, when applicable, the name of the broker-dealer providing the contra side.

The foregoing exemption from Rule 10a-1 is based solely on your representations and the facts you have presented to the staff, and is strictly limited to the application of this rule to transactions under the circumstances described above. Such transactions should be discontinued, pending presentation of the facts for our consideration, in the event that any material change occurs with respect to any of those facts or representations. The exemption granted herein is subject to modification or revocation if at any time the Commission determines that such action is necessary or appropriate in furtherance of the purposes of the Exchange Act.³ In addition, your attention is directed to the anti-fraud and anti-manipulation provisions of the Exchange Act, particularly Sections 9(a) and 10(b), and Rule 10b-5 thereunder. Responsibility for compliance with these and other applicable provisions of the federal or state securities laws must rest with Harborside and with participants effecting VWAP short sale transactions. The Division expresses no view with respect to other questions that the proposed transactions may raise, including, but not limited to, the applicability of other federal and state laws to the proposed transactions.

³ It is noted that the Commission has proposed in Regulation SHO to codify an express exemption for VWAP transactions that satisfy certain conditions. See Securities Exchange Act Release No. 48709 (Oct. 28, 2003), 68 FR 62972, 62982 (Nov. 6, 2003). If the exemption for VWAP transactions proposed in Regulation SHO is adopted, the relief that Harborside requested, and is hereby granted in this letter, would cover VWAP short sale transactions in all covered securities that satisfy these certain conditions.

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

A handwritten signature in cursive script that reads "James A. Brigagliano".

James Brigagliano
Assistant Director

Attachment

March 8, 2004

VIA FACSIMILEWRITER'S DIRECT LINE
202.295.4157
akroll@foley.com EMAILCLIENT/MATTER NUMBER
082294-0102

James A. Brigagliano
Assistant Director
Division of Market Regulation
United States Securities and Exchange
Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Request for Rule 10a-1 Exemption for Certain Transactions Executed
at the VWAP

Dear Mr. Brigagliano:

On behalf of Harborside Securities, LLC, ("Harborside") a registered broker-dealer, we hereby request that the United States Securities and Exchange Commission ("Commission" or "SEC") grant, pursuant to the authority provided to it under Rule 10a-1(f) under the Securities Exchange Act of 1934, as amended, ("Exchange Act") an exemption from Rule 10a-1 under the Exchange Act¹ for Harborside clients that seek to execute short sale transactions that Harborside proposes to match prior to the opening of regular trading and execute after the close of regular trading at the volume weighted average price ("VWAP").

Harborside presently engages in transactions on behalf of institutional clients and other broker-dealers in both exchange-listed securities ("Listed Securities") and NASDAQ-listed securities.

Harborside proposes to offer a VWAP order-matching program that would allow its institutional customers the opportunity to submit short sale trade orders to Harborside prior to regular trading hours (9:30 am - 4:00 pm Eastern Time), on any day when the securities markets in the United States are open for business. Prior to regular trading hours, Harborside would manually match the short sale trade orders with contra-side purchase orders. Harborside would provide execution of the matched orders at the VWAP after regular trading hours that day.

Short sale orders would be permitted both in Listed Securities and in NASDAQ-listed securities. The VWAP for each transaction would be based on widely disseminated data retrieved from third party market data providers such as Bloomberg. The calculation methodology for each

¹ 17 CFR 240.10a-1.

matched order would use executions reported either on the "primary market" or executions reported to the facilities of the "Consolidated Tape Association" as specified by Harborside's client prior to Harborside's acceptance of an order.

To the extent possible, Harborside would match internally short sale orders it receives from customers with purchase orders received from other customers or other broker-dealers. If, however, an order received by Harborside on any day that the VWAP match is available cannot be matched internally, Harborside would seek contra-side liquidity from another broker-dealer that either (1) as agent on behalf of its own customer would match the Harborside customer's VWAP order; (2) as riskless principal on behalf of its own customer would match the Harborside customer's VWAP order, or (3) would itself, as principal, match the Harborside customer's VWAP order. Therefore, for any VWAP order received by Harborside seeking a match, the counterparty could be a broker-dealer, rather than another Harborside customer.

When a broker-dealer provides the contra-side of a VWAP trade, as agent, riskless principal or principal, the broker-dealer would not be a customer of Harborside as that term is generally understood. Rather, Harborside as agent for its customer will effect the transaction with the contra-side broker-dealer through ACT.

Rule 10a-1

Rule 10a-1 was adopted by the Commission in 1938 under Section 10(a) of the Exchange Act.² Rule 10a-1 provides, generally, that a short sale in a Listed Security reported in the consolidated transaction reporting system can be effected (1) at a price above the price at which the immediately preceding sale was effected (the "plus tick") or (2) at the last sale price if it is higher than the last different price ("zero-plus tick"). The rule prohibits short sales on minus ticks or zero-minus ticks, subject to certain limited exceptions. The reference price for the so called "tick test" is either the last transaction price reported pursuant to an effective transaction reporting plan or the last transaction price on a particular exchange. Rule 10a-1 applies to all transactions in Listed Securities whether effected through the facility of a national securities exchange or in the over-the-counter market.³ In addition, Rule 10a-1 applies at all times, including outside of regular trading hours.

Analysis

Because of the nature of the methodology used to calculate the price for transactions effected as a result of a VWAP match, certain short sale transactions by a Harborside customer agreed upon before the commencement of regular trading could be effected after regular trading

² 15 USC 78j(a).

³ In 1994 the NASD adopted Rule 3350, which has the effect of generally prohibiting NASD members from effecting short sales in NASDAQ NMS securities at or below the best bid when the best bid displayed is below the preceding best bid in a security. Rule 3350 only applies during regular trading hours.

hours at a price below the last sale reported in the consolidated reporting system. If so, absent an exemption, these customer transactions would violate the tick rule of Rule 10a-1.

Although short selling can be used as a tool for manipulation, the manner in which Harborside proposes to effect the proposed VWAP match transactions should substantially eliminate the possible use of these trades for manipulative purposes. Indeed, the proposed VWAP matched short sale transactions that will be effected through Harborside are in effect no different from the short sale transactions effected through other VWAP match programs that previously have received exemptions from Rule 10a-1.⁴

Harborside's proposed program should not give rise to any additional or novel concerns with regard to possible short selling in an effort to manipulate or destabilize trading in any particular security. The parties to each transaction will irrevocably agree to a transaction for which orders are matched and executed at the VWAP, customer to customer or customer to third party broker-dealer, before the opening of the regular trading on the date of the transaction. The terms of each transaction will prohibit a change of pricing, namely away from the VWAP, and the parties will have agreed that execution will be at the VWAP for that day. Furthermore, the VWAP short sales agreed to before the opening of regular trading that are the subject of this letter will not be used as part of the VWAP calculation for that day. Because the parties will have agreed before the market opens to use the VWAP as the execution price, these transactions should not exert any "downward price pressure" on the subject stock's price. In addition, short sale transactions effected in the VWAP match will be marked as "short exempt" and will be reported using a special VWAP trade modifier.

If, however, one of the parties were to go into the market intraday with the intent to move the market, that party's trades, if short sales, will be subject to the tick rule. Thus, Rule 10a-1 will operate with regard to that party's trading, without regard to the party's VWAP transaction.

Finally, because the requested exemption from the tick test for VWAP matches would be permitted only in either (a) "actively traded" securities or in securities that are one of the securities in the S&P 500 or (b) securities that are part of a basket trade of 20 or more securities, and the subject security does not comprise more than 5% of the value of the basket traded, the opportunity for manipulation will be further lessened. Indeed, as the Commission indicated in its recent release discussing its proposal to amend Rule 10a-1, other Commission anti-manipulation rules assume that highly liquid securities are less vulnerable to manipulation and abuse than

⁴ Letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, Securities and Exchange Commission, to Soo Yim, Wilmer, Cutler & Pickering, dated December 7, 2000 ("Jeffries and Co."); Letter from James Brigagliano, Assistant Director, Division of Market Regulation, Securities and Exchange Commission, to Andre E. Owens, Schiff, Hardin & Waite, dated March 30, 2001 ("ITG, Inc."); Letter from James Brigagliano, Assistant Director, Division of Market Regulation, SEC, to Sam Scott Miller, Esq., Orrick, Harrington & Sutcliffe LLP, dated May 11, 2001 ("Morgan Stanley & Co."); Letter from James Brigagliano, Assistant Director, Division of Market Regulation, Securities and Exchange Commission, to William W. Uchimoto, Esq., General Counsel, Vie Institutional Services, dated February 12, 2003 ("Vie Institutional Sales").

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securities that are less liquid.⁵ Furthermore, the amendments to Rule 10a-1 proposed in that release include an express exemption for VWAP transactions that satisfy the conditions articulated in the previous letters referred to in footnote 4 above and that Harborside represents in this letter that it will satisfy if the requested exemption is granted.⁶

Based on the above, Harborside requests an exemption from the tick test under Rule 10a-1 for short sale transactions in Listed Securities by Harborside clients that have been guaranteed the VWAP by Harborside prior to the opening of regular trading, subject to the following terms and conditions:

1. Harborside will not accept for VWAP matching orders for short sale transactions that are pre-arranged as that term is construed under Section 9(a)(1) of the Exchange Act.⁷
2. Short sale transactions effected in the VWAP match may not be made for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.
3. Any short sale transaction in the VWAP match in Listed Securities (1) will be limited to Listed Securities that are "actively-traded securities" as that term is defined under Regulation M⁸ or that are one of the securities that comprise the S & P 500 Index or (2) if the subject Listed Securities are not "actively-traded securities" or S& P 500 Index securities, will only be permitted if the short sale transaction will be conducted as part of a basket transaction involving 20 or more securities in which the subject Listed Security does not comprise more than 5% of the value of the basket traded.
4. Harborside will maintain and provide to the Division of Market Regulation staff, upon request, separately retrievable written records pertaining to each exempt short sale transaction effected in the VWAP match, including the date, time, security, price, size of each transaction, and, when applicable, the name of the broker-dealer providing the contra-side.
5. Harborside's clients will effect exempt short sale transactions using a VWAP value of the Listed Security determined in reference to transactions executed either in the consolidated marketplace or in the "primary market" for the Listed Security. The referenced market

⁵ Proposed Rule: Short Sales, Securities Exchange Act Release No. 48709 (October 28, 2003)
<<http://www.sec.gov/rules/proposed/34-48709.htm>>

⁶ See Securities Exchange Act Release No. 48709, 68 FR at 62982. Thus, we believe that if the proposed exemption in Regulation SHO is adopted, the relief requested in this letter would cover both exchange-listed and NASDAQ NMS securities that satisfy these conditions.

⁷ 15 USC 78i(a)(1)(B) and (C). This statutory provision prohibits pre-arranged orders to buy and/or sell any security at substantially the same time and at substantially the same price for the purpose of creating a false or misleading appearance of active trading in that security.

⁸ 17 CFR 242.101(c)(1).

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will be designated by the customer prior to regular trading hours on the day of the VWAP transaction.⁹

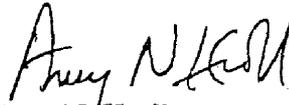
6. Harborside clients will be allowed to effect exempt short sale transactions on a VWAP basis through Harborside with another broker-dealer as the contra side only if the total aggregate positions of Harborside's clients' short sales being effected on a VWAP basis in the subject security with one or more such contra-parties does not exceed 10% of the subject Listed Security's relevant ADTV, as such term is defined in Regulation M. (The foregoing volume restriction will not apply to any exempt short sale transaction by a client where it is part of an agency cross transaction that Harborside effects between two of its clients.)

Conclusion

For the reasons stated above, we request that the Commission grant a limited exemption under Rule 10a-1 for Harborside customers that seek through Harborside to execute short sale transactions in Listed Securities on a VWAP basis.

If you have any questions or would like additional information regarding this request, please do not hesitate to contact me at (202) 295-4157.

Very truly yours,


Amy N. Kroll

cc: Kevin J. Campion, Special Counsel
United States Securities and Exchange Commission

Joan M. Collopy, Special Counsel
United States Securities and Exchange Commission

⁹ To qualify as the "primary market," the referenced market must account for 75% or more of the Listed Security's ADTV, as defined in Regulation M (17 CFR 242.100(b)), as reported by the referenced market during the two full calendar months immediately preceding the date of the proposed short sale or during any 60 consecutive calendar days ending within the 10 calendar days preceding the date of the proposed short sale must be equal to or greater than 75% of the world wide average daily trading volume of the security during the same relevant time period.