

Office of The Secretary
February 2, 1938

TO THE MEMBERS OF THE EXCHANGE:

Under date of January 24, 1938, the Securities and Exchange Commission promulgated rules X-3B-3, X-10A-1 and X-10A-2 relative to short selling. These rules were sent to members of the Exchange by this office under date of January 28, 1938. They are reprinted on page H-135 of the Directory and Guide. The rules become effective on Tuesday morning, February 8, 1938.

The following comments and interpretations of these rules are intended for the guidance of members and their customers. The Director of the Trading and Exchange Division of the Securities and Exchange Commission has advised the Exchange that in his opinion these comments and interpretations are correct.

1. *General Rule.* In general, the rule prohibits any "short sale" of a security, by the use of any facility of any national securities exchange, at or below the last regular way sale price of any such security on such exchange. A "short sale" is defined as (1) any sale of a security which the seller does not own; or (2) any sale which is consummated by the delivery of a security borrowed by or for the account of the seller becomes a "short sale" if delivery to the purchaser is made by the use of borrowed securities. This may often be the case if the original security is not available in or near New York in negotiable form at the time of sale.

Although the term "short sale" may thus include many sales which would ordinarily be regarded as long sales, the prohibition of general rule does not apply to (1) any person, whether a member or non-member, selling a security which he owns and intends to deliver as soon as is possible without undue inconvenience or expense; or (2) any *member* executing for an account in which he has no interest a sell order *marked* "long" (see paragraph 4 below); or (3) any sale of an odd lot. Certain additional transactions by odd-lot dealers are exempted.

The general prohibition referred to above has the effect of a criminal law. Any person, including any member or any customer, who effects for his own account or for any other account any "short sale" in violation of the rule, may be guilty of a criminal offense.

2. *Securities subject to the Rule.* The rule applies, generally speaking, to all securities dealt in upon any national securities exchange, other than government or municipal securities.

3. *Place of Transaction.* The rule applies to any short sale *effected* by the use of any facility of a national securities exchange. In consequence, it covers all short sales (other than odd lots and other sales exempted by the rule itself) made upon the Exchange, of any security subject to the rule. The rule does not apply, however to sales not made on any national securities exchange.

4. *Marking of Orders.* Every sell order (including odd-lots) in a security subject to the rule, which is executed on the Exchange whether originated or handled by a member, must be marked to indicate whether it is "long" or "short". The abbreviations "L" or "S" may be used. A member, (including any floor broker) or any employee may mark an order "long" only if (1) the customer's account is "long" the security involved; or (2) the member or employee is informed that the seller owns the security and will deliver it as soon as possible without undue inconvenience or expense. To obviate the necessity of hurriedly obtaining the information specified in rule X-10A-2, it is advisable for the member when he receives the order also to obtain information from the seller as to the practicality of then delivering the security. As a method of obtaining such information with respect to an order to sell, a member (including any floor broker) may enter into any bona fide written agreement with his customer that the customer, when placing "short" sell orders, will designate them as such, and that the designation of a sell order as "long" is a representation by the customer to the member that the customer owns the security, that it is then impracticable to deliver the security to such member and that the customer will deliver it as soon as is possible without undue inconvenience or expense.

5. *Ownership of Securities.* A person is deemed to own a security if (1) he or his agent has title to it; or (2) he has purchased or has entered into an unconditional contract, binding on both parties, to purchase it but has not yet received it; or (3) he owns a security convertible into or exchangeable for it and has tendered such security for conversion or exchange; or (4) he has an option to purchase or acquire it and has exercised such rights or warrants. He is not deemed to own a security if he owns securities for conversion or exchange, or if he has an option or owns rights or warrants entitling him to such security, but has not exercised them.

Within the meaning of the rules a person "owns" securities only subject to the extent that he has a net long position in such securities. Thus, if a person maintains two accounts and is short 1000 shares of a security in one and long 1000 shares of the same security in another, any sales of such security by such person are "short sales" and are subject to the provisions of the rules.

6. *Price at which Short Sales may be Made.* No short sale which is subject to the rule may be effected on the Exchange at or below the last regular way sale price

of the security on the Exchange. This applies to short sales made for delayed delivery, seller's option, etc., as well as to those made the regular way. A short sale at the opening must be above the last regular way sale price, irrespective of whether such last sale occurred on the preceding day or on some earlier day, and irrespective of whether the security has, since such last sale, been quoted ex-dividend or ex-rights or ex-a distribution of any kind.

When a security is dealt in on two or more national securities exchanges, the last regular way sale price on the particular exchange involved is controlling. Thus, if on a given day General Motors closes at 35 on the New York Stock Exchange, and at 34 on another national securities exchange, short sales at the opening the next day may be made at or above 35-1/8 on the New York Stock Exchange, and at or above 34-1/8 on the other exchange.

The price which governs the making of short sales is the last regular way sale price regardless of the identity of the participants therein and regardless of whether it was itself a short sale. Thus, a member having an order to sell 500 shares of stock may offer the same at 50-1/8, if the last sale regular way was 50. If a transaction takes place at 50-1/8 in which he does not participate, he may not offer his 500 shares at 50-1/4 in one lot; but if the member sells any part of his 500 shares, e.g., 100 shares, at 50-1/4, he may offer the balance of his order below 50-3/8. If the next sale should be at 50-1/8, he may offer such balance at 50-1/4 but not lower. Of course, no member may sell short for his own account at any price at which he could not sell short for a customer.

In any case of securities dealt in at variations of less than 1/8th, the price of a short sale must not be less than the last regular way sale price plus the minimum variation for the security in question.

7. *When issued transactions.* The rules apply to the sale of "when issued" securities in the same manner as issued securities. In the case of a sale of a "when issued" security, the last "regular way" sale price means the last price at which the "when issued" security has sold on the Exchange. A person is deemed to be the owner of a "when issued" security if he has entered into a contract to purchase the same binding on both parties and subject only to the condition of issuance or, by virtue of his ownership of an issued security, will be entitled to receive, without the payment of consideration, the "when issued" security, to the extent that he has not already disposed of such "when issued" security.

8. *Covering Transactions.* If on the due date of delivery of a security sold pursuant to an order marked "long", the member has not received the security from the customer, he must cover the open position unless he knows or has been informed by the seller either (1) that the security is in transit to him; or (2) that the seller owns the security, that it is then impracticable to deliver it and that

it will be delivered as soon as possible without undue inconvenience or expense. If the member has received the security at his main or branch office, or if he knows or has been informed by the seller that either (1) or (2) is the case, he may at his option either fail to deliver or make delivery with borrowed securities. If, however, he neither knows nor is informed by the seller that either of these situations exists, and has not received the security, he must cover the transaction by buying in, for "cash", for the account of the customer, the security sold. Such by-ins are not to be given to the Secretary of Exchange for execution, but are to be effected by the member directly or through an agent of his own choosing. If on the date when delivery upon the original contract with the security so received, or with borrowed securities, or may fail to make delivery therein.

The provisions of this paragraph apply to odd lots as well as to full lots.

9. Loans of Securities between Members. A member may, without regard to the restrictions imposed by rule X-10A-2 and without inquiry as to the purpose of the loan, lend a security to another member. The lending member may nonetheless be criminally liable for a violation of the short selling rules if he knows that the borrower intends to violate such rules.

ROBERT L. FISHER,
Secretary.