

processing capability for ArcaEx Reserve Orders<sup>6</sup> in exchange-listed securities. An Equity Trading Permit Holder (“ETP Holder”) could use this new order modifier when its Reserve Order in an exchange-listed security is locked by another market and that market has not shipped a commitment or moved its quote to clear the lock. The Proactive if Locked Reserve modifier would allow an ETP Holder to instruct ArcaEx to ship its Reserve order to an away market when the Reserve Order has been locked (or crossed) by the away market and the offending away market has not resolved the lock (or cross) in a timely manner. Under the proposal, if the away market does not respond to a locked market complaint as provided for under the ITS Plan within an acceptable time period based on average responses from ITS participants, ArcaEx would proactively route an order to the offending market for the away market’s displayed size up to the reserve amount of such order.<sup>7</sup>

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>8</sup> and, in particular, the requirements of Section 6(b) of the Act<sup>9</sup> and the rules and regulations thereunder. The Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>10</sup> which requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

Specifically, the Commission believes that, in providing a method for ETP Holders to proactively unlock or uncross markets and execute their orders while working within the requirements of the ITS Plan, the proposed rule change, as amended, should provide greater efficiencies in the marketplace by giving ArcaEx participants increased opportunities for executing orders. In particular, the Commission believes that allowing ArcaEx participants to utilize this order

<sup>6</sup> Reserve Orders, defined in PCXE Rule 7.31, are limit orders with a portion of the size displayed and with a reserve portion of the size not displayed.

<sup>7</sup> See ITS Plan Exhibit B, Section (d).

<sup>8</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

modifier may enhance order interaction and foster price competition.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>11</sup> that the proposed rule change (File No. SR-PCX-2004-59), as amended, be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**J. Lynn Taylor,**  
Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50854; File No. SR-PCX-2004-122]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc. Relating to the Implementation of a New Order Audit Trail System

December 14, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 14, 2004, the Pacific Exchange, Inc. (“PCX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comment 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 Exchange proposes to amend its rules relating to the systematization of orders in connection the requirement to design and implement a consolidated options audit trail system (“COATS”). The text of the proposed rule change appears below. Additions are italicized; deletions are in brackets.

\* \* \* \* \*

#### Rule 6

##### Options Trading

##### Applicability, Definitions and References

Rule 6.1(a)—No change.

<sup>1</sup> 15 U.S.C. 78s(b)(2).

<sup>2</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

(b) Definitions. The following items as used in Rule 6 shall, unless the context otherwise indicates, have meanings herein specified:

(1)-(38)—No change.

(39) The term “Electronic Order Capture System (“EOC”) means the Exchange’s electronic audit trail and order tracking system that provides an accurate time-sequenced record of all orders and transactions on the Exchange pursuant to Section IV.B.e.(v) of the Commission’s order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. EOC records the receipt of an order and documents the life of the order through the process of execution, partial execution, or cancellation. This system includes the electronic communications interface between EOC booth terminals and the Floor Broker Hand Held applications. Each OTP Holder or OTP Firm’s EOC booth terminal and each Floor Broker Hand Held Terminal contains an electronic order entry screen that displays the terms and conditions of each order received by that OTP Holder or OTP Firm. OTP Holders and OTP Firms may record the details of the order directly into the EOC system as described herein, or, in the alternative, into the Electronic Tablet described in subsection (b)(40) below.

(40) The term “Electronic Tablet” means the Exchange’s electronic method of recording orders that are hand written and transmitted to a Floor Broker’s workstation for representation in order to create an accurate time-sequenced record of orders on the Exchange. The Electronic Tablet will automatically timestamp the receipt of an order when such order is transmitted to a Floor Broker’s workstation for representation in the trading crowd and document the life of the order through the process of execution, partial execution or cancellation. This system includes the ability for a Floor Broker to hand write order information and automatically timestamp the report and provides a method to display report images at an OTP Holder or OTP Firm’s workstation to manually key the order information for clearing purposes. Such clearing information will become part of the data required pursuant to Section IV.B.e.(v) of the commission’s Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. OTP Holders and OTP Firms may record the details of the order directly into the EOC system (as

*described above in subsection (b)(39)) or, in the alternative, into the Electronic Tablet as described herein.*

(c)–(e)—No change.

### Admission to and Conduct on the Options Trading Floor

Rule 6.29a)–(g)—No change.

(h)(1)–(2)—No change.

(3) Requirements and Conditions.

(A)—No change.

(B) Orders transmitted by registered Exchange Market Makers may be entered directly to the trading posts. All other orders may be entered directly to the trading posts only during outgoing telephone calls that are initiated at the option posts. Pursuant to Rule 6.67(c), all such orders must be immediately recorded into the EOC or the Electronic Tablet unless the exception set forth in Rule 6.67(d)(1)(A) applies, in which case the EOC/Electronic Tablet Contingency Reporting Procedures will be in effect in accordance with Rule 6.67(d)(2).

(C)—No change.

(4)—No change.

(5) Floor Brokers.

(A)–(B)—No change.

(C) EOC or Electronic Tablet Ticket to Follow Procedures Pursuant to Rule 6.67(d)(1)(A). A Floor Broker in a trading crowd who receives a telephonic [a] order from an OTP Holder or OTP Firm representative located on the Trading Floor may represent that order immediately in the trading crowd, provided (a) that an order ticket for the order must be prepared and time stamped in the OTP Holder or OTP Firm booth before the order is transmitted telephonically to the Floor Broker and represented in the trading crowd; and (b) that the written, time-stamped order ticket for the order must be taken to the Floor Broker in the trading crowd immediately after it has been prepared.

(D)—No change.

(6)–(10)—No change.

Commentary:

.01–.02—No change.

.03 While on the Trading Floor, clerks must [shall] display at all times the badge(s) supplied to them by the Exchange. [Any Market-Maker clerk who writes up an option order on the Options Floor must give his employer a copy of that order before it is delivered; the employer must retain the copy on his person until it is executed.] A clerk receiving a phone order must immediately record the details of the order into EOC or the Electronic Tablet pursuant to Rule 6.67(c), except as otherwise provided in Rule 6.67(d)(1)(A). [must initial, must mark

as opening or closing and must time-stamp the order.]

.04—No change.

\* \* \* \*

### Fast Markets and Unusual Market Conditions

Rule 6.28(a)—No change.

(b)(1)—No change.

(2) For orders excepted from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A), [T]he OBO may temporarily move less active issues to another post if the Book is extremely active. [Books left at the post may be separated and order books provided for the most active series to facilitate order flow. A special time stamp will be placed behind the Book to stamp incoming transactions before they go to Price Reporting.]

(3)–(6)—No change.

(c)–(d)—No change.

\* \* \* \*

### Appointment of Market Makers

Rule 6.35—No change.

Commentary:

.01–.03—No change.

.04 For the purposes of this rule, temporarily undertaking the obligations of a Primary Appointment with respect to non-Primary Appointment classes of option contracts at the request of an Exchange OTP Holder or OTP Firm shall not be deemed trading in non-Primary Appointment classes. In addition, a Market Makers' trades effected through a Floor Broker do not count for nor against the Market Maker's 75% requirement, regardless of whether the trades are in issues within or without his Primary Appointment. Also, Market Makers who are solicited on an order on behalf of an account other than that of another Market Maker may accommodate such orders, provided that the orders are clearly announced in the trading crowd as solicited, and such transactions shall not count for nor against the 75% requirement. Such orders [trades] must [shall] be designed by the Market Maker with an "S" in the "[o]Optional Data" field [section] of [the] EOC or the Electronic Tablet or, for orders excepted from EOC or the Electronic Tablet pursuant to Rule 6.67(d)(1)(A), in the "Optional Data" section of the trade ticket.

.05—No change.

\* \* \* \*

### Crossing Orders and Stock/Option Orders

Rule 6.47(a)—No change.

(b) Crossing of Facilitation Orders. A Floor Broker who holds an order for a public customer or a broker-dealer

("customer order") and an order for the proprietary account of an OTP Holder OTP Firm that is representing that customer (the "facilitation order") may cross such orders only if the following procedures are followed.

(1)—No change. (2) The option order tickets for both the [f]Facilitation orders and [the] customer orders must be entered into EOC or the Electronic Tablet and [display] all of the terms of such orders, including any contingencies involving, and all related transactions in, either options or underlying or related securities, must be displayed on EOC or the Electronic Tablet. If facilitation orders and customer orders are excepted from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A), then order tickets must display this same information. The Floor Broker must disclose all securities that are components of the customer order.

(3)–(6)—No change.

(c)—No change.

(1)–(3)—No change.

(4) "Solicited" must [shall] be entered [written] in the "Optional Data" field of the EOC or the Electronic Tablet or, for orders excepted from EOC or the Electronic Tablet pursuant to Rule 6.67(d)(1)(A), written in the "Optional Data" section of the trade ticket. [area on the order ticket of the solicited order. If the solicited order is for a market maker account, the order ticket shall be personally initialed by the solicited market maker, who must have in his possession a copy of such order ticket at all times such order is active.]

(5)—No change.

(d)–(e)—No change.

(f) Stock/Option and SSF/Option Orders. When a stock/option order is taken to a crowd for execution, the stock transaction or SSF transaction must be effected prior to the option transaction pursuant to Rule 6.47, Commentary .04. The following procedure applies to all executions of stock/option and SSF/option orders: [A]fter an agreement with other OTP Holders or OTP Firms of the crowd has been reached as to the terms of the transaction, the option order must be entered into EOC or the Electronic Tablet or, for orders excepted from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A), written on tickets [must be written up] and time stamped. However, the option transaction will [order tickets should] not be reported to Options Price Reporting Authority ("OPRA") by EOC or Electronic Tablet or, for orders excepted from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A), turned in to the Order Book Official at this time. The OTP Holders or OTP

Firms *will* [shall] attempt to immediately effect the transaction in the underlying or related security. If the stock transaction cannot be executed immediately or is effected at a price other than *an* [the] agreed-upon price, the OTP Holders or OTP Firms *will* [shall] not be held to the option transaction. If the stock transaction is effected at *an* [the] agreed-upon price, then all the OTP Holders or OTP Firms who participated in the option transaction *will* [shall] be held to their agreed-upon price. At the time the stock transaction is effected, the option transaction *must be immediately entered into EOC or the Electronic Tablet and reported to OPRA or, for orders excepted from EOC or the Electronic tablet, pursuant to Rule 6.67(d)(1)(A), trade tickets must [should] be given to the Order Book Official.*

(f)(2)—No change.

Commentary:

.01–.06—No change.

\* \* \* \* \*

### **Discretionary Transactions**

Rule 6.48.(a)–(b)—No change.

(c) A Market Marker shall not exercise discretion in an account unless he has a direct interest in such account. Market Makers may not exercise discretion over any account other than: A joint account approved pursuant to Rule 6.39, or an account in which the Market Maker has a direct interest. For purposes of this Rule, the term “direct interest” in an account is limited in its meaning to include only a participation in the profits and losses in such account, or in the case of a partnership or corporation, a representative of such partnership or corporation who has a supervisory responsibility over such account. Only persons registered as Market Makers and subject to the performance obligations set forth in Rule 6.37, may exercise discretion over an account.

(1) A Market Marker wishing to effect such discretionary transactions for accounts other than the Market Marker’s personal account or a joint account must enter the order with a Floor Broker and the procedures set forth in Rule 6.85. The identification of the order as a discretionary order is required pursuant to [PCX] Rule 6.68(a)(5). [(7), “Record of Orders.”]

(A) The *clearing acronym* [name] of the Market Marker for whom the transaction is being executed must be [printed at the bottom of the ticket (B-6-1(c)),] *entered into EOC or the Electronic Tablet, for orders excepted from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A), written on the ticket along with the clearing*

*acronym* [badge number] of the Market Maker exercising discretion [(i.e. e.g., Joe Trader/MO7)]; and

(B) A “D” must be placed after the Market Maker’s *clearing acronym* [number,] for whose account the trade is executed[, in the firm box (e.g., MO5 D)].

### **Solicited Transactions**

Rule 6.49(a)–(b)—No change.

(c) “Solicited” *must* [shall] be *entered* [written] in the “Optional Data” field of EOC or the Electronic Tablet for [area on the order ticket of] the Solicited order. *For orders excepted from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A), “Solicited” must be written in the “Optional Data” section on the order ticket of the Solicited order.*

\* \* \* \* \*

### **ORDER BOOK OFFICIALS**

#### **Order Book Official Defined**

#### **Obligations for Orders**

Rule 6.52(a)–(d)—No change.

Commentary:

.01–.03—No change.

.04 For purposes of this Section, *orders excepted from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A)*, will be within the custody of Order Book Officials only when they have been deposited, properly timestamped and marked, in the proper receptacle.

.05—No change.

\* \* \* \* \*

#### **Certain Types of Orders Defined**

Rule 6.62(a)–(b)—No change.

(c) A contingency order is a limit or market order to buy or sell that is contingent upon a condition being satisfied. [while the order is at the Post.]

(d)—No change.

(e) Not held order. *A not held order is an order that provides a broker with discretion as to price or time in executing the order. A “not held” order must be designated as such in the “Optional Data” field of the EOC or the Electronic Tablet. For orders excepted from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A), a [A] not held order [is an order that] is market “not held”, “NH”, “take time” or marked with some [that bears any]*

*qualifying notation giving discretion as to the price or time at which such order is to be executed. The “not held” designation must appear in the “special instructions” portion of the order ticket. Orders that merely include a “not held” designation as part of the time stamp will not be deemed to be “not held” orders.*

(f)–(k)—No change.

\* \* \* \* \*

### **Order Format and System Entry Requirements**

#### **[Orders Required to be in Written Form]**

Rule 6.67(a). Transmitted to the Floor. Each order transmitted to the Floor must be recorded legibly in a *format* [written form] that has been approved by the Exchange, and the OTP Holder receiving such order must record the time of its receipt on the Floor. Each such order must be in a legible *format* [written form] when *transmitted* [taken] to the post for attempted execution. Orders sent electronically through the Exchange’s Member Firm Interface or *orders entered into the Exchange’s EOC or the Electronic Tablet* are [deemed to be written] *approved formats* (as described in subsection (b) below) for transmitting orders for purposes of Rule 6.67.

#### **(b) Order Format Requirements.**

*Orders sent to the Exchange for execution must comply with the order format requirements established by the Exchange relating to, among other things, option symbol, expiration month, exercise price, type of option (call or put), quantity of option contracts, clearing member organization, whether the order is to buy or sell, and whether the order is market or limit.*

[(b) Cancellations and changes. Each cancellation of, or change to, an order that has been transmitted to the Floor must be recorded legibly in a written form that has been approved by the Exchange, and the OTP Holder receiving such cancellation or change must record the time of its receipt on the Floor.] (c) *EOC or Electronic Tablet Entry Requirement.* Every OTP Holder or OTP Firm that receives an order for execution on the Exchange must immediately, prior to representation in the trading crowd, record the details of the order (including any modification of the terms of the order or cancellation of the order) into either the EOC or the Electronic Tablet, unless such order has been entered into the Exchange’s other electronic order processing facilities (e.g., orders sent electronically through the Exchange’s Member Firm Interface).

(1) *EOC.* The details of each order required to be recorded upon receipt must include the data elements prescribed in Rule 6.68(a)(1) through (9), and such other information as may be required by the Exchange from time to time. The remaining elements prescribed in Rule 6.68(a) shall be recorded as the events occur and/or during trade reporting procedures.

(2) *Electronic Tablet.* The details of each order required to be recorded upon receipt must include the data elements prescribed in Rule 6.68(a)(1) through (6), and such other information as may be required by the Exchange from time to time. The remaining elements prescribed in Rule 6.68(a) shall be recorded as the events occur and/or during trade reporting procedures.

[(c) Executions. An OTP Holder transmitting from the Floor a report of the execution of an order must record the time at which a report of such execution is received by such OTP Holder.]

(d)(1) *Exceptions to EOC or Electronic Tablet Entry Requirements.* The EOC or Electronic Tablet entry requirement provision of subsection (c) will not apply to the following:

(A) Any EOC or Electronic Tablet system disruption or malfunction as confirmed by two Trading Officials or Exchange staff (as designated by the Chief Regulatory Officer).

(2) *EOC/Electronic Tablet Contingency Reporting Procedures.* If the exception set forth in subsection (d)(1)(A) applies, then the following procedures must be followed.

(A) OTP Holders and OTP Firms shall use a backup supply of tickets to record the details of all orders (the data elements of which are prescribed in Rule 6.68(a)(1) through (9)), received through non-electronic means. The order ticket must be processed in accordance with Rule 6.2(h)(5)(C). All order events (i.e., receipt, changes, execution, partial execution, cancellation, or nothing done) must be immediately time stamped (a time stamp synchronized with the National Institute of Standards and Technology Atomic Clock in Boulder Colorado "NIST Clock" will be available at all OTP Holder and OTP Firm booths and trading posts).

(B) During such circumstances, existing rules on manual processing of order tickets are applicable.

(C) If there is an EOC or Electronic Tablet system disruption/malfunction as set forth in subsection (1)(A), the EOC or Electronic Tablet order entry requirements in Rule 6.67(c) will be reinstated once the disruption/malfunction to the EOC or Electronic Tablet system has been corrected as determined by one Trading Official or Exchange staff (as the case may be). Once the disruption/malfunction to the EOC or Electronic Tablet system has been corrected, all OPT Holders and OTP Firms affected by the system disruption/malfunction must input all relevant orders into an EOC device via the "as-of" field, noting the times of

events of the orders. The required information must be entered into EOC by such prescribed period of time, as determined by the Exchange, following the trade, but no later than the end of the trading day that such trade occurred (or on the day the order was received if no trade was executed). Any OTP Holder or OTP Firm who fails to follow such procedures will be subject to disciplinary action pursuant to Rule 10.

[(d) A Floor Broker may represent a telephonic order, with a ticket to follow, as provided in Rule 6.2(h)(4)(C).]

[(e) Hand Signals. The following regulations govern the proper use of hand signals on the Options Trading Floor: (1) Hand signals may always be used to request and to relay information regarding current quotations and market size. Hand signals may also be used to increase or decrease the size of an order, to change the order's limit, to cancel an order or to activate a market order.

Any cancellation of or change to an order relayed to a Floor Broker through the use of hand signals also must be relayed to the Floor Broker in a time stamped, written form immediately thereafter. All cancellations and changes of orders held by the Order Book Official must be in written form. Executing brokers who receive such communications must have a written order in their possession with all of the following information on the ticket:

Underlying security ticker symbol  
Expiration month  
Striking price  
Volume  
Purchase or Sale Notation  
Whether Market or Limit Order

(2) Cancellation of orders held by the Floor Broker must be in written form in accordance with current practice. A Floor Broker may cancel an order through the use of hand signals if it is followed immediately by written cancellation. (3) Any change to an order must be documented in writing outside of the crowd and the ticket time-stamped, before the revised order may be represented.] [(f) Any OTP Holder desiring to use an order form in a format other than that provided by the Exchange must submit such form to the Exchange and obtain its approval prior to using such form on the Floor.]

(e) The system entry requirement prescribed in subsection (c), above, will be operative on or before January 10, 2005.

*Commentary .01: FLEX and Cabinet Trades are exempt from the EOC and Electronic Tablet Entry Requirements as set forth in Rule 6.67(c). Such trades shall be processed using manual time stamped order tickets. The PCX will maintain a separate record (i.e.,*

*spreadsheet) of quotes, orders and transactions related to such trades in the same format require pursuant to Section IV.B.e.(v) of the Commission's order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions.*

\* \* \* \* \*

## Record of Orders

Rule 6.68(a). Every OTP Holder or OTP Firm must [shall] maintain and preserve for the period specified under SEC Rule 17a-4, a [written] record of every order and of any other instruction given or received for the purchase or sale of option contracts. *The Exchange shall maintain and preserve all electronic orders on behalf of the OTP Holder or OTP Firm.* Such record must [shall] show the terms and conditions (market order, limit order, etc.) of the order or instruction and of any modification or cancellation thereof, and in addition must [shall] include:

[(1) the account designation for which such order is to be executed; (2) the date and time stamp indicating the time the order was entered and executed or cancelled; (3) the type of option and the underlying stock; (4) the expiration month, the exercise price, the number of option contracts and the execution price (premium); (5) whether the order is a purchase or a sale (writing) and whether the order is an opening or a closing transaction; (6) whether the order is solicited or unsolicited; and (7) whether the order is discretionary.]

(1) *CMTA Information and claring OTP Holder or Firm;*

(2) *Option symbol, expiration month, exercise price, and type of option (call or put);*

(3) *Side of market (buy or sell) and order type (customer, firm, firm market maker);*

(4) *Quantity of option contracts;*

(5) *Any limit price, stop price, or special conditions;*

(6) *Opening or closing transaction;*

(7) *Time in force;*

(8) *Account origin code;*

(9) *Solicited or unsolicited;*

(10) *Order identification number;*

(11) *Order entry date and time, or the date and time of any modification of the terms of the order or cancellation of the order;*

(12) *Order execution time and price;*

(13) *Identity of the executing broker and the other party to the transaction; and*

(14) *Such other information as may be required by the Exchange.*

(b) *Record Retention for Orders Excepted from EOC or the Electronic*

*Tablet Pursuant to Rule 6.67(d)(1)(A).* In addition to the white (control) copy, and/or hard copy, which must be kept for the entire amount of time specified in Securities Exchange Act Rule 17a-4, the green (commission) copy must also be retained for a minimum of 48 hours from the trade date. In the case of those orders executed by independent Floor Brokers, it is their responsibility to retain the green (commission) copy, and the executing OTP Holder must retain the white or hard copy. Also, all such records must be readily available for use on the trading floor for the resolution of any problems relating to the execution of these orders.

\* \* \* \* \*

### Reporting Duties

Rule 6.69(a)–(e)—No change.

Commentary:

.01 *EOC or Electronic Tablet Reporting Procedure.*

The Exchange has established the following procedure for reporting of transactions pursuant to Rule 6.69. For each transaction on the Exchange in which an OTP Holder [he] participates as seller, that [a floor] OTP Holder will [shall] immediately record into EOC or the Electronic Tablet, [on a card or ticket in a form acceptable to the Committee his] its assigned broker initial code, the symbol of the underlying security, the type, expiration month and exercise price of the option contract sold, the transaction price, the number of contract units comprising the transaction, the name of the contra clearing member, and the assigned broker initial code of the contra OTP Holder or OTP Firm. OTP Holders or OTP Firms must report any [shall] identify price reporting tickets which represent the partial execution of a larger order into EOC or the Electronic Tablet [the manner prescribed by the Exchange. The card or ticket for a] Any agency order must [shall] also include the account origin code[.], [as set forth in Commentary .02 below. This reporting card or ticket shall immediately be time-stamped at the station where option contracts of the class involved are traded and attached to the appropriate "buy" ticket. The card or ticket shall then be placed in the price reporting card box provided at the station. Before placing the tickets in the box, the OTP Holder shall use his best efforts to make sure that the Order Book Official with respect to option contracts of the class involved, or the Order Book Official clerk, is aware of the transaction and its price. In transactions when the buyer accepts tickets from the seller(s), it shall be the buyer's responsibility to time-stamp the tickets, use best efforts at securing the Order Book Staff's attention

to the transaction, and submit the tickets into the box.] Any OTP Holder failing to immediately report a transaction in accordance with Rule 6.69 will [shall] be subject to [being fined] disciplinary action pursuant to Rule 10. [by the Exchange.]

.02—*Reserved.*

[.02 Reporting of Trade Information. The responsibility for time stamping and reporting of trades to the Order Book is as follows: (a) One buyer, multiple sellers—responsibility is with the buyer

(b) One seller, multiple buyers—responsibility is with the seller(c) one buyer, one seller—responsibility is with the seller]

.03 *Origin Codes for Orders Excepted from EOC or the Electronic Tablet Pursuant to Rule 6.67(d)(1)(A).*

For purposes of Rule 6.69(d), trade information includes the proper account origin codes, which are as follows: "C" for non-broker-dealer customer accounts; "F" for firm proprietary accounts; "M" for Market Maker accounts; and "B/D" for firm orders of non-OTP Holder or OTP Firm broker-dealer accounts, stock specialist accounts, or customer account trades of the broker-dealer or non-OTP Holder or OTP Firm broker-dealer. In addition, Market Maker clearing firms are directed to instruct their respective trading desks to identify Market Maker orders that are entered from off the floor and not entitled to Market Maker margin treatment by placing a "C" after the Market Maker's number in the "firm" box on the ticket. Floor Brokers, when accepting an order by phone from a Market Maker, are similarly directed to identify that order in the same manner.

.04—No change.

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### Priority and Order Allocation Procedures

Rule 6.75(a)–(h)—No change.

Commentary:

.01–.03—No change.

.04 Combination, Spread and Straddle Orders. Following are the proper trading procedures for combination, spread and straddle orders:

(a) Announcing the Order. Any OTP Holder or OTP Firm holding a combination, spread, or straddle order must [write it on one ticket and must] bid or offer for each series in the order. For orders expected from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A), such orders must be written on a ticket in accordance with Rule 6.2(h)(5)(C). The OTP Holder or OTP Firm may express the order as it applies to each separate series or may

express the order at its total or net debit/credit alone, so long as it is clear that the OTP Holder or OTP Firm is attempting to execute both series as a combination, spread, or straddle. The executing OTP Holder or OTP Firm must ensure that the trading crowd is aware of the request for a market and has an opportunity to participate in the transaction.

(b)–(g)—No change.

\* \* \* \* \*

### Joint Accounts

Rule 6.84(a)–(h)—No change.

Commentary:

.01–.02—No change.

.03 Transactions on the Floor will be presumed to be for the proprietary account of the individual OTP Holder or OTP Firm unless the executing OTP Holder or OTP Firm enters the joint account symbol into EOC or the Electronic Tablet. For orders excepted from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A), transactions on the Floor will be presumed to be for the proprietary account of the individual OTP Holder or OTP Firm unless the joint account symbol is given up and used on the trade ticket to represent the joint account as the executing OTP Holder or OTP Firm.

.04 Any order of a joint account participant[,] that [which] is executed by a Floor Broker, must [shall] be in accordance with the procedures set forth in Rule 6.85, except that the joint account trading number with its alpha identification must be entered into EOC or the Electronic Tablet, or, for order excepted from EOC or the Electronic Tablet, pursuant to Rule 6.67(d)(1)(A), the joint account trading number with its alpha identification must [should] appear in the "executing firm" area. Additionally, a joint account may not bid, offer, purchase, sell, or enter orders in an option series in which a Floor Broker holds an order on behalf of the joint account or for the proprietary account of another participant in the joint account. Orders of joint account participants in a particular option series may not be concurrently represented[,] by one or more Floor Brokers.

.05–.07—No change.

\* \* \* \* \*

### Market Maker Orders Executed By Floor Brokers

Rule 6.85(a)–(c)—No change.

Commentary:

.01–.02—No change.

.03 Orders Excepted from EOC or the Electronic Tablet Pursuant to Rule 6.67(d)(1)(A). Market Maker order

tickets should be prepared by the Market Maker, when possible. All orders *must* [shall] be recorded and time-stamped, pursuant to Rule 6.67. Order tickets *must* [shall] include the acronym of the Market Maker entering the order in the area marked "buying firm/selling firm," within the Market Maker's name printed at the bottom of the ticket. Order tickets must be marked to indicate whether the order is "GTC" or day only. The acronym of the executing Floor Broker *must* [shall] be written in the area marked "executing member." When utilizing a "partial order" ticket to facilitate the completion of an order, the control number of the original order ticket must be written on the partial order ticket. Except as provided in Rule 6.2(h)(5)(i)(4)(C) (Ticket to Follow Rule), when a Floor Broker receives a verbal order from a Market Maker, or when a Floor Broker is requested by a Market Maker to alter an order in his possession in any way, the Floor Broker *must* [shall] immediately prepare an order ticket from outside the trading crowd and timestamp it.

\* \* \* \* \*

#### Floor Broker Hand-held Terminals

Rule 6.89(a)—No change.

(b) Proprietary Brokerage Order Routing Terminals:

(1)–(3)—No change.

(4)(A)—No change.

(B) *Orders Excepted from EOC or the Electronic Tablet Pursuant to Rule 6.67(d)(1)(A)*. When an OTP Holder or OTP Firm executes an order that was received over a Terminal, the OTP Holder or OTP Firm must fill out and *immediately* time stamp a trading ticket [within one minute of the execution]. Exchange rules on record keeping and trade reporting are unchanged.

(C)–(D)—No change.

(5)–(7)—No change.

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

In its filing with the Commission, the Exchange 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. The PCX has prepared summaries, set forth in Section s A, B and C below, of the most significant aspects of such statements.

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

##### 1. Purpose

a. *Background.* The Exchange is proposing this rule change to comply with the requirement to implement COATS. In connection with the filing of this proposed rule change, the PCX withdraws SR-PCX-2002-57, and Amendment Nos. 1–4 thereto, which the Exchange previously filed to comply with the requirement to implement COATS.<sup>3</sup>

Specifically, the Exchange is proposing to effect rule changes to support the implementation of its new audit trail system known as Electronic Order Capture System ("EOC"). The EOC is intended to fulfill one of the undertakings contained in the Commission's Order Instituting Public Administrative Proceedings Pursuant to Sections 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. ("Order").<sup>4</sup> Specifically, this rule filing is intended to respond to Section IV.B.e(v) of the Order, which requires, among other things, that the PCX incorporate into its audit trail all non-electronic orders such that the audit trail provides an accurate, time-sequenced record of electronic and other orders, quotations and transactions, beginning with the receipt of the order and documenting the life of the order through the process of execution, partial execution, or cancellation.<sup>5</sup>

Currently, the PCX operates two electronic order routing and execution system called Pacific Options Exchange Trading System ("POETS")<sup>6</sup> and PCX Plus,<sup>7</sup> and other peripheral systems including the Pacific Options Processing System ("POPS")<sup>8</sup> and the Floor Broker

<sup>3</sup> See Securities Exchange Act Release No. 48264 (July 31, 2003), 68 FR 47124 (August 7, 2003) (SR-PCX-2002-57).

<sup>4</sup> See Securities Exchange Act Release No. 43268 (September 11, 2000) and Administrative Proceeding File No. 3-10282.

<sup>5</sup> *Id.* at 13–14.

<sup>6</sup> POETS is the Exchange's automated trading system comprised of an options order routing system, an automatic execution system ("Auto-Ex"), an on-line limit order book system ("Auto-Book"), and an automatic market quote update system ("Auto-Quote").

<sup>7</sup> See Securities Exchange Act Release No. 47838 (May 13, 2003), 68 FR 27129 (May 19, 2003) (Order approving PCX Plus).

<sup>8</sup> POPS is the Exchange's automated system that compares trade information entered by OTP Holders and Firms and submits trades to the Options Clearing Corporation for clearance and settlement.

Hand Held trading system,<sup>9</sup> in conjunction with traditional open outcry trading with Floor Brokers and competing Market Makers. The Exchange's Member Firm Interface ("MFI") enables OTP Holders and OTP Firms to send orders electronically to the Exchange for delivery to POETS, PCX Plus, a Floor Broker Hand Held Terminal, or to an OTP Holder or OTP Firm's default destination.<sup>10</sup> While all executions using POETS, PCX Plus, and electronic hand-held devices carry immediately assigned system times, orders that are routed to the trading floor of the Exchange by telephone or sent to the OTP Holder or OTP Firm's printers located on the trading floor generally require manual trade ticket processing. Under the proposal, the EOC will eliminate the manual processing of order tickets and will further facilitate the creation and development of a comprehensive audit trail and automated surveillance systems for these orders that are currently processed manually.

##### b. Summary of Proposed Rule Changes.

The Exchange is proposing to adopt changes to its rules regarding the record of orders (principally PCX Rules 6.67 and 6.68) to enhance the Exchange's audit trail and self-regulatory capabilities. The proposed changes to the text of the PCX rules are summarized below.

1. *EOC/Electronic Tablet.* The Exchange is proposing to adopt new PCX Rule 6.67(c),<sup>11</sup> which requires that every OTP holder or OTP Firm that receives an order for execution of the Exchange must immediately<sup>12</sup> record the details of the order (including any modification of the terms of the order or cancellation of the order) into EOC, unless such order has been entered into the Exchange's other electronic order processing facilities<sup>13</sup> (e.g., orders sent

<sup>9</sup> The Floor Broker Hand Held interface is an automated order delivery system that enables Floor Brokers to receive and execute orders electronically, and to report trade executions to the tape via the Options Price Reporting Authority ("OPRA") and to POPS for clearing. See PCX Rule 6.89.

<sup>10</sup> An OTP Holder or OTT Firm's default destination may be either a particular firm booth or a remote entry site, to which orders that fail to meet the eligibility criteria necessary for Auto-Ex or Auto-Book will be delivered.

<sup>11</sup> Former Rules 6.67(b), (c) and (d) are being deleted as they are redundant and superfluous provisions pursuant to proposed Rules 6.67(c), 6.67(d) and 6.67(d)(1).

<sup>12</sup> The Exchange commits that it will implement proactive and effective surveillance procedures for violations of Exchange rules and federal securities laws, including, but not limited to, rules prohibiting trading ahead and front running, related to the entry of customer orders into the EOC system.

<sup>13</sup> The EOC entry requirement will also apply to PCX Plus.

electronically through the Exchange's MFI).<sup>14</sup> OTP Holders and OTP Firms will have two ways to record the details of an order into EOC prior to representation in the trading crowd: (i) Direct entry into the EOC system, or (ii) entry to an Electronic Tablet that enables the user to hand-write the order information onto the tablet, which converts the information into an electronic format. The information from the Electronic Tablet is then transmitted to a Floor Broker's workstation for representation with an automatic timestamp for order receipt. A booth clerk will then key in the order information from the Electronic Tablet into the EOC system for clearing purposes in order for it to become part of the data required for COATS.

The details of each order that will be required to be recorded upon receipt if directly entered into the EOC system include the following:<sup>15</sup> (1) CMTA information/Clearing OTP Holder or Firm; (2) Option symbol, expiration month, exercise price, and type of option (call or put); (3) Side of market (buy or sell); (4) Quantity of option contracts; (5) Any limit price, stop price, or special conditions, (6) Opening or closing transaction; (7) Time in force; (8) Account origin code; and (9) Solicited or unsolicited.<sup>16</sup>

The details of each order that will be required to be recorded upon receipt if entered into the Electronic Tablet include the following: (1) CMTA information/Clearing OTP Holder or Firm; (2) Option symbol, expiration month, exercise price, and type of option (call or put); (3) Side of market (buy or sell); (4) Quantity of option contracts; (5) Any limit kprice, stop price, or special conditions, and (6) Opening or closing transaction.

Therefore, OTP Holders and OTP Firms may comply with proposed PCX Rule 6.67(c) in one of three ways: (1) Required order details may be transmitted via the Exchange's other electronic order processing facilities

<sup>14</sup> The systemic entry requirement would not be applicable to transactions initiated on the Floor and executed by a registered Market Maker or a Lead Market Maker for their own account, as such trades that may be initiated on the Floor and that they are already reported to POETS via proprietary handheld devices.

<sup>15</sup> The Exchange notes that certain data elements tied to execution, such as executing broker, contra broker, execution time and price are not required to be entered by this Rule, as they are not available at the time that order details are entered into EOC. The Exchange also notes that the order entry time and identification number are automatically assigned upon entry into EOC.

<sup>16</sup> The proposed rule also includes a provision that would require OTP Holders and OTP Firms to record such other information as may be required by the Exchange from time to time.

that electronically assign the time of receipt on the Exchange; (2) Order details may be routed to the OTP Holder or OTP Firm booth by telephone or be sent to the OTP Holder or OTP Firm's printer located on the Floor, and immediately entered into EOC (either directly into EOC or via the Electronic Tablet), which will electronically assign the time of receipt of the Exchange; or (3) Orders may be received during outgoing telephone calls that are initiated at the option post, and then immediately entered into the EOC (either directly into EOC or via the electronic Tablet), which will electronically assign the time of receipt of the Exchange pursuant to PCX Rule 6.2(h)(3)(B).<sup>17</sup>

The EOC device that is used to record the details of the order upon receipt on the Floor is an Exchange provided system.<sup>18</sup> The EOC and the enhancements to the existing Floor Broker Hand Held Terminal applications will support the entry of all order types (including contingency and complex orders, *i.e.*, multiple-leg option and stock/option orders) and all required information, as well as provide quick entry templates to speed data entry. Once an OTP Holder or OTP Firm's booth clerk records the details of an order into EOC (or the Electronic Tablet) or in the case when a Floor Broker receives an order pursuant to PCX Rule 6.2(h)(3)(B), the order is routed electronically to a Floor Broker Hand Held Terminal for representation in the trading crowd.<sup>19</sup> OTP Holders and OTP Firms will have the capability to track and display all orders that are submitted through the EOC, as all orders will be assigned a unique identifier that will be used throughout the life of the order.

The Exchange believes that the implementation of EOC and the Electronic Tablet, as described above, will improve order information management features resulting in operational efficiencies for OTP Holders and OTP Firms.

**2. Order Format Requirements.** The Exchange's current rules governing the

<sup>17</sup> The Exchange's order processing systems have been designed so that the clocking mechanisms do not deviate by more than three seconds from the Naval Observatory atomic clock in Washington, DC.

<sup>18</sup> The EOC will not initially support the use of a OTP Holder or OTP Firm's proprietary system to comply with the proposed order entry requirements.

<sup>19</sup> Orders sent via the EOC interface to a Floor Broker in the trading crowd may subsequently be transmitted electronically to another Floor Broker on the Floor. When an order is transmitted from one OTP Holder or OTP Firm to another, the EOC will capture each phase of processing at the order moves from entry to execution.

order format requirements in transmitting orders to the Exchange are set forth in PCX Rule 6.67(a). The Exchange is proposing to add interpretive language to make it clear that EOC and the Electronic Tablet are approved formats for transmitting orders for purposes of this Rule. In addition, proposed PCX Rule 6.67(b) requires that orders sent to the Exchange for execution must comply with the order format requirements established by the Exchange relating to, among other things, option symbol, expiration month, exercise price, type of option (call or put); quantity of option contracts, clearing member organization, whether the order is to buy or sell, and whether the order is market or limit.

#### **3. Exceptions to EOC Entry Requirement.**

An exception to the requirement for recording order information into EOC or the Electronic Tablet is contained in proposed PCX Rule 6.67(d). Under this proposed rule, if a disruption or malfunction to EOC or the Electronic Tablet or any other Exchange electronic order processing system occurs, the EOC or the Electronic Tablet entry requirement will be suspended upon the approval of two Trading Officials, and the EOC/Electronic Tablet Contingency Reporting Procedures will be in effect pursuant to PCX Rule 6.67(d)(1)(A).<sup>20</sup> If the Exchange is still able to process and disseminate quotes accurately, then any orders received by the Exchange will be processed manually through the use of paper tickets. In such circumstances, all other Exchange rules governing options trading will remain in effect. Accordingly, the Exchange intends to retain its existing rules that are applicable to the manual processing of order tickets. Minor changes have been made throughout the existing options trading rules to allow for manual processing of trade tickets when necessary.

**4. Record of Orders.** Current PCX Rule 6.68(a) requires OTP Holder and OTP Firms to maintain and preserve certain information items relating to the terms of each option order. The Exchange is proposing to make minor technical changes to the text by renaming and renumbering certain information items enumerated in the Rule for clarity. The Exchange is also proposing language to specify that the Exchange shall maintain

<sup>20</sup> Under the proposed rule, OTP Holders and OTP Firms must use a backup supply of tickets to record the details of the order received through non-electronic means and time stamp the order of events. Once the disruption or malfunction has been corrected, as determined by one Floor Official, OTP Holders and OTP Firms must input all orders into the EOC device using the "as-of" field.

and preserve all electronic orders on behalf of OTP Holders and OTP Firms. The proposed rule change does not replace existing requirements for recording orders contained in this Rule.

The Exchange is also proposing to amend PCX Rule 6.68(b) to make it clear that OTP Holders and OTP Firms must comply with their record keeping obligations for order excepted from the EOC/Electronic Tablet requirements.

**5. Reporting of Trade Information.** The Exchange proposes to rescind current PCX Rule 6.69, Commentary .02, which relates to the trade reporting requirements of OTP Holders and OTP Firms. The Exchange believes that this rule is superfluous and that it is inconsistent with PCX Rule 6.69(b), which already requires that the OTP Holder or OTP Firm representing the sell side of a transaction is responsible for reporting the transaction to the Exchange in a form and manner prescribed by the Exchange. Therefore, because current PCX Rule 6.69(b) accurately reflects the PCX's existing trade reporting requirements, the Exchange is proposing to eliminate Commentary .02 of this rule for clarity.

Proposed new PCX Rule 6.69, Commentary .03 specifies the reporting procedures for orders that are manually processed when there is a disruption or malfunction with the EOC pursuant to proposed new PCX Rule 6.67(d)(A)(1). This proposed new rule was adopted from current PCX Rule 6.67, Commentary .01.

**6. Cabinet Trades and FLEX Options.** The Exchange also proposes to add a Commentary .01 to PCX Rule 6.67, which states that Cabinet Trades<sup>21</sup> and FLEX<sup>22</sup> options are exempt from the EOC and Electronic Tablet Entry Requirements as set forth in PCX Rule 6.67(c). However, such trades will be processed using manual time stamped order tickets. The PCX will maintain a separate record of quotes, orders and transactions related to such trades in the same format as the COATS data and will make such information available upon Commission request.

**7. Implementation Date.** The system entry requirement proposed in this rule change will become completely operative on January 10, 2005.<sup>23</sup>

**8. Miscellaneous Changes.** The Exchanges proposes to make several minor, non-substantive changes to the text of several existing PCX Rules to correct stylistic, grammatical and typographical errors and to conform the

proposed rules to the new EOC and Electronic Table requirements.

## 2. Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)<sup>24</sup> of the Act, in general, and further the objectives of Section 6(b)(5),<sup>25</sup> in particular, because it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments and perfect the mechanisms of a free and open market and to protect investors and the public interest. In addition, the Exchange believes that the proposed rule change is consistent with provisions of Section 11A(a)(1)(B) of the Act,<sup>26</sup> which states that new data processing and communications techniques create the opportunity for more efficient and effective market operations.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments on the proposed rule change were neither solicited nor 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 self-regulatory organization 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 is consistent with the Act. Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment from (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rules-comments@sec.gov](mailto:rules-comments@sec.gov). Please include File No. SR-PCX-2004-122 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathon G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File No. SR-PCS-2004-122. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 Room, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the PCX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-PCX-2004-122 and should be submitted on or before January 6, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>27</sup>

J. Lynn Taylor,  
Assistant Secretary.

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<sup>21</sup> See PCX Rule 6.80.

<sup>22</sup> See PCX Rule 5.30(b)(4).

<sup>23</sup> See proposed PCX Rule 6.67(f).

<sup>24</sup> 15 U.S.C. 78f(b).

<sup>25</sup> 15 U.S.C. 78f(b)(5).

<sup>26</sup> 15 U.S.C. 78k-1(a)(i)(B).

<sup>27</sup> 17 CFR 200.30-3(a)(12).