2. Statutory Basis

The rule change is authorized by, and consistent with, Section 15A(k) of the Act.[5]

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

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

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

NFA did not publish the rule changes to the membership for comment. NFA did not receive comment letters concerning the rule changes.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Pursuant to Section 19(b)(7)(B) of the Act,[6] the proposed rule change became effective on May 2, 2003.

Within 60 days of the date of effectiveness of the proposed rule change, the Commission, after consultation with the CFTC, may summarily abrogate the proposed rule change and require that the proposed rule change be refiled in accordance with the provisions of Section 19(b)(1) of the Act.[7]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change conflicts with the Act. Persons making written submissions should file nine copies of the submission with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically to the following e-mail address: *rule-comments@sec.gov.* 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. Copies of these filings also will be available for inspection and copying at the principal office of NFA. Electronically submitted comments will be posted on the Commission's Web site (*http://www.sec.gov*). All submissions should refer to File No. SR–NFA–2003–03 and should be submitted by June 9, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[8]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 03–12454 Filed 5–16–03; 8:45 am]

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[5] 15 U.S.C. 78o–3(k).

[6] 15 U.S.C. 78s(b)(7)(B).

[7] 15 U.S.C. 78s(b)(1).

[8] 17 CFR 200.30–3(a)(75).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47838; File No. SR–PCX–2002–36]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendments No. 2 and 3 to the Proposed Rule Change by the Pacific Exchange, Inc. Relating to the Exchange's New Trading Platform for Options, PCX Plus

May 13, 2003.

I. Introduction

On June 27, 2002, the Pacific Exchange, Inc. (''PCX'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC''), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] a proposed rule change to adopt new rules for the implementation of its new trading platform for options, PCX Plus. The PCX's proposal also includes new rules on priority and allocations of orders, rule changes to permit options Market Makers [3] to conduct their trading activities from locations away from the trading floor, and proposed system changes to accommodate new order handling procedures and automated trade processing. On November 6, 2002, the PCX filed Amendment No. 1 to the proposed rule change.[4] The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on November 18, 2002.[5] The Commission received four comment letters with respect to the proposal and Amendment No. 1.[6] On April 9, 2003, the PCX filed Amendment No. 2 to the proposed rule change.[7] On April 16, 2003, the PCX filed Amendment No. 3 to the proposed rule change, withdrew Amendment No. 3 on April 22, 2003, and refiled Amendment No. 3 on April 22, 2003.[8] This order approves the proposed rule change and Amendment No. 1; grants accelerated approval to Amendments No. 2 and 3 to the proposed rule change; and solicits comments from interested persons on Amendments No. 2 and 3.

II. Description of the Proposal

The Exchange has designed a new trading platform for options, PCX Plus. This new hybrid model combines the features of traditional floor-based markets and new electronic trading systems, while preserving a single marketplace with a single book. It allows PCX members to trade as Market Makers from locations away from the trading floor. For those options designated for trading on PCX Plus, the proposal replaces the PCX's current priority rules with new ones and expands upon the Exchange's current trading rules by permitting the entry of

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Proposed PCX Rule 6.32(a) (defines ''Market Maker'' as an individual who is registered with the Exchange for the purpose of making transactions as a dealer-specialist on the floor of the Exchange or, in the case of a Remote Market Maker, through the facilities of the Exchange).

[4] Amendment No. 1 replaced the PCX's original Rule 19b–4 filing in its entirety.

[5] Securities Exchange Act Release No. 46803 (November 8, 2002), 67 FR 69580 (''Notice of the Proposal'').

[6] *See* letters to Jonathan G. Katz, Secretary, Commission, from Thomas Peterffy, Chairman, and David M. Battan, Vice President and General Counsel, Interactive Brokers Group LLC (''IB Group''), dated December 9, 2002 (''IB Group Letter''); Meyer S. Frucher, Chairman and Chief Executive Officer, Philadelphia Stock Exchange, Inc. (''Phlx''), dated December 9, 2002 (''Phlx Letter''); Thomas N. McManus, Executive Director and Counsel, Morgan Stanley & Co., Incorporated (''Morgan Stanley''), dated January 6, 2003 (''Morgan Stanley Letter''); and Gerald D. O'Connell, Associate Director, Susquehanna International Group, LLP (''Susquehanna''), dated January 8, 2003 (''Susquehanna Letter'') (collectively, ''Comment Letters'').

[7] *See* letter from Kathryn L. Beck, Senior Vice President, General Counsel, and Corporate Secretary, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (''Division''), Commission, dated April 7, 2003 (''Amendment No. 2''). *See* Section III. of this order for a detailed description of Amendment No. 2.

[8] *See* letter from Peter D. Bloom, Acting Managing Director, Regulatory Policy, PCX, to Deborah L. Flynn, Assistant Director, Division, Commission, dated April 14, 2003 (''Amendment No. 3''). The PCX withdrew Amendment No. 3 and refiled it on April 22, 2003, after making minor technical changes to the proposed rule text. *See* letter from Peter D. Bloom, Acting Managing Director, Regulatory Policy, PCX, to Deborah L. Flynn, Assistant Director, Division, Commission, dated April 21, 2003. In Amendment No. 3, PCX made clarifications to proposed Commentary .02 to PCX Rule 6.64 regarding the procedures for determining a single price opening for options issues designated for trading on PCX Plus.

eligible orders of all account types into the Exchange's Consolidated Book,[9] including public customer, Market Maker, and broker-dealer orders. The new trading platform will also accommodate independent quotations from numerous market participants. In addition, the Exchange represents that PCX Plus provides intermarket price protection and would operate in a manner consistent with the Options Intermarket Linkage Plan (''Linkage Plan'').[10]

Under the PCX's proposal, orders would be allocated to Market Makers on a ''size pro rata'' basis. This formula would reward larger-sized bids and offers with greater participation in trades. In addition, the proposal would grant significant trade participation rights to market participants who are first to improve the PCX quote. Under this proposed rule change, a member who improves the quote and stands alone at that price for three seconds would receive First Improved Quote (''FIQ'') status. Those with FIQ status would be guaranteed, at least, the greater of: (1) 40% of the next order(s) to buy or sell the same series (for a minimum of 20 contracts), or (2) the total size that it would receive pursuant to a size pro rata allocation. Market Makers must establish the best bid or offer (''BBO'') or quote at the BBO to participate in automated trades.

The proposed new PCX Plus structure would involve four types of Market Makers on the Exchange.[11] Lead Market Makers (''LMMs'') would continue to provide two-sided markets throughout the trading day, while conducting their trading activities on the trading floor of the Exchange.[12] Remote Market Makers (''RMMs'') would be permitted to enter quotes and effect trades from off-site locations and to select their appointed issues. RMMs would be required to provide two-sided quotations in each issue in which they are appointed during 60% of the time the Exchange is open for trading. Floor Market Makers (''FMMs''), who are registered Market Makers with basic obligations on the Options Floor, would continue to trade as they do today and would supply independently generated Quotes with Size.[13] Members would also be permitted to act as Supplemental Market Makers (''SMMs''), who would be provided with tools that allow them to add liquidity at the same price that is then being disseminated by the LMM.

Under the proposal, LMMs would be eligible to receive up to 40% in guaranteed participation on trades occurring at their disseminated markets. Members would also be entitled to receive up to 40% trade participation if they maintain FIQ status. Although members may receive more than 40% participation by virtue of a pro rata allocation, no member would be eligible to receive more than 40% participation as a guarantee by rule. LLMs would be entitled only to the greater of their 40% guaranteed participation or their size pro rata allocation, subject to the size of the LMM's disseminated size.[14] The proposal is also designed to limit firms interacting with their customers' orders to receiving no more than a 40% share of such orders before the orders are exposed to further competition. Finally, no member would be allocated option contracts in excess of their expressed trading interest.

The proposal would allow available trading interest on the Exchange to be aggregated by price and size. Currently, only orders for the accounts of public customers are eligible to be represented in the PCX order book. Under the proposal, orders for all account types—including public customer, Firm, Market Maker and Non-Member Market Maker—may be represented in the Consolidated Book, along with Quotes with Size of PCX Market Makers (which would be entered for handling as if they were orders). Public customer orders displayed at the best price would continue to receive first priority on the Exchange.[15] In addition, all classes of market makers will have the same ability to access information about the depth and size of quotes and orders on PCX Plus.[16]

Market and marketable limit orders routed electronically to PCX Plus would receive immediate executions against bids and offers in the Consolidated Book, unless a specified condition applies, in which case the order (or a portion of it) would be routed to a Floor Broker Hand Held Terminal for execution. The proposal also establishes new procedures for Market Makers' trading interest that interact electronically with orders in the Consolidated Book. In such situations, a Market Maker who initiates a transaction would be limited to 40% of the available customer contracts at the execution price or the Market Maker's size pro rata share, whichever amount is greater. The Market Maker would then be eligible to trade the remaining option contracts at the execution price once other Crowd Participants[17] have had an opportunity to participate.

While the proposal is intended to further automate options trading on the Exchange, the Exchange represents that the proposed new system would continue to facilitate open outcry trading as currently practiced today, particularly for large transactions and executions of complex orders and contingency orders. When an order is entered by phone or re-routed to a Hand Held Terminal for execution, a Floor Broker would represent it at the appropriate trading post and would be afforded priority first to public customer interest in the Consolidated Book, then to bids or offers in the trading crowd, and finally to any Firm or Market Maker interest in the Consolidated Book.[18]

The Exchange proposes to phase in the use of PCX Plus in particular issues, while simultaneously phasing out the current Auto-Ex ''wheel'' functionality. During the phase-in period, the Exchange represents that it would have two sets of trading rules in operation, each applying to a different set of option issues traded on the Exchange. PCX represents that PCX Plus will be implemented gradually on an issue-by-issue basis beginning on December 15, 2003, and will become completely

[9] *See* proposed PCX Rule 6.1(b)(37) (defining ''Consolidated Book'' as the Exchange's electronic book of limit orders for the accounts of public customers and broker-dealers, and Quotes with Size. All orders and Quotes with Size that are entered into the Consolidated Book will be ranked and maintained in accordance with the rules of priority as provided in proposed PCX Rule 6.76).

[10] *See* Securities Exchange Act Release Nos. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (order approving the Linkage Plan submitted by American Stock Exchange LLC, Chicago Board Options Exchange, Inc. and International Securities Exchange, Inc.); 43574 (November 16, 2000), 65 FR 70850 (November 28, 2000) (order approving the PCX as participant in Options Intermarket Linkage Plan); and 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000) (order approving Philadelphia Stock Exchange, Inc. as participant in the Linkage Plan).

[11] *See* proposed PCX Rule 6.32(a).

[12] LMMs will also be responsible for performing certain functions under the Linkage Plan. *See supra* note 10.

[13] *See* proposed PCX Rule 6.1(b)(33) (which defines ''Quote with Size'' as a quotation to buy or sell a specific number of option contracts at a specific price that a Market Maker has entered into PCX Plus through an electronic interface).

[14] *See* proposed PCX Rule 6.76(a)(2)(C)(iii).

[15] Under the PCX's proposal, inbound orders are allocated based on the following priority sequence: public customer orders have first priority to trade against such orders; quotes with FIQ status have second priority (subject to a 40% cap); the portion of the order subject to LMM guaranteed participation will be allocated next; followed by any trading interest for the accounts of non-public customers. *See* proposed PCX Rule 6.76(a).

[16] *See* proposed subsection (c) to PCX Rule 6.57.

[17] *See* proposed PCX Rule 6.1(b)(38) (which defines ''Crowd Participants'' as the Market Makers appointed to an option issue under Rule 6.35, and any Floor Brokers actively representing orders at the best bid or offer on the Exchange for a particular option series.)

[18] *See* proposed PCX Rule 6.76(d).

operative and applicable to all options issues by June 30, 2004.[19]

For a more detailed description of the specific proposed amendments to PCX's rules, see the Section II.A.1.b. (''Summary of Proposed Changes to PCX's Rules'') in the Notice of the Proposal.[20]

III. Description of Amendments No. 2 and 3 to the Proposal

In Amendments No. 2 and 3, the PCX proposed changes to the proposed PCX Plus rules to address specific questions and concerns raised by the Comment Letters and by Commission staff.

A. Automated Opening Rotation Process

The Exchange proposes to modify PCX Rule 6.64(d) to clarify how the automated opening rotation would work in PCX Plus and to add PCX Rule 6.64, Commentary .02 to codify the procedure for determining a single price opening for option issues designated for trading on PCX Plus. The proposed automated opening rotations used by PCX Plus would differ from those currently used on the Trading Floor in the following respects: (1) There would be no ''manual'' openings as provided in current PCX Rule 6.64(b); (2) all account types (including orders for the accounts of broker-dealers and Market Maker Quotes with Size) would be eligible to participate in the opening; (3) the concept of an ''imbalance threshold'' (as described in current Rule PCX 6.64(c)(2)(D)) would no longer apply; and (4) there would be an electronic Requests for Quotes (''RFQ'') process when the opening price cannot be determined within certain parameters. The manner in which the opening rotation would operate is described below.

1. Establishing a Market for the Opening Rotation

Opening rotations for options designated for trading on PCX Plus would be conducted at the commencement of each trading day using the process described in proposed PCX Rule 6.64(d). In Amendment No. 2, PCX proposes to modify the proposal to specify that the PCX Plus system would accept market and limit orders and Quotes with Size for inclusion in the opening rotation process (''Rotation Process'') up until the Rotation Process is initiated in that option series. PCX further clarifies in Amendment No. 2 that market orders would have priority over limit orders during the Rotation Process and any open orders residing in the Consolidated Book from the previous trading session would be included in the Rotation Process. As set forth in the Notice of Proposal, contingency orders (except for ''opening only'' orders) will not participate in the Rotation Process.[21] Amendment No. 2 also clarifies that after the primary market for the underlying security disseminates the opening trade or the opening quote, the related option series would be opened automatically based on the following principles and procedures set forth in the Notice of Proposal.

First, PCX Plus would verify that a Quote with Size has been received from the LMM before a series is eligible for the Rotation Process. Second, PCX Plus would determine a single price at which a particular option series would be opened, as provided in proposed Commentary .02 and as described below. Third, orders in the PCX Plus system would maintain priority over Market Maker bids and offers that are not being represented in the Consolidated Book as Quotes with Size. Orders in the PCX Plus system would be matched up with one another, based on the priority rules as set forth in proposed Rule 6.76(a); provided, however, that (1) Market Maker Quotes with Size would have priority over orders for Firms, Market Makers, and Non-Member Market Makers during the Rotation Process and (2) orders for the accounts of Firms, Market Makers, and Non-Member Market Makers would be executed based on price/time priority during the Rotation Process. Finally, following the opening, any unexecuted contracts would be represented as bids and offers on the Exchange.

2. Determining the Opening Price for Option Issues Designated for Trading on PCX Plus

In Amendments No. 2 and 3, PCX proposes to add Commentary .02 to PCX Rule 6.64 to establish the process by which PCX Plus would automatically determine a single price at which a particular option series would be opened. The opening price is that price at which the maximum number of contracts may be executed within the established market. The opening price would always be on or between the bid and offer established by the Rotation Process. If there were two or more prices at which the maximum number of contracts are executable within the established market, then the opening price would be the midpoint of the available prices. If, however, the midpoint of the available prices is not consistent with the minimum price variation (''MPV''),[22] the opening price would be determined as follows: (1) At the next higher (lower) price that is consistent with the MPV if that price is closer to the midpoint than the next lower (higher) price that is consistent with the MPV; (2) if the next higher and lower prices that are consistent with the MPV are equidistant from the midpoint, at the next higher or lower price consistent with the MPV that leaves the least residual customer limit order volume;[23] or (3) if the next higher and lower prices consistent with the MPV are equidistant from the midpoint price and leave the same residual customer limit order volume, at the price that the next MPV greater than the midpoint price.[24]

To illustrate how the PCX proposes to establish the opening price, assume that the established market is 6.00–6.50 and that the maximum number of options contracts that could be matched is 250 contracts at prices on or between 6.10 and 6.40. Since the resulting midpoint price of 6.25 represents a price increment other than an eligible MPV permitted under the Exchange's rules, the PCX Plus system will select the eligible MPV that is closest to the 6.25 midpoint which, in this case, is either 6.20 or 6.30. Since the midpoint at the MPV is equidistant (*i.e.*, 0.05) from both the higher and lower prices, the opening price will be set at the price that will result in the least trading on the customer limit orders residing in the Consolidated Book. If the customer limit order volume is the same amount for both the higher and lower prices, then the opening price will be set at the nearest MPV that is greater than the midpoint which, in this example, would be 6.30.

In the event that the opening price cannot be determined within the range of 75% of the lowest Quote with Size bid and 125% of the highest Quote with Size offer, the PCX proposes that the PCX Plus system would initiate an RFQ

[19] *See* Amendment No. 2, *supra* note 7.

[20] *See* Notice of the Proposal, *supra* note 5. *See also* Amendment No. 2, *supra* note 7, which proposes additional amendments to some of those PCX rules.

[21] PCX believes that the exclusion of these order types will simplify and facilitate the process for completing the opening. Market participants that desire to have such orders represented in the opening can choose not to impose the contingency until after the opening if they want to attempt to participate in the opening.

[22] The Exchange's current MPV for option contracts quoted under $3 is $0.05 and for option contracts quoted at or above $3 is $0.10. *See* PCX Rule 6.72.

[23] PCX believes that this opening match criterion is reasonable and is structured fairly by selecting an opening price that would leave the fewest resting customer orders in the Consolidated Book.

[24] *See* Amendment No. 2, *supra* note 7 and Amendment No. 3, *supra* note 8.

process as follows: First, an RFQ would be sent to all Crowd Participants. The RFQ would indicate the series and the total sell (buy) interest at the lowest Quote with Size bid (highest Quote with Size offer), if insufficient bids (offers) have been submitted. Second, all opening eligible bids and offers would continue to be accepted during the RFQ period for inclusion in the opening transaction calculation. At the conclusion of the RFQ period, the Rotation Process would determine an opening price pursuant to proposed subsection (b) of Commentary .02 to proposed PCX Rule 6.64(d). Third, if the Rotation Process cannot be completed after the first RFQ, a second RFQ would be disseminated. Fourth, if the Rotation Process cannot be completed following the second RFQ period, a third, expanded, RFQ would be disseminated to all Crowd Participants and any other Market Makers logged on to the system. PCX proposes that the expanded RFQ would include: (1) The series; (2) the volume representing the total sell (buy) interest at the lowest Quote with Size bid (highest Quote with Size offer), if insufficient bids (offers) have been submitted; and (3) the side of the market with the imbalance. Finally, if the Rotation Process cannot be completed following the third RFQ period, an alert would be generated to Exchange staff. No additional RFQs would be disseminated. The Rotation Process would attempt to open the series every 30 seconds until it can be successfully completed.

B. Appointment of RMMs

In Amendment No. 2, the Exchange proposes to add a new proposed subsection (h) [25] to PCX Rule 6.35 to allow Member Firms [26] who own or lease multiple seats to have an equal number of primary appointments available to them as would an individual that owns or leases the same number of seats. Under proposed PCX Rule 6.35(h), if a Member Firm has two or more Nominees [27] that are registered as RMMs, then the number of seats held in the name of such RMMs may be aggregated for the purpose of determining the number of options issues eligible for primary appointment pursuant to proposed PCX Rule 6.35(g)(2). The distribution of the option issues as primary appointments for each RMM would be at the discretion of the Member Firm; however, an RMM would be prohibited from concurrently trading or quoting the same option issue as an RMM who is a Nominee for the same Member Firm. Additionally, for purposes of PCX Rule 6.35, the primary appointment would apply collectively to the Member Firm (subject to the approval of the Options Allocation Committee), rather than to each Nominee registered as a RMM.

The PCX believes that the proposed new subsection (h) to PCX Rule 6.35 is consistent with current membership rules as each RMM that performs market-making activities on behalf of the Member Firm would have to be assigned a membership in order to trade on PCX Plus. In addition, each RMM would have to be registered and properly qualified pursuant to current PCX Rule 6.33.

C. Restriction on the Entry of Two-Sided Quotations

Under proposed PCX Rule 6.37(h)(5), as published in the Notice of the Proposal, RMMs would be required to trade at least 75% of their average daily trading volume per quarter in issues included in their primary appointments. RMMs would be permitted to trade up to 25% of their quarterly contract volume in option issues that are not included within their primary appointments. In Amendment No. 2, the Exchange proposes to amend its proposal to include a provision that would restrict RMMs from entering two-sided quotations in option issues that are not included within their primary appointments. However, RMMs would be permitted to enter single-sided quotes [28] and multiple orders to buy and sell the same option series. PCX believes that such restriction is necessary to ensure the proper performance of the PCX Plus system and to prevent RMMs from circumventing the spirit and intent of limiting the number of option issues per seat as set forth in proposed PCX Rule 6.35(g)(2).

D. LMM Trade Allocation Methodology

The Exchange proposes to amend proposed PCX Rule 6.76(a)(2)(C) concerning the methodology used to allocate trades to LMMs. As discussed in the Notice of the Proposal, LMMs in options trading in PCX Plus would be guaranteed an allocation up to 40% of the incoming trading interest on trades occurring at their disseminated markets. The LMM's 40% participation would apply to the quantity remaining after all public customer orders and quotes with FIQ status, if any, have first been executed.[29] In addition, if there were contracts remaining to be executed, the remaining portion of the LMM's bid or offer would have participated in the ''size pro rata'' allocation, as provided in proposed PCX Rule 6.76(a)(4). Thus, LMMs would have received both a 40% guaranteed participation and a size pro rata allocation.

In response to the Phlx Letter, which argued that the proposed trade allocation methodology would provide LMMs with a disproportionate share of the incoming order flow, PCX proposes in Amendment No. 2 to eliminate proposed PCX Rule 6.76(a)(2)(C)(iv) and proposes to amend proposed PCX Rule 6.76(a)(2)(C)(iii) so that LMMs would receive an allocation representing the greater of their 40% guaranteed participation or their size pro rata allocation, but no greater than the size of the LMM's disseminated size.[30]

E. Obvious Error and Trade Nullification/Price Adjustment Rules

In a separate rule filing, the Exchange proposes to adopt new rules that would allow it to either adjust or nullify a transaction in circumstances where a member or its customer has made an error and the price of the execution is ''obviously'' not correct.[31] The proposed rules will contain objective standards regarding when a transaction was clearly the result of an ''obvious error,'' under what circumstances a trade would be adjusted or nullified, and to what price a trade would be adjusted if adjustment were appropriate under the circumstances. The Exchange represents that its obvious error and trade nullification/price adjustment rules applicable to PCX Plus will be based

[25] Proposed Rule 6.35(h) is being renumbered as proposed PCX Rule 6.35(i).

[26] A ''Member Firm'' means ''a partnership, corporation, limited liability company or other organization in good standing who owns or leases a membership or upon whom a member has conferred privileges of membership pursuant to and in compliance with Article VIII of the PCX Constitution.'' *See* PCX Rule 1.1(j).

[27] A ''Nominee'' means ''a Member Firm which owns more than one membership may register such additional membership or memberships in the name of a nominee or nominees subject to such conditions and requirements as the Board of Governors may prescribe.'' *See* Article VIII, Section 2(a) of the PCX Constitution.

[28] RMMs enter single-sided quotes directly into an interface with PCX Plus. RMMs would not be permitted, however, to stream quotes in such issues. RMMs also could enter orders through a proprietary brokerage terminal, which would be routed to a floor broker for representation. An RMM may choose to enter an order, rather than a single-sided quote, when the order is complex, is being entered on a contingency basis, or involves other discretion. Telephone call between Sonia Trocchio, Special Counsel, Division, Commission, and Pete Armstrong, Senior Vice President, Options Floor Operations, PCX on April 16, 2003.

[29] Proposed PCX Rule 6.76(a)(2)(C)(ii).

[30] The LMM's disseminated size would not include the size of any SMMs quoting at the LMM's disseminated price. Telephone call between Sonia Trocchio, Special Counsel, Division, Commission, and Pete Armstrong, Senior Vice President, Options Floor Operations, PCX on April 17, 2003.

[31] *See* File No. SR–PCX–2002–01.

upon the rules that the Commission ultimately approves in File No. SR–PCX–2002–01, and not the existing Price Adjustment rules.[32] The Exchange further represents that it will not implement PCX Plus before File No. SR–PCX–2002–10 has been approved by the Commission.

F. System Phase-In and Applicability of Rules

In response to the request of Commission staff, PCX proposes to amend proposed PCX Rule 6.90(b) to clarify the application of trading rules in option issues traded on PCX Plus during the phase-in period. During the phase-in period, PCX would have two sets of trading rules in operation, each applying to a different set of option issues traded on the Exchange. Accordingly, PCX estimates that the rules applicable to PCX Plus would be implemented gradually on an issue-by-issue basis beginning on December 15, 2003, and would become completely operative and applicable to all options issues by June 30, 2004. At that time, the rules relating to PCX Plus would supercede existing rules that are inapplicable to the new trading environment.[33] The PCX represents that the purpose of the gradual rollout schedule is to give PCX and its members the opportunity to observe and gain experience with the new system and to give PCX the opportunity to make any adjustments and changes to the system (in consultation with and approval by the Commission), if and when necessary.

G. Prevention of the Misuse of Material, Non-Public Information

In Amendment No. 2, PCX represents that PCX Rule 2.6(e) (Prevention of the Misuse of Material, Non-Public Information) would apply to members trading on PCX Plus. PCX believes that PCX Rule 2.6(e) would require a PCX Market Maker to maintain information barriers (that are reasonably designed to prevent the misuse of material, non-public information by such member) with any affiliates that may act as a specialist or market maker in any security underlying the options for which the PCX member acts as a Market Maker.

H. Maximum Order Size Eligibility

As discussed in the Notice of the Proposal, proposed PCX Rule 6.76 provides that the maximum size of an inbound order (the ''Maximum Order Size'') that may be eligible for execution on PCX Plus will be established by the LMM in the issue, subject to the approval of two Floor Officials, whose approval must be further ratified by the Options Floor Trading Committee. In Amendment No. 2, the Exchange proposes to modify this provision to require approval of the LMM's initial determination of the Maximum Order Size by the Options Floor Trading Committee. In addition, the Exchange proposed to add the following text: ''Any request by the LMM for changes to the Maximum Order Size must be accompanied by a verified statement indicating the business reason for the change and the estimated duration of such change. Such requests must be approved by two Floor Officials, whose approval must be further ratified by the Options Floor Trading Committee.'' Furthermore, in Amendment No. 2, PCX proposes to add language to proposed PCX Rule 6.76 to prohibit a LMM from requesting changes to the Maximum Order Size in order to manipulate the operation of PCX Plus or for any anti-competitive purposes.

The Exchange believes that the proposed amendment to proposed PCX Rule 6.76 addresses the competitive concerns raised by the Commission staff and is consistent with the terms and spirit of the Commission's Order.[34]

I. Linkage Plan

The Commission staff requested the Exchange to clarify the application of the definition of ''Eligible Market Maker,'' as that term is used in the Linkage Plan[35] and in PCX Rule 6.92. In this regard, for purposes of the Linkage Plan, PCX represents in Amendment No. 2 that a PCX Market Maker would be considered an Eligible Market Maker if the PCX Market Maker is logged on to the PCX Plus system and provides continuous two-sided quotations (or, in the case of a SMM, the size of its quotation) through an electronic interface to the PCX Plus System.

J. Quoting Obligations of SMMs and FMMs

The quoting obligations of SMMs and FMMs are set forth in proposed PCX Rule 6.37(g)(3) and (4), respectively. In Amendment No. 2, the Exchange proposes to modify these proposed rules to clarify that when the aforementioned Market Makers are present in the trading crowd, they would be required to provide quotations on PCX Plus through an electronic interface with the Exchange, but would be permitted to also provide quotations by public outcry. In addition, whenever a Floor Broker represents an order in the trading crowd and calls for a market in a particular options series, each SMM and FMM present at the trading post would be obligated to vocalize a two-sided, legal-width market (pursuant to PCX Rule 6.37(b)(1)).

The Exchange believes that this proposed amendment to proposed PCX Rule 6.37 will ensure that SMMs and FMMs meet their affirmative obligations and be entitled to receive special margin treatment by assisting the LMM in maintaining a fair and orderly market.

K. Suspension of the PCX Plus System

In the Notice of the Proposal, proposed PCX Rule 6.90(g) included provisions regarding the suspension of the PCX Plus system in the event of any disruption or malfunction in the use or operation of system, as well as any other unusual market conditions not involving a system malfunction. In Amendment No. 2, the Exchange proposes to amend proposed PCX Rule 6.90(g) as follows:

First, the Exchange proposes to eliminate that portion of the text in proposed Rule 6.90(g)(1) that refers to the declaration of a ''fast market'' by two Floor Officials. The Exchange believes that the deleted phrase ''declare a fast market'' is inapplicable given its market structure and trading system. The PCX Plus system enables Market Makers to set parameters establishing the amount of their quotation size that would be available for execution against inbound interest, with the system automatically executing such orders according to these parameters. Consequently, when a system disruption or malfunction occurs but the Exchange is able to process and disseminate quotes accurately, any orders received by the Exchange would be routed to Floor Broker Hand Held Terminals for representation in the trading crowd. In such circumstances, Market Maker bids and offers would continue to be firm pursuant to PCX Rule 6.86 and SEC Rule 11Ac1–1 under the Act. Regular trading procedures would be resumed by the Exchange when two Floor Officials determine that the disruption or malfunction is corrected.

Second, the Exchange proposes to add language to proposed PCX Rule 6.90(g)(1) to clarify that those orders

[32] Telephone call between Deborah Flynn, Assistant Director, Division, Commission, and Kathryn Beck, Senior Vice President, General Counsel, and Corporate Secretary, PCX on April 14, 2003.

[33] *See* proposed PCX Rule 6.90(b).

[34] *See* Order Instituting Public Administrative Proceedings Pursuant to section 19(h)(1) of the Act, Making Findings and Imposing Remedial Sanctions (''Settlement Order''). Securities Exchange Act Release No. 43268 (September 11, 2000) (File No. 3–10282).

[35] *See* Linkage Plan, *supra* note 10, section 2(7) (definition of ''Eligible Market Maker'').

that are routed to Floor Broker Hand Held Terminals for manual representation during a system disruption or malfunction would be executed pursuant to the order execution and priority principles set forth in proposed PCX Rule 6.76(d).

Finally, the Exchange proposes to eliminate proposed PCX Rule 6.90(g)(2), which relates to other unusual market conditions not involving a system malfunction, because it is superfluous. The Exchange believes that under any circumstance where a fair and orderly market cannot be maintained, the trading halt guidelines set forth in current PCX Rule 6.65 will be followed. Trading may be resumed whenever two Floor Officials determine that a fair and orderly market may be maintained. The Exchange also proposes to make a conforming change to PCX Rule 6.28(c)(6) by eliminating that portion of the text that refers to the suspension of the PCX Plus system during fast markets and unusual market conditions, as this provision is no longer applicable.

L. Applicability of Automated System Access Privileges (''ASAP'') Memberships

ASAP Memberships are governed by current PCX Rule 1.14, which allows certain qualified broker-dealers (''ASAP Members'') electronic access to the Exchange's automated options trading system, Pacific Options Exchange Trading System (''POETS''), as well as any other systems approved by the PCX's Board of Governors. In Amendment No. 2, PCX represents that an ASAP Membership cannot be utilized: (1) To effect trades via PCX Plus, or (2) by a member to act as a RMM.

M. Miscellaneous Changes

Finally, in Amendment No. 2, the PCX proposes the following technical and miscellaneous changes:

1. *PCX Rule 6.52*—The Exchange proposes to change the text of proposed PCX Rule 6.52(a) to clarify that, for those option issues designated for trading on PCX Plus, limit orders for the accounts of public customers, broker-dealers, and Market Makers, and Quotes with Size of Market Makers will be eligible for placement in the Consolidated Book. In option issues not designated for trading on PCX Plus, the Exchange proposes to retain the provisions contained in current PCX Rule 6.52(a) and (c),[36] which would be renumbered as subsections (b) and (d), respectively (current PCX Rule 6.52(b) would be renumbered as subsection (c)).

2. *Proposed PCX Rule 6.76(b)(2)(B)*—The Exchange also proposes to change the text in proposed PCX Rule 6.76(b)(2)(B) to clarify that the provisions in paragraph (B) would apply to a Firm or Non-Member Market Maker order that was entered one minute or more before the inbound order.

3. *Proposed PCX Rule 6.90(e)*—Proposed PCX Rule 6.90(e) sets forth the practices that would be prohibited on PCX Plus. The Exchange represents that the requirements of this rule would apply only to members and member organizations that have direct electronic access to PCX Plus and are responsible for the execution and settlement of any resulting trades.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendments No. 2 and 3 to the proposed rule change, including whether Amendments No. 2 and 3 are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. 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. Copies of such filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR–PCX–2002–36 and should be submitted by June 9, 2003.

V. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations promulgated thereunder applicable to a national securities exchange and, in particular, with the requirements of section 6(b) of the Act.[37] Specifically, the Commission finds that approval of the proposed rule change, as amended, is consistent with section 6(b)(5) of the Act[38] in that it is designed to facilitate transactions in securities; to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; 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.

A. Obligations of Market Makers

The PCX Plus proposal contemplates four types of Maker Makers: LMMs, RMMs, FMMs, and SMMs. LMMs are required to provide continuous two-sided quotes that meet certain spread parameters throughout the trading day in each of their appointed issues. LMMs must enter their quotations through an automated quotation system, but may also provide quotations by public outcry.

RMMs enter quotations from off-floor locations through an electronic interface with the Exchange.[39] Further, because PCX Rule 6.37(h)(1) states that all rules applicable to market makers apply to RMMs unless otherwise provided, PCX Rule 6.37(a)–(c) would apply to RMMs.[40] In addition, RMMs are required to provide continuous two-sided quotations that meet certain quote spread parameters in each of their appointed issues 60% of the time that the Exchange is open for options trading, and may not enter two-sided quotes in options issues that are not included in the RMMs primary appointment. RMMs could, however, enter single-sided quotes and multiple orders to buy and sell the same option series in issues outside their primary appointment.

FMMs would be physically located in the trading crowd, and like RMMs,

[36] Current PCX Rule 6.52(c) describes the circumstances and procedures to be followed by Floor Brokers for the entry, cancellation and changes of orders held by the Order Book Official.

[37] 15 U.S.C. 78f(b). In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

[38] 15 U.S.C. 78f(b)(5).

[39] The Commission notes that, in Amendment No. 2, PCX represented that an ASAP Membership, governed by PCX Rule 1.14, cannot be used to effect trades via PCX Plus, or to act as a RMM. *See* Amendment No. 2, *supra* note 7.

[40] PCX Rule 6.37(a) states that transactions of a market maker should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market. PCX Rule 6.37(b) states, among other things, that a market maker is expected to engage, to a reasonable degree under the existing circumstances, in dealings for his own account when there is a lack of price continuity, a temporary disparity between the supply of and demand for a particular option contract, or a temporary distortion of the price relationships between option contracts of the same class. PCX Rule 6.37(c) sets forth the requirements for trading by a market maker in options classes to which the market maker is not appointed.

would be required to provide two-sided quotations that meet certain quote spread parameters through an auto-quoting device when present in the trading crowd. FMMs would also be obligated to vocalize a two-sided legal-width market whenever a floor broker enters the trading crowd.

Finally, when present in the trading crowd, SMMs would be required to provide the size of their quotations at the LMM's bid or offer through an electronic interface device. Also, like FMMs, SMMs would be obligated to vocalize a two-sided, legal-width market whenever a floor broker enters the trading crowd.

In addition, all Market Makers must trade at least 75% of their average daily trading volume per quarter in issues included in their primary appointment.[41] All Market Makers, except RMMs, must also execute at least 60% of their transactions in-person.

Market Makers receive certain benefits for carrying out their duties. For example, a lender may extend credit to a broker-dealer without regard to the restrictions in Regulation T of the Board of Governors of the Federal Reserve system if the credit is to be used to finance the broker-dealer's activities as a specialist or market maker on a national securities exchange.[42] The Commission believes that a Market Maker must have an affirmative obligation to hold itself out as willing to buy and sell options for its own account on a regular or continuous basis to justify this favorable treatment. In this regard, the Commission believes that PCX's rules impose such affirmative obligations on PCX Plus Market Makers.

B. Priority and Allocation

Under the proposal, the best priced bids and offers have priority over worse priced bids and offers. The Commission believes that the capability that PCX Plus provides to market makers to independently submit their quotes and then reward market makers with better quotes through this priority rule should substantially enhance incentives to quote competitively by providing market participants that improve the quote with an allocation of the resulting trade.[43]

In addition, bids and offers for public customers would get first priority over other bids or offers at the same price. If there is more than one highest bid or lowest offer for a public customer, the bids/offers would be ranked based on time priority. Non-customer orders and Quotes with Size would be allocated (after any LMM or FIQ guarantees, discussed below) on a size pro rata basis.

1. LMM Guarantee

PCX Rule 6.82 currently provides LMMs with a 40% participation right in transactions occurring at their disseminated bids and/or offers in their allocated issues. PCX Plus rules would also guarantee to the LMM 40% of the portion of an order traded at the LMM's quote that remains after the execution of all public customer orders and quotes with FIQ status. The LMM, however, would be entitled to its size pro rata allocation, if it were greater than the allocation it would receive under the LMM guarantee. In no event would the LMM be allocated contracts greater than its disseminated size.[44]

The Commission recognizes that a large guaranteed participation right will erode the incentive of other market makers to make competitive markets. Thus, the Commission must weigh whether a proposed participation right adequately balances the aim of rewarding the specialist or lead market maker with the aim of leaving a sizeable enough portion of the incoming order for the other market makers quoting at the same price.[45] The Commission has previously taken the position that a trade participation right that does not exceed 40%, including any guaranteed percentage of the trade to be accorded to any other trade participant, is not inconsistent with the Act.[46]

2. FIQ Status

A non-customer order or Quote with Size that improves the best bid or offer on the Exchange will have FIQ status with respect to other bids or offers at the same price, unless it is matched or further improved within three seconds. An order or Quote with Size with FIQ status is entitled to trade against the greater of: (1) 40% of the next inbound electronic order or orders (after public customer orders have been executed), and (2) the total size that the order or Quote with Size with FIQ status would be entitled to receive pursuant to a size pro rata allocation. An order or Quote with Size with FIQ status would not be awarded a greater number of contracts than the size of the bid or offer with FIQ status. LLMs would be entitled only to the greater of their 40% guaranteed participation or the number of contracts the LMM would be entitled to receive for having FIQ status.[47]

The Phlx commented that because the ''LMM need only match the price improving quote (as opposed to further improving it), LMMs likely would automate the matching process to ensure that no Market Maker that improves the quote would ever be able to maintain FIQ status.''[48] The Commission, however, does not believe that giving any preference to a Market Maker that first improves the quote is required by the Act. The Commission also believes that because all PCX Plus Market Makers will be able to independently and automatically generate quotes in all series and will participate in the trade pursuant to the size pro rata allocation when they are at the best price, that even if the Market Maker loses its FIQ status because its quote is matched by another Market Maker or the LMM, the proposal substantially enhances incentives to quote competitively.[49] Finally, although it is not unlawful for a market maker to take the prices offered by its competitors into account when setting its own prices, or to follow or copy prices of its

[41] PCX represents that this 75% average daily trading volume requirement will apply to all PCX Market Makers pursuant to PCX Rule 6.35, Commentary .03. Telephone conversation between Kathryn Beck, Senior Vice President, General Counsel, and Corporate Secretary, PCX, and Sapna C. Patel, Attorney, Division, Commission, on April 10, 2003.

[42] *See* 12 CFR 221.5(c)(6).

[43] The Exchange has submitted the proposed rule change pursuant to subparagraph IV.B.h.(i)(aa) of the Commission's September 11, 2000 Order Instituting Public Administrative Proceedings Pursuant to section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions, which required the PCX (as well as other floor-based option market exchanges) to adopt new, or amend existing rules to substantially enhance incentives to quote competitively and substantially reduce disincentives to act competitively. *See* Settlement Order, *supra* note 34.

[44] Proposed PCX Rule 6.76(a)(2)(C)(iii).

[45] *See* Securities Exchange Act Release No. 43100 (July 31, 2000), 65 FR 48778, 48787–90 (August 9, 2000) (''Phlx 80/20 Proposal'') (Commission requested comment on whether the proposal by the Phlx to establish an 80% specialist guarantee would be consistent with the Act).

[46] *See, e.g.*, Securities Exchange Act Release No. 45936 (May 15, 2002), 67 FR 36279, 26280 (May 23, 2002) (SR-CBOE–2002–10) (approving participation entitlements that range from 34 percent to 40 percent for the DPM providing the primary quote feed, depending on the total number of appointed market makers in the option); Securities Exchange Act Release No. 42835 (May 26, 2000), 65 FR 35683, 35685–66 (June 5, 2000) (SR–CBOE–99–10) (approving DPM guarantee for crossed orders that, when combined with the percentage crossed by the floor broker, cannot exceed 40% of the original order (after relevant public customer orders have been satisfied)); and Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388, 11398 (March 2, 2000) (approving International Securities Exchange's application for registration as a national securities exchange, which contains a 40% participation right for facilitating EAMs); *see also* Phlx 80/20 Proposal, *supra* note 45.

[47] *See* proposed PCX Rule 6.76(a)(3)(C).

[48] *See* Phlx Letter, *supra* note 6.

[49] Currently, a Market Maker that improves the quote would be able to participate in the resulting trade only if that Market Maker happens to be next on the Auto-Ex ''wheel.''

competitors, such a decision must be a unilateral business judgment not intended to harass or punish a competitor for improving prices or otherwise acting competitively and not the result of collusive agreement. Accordingly, the Commission expects that the PCX will surveil its market to ensure that market makers are not coordinating quotes in PCX Plus or engaging in other anticompetitive conduct.

C. Linkage Obligations

Under PCX Rule 6.92(a), an ''Eligible Market Maker'' for purposes of the Linkage Plan is defined as ''a market maker that: (i) Is assigned to, and is providing two-sided quotations in, the Eligible Option Class; (ii) is logged on to participate in Auto-Ex in such Eligible Option Class; [50] and (iii) is in compliance with the requirements of PCX Rule 6.95 (relating to limitation on principal order access).'' [51] PCX Market Makers would be considered to be Eligible Market Makers participating in the automated execution system for PCX Plus issues if they are logged on to the PCX Plus system and provide continuous two-sided quotes (or, with respect to SMMs, the size of their quote) through an electronic interface to the PCX Plus System. The Commission notes that to enable PCX to comply with its obligations under the Linkage Plan, PCX Rules 6.92 through 6.96 will apply to the PCX Plus system.[52] The Commission also notes that PCX clarified in Amendment No. 2 that LLMs have responsibility for handling incoming Linkage orders. The Commission believes that these provisions should assure other Linkage Plan participants that the introduction of PCX Plus should not jeopardize the PCX's ability to satisfy its obligations under the Linkage Plan.

D. PCX Plus Executions

PCX Plus provides for automated executions and manual executions, as well as split-price executions and electronic book executions. The PCX represents that once PCX Plus is completely phased in, it will replace the PCX's current Auto-Ex ''wheel'' in its entirety.

Under PCX's current rules, an incoming eligible market or marketable limit order is automatically executed against an order in the PCX order book if there is an order representing the best price on the Exchange. Otherwise, the inbound order, or a portion of it, is executed by Market Makers in the trading crowd who are logged onto PCX's Auto-Ex ''wheel.''

Under PCX Plus, inbound marketable orders would be immediately executed against bids and offers in the Consolidated Book unless: (1) The size of the inbound order exceeds the PCX's established Maximum Order Size; [53] or (2) the inbound order is for the account of a Firm or Non-Market Maker and more than 50% of the aggregate trading interest in the Consolidated Book at the execution price is for the account(s) of public customers. If either of these two conditions exist, the inbound order would be routed to a Floor Broker Hand Held Terminal for manual execution by the trading crowd based on priority rules in proposed PCX Rule 6.76(d).

If the inbound marketable order does not meet the two conditions above, the way it would be executed under the proposed rules would differ depending on whether a single firm or Non-Member Market Maker order at the best price on the Consolidated Book was entered less than one minute, or one minute or more, before the inbound order.[54]

The Commission notes that inbound electronic orders entered through PCX Plus will receive split-price execution at multiple price levels if there is insufficient trading interest at the best price in the Consolidated Book and the remainder of the order can be filled at one or more other price levels in the Consolidated Book. The Commission notes that, consistent with the Linkage Plan, under the PCX's proposed rules for PCX Plus, the order cannot be executed at a price that trades through another market, and so the balance of the order, if any, will either be placed on the Consolidated Book, or, if it locks or crosses the NBBO, routed to a Floor Broker Hand Held Terminal for manual execution.[55]

Under the PCX Plus system, Market Makers can receive electronic book executions when they enter a Quote with Size that initiates a trade with the Consolidated Book. The initiating Quote with Size will immediately execute against the Consolidated Book if the percentage of the transaction including public customer interest comprises no more than 40% of the transaction. If the public customer interest is more than 40% of the transaction, the initiating Quotes with Size will receive the greater of the 40% of the public customer interest in the Consolidated Book at that price, or the total size that the initiating Quote with Size would receive on a size pro rata allocation. The Crowd Participants will then have an opportunity to obtain the balance of the Consolidated Book on a size pro rata basis. The Commission notes that split-price executions will not occur with electronic book executions.

The Commission believes that the various types of PCX Plus executions, including automated and manual executions, as well as split-price and electronic book executions, should allow Market Makers and floor brokers to provide more efficient and immediate executions for inbound orders and Quotes with Size, subject to priority and allocation principles.

E. Section 11(a) of the Act

Under the proposed rules, public customer orders would always receive first priority. Therefore, the Commission believes that the PCX Plus system should comply with section 11(a) of the Act.[56]

F. NBBO Step-Up Feature

The PCX proposes to incorporate an NBBO Step-Up feature for PCX Plus that is similar to its current PCX Rule 6.87(i), which allows PCX members logged on to Auto-Ex to step up to the NBBO in executing incoming orders. Under PCX Plus, an LMM in an issue would have the discretion, subject to the approval of two Floor Officials, to use the NBBO Step-Up feature to step up and execute orders at the NBBO price when the NBBO is better than the PCX's disseminated price. The LMM also would have the discretion to use the NBBO Step-Up feature to disseminate Quotes with Size at the NBBO, which would then be disseminated via Options Price Reporting Authority.

The Commission notes that the LMM in an issue may not use the NBBO Step-Up feature to match quotations of other PCX participants who are quoting at the NBBO.[57] The Commission further notes that SMMs may choose, but are not required, to participate in the NBBO Step-Up feature.[58] Thus, SMMs cannot

[50] PCX represents that it will amend this rule to clarify that a market maker logged on to participate in PCX Plus would also satisfy the requirements of this provision. Telephone call between Kathryn L. Beck, Senior Vice President, PCX and Sonia Trocchio, Special Counsel, Division, Commission on April 8, 2003.

[51] The Commission approved the Linkage Plan in July 2000. *See supra* note .

[52] PCX represents that it will amend these rules, as necessary, to clarify their applicability to PCX Plus. Telephone call between Kathryn L. Beck, Senior Vice President, PCX and Sonia Trocchio, Special Counsel, Division, Commission on April 8, 2003.

[53] Proposed PCX Rule 6.76(b)(1). The Maximum Order Size eligible for execution on PCX Plus will be established by the LLM in the issue, subject to approval of the Options Floor Committee.

[54] Proposed PCX Rule 6.76(b)(2).

[55] PCX Rule 6.76(b)(3).

[56] 15 U.S.C. 78k(a).

[57] Proposed PCX Rule 6.76(b)(5)(B).

[58] Proposed PCX Rule 6.76(b)(5).

be required to trade at a price that is not their own quote, unless they so choose. As a result, the Commission believes that the NBBO step-up feature will not undermine SMMs' incentives to add size to the LMM's quotes.

G. Crossing Rules

The PCX Plus proposal incorporates a new crossing mechanism that would permit the cross and execution of two orders with instructions to match the identified buy-side with the identified sell-side at a specified cross price.[59] Under the crossing mechanism, a PCX Broker (defined as a member, member organization, or associated person who enters orders as agent for accounts other than for Market Makers) would enter certain terms of each cross order into PCX Plus for electronic execution. If the cross price entered is outside of the BBO, PCX Plus would reject the cross orders. If the cross price is between the BBO, the order designated by the PCX Broker as the side to be exposed to the market would be displayed to the other members for 30 seconds. The exposed order would also be sent to OPRA for public dissemination.[60]

The PCX proposal establishes certain prohibitions regarding cross orders to prevent internalization and to promote competition. Under the proposal, it would be a violation of PCX rules for a PCX Broker to be a party to any arrangement designed to circumvent proposed PCX Rule 6.76(c) by providing an opportunity for a public customer or a broker-dealer to execute against agency orders handled by the PCX Broker immediately upon their entry into PCX Plus. PCX Brokers also would not be permitted to execute as principal any orders they represent as agent unless: (1) Agency orders are first exposed on the Exchange for at least 30 seconds; (2) the PCX Broker utilizes the crossing mechanism pursuant to proposed PCX Rule 6.76(c)(2); or (3) the PCX Broker executes the orders pursuant to PCX Rule 6.47 (''Crossing'' Orders and Stock/Option Orders). The Commission believes that these rules should promote intramarket price competition by providing market makers with a reasonable opportunity to compete for a significant percentage of the incoming order and, therefore, should protect investors and the public interest.

[59] Proposed PCX Rule 6.76(c). In addition, PCX Rule 6.94 prohibits crosses from occurring outside of the NBBO.

[60] Telephone call between Sonia Trocchio, Special Counsel, Division, Commission, and Pete Armstrong, Senior Vice President, Options Floor Operations, PCX on April 16, 2003.

H. Integrated Market Making and Side-by-Side Trading

The PCX has indicated that PCX Rule 2.6(e), which governs the use of material, non-public information, would apply to members trading on PCX Plus. The PCX has represented that this rule would require a PCX Market Maker to maintain information barriers—that are reasonably designed to prevent the misuse of material, non-public information by such member—with any affiliates that may act as specialist or market maker in any security underlying the options for which the PCX member acts as a Market Maker. The Commission believes that the requirement that there be an information barrier between the PCX Market Maker and its affiliates with respect to transactions in the option and the underlying security serve to reduce the opportunity for unfair trading advantages or misuse of material, non-public information.

I. Prohibited Practices

The PCX proposal includes certain prohibited practices for PCX members entering orders through PCX Plus.[61] The proposed prohibitions are similar to those under current PCX Rule 6.87(d).

PCX members would be prohibited from dividing up orders considered to be part of a single investment decision into small lots in order to stay within the Maximum Order Size established pursuant to PCX Rule 6.76. Multiple orders to trade the same option issue that are on the same side of the market, whether long or short, and multiple orders to trade the same options series entered within any 15-second period for the account of the same beneficial owner will be presumed to be based on a single investment decision. The Commission finds that the 15-second requirement as applicable to multiple orders for the same beneficial owner is consistent with the provisions of the Act and the rules and regulations thereunder. The Commission believes that fifteen seconds is a sufficient time period to allow Market Makers to change their quotations following an execution, while at the same time not unduly long as to place a burden on investors seeking to execute transactions on the Exchange. The Commission believes that this prohibition should prevent the splitting of orders on behalf of the same beneficial owner to meet PCX Plus eligibility, while providing a safe-harbor rule for multiple orders entered after the 15-second time period. The Exchange has represented and the Commission notes that the prohibition against splitting orders applies only to PCX members and member organizations that have direct electronic access to PCX Plus, and does not apply in any way to customers.

[61] Proposed PCX Rule 6.90(e).

J. Suspension of PCX Plus

The PCX Plus proposal includes rules regarding the suspension of PCX Plus.[62] Under the proposed PCX Plus rules, PCX Plus could be suspended in the event of any disruption or malfunction in the use or operation of the system by two Floor Officials. The Commission notes that if the PCX Plus system is suspended for any reason, the priority and allocation rules of PCX Plus set forth in PCX Rule 6.76(d) would apply.

K. Obvious Error

The Exchange represents that its obvious error and trade nullification/price adjustment rules applicable to PCX Plus will be based upon the rules that the Commission ultimately approves in File No. SR–PCX–2002–01, and not the existing Price Adjustment rules. Further, PCX represents that it will not implement PCX Plus until File No. SR–PCX–2002–01 has been approved by the Commission. Thus, the implementation of PCX Plus is contingent upon the Commission's approval of SR–PCX–2002–01.

VI. Accelerated Approval of Amendments No. 2 and 3

The Commission finds good cause for approving Amendments No. 2 and 3 to the proposed rule change prior to the thirtieth day after the amendments are published for comment in the **Federal Register** pursuant to section 19(b)(2) of the Act.[63] Amendment No. 2 addresses concerns raised in some of the Comment Letters,[64] as well as issues and concerns raised by Commission staff. Amendment No. 3 clarifies proposed Commentary .02 of PCX Rule 6.64 regarding procedures for determining a single price opening for options issues designated for trading on PCX Plus. The

[62] PCX Rule 6.90(g).

[63] 15 U.S.C. 78s(b)(2).

[64] The Commission notes that two of the commenters, IB Group and Morgan Stanley, supported the PCX's proposal and urged the Commission to approve the proposal. The other two commenters, the Phlx and Susquehanna, raised concerns regarding the PCX's proposal. The Phlx's comments focused mainly on preferential treatment afforded to LMMs. As discussed above, the PCX addressed the concerns raised by the Phlx Letter and the Commission staff in Amendment No. 2. The Susquehanna Letter raised general concerns about the practice of internalization in the options markets, not limited to PCX's proposal, and asked the Commission to consider its policy against internalization in reviewing the PCX's proposed rules. See Comment Letters, supra note 6.

Commission believes that the proposed changes in Amendments No. 2 and 3 are necessary to the proper functioning and implementation of PCX Plus, and therefore, believes that accelerated approval of Amendments No. 2 and 3 is appropriate.

VII. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with section 6(b)(5) of the Act.[65]

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[66] that the proposed rule change (SR–PCX–2002–36) and Amendment No. 1 are approved, and that Amendments No. 2 and 3 thereto are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[67]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 03–12456 Filed 5–16–03; 8:45 am]

BILLING CODE 8010–01–P

[65] 15 U.S.C. 78f(b)(5).

[66] 15 U.S.C. 78s(b)(2).

[67] 17 CFR 200.30–3(a)(12).

SMALL BUSINESS ADMINISTRATION

[Declaration of Disaster #3500]

State of Alabama

As a result of the President's major disaster declaration on May 12, 2003, I find that Bibb, Blount, Calhoun, Cullman, DeKalb, Etowah, Jackson, Jefferson, Madison, Marshall, Morgan, Shelby, St. Clair, Talladega, Tuscaloosa and Walker Counties in the State of Alabama constitute a disaster area due to damages caused by severe storms, tornadoes, and flooding occurring on May 5, 2003 and continuing. Applications for loans for physical damage as a result of this disaster may be filed until the close of business on July 11, 2003 and for economic injury until the close of business on February 12, 2004 at the address listed below or other locally announced locations: U.S. Small Business Administration, Disaster Area 2 Office, One Baltimore Place, Suite 300, Atlanta, GA 30308.

In addition, applications for economic injury loans from small businesses located in the following contiguous counties may be filed until the specified date at the above location: Cherokee, Chilton, Clay, Cleburne, Coosa, Fayette, Greene, Hale, Lawrence, Limestone, Marion, Perry, Pickens and Winston in the State of Alabama; Chattooga, Dade and Walker counties in the State of Georgia; and Franklin, Lincoln and Marion counties in the State of Tennessee.

The interest rates are:

	Percent
For Physical Damage:	
Homeowners with Credit Available Elsewhere	5.625
Homeowners without Credit Available Elsewhere	2.812
Businesses with Credit Available Elsewhere	5.906
Businesses and Non-Profit Organizations without Credit Available Elsewhere	2.953
Others (Including Non-Profit Organizations) with Credit Available Elsewhere	5.500
For Economic Injury:	
Businesses and Small Agricultural Cooperatives without Credit Available Elsewhere	2.953

The number assigned to this disaster for physical damage is 350012. For economic injury the number is 9V2900 for Alabama; 9V3000 for Georgia; and 9V3100 for Tennessee.

(Catalog of Federal Domestic Assistance Program Nos. 59002 and 59008).

Dated: May 13. 2003.

Herbert L. Mitchell,

Associate Administrator for Disaster Assistance.

[FR Doc. 03–12471 Filed 5–16–03; 8:45 am]

BILLING CODE 8025–01–P

SMALL BUSINESS ADMINISTRATION

[Declaration of Disaster #3497]

State of Missouri; (Amendment #1)

In accordance with a notice received from the Department of Homeland Security—Federal Emergency Management Agency, effective May 9, 2003, the above numbered declaration is hereby amended to include Bollinger, Cape Girardeau, Franklin, Jefferson, Perry, Saint Francois, Sainte Genevieve, Saint Louis, Scott, Stoddard and Washington Counties in the State of Missouri as disaster areas due to damages caused by severe storms, tornadoes and flooding occurring on May 4, 2003 and continuing.

In addition, applications for economic injury loans from small businesses located in the contiguous counties of Butler, Crawford, Dunklin, Gasconade, Independent City of St. Louis, Iron, Madison, Mississippi, New Madrid, St. Charles, Warren and Wayne in the State of Missouri; and Alexander, Jackson, Madison, Monroe, Randolph, St. Clair and Union Counties in the State of Illinois may be filed until the specified date at the previously designated location. All other counties contiguous to the above named primary county have been previously declared.

The economic injury number assigned to Illinois is 9V2800.

All other information remains the same, *i.e.,* the deadline for filing applications for physical damage is July 7, 2003, and for economic injury the deadline is February 6, 2004.

(Catalog of Federal Domestic Assistance Program Nos. 59002 and 59008).

Dated: May 13, 2003.

Herbert L. Mitchell,

Associate Administrator for Disaster Assistance.

[FR Doc. 03–12470 Filed 5–16–03; 8:45 am]

BILLING CODE 8025–01–P

SMALL BUSINESS ADMINISTRATION

[Declaration of Disaster #3501]

State of New York

As a result of the President's major disaster declaration on May 12, 2003, I find that Cayuga, Monroe, Oneida, Onondaga, Ontario, Oswego, Seneca and Wayne Counties in the State of New York constitute a disaster area due to damages caused by an ice storm occurring on April 3 through April 5, 2003. Applications for loans for physical damage as a result of this disaster may be filed until the close of business on July 11, 2003 and for economic injury until the close of business on February 12, 2004 at the address listed below or other locally announced locations: U.S. Small Business Administration, Disaster Area 1 Office, 360 Rainbow Blvd., South 3rd Fl., Niagara Falls, NY 14303–1192.

In addition, applications for economic injury loans from small businesses located in the following contiguous counties may be filed until the specified date at the above location: Cortland, Genesee, Herkimer, Jefferson, Lewis, Livingston, Madison, Orleans, Otsego, Schuyler, Steuben, Tompkins and Yates in the State of New York.

The interest rates are:

	Percent
For Physical Damage:	
Homeowners with Credit Available Elsewhere	5.875
Homeowners without Credit Available Elsewhere	2.937