



RULE
ADOPTION
NOTICE

RAN-03-10
March 12, 2003

**TO: All PCX Members and Member Organizations
ETP Holders and Sponsored Participants**

FROM: Department of Regulatory Policy

**SUBJECT: Archipelago Exchange New Order Types
(File No. SR-PCX-2002-75)**

On December 9, 2002 the Pacific Exchange, Inc. filed with the Securities and Exchange Commission a proposal to adopt several new order types (i.e., Inside Limit, Passive Discretionary, Discretion Limit, Pegged, Random Reserve, and Sweep Reserve) on its equities trading facility, the Archipelago Exchange ("ArcaEx"). On March 7, 2003 the Commission approved the PCX's proposed rule change.

The following is the text of the rule change. Questions regarding this bulletin may be directed to Peter Bloom at (415) 393-4166.

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EXHIBIT A

Text of the Rule Change:¹

PCX Equities, Inc.

Rule 1 **Definitions**

Rule 1.1(a) – (z) – No change.

Nasdaq[/NM] Security

(aa) The term "Nasdaq[/NM] Security" shall mean any security (i) designated as an eligible [national market system] security pursuant to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges ("Nasdaq Unlisted Trading

¹ New text is underscored; deleted text is in brackets.

Privileges Plan”), as amended, [NASD’s “National Market System Securities Designation Plan with respect to Nasdaq Securities,”] filed with and approved by the Commission pursuant to SEC Rule 11Aa2-1 under the Exchange Act and (ii) that is either listed on the Corporation pursuant to Rule 5 or as to which unlisted trading privileges have been granted pursuant to Section 12(f) of the Exchange Act.

Rule 1.1 (bb) – (hh) – No change.

OTC/UTP Plan

(ii) The term “OTC/UTP Plan” shall mean the Nasdaq Unlisted Trading Privileges [National Market/Unlisted Trading System/Unlisted Trading Privileges] Plan, as from time to time amended according to its provisions.

OTC/UTP Listing [Primary] Market

(jj) The term “OTC/UTP Listing [Primary] Market” for a Nasdaq[/NM] Security shall have the same meaning assigned to it in the Nasdaq Unlisted Trading Privileges Plan, as amended. [means Nasdaq; provided, however, that if for any 12-month period the number of reported transactions and the reported share volume in a Nasdaq/NM Security in any other OTC/UTP Participant’s market exceeds 50% of the aggregate reported transactions and reported share volume of all OTC/UTP Participants in such security, then that OTC/UTP Participant’s market shall be the OTC/UTP Primary Market.]

OTC/UTP Regulatory Halt

(kk) The term “OTC/UTP Regulatory Halt” means a trade suspension or halt called by the OTC/UTP Listing [Primary] Market for the purpose of dissemination of material news.

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Rule 7 Equities Trading

Trading in Nasdaq[/NM] Securities

Rule 7.18(a) *Access.*

(1) The Corporation shall permit each Nasdaq Market Maker, acting in its capacity as a market maker, telephone access, or such other access as may be established between the Corporation and the Nasdaq System (collectively, “approved access”), to the Corporation for each Nasdaq[/NM] Security in which such market maker is registered as a market maker. Such approved access shall include appropriate procedures to assure the timely response to communications received through telephone or other approved access.

(2) Nasdaq Market Makers may use such approved access to transmit orders for execution on the Corporation. Market Makers, via the facilities of the Corporation, may send orders via approved access to any Nasdaq Market Maker in each Nasdaq[/NM] security in which it displays quotations.

(3) – No change.

(4) No Market Maker shall permit the imposition of any access or execution fee, or any other fee or charge, with respect to transactions in Nasdaq[/NM] Securities effected with Nasdaq Market Makers that are communicated to the Corporation through telephone access.

(b) – No change.

(c) *OTC/UTP Regulatory Halts.* Whenever, in the exercise of its regulatory function, the OTC/UTP Listing [Primary] Market for a Nasdaq[/NM] Security determines that an OTC/UTP Regulatory Halt is appropriate, the Corporation shall halt or suspend trading in that security until the notification by the OTC/UTP Listing [Primary] Market that the halt or suspension is no longer in effect. The Corporation will assume that adequate publication or dissemination has occurred upon the expiration of one hour after initial publication in a national news dissemination service of the information that gave rise to an OTC/UTP Regulatory Halt and may, at its discretion, reopen trading at that time, notwithstanding notification from the OTC/UTP Listing [Primary] Market that the halt or suspension is no longer in effect.

(d) *Applicability.* The following Rules of the Corporation will not be applicable to transactions on the Corporation in Nasdaq[/NM] Securities: Rules 7.16, 7.55 - 7.57.

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Orders and Modifiers

Rule 7.31(a) – (c) – No change.

(d) Inside Limit Order. A Limit Order, which, if routed away pursuant to Rule 7.37(d), will be routed to the market participant with the best displayed price. Any unfilled portion of the order will not be routed to the next best price level until all quotes at the current best bid or offer are exhausted. If the order is no longer marketable it will be ranked in the Arca Book pursuant to Rule 7.36. [Reserved.]

(e) Immediate-or-Cancel Order. A market or limit order that is to be executed in whole or in part as soon as such order is received, and the portion not so executed is to be treated as canceled. An immediate-or-cancel order for Trade-Through Exempt Securities (as defined in Rule 7.37) will be permitted to trade at a price no more than three cents (\$0.03) away from the NBBO displayed in the Consolidated Quote. The NBBO price protection provision set forth in Rule 7.37 will not apply to immediate-or-cancel orders in Nasdaq securities.

(f) – (g) – No change.

(h) Working Order. Any order with a conditional or undisplayed price and/or size designated as a "Working Order" by the Corporation, including, without limitation:

(1) – No change.

(2) Discretionary Order. An order to buy or sell a stated amount of a security at a specified, undisplayed price (the "discretionary price"), in addition to at a specified, displayed price ("displayed price.")

(A) Passive Discretionary Order. A Discretionary Order may be designated as a Passive Discretionary Order and such order will be routed pursuant to Rule 7.37(d) only if the displayed price is marketable against an away market participant.

(i) For Passive Discretionary Orders in exchange-listed securities, if the discretionary price is marketable, such order will only interact with trading interest in the Arca Book pursuant to Rule 7.37(b)(2) and will not be routed away. A Passive Discretionary Order for ITS Trade-Through Exempt Securities will be permitted to trade at a price no more than three cents (\$0.03) away from the NBBO displayed in the Consolidated Quote.

(ii) For Passive Discretionary Orders in Nasdaq securities, if the discretionary price can be matched against orders in the Arca Book, such order will interact with trading interest in the Arca Book pursuant to 7.37(b)(2). The NBBO price protection provision set forth in Rule 7.37 will not apply to Passive Discretionary Orders in Nasdaq securities.

(B) Discretion Limit Order. A Discretionary Order may be designated as a Discretion Limit Order for Nasdaq securities only. If the discretionary price of a Discretion Limit Order can be matched against trading interest in the Arca Book, then such order will be executed at the discretionary price or better. If the discretionary price of a Discretion Limit Order can be matched against an away market participant, then such order will be routed pursuant to Rule 7.37(d) but only if the displayed share size of the Discretion Limit Order is equal to or less than the displayed share size of the away market participant. The NBBO price protection provision set forth in Rule 7.37 will not apply to Discretion Limit Orders in Nasdaq securities.

(3) Reserve Order. A limit order with a portion of the size displayed and with a reserve portion of the size ("reserve size") that is not displayed on the Corporation.

(A) Sweep Reserve Order. A Reserve Order may be designated as a Sweep Reserve Order. Based upon a User's instruction, if the displayed price of a Sweep Reserve Order is marketable against an away market participant(s), then such order will be routed (i) serially as component orders, such that each

component corresponds to the displayed size, or (ii) only once in its entirety, including both the displayed and reserve portions.

(B) Random Reserve Order. A Reserve Order designated as a Random Reserve Order will have a random reserve value (as expressed in share quantity) which, as a range of round lots, will vary the displayed size of the Reserve Order. A random reserve value set to zero will permit the displayed size of the Reserve Order to vary within 20% of the original specified displayed size.

(i) – (u) – No change.

(v) NOW Order. A Limited Price Order that is to be executed in whole or in part on the Corporation, and the portion not so executed shall be routed pursuant to Rule 7.37(d) only to one or more NOW Recipients for immediate execution as soon as the order is received by the NOW Recipient. Any portion not immediately executed by the NOW Recipient shall be cancelled. If a NOW Order is not marketable when it is submitted to the Corporation, it shall be cancelled. NOW Orders may not be Directed Orders. NOW Orders for ITS Trade-Through Exempt Securities (as defined in Rule 7.37) may be routed and executed at a price that is no more than three cents (\$0.03) away from the NBBO displayed in the Consolidated Quote. The NBBO price protection provision set forth in Rule 7.37 will not apply to NOW Orders in Nasdaq securities.

(w) PNP Order (Post No Preference). A limit order to buy or sell that is to be executed in whole or in part on the Corporation, and the portion not so executed is to be ranked in the Arca Book, without routing any portion of the order to another market center; provided, however, the Corporation shall cancel a PNP Order that would lock or cross the NBBO. PNP Orders for Trade-Through Exempt Securities (as defined in Rule 7.37) will not be canceled at the time of order entry if such orders would lock or cross the NBBO. PNP Orders in ITS Trade-Through Exempt Securities may be executed at a price no more than three cents (\$0.03) away from the NBBO displayed in the Consolidated Quote. The NBBO price protection provision set forth in Rule 7.37 will not apply to PNP Orders in Nasdaq securities.

(x) – (bb) – No change.

(cc) Pegged Order. A limit order to buy or sell a stated amount of a security at a display price set to track the current bid or ask of the NBBO in an amount specified by the User. The tracking of the relevant Consolidated Quote information for Pegged Orders will occur on a real-time basis. The associated price of each Pegged Order that is updated will be assigned a new entry time with priority in accordance with Rule 7.36(a). A Pegged Order may be designated as a Reserve Order or Discretionary Order. The displayed price of a Pegged Order designated as a Discretionary Order will be used to reflect changes in the NBBO (the discretionary price of a Pegged Order will re-price based on the corresponding change in the displayed price).

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Order Execution

Rule 7.37. Subject to the restrictions on short sales under Rule 10a-1 under the Exchange Act, like-priced orders, bids and offers shall be matched for execution by following Steps 1 through 5 in this Rule; provided, however, for an execution to occur in any Order Process, the price must be equal to or better than the NBBO, unless the Archipelago Exchange has routed orders to away markets at the NBBO, where applicable (however, a User may submit a NOW Order or Primary Only Order that may be routed to an away market without consideration of the NBBO). This rule will not apply to designated order types including IOC, NOW, PNP, Passive Discretionary, Discretion Limit (except for exchange-listed securities), IOC Cross and PNP Cross orders in Nasdaq securities or securities that are subject to an exemption from the Commission under SEC Rule 11Aa3-2(f) to the trade-through provisions of the ITS Plan ("ITS Trade-Through Exempt Securities"). Orders in ITS Trade-Through Exempt Securities will be effected at a price no more than three cents (\$0.03) away from the best bid and offer quoted in CQS. Orders in Nasdaq securities designated as IOC, NOW, PNP, Passive Discretionary, Discretion Limit, IOC Cross and PNP Cross orders will be effected at a price no worse than the BBO pursuant to Rule 7.36 and the applicable provisions in this Rule.

(a) – No change.

(b)(1) – No change.

(2) *Step 3: Working Order Process.*

(A) An incoming marketable order shall be matched for execution against orders in the Working Order Process in the following manner:

(i) – (iii) – No change.

(iv) Determination of a Passive Discretionary Order's Execution Price.

(a) For Nasdaq Securities, if the BBO is outside the NBBO and a Passive Discretionary Order(s) within the Working Order Process has a discretionary price worse than the NBBO, then the incoming order will execute against such Passive Discretionary Order(s) at the price of the incoming order or the displayed price of the Discretionary Order(s), whichever is better.

(b) For Nasdaq Securities, if the BBO is outside the NBBO and a Passive Discretionary Order(s) within the Working Order Process has a discretionary price equal to or better than the NBBO, then the incoming order will execute against such Passive Discretionary Order(s) pursuant to subsection (2)(A)(ii) above.

(c) For ITS Trade-Through Exempt Securities (as defined in Rule 7.37), if the BBO is outside the NBBO and a Passive Discretionary Order(s) within the Working Order Process has a discretionary price worse than the NBBO by three cents (\$0.03) or less, the incoming order will execute against such Passive Discretionary Order(s) at the price of the incoming order or the displayed price of the Discretionary Orders(s), whichever is better.

(v) – No change.

(B) An incoming order that is not marketable shall be matched for execution against orders in the Working Order Process in the following manner:

(i) – (ii) – No change.

(C) With the exception of Passive Discretionary Orders and Discretion Limit Orders, [I]if any change in the NBBO or other available away trading interest would cause a potential match between the away order and an order in the Working Order Process, a commitment to trade shall be sent to that market center or market participant pursuant to Step 5 below after having proceeded through Step 4.

(i) Passive Discretionary Orders will be routed away only if the displayed price is marketable against an away market participant.

(ii) Discretion Limit Orders will be routed away only if the displayed share size of the Discretion Limit Order is equal to or less than the displayed share size of the away market participant.

(c) – (e) – No change.