



RULE
ADOPTION
NOTICE

RAN-04-51
November 5, 2004

TO: All PCX OTP Holders and OTP Firms

FROM: Department of Regulatory Policy

**SUBJECT: Priority and Order Allocation Procedures for PCX Plus
(File No. SR-PCX-2004-78)**

On August 10, 2004, the Exchange filed with the Securities and Exchange Commission a proposed rule to amend PCX Rule 6.76 to eliminate the requirement that inbound marketable broker dealer orders route to Floor Broker Hand Held Terminals in some trading scenarios in lieu of receiving immediate electronic executions and to eliminate Electronic Book Executions pursuant to PCX Rule 6.76(b)(4). The Commission approved the proposed rule change on September 23, 2004.

The following is the text of the rule change. Questions regarding this bulletin may be directed to Steven Matlin at (415) 393-4084.

EXHIBIT A
Text of the Proposed Rule Change:¹

**Rules of the
Pacific Exchange, Inc.**

**Rule 6
Options Trading**

Priority and Order Allocation Procedures

Rule 6.76. The rules of priority and order allocation procedures set forth in this Rule 6.76 will apply to option issues designated by the Exchange to be traded in PCX Plus. The maximum size of an inbound order that may be eligible for execution on PCX Plus pursuant to Rule 6.76(b) ("the Maximum Order Size") will be initially established by the LMM in the issue, subject to the approval of the Exchange. Any request by the LMM for changes to the Maximum Order Size

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

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 Exchange. An LMM is prohibited from requesting changes to the Maximum Order Size in order to manipulate the operation of PCX Plus or for any anti-competitive purposes.

(a) – No Change.

(b) PCX Plus Executions. This subsection (b) addresses situations in which orders or Quotes with Size are executed through PCX Plus.

(1) An inbound order that is marketable will be immediately executed against bids and offers in the Consolidated Book, unless [one of the following conditions applies:]

[(A)] the size of the inbound order exceeds the Maximum Order Size established pursuant to Rule 6.76.[]; or

(B) the inbound order is for the account of a Firm or Non-OTP Holder or OTP Firm Market Maker and more than 50% of the aggregate trading interest in the Consolidated Book at the execution price is for the account (or accounts) of Public Customers.]

If it does exceed the maximum order size, [the conditions specified in subsections (A) or (B) above apply,] the order will be represented in the trading crowd pursuant to Rule 6.76(d).

(2) An inbound order will be either fully or partially executed as follows:

(A) If more than 40% of the size in the Consolidated Book is comprised of a single Firm or Non-OTP Holder or OTP Firm Market Maker order at the price at which the inbound order would trade[, and such Firm or Non-OTP Holder or OTP Firm Market Maker order was entered less than one minute before the inbound order,] then:

(i) the inbound order will first be matched against all available Public Customer interest in the Consolidated Book;

(ii) the inbound order, if not entirely filled, will then satisfy any available interest based on FIQ status and LMM guaranteed participation pursuant to Rule 6.76(a);

(iii) the inbound order, if not entirely filled, will then match, on a size pro rata basis, with the interest of the Market Makers, Firms and Non-OTP Holder or OTP Firm Market Makers in the Consolidated Book;[] provided that the size pro rata share interest of each individual Firm and each Non-OTP Holder or OTP Firm Market Maker will be limited to 40% of the size of the remaining inbound

order; and

(iv) the balance of the order, if any, will then be routed to a Floor Broker Hand Held Terminal.

(B) If the same conditions set forth in subsection (b)(2)(A) above apply but the Firm or Non-OTP Holder or OTP Firm Market Maker order was entered one minute or more before the inbound order, then:

(i) the inbound order will first be matched against all available Public Customer interest in the Consolidated Book;

(ii) the inbound order, if not entirely filled, will then satisfy any available interest based on FIQ status and LMM guaranteed participation pursuant to Rule 6.76(a);

(iii) the inbound order, if not entirely filled, will then match, on a size pro rata basis, with the interest of the Market Makers, Firms and Non-OTP Holder or OTP Firm Market Makers in the Consolidated Book; provided that the size pro rata share interest of each individual Firm and each Non-OTP Holder or OTP Firm Market Maker will be limited to 40% of the size of the remaining inbound order;

(iv) the inbound order, if not entirely filled, will then match, on a size pro rata basis, with all other remaining volume in the Consolidated Book of Firms and Non-OTP Holder or OTP Firm Market Makers who were previously limited to 40%;] and

(v) the balance of the order, if any, will then be either:

(a) routed to a Floor Broker Hand Held Terminal in the case where the order locks or crosses the NBBO; or

(b) executed at the next available price level based on split-price execution, as provided in subsection (b)(3), below.

If neither of the conditions specified in subsections (a) or (b) apply, and the order is no longer marketable, then such order will be represented in the Consolidated Book.

(b)(3) – No Change.

(b)(4) – Reserved. [Electronic Book Execution. This subsection addresses situations in which Market Makers interact electronically with orders in the Consolidated Book. When a Quote with Size from a Market Maker initiates a trade with the Consolidated Book (the "initiating Quote with Size"), an Electronic Book Execution will occur as follows.

(A) The initiating Quote with Size will immediately execute against the Consolidated Book if the percentage of the transaction involving Public Customer interest (as represented in the Consolidated Book) would comprise no more than 40% of the transaction (e.g., if the initiating Quote with Size is for 20 contracts and the size in the Consolidated Book at the execution price is 50 contracts, six contracts of which are the Public Customer interest ($6 \div 20 = 30\%$), then the initiating Quote with Size for 20 contracts will be executed in full).

(B) If the initiating Quote with Size would effect a transaction against the Consolidated Book and the percentage of the transaction involving Public Customer interest would comprise more than 40% of the transaction, then the initiating Quote with Size will be processed as follows:

(i) the Market Makers initiating Quote with Size will receive an execution comprising the greater of:

(a) 40% of the Public Customer interest in the Consolidated Book at that price; or

(b) the total size to which the inbound initiating Quote with Size would receive pursuant to a size pro rata allocation.

(ii) the balance of the Consolidated Book at that price will be displayed for three seconds (via a System Alert Message - SAM) to all "Crowd Participants" (as defined in Rule 6.1(b)(38)).

(a) A Floor Broker holding an order for an account in which such broker has an interest, the account of an associated person, or an account with respect to which the Floor Broker or an associated person thereof exercises investment discretion, shall not be eligible for participation in Electronic Book Executions.

(iii) the balance of the Public Customer interest in the Consolidated Book will then be allocated on size pro rata basis to all Crowd Participants, if any, who have entered bids or offers to trade at the execution price within the three seconds provided.

(iv) after the Public Customer interest has been allocated, the initiating Quote with Size will match against all remaining interest in the Consolidated Book. If the initiating Quote with Size does not fill the Consolidated Book, then all Crowd Participants will be matched on a size pro rata basis with the remaining interest in the Consolidated Book at that price.

(v) if the remaining Quotes with Size are executable at the next price level, they will be matched against the Consolidated Book on a size pro rata basis.]

(b)(5) - (c) – No Change.

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