

eligible orders of all account types into the Exchange's Consolidated Book,<sup>9</sup> 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").<sup>10</sup>

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.<sup>11</sup> 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.<sup>12</sup> 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.<sup>13</sup> 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. LMMs 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.<sup>14</sup> 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.<sup>15</sup> 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.<sup>16</sup>

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<sup>17</sup> 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.<sup>18</sup>

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

<sup>9</sup> 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).

<sup>10</sup> 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).

<sup>11</sup> See proposed PCX Rule 6.32(a).

<sup>12</sup> LMMs will also be responsible for performing certain functions under the Linkage Plan. See *supra* note 10.

<sup>13</sup> 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).

<sup>14</sup> See proposed PCX Rule 6.76(a)(2)(C)(iii).

<sup>15</sup> 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).

<sup>16</sup> See proposed subsection (c) to PCX Rule 6.57.

<sup>17</sup> 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.)

<sup>18</sup> See proposed PCX Rule 6.76(d).