

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

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.

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.