

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 Firms²⁶ 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 Nominees²⁷ 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 quotes²⁸ 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.