

competitors, such a decision must be a unilateral business judgment not intended to harass or punish a competitor for improving prices or otherwise acting competitively and not the result of collusive agreement. Accordingly, the Commission expects that the PCX will surveil its market to ensure that market makers are not coordinating quotes in PCX Plus or engaging in other anticompetitive conduct.

### C. Linkage Obligations

Under PCX Rule 6.92(a), an "Eligible Market Maker" for purposes of the Linkage Plan is defined as "a market maker that: (i) Is assigned to, and is providing two-sided quotations in, the Eligible Option Class; (ii) is logged on to participate in Auto-Ex in such Eligible Option Class;<sup>50</sup> and (iii) is in compliance with the requirements of PCX Rule 6.95 (relating to limitation on principal order access)."<sup>51</sup> PCX Market Makers would be considered to be Eligible Market Makers participating in the automated execution system for PCX Plus issues if they are logged on to the PCX Plus system and provide continuous two-sided quotes (or, with respect to SMMs, the size of their quote) through an electronic interface to the PCX Plus System. The Commission notes that to enable PCX to comply with its obligations under the Linkage Plan, PCX Rules 6.92 through 6.96 will apply to the PCX Plus system.<sup>52</sup> The Commission also notes that PCX clarified in Amendment No. 2 that LLMs have responsibility for handling incoming Linkage orders. The Commission believes that these provisions should assure other Linkage Plan participants that the introduction of PCX Plus should not jeopardize the PCX's ability to satisfy its obligations under the Linkage Plan.

### D. PCX Plus Executions

PCX Plus provides for automated executions and manual executions, as well as split-price executions and electronic book executions. The PCX represents that once PCX Plus is completely phased in, it will replace the

PCX's current Auto-Ex "wheel" in its entirety.

Under PCX's current rules, an incoming eligible market or marketable limit order is automatically executed against an order in the PCX order book if there is an order representing the best price on the Exchange. Otherwise, the inbound order, or a portion of it, is executed by Market Makers in the trading crowd who are logged onto PCX's Auto-Ex "wheel."

Under PCX Plus, inbound marketable orders would be immediately executed against bids and offers in the Consolidated Book unless: (1) The size of the inbound order exceeds the PCX's established Maximum Order Size;<sup>53</sup> or (2) the inbound order is for the account of a Firm or Non-Market Maker and more than 50% of the aggregate trading interest in the Consolidated Book at the execution price is for the account(s) of public customers. If either of these two conditions exist, the inbound order would be routed to a Floor Broker Hand Held Terminal for manual execution by the trading crowd based on priority rules in proposed PCX Rule 6.76(d).

If the inbound marketable order does not meet the two conditions above, the way it would be executed under the proposed rules would differ depending on whether a single firm or Non-Member Market Maker order at the best price on the Consolidated Book was entered less than one minute, or one minute or more, before the inbound order.<sup>54</sup>

The Commission notes that inbound electronic orders entered through PCX Plus will receive split-price execution at multiple price levels if there is insufficient trading interest at the best price in the Consolidated Book and the remainder of the order can be filled at one or more other price levels in the Consolidated Book. The Commission notes that, consistent with the Linkage Plan, under the PCX's proposed rules for PCX Plus, the order cannot be executed at a price that trades through another market, and so the balance of the order, if any, will either be placed on the Consolidated Book, or, if it locks or crosses the NBBO, routed to a Floor Broker Hand Held Terminal for manual execution.<sup>55</sup>

Under the PCX Plus system, Market Makers can receive electronic book executions when they enter a Quote with Size that initiates a trade with the Consolidated Book. The initiating Quote

with Size will immediately execute against the Consolidated Book if the percentage of the transaction including public customer interest comprises no more than 40% of the transaction. If the public customer interest is more than 40% of the transaction, the initiating Quotes with Size will receive the greater of the 40% of the public customer interest in the Consolidated Book at that price, or the total size that the initiating Quote with Size would receive on a size pro rata allocation. The Crowd Participants will then have an opportunity to obtain the balance of the Consolidated Book on a size pro rata basis. The Commission notes that split-price executions will not occur with electronic book executions.

The Commission believes that the various types of PCX Plus executions, including automated and manual executions, as well as split-price and electronic book executions, should allow Market Makers and floor brokers to provide more efficient and immediate executions for inbound orders and Quotes with Size, subject to priority and allocation principles.

### E. Section 11(a) of the Act

Under the proposed rules, public customer orders would always receive first priority. Therefore, the Commission believes that the PCX Plus system should comply with section 11(a) of the Act.<sup>56</sup>

### F. NBBO Step-Up Feature

The PCX proposes to incorporate an NBBO Step-Up feature for PCX Plus that is similar to its current PCX Rule 6.87(i), which allows PCX members logged on to Auto-Ex to step up to the NBBO in executing incoming orders. Under PCX Plus, an LMM in an issue would have the discretion, subject to the approval of two Floor Officials, to use the NBBO Step-Up feature to step up and execute orders at the NBBO price when the NBBO is better than the PCX's disseminated price. The LMM also would have the discretion to use the NBBO Step-Up feature to disseminate Quotes with Size at the NBBO, which would then be disseminated via Options Price Reporting Authority.

The Commission notes that the LMM in an issue may not use the NBBO Step-Up feature to match quotations of other PCX participants who are quoting at the NBBO.<sup>57</sup> The Commission further notes that SMMs may choose, but are not required, to participate in the NBBO Step-Up feature.<sup>58</sup> Thus, SMMs cannot

<sup>50</sup> PCX represents that it will amend this rule to clarify that a market maker logged on to participate in PCX Plus would also satisfy the requirements of this provision. Telephone call between Kathryn L. Beck, Senior Vice President, PCX and Sonia Trocchio, Special Counsel, Division, Commission on April 8, 2003.

<sup>51</sup> The Commission approved the Linkage Plan in July 2000. See *supra* note .

<sup>52</sup> PCX represents that it will amend these rules, as necessary, to clarify their applicability to PCX Plus. Telephone call between Kathryn L. Beck, Senior Vice President, PCX and Sonia Trocchio, Special Counsel, Division, Commission on April 8, 2003.

<sup>53</sup> Proposed PCX Rule 6.76(b)(1). The Maximum Order Size eligible for execution on PCX Plus will be established by the LLM in the issue, subject to approval of the Options Floor Committee.

<sup>54</sup> Proposed PCX Rule 6.76(b)(2).

<sup>55</sup> PCX Rule 6.76(b)(3).

<sup>56</sup> 15 U.S.C. 78k(a).

<sup>57</sup> Proposed PCX Rule 6.76(b)(5)(B).

<sup>58</sup> Proposed PCX Rule 6.76(b)(5).