

be required to trade at a price that is not their own quote, unless they so choose. As a result, the Commission believes that the NBBO step-up feature will not undermine SMMs' incentives to add size to the LMM's quotes.

#### G. Crossing Rules

The PCX Plus proposal incorporates a new crossing mechanism that would permit the cross and execution of two orders with instructions to match the identified buy-side with the identified sell-side at a specified cross price.<sup>59</sup> Under the crossing mechanism, a PCX Broker (defined as a member, member organization, or associated person who enters orders as agent for accounts other than for Market Makers) would enter certain terms of each cross order into PCX Plus for electronic execution. If the cross price entered is outside of the BBO, PCX Plus would reject the cross orders. If the cross price is between the BBO, the order designated by the PCX Broker as the side to be exposed to the market would be displayed to the other members for 30 seconds. The exposed order would also be sent to OPRA for public dissemination.<sup>60</sup>

The PCX proposal establishes certain prohibitions regarding cross orders to prevent internalization and to promote competition. Under the proposal, it would be a violation of PCX rules for a PCX Broker to be a party to any arrangement designed to circumvent proposed PCX Rule 6.76(c) by providing an opportunity for a public customer or a broker-dealer to execute against agency orders handled by the PCX Broker immediately upon their entry into PCX Plus. PCX Brokers also would not be permitted to execute as principal any orders they represent as agent unless: (1) Agency orders are first exposed on the Exchange for at least 30 seconds; (2) the PCX Broker utilizes the crossing mechanism pursuant to proposed PCX Rule 6.76(c)(2); or (3) the PCX Broker executes the orders pursuant to PCX Rule 6.47 ("Crossing" Orders and Stock/Option Orders). The Commission believes that these rules should promote intramarket price competition by providing market makers with a reasonable opportunity to compete for a significant percentage of the incoming order and, therefore, should protect investors and the public interest.

<sup>59</sup> Proposed PCX Rule 6.76(c). In addition, PCX Rule 6.94 prohibits crosses from occurring outside of the NBBO.

<sup>60</sup> Telephone call between Sonia Trocchio, Special Counsel, Division, Commission, and Pete Armstrong, Senior Vice President, Options Floor Operations, PCX on April 16, 2003.

#### H. Integrated Market Making and Side-by-Side Trading

The PCX has indicated that PCX Rule 2.6(e), which governs the use of material, non-public information, would apply to members trading on PCX Plus. The PCX has represented that this rule would require a PCX Market Maker to maintain information barriers—that are reasonably designed to prevent the misuse of material, non-public information by such member—with any affiliates that may act as specialist or market maker in any security underlying the options for which the PCX member acts as a Market Maker. The Commission believes that the requirement that there be an information barrier between the PCX Market Maker and its affiliates with respect to transactions in the option and the underlying security serve to reduce the opportunity for unfair trading advantages or misuse of material, non-public information.

#### I. Prohibited Practices

The PCX proposal includes certain prohibited practices for PCX members entering orders through PCX Plus.<sup>61</sup> The proposed prohibitions are similar to those under current PCX Rule 6.87(d).

PCX members would be prohibited from dividing up orders considered to be part of a single investment decision into small lots in order to stay within the Maximum Order Size established pursuant to PCX Rule 6.76. Multiple orders to trade the same option issue that are on the same side of the market, whether long or short, and multiple orders to trade the same options series entered within any 15-second period for the account of the same beneficial owner will be presumed to be based on a single investment decision. The Commission finds that the 15-second requirement as applicable to multiple orders for the same beneficial owner is consistent with the provisions of the Act and the rules and regulations thereunder. The Commission believes that fifteen seconds is a sufficient time period to allow Market Makers to change their quotations following an execution, while at the same time not unduly long as to place a burden on investors seeking to execute transactions on the Exchange. The Commission believes that this prohibition should prevent the splitting of orders on behalf of the same beneficial owner to meet PCX Plus eligibility, while providing a safe-harbor rule for multiple orders entered after the 15-second time period. The Exchange has represented and the

Commission notes that the prohibition against splitting orders applies only to PCX members and member organizations that have direct electronic access to PCX Plus, and does not apply in any way to customers.

#### J. Suspension of PCX Plus

The PCX Plus proposal includes rules regarding the suspension of PCX Plus.<sup>62</sup> Under the proposed PCX Plus rules, PCX Plus could be suspended in the event of any disruption or malfunction in the use or operation of the system by two Floor Officials. The Commission notes that if the PCX Plus system is suspended for any reason, the priority and allocation rules of PCX Plus set forth in PCX Rule 6.76(d) would apply.

#### K. Obvious Error

The Exchange represents that its obvious error and trade nullification/price adjustment rules applicable to PCX Plus will be based upon the rules that the Commission ultimately approves in File No. SR-PCX-2002-01, and not the existing Price Adjustment rules. Further, PCX represents that it will not implement PCX Plus until File No. SR-PCX-2002-01 has been approved by the Commission. Thus, the implementation of PCX Plus is contingent upon the Commission's approval of SR-PCX-2002-01.

### VI. Accelerated Approval of Amendments No. 2 and 3

The Commission finds good cause for approving Amendments No. 2 and 3 to the proposed rule change prior to the thirtieth day after the amendments are published for comment in the **Federal Register** pursuant to section 19(b)(2) of the Act.<sup>63</sup> Amendment No. 2 addresses concerns raised in some of the Comment Letters,<sup>64</sup> as well as issues and concerns raised by Commission staff. Amendment No. 3 clarifies proposed Commentary .02 of PCX Rule 6.64 regarding procedures for determining a single price opening for options issues designated for trading on PCX Plus. The

<sup>62</sup> PCX Rule 6.90(g).

<sup>63</sup> 15 U.S.C. 78s(b)(2).

<sup>64</sup> The Commission notes that two of the commenters, IB Group and Morgan Stanley, supported the PCX's proposal and urged the Commission to approve the proposal. The other two commenters, the Phlx and Susquehanna, raised concerns regarding the PCX's proposal. The Phlx's comments focused mainly on preferential treatment afforded to LMMs. As discussed above, the PCX addressed the concerns raised by the Phlx Letter and the Commission staff in Amendment No. 2. The Susquehanna Letter raised general concerns about the practice of internalization in the options markets, not limited to PCX's proposal, and asked the Commission to consider its policy against internalization in reviewing the PCX's proposed rules. See Comment Letters, *supra* note 6.

<sup>61</sup> Proposed PCX Rule 6.90(e).