

facility pursuant to UTP,<sup>4</sup> PCX proposes to adopt several new order types, which are currently in use on the Archipelago electronic communication network ("ECN").<sup>5</sup> These proposed order types will apply to both Nasdaq and listed securities traded on ArcaEx.<sup>6</sup> The Exchange believes that these order types will provide ETP Holders<sup>7</sup> and Sponsored Participants<sup>8</sup> (collectively "Users") greater flexibility in determining how their orders will be executed. The proposed order types are discussed below.

#### a. Inside Limit Order

An Inside Limit Order is a limit order that is to be executed in whole or in part on ArcaEx, and the portion not so executed would be routed pursuant to rule 7.37(d) to the market participant<sup>9</sup> with the best displayed price. Any unfilled portion of the order would not be routed to the next best price level until all quotes at the current best bid or offer are exhausted. For example, after having proceeded through the four order execution processes of the ArcaEx Book,<sup>10</sup> there remains an unexecuted portion of an Inside Limit Order to buy at a price of 12.50. ArcaEx would route the order to the away market participant with the best displayed offer. Suppose the best displayed offer by other market participants is Market A at 12.45, Market B at 12.46, Market C at 12.47, and Market D at 12.50. The Inside Limit Order would be routed first to Market A at 12.45. The balance of the Inside Limit Order would not be routed to the next

price level (*i.e.*, Market B at 12.46) until the current offer is exhausted. Each successive number of shares remaining (if any) would be routed at the next price level in the same manner. If the Inside Limit Order is no longer marketable it would be ranked in the Arca Book pursuant to rule 7.36.

#### b. Discretionary Orders

Currently, a User can submit a Discretionary Order, which is an order to buy or sell a stated amount of a security at a specified, undisplayed price (the "discretionary price"), as well as at a specified, displayed price. The undisplayed prices of a Discretionary Order are represented in the Working Order Process<sup>11</sup> and can be matched with orders on the other side of the market under prescribed conditions. Since the Discretionary Order type allows a User to represent a single order at multiple price points, investors are able to express their trading interest more accurately than is possible with traditional order types. The Exchange is proposing to adopt two new variations of the Discretionary Order called a "Passive Discretionary Order" and a "Discretion Limit Order," which would provide Users with more flexibility when such orders are routed to away market participants. A summary of these proposed order types is discussed below.

#### i. Passive Discretionary

The Exchange proposes to add PCXE rule 7.31(h)(2)(A) to define a Passive Discretionary Order. A Discretionary Order may be designated as a Passive Discretionary Order and such order would be routed pursuant to rule 7.37(d) only if the displayed price is marketable against an away market participant. If the discretionary price of a Passive Discretionary Order were marketable, such order would only interact with trading interest in the ArcaEx Book pursuant to rule 7.37(b)(2) and would not be routed away. Under the proposal, the Passive Discretionary order type will be available for exchange-listed and Nasdaq securities. For Passive Discretionary Orders in exchange-listed securities, if the discretionary price is marketable, such order will only interact with trading interest in the ArcaEx Book pursuant to rule 7.37(b)(2) and will not be routed away. A Passive Discretionary Order for ITS Trade-Through Exempt Securities (as defined in rule 7.37) will be

permitted to trade at a price no more than three cents (\$0.03) away from the NBBO displayed in the Consolidated Quote. For Passive Discretionary Orders in Nasdaq securities, if the discretionary price can be matched against orders in the ArcaEx Book, then such order will interact with trading interest in the ArcaEx Book pursuant to 7.37(b)(2). The NBBO price protection provision set forth in rule 7.37 will not apply to Passive Discretionary Orders in Nasdaq securities.

To illustrate how this order type is processed by the ArcaEx trading system, suppose that a User submits a Passive Discretionary Order to buy 1000 shares at 12.48 (discretion to 12.50). After first attempting to match the order with available trading interest in the ArcaEx Book (up to a price of 12.50), ArcaEx would route the order to an away market participant, but only if the offer published by the market participant is equal to or less than the displayed price of 12.48. In the event that a Passive Discretionary Order routed from ArcaEx to another market participant is not executed in its entirety at the other market participant's quote, ArcaEx would attempt to match the residual against trading interest in the ArcaEx Book pursuant to rule 7.37. Finally, if the Passive Discretionary Order is no longer marketable it would be ranked in the ArcaEx Book pursuant to rule 7.36.

#### ii. Discretion Limit

The Exchange also proposes to add PCXE rule 7.31(h)(2)(B) to define a Discretion Limit Order. A Discretionary Order may be designated as a Discretion Limit Order for Nasdaq securities only. If the discretionary price of a Discretion Limit Order could be matched against trading interest in the ArcaEx Book, then such order would be executed at the discretionary price or better against the displayed share size of available trading interest in the ArcaEx Book, regardless of size. If the discretionary price of a Discretion Limit Order could be matched against an away market participant, then such order would be routed pursuant to rule 7.37(d) but only if the displayed share size of the Discretion Limit Order is equal to or less than the displayed share size of the away market participant. As discussed in more detail in section 2 below, the Exchange is proposing that the NBBO price protection provision set forth in rule 7.37 will not apply to Discretion Limit Orders.

#### c. Reserve Orders

Under current PCXE rule 7.31(h)(3), a Reserve Order is a limit order with a portion of the size displayed and with a reserve portion of the size ("reserve size") that is not displayed on the

<sup>4</sup> The Nasdaq UTP Plan was initially approved in 1990. See Securities Exchange Act Release No. 28146 (June 26, 1990), 55 FR 27919 (July 6, 1990) (S7-24-89). It has subsequently been amended on several occasions to, among other things, admit new Participants. See also Securities Exchange Act Release No. 46381 (August 19, 2002), 67 FR 54687 (August 23, 2002) (S7-24-89) (Order approving most recent amendments to Nasdaq UTP Plan, the 13th Amendment).

<sup>5</sup> The broker-dealer commonly referred to as the Archipelago ECN is Archipelago Securities, a wholly owned subsidiary of Archipelago Holdings LLC and a member of the NASD. The ECN function will cease to operate as such once all the Nasdaq securities have been transferred to ArcaEx.

<sup>6</sup> The proposed Discretion Limit order type will apply to Nasdaq securities only. See proposed PCXE rule 7.31(h)(2)(B).

<sup>7</sup> See PCXE rule 1.1(n).

<sup>8</sup> A "Sponsored Participant" means "a person which has entered into a sponsorship arrangement with a Sponsoring ETP Holder pursuant to [PCXE] rule 7.29." See PCXE rule 1.1(tt).

<sup>9</sup> See PCXE rule 1.1(w) (definition of "market participant").

<sup>10</sup> ArcaEx maintains an electronic file of orders, called the ArcaEx Book, through which orders are displayed and matched. The ArcaEx Book is divided into four components, called processes—the Directed Order Process, the Display Order Process, the Working Order Process, and the Tracking Order Process. See PCXE rule 7.37 for a detailed description of these order execution processes.

<sup>11</sup> The Working Order Process is the third step in the ArcaEx execution algorithm. Working Orders are defined to include any order with a conditional or undisplayed price and/or size, including All-or-None, Discretionary, and Reserve Orders. See PCXE rule 7.37(b)(2) (description of "Working Order Process").