

("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 3, 2003, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the PCX. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

### **I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The PCX is proposing to amend PCX Rule 6.76(b)(4)(B)(ii), governing Electronic Book Executions ("EBEs"), in order to restrict a Floor Broker from effecting transactions (via the System Alert Message, "SAMs") for its own account or the account of associated persons. The Exchange is also proposing to amend PCX Rule 6.90(b) in order to modify the implementation date of PCX Plus. The text of the proposed rule change is set forth below. Additions are in italics; deletions are in brackets.

\* \* \* \* \*

### **Rules of the Board of Governors of the Pacific Exchange, Inc.**

#### *Rule 6 Options Trading*

#### **PCX Plus Priority and Order Allocation Procedures**

Rule 6.76(a)—No change.

(b)(1)–(3)—No change.

(4)(A)—No change.

(B)(i)—No change.

(ii)—the balance of the Consolidated Book at that price will be displayed for three seconds (via a System Alert Message—SAM) to all "Crowd Participants" (as defined in Rule 6.1(b)(38)).

*(a) A Floor Broker holding an order for an account in which such broker has an interest, the account of an associated person, or an account with respect to which the Floor Broker or an associated person thereof exercises investment discretion, shall not be eligible for participation in Electronic Book Executions.*

(iii)–(v)—No change.

(5)—No change.

(c)–(d)—No change.

*Commentary:*

01—No change.

*.02 For purposes of Rule 6.76(b)(4)(B)(ii), during the initial rollout of PCX Plus, the Floor Broker Hand Held terminals will not have the functionality to support Floor Broker*

*interaction with EBEs via SAMs. Such functionality will become available to Floor Brokers on or before June 30, 2004. The PCX will file a proposed rule change with the Commission when the Floor Broker Hand Held terminals have such functionality.*

\* \* \* \* \*

Rule 6.90(a)—No Change.

(b) System Phase-In and Applicability of the Rules. The PCX estimates that the rules applicable to PCX Plus will be implemented gradually on an issue-by-issue basis beginning *October 6, 2003* [December 15, 2003], and will become completely operative and applicable to all options issues by June 30, 2004. At that time, the rules relating to PCX Plus will supersede existing rules that are inapplicable to the new trading environment.

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### **II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the PCX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The PCX has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

#### *A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

##### **1. Purpose**

The Exchange is proposing to amend PCX Rule 6.76(b)(4)(B)(ii), governing EBEs, in order to restrict Floor Broker from effecting transactions (via SAMS) for its own account or the account of associated persons, or an account with respect to which a Floor Broker exercises investment discretion.

PCX Rule 6.76(b)(4) Governs Market Makers' interaction with orders in the Consolidated Book. Under this rule, when a Market Maker initiates a trade with the Consolidated Book, that Market Maker receives an allocation of the order while the balances of the order in the Book is allocated on a size pro rata basis to all "Crowd"<sup>3</sup> who respond to the SAM within three seconds. Initially, the Floor Broker Hand Held terminals will

<sup>3</sup> See PCX Rule 6.1(b)(38). Crowd Participants include Market Makers appointed to an option issue and any Floor Brokers actively representing orders at the best bid or offer on the Exchange for a particular options series.

not have the functionality to support Floor Broker interaction with EBEs via SAMS.<sup>4</sup> This rule change is designed to ensure Broker compliance with Section 11(a) of Act<sup>5</sup> for the anticipated implementation of such functionality.

In adopting this provision Floor Brokers, the Exchange recognizes that allowing Floor Brokers to represent certain broker dealer orders could raise issues under the Act. By prohibiting Floor Broker representation of proprietary or affiliated orders, the PCX believes that this rule will go beyond the requirements of Section 11(a) of the Act.

The Exchange also proposes to amend PCX Rule 6.90(b), which governs PCX Plus' implementation date. The Exchange wishes to amend the phase-in implementation date to "October 6, 2003" from the originally anticipated implementation date of "December 15, 2003." As stated in the rule, the Exchange expects that PCX Plus will become completely operative and applicable to all options issues by June 30, 2004.

##### **2. Basis**

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>6</sup> in general, and furthers the objectives of Section 6(b)(5),<sup>7</sup> in particular, in that it is designed to facilitate transactions in securities, to promote just and equitable principles of trade, to enhance competition and to protect investors and the public interest.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

<sup>4</sup> The PCX will file a proposed rule change with the Commission when the Floor Broker Hand Held terminals have such functionality.

<sup>5</sup> 15 U.S.C. 78k(a). Section 11(a) prohibits a member of a national securities exchange from effecting transactions on the exchange for its own account, the account of associated person, or an account in which it or an associated person exercises investment discretion. However, Section 11(a) also includes a number of exceptions to its general prohibition on proprietary trading. Most notably, Section 11(a)(1)(G) allows an exception when a member follows the conditions set forth in Rule 11a1-1(T) (e.g., yield priority, parity, and precedence in execution of such orders).

<sup>6</sup> 15 U.S.C. 78f(b).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.