

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51108; File No. 4-429)

January 31, 2005

Joint Industry Plan; Notice of Summary Effectiveness on a Temporary Basis of Joint Amendment No. 14 to the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage Relating to the Limitation in Liability for Filling Satisfaction Orders Sent Through the Linkage at the End of the Trading Day, and Notice of Filing of Such Amendment

I. Introduction

On January 28, 2005, January 31, 2005, January 26, 2005, January 27, 2005, January 28, 2005, and January 28, 2005, the American Stock Exchange LLC (“Amex”), the Boston Stock Exchange, Inc. (“BSE”), the Chicago Board Options Exchange, Inc. (“CBOE”), the International Securities Exchange (“ISE”), the Pacific Exchange, Inc. (“PCX”), and the Philadelphia Stock Exchange, Inc. (“Phlx”) (collectively, “Participants”), respectively, filed with the Securities and Exchange Commission (“Commission”) pursuant to Section 11A of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 11Aa3-2 thereunder,<sup>2</sup> an amendment (“Joint Amendment No. 14”) to the Plan for the Purpose of Creating and Operating an

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<sup>1</sup> 15 U.S.C. 78k-1.

<sup>2</sup> 17 CFR 240.11Aa3-2.

Intermarket Option Linkage (“Linkage Plan”).<sup>3</sup> In Joint Amendment No. 14, the Participants propose to extend the pilot provision limiting Trade-Through<sup>4</sup> liability at the end of the trading day for an additional year, until January 31, 2006, and to increase the limitation on liability from 25 contracts to 50 contracts. This order summarily puts into effect Joint Amendment No. 14 on a temporary basis not to exceed 120 days, and solicits comment on Joint Amendment No. 14 from interested persons.<sup>5</sup>

## II. Description of the Proposed Amendment

In Joint Amendment No 14, the Participants propose to extend the pilot contained in Section 8(c)(ii)(B)(2)(b) of the Linkage Plan, which limits Trade-Through liability at the end of

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<sup>3</sup> On July 28, 2000, the Commission approved a national market system plan for the purpose of creating and operating an intermarket options market linkage (“Linkage”) proposed by Amex, CBOE, and ISE. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000). Subsequently, Phlx, PCX, and BSE joined the Linkage Plan. See Securities Exchange Act Release Nos. 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000); 43574 (November 16, 2000), 65 FR 70850 (November 28, 2000); and 49198 (February 5, 2004), 69 FR 7029 (February 12, 2004). On June 27, 2001, May 30, 2002, January 29, 2003, June 18, 2003, January 29, 2004, June 15, 2004, June 17, 2004, July 2, 2004, and October 19, 2004, the Commission approved joint amendments to the Linkage Plan. See Securities Exchange Act Release Nos. 44482 (June 27, 2001), 66 FR 35470 (July 5, 2001); 46001 (May 30, 2002), 67 FR 38687 (June 5, 2002); 47274 (January 29, 2003), 68 FR 5313 (February 3, 2003); 48055 (June 18, 2003), 68 FR 37869 (June 25, 2003); 49146 (January 29, 2004), 69 FR 5618 (February 5, 2004); 49863 (June 15, 2004), 69 FR 35081 (June 23, 2004); 49885 (June 17, 2004), 69 FR 35397 (June 24, 2004); 49969 (July 2, 2004), 69 FR 41863 (July 12, 2004); and 50561 (October 19, 2004), 69 FR 62920 (October 28, 2004).

<sup>4</sup> A “Trade-Through” is defined as a transaction in an options series at a price that is inferior to the national best bid and offer. See Section 2(29) of the Linkage Plan.

<sup>5</sup> A proposed amendment may be put into effect summarily upon publication of notice of such amendment, on a temporary basis not to exceed 120 days, if the Commission finds that such action is necessary or appropriate in the public interest, for the protection of investors or the maintenance of fair and orderly markets, to remove impediments to, and perfect mechanisms of, a national market system or otherwise in furtherance of the purposes of the Act. See 17 CFR 240.11Aa3-2(c)(4).

the trading day for an additional year, until January 31, 2006, and to increase the limitation on liability from 25 contracts to 50 contracts, per Satisfaction Order.<sup>6</sup> The proposed increase in the limit on liability would become effective on February 1, 2005, when the current pilot expires. Pursuant to the pilot as currently in effect, the Trade-Through liability of a member of a Participant is limited to 25 contracts per Satisfaction Order for the period between five minutes prior to the close of trading in the underlying security and the close of trading in the options class.

### III. Discussion

When the Participants proposed Joint Amendment No. 4 to the Linkage Plan,<sup>7</sup> the Participants represented to the Commission that their members had expressed concerns regarding their obligations to fill Satisfaction Orders (which may be sent by a Participant's member that is traded through) at the close of trading in the underlying security. Specifically, the Participants represented that their members were concerned that they may not have sufficient time to hedge the positions they acquire.<sup>8</sup> The Participants stated that they believed that their proposal to limit liability at the end of the options trading day to the filling of 10 contracts per exchange, per transaction would protect small customer orders, but still establish a reasonable limit for their members' liability. The Participants further represented that the proposal should not affect a

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<sup>6</sup> A "Satisfaction Order" is defined as an order sent through the Linkage to notify a Participant of a Trade-Through and to seek satisfaction of the liability arising from that Trade-Through. See Section 2(16)(c) of the Linkage Plan.

<sup>7</sup> See Securities Exchange Act Release Nos. 47028 (December 18, 2002), 67 FR 79171 (December 27, 2002) (Notice of Proposed Joint Amendment No. 4).

<sup>8</sup> See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Annette Nazareth, Director, Division of Market Regulation, Commission, dated November 19, 2002.

member's potential liability under an exchange disciplinary rule for engaging in a pattern or practice of trading through other markets under Section 8(c)(i)(C) of the Linkage Plan.

The Commission approved the proposed amendment for a one-year pilot<sup>9</sup> to give the Participants and the Commission an opportunity to evaluate: (1) the need for the limitation on liability for Trade-Throughs near the end of the trading day; (2) whether 10 contracts per Satisfaction Order is the appropriate limitation; and (3) whether the opportunity to limit liability for Trade-Throughs near the end of the trading day leads to an increase in the number of Trade-Throughs.

In the order approving Joint Amendment No. 4, the Commission stated that in the event the Participants chose to seek permanent approval of this limitation, the Participants must provide the Commission with a report regarding data on the use of the exemption no later than 60 days before seeking permanent approval ("Report").<sup>10</sup> The Commission specified that the Report should include information about the number and size of Trade-Throughs that occur during the last seven minutes of the equity options trading day and during the remainder of the trading day, the number and size of Satisfaction Orders that Participants might be required to fill without the limitation on liability and how those amounts are affected by the limitation on liability, and the extent to which the Participants use the underlying market to hedge their options

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<sup>9</sup> See Securities Exchange Act Release Nos. 47298 (January 31, 2003), 68 FR 6524 (February 7, 2003) (Temporary effectiveness of pilot program on a 120-day basis); and 48055 (June 18, 2003), 68 FR 37869 (June 25, 2003) (Order approving Joint Amendment No. 4). The Commission subsequently extended the pilot program twice, until June 30, 2004 and January 31, 2005, respectively. See Securities Exchange Act Release Nos. 49146 (January 29, 2004), 69 FR 5618 (February 5, 2004) (Order approving Joint Amendment No. 8); and 49863 (June 15, 2004), 69 FR 35081 (June 23, 2004) (Order approving Joint Amendment No. 12).

<sup>10</sup> See Order approving Joint Amendment No. 4, supra note 9.

positions.<sup>11</sup> In a subsequent amendment to the Linkage Plan for the purpose of extending the pilot, Joint Amendment No. 8, the Participants represented that if they were to seek to make the limitation on Trade-Through liability permanent, they would submit the Report to the Commission no later than March 31, 2004.<sup>12</sup>

Following another extension of the pilot program, certain Participants provided the Commission with portions of the data required in the Report, but were unable to provide sufficient information to enable the Commission to evaluate whether permanent approval would be appropriate. The Commission extended the pilot program until January 31, 2005, to allow the limitation to continue in effect, with an increase in liability to 25 contracts, to enable the Participants to continue to gather and the Commission to evaluate the data relating to the effect of the operation of the pilot program.<sup>13</sup>

Since this last extension of the pilot program, the Participants have provided no additional data to the Commission to justify permanent approval of the limitation on liability. The Participants have represented that they are currently considering amendments to the Linkage Plan that, if proposed and approved, could obviate the need for the limitation on liability for Trade-Throughs at the end of the trading day. Specifically, the amendments the Participants are considering are intended to minimize the incidence of Trade-Throughs, and subsequently decrease the incidence of Satisfaction Orders. The Participants have represented that these amendments could be in effect within a year, and at that time, Participants would either allow the pilot program to lapse, or, if they believed that a continuation of the limitation was appropriate,

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<sup>11</sup> Id.

<sup>12</sup> See Order approving Joint Amendment No. 8, supra note 9.

<sup>13</sup> See Order approving Joint Amendment No. 12, supra note 9.

would discuss that matter with the Commission staff. In this regard, the Commission notes that the Participants must submit sufficient information to enable the Commission to evaluate whether permanent approval would be appropriate no later than 60 days prior to seeking permanent approval before the Commission will consider permanent approval of the pilot program.

After careful consideration, the Commission finds that the proposed amendment to the Linkage Plan seeking to extend the pilot provision limiting Trade-Through liability for the period between five minutes prior to the close of trading in the underlying security and the close of trading in the options class for an additional year, and to increase the limitation on liability from 25 contracts to 50 contracts per Satisfaction Order, is consistent with the requirements of the Act and the rules and regulations thereunder.<sup>14</sup> Specifically, the Commission finds that the proposed amendment to the Linkage Plan is consistent with Section 11A of the Act<sup>15</sup> and Rule 11Aa3-2 thereunder,<sup>16</sup> in that it is appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets. Specifically, the Commission believes that extending the pilot program and raising the limitation on liability to 50 contracts per Satisfaction Order will afford the Participants the opportunity to either gather sufficient information to justify the need for the pilot program or determine that the exemption from Trade-Through liability is no longer necessary. The Commission believes that raising the limitation on liability to 50 contracts per Satisfaction Order will increase the average size of Satisfaction Order fills during the end of the

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<sup>14</sup> In approving this Joint Amendment No. 14, the Commission has considered its impact on efficiency, competition and capital formation.

<sup>15</sup> 15 U.S.C. 78k-1.

<sup>16</sup> 17 CFR 240.11Aa3-2.

options trading day, thereby enhancing customer order protection. In addition, the Commission finds, as described further below, that it is appropriate to put into effect summarily Joint Amendment No. 14 upon publication of this notice, on a temporary basis for 120 days. The Commission believes that such action is appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets because it will allow the pilot to continue without interruption during the comment period.<sup>17</sup> Therefore, the Commission is extending the effectiveness of Section 8(c)(ii)(B)(2)(b) of the Linkage Plan on a temporary basis for 120 days, with the increase in the limitation in liability to 50 contracts per Satisfaction Order, for an additional year, until January 31, 2006.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether proposed Joint Amendment No. 14 is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number 4-429 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

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<sup>17</sup> 17 CFR 240.11Aa3-2(c)(4).

All submissions should refer to File Number 4-429. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to proposed Joint Amendment No. 14 that are filed with the Commission, and all written communications relating to proposed Joint Amendment No. 14 between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filings also will be available for inspection and copying at the principal offices of the Amex, BSE, CBOE, ISE, PCX and Phlx. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File Number 4-429 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 11A of the Act<sup>18</sup> and Rule 11Aa3-2(c)(4) thereunder,<sup>19</sup> that Joint Amendment No. 14 is summarily put into effect until May 31, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>20</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>18</sup> 15 U.S.C. 78k-1.

<sup>19</sup> See supra note 17.

<sup>20</sup> 17 CFR 200.30-3(a)(29).