SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51576 ; File No. SR-PCX-2005-35)  
April 19, 2005  

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Relating to the SizeQuote Mechanism for the Execution of Large-Sized Orders in Open Outcry

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) and Rule 19b-4 thereunder, notice is hereby given that on April 7, 2005, the Pacific Exchange, Inc. (“PCX” or “Exchange”) filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The PCX filed the proposal pursuant to Section 19(b)(3)(A) under the Act, and Rule 19b-4(f)(6) thereunder, which renders the proposal effective upon filing with the Commission. 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 Exchange proposes to add PCX Rule 6.47(g) to adopt, on a pilot basis through February 15, 2006, a SizeQuote Mechanism for the execution of large-sized orders in open outcry. The text of the proposed rule change is below. Proposed new language is in italics.

Rules of the Pacific Exchange, Inc.

Rule 6

Rule 6.47(a) – (f) – No Change.

Rule 6.47(g) – Open Outcry “SizeQuote” Mechanism

(i) SizeQuotes Generally. The SizeQuote Mechanism is a process by which a Floor Broker (“FB”) may execute and facilitate large-sized orders in open outcry. Floor brokers must be willing to facilitate the entire size of the order for which they request SizeQuotes (the “SizeQuote Order”). The Exchange shall determine the classes in which the SizeQuote Mechanism will apply. The SizeQuote Mechanism will operate as a pilot program which expires February 15, 2006.

(A) Eligible Order Size: The Exchange shall establish the eligible order size however such size shall not be less than 250 contracts.

(B) Trading Crowd: The term “Trading Crowd” shall be as defined in PCX Rule 6.1(b)(30) and for purposes of this rule only shall also include any Floor Broker who is present at the trading post.

(C) Public Customer Priority: Public customer orders in the Consolidated Book have priority to trade with a SizeQuote Order over any member of the Trading Crowd providing a SizeQuote response at the same price as the order in the Consolidated Book.

(D) LMM Participation Rights: The LMM participation entitlement shall not apply to SizeQuote transactions.

(E) FBs may not execute a SizeQuote Order at a price inferior to the national best bid or offer (“NBBO”). Unless a SizeQuote request is properly canceled in accordance with paragraph (iv), a FB is obligated to execute the entire SizeQuote Order at a price
that is not inferior to the NBBO in situations where there are no SizeQuote responses received or where such responses are inferior to the NBBO.

(ii) SizeQuote Procedure: Upon request from a FB for a SizeQuote, members of the Trading Crowd may respond with indications of the price and size at which they would be willing to trade with a SizeQuote Order. After the conclusion of time during which interested Trading Crowd member’s have been given the opportunity to provide their indications, the FB must execute the SizeQuote Order with the members of the Trading Crowd and/or with a firm facilitation order in accordance with the following procedures:

(A) Executing the Order at the Trading Crowd’s Best Price: Members of the Trading Crowd that provide SizeQuote responses at the highest bid or lowest offer (“best price”) have priority to trade with the SizeQuote Order at that best price. Allocation of the order among members of the Trading Crowd shall be prorata, up to the size of each member’s SizeQuote response. The FB must trade at the best price any contracts remaining in the original SizeQuote Order that were not executed by the members of the Trading Crowd providing SizeQuote responses.

(B) Executing the Order at a Price that Improves upon the Trading Crowd’s Price by One Minimum Increment: Members of the Trading Crowd that provide SizeQuote responses at the best price (“Eligible Trading Crowd Members”) have priority to trade with the SizeQuote Order at a price equal to one trading increment better than the best price (“improved best price”). Allocation of the order among Eligible Trading Crowd Members at the improved best price shall be prorata, up to the size of each eligible Trading Crowd Member’s SizeQuote response. The FB must trade at the improved best
price any contracts remaining in the original SizeQuote Order that were not executed by
Eligible Trading Crowd Members.

(C) Trading at a Price that Improves upon the Trading Crowd’s Price by more
than One Minimum Increment: A FB may execute the entire SizeQuote Order at a price
two trading increments better than the best price communicated by the Trading Crowd
members in their responses to the SizeQuote request.

(iii) Definition of Trading Increments: Permissible trading increments are $0.05 for
options quoted below $3.00 and $0.10 for all others. In classes in which bid-ask relief is granted
pursuant to Rule 6.37(b)(1)(F), the permissible trading increments shall also increase by the
Corresponding amount. For example, if a series trading above $3.00 has double-width bid-ask
relief, the permissible trading increment for purposes of this rule shall be $0.20.

(iv) It will be a violation of the FB’s duty of best execution to its customer if it were to
cancel a SizeQuote Order to avoid execution of the order at a better price. The availability of the
SizeQuote Mechanism does not alter a FB’s best execution duty to get the best price for its
customer. A SizeQuote request can be canceled prior to the receipt by the FB of responses to the
SizeQuote request. Once the FB receives a response to the SizeQuote request, if he/she were to
cancel the order and then subsequently attempt to execute the order at an inferior price to the
previous SizeQuote response, there would be a presumption that the FB did so to avoid execution
of its customer order in whole or in part by the others at the better price.

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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 Exchange 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

PCX rules impose several obligations upon Floor Brokers (“FBs”) including the requirement in paragraph (a) of PCX Rule 6.46, “Responsibilities of Floor Brokers,” that a FB handling an order use due diligence to execute the order at the best price or prices available. PCX Rule 6.46, Commentary .01, supplements this requirement by requiring FBs to ascertain whether a better price than is being displayed at that time is being quoted by another FB or a Market Maker. In order to assist FBs in their exercise of due diligence, the Exchange believes it would be beneficial to adopt new procedures governing the execution of certain large-sized orders, which by virtue of their large size often require specialized handling. The purpose of this rule filing, therefore, is to adopt, on a pilot basis through February 15, 2006, a trading procedure mechanism called the SizeQuote Mechanism for use by FBs in their respective representation of large-sized orders in open outcry.

The SizeQuote Mechanism is a process by which a FB, in his/her exercise of due diligence to execute orders at the best price(s), may execute and facilitate large-sized orders in
open outcry. For purposes of this rule, the minimum qualifying order size is 250 contracts and FBs must stand ready to facilitate the entire size of the order for which they request SizeQuotes (the “SizeQuote Order”). The SizeQuote procedure works as follows:

A FB holding an order for at least 250 contracts must specifically request a SizeQuote from the Trading Crowd. Upon such a request by a FB, any member of the Trading Crowd may respond with indications of the price and size at which they would be willing to trade with a SizeQuote Order. A member of the Trading Crowd may respond with any size and price they desire (subject to the rules governing the current market maker obligation requirements) and as such are not obligated to respond with a size of at least 250 contracts. The proposal provides that FBs may not execute a SizeQuote Order at a price inferior to the National Best Bid or Offer (“NBBO”). Proposed paragraph (g)(i)(E) clarifies that unless a SizeQuote request is properly canceled in accordance with paragraph (iv), a FB is obligated to execute the entire SizeQuote Order at a price that is not inferior to the NBBO in situations where there are no SizeQuote responses received or where such responses are inferior to the NBBO.

After the conclusion of time during which interested Trading Crowd members have been given the opportunity to provide their indications, the FB will execute the SizeQuote Order he is

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6 The Exchange will determine the classes in which SizeQuote operates and may vary the minimum qualifying order size, provided such number may not be less than 250 contracts.

7 See paragraph (b)(3) of PCX Rule 6.1, “Applicability, Definitions and References.” For purposes of the proposed rule only, the definition of "Trading Crowd" shall also include Floor Brokers who are present at the trading post.
holding with a Trading Crowd member(s) or with a facilitation order, or both, in accordance with the following procedure:

**Executing the SizeQuote Order at the Trading Crowd’s best price:** The Trading Crowd member(s) that provided SizeQuote responses at the highest bid or lowest offer (“best price”) have priority to trade with the SizeQuote Order at that best price. For example, assume a FB requests a SizeQuote and a Trading Crowd member(s) responds with a market quote of $1.00-$1.20 for 1,000 contracts. This quote constitutes the “best price” and those Trading Crowd members that responded have priority at those prices. If the FB chooses to trade at either of those prices, the SizeQuote Order will be allocated pro-rata to those Trading Crowd members that responded with a quote at the best price, up to the size of their respective quotes. If in the above example the SizeQuote Order is for more than 1,000 contracts, the FB must trade the balance with a facilitation order at the best price. Trading Crowd members that did not respond to the SizeQuote request would not be eligible to participate in the allocation of this trade.

**Executing the order at a price that improves upon the Trading Crowd’s price by one minimum increment:** Trading Crowd members that provide SizeQuote responses at the best price (“Eligible Trading Crowd Members”) have priority to trade with the SizeQuote Order at a price equal to one minimum increment better than the best price (“Improved Best Price”).

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8 The FB will execute the SizeQuote Order either with Trading Crowd members or with a firm facilitation order, or both, in accordance with the requirements of proposed PCX Rule 6.7(g)(ii).

9 Public customers in the Consolidated Book have priority to trade with a SizeQuote Order over any Trading Crowd member providing a SizeQuote response at the same price as the order in the Consolidated Book. See proposed PCX Rule 6.47(g)(i)(C). This example assumes there are no public customer orders at the SizeQuote response price.

10 There will be no Lead Market Maker (“LMM”) participation entitlement in SizeQuote trades, even if the LMM is among the Trading Crowd members quoting at the best price.
Accordingly, using the example above, Eligible Trading Crowd Members, if they desire, have priority at prices of $1.05 and $1.15 for up to 1,000 contracts.  If the FB chooses to trade at either of those prices, the SizeQuote Order will be allocated pro-rata at the Improved Best Price to those Eligible Trading Crowd Members that responded with a quote at the best price, up to the size of their respective quotes. If the SizeQuote Order is for more than 1,000 contracts, the FB must trade the balance with a facilitation order at the Improved Best Price. Trading Crowd members that did not respond to the SizeQuote request would not be eligible to participate in the allocation of this trade.

**Trading at a price that improves upon the Trading Crowd’s price by more than one minimum increment:** A FB may execute the entire SizeQuote Order with a facilitation order at a price two minimum increments better than the best price communicated by the Trading Crowd members in their responses to the SizeQuote request. Using the example above, a FB could trade the SizeQuote Order with a facilitation order at $1.10. Trading Crowd members would not be able to participate in the trade at that price.

The Exchange also proposes to adopt new paragraph (iv) to explicitly state that it will be a violation of the FB’s duty of best execution to its customer if it were to cancel a SizeQuote Order to avoid execution of the order at a better price. The availability of the SizeQuote Mechanism does not alter a FB’s best execution duty to get the best price for its customer. A SizeQuote request can be cancelled prior to the receipt by the FB of responses to the SizeQuote request. Once the FB receives a response to the SizeQuote request, if he/she were to cancel the order and then subsequently attempt to execute the order at an inferior price to the previous

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11 Obviously, there is no obligation requiring a Trading Crowd member to trade at a price that is better than his/her verbal quote.
SizeQuote response, there would be a presumption that the FB did so to avoid execution of its customer order in whole or in part by others at the better price.

The Exchange represents that it will provide the Commission at the end of the pilot period a report summarizing the effectiveness of the SizeQuote program. Pending a report that indicates that the SizeQuote program has been successful, the Exchange anticipates submitting a rule filing that either requests extension of the SizeQuote program or permanent approval of the pilot.

The Exchange believes that the SizeQuote proposal provides a well balanced mechanism that enhances the Trading Crowd’s ability to quote competitively and participate in open outcry trades while at the same time creating a process that gives greater certainty to FBs in the execution of large orders. Under the proposal, Trading Crowd members not only will have priority at the price of the quote they give in response to a SizeQuote request, but they also will have priority, if they want it, at a price that is one trading increment better than their quote. FBs will now have more certainty in that Trading Crowd members will have one opportunity to respond with a quote response and if they do not, they will not participate in the trade. Moreover, once a Trading Crowd member gives his/her best price (i.e., SizeQuote response), he/she may not subsequently change the terms of that response after the FB announces its intention to trade, although the Trading Crowd member will have priority at a price that is one trading increment better than his/her quote. This further enhances a Trading Crowd member’s incentives to quote competitively.

The Exchange also believes that the proposal enhances a Trading Crowd member’s incentive to quote competitively by giving complete priority at not only his/her price but also at one trading increment better than his/her SizeQuote response.
2. **Basis**

For the above reasons, the Exchange believes that the proposed rule change would enhance competition. The Exchange believes that the proposed rule change is consistent with Section 6(b)\(^{12}\) of the Act, in general, and furthers the objectives of Section 6(b)(5),\(^ {13}\) in particular, in that it is designed to facilitate transactions in securities, to promote just and equitable principles of trade 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.

**C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

Written comments on the proposed rule change were neither solicited nor received.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

The Exchange has filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act\(^ {14}\) and subparagraph (f)(6) of Rule 19b-4 thereunder.\(^ {15}\) Because the foregoing proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

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\(^{13}\) 15 U.S.C. 78f(b)(5).


As required under Rule 19b-4(f)(6)(iii), the PCX provided the Commission with written notice of its intent to file the proposed rule change at least five business days prior to the filing of the proposal with the Commission or such shorter period as designated by the Commission.

A proposed rule change filed under Rule 19b-4(f)(6) generally does not become operative prior to 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii) permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The PCX has requested that the Commission waive the 30-day operative delay specified in Rule 19b-4(f)(6) because the PCX’s proposal is similar to the SizeQuote Mechanism provided under the rules of the Chicago Board Options Exchange, Incorporated (“CBOE”).

Accordingly, the PCX believes that the proposal will allow for a more efficient and effective market operation and is necessary for competitive purposes.

The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because the proposed rule change is substantially similar to a rule adopted previously by the CBOE. The CBOE’s proposed rule was published for comment and the Commission received no comments regarding the CBOE’s proposal. The Commission believes that the PCX’s proposal raises no new issues or regulatory concerns that the Commission did not consider in approving the CBOE’s proposal. For this reason, the Commission believes that waiving the 30-day operative delay is consistent with the protections of

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17 See CBOE Rule 6.74(f) and CBOE Order, supra note 16. For purposes of waiving the 30-day operative delay, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).
investors and the public interest, and the Commission designates the proposal to be operative immediately on a pilot basis through February 15, 2006.

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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. Please include File Number SR-PCX-2005-35 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.

All submissions should refer to File Number SR-PCX-2005-35. 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 the proposed rule change that are filed with the Commission, and all written communications
relating to the proposed rule change 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 Section. Copies of
such filing also will be available for inspection and copying at the principal office of the
Exchange. 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 available publicly. All submissions should refer to File Number SR-PCX-
2005-35 and should be submitted on or before [insert date 21 days from publication in the
Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated
authority.18

Margaret H. McFarland
Deputy Secretary