

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52008; File No. SR-PCX-2005-78)

July 11, 2005

Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Amending Obvious Error Rule for Equity Options

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 1, 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, II, and III below, which Items have been prepared by the PCX. The Exchange filed the proposed rule change as a “non-controversial” rule change under Rule 19b-4(f)(6) under the Act,<sup>3</sup> 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 PCX proposes to amend its obvious error rule for equity options. Below is the text of the proposed rule change. Proposed additions are in italics and proposed deletions are in [brackets].

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

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

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

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**Pacific Exchange, Incorporated**

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**Rule 6.87(a) – 6.87(g) Commentary .03 – No Change.**

**Rule 6.87(g) Commentary .04** – Buyers of options with a zero bid [and \$.05 offer (i.e., a Theoretical Price of \$.05)] may request that their execution be busted if at least [the two] one strike[s] below (for calls) or above (for puts) in the same options class [were] was quoted with a zero bid [and \$.05 offer] at the time of the execution. Such buyers must follow the procedures of Rule 6.87(g)(3) above.

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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, Proposed Rule Change

1. Purpose

The Exchange proposes to revise its obvious error rule with respect to equity options (PCX Rule 6.87(g)) (“Obvious Error Rule”) to adjust the terms that relate to nullification of no bid series as set forth in PCX Rule 6.87(g) Commentary .04.

Under the current Obvious Error Rule, transactions in options series quoted no bid at a nickel (i.e., \$.05 offer) will be nullified provided at least two strike prices below (for calls) or

above (for puts) in the same options class was quoted no bid at a nickel at the time of execution. A “no bid” option refers to an option where the bid price is \$0.00.<sup>4</sup> Series of options quoted no bid are usually deep out-of-the-money series that are perceived as having little if any chance of expiring in-the-money.<sup>5</sup> For this reason, relatively few transactions occur in these series, and those that do are usually the result of a momentary pricing error. In some cases, the pricing error is substantial enough such that other provisions in the Obvious Error Rule become applicable. In many cases PCX Rule 6.87(g) Commentary .04 is the only provision that would apply to the pricing error.

The proposed rule change would amend the conditions set forth in PCX Rule 6.87(g) Commentary .04 that provide that the option series must be quoted at no bid at a nickel and instead only require that the option series be quoted at no bid. In addition, the proposed rule would allow a transaction to be nullified if a series is quoted at no bid one strike price below (for calls) or above (for puts) instead of two strikes below (for calls) or above (for puts) as set forth in the current rule. The reason for these changes is that options that are priced at no bid, regardless of the offer, are usually deep out-of-the-money series that are perceived as having little if any chance of expiring in-the-money. This is especially the case when the series below (for calls) or above (for puts) in the same option class similarly is quoted no bid. In this regard, the offer price is irrelevant. Therefore, transactions in series that are quoted no bid at a dime, for example, are just as likely to be the result of an obvious error as are transactions in series that are quoted no

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<sup>4</sup> When the bid price is \$0.00, the offer price is typically \$0.05. In this instance, the option typically is referred to as “no bid at a nickel.”

<sup>5</sup> For example, on July 11<sup>th</sup> with the underlying stock trading at \$21, the July 40 calls likely will be quoted no bid at a nickel.

bid at a nickel when the series below (for calls) or above (for puts) in the same option class similarly is quoted at no bid.

2. Statutory Basis

The PCX 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) of the Act<sup>7</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and national market system.

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

The PCX does not believe that the proposed rule change will impose any inappropriate burden on competition 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

Because the proposed rule change: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of filing, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>8</sup> and subparagraph (f)(6)

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

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

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

of Rule 19b-4 thereunder.<sup>9</sup> As required under Rule 19b-4(f)(6)(iii),<sup>10</sup> the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of the filing of the proposed rule change.

At any time within 60 days of the filing of the 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 the 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](mailto:rule-comments@sec.gov). Please include File Number SR-PCX-2005-78 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9309.

All submissions should refer to File Number SR-PCX-2005-78. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

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<sup>9</sup> 17 CFR 240.19b-4(f)(6).

<sup>10</sup> 17 CFR 240.19b-4(f)(6)(iii).

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, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the PCX. 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-2005-78 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.<sup>11</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>11</sup> 17 CFR 200.30-3(a)(12).