

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52345; File No. SR-PCX-2005-61)

August 26, 2005

Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Approving Proposed Rule Change, and Amendment No. 1 Thereto, Establishing a De Minimis Exception to the 80/20 Test

I. Introduction

On April 26, 2005, the Pacific Exchange, Inc. (“PCX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change seeking to modify the 80/20 Test in determining limitations on Principal Order³ access under the rules imposed by the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (“Linkage Plan”)⁴ and related rules. On July 29, 2005, the Exchange submitted Amendment No. 1 to the proposed rule change. The proposed rule change, as amended, was noticed for comment in the Federal Register on July 27, 2005.⁵ The Commission received no

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Exchange defines a Principal Order as an order for a principal account of an eligible Market Maker that does not relate to a customer order the Market Maker is holding. See PCX Rule 6.92(a)(12)(ii).

⁴ 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 the American Stock Exchange, LLC, Chicago Board Options Exchange, Inc., and the International Stock Exchange, Inc. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000). Subsequently, the Philadelphia Stock Exchange, Inc., the PCX and the Boston Stock Exchange, Inc. 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).

⁵ See Securities Exchange Act Release No. 52070 (July 20, 2005), 70 FR 43490 (July 27, 2005).

comments on the proposed rule change. This order approves the proposed rule change, as amended.

II. Description

The purpose of this proposed rule change, as amended, is to implement proposed Joint Amendment No. 17 to the Linkage Plan. Joint Amendment No. 17, together with this proposed rule change, would modify the “80/20 Test” set forth in Section 8(b)(iii) of the Linkage Plan and PCX Rule 6.96. PCX Rule 6.96 states that Market Makers should send Principal Orders through Linkage on a limited basis and not as a primary aspect of their business. The 80/20 Test implements this general principle by prohibiting a Market Maker from sending Principal Orders in an eligible option class if, in the last calendar quarter, the Market Maker’s Principal Order contract volume is disproportionate to the Market Maker’s contract volume executed against customer orders in its own market.

The Exchange believes that applying the 80/20 Test has resulted in anomalies for Market Makers with limited volume in an eligible option class. Specifically, if a Market Maker has very little overall trading volume in an option, the execution of one or two Principal Orders during a calendar quarter could result in the Market Maker failing to meet the Test. This would bar the Market Maker from using the Linkage to send Principal Orders in that option class for the following calendar quarter. The Exchange contends that it was not its intention to bar Market Makers with limited volume from sending Principal Order through the Linkage in these circumstances since such trading was not “a primary aspect of their business.” Thus, the proposed rule would create a de minimis exemption from the 80/20 Test for Market Makers that have total contract volume of less than 1,000 contracts in an option class for a calendar quarter.

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁶ In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act⁷ which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors and the public interest. The Commission believes that the proposed rule change will increase the availability of Linkage to members of the Participants by limiting the applicability of the 80/20 Test in situations where market makers have minimal trading volume in a particular options class.

The Commission recognizes that the Exchange does not believe that it is necessary to bar market makers with limited volume from sending Principal Orders through the Linkage, as such trading does not raise concerns that a member is sending such orders as "a primary aspect of their business." The Commission believes that the de minimis exemption from the 80/20 Test proposed by the Exchange for market makers that have a total contract volume of less than 1,000 contracts in an options class for a calendar quarter should ensure that members with relatively low volume in a particular options class can send a reasonable number of Principal Orders without being barred from using the Linkage by application of the 80/20 Test in the following calendar quarter.

⁶ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁷ 15 U.S.C. 78f(b)(5).

IV. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁸ that the proposed rule change (SR-PCX-2005-61), as amended, is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland
Deputy Secretary

⁸ 15 U.S.C. 78s(b)(2).

⁹ 17 CFR 200.30-3(a)(12).