firms to do so. NASD Regulation believes that on-line traders may benefit from the information provided in the day-trading risk disclosure statement regardless of whether the on-line firm whose Web site the trader is visiting or using promotes a day-trading strategy.

2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that the proposed rule change requiring certain member firms to post the margin disclosure and day-trading risk disclosure statements on their Web sites will help protect investors and the public interest in a trading environment where increasing numbers of investors are trading on-line or accessing broker/dealers through Web sites.

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

NASD Regulation does not believe that the proposed rule change will result in 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 were neither solicited nor received.

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

The proposed rule change has been filed by the Association as a "non-controversial" rule change under Section 19(b)(3)(A) of the Act,[7] and Rule 19b–4(f)(6) thereunder.[8] 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 after the date of filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that NASD Regulation has given the Commission 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 filing of the proposed rule change, or such shorter time as designated by the Commission, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act[9] thereunder.[10]

A proposed rule change filed under Rule 19b–4(f)(6)[11] requires that a self-regulatory organization give the Commission 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 filing the proposed rule change. However, Rule 19b–4(f)(6)(iii)[12] permits the Commission to designate a shorter time. NASD Regulation seeks to have the five-business-day pre-filing requirement waived with respect to the proposed rule change. The Commission has determined to waive the five-business-day pre-filing requirement. The Commission notes that NASD proposes to make the proposed rule change operative on July 1, 2002.

At any time within 60 days of this filing, the Commission may summarily abrogate this proposal 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR–NASD–2002–69 and should be submitted by July 18, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[13]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–16257 Filed 6–26–02; 8:45 am]

BILLING CODE 8010–01–P

[7] 15 U.S.C. 78s(b)(3)(A).

[8] 17 CFR 240.19b–4(f)(6).

[9] 15 U.S.C. 78(b)(3)(A).

[10] 17 CFR 240.19b–4(f)(6).

[11] 17 CFR 240.19b–4(f)(6).

[12] 17 CFR 240.19b–4(f)(6)(iii).

[13] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–46096; File No. SR–PCX–2001–17]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. Relating to Auto-Ex Price Improvement Incentive for Market Makers

June 20, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on January 16, 2002, 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 Exchange. On May 3, 2002, the Exchange filed Amendment No. 1 to the proposed rule change.[3] On June 14, 2002, the Exchange filed Amendment No. 2 to the proposed rule change.[4] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The PCX proposes a rule change that is intended to encourage competition among Market Makers for trades on its automatic execution system for options ("Auto-Ex") by rewarding individual

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* letter from Cindy L. Sink, Senior Attorney, Regulatory Policy, PCX, to Deborah L. Flynn, Assistant Director, Division of Market Regulation ("Division"), Commission, dated May 2, 2002 ("Amendment No. 1"). Amendment No. 1 replaced in its entirety the proposed rule text and the Exchange's statement regarding the proposed rule change.

[4] See letter from Michael D. Pierson, Vice President, Regulatory Policy, PCX, to Steven G. Johnston, Special Counsel, Division, Commission, dated June 13, 2002 ("Amendment No. 2"). Amendment No. 2 deleted language from Rule 6.87(k)(2)(c)(ii) and Commentary .04 to Rule 6.87 to reflect changes to PCX's Rules approved by the Commission.

Market Makers who improve the disseminated market.

The text of the proposed rule change is set forth below. New text is italicized.

Rule 6.87

* * * * *

(k)

* * * * *

(2) Auto-Ex Price Improvement Incentive Program

(A) A Market Maker who improves the disseminated quote will be given Priority Status on the Auto-Ex System as provided below.

(i) To receive priority, a Market Maker must improve the disseminated market by inputting the improved quote into a Market Maker Hand Held Terminal and simultaneously by vocalizing the improved bid or offer. The improved market will be disseminated via the Options Price Reporting Authority (''OPRA'').

(ii) The improved quote must be in a size that is at least the lesser of ten contracts or the disseminated size.

(iii) The Market Maker who improved the disseminated market must remain in the crowd and will be responsible for filling orders in the crowd until that Market Maker no longer has priority.

(iv) If orders are re-routed to Floor Broker Hand-Held Terminals for execution pursuant to Commentary .07, Floor Brokers will identify the improved quote by an alert in the system and will use their best efforts to assure that Market Makers with Priority Status receive allocations of contracts as provided in subsection (E), below.

(B) The Market Maker's priority for both automatic and manual executions will continue until one of the following occurs:

(i) the Market Maker's commitment size is filled;

(ii) the Market Maker's better price is improved; or

(iii) the Market Maker removes the bid or offer that improved the disseminated quote.

(C) The following provisions apply if the improved quote is matched:

(i) Market Makers who match the improved quote immediately (i.e., within one second) will be deemed to have Priority Status and will be allocated contracts as provided in subsection (E), below.

(ii) Market Makers who match the improved market, but who do not match it immediately, will not be given Priority Status.

(iii) An incoming order in a size greater than the size of the market improvement, including any matching quotes, will receive split price execution.

(iv) If the LMM matches the improved quote via Auto-Quote or QTX after one second, then inbound orders will be assigned pursuant to Rule 6.87(k)(1), but only after Market Makers with Priority Status have first been satisfied.

(D) The following provisions apply if the improved quote is further improved:

(i) If the improved quote is improved by Auto-Quote or QTX, then inbound orders will be assigned pursuant to Rule 6.87(k)(1).

(ii) If a Market Maker improves the improved quote, the Market Maker who subsequently improved the quote will be given Priority Status.

(E) Order Allocation Process.

(i) A Market Maker with Priority Status who quotes alone at the best price will be allocated 100% of the incoming orders up to the size of the Market Maker's quote.

(ii) If more than one Market Maker improves the quote, then such Market Makers will be allocated contracts as follows:

(a) Market Makers with Priority Status will be on parity and will be allocated 40% of the next incoming order or orders on an equal distribution basis, up to their quoted sizes. The 40% allocation will be effected only after all public customer orders at the same price have first been executed. Orders will continue to be allocated in this manner until the total number of contracts allocated pursuant to this subsection equals or exceeds 20 contracts, at which time Priority Status will no longer apply. For example, Priority Status will no longer apply once a Market Maker has been allocated 40 contracts based on an allocation of 40% of a single 100-contract order, pursuant to this subsection. Likewise, Priority Status will no longer apply once a Market Maker has been allocated a total of 24 contracts based on three subsequent allocations of 8 contracts, each of which are based on allocations of 40% of 20 contracts.

(b) All other outstanding bids and offers at the improved price, as well as any bids and offers representing the remaining sizes of Market Maker quotes with Priority Status, will then receive allocations on a size pro rata basis.

(c) LMMs quoting at the improved price will be eligible to receive guaranteed participation in connection with allocations made pursuant to subsection (b), above, but not for allocations made pursuant to subsection (a), above.

(3) Interim Price Improvement Incentive Program

(A) A Market Maker who improves the disseminated quote will receive Priority Status as provided below.

(i) To receive Priority Status, a Market Maker must improve the disseminated quote via open outcry by a size that is at least the lesser of ten contracts or the disseminated size.

(ii) The improved quote will be keyed into POETS by the Order Book Official (''OBO'') and will be disseminated via OPRA.

(iii) When a Market Maker improves the quote in a particular series, orders in that series will be routed to Floor Broker Hand Held Terminals for execution. However, if the LMM has set Auto-Ex to execute incoming orders at the NBBO pursuant to Rule 6.87(i), and a Market Maker has improved the PCX BBO but not the NBBO, then incoming orders may be executed automatically at the NBBO pursuant to Rule 6.87(k)(1). If incoming orders are not automatically executed at the NBBO in such circumstances (e.g., because they exceed a size parameter), then they will be re-routed to a Floor Broker Hand-Held Terminal for execution. When that occurs, the Market Maker who improved the PCX BBO (but not the NBBO) will have Priority Status at the PCX BBO price. If the PCX BBO becomes the NBBO, that Market Maker will have Priority Status.

(iv) Floor Brokers will identify the improved quote by an alert in the system and must use their best efforts to identify the Market Makers with Priority Status and assure that such Market Makers receive allocations of contracts as provided in this subsection (E), below.

(v) The Market Maker who improved the disseminated market must remain in the trading crowd and will be responsible for filling orders in the crowd until that Market Maker no longer has priority.

(B) The Market Maker's Priority Status will continue until one of the following occurs:

(i) the Market Maker's commitment size is filled;

(ii) the Market Maker's better price is improved; or

(iii) the Market Maker removes the bid or offer that improved the disseminated quote;

(C) The following provisions apply if the improved quote is matched:

(i) Market Makers who match the improved quote immediately (i.e., within one second) will be deemed to have Priority Status and will be allocated contracts as provided in subsection (E) below.

(ii) Market Makers who match the improved market, but who do not match it immediately, will not be given Priority Status.

(iii) An incoming order in a size greater than the size of the market improvement, including any matching quotes, will receive split price execution in the trading crowd.

(iv) If the LMM matches the improved quote via Auto-Quote or QTX after one second, then inbound orders will be assigned pursuant to 6.87(k)(1), but only after Market Makers with Priority Status have first been satisfied.

(D) The following provisions apply if the improved quote is further improved:

(i) If a Market Maker improves the improved quote, the Market Maker who subsequently improved the quote will be given Priority Status.

(ii) If the improved quote is improved by Auto-Quote or QTX, then inbound orders will be assigned pursuant to 6.87(k)(1).

(E) Order Allocation Process

(i) A Market Maker with Priority Status who quotes alone at the best price will be allocated 100% of the incoming orders up to the size of that Market Maker's quote.

(ii) If more than one Market Maker improves the quote, then such Market Makers will be allocated contracts as follows:

(a) Market Makers with Priority Status will be on parity and will be allocated 40% of the next incoming order or orders on an equal distribution basis, up to their quoted sizes. The 40% allocation will be effected only after all public customer orders at the same price have first been executed. Orders will continue to be allocated in this manner until the total number of contracts allocated pursuant to this subsection equals or exceeds 20 contracts, at which time Priority Status will no longer apply. For example, Priority Status will no longer apply once a Marker Maker has been allocated 40 contracts based on an allocation of 40% of a single 100-contract order, pursuant to this subsection. Likewise, Priority Status will no longer apply once a Market Maker has been allocated a total of 24 contracts based on three subsequent allocations of 8 contracts, each of which are based on allocations of 40% of 20 contracts.

(b) All other outstanding bids and offers at the improved price, as well as any bids and offers representing the remaining sizes of Market Maker quotes with Priority Status, will then receive allocations on a size pro rata basis.

(c) LMMs quoting at the improved price will be eligible to receive guaranteed participation in connection with allocations made pursuant to subsection (b), above, but not for allocations made pursuant to subsection (a), above.

Commentary

* * * * *

.02 For purposes of Rules 6.87(k)(2) and 6.87(k)(3), references to Market Makers include Lead Market Makers.

.03 Rules 6.87(k)(2) and 6.87(k)(3) apply to all classes and series of option contracts traded on the Exchange.

.04 The Auto-Ex guaranteed size is the size the LMM has guaranteed to the Options Allocation Committee.

.05 Split price execution refers to an execution of a trade where some of the contracts in the order will receive an execution at the best available price, and the remainder of the contracts in the order will be executed at the next best available price. Under Rule 6.87(k)(2), an incoming order will be filled at the improved price until the improved quote and quotes matching the improved quote have been satisfied. The balance of the incoming order will be executed at the next best price. In the interim program, the balance of the order will be executed in the trading crowd. In the permanent program, split price execution will be automated.

.06 Rule 6.87(k)(3), the Interim Price Improvement Incentive Program, will become operative on or before July 15, 2002 and will continue to apply until Rule 6.87(k)(2) becomes operative. Rule 6.87(k)(2) will be rolled out gradually until such time that it is implemented floor wide. The PCX estimates that Rule 6.87(k)(2) will commence operation in December 2002 and will become completely operative by the third quarter of 2003. At that time, Rule 6.87(k)(2) will supercede Rule 6.87(k)(3).

.07 POETS re-routes orders to Floor-Broker Hand-Held terminals if: (i) the inbound order exceeds the established size parameter for automatic execution; (ii) the order is for the account of a broker-dealer and the Exchange has not designated broker-dealer orders as eligible for automatic execution in the issue; (iii) the Auto-Ex system has been suspended pursuant to Rule 6.87(i); (iv) the NBBO is crossed or locked and the Auto-Ex system has been set to re-route orders pursuant to Rule 6.87(j); or (v) the order would otherwise receive an execution at a price that is inferior to the NBBO.

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 self-regulatory organization 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 Exchange 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

Background. The proposed rule change is intended to substantially enhance incentives for PCX Market Makers to quote competitively and substantially reduce disincentives for market participants to act competitively.[5] Currently, changes to the PCX's disseminated quote are effected either by Auto-Quote, by the proprietary quote feed (''QTX'') of an Lead Market Maker (''LLM''), or by manual input. First, in Pacific Options Exchange Trading System (''POETS'')[6] or QTX processing, Auto-Quote parameters are established and maintained by the LMM. As the price of the underlying security changes, the system recalculates the bid/ask prices of each option series. This recalculated bid/ask price establishes the published price for inbound orders and defines the execution price for trades effected through the automatic execution system.

[5] The PCX's settlement with the Commission requires the PCX, among other things, to adopt rules concerning its automated quotation and execution systems which substantially enhance incentives to quote competitively and substantially reduce disincentives for market participants to act competitively. *See* Securities Exchange Act Release No. 43268 (September 11, 2000), Administrative Proceeding File No. 3–10282. The Exchange notes that the Commission previously has approved a PCX rule change proposal that the Exchange believes serves to encourage its Market Makers to quote more competitively and to be rewarded with trades executed on Auto-Ex. *See* Securities Exchange Act Release No. 44847 (September 25, 2001), 66 FR 50237 (October 2, 2001) (File No. SR –PCX–2001–05) (Accelerated approval of proposal to assign orders to Market Makers who are logged-on Auto-Ex, based on the percentage of their in-person agency contracts traded in a particular issue.). Pursuant to the approved rule change, Auto-Ex orders are assigned to Market Makers according to the number of in-person agency contracts they have traded (excluding Auto-Ex contracts traded) in a particular issue compared to all of the Market Maker in-person contracts (excluding Auto-Ex contracts) during a review period. The review period is determined by the Options Floor Trading Committee and may be no longer than two weeks.

[6] POETS is the Exchange's automated trading system comprised of an options order routing system, an automatic execution system (''Auto-Ex''), an on-line limit order book system and an automatic market quote update system (''Auto-Quote'').

Second, the bid and ask prices for options of a particular series may also be changed manually by an exchange or LMM employee, who enters new quotes of floor members that are vocalized in the trading crowd by public outcry.

Currently, inbound electronic orders that are executed on Auto-Ex are assigned to the Market Makers who are logged on to Auto-Ex by rotation.[7] The number of contracts assigned to Market Makers on Auto-Ex is based upon the number of their in-person agency contracts traded in an issue (excluding Auto-Ex contracts traded) compared to all of the Market Maker in-person agency contracts traded in the issue (excluding Auto-Ex contracts traded) during a review period.[8]

Auto-Ex Price Improvement Incentive Program. The proposed rule change provides an incentive for Market Makers[9] to improve the disseminated prices on the PCX by assigning priority on Auto-Ex to the Market Maker who improved the disseminated quote.[10] A Market Maker who improves the disseminated quote would be given Priority Status on the Auto-Ex System as follows.

To receive priority, a Market Maker would be required to improve the disseminated market by inputting the improved quote into a Market Maker Hand Held Terminal and simultaneously by vocalizing the improved bid or offer. The improved market would be disseminated via the Options Price Reporting Authority (''OPRA''). The improved quote would be required to be in a size that is at least the lesser of ten contracts or the disseminated size.[11] The Market Maker who improved the disseminated market would be required to remain in the crowd and would be responsible for filling orders in the crowd until that Market Maker no longer has priority.

If orders are re-routed to Floor Broker Hand-Held Terminals for execution,[12] Floor Brokers would identify the improved quote by an alert in the system and would use their best efforts to assure that Market Makers with Priority Status receive allocations of contracts as provided in proposed PCX Rule 6.87(k)(2)(E), setting forth the order allocation process.

The Market Maker's priority for both automatic and manual executions would continue until one of the following occurs: the Market Maker's commitment size is filled; the Market Maker's better price is improved; or the Market Maker removes the bid or offer that improved the disseminated quote.

The following provisions would apply if the improved quote is matched: Market Makers who match the improved quote immediately (*i.e.,* within one second) would be deemed to have Priority Status and would be allocated contracts as provided in proposed PCX Rule 6.87(k)(2)(E). Market Makers who match the improved market, but who do not match it immediately, would not be given Priority Status. An incoming order in a size greater than the size of the market improvement, including any matching quotes, would receive split price execution.[13] If the LMM matches the improved quote via Auto-Quote or QTX after one second, then inbound orders would be assigned pursuant to PCX Rule 6.87(k)(1),[14] but only after Market Makers with Priority Status have first been satisfied.[15]

The following provisions would apply if the improved quote is further improved: If the improved quote is improved by Auto-Quote or QTX, then inbound orders would be assigned pursuant to PCX Rule 6.87(k)(1).[16] If a Market Maker improves the improved quote, the Market Maker who subsequently improved the quote would be given Priority Status.

Order Allocation Process. Proposed PCX Rule 6.87(k)(2)(E) provides that a Market Maker with Priority Status who quotes alone at the best price would be allocated 100% of the incoming orders up to the size of the Market Maker's quote. However, if more than one Market Maker improves the quote, then such Market Makers would be allocated contracts as follows: First, under subsection (E)(ii)(a) to proposed PCX Rule 6.87(k)(2), Market Makers with Priority Status would be on parity and would be allocated 40% of the next incoming order or orders on an equal distribution basis, up to their quoted sizes. The 40% allocation would be effected only after all public customer orders at the same price have first been executed. Orders would continue to be allocated in this manner until the total number of contracts allocated pursuant to this subsection equals or exceeds 20 contracts, at which time Priority Status would no longer apply.[17]

[7] PCX Rule 6.87(k)(1) governs the rotational assignment of Auto-Ex orders. *See supra* note 5.

[8] *See supra* note 5.

[9] For purposes of this proposal, references to Market Makers include Lead Market Makers. *See* proposed Commentary .02.

[10] The proposed rule changes set forth in this filing cover all classes and series of option contracts traded on the Exchange. *See* proposed Commentary .03.

[11] Under PCX Rule 6.86(c)(1)(A), the Exchange may, under certain circumstances, disseminate a size less than the guaranteed size (the guaranteed size is the minimum firm quote size for which the LLM has, during the allocation process, pledged to make markets). See Securities Exchange Act Release No. 46029, June 4, 2002 (**Federal Register** publication pending). Assume, for example, that the LLM is disseminating a market of 2 bid, 2.20 asked, in a particular option series for which the guaranteed size is twenty contracts. Then assume that a customer order to buy one contract for 2.10 is entered on the Exchange, making the new best bid and offer on the Exchange 2.10 bid, 2.20 asked. In this situation, the Exchange disseminates the true size of the customer order for one contract. Under the instant proposed rule change, under the circumstances above, one contract would become the minimum amount by which a Market Maker could improve the disseminated quote. Telephone conversation between Michael D. Pierson, Vice President, PCX, and Steven G. Johnston, Special Counsel, Division, Commission, on June 6, 2002.

[12] As noted in proposed Commentary .07, POETS will re-route orders to Floor-Broker Hand-Held terminals if: (i) the inbound order exceeds the established size parameter for automatic execution; (ii) the order is for the account of a broker-dealer and the Exchange has not designated broker-dealer orders as eligible for automatic execution in the issue; (iii) the Auto-Ex system has been suspended pursuant to PCX Rule 6.87(i), which permits the Options Floor Trading Committee to designate orders in certain option issues for default manual representation in the trading crowd if an order would be executed at a price more than one trading increment away from the PCX market; (iv) the NBBO is crossed or locked and the Auto-Ex system has been set to re-route orders pursuant to PCX Rule 6.87(j); or (v) the order would otherwise receive an execution at a price that is inferior to the NBBO.

[13] Split price execution refers to an execution of a trade where some of the contracts in the order will receive an execution at the best available price, and the remainder of the contracts in the order will be executed at the next best available price. Under Proposed PCX Rule 6.87(k)(2), an incoming order would be filled at the improved price until the improved quote and quotes matching the improved quote have been satisfied. The balance of the incoming order would be executed at the next best price. In the interim program, the balance of the order would be executed in the trading crowd. In the permanent program, split price execution would be automated.

[14] *See supra* note 7. An exception would be made in the case where incoming orders would be assigned to Floor-Broker Hand-Held Terminals pursuant to proposed Commentary .07 (*See supra* note 12). In that situation, Market Makers with Priority Status would retain priority at the improved price until filled, but additional incoming orders would be allocated to crowd members consistent with current PCX rules, including rules governing open outcry trading. Telephone conversation between Michael D. Pierson, Vice President, PCX, and Steven G. Johnston, Special Counsel, Division, Commission, on May 9, 2002.

[15] If the LMM matches the improved quote via Auto-Quote or QTX within one second, then no Market Makers would have priority status and inbound orders would be assigned pursuant to PCX Rule 6.87(k)(1). Telephone conversation among Michael D. Pierson, Vice President, and Cindy L. Sink, Senior Attorney, Regulatory Policy, PCX; and Elizabeth K. King, Associate Director, Division, Commission, and Steven G. Johnston, Special Counsel, Division, Commission, on May 28, 2002.

[16] *See supra* note 7.

[17] For example, Priority Status would no longer apply once a Market Maker has been allocated 40 contracts based on an allocation of 40% of a single 100-contract order, pursuant to this subsection. Likewise, Priority Status would no longer apply once a Market Maker has been allocated a total of 24 contracts based on three subsequent allocations of 8 contracts, each of which are based on allocations of 40% of 20 contracts.

Second, under proposed subsection (E)(ii)(b) to proposed PCX Rule 6.87(k)(2), all other outstanding bids and offers at the improved price, as well as any bids and offers representing the remaining sizes of Market Maker quotes with Priority Status, would then receive allocations on a size pro rata basis.

With regard to LMM guaranteed participation under PCX Rule 6.82(d), LMMs quoting at the improved price would be eligible to receive guaranteed participation in connection with allocations made under subsection (E)(ii)(b) to proposed PCX Rule 6.87(k)(2), but not under subsection (E)(ii)(a) of the proposed rule.

The PCX estimates that the technology changes necessary to begin implementing the proposed rule and make its provisions operative would take approximately 10 months. The proposed rule would be implemented gradually until such time that it is implemented floor wide. The PCX estimates that the proposed rule would commence operation in December 2002 and would become completely operative by the third quarter of 2003. However, the Exchange is proposing to adopt an interim program, described below, to reward Market Makers who improve the disseminated market until this program is available. Once the permanent program set forth above is operative, it would supersede the interim program.

Interim Price Improvement Incentive Program. The Exchange proposes to adopt an interim rule change to become operative on or before July 15, 2002 and to remain operative until the above-described rule change becomes operative. Under the interim program, a Market Maker who improves the disseminated quote would receive Priority Status as follows.

To receive Priority Status, a Market Maker would be required to improve the disseminated quote via open outcry by a size of ten contracts or the disseminated size, whichever is less.[18] The improved quote would be keyed into POETS by the Order Book Official (''OBO'') and would be disseminated via OPRA. When a Market Maker improves the quote in a particular series, orders in that series would be routed to Floor Broker Hand Held Terminals for execution. However, if the LMM has set Auto-Ex to execute incoming orders at the NBBO pursuant to PCX Rule 6.87(i), and a Market Maker has improved the PCX BBO but not the NBBO, then incoming orders would be permitted to execute automatically at the NBBO. However, in circumstances where incoming orders are not automatically executed at the NBBO (*e.g.,* because they exceed a size parameter), orders would be re-routed to a Floor Broker Hand-Held Terminal for execution.[19] When that occurs, the Market Maker who improved the PCX BBO (but not the NBBO) would have Priority Status at the PCX BBO price. If the PCX BBO becomes the NBBO, that Market Maker would have Priority Status.

Floor Brokers would identify the improved quote by an alert in the system and would be required to use their best efforts to identify the Market Makers with Priority Status and assure that such Market Makers receive allocations of contracts as provided in proposed PCX Rule 6.87(k)(3)(E), the order allocation process. The Market Maker who improved the disseminated market would be required to remain in the trading crowd and would be responsible for filling orders in the crowd until that Market Maker no longer has priority.

The Market Maker's Priority Status would continue until one of the following occurs: the Market Maker's commitment size is filled; the Market Maker's better price is improved; or the Market Maker removes the bid or offer that improved the disseminated quote.

The following provisions would apply if the improved quote is matched: Market Makers who match the improved quote immediately (*i.e.,* within one second) would be deemed to have Priority Status and would be allocated contracts as provided in proposed PCX Rule 6.87(k)(3)(E). Market Makers who match the improved market, but who do not match it immediately, would not be given Priority Status. An incoming order in a size greater than the size of the market improvement, including any matching quotes, would receive split price execution in the trading crowd.[20] If the LMM matches the improved quote via Auto-Quote or QTX after one second, then inbound orders would be assigned pursuant to PCX Rule 6.87(k)(1),[21] but only after Market Makers with Priority Status have first been satisfied.[22]

The following provisions would apply if the improved quote were further improved: If a Market Maker improves the improved quote, the Market Maker who subsequently improved the quote would be given Priority Status. If the improved quote were improved by Auto-Quote or QTX, then inbound orders would be assigned pursuant to PCX Rule 6.87(k)(1).

Order Allocation Process for the Interim Program. Under proposed PCX Rule 6.87(k)(3), a Market Maker with Priority Status who quotes alone at the best price would be allocated 100% of the incoming orders up to the size of the Market Maker's quote. However, if more than one Market Maker improves the quote, then such Market Makers would be allocated contracts as follows: First, under proposed subsection (E)(ii)(a) to proposed PCX Rule 6.87(k)(3), Market Makers with Priority Status would be on parity and would be allocated 40% of the next incoming order or orders on an equal distribution basis, up to their quoted sizes. The 40% allocation would be effected only after all public customer orders at the same price have first been executed. Orders would continue to be allocated in this manner until the total number of contracts allocated pursuant to this subsection equals or exceeds 20 contracts, at which time Priority Status would no longer apply.[23] Second, under subsection (E)(ii)(b) to proposed PCX Rule 6.87(k)(3), all other outstanding bids and offers at the improved price, as well as any bids and offers representing the remaining sizes of Market Maker quotes with Priority Status, would then receive allocations on a size pro rata basis.

With regard to LMM guaranteed participation under PCX Rule 6.82(d), LMMs quoting at the improved price would be eligible to receive guaranteed participation in connection with allocations made under subsection (E)(ii)(b) to proposed PCX Rule 6.87(k)(3), but not under subsection (E)(ii)(a) to proposed PCX Rule 6.87(k)(3).

2. Statutory Basis

The Exchange believes that this proposal is consistent with section 6(b) of the Act[24] in general, and furthers the objectives of section 6(b)(5),[25] in particular, in that it is designed to facilitate transactions in securities, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitation transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

[18] *See supra* note 11.

[19] *See supra* note 12. Telephone conversation between Cindy L. Sink, Senior Attorney, Regulatory Policy, PCX and Steven G. Johnston, Special Counsel, Division, Commission, on May 29, 2002.

[20] *See supra* note 13.

[21] *See supra* note 14.

[22] *See supra* note 15.

[23] *See supra* note 17.

[24] 15 U.S.C. 78f(b).

[25] 15 U.S.C. 78f(b)(5).

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

The PCX 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

No written comments were either solicited or received.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days or such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change, or,

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the proposed rule change and Amendment No. 1 thereto, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. 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 Room, 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of the proposed rule change and amendments will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR–PCX–2001–17 and should be submitted by July 18, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[26]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–16200 Filed 6–26–02; 8:45 am]

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[26] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–46095; File No. SR–Phlx–2002–04]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendments Nos. 1 through 7 thereto by the Philadelphia Stock Exchange, Inc. Relating to Electronic Interface With AUTOM for Phlx Specialists and Registered Options Traders

June 20, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on January 15, 2002, the Philadelphia Stock Exchange, Inc. (''Phlx'' 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 Phlx. On March 6, 2002, the Exchange filed Amendment No. 1 to the proposed rule change.[3] On March 14, 2002, the Exchange filed Amendment No. 2 to the proposed rule change.[4] On March 26, 2002, the Exchange filed Amendment No. 3 to the proposed rule change.[5] On April 2, 2002, the Exchange filed Amendment No. 4 to the proposed rule change.[6] On May 16, 2002, the Exchange filed Amendment No. 5 to the proposed rule change.[7] On June 12, 2002, the Exchange filed Amendment No. 6 to the proposed rule change. On June 19, 2002, the Exchange filed Amendment No. 7 to the proposed rule change.[8] 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 Philadelphia Stock Exchange, Inc. (''Phlx'' or ''Exchange''), pursuant to Rule 19b–4 of Act, proposes to amend Phlx Rule 1080, *Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution*

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* letter from Richard S. Rudolph, Director and Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (''Division''), Commission, dated March 5, 2002 (''Amendment No. 1''). Amendment No. 1: (1) clarified provisions relating to the minimum size of an on-floor order for the proprietary account of a Registered Options Traders (''ROTs'') or specialist; (2) specified how contracts that remain after Price Improving ROTs and specialists have received their entitlement will be allocated; and (3) stipulated the timeframe for implementing proposed system changes.

[4] *See* letter from Richard S. Rudolph, Director and Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated March 13, 2002 (''Amendment No. 2''). Amendment No. 2 clarified: (1) the responsibility for allocating incoming orders to ROTs pursuant to the proposed rule change; (2) the relationship between current Phlx rules pertaining to the precedence of orders under the proposed rule change; and (3) plans to make an electronic interface available to member firms.

[5] *See* letter from Richard S. Rudolph, Director and Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated March 25, 2002 (''Amendment No. 3''). Amendment No. 3: (1) clarified that certain Phlx rules pertaining to the precedence of orders would not apply to allocation of orders under the proposed rule change; and (2) corrected a typographical error in the proposed rule text.

[6] *See* letter from Richard S. Rudolph, Director and Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated April 1, 2002 (''Amendment No. 4''). Amendment no. 4: (1) clarified the Exchange's commitment to modify its systems to automatically execute eligible incoming orders against price-improving orders placed on the limit order book pursuant to the proposed rule; (2) clarified the proposal's approach to allocating remaining contracts after an execution or executions have filled a price-improving order or price-improving orders; (3) established that a price-improving ROT or specialist shall not be required to participate in a trade above its stated size; (4) specified the specialist's responsibility to ensure that incoming price-improving orders are filled up to their stated size; and (5) eliminated the requirement that eligibility for order delivery be subject to Options Committee approval.

[7] *See* letter from Richard S. Rudolph, Director and Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated May 15, 2002 (''Amendment No. 5''). Amendment No. 5: (1) clarified terminology and definitions; (2) stipulated when and how crowd participants may match price-improving orders; and (3) established a Special Allocation that provides that a Price Improving ROT/Specialist is entitled to receive the largest number of contracts among all crowd participants at that price and how long such Special Allocation would remain in effect.

[8] *See* letter from Richard S. Rudolph, Director and Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated June 11, 2002 (''Amendment No. 6'') and dated June 18, 2002 (''Amendment No. 7''). Amendments No. 6 and No. 7 corrected the marked changes to the proposed rule text to reflect current Phlx rules, reinserted the proposed rule text in the 3rd paragraph of Rule 1080 commentary .04, and corrected a typographical error.