

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-49969; File No. 4-429)**

**July 2, 2004**

**Joint Industry Plan; Order Approving Joint Amendment No. 11 to the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage Relating to the Processing of Satisfaction Orders**

**I. Introduction**

On February 18, 2004, March 1, 2004, March 23, 2004, April 20, 2004, April 23, 2004, and April 28, 2004, the International Securities Exchange, Inc. ("ISE"), the American Stock Exchange LLC ("Amex"), the Chicago Board Options Exchange, Inc. ("CBOE"), the Pacific Exchange, Inc. ("PCX"), the Philadelphia Stock Exchange, Inc. ("Phlx"), and the Boston Stock Exchange, Inc. ("BSE"), (collectively, the "Participants"), respectively, filed with the Securities and Exchange Commission ("Commission") an amendment ("Joint Amendment No. 11") to the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Linkage Plan").<sup>1</sup> The amendment proposes to change the manner in which the Participants and their

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<sup>1</sup> On July 28, 2000, the Commission approved a national market system plan for the purpose of creating and operating an intermarket option 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 70850 (November 28, 2000); 43574 (November 16, 2000), 65 FR 70851 (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, and January 29, 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); and 49146 (January 29, 2004), 69 FR 5618 (February 5, 2004).

members process Satisfaction Orders<sup>2</sup> they send following a Trade-Through<sup>3</sup>, and the executions (“fills”) that arise from such orders.

The proposed amendment to the Linkage Plan was published in the Federal Register on May 19, 2004.<sup>4</sup> No comments were received on the proposed amendment. This order approves the proposed amendment to the Linkage Plan.

## **II. Description of the Proposed Amendment**

The Participants propose to change the manner in which they process Satisfaction Orders following a Trade-Through in Joint Amendment No. 11. Pursuant to the Linkage Plan, if a disseminated quote that is traded through represents a customer order, a member representing that order may send a Satisfaction Order.<sup>5</sup> Upon receipt of the Satisfaction Order, the member that initiated the Trade-Through can either fill the Satisfaction Order, or cause the price of the transaction that constituted the Trade-Through to be corrected to a price at which a Trade-Through would not have occurred.<sup>6</sup> While the Participants believe this process generally works well, the experience with the Options Intermarket Linkage (“Linkage”) to date has led the Participants to agree to three changes related to Satisfaction Order processing.

In Joint Amendment No. 11, the Participants explain that currently, the Linkage Plan permits a Participant to send a Satisfaction Order for the full size of the customer order traded

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<sup>2</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>3</sup> A “Trade-Through” is defined as a transaction in an options series at a price that is inferior to the National Best Bid or Offer. See Section 2(29) of the Linkage Plan.

<sup>4</sup> See Securities Exchange Act Release No. 49691 (May 12, 2004), 69 FR 28954.

<sup>5</sup> See Sections 7(a)(ii)(D) & 8(c)(ii)(B)(2) of the Linkage Plan.

<sup>6</sup> See Section 8(c)(ii)(A) of the Linkage Plan.

through, regardless of the size of the transaction that caused the Trade-Through (although the Participant receiving the Satisfaction Order that elects to execute it must limit its execution to the size of the Trade-Through).<sup>7</sup> The amendment proposes that the size of the Satisfaction Order be limited to the lesser of the size of the customer order traded through and the size of the transaction that caused the Trade-Through.

In addition, the proposed amendment explains that the Linkage Plan currently permits a Participant that sends a Satisfaction Order through Linkage to reject the receiving Participant's fill within 30 seconds of being notified of the fill if the customer order that underlies the Satisfaction Order either has been executed on the sending exchange or has been canceled while the Satisfaction Order is being processed.<sup>8</sup> However, if the order is filled or canceled, the Participants represent that there is currently no requirement in the Linkage Plan for the Participant that sent the Satisfaction Order to cancel it while it is still pending execution on another market. The Participants believe that this aspect of the Linkage Plan leads to the rejection of Satisfaction Order fills that may have been avoided had the Satisfaction Order been canceled. To address this issue, the amendment proposes a requirement that a Participant cancel a pending Satisfaction Order that it sent through Linkage as soon as practical if the underlying customer order is filled or canceled. The proposed amendment would clarify that the customer order must be canceled or executed prior to the receipt of the Satisfaction Order fill report.

Lastly, as noted above, a Participant can reject a Satisfaction Order fill if the underlying customer order is executed or canceled while the Satisfaction Order is pending. However, the member that initiated the Satisfaction Order may, itself, trade against the customer order before the member receives a notice from the receiving Participant that the Satisfaction Order has been

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<sup>7</sup> See Section 8(c)(ii)(B)(2) of the Linkage Plan.

<sup>8</sup> See Section 8(c)(ii)(C) of the Linkage Plan.

filled. In this case, the Participants believe that it would be inappropriate to reject the fill. Accordingly, the proposed amendment would provide that a Participant may not reject the fill of the Satisfaction Order when the underlying customer order has been executed against the member that initiated the Satisfaction Order.

### **III. Discussion**

After careful consideration, the Commission finds that proposed Joint Amendment No. 11 to the Linkage Plan is consistent with the requirements of the Act and the rules and regulations thereunder. Specifically, the Commission finds that the proposed amendment to the Linkage Plan is consistent with Section 11A of the Act<sup>9</sup> and Rule 11Aa3-2 thereunder,<sup>10</sup> in that it should clarify the Participants' obligations with respect to the sending of Satisfaction Orders and the receipt of Satisfaction Order fills, which should facilitate the fair and efficient processing of Satisfaction Orders through the Linkage in furtherance of the goals of a national market system.

### **IV. Conclusion**

IT IS THEREFORE ORDERED, pursuant to Section 11A of the Act<sup>11</sup> and Rule 11Aa3-2 thereunder,<sup>12</sup> that the proposed Joint Amendment No. 11 is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>9</sup> 15 U.S.C. 78k-1.

<sup>10</sup> 17 CFR 240.11Aa3-2.

<sup>11</sup> See supra note 10.

<sup>12</sup> See supra note 11.

<sup>13</sup> 17 CFR 200.30-3(a)(29).