

available publicly. All submissions should refer to File Number SR-PCX-2004-39 and should be submitted on or before July 6, 2004.

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49832; File No. SR-Phlx-2003-59]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendments No. 1, 2, 3, 4, and 5 by the Philadelphia Stock Exchange, Inc. Relating to the Exchange's New Electronic Trading Platform, "Phlx XL"

June 8, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 3, 2003, 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 Exchange. On December 9, 2003, December 11, 2003, January 28, 2004, and May 11, 2004, the Exchange filed Amendments No. 1, 2, 3, and 4, respectively, to the proposed rule change.<sup>3</sup> On June 4, 2004, the Exchange filed Amendment No. 5 to the proposed rule change.<sup>4</sup> 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 Phlx proposes to adopt new rules for the implementation of its new electronic trading platform for options known as "Phlx XL." The text of the proposed rule change, as amended, is available at the Office of the Secretary, the Phlx, at the Commission, and on the Commission's Web site, <http://www.sec.gov>.

#### 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. 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

The purpose of the proposed rule change is to adopt rules regarding the Exchange's new electronic trading platform, Phlx XL. The proposal would permit certain on-floor Exchange members, as described below, to submit streaming electronic option quotations via electronic interface with the Exchange's Automated Options Market ("AUTOM") System.<sup>5</sup>

###### Implementation and Deployment

The Exchange represents that it will begin the initial rollout of Phlx XL on an issue-by-issue basis, beginning with the first of approximately 10 issues included in the initial rollout not later than 10 days following the Commission's approval of the proposed

rules applicable to Phlx XL. The Exchange plans to expand the deployment of Phlx XL to include the Top 120 equity options within 8 months of the initial deployment, and the Exchange expects to roll out Phlx XL for all options floor wide not later than December 31, 2005.<sup>6</sup>

###### Streaming Quote Options

Proposed Phlx Rule 1080(k) would provide that the Exchange's Options Committee<sup>7</sup> may, on an issue-by-issue basis, determine the specific issues in which Streaming Quote Traders ("SQTs"), as defined in Phlx Rule 1014(b)(ii), may generate and submit option quotations electronically through an electronic interface with AUTOM via an Exchange approved proprietary electronic quoting device. Such issues would be known as "Streaming Quote Options."

###### Streaming Quote Traders and Quoting Requirements

The proposed rules would provide that the term Registered Options Trader ("ROT") would include an SQT. An SQT would be defined in proposed Phlx Rule 1014(b)(ii) as an ROT who has received permission from the Exchange to generate and submit option quotations electronically through an electronic interface with AUTOM via an Exchange approved proprietary electronic quoting device in eligible options to which such SQT is assigned. With respect to Streaming Quote Options (defined below) to which an SQT is assigned, such SQT would be responsible to quote continuous, two-

<sup>6</sup> In January 2004, the Exchange submitted a proposal to modify the timing of the deployment of the ROT Access feature of its Automated Options Market (AUTOM) system in light of the Exchange's proposal to introduce Phlx XL. See Securities Exchange Act Release No. 49151 (January 29, 2004), 69 FR 6010 (February 9, 2004) (SR-Phlx-2004-01). Specifically, if Phlx XL is not deployed floor-wide for all options by April 30, 2005, the Exchange has committed to ensure that, as of that date, the AUTOM system automatically executes eligible incoming orders in options that are not then Streaming Quote Options (as defined below) against Phlx Price Improving ROT and specialist price improving orders and orders matching such price-improving orders entered via the electronic interface with AUTOM, as described in Commentary .04 to Phlx Rule 1080.

<sup>7</sup> The Options Committee has general supervision of the dealings of members on the equity and index options trading floor, and of the premises of the exchange facility immediately adjacent thereto. It is responsible to make or recommend for adoption, and administer such rules as it may deem necessary for the convenient and orderly transaction of business upon the equity and index options trading floor. The Committee has supervision of the activities on the equity and index options trading floor of specialists, assistant specialists, registered option traders, floor brokers, and other types of market-makers. See Exchange By-Law Article X, Section 10-19.

<sup>13</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> See letters from Richard S. Rudolph, Director and Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated December 9, 2004 ("Amendment No. 1"); December 11, 2003 ("Amendment No. 2"); January 28, 2004 ("Amendment No. 3"); and May 10, 2004, replacing Form 19b-4 in its entirety ("Amendment No. 4").

<sup>4</sup> See letter from Richard S. Rudolph, Director and Counsel, Phlx, to Deborah Lassman Flynn, Assistant Director, Division, Commission, dated June 3, 2004 ("Amendment No. 5"). In Amendment No. 5, the Exchange (i) amended certain proposed rules, (ii) removed a sentence from the purpose section of the notice, and (iii) committed to: (A) correct any technical drafting and/or typographic errors or omissions contained in the proposed rule change, and (B) provide a more detailed description of the procedures by which the opening price on Phlx XL would be established.

<sup>5</sup> AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM's automatic execution features, AUTO-X, Book Sweep and Book Match. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor. See Phlx Rule 1080.

sided markets in not less than 60% of the series in each Streaming Quote Option (as defined in proposed Phlx Rule 1080(k)) in which such SQT is assigned. The specialist assigned in a Streaming Quote Option, however, would be required to quote continuous, two-sided markets in 100% of the series in each assigned option.<sup>8</sup> ROTs who are not SQTs would continue to be responsible to fulfill all of the requirements for ROTs set forth in Phlx Rule 1014.

Proposed Phlx Rule 1014(b)(ii)(B) would set forth the minimum quotation size for specialists and SQTs in Streaming Quote Options traded on Phlx XL. Specifically, the proposed rule would provide that, during a six-month period commencing on the date of the initial deployment of Phlx XL (the "initial six-month period"), the specialist and any SQT assigned in a Streaming Quote Option would be permitted temporarily to submit electronic quotations with a size of fewer than 10 contracts for a period of 60 days after such option begins trading as a Streaming Quote Option. Beginning on the sixty-first day after such option begins trading as a Streaming Quote Option, SQTs and the specialist assigned in such Streaming Quote Option would be required to submit electronic quotations with a size of not less than 10 contracts.

Subsequently, during a six-month period commencing on the first day following the expiration of the initial six-month period, the specialist and any SQT assigned in a Streaming Quote Option would be permitted to submit electronic quotations with a size of fewer than 10 contracts for a period of 30 days after such option begins trading as a Streaming Quote Option. Beginning on the thirty-first day after such option begins trading as a Streaming Quote Option, SQTs and the specialist assigned in such Streaming Quote Option would be required to submit electronic quotations with a size of not less than 10 contracts.

Thereafter, the specialist and any SQT assigned in a Streaming Quote Option that is newly listed and deployed on Phlx XL would be required to submit

electronic quotations with a size of not less than 10 contracts beginning on the date on which such Streaming Quote Option begins trading on Phlx XL. The purpose of this provision is to enable SQTs and the specialist in a Streaming Quote Option, during the initial stages of deployment of Phlx XL, to quote with a size of less than ten contracts so that such SQTs and specialists may determine over this period of time that their quotation systems and models function properly and reliably, and to make necessary changes, if any, during this time in order to manage their risk while providing fair and orderly markets in the Streaming Quote Option. The ten-contract minimum quotation size obligation would apply only to an SQT or specialist's undecrementated quote.<sup>9</sup> An SQT would be permitted to submit electronic quotations only while such SQT is physically present on the floor of the Exchange.

Under Phlx XL, SQTs and the specialist would be able to quote verbally in open outcry in response to a request for a market, or to quote electronically (or submit orders electronically) by use of an Exchange-approved quoting device.

Non-SQT ROTs trading Streaming Quote Options would be required to quote verbally in response to a request for a market, and would continue to have the ability to place limit orders electronically directly onto the limit order book through electronic interface with AUTOM.<sup>10</sup> A non-SQT ROT would not, however, have the same continuous, electronic quoting requirements as an SQT trading the same Streaming Quote Option, unless such non-SQT ROT would trade in excess of a specified number of contracts electronically (*i.e.*, by way of placing limit orders on the book that are executed via Book Match or Book Sweep, as described more fully below) in a given calendar quarter.

With respect to non-SQT ROTs in Streaming Quote Options, the proposed rule would require that, during the initial six-month period, for a period of sixty days commencing immediately after an option begins trading as a Streaming Quote Option, such non-SQT ROTs may provide such quotations with a size of fewer than 10 contracts.

Beginning on the sixty-first day after such option begins trading as a Streaming Quote Option, such quotations would be required to be for a size of at least 10 contracts. During a six month period commencing on the first day following the expiration of the initial six-month period, such non-SQT ROTs may provide such quotations with a size of fewer than 10 contracts for a period of thirty days after such option begins trading as a Streaming Quote Option. Beginning on the thirty-first day after such option begins trading as a Streaming Quote Option, such quotations would be required to be for a size of at least 10 contracts. Thereafter, such non-SQT ROTs would be required to provide such quotations with a size of not less than 10 contracts beginning on the date on which such Streaming Quote Option begins trading on Phlx XL.

The same size requirements set forth for non-SQT ROTs in open outcry (as set forth in the preceding paragraph) would apply to non-SQT ROTs who are required to submit electronic quotations in a Streaming Quote Option for which a non-SQT ROT transacts more than 20% of his/her contract volume in a Streaming Quote Option electronically (*i.e.*, by way of placing limit orders on the limit order book that are executed electronically and allocated automatically in accordance with proposed Phlx Rule 1014(g)(vii)) versus in open outcry during any calendar quarter.

The Exchange proposes to establish additional obligations for non-SQT ROTs trading Streaming Quote Options who do not apply to become SQTs but nonetheless would be required to submit electronic quotations because of the percentage of contracts in Streaming Quote Options they trade electronically. Specifically, if a non-SQT ROT trading a Streaming Quote Option transacts more than 20% of its contract volume electronically in an assigned option that is a Streaming Quote Option during any calendar quarter, such non-SQT ROT would be required to submit continuous two-sided electronic quotations in a designated percentage of series within the Streaming Quote Option (depending on the total Exchange volume traded electronically in such Streaming Quote Option), beginning with the commencement of the following calendar quarter. The following schedule would apply:

<sup>8</sup> For example, if an SQT is assigned in one Streaming Quote Option that includes five series (A, B, C, D, and E), such SQT would be required to quote continuous, two-sided markets in three of those series in order to fulfill the 60% quoting requirement. If such an SQT initially submits quotations in series A, B, and C, and the size associated with the quotation in Series A is exhausted, such SQT would be required either to refresh its quotation in Series A while continuing to submit quotations in Series B and C, or to submit new quotations in any three of the five series, in order to fulfill the 60% quoting requirement.

<sup>9</sup> For example, if a specialist or SQT electronically submits a quotation with a size of 10 contracts, and three of those contracts are executed (leaving a disseminated quotation size of seven contracts), such specialist or SQT would be permitted continue to disseminate that electronic quotation with a size representing the remaining 7 contracts. If, however, such specialist electronically submits a revised quotation, such revised quotation would be required to be for a size of 10 contracts.

<sup>10</sup> See Phlx Rule 1080, Commentary .04.

Percent of overall streaming quote option volume transacted on the exchange during the previous quarter that was transacted electronically	Electronic quoting percent (% of series)
50 or Below .....	20
51-75 .....	40
Above 75 .....	60

For example, if 83% of the total volume on the Exchange in a particular Streaming Quote Option is transacted electronically, non-SQT ROTs in such Streaming Quote Option would be required to maintain continuous quotations in 60% of the series. The Exchange will monitor on a calendar quarter basis the percentage of contracts transacted electronically on the Exchange in each particular Streaming Quote Option for the purpose of adjusting the applicable electronic quoting percentage during the next succeeding calendar quarter.

Proposed Phlx Rule 1014(b)(ii)((C)(1)(d) would clarify that any volume transacted electronically by a non-SQT ROT (*i.e.*, limit orders placed on the limit order book that are executed via Book Match or Book Sweep) would not count towards the ROT's in-person requirement contained in Phlx Rule 1014, Commentary .01.<sup>11</sup>

#### SQT Participation in Openings

In order to clarify the interaction of SQT quotations with opening orders, the Exchange proposes to adopt Phlx Rule 1017(g), which would provide that, with respect to Streaming Quote Options, SQTs may participate in opening transactions by submitting electronic quotations to interact with opening orders.

Exchange openings and re-openings in options are currently conducted by way of rotation procedures<sup>12</sup> or by way

<sup>11</sup> Phlx Rule 1014, Commentary .01 provides that, in order for an ROT to receive specialist margin treatment for off-floor orders in any calendar quarter, the ROT must execute the greater of 1,000 contracts or 80% of his total contracts that quarter in person.

<sup>12</sup> A trading rotation is a series of very brief time periods during each of which bids, offers and transactions in only a single, specified option contract can be made. Opening rotations, currently conducted by the specialist assigned in the particular option, are held promptly following the opening of the underlying security on the primary market where it is traded. An underlying security shall be deemed to have opened on the primary market where it is traded if such market has (i) reported a transaction in the underlying security or (ii) disseminated opening quotations for the underlying security and not given an indication of a delayed opening. The Specialist generally first opens the one or more series of options of a given class having the nearest expiration, then proceeds to a series of options having the next most distant expiration, and so forth, until all series have been opened. The Specialist determines which type of option should open first, and may alternate the

of Series Opening Request Ticket ("SORT") procedures, as provided in Phlx Rule 1047.<sup>13</sup> Rotation procedures allow a brief period of auction pricing for each option series during which bids and offers and transactions for that option class may normally only occur in that series. Proposed Phlx Rule 1017(g) would clarify that such an auction would include, with respect to Streaming Quote Options, bids and offers submitted electronically by SQTs and/or the specialist.

The opening auction in Streaming Quote Options traded on Phlx XL will continue to be managed by the specialist, principally using the X-Station.<sup>14</sup> Using the X-Station the specialist will be able to see and ascertain the best bid and offer, including limit orders and, with respect to Streaming Quote Options traded on Phlx XL, electronic quotations submitted by SQTs. The specialist will also continue to take into account bids, offers or orders voiced in the trading crowd during the opening auction when determining the opening price.

Proposed Phlx Rule 1017(b)(ii) would provide that, in connection with an opening in a Streaming Quote Option (as defined in Phlx Rule 1080(k)), a bid submitted electronically by the specialist or an SQT in such Streaming Quote Option which is at a higher price than the price at which the option is to be opened and an offer submitted electronically by the specialist or an SQT in such Streaming Quote Option

opening of put series and call series or may open all series of one type before opening any series of the other type, depending on current market conditions except in the case of a modified rotation.

Modified rotations include "reverse" and "shotgun" rotations. A "reverse rotation" is an opening rotation where the Specialist first opens the one or more series of options of a given class having the most distant expiration, then proceed to the next nearest expiration, and so forth, ending with the nearest expiration, until all series have been opened. A "shotgun rotation" is an opening rotation in which each option series opens in the same manner and sequence as during a regular trading rotation but is permitted to freely trade once all option series with the same expiration month have been opened. See Phlx Rule 1047, Commentary .01(a) and (b).

<sup>13</sup> A SORT opening is one where the specialist opens all series in an options class simultaneously after rotating only those series for which a SORT was received. The SORT is a form submitted by a member with interest in a particular series to the specialist, at least five minutes prior to the opening of trading, and signals the specialist to rotate that series. Prior to conducting a SORT procedure, the specialist must announce to the crowd that such a procedure will be utilized, and in which series, if any, a SORT has been received. See Phlx Rule 1047, Commentary .01(c).

<sup>14</sup> The X-Station is a component of AUTOM used by the specialist as an on-floor display of the electronic limit order book, and as a tool for, among other things, the manual execution of orders that are due for execution.

which is at a lower price than the price at which the option is to be opened, are to be executed at the opening price. The purpose of this provision is to ensure that an SQT would receive the best execution at the opening when such SQT's quotation is higher (lower) than the bid (offer).<sup>15</sup>

#### Assignment in Streaming Quote Options

The Options Allocation, Evaluation and Securities Committee ("OAESC")<sup>16</sup> would assign SQTs in one or more eligible options in a similar fashion to the current practice of allocation of trading privileges to specialists. Proposed Phlx Rule 507 would set forth the solicitation, application and review process to be followed by the OAESC.

Proposed Phlx Rule 507 would also provide that an application for assignment in Streaming Quote Options would be submitted in writing to the Exchange's designated staff and would be required to include, at a minimum, the name of the SQT applicant and written verification from the Exchange's Membership Services Department that such SQT applicant is qualified as a ROT.

In order to ensure an SQT applicant's technological readiness to submit electronic quotes, proposed Phlx Rule 507(b)(ii) would mandate that no application for assignment in Streaming Quote Options would be approved by the OAESC without written certification signed by an officer (Vice President or above) of the Exchange's Financial Automation Department<sup>17</sup> indicating that the SQT applicant has sufficient technological ability to support his/her continuous quoting requirements as set forth in Phlx Rule 1014(b)(ii), and the SQT applicant has successfully completed, or is scheduled to complete, testing of its quoting system with the Exchange.

In order to clarify that proposed Phlx Rule 507 is not intended to function as a barrier to entry to the Exchange's marketplace while still taking into

<sup>15</sup> The Exchange is not proposing a completely automated opening process at this time.

<sup>16</sup> The Options Allocation, Evaluation and Securities Committee has jurisdiction over the allocation, retention and transfer of the privileges to deal in all options to, by and among members on the options and foreign currency options trading floors. See Exchange By-Law Article X, Section 10-7. See also, Phlx Rule 500.

<sup>17</sup> The Exchange's Financial Automation Department is responsible for the design, development, implementation, testing and maintenance of the Exchange's automated trading systems, surveillance systems, and back office systems, and for monitoring the quality of performance and operational readiness of such systems, in addition to user training and validation of user technology as it pertains to such users' interface with the Exchange's systems.

account the possibility that, initially, quote capacity may become an issue surrounding the number of SQTs who could begin trading as such, the Exchange proposes to add Phlx Rule 507(b)(iii) in order to provide that (i) Phlx Rule 507 places no limit on the number of qualifying ROTs that may become SQTs and (ii) any applicant that is qualified as an ROT in good standing and that satisfies the technological readiness and testing requirements described in sub-paragraph (b)(ii), must be approved as an SQT. However, based on system constraints, capacity restrictions or other factors relevant to the maintenance of a fair and orderly market, the Board may defer, for a period to be determined in the Board's discretion, approval of qualifying applications for SQT status pending any action required to address the issue of concern to the Board. The Board may not defer a determination of the approval of the application of any SQT applicant or place any limitation(s) on access to Phlx XL on any SQT applicant unless the basis for such limitation(s) or deferral have been objectively determined by the Board, subject to Commission approval or effectiveness pursuant to a rule change filing under section 19(b) of the Act. The Committee must provide written notification to any SQT applicant whose application is the subject of such limitation(s) or deferral, describing the objective basis for such limitation(s) or deferral.

The proposed rule also includes a provision that, during the first six months of the deployment of Phlx XL, an SQT applicant member or member organization that has, for at least the immediately preceding twelve months: (i) Been a member of the Exchange and (ii) maintained a continuous presence as an ROT in the trading crowd associated with the Streaming Quote Option(s) that are the subject of the application, must be guaranteed an assignment in the Streaming Quote Option, provided that such member organization has received the written certification concerning technological readiness as set forth in proposed Phlx Rule 507(b)(ii).

Proposed Phlx Rule 507(g) would clarify that an appeal to the Board of Governors from a decision of the Committee may be taken by a member or member organization interested therein by filing with the Secretary of the Exchange written notice of appeal within ten (10) days after the decision has been rendered, in accordance with Exchange By-Law Article XI, Section 11-1.

### Trade Allocation in Streaming Quote Options

The proposed rules would codify the trade allocation algorithm that would apply to orders or electronic quotes in Streaming Quote Options that result in automatic executions<sup>18</sup> via the AUTOM System.<sup>19</sup> In the case of trades stemming from orders that are not automatically executed and instead handled manually by the specialist or represented in the trading crowd by a Floor Broker, current Exchange rules concerning allocation of non-automatically executed trades would apply.<sup>20</sup>

The proposed rules would require that automatically executed trades in Streaming Quote Options would be allocated among the specialist and crowd participants with orders or quotations at the Exchange's disseminated price after public customer market and marketable limit orders have been executed. This aspect

<sup>18</sup> Trades in Streaming Quote Options involving inbound orders and specialist and SQT quotes delivered via AUTOM would be automatically executed by the Book Sweep function (described below); and by the Book Match function (described below). Eligible orders for non-Streaming Quote Options delivered via AUTOM would be automatically executed via AUTO-X, an automatic execution feature of AUTOM (see Phlx Rule 1080(c)), or against contra-side orders resting on the limit order book by Book Match under Phlx Rule 1080(g)(ii).

<sup>19</sup> The proposed trade allocation rules would only apply to trades in Streaming Quote Options that are automatically executed via Book Match pursuant to Phlx Rule 1080(g)(ii) and via Book Sweep pursuant to Phlx Rule 1080(c)(ii). Currently, trades that are automatically executed via AUTO-X are allocated among the specialist and ROTs participating on the "Wheel." The "Wheel" is a feature of AUTOM that provides an automated mechanism for assigning specialists and ROTs signed on the Wheel for a given listed option, on a rotating basis, as contra-side participants to trades executed via AUTO-X. See Phlx Rule 1080(g) and Option Floor Procedure Advice ("OFFPA") F-24. Under the instant proposal, trades in Streaming Quote Options that are automatically executed via Book Match pursuant to the proposed amendments to Phlx Rule 1080(g)(ii) would be allocated automatically according to the algorithm set forth in proposed Phlx Rule 1014(g)(vii) and proposed OFFPA B-6, Section F. Trades in non-Streaming Quote Options that are automatically executed via AUTO-X would continue to be allocated on the Wheel or by Book Match.

<sup>20</sup> In April 2003, the Commission approved the Exchange's proposal to adopt Phlx Rule 1014(g)(v) and OFFPA B-6 concerning the allocation of non-automatically executed orders in options. See Securities Exchange Act Release No. 47739 (April 25, 2003), 68 FR 23354 (May 1, 2003) (SR-Phlx-2001-39). That proposal was filed in response to *Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Sanctions*, Securities Exchange Act Release No. 43268 (September 11, 2000) and Administrative Proceeding File 3-10282 (the "Order"). While the instant proposal is not filed in direct response to the Order, the Exchange believes that the proposed rules concerning the allocation of trades in Streaming Quote Options are consistent with the requirements of the Order.

of the proposed rule change is consistent with current Exchange rules concerning the priority of customer orders.<sup>21</sup>

*Quoting alone at the Exchange's best bid/offer.* The proposed rules would provide that, if one Phlx XL participant is quoting alone at the disseminated price and its quote is not matched by another Phlx XL participant prior to execution, such Phlx XL participant would be entitled to receive a number of contracts up to the size associated with his/her quote.

*Parity.* The proposed rules would codify the automatic allocation algorithm that would apply to orders or electronic quotes in Streaming Quote Options that result in automatic executions when two or more Phlx XL participants have quotes or booked limit orders at the Exchange's disseminated price.<sup>22</sup>

Quotations entered electronically by the specialist or an SQT that do not cause an order resting on the limit order book to become due for execution may be matched, or joined, at any time by quotations entered electronically by the specialist and/or other SQTs, and by ROT limit orders placed on the limit order book via electronic interface, and would be deemed to be on parity, subject to the requirement that orders of controlled accounts must yield priority to customer orders as set forth in Phlx Rule 1014(g)(i)(A). This means specifically that if a customer limit order represents all or a portion of the Exchange's disseminated size, such customer limit order would be executed first up to its disseminated size, before the specialist or any SQT, non-SQT ROT, or off-floor broker-dealer would be entitled to receive any contracts.

Quotations entered electronically by the specialist or an SQT that cause the specialist's quote, an SQT's quote, or an order resting on the limit order book to become due for execution would be subject to execution under the proposed

<sup>21</sup> Phlx Rule 1014(g)(i)(A) requires that orders of controlled accounts must yield priority to customer orders. A "controlled account" includes any account controlled by or under common control with a broker-dealer (such as a specialist or an SQT). Customer accounts are all other accounts.

<sup>22</sup> Phlx Rules 119, 120, and 1014(g) are the general rules concerning establishment of parity and priority in the execution of orders on the options floor. The trade allocation algorithm in proposed Phlx Rule 1014(g)(vii) generally does not contemplate that price-time priority would apply to quotes and orders in Streaming Quote Options. Proposed Phlx Rule 1014(g)(vii)(B)(3) thus would state that, notwithstanding the first sentence of Phlx Rule 1014(g)(i), neither Phlx Rule 119(a)-(d) and (f), nor Phlx Rule 120 (insofar as it incorporates those provisions by reference) would apply to the allocation of automatically executed trades in Streaming Quote Options.

amended rules concerning the Exchange's Book Match or Book Sweep functions, described more fully below.

*Specialist on parity.* If the specialist is quoting at the Exchange's best bid/offer, after public customer market and marketable limit orders have been executed, the specialist would initially be entitled to receive the entire allocation in orders for five contracts or fewer provided, however, that on a quarterly basis, the Exchange will evaluate what percentage of the volume executed on the Exchange is comprised of orders for five contracts or fewer executed by specialists, and will reduce the size of the orders included in this provision if such percentage is over 25%.

Respecting orders for greater than five contracts, the specialist would be entitled to receive the greater of the proportion of the total disseminated size at the disseminated price represented by the size of the specialist's quote; or:

- 60% of the contracts to be allocated if the specialist is on parity with one SQT or one non-SQT ROT that has placed a limit order on the book at the Exchange's disseminated price;
- 40% of the contracts to be allocated if the specialist is on parity with two SQTs or non-SQT ROTs that have placed a limit order on the book at the Exchange's disseminated price; and
- 30% of the contracts to be allocated if the specialist is on parity with three or more SQTs or non-SQT ROTs that have placed a limit order on the book at the Exchange's disseminated price.

In order to be entitled to receive the specified percentages, and the five contract or fewer order preference, the specialist must be quoting at the Exchange's disseminated price. The specialist would not be entitled to receive a number of contracts that is greater than the size associated with the specialist's quote.

The Exchange believes that the specialist's entitlement under this algorithm should enable the Exchange to attract and retain highly capitalized specialist units who can capture order flow for the Exchange. According to the Exchange, because the specialist unit is currently a key Exchange member organization engaged in aggressive and often expensive marketing efforts to attract order flow in particular options, the Exchange seeks to provide the appropriate encouragement to specialists to plan, invest in, and effect marketing strategies. Therefore, the Exchange believes that these programs provide specialists with the appropriate incentive to create more depth and liquidity. Moreover, the Exchange believes that the specialist's entitlement

in the proposed algorithm reasonably rewards specialists for their additional obligations, such as the proposed requirement to quote 100% of the series in all Streaming Quote Options in which they are assigned (whereas SQTs would be required by proposed Phlx Rule 1014(b)(ii) to quote in 60% of the series in Streaming Quote Options in which they are assigned); the obligation to handle limit orders on the book; the obligation under the Plan for the Purpose of Creating and Operating an Intermarket Options Linkage (the "Linkage Plan")<sup>23</sup> to handle all inbound Linkage Orders and to send Satisfaction Orders on behalf of customer limit orders on the specialist's book; and the obligation, under certain circumstances, to allocate manually executed trades.<sup>24</sup>

After public customer limit orders have been executed and the specialist has received its entitlement, SQTs quoting at the disseminated price and non-SQT ROTs that have placed limit orders on the limit order book which represent the Exchange's disseminated price would be entitled to receive a number of contracts that is the proportion of the aggregate size associated with SQT quotes and non-SQT ROT limit orders on the book at the disseminated price represented by the size of the SQT's quote or, in the case of a non-SQT ROT, by the size of the limit order they have placed on the limit order book. Such SQT(s) and non-SQT ROTs would not be entitled to receive a number of contracts that is greater than the size associated with their quotation or limit order.

With respect to contracts relating to off-floor broker-dealer limit orders resting on the limit order book that are executed and allocated automatically, if any contracts remain to be allocated after the specialist, SQTs and non-SQT ROTs with limit orders on the limit order book have received their respective allocations, off-floor broker-dealers that have placed limit orders on the limit order book which represent the Exchange's disseminated price would be entitled to receive a number of contracts that is the proportion of the aggregate size associated with off-floor broker-dealer limit orders on the limit order book at the disseminated price represented by the size of the limit order they have placed on the limit order book. Such off-floor broker-dealers would not be entitled to receive a

number of contracts that is greater than the size that is associated with its quote.

However, when an off-floor broker-dealer order is resting on the limit order book at the Exchange's disseminated bid or offer, an order executed manually by the specialist would be required to be allocated first to customer orders, and next to off-floor broker-dealer limit orders, before the specialist and SQTs with quotations at the same price and non-SQT ROTs that have placed limit orders via electronic interface at the same price would be entitled to receive their respective allocations under proposed Phlx Rule 1014(g)(vii).

Currently, Phlx Rule 1014(g)(i)(A) provides that orders of controlled accounts<sup>25</sup> must yield priority to customer orders, but that orders of controlled accounts are not required to yield priority to other controlled account orders. The Exchange proposes to amend Phlx Rule 1014(g)(i)(A) to require the specialist, SQTs and non-SQT ROTs to yield priority to off-floor broker-dealer limit orders in Streaming Quote Options resting on the limit order book solely in the limited circumstance where the specialist executes such an order manually, and not in the circumstance where such an order is executed and allocated automatically under Phlx XL. The purpose of this provision is to ensure that the specialist complies with the fiduciary obligation that devolves upon the specialist when acting as agent for such a limit order.

In the situation where the off-floor broker-dealer limit order resting on the limit order book is executed and allocated automatically, the Exchange believes that the operation of the proposed automatic trade allocation algorithm contained in proposed Phlx Rule 1014(g)(vii), which would allocate contracts to off-floor broker-dealer limit orders resting on the limit order book after customers, the specialist, SQTs and non-SQT ROTs have received their respective allocations is appropriate since the specialist is not acting as "agent" for such an order in such a circumstance.

#### Off-Floor Broker-Dealer Orders and section 11(a) of the Act

Exchange rules do not currently distinguish between members or non-members respecting "off-floor broker-dealer" orders. The Exchange believes that its definition of "off-floor broker-dealer,"<sup>26</sup> which does not make this

<sup>23</sup> See Securities Exchange Act Release Nos. 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000) (Notice of Phlx Joining the Plan) and 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (Approval of the Plan).

<sup>24</sup> See Phlx Rule 1014(g)(vi) and OFPA F-2.

<sup>25</sup> Phlx Rule 1014(g)(i)(A) defines a controlled account as any account controlled by or under common control with a broker-dealer. Customer accounts are all other accounts.

<sup>26</sup> The term "off-floor broker-dealer" means a broker-dealer that delivers orders from off the floor

distinction, is consistent with section 11(a) of the Act<sup>27</sup> and the rules thereunder.

Section 11(a) prohibits a member of a national securities exchange from effecting transactions on the exchange for its own account, the account of an associated person, or an account in which it or an associated person exercises investment discretion, unless certain exceptions apply. One such exception is Rule 11a2-2(T) under the Act,<sup>28</sup> known as the "Effect Versus Execute Rule," permits an exchange member, subject to certain conditions, to effect a transaction for such accounts, utilizing an unaffiliated member to execute transactions on an exchange floor. The Rule requires that: (i) The order must be transmitted from off the exchange floor; (ii) once the order has been transmitted, the exchange member that transmitted the order may not participate in the execution; (iii) the transmitting member may not be affiliated with the executing member; and (iv) neither nor the member nor the associated person may retain any compensation in connection with effecting such a transaction respecting accounts over which either has investment discretion without the express written consent of the person authorized to transact business in the account. When the Exchange received Commission approval to allow off-floor broker dealers to deliver proprietary orders to the limit order book over AUTOM,<sup>29</sup> the Commission provided the Exchange with interpretive guidance based on the Exchange's representations that the Effect vs. Execute Rule was applicable to off-floor broker-dealer orders that are delivered via AUTOM.<sup>30</sup>

The instant proposal, which includes proposed rules relating to the priority and trade allocation of off-floor broker-dealer limit orders handled manually, may affect the yielding of priority by member and non-member off-floor

broker-dealer limit orders in certain instances. Specifically, Section 11(a)(1)(G) of the Act<sup>31</sup> provides an exemption from the prohibition against a member of a national securities exchange from effecting transactions on the exchange for its own account, the account of an associated person, or an account in which it or an associated person exercises investment discretion for any transaction for a member's own account for a member who engages in a specific securities business, but requires such member to yield priority, parity, and precedence in execution to orders for the account of persons who are not members or associated with members of the exchange.<sup>32</sup>

As stated above, proposed Phlx Rule 1014(g)(i)(A) currently provides that orders of controlled accounts must yield priority to customer orders, and that orders of controlled accounts are not required to yield priority to other controlled account orders, except when the specialist manually executes an off-floor broker-dealer limit order on the limit order book as provided in proposed Phlx Rule 1014(g)(i)(A). The Exchange believes that the only potential issue raised by including both member and non-member off-floor broker-dealers is the issue of manual allocation of contracts by specialists among such member and non-member off-floor broker-dealers, and the requirement that member broker-dealers who satisfy a "business mix test,"<sup>33</sup> and

who therefore rely on the section 11(a)(1)(G) exemption, yield priority to non-member broker-dealers.

The Exchange believes that its proposal to include member and non-member off-floor broker-dealers together in proposed Phlx Rule 1014(g)(i)(A) relating to the manual trade allocation rules is consistent with Section 11(a) of the Act and Rule 11a1-1(T) thereunder because Exchange rules require any order to which the yielding requirement of Section 11(a)(1)(G)(i) applies is required to be marked with the requirement to yield priority, including such orders placed on the limit order book by Floor Brokers.<sup>34</sup> Thus, specialists manually allocating such orders to off-floor broker-dealers would know from the notation on the order which member off-floor broker-dealer limit orders must yield to non-member off-floor broker-dealer orders.

*Specialist not on parity.* If the specialist is not quoting at the

others participating in effecting the order that it is for the account of a member.

Immediately before executing the order, a member (other than the specialist in such security) presenting any order for the account of a member on the exchange shall clearly announce or otherwise indicate to the specialist and to other members then present for the trading in such security on the exchange that he is presenting an order for the account of a member.

Notwithstanding rules of priority, parity, and precedence otherwise applicable, any member presenting for execution a bid or offer for its own account or for the account of another member shall grant priority to any bid or offer at the same price for the account of a person who is not, or is not associated with, a member, irrespective of the size of any such bid or offer or the time when entered.

A member shall be deemed to meet the requirements of Section 11(a)(1)(G)(i) of the Act if during its preceding fiscal year more than 50 percent of its gross revenues was derived from one or more of the sources specified in that section. In addition to any revenue which independently meets the requirements of Section 11(a)(1)(G)(i), revenue derived from any transaction specified in paragraph (A), (B), or (D) of Section 11(a)(1) of the Act or specified in Rule 11a1-4(T) shall be deemed to be revenue derived from one or more of the sources specified in Section 11(a)(1)(G)(i). A member may rely on a list of members which are stated to meet the requirements of Section 11(a)(1)(G)(i) if such list is prepared, and updated at least annually, by the exchange. In preparing any such list, an exchange may rely on a report which sets forth a statement of gross revenues of a member if covered by a report of independent accountants for such member to the effect that such report has been prepared in accordance with generally accepted accounting principles.

17 CFR 240.11a1-1T.

<sup>34</sup> Phlx Rule 1014(g)(i)(A) and OFPA B-6 require that orders of controlled accounts, other than ROTs and Specialists market making in-person, must be (1) verbally communicated as for a controlled account when placed on the floor and when represented to the trading crowd and (2) recorded as for a controlled account by appropriately circling the "yield" field on the floor ticket of any such order (except market maker tickets) or, in the case of trades involving a Floor Broker, by making the appropriate notation the Options Floor Broker Management System.

of the Exchange for the proprietary account(s) of such broker-dealer, including a market maker located on an exchange or trading floor other than the Exchange's trading floor who elects to deliver orders via AUTOM for the proprietary account(s) of such market maker. See Phlx Rule 1080(b)(i)(C).

<sup>27</sup> 15 U.S.C. 78k(a).

<sup>28</sup> 17 CFR 240.11a2-2T.

<sup>29</sup> See Securities Exchange Act Release No. 45758 (April 15, 2002), 67 FR 19610 (April 22, 2002) (SR-Phlx-2001-40) (Order approving the establishment of a six-month pilot program relating to broker-dealer access to AUTOM); see also Securities Exchange Act Release No. 46660 (October 15, 2002), 67 FR 64951 (October 22, 2002) (SR-Phlx-2002-50) (Order granting permanent approval of the pilot program providing broker-dealer access to AUTOM).

<sup>30</sup> See letter from Paula R. Jenson, Deputy Chief Counsel, Division of Market Regulation, Commission, to Richard S. Rudolph, Counsel, Phlx, dated April 15, 2002.

<sup>31</sup> 15 U.S.C 78k(a)(1)(G).

<sup>32</sup> Section 11(a)(1)(G) of the Act provides that it shall not make unlawful any other transaction for a member's own account, provided that (i) such member is primarily engaged in the business of underwriting and distributing securities issued by other persons, selling securities to customers, and acting as broker, or any one or more of such activities, and whose gross income normally is derived principally from such business and related activities and (ii) such transaction is effected in compliance with rules of the Commission which, at a minimum, assure that the transaction is not inconsistent with the maintenance of fair and orderly markets and yields priority, parity and precedence in execution to orders for the account of persons who are not members or associated with members of the exchange.

<sup>33</sup> Rule 11a1-1T under the Act provides that a transaction effected on a national securities exchange for the account of a member which meets the requirements of Section 11(a)(1)(G)(i) of the Act shall be deemed, in accordance with the requirements of Section 11(a)(1)(G)(ii), to be not inconsistent with the maintenance of fair and orderly markets and to yield priority, parity, and precedence in execution to orders for the account of persons who are not members or associated with members of the exchange if such transaction is effected in compliance with each of the following requirements:

A member shall disclose that a bid or offer for its account is for its account to any member with whom such bid or offer is placed or to whom it is communicated, and any member through whom that bid or offer is communicated shall disclose to

Exchange's disseminated price, SQTs quoting at the disseminated price and non-SQT ROTs that have placed limit orders on the limit order book which represent the Exchange's disseminated price would be entitled to receive a number of contracts that is the proportion of the total remaining disseminated size at the disseminated price represented by the size of the SQT's quote or, in the case of a non-SQT ROT, by the size of the limit order they have placed on the limit order book. Thereafter, off-floor broker-dealers that have placed limit orders on the limit order book which represent the Exchange's disseminated price would be entitled to receive a number of contracts that is the proportion of the aggregate size associated with off-floor broker-dealer limit orders on the limit order book at the disseminated price represented by the size of the limit order they have placed on the limit order book, not to exceed the size of their limit orders.

*Split price executions.* Proposed Phlx Rule 1014(g)(vii)(B)(3) would provide that there would be no automatic split-price executions in Streaming Quote Options. Therefore, if a market order or an electronic quotation to be executed in a Streaming Quote Option is received for a greater number of contracts than the Exchange's disseminated size, the portion of such an order or quotation executed via Book Match at the Exchange's disseminated size would be allocated in accordance with proposed Phlx Rule 1014(g)(vii). Contracts remaining in such an order would be represented by the specialist and handled in accordance with Exchange rules.

The Exchange believes that, respecting Streaming Quote Options in which specialists and SQTs submit independent electronic quotations, it is inappropriate for the Exchange to establish the next price at which the remaining contracts in a market order should be executed after the Exchange's disseminated size is exhausted. To ensure that the remaining contracts in such an order are executed at the best price available from Exchange specialists and SQTs, the Exchange would not automatically execute the remaining portion of such an order. Instead, the Exchange believes that the specialist, SQTs and ROTs should re-establish their bids and offers upon exhaustion of the Exchange's disseminated size and execute the remaining contracts manually.

*Participation in non-electronic orders.* An SQT participating in a crowd (together with the specialist and non-SQT ROTs in the crowd) would be

permitted to participate in manual trades initiated by Floor Brokers or the specialist in such a crowd.

Accordingly, an SQT generally must be present in the trading crowd to participate in non-electronic trades, with one exception. While the proposed rules generally require in-crowd presence to participate in non-electronic trades, proposed Phlx Rule 1014, Commentary .05(c) would provide that, where a non-electronic trade is initiated by a Floor Broker or specialist, an SQT assigned in a Streaming Quote Option who is located in the SQT Zone (as described below) for the Streaming Quote Option, but who is not participating in the crowd trading the Streaming Quote Option, would be able to participate in such a manual trade only if the non-electronic order is executed at the price quoted by the non-crowd participant SQT at the time of execution. For purposes of trade allocation, such an SQT would be entitled to receive contracts under existing Phlx Rule 1014(g)(v), which applies to the allocation of contracts for orders handled manually by the specialist or represented in the crowd by a floor broker.

The proposed rule would permit the specialist and/or SQTs participating in a crowd, in response to a verbal request for a market by a floor broker, to state a bid or offer that is different than their electronically submitted bid or offer, provided that such stated bid or offer is not inferior to such electronically submitted bid or offer, with one exception.

Specifically, Commentary .05(c) would provide that the requirement that a specialist or SQT state a bid or offer that is not inferior to their electronically submitted quotation would not apply if such response is to a floor broker's solicitation of a single bid or offer as set forth in Phlx Rule 1033(a)(ii). In such a situation, Phlx Rule 1033(a)(ii) permits the members of a trading crowd to discuss, negotiate and agree upon the price or prices at which an order of a size greater than the Exchange's disseminated size can be executed at that time, or the number of contracts that could be executed at a given price or prices.<sup>35</sup> This is especially true of

<sup>35</sup> Phlx Rule 1033(a)(ii) and Options Floor Procedure Advice ("Advice") F-32, Solicitation of Quotations, provide that, in response to a floor broker's solicitation of a single bid or offer, the members of a trading crowd (including the specialist and ROTs) may discuss, negotiate and agree upon the price or prices at which an order of a size greater than the AUTO-X guarantee can be executed at that time, or the number of contracts that could be executed at a given price or prices. Notwithstanding the foregoing, a single crowd participant may voice a bid or offer independently

extremely large sized orders where the trading crowd may determine by agreement to quote a single price that could be inferior to an electronic quotation submitted by a specialist or an SQT.<sup>36</sup>

In order to remain consistent with the Linkage Plan, the Exchange proposes to amend Phlx Rule 1033(a)(ii) and Advice F-32 to provide that orders executed under the Rule and Advice are subject to the provisions of the Linkage Plan and Phlx Rules 1083—1087 respecting Trade-Throughs.<sup>37</sup>

from, and differently from, the members of a trading crowd (including the specialist and ROTs). See Securities Exchange Act Release No. 45573 (March 15, 2002), 67 FR 13674 (March 25, 2003) (SR-Phlx-2001-33) (filed in response to Section IV.B.j. of the Order, which requires the Exchange (as well as the other respondent options exchanges) to implement certain undertakings. One such undertaking to adopt new, or amend existing, rules to include any practice or procedure whereby market makers trading any particular option class determine by agreement the spreads or option prices at which they will trade any option class, or the allocation of orders in that option class).

<sup>36</sup> As stated in the Exchange's proposal to adopt Phlx Rule 1033(a)(ii),

"Ordinarily, in meeting their obligation to make fair and orderly markets, Phlx specialists and ROTs would be expected to make independent business decisions concerning what market to quote at a particular point in time, in lieu of discussing or agreeing with other members of the trading crowd on what should be the market for a particular option. In order to make fair and orderly markets and to respond efficiently to the needs of investors, however, the Phlx believes that there are circumstances where some coordination among ROTs and specialists is both necessary and beneficial.

For example, when a request for a market to buy or sell a large number of options contracts is presented by the floor broker to the trading crowd, the customer on whose behalf the request is made typically wants to know promptly at what single price all of the options represented by the request may be bought or sold. However, such large trades typically require more liquidity than any single ROT or the specialist is able to provide. Coordinated efforts of the trading crowd are, thus, necessary to respond to such a request and to fill any resulting order to buy or sell the option at a single price. In this regard, borrowing a phrase from corporate principles, the Phlx believes that the trading crowd is properly viewed as a "joint venture," in which the resources of the individual crowd members are combined to produce the necessary liquidity to respond to the needs of investors and to compete effectively with other options exchanges.

When an options order exceeds the size that individual trading crowd members can execute, the Phlx believes that the trading crowd must act as a joint venture or single economic unit. In this situation, the trading crowd must reach agreement on the price they will offer because the customer desires a single price. Significantly, in the Exchange's view, the antitrust laws permit competitors to collaborate to produce and sell a product that they could not otherwise offer individually. In fact, such activity is pro-competitive because it increases output and increases the number of competitors."

See Securities Exchange Act Release No. 45391 (February 4, 2002), 67 FR 6570 (February 12, 2002) (SR-Phlx-2001-33).

<sup>37</sup> Under the Linkage Plan and Exchange Rules, a "Trade-Through" means a transaction in an options

## Crowd Area

For purposes of Phlx Rule 1014, Commentary .03, an SQT or non-SQT ROT would be deemed to be participating in a crowd if such SQT or non-SQT ROT is, at the time an order is represented in the crowd, physically located in a specific "Crowd Area." A Crowd Area would consist of a physical location marked with specific, visible physical boundaries on the options floor, as determined by the Options Committee.<sup>38</sup> An SQT or non-SQT ROT who is physically present in such Crowd Area may engage in options transactions in assigned issues as a crowd participant in such a Crowd Area, provided that such SQT or non-SQT ROT fulfills the requirements set forth in Phlx Rule 1014. An SQT or non-SQT ROT would be deemed to be participating in a single Crowd Area, and thus would not be permitted to be a crowd participant in more than one particular Crowd Area at any specific time.

## SQT Zones

Proposed Phlx Rule 1014, Commentary .05(b) would provide that an SQT may be assigned to (and thus submit quotes electronically in) up to all of the options located within a specified physical zone on the Exchange Floor (an "SQT Zone") provided that such SQT is physically present in such SQT Zone. Thus, each member organization must have at least one SQT physically present in each SQT Zone in which such member organization submits electronic

quotations. An SQT Zone could consist of multiple Crowd Areas. Each SQT Zone would be identified as including specific Crowd Areas (for example, "SQT Zone 1" might be identified as encompassing Crowd Areas A–D, "SQT Zone 2" might be identified as encompassing Crowd Areas E–H, etc.).

Initially, there would be one SQT Zone representing the entire options trading floor. This means that an SQT could submit electronic quotations in any Streaming Quote Option while such SQT is physically on the Exchange floor.

The number and location of any additional SQT Zones would be determined by the Options Committee based on its review of quote and trade data during the first six months of the deployment of Phlx XL. Proposed Phlx Rule 1014, Commentary .05(c) would require the Exchange to file for, and receive, Commission approval in the event the Options Committee determines to change the number and/or location of SQT Zones.

## ROT Limit Orders

The proposed rule change would amend the Exchange's rules regarding ROT electronic access to the limit order book.<sup>39</sup> Currently, ROTs are permitted by rule to enter electronic price improving limit orders (and orders matching such orders entered by the specialist or other ROTs in the trading crowd) onto the limit order book via electronic interface with AUTOM, and are entitled to receive a special allocation in trades stemming from such price improving limit orders.<sup>40</sup> Under the instant proposal, ROTs would be permitted under Phlx Rule 1080(b)(i)(B) and Commentary .04 to place certain limit orders on the limit order book electronically. The requirement that such limit orders be price-improving

orders, however, would be deleted. ROTs would be permitted to place limit orders, including Good Till Cancelled ("GTC") orders, on the limit order book whether such an order improves the then-prevailing Exchange market or not. ROTs entering limit orders on the book would be required to submit such orders with a size of at least ten contracts in both Streaming Quote Options and non-Streaming Quote Options. "Price-Improving ROTs" that place price-improving limit orders would continue to be entitled to receive contracts under the aforementioned special allocation.

The proposed rule would provide that, respecting Streaming Quote Options, inbound AUTOM orders or electronic quotations eligible for execution against non-SQT ROT orders entered into AUTOM via electronic interface would be automatically executed and would be allocated automatically pursuant to Exchange rules.<sup>41</sup>

The Exchange believes that the instant proposal, which would enable SQTs to stream electronic quotes, combined with the size *pro rata* allocation algorithm applicable to automatically executed trades resulting from such quotes, rewards market participants for quoting and providing liquidity at the best price. The Exchange believes that the result would thus be substantially enhanced incentives for market participants to quote competitively and substantially reduced disincentives to quote competitively. In Streaming Quote Options, non-SQT ROTs with limit orders on the book at the Exchange's disseminated price that are automatically executed would be allocated contracts according to proposed new Phlx Rule 1014(g)(vii), which, as stated above, would reward non-SQT ROTs who provide liquidity at the best price.

## Book Match

Book Match is a feature of AUTOM that currently provides automatic executions for inbound AUTOM-delivered customer and off-floor broker-dealer<sup>42</sup> orders against customer limit orders on the book. The proposed rules would enhance Book

series at a price that is inferior to the NBBO. The Linkage Plan and Exchange Rules provide that, absent reasonable justification and during normal market conditions, members should not effect Trade-Throughs. See Phlx Rule 1085(a)(1). If a Trade-Through occurs, the Linkage Plan and Exchange Rules provide certain rights and remedies for aggrieved parties whose markets are traded through. A Block Trade (defined in the Linkage Plan and Exchange Rules as a trade that involves 500 or more contracts and has a premium value of at least \$150,000) effected at a price outside the NBBO is not deemed to be a Trade-Through for purposes of surveillance and enforcement, provided that the member(s) that execute such a Block Trade have satisfied all aggrieved parties in accordance with the Linkage Plan and Exchange Rules. See Phlx Rule 1085(d)(2).

<sup>38</sup> While the proposed rules would grant authority to assign trading privileges in Streaming Quote Options to the OAESC (which includes three off-floor persons, one public Governor, and one non-industry governor pursuant to Phlx Rule 500), the proposed rules would grant authority to determine the physical location of Crowd Areas and SQT Zones to the Options Committee, which is composed of specialists, ROTs and Floor Brokers who conduct business on the Exchange's Options Floor. The purpose of this provision is to ensure that Exchange members who are most familiar with the physical configuration and layout of the Exchange's Options Floor (*i.e.*, the members of the Options Committee) determine such physical location.

<sup>39</sup> In November, 2002, the Commission approved the Exchange's proposal to allow on-floor, in-crowd ROTs to place electronic price-improving limit orders on the limit order book via electronic interface with AUTOM, and to provide a special trade allocation algorithm applicable to trades involving such limit orders. See Securities Exchange Act Release No. 46763 (November 1, 2002), 67 FR 68898 (November 13, 2003) (SR-Phlx-2002-04). That proposal was filed in response to the Order (*see supra* note 20) which required, among other things, that the respondent exchanges adopt new, or amend existing, rules concerning its automated quotation systems which substantially enhance incentives to quote competitively and substantially reduce disincentives for market participants to act competitively. The Commission recently approved Phlx's proposal to modify the timetable for the automatic execution of such limit orders as such automaton relates to both Streaming Quote Options and non-Streaming Quote Options. See Securities Exchange Act Release No. 49151 (January 29, 2004), 69 FR 6010 (February 9, 2004) (SR-Phlx-2004-01).

<sup>40</sup> *Id.*

<sup>41</sup> Respecting Streaming Quote Options, non-SQT ROT limit orders on the book, entered electronically or manually by the specialist that are automatically executed would be allocated pursuant to proposed Phlx Rule 1014(g)(vii).

<sup>42</sup> Phlx Rule 1080(b)(i)(C) defines an "off-floor broker-dealer" as a broker-dealer that delivers orders from off the floor of the Exchange for the proprietary account(s) of such broker-dealer, including a market maker located on an exchange or trading floor other than the Exchange's trading floor who elects to deliver orders via AUTOM for the proprietary account(s) of such market maker.

Match to provide that the contra-side to automatically executed inbound eligible orders would be a limit order on the book or specialist and/or SQT electronic quotes ("electronic quotes") at the disseminated price where the Exchange's disseminated size includes a limit order on the book and/or electronic quotes at the disseminated price. The enhancements would involve the automatic execution of inbound market and marketable limit orders against contra-side booked limit orders and/or quotes that are included in the Exchange's disseminated quotation.

Book Match would not be engaged: (i) When the Exchange's disseminated price represented by a limit order on the book is not the National Best Bid or Offer ("NBBO"); (ii) for pre-opening orders; and (iii) during trading rotations. In these situations, incoming orders would be subject to manual handling by the specialist.

The Exchange believes that the proposed enhancements to Book Match should provide for a greater number of automatic executions involving matching inbound orders against booked limit orders and SQT and specialist quotations that are included in the Exchange's disseminated quotation, thus providing customers with quicker, more efficient executions for a larger number of trades.

#### Book Sweep

Similar to Book Match, the Book Sweep function currently matches specialist quotations generated by Auto-Quote (or by a proprietary quoting system called "Specialized Quote Feed" or "SQF") against booked limit orders representing the Exchange's disseminated bid or offer when such quotations lock or cross the booked limit order (provided that the disseminated bid or offer is at the NBBO). Currently, Phlx Rule 1080(c)(iii) provides that, when the bid or offer generated by the Exchange's Auto-Quote system or SQF matches (locks) or crosses the Exchange's best bid or offer in a particular series as established by an order on the limit order book, orders on the limit order book in that series will be automatically executed up to the size associated with the quote that locks or crosses the order on the limit order book and allocated among crowd participants signed onto the Wheel.

Book Sweep would be enhanced in Phlx XL for Streaming Quote Options under the instant proposed rule change to allow SQT quotations, in addition to specialist quotations, to initiate the Book Sweep function. The SQT Book Sweep feature would function in essentially the same manner as the

current Auto-Quote or SQF Book Sweep feature, *i.e.*, when an SQT submits a quotation that locks or crosses a limit order on the book that represents the Exchange's best bid or offer, such limit order would be executed automatically up to the size associated with the SQT's quotation, and would be automatically allocated in accordance with Exchange rules. The specialist or SQT may manually initiate the Book Sweep feature by sending a manual quote in situations where the specialist or SQT's automatic generation of electronic quotations is suspended due to, for example, a system malfunction. Eligible orders on the limit order book would be automatically executed up to the size associated with the quote that matches or crosses such limit orders. Orders on the limit order book would not be eligible for Book Sweep when the NBBO is crossed (*i.e.*, 2.10 bid, 2 offer).

The current functionality of Book Sweep would remain effective for non-Streaming Quote Options. The above-described enhancements would apply to Streaming Quote Options, and the Exchange proposes to amend Phlx Rule 1080(c)(iii) to reflect the Book Sweep functionality for both Streaming Quote and non-Streaming Quote Options.

#### NBBO Step-Up

The Exchange's current rules relating to the "NBBO Step-Up" AUTO-X function would be deleted for all options, including both Streaming Quote Options and non-Streaming Quote Options. The purpose of this proposal is to enhance incentives for specialists and SQTs to quote competitively at the NBBO, rather than relying on the representation that the Exchange would "step up" and automatically execute at the NBBO as disseminated by another exchange if such other exchange's disseminated market falls within a specified "step-up parameter" of the Exchange's disseminated quote.

#### Firm Quotations

The introduction of independent streaming options quotations in Phlx XL necessitates various changes to the Exchange's "Firm Quote" requirements.

*Definition of disseminated size.* The Exchange proposes to amend Phlx Rule 1082, Firm Quotations, by establishing by rule the Exchange's firm quotation size with respect to non-Streaming Quote Options and with respect to Streaming Quote Options.<sup>43</sup>

<sup>43</sup> Rule 11Ac1-1(d)(1)(i) under the Act permits an exchange to establish by rule, and periodically publish, the quotation size for listed options, for which responsible brokers or dealers are obligated to execute an order. 17 CFR 240.11Ac1-1(d)(1)(i).

Respecting non-Streaming Quote Options, the Exchange's "disseminated size" would be defined as, with respect to the disseminated price, at least the sum of the size associated with: (1) Limit orders; and (2) specialists' quotations generated by Auto-Quote or Specialized Quote Feed ("SQF") as described in Phlx Rule 1080, Commentary .01 (which represents the collective quotation size of the specialist and any ROTs bidding or offering at the disseminated price unless an ROT has expressly indicated otherwise in a clear and audible manner). The proposed definition of "disseminated size" respecting non-Streaming Quote Options would provide more specificity to the current definition, which includes at least the sum of limit orders and allows, but does not require, the specialist and/or crowd to add additional size to the Exchange's disseminated size. The Exchange believes that the requirement that specialists' quotations generated by Auto-Quote or SQF be included in the disseminated size provides a more accurate and transparent reflection of the size for which the Exchange is firm in quotations for non-Streaming Quote Options.

The Exchange is proposing to adopt new Phlx Rule 1082(a)(ii)(B) to establish by rule the definition of "disseminated size" that would apply to Streaming Quote Options. Specifically, for Streaming Quote Options, "disseminated size" would mean, with respect to the Exchange's disseminated price, at least the sum of the size associated with limit orders, specialists' quotations,<sup>44</sup> and SQTs' quotations. The Exchange would disseminate the aggregate size of these three components.

Proposed Phlx Rule 1082(a)(ii)(C)(1) would provide that, if an SQT's quotation size in a Streaming Quote Option is exhausted, such SQT's quotation would be deleted from the Exchange's disseminated quotation until the time the SQT revises his/her quotation. Although such SQT's quotation size in a given series may be exhausted and thus removed from the Exchange's disseminated quotation in that series, such an SQT would nonetheless continue to be required to submit continuous two-sided quotations in not less than 60% of the series in each Streaming Quote Option in which

<sup>44</sup> Because the specialist and SQTs in Streaming Quote Options would be quoting independently, the term "specialist's quotations" with respect to Streaming Quote Options would mean the individual specialist's quotation, including, for purposes of the definition of "disseminated size," the size associated with such a quotation.

such SQT is assigned, in accordance with proposed Phlx Rule 1014(b)(ii)(B).

Proposed Phlx Rule 1082(a)(ii)(C)(2) would provide that, if the Exchange's disseminated size in a particular series in a Streaming Quote Option is exhausted, the Exchange would disseminate the next best available quotation.<sup>45</sup> If no specialist or SQT has revised their quotation immediately following the exhaustion of the Exchange's disseminated size, the Exchange would automatically disseminate the specialist's most recent disseminated price prior to the time of such exhaustion with a size of one contract.

This provision is intended to address the situation in which the size associated with all SQT quotations in a given series, together with the specialist's quotation in such series, are exhausted.<sup>46</sup> The purpose of this proposal is to ensure that the specialist is fulfilling the continuous quoting requirement set forth in proposed Phlx Rule 1014(b)(ii)(B) by disseminating continuous two-sided markets in Streaming Quote options in which such specialist is assigned, while permitting the specialist to revise its quote. If SQTs continue to submit quotations at the disseminated price, inbound AUTOM orders or quotes would be eligible for automatic execution against such SQT quotations.

#### *Responsible broker or dealer.*

Currently, the Exchange's disseminated market (whether by Auto-Quote or specialized quote feed) is deemed to represent the quotations of all ROTs in that option unless an ROT has expressly indicated otherwise.<sup>47</sup> All ROTs in such an option who have not expressly indicated that the disseminated market does not represent their quote would collectively be bidding or offering at the disseminated price, and thus are the collective "responsible brokers or dealers" for purposes of the Exchange's "Firm Quote" requirement. Phlx Rule 1082(b) currently provides that responsible brokers or dealers bidding

(or offering) at the disseminated price are collectively required to execute orders presented to them at such price up to the disseminated size. This would remain in effect for non-Streaming Quote Options.

Because, however, SQTs and specialists would be quoting independently in Streaming Quote Options, each individual SQT and specialist would be deemed to be the "responsible broker or dealer" in Streaming Quote Options. To address this change, proposed new Phlx Rule 1082(b)(ii) would provide that, with respect to Streaming Quote Options, in the event an SQT or specialist in a Streaming Quote Option has electronically communicated on the Exchange bids or offers for a Streaming Quote Option, each such SQT or specialist would be considered a "responsible broker or dealer" for that bid or offer, up to the size associated with such responsible broker or dealer's bid or offer. There thus would be individual "responsible brokers or dealers," and no "collective" firm quotation requirement, in Streaming Quote Options.<sup>48</sup>

*Locked and crossed markets.* Two new Commentaries to Phlx Rule 1082 are proposed, relating to the situation in which a specialist or SQT's quotation locks (i.e., 1.00 bid, 1.00 offer) or crosses (i.e., 1.10 bid, 1.00 offer) another quotation.

Because the specialist and multiple SQTs would be quoting simultaneously, there may be instances where quotes may become locked. Under the proposal, the Exchange would disseminate the locked market and both quotations (bid and offer) would be deemed "firm" disseminated market quotations. Once SQT and/or specialists' quotations become locked, a

one-second "counting period" will begin during which SQTs and/or specialists whose quotations are locked may eliminate the locked market. However, such SQT and/or specialist would be obligated to execute orders at their disseminated quotation. During the "counting period" SQTs and specialists located in the Crowd Area in which the option that is the subject of the locked market is traded will continue to be obligated to respond to floor brokers as set forth in Phlx Rule 1014, Commentary .05(c), and would continue to be obligated for one contract in open outcry to other SQTs, non-SQT ROTs, and specialists.

If at the end of the counting period the quotations remain locked, the locked quotations will automatically execute against each other in accordance with the allocation algorithm set forth in Phlx Rule 1014(g)(vii).

The Options Committee may shorten the duration of the one-second "counting period." The quotation that is locked may be executed by another order during the one-second "counting period."

*Crossed Markets.* The Exchange will not disseminate an internally crossed market (e.g., \$1.10 bid, 1.00 offer). If an SQT or specialist submits a quotation in a Streaming Quote Option ("incoming quotation") that would cross an existing quotation ("existing quotation"), the Exchange will: (i) Change the incoming quotation such that it locks the existing quotation; (ii) send a notice to the SQT or specialist that submitted the existing quotation indicating that its quotation was crossed; and (iii) send a notice to the specialist or SQT that submitted the incoming quotation, indicating that its quotation crossed the existing quotation and was changed. Such a locked market would be handled in accordance with proposed Commentary .01 concerning locked markets. During the one-second counting period, if the existing quotation is cancelled subsequent to the time the incoming quotation is changed, the incoming quotation will automatically be restored to its original terms.

#### *Other Rules and OFPAs*

*The Wheel.* The Exchange is proposing to amend its OFPA F-24 to reflect that the Wheel will apply only to non-Streaming Quote Options. Because a new trade allocation algorithm would become effective with respect to Streaming Quote Options, taking into account the entitlements of the specialist, SQTs, ROTs and off-floor broker-dealers based on the size associated with their quotes and/or limit

<sup>45</sup> The Exchange would have available the quotations submitted by the specialist and SQTs in a particular series, and would disseminate only the aggregate size of SQT and specialist quotations at the best bid and offer on the Exchange. If the best bid or offer is exhausted and not refreshed, the Exchange would disseminate the next best bid or offer submitted by the specialist and/or SQTs quoting in the series.

<sup>46</sup> Rule 11Ac1-1(d)(3) under the Act provides that no responsible broker or dealer shall be obligated to execute a transaction for any listed option if, prior to the presentation of an order, the responsible broker or dealer has communicated to its exchange, a revised quotation size or a revised bid or offer.

<sup>47</sup> 17 CFR 240.11Ac1-1(d)(3). See also 17 CFR 240.11Ac1-1(c)(3)(i)(A) and (c)(3)(ii)(A).

<sup>48</sup> See Phlx Rule 1080, Commentary .01(c).

<sup>48</sup> This is consistent with Rule 11Ac1-1(a)(21)(i) under the Act, which provides:

"The term responsible broker or dealer shall mean:

(i) When used with respect to bids or offers communicated on an exchange, any member of such exchange who communicates to another member on such exchange, at the location (or locations) designated by such exchange for trading in a covered security, a bid or offer for such covered security, as either principal or agent; provided, however, That, in the event two or more members of an exchange have communicated on such exchange bids or offers for a covered security at the same price, each such member shall be considered a 'responsible broker or dealer' for that bid or offer, subject to the rules of priority and precedence then in effect on that exchange; and further provided, That for a bid or offer which is transmitted from one member of an exchange to another member who undertakes to represent such bid or offer on such exchange as agent, only the last member who undertakes to represent such bid or offer as agent shall be considered the 'responsible broker or dealer' for that bid or offer." 17 CFR 240.11Ac1-1(a)(21)(i).

orders, the trade allocation algorithm applicable to non-Streaming Quote Options would not apply in Streaming Quote Options.<sup>49</sup>

*Auto-X Disengagement.* The provisions relating to orders otherwise eligible for automatic execution via AUTO-X currently included in Phlx Rule 1080(c)(iv) would continue to apply to non-Streaming Quote Options; such provisions would not apply to Streaming Quote Options because the automatic execution function for Streaming Quote Options is Book Match or Book Sweep, not AUTO-X.

Currently, Phlx Rule 1080(c)(iv)(I) provides that, when the number of contracts automatically executed within a 15 second period in an option (subject to a pilot program until November 30, 2004) exceeds the specified disengagement size, a 30 second period ensues during which subsequent orders are handled manually by the specialist. The proposed rule change would amend the rule to provide that this provision would continue to apply only to non-Streaming Quote Options.

Automatic executions in Streaming Quote Options would be initiated under the Book Match or Book Sweep function and allocated automatically in accordance with proposed Phlx Rule 1014(g)(vii), whereas automatic executions in non-Streaming Quote Options would be executed via AUTO-X and allocated on the Wheel.

Proposed Phlx Rule 1080(c)(iii) would provide that Book Sweep would be engaged when AUTO-X is engaged, and would be disengaged when AUTO-X is disengaged. In order to disengage AUTO-X, a specialist is required to obtain the approval of two Floor Officials pursuant to OFPA A-13, and under extraordinary circumstances, pursuant to Phlx Rule 1080(e). Moreover, the specialist would not be able to disengage AUTO-X (and thus the Book Sweep function) such that an SQT could not initiate Book Sweep manually; an SQT would have the ability to initiate the Book Sweep function regardless of whether the specialist has obtained the necessary Floor Official approval and disengaged the AUTO-X feature. The "disengagement" provision is not proposed for Streaming Quote Options because when the size associated with

an individual specialist or SQT's quotation is exhausted, there is no "disengagement" of a system; such a quotation would be handled in accordance with proposed Phlx Rules 1082(a)(ii)(C)(1) and (2), as stated above.

*Removal of Unreliable Quotes.* While the Exchange is proposing to delete the provisions in Phlx Rule 1080(c)(i) relating to the NBBO Feature, certain language contained in that rule describing the conditions and procedures under which the Exchange can exclude another market's quotes from its calculation of the NBBO would be retained. The provisions relating to the removal of unreliable quotes from another exchange from the Exchange's calculation of NBBO are intended to apply to both Streaming Quote Options and non-Streaming Quote Options.

*Eligible AUTOM order types.* Currently, the specialist, when alerted by AUTOM, handles the conversion of contingency orders on the limit order book into market or marketable limit orders when the respective condition applicable to such orders is manifested. The Exchange's systems do not currently perform this task electronically. The Exchange therefore proposes to amend Phlx Rule 1080(b)(i)(a), Eligible Orders, to provide that the following contingency order types would not be eligible for delivery via AUTOM: stop, stop limit market close, market on opening, limit on opening, and limit close.<sup>50</sup> Because the conversion of these contingency order types is not done electronically by AUTOM, such order types would not be eligible for electronic entry on the electronic limit order book. Previously, any limit order on the book that became due for execution against an inbound electronic order delivered via AUTOM was handled manually by the specialist; with the development and deployment of Book Match, such contingency orders may now be executed electronically, but would not be converted electronically. Thus, such orders would not be placed on the electronic limit order book.

Customers wishing to submit such orders would be required to do so by way of representation by a Floor Broker.

*Eligible order delivery size.* In order to allow a greater number of orders to be delivered electronically to the Exchange via AUTOM, the Exchange proposes to amend Phlx Rules 1080(b)(i)(A), (B), and (C) to increase the maximum AUTOM order delivery size from 1,000 contracts to 5,000 contracts for all eligible order types. This increase would apply to

both Streaming Quote Options and non-Streaming Quote Options.

## 2. Statutory Basis

The Exchange believes that its proposal to adopt Phlx XL is consistent with Section 6(b) of the Act<sup>51</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>52</sup> in particular, in that it is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanisms of a free and open market and a national market system, and to protect investors and the public interest, by creating an electronic trading platform designed to provide Exchange members with substantially enhanced incentives to quote competitively, increase the depth and liquidity in the Exchange's markets, and to allow the Exchange to remain competitive for order flow by providing order flow providers with an electronic trading platform that will assist them in fulfilling their duty of best execution on behalf of their customers.

The Exchange believes that the obligation for SQTs to quote in 60% of the series in all Streaming Quote Options in which they are assigned, and the requirement that specialists quote in 100% of the series in all Streaming Quote Options in which they are assigned, is consistent with the notion that market makers receive certain benefits for carrying out their duties because of those obligations. For example, with respect to margin treatment, market makers may obtain credit from lenders without regard to the restrictions in Regulation T of the Board of Governors of the Federal Reserve system if the credit is to be used to finance a specialist or market maker's activities on a national securities exchange.<sup>53</sup> The Exchange believes that the affirmative obligation in the proposal, that SQTs and specialists hold themselves out as willing to buy and sell options for their own account on a regular and continuous basis, justifies this favorable treatment.

Additionally, the Exchange believes that the additional obligations of the specialist, such as the obligation to handle limit orders on the book; the obligation under the Linkage Plan to handle all inbound Linkage Orders and to send Satisfaction Orders on behalf of customer limit orders on the specialist's book; and the obligation, under certain circumstances, to allocate manually executed trades, justifies the proposed enhanced participation rights afforded

<sup>49</sup> Currently, and with respect to non-Streaming Quote Options under the instant proposal, AUTO-X participation would be assigned to Wheel Participants on a rotating basis, beginning at a random place on the rotational Wheel each day, from those participants signed-on in that listed option at that time. The Wheel rotates and assigns contracts depending upon the size of the order executed and the number of Wheel participants in a given option. See OFPA F-24.

<sup>50</sup> For a complete description of these order types, see Phlx Rule 1066.

<sup>51</sup> 15 U.S.C. 78f(b).

<sup>52</sup> 15 U.S.C. 78f(b)(5).

<sup>53</sup> See 12 CFR 221.5(c)(6).

to specialists in Streaming Quote Options.

The Exchange further believes that the proposed rule change regarding Book Match, in which orders and quotes interact directly with one another for execution, is consistent with Congress's stated goal in Section 11A(a)(1)(C)(v) of the Act<sup>54</sup> that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure an opportunity for investors' orders to be executed without the participation of a dealer.

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

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

#### *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 of 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 the 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 foregoing, including whether the proposed rule change, as amended, 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-Phlx-2003-59 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-Phlx-2003-59. 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, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the Phlx. 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-Phlx-2003-59 and should be submitted on or before June 6, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>55</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

[FR Doc. 04-13403 Filed 6-9-04; 2:12 pm]

**BILLING CODE 8010-01-P**

### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-49807; File No. SR-Phlx-2004-22]

#### **Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Susquehanna Indices, LLP Disclaimer**

June 4, 2003.

On March 22, 2004, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change to amend Exchange Rule 1104A, which applies to indexes maintained by Susquehanna Indices, LLP.<sup>3</sup> The rule generally provides that Susquehanna makes no warranty, express or implied, to the results of SIG Investments Index. The Phlx is proposing to add a new index which it trades options on, to the disclaimer in Phlx Rule 1104A, the SIG Cable, Media & Entertainment Index.

The proposed rule change was published for comment in the **Federal Register** on May 3, 2004.<sup>4</sup> The Commission received no comments on the proposal. This order approves the proposed rule change.

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.<sup>5</sup> In particular, the Commission believes that the proposed rule change is consistent with section 6(b)(5) of the Act<sup>6</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, to remove impediments to and perfect the mechanism of a free and open market and a national market system, to protect investors and the public interest and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. The Commission believes that the proposed rule change should assist investors by clarifying the nature of any warranty, express or implied, as to results to be obtained by any person or entity when trading Phlx options on the SIG, Cable, Media & Entertainment Index.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>7</sup> that the proposed rule change (SR-Phlx-2004-22) be, and it hereby is, approved.

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

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

<sup>3</sup> The Commission notes that it approved Phlx Rule 1104A on July 7, 2003. See Securities Exchange Act Release No. 48135 (July 7, 2003), 68 FR 42154 (July 16, 2003) (approving SR-Phlx-2003-21).

<sup>4</sup> See Securities Exchange Act Release No. 49605 (April 22, 2004), 69 FR 24209.

<sup>5</sup> 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).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>7</sup> 15 U.S.C. 78s(b)(2).

<sup>54</sup> 15 U.S.C. 78k-1(a)(1)(C)(v).

<sup>55</sup> 17 CFR 200.30-3(a)(12).