For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[15]

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–43684; File No. SR–Phlx–00–93]

Self-Regulatory Organizations; Notice of Filing and Order Granting Partial Accelerated Approval of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto by the Philadelphia Stock Exchange, Inc. Relating to Providing Automatic Executions for Public Customer Orders at the NBBO

December 6, 2000.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on October 16, 2000, the Philadelphia Stock Exchange, Inc. (''Phlx'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On November 22, 2000 and December 1, 2000, the Exchange submitted Amendments Nos. 1 [3] and 2,[4] respectively, to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and to grant accelerated approval to the portion of the proposal allowing AUTO–X eligible orders to be automatically executed at the NBBO, provided that the NBBO is not better than the specialist's BBO by a predetermined step-up parameter.[5]

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

A. NBBO Feature

The Exchange proposes an enhancement to AUTO–X, the automatic execution feature of the Exchange's Automated Options Market (''AUTOM'') System, that would allow AUTO–X eligible orders to be automatically executed at the NBBO, provided that the NBBO is not better than the specialist's BBO by a predetermined ''step-up parameter.'' The enhancement is known as the ''NBBO Feature.''

Under proposed Rule 1080(c)(i), the NBBO Feature would execute AUTO–X eligible orders at the NBBO for certain options designated by the Options Committee as eligible for the NBBO Feature (''automatic step-up options''), provided that the NBBO does not differ from the specialist's BBO by more than the step-up parameter. The step-up parameter for automatic step-up options would be the minimum trading increment (one ''tick'') for options in that series established pursuant to Exchange Rule 1034, or any greater amount established by the Options Committee in respect of specified automatic step-up options or series of options.

The proposal provides that orders that would otherwise qualify as automatic step-up options would be executed manually in accordance with Exchange rules in three circumstances: (1) Where the specialist's best bid or offer [6] is inferior to the current best bid or offer in another market by more than the step-up parameter; (2) where the NBBO is crossed (*i.e.,* 2 bid, 2 asked); or locked (*i.e.,* 2 bid, 2 asked); or (3) in respect of equity options other than automatic step-up options where the specialist's BBO is inferior to the current best bid or offer in another market by any amount. The proposed rule would also include a provision that an order may also be executed partially by AUTO–X and partially manually.

In addition, under the proposal, the Chairman of the Options Committee or his designee [7] (or if the Chairman of the Options Committee or his designee is unavailable, two Floor Officials) may determine to disengage the NBBO Feature for orders in certain automatic step-up options after notice to AUTOM users. In circumstances where the NBBO Feature is disengaged, such orders will continue to be executed manually, in accordance with Exchange rules. Finally, an additional proposed amendment to Exchange Rule 1080(e) would provide that the NBBO Feature is always disengaged when AUTO–X is disengaged.

B. Exclusion of Unreliable Quotes from NBBO

Where the Chairman of the Options Committee or his designee (or if the Chairman of the Options Committee or his designee is unavailable, two Floor Officials), determines that quotes in certain automatic step-up options on the Exchange or other markets are deemed not to be reliable, such unreliable quotes would be excluded from the calculation of NBBO, and customers would receive an automatic execution at NBBO based on the remaining markets whose quotes are not deemed to be unreliable.

A quote could be deemed not to be reliable because of Exchange communications or systems problems; fast markets; delays in the dissemination of quotes because of queues on the Options Price Reporting Authority (''OPRA'') (in which case the Exchange would know that there is a delay in the dissemination of quotes from the other exchanges, which would likely render such quotes stale); or if the Exchange is advised by another exchange that it is experiencing communication or system problems that would cause its disseminated quotes to be unreliable.

The text of the proposed rule change is as follows. New text is italicized.

Rule 1080. (a)–(b) No change.

(c) AUTO–X—AUTO–X is a feature of AUTOM that automatically executes public customer market and marketable limit orders up to the number of contracts permitted by the Exchange for certain strike prices and expiration months in equity options and index options, unless the Options Committee

[15] 17 CFR 200.30–3(a)(12).

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

[2] 17 CFR 240.19b–4.

[3] In Amendment No. 1, the Phlx restated its filing in its entirety to clarify, in part, (1) the factors used in determining which options would qualify as step-up options; (2) when quotes would be deemed unreliable in the rule text; and (3) the factors to be considered in determining whether quotes previously deemed unreliable would be included in the national best bid or offer (''NBBO''). Amendment No. 1 also provides for a memoranda listing all automatic step-up options to be circulated to Exchange members and member organizations. *See* letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (''Division''), Commission, dated November 20, 2000 (with attached restated 19b–4 filing) (''Amendment No. 1'').

[4] In Amendment No. 2, the Phlx restated its filing in its entirety to (1) clarify that there may be some circumstances where the specialist's best bid or offer (''BBO'') in inconsistent with the Exchange's BBO; (2) make conforming changes to its rule language to reflect that the specialist's quote may not be the Exchange's BBO; and (3) make technical corrections to its rule text. *See* letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated November 30, 2000 (with attached restated 19b–4 filing) (''Amendment No. 2'').

[5] The Commission is not approving the portion of the proposed rule change that would allow the Exchange to determine when unreliable quotes would be excluded from the calculation of the NBBO. Further, approval of the automatic step-up feature should not be interpreted as suggesting that the Commission is predisposed to approving the remainder of the proposal.

[6] The proposed rule states that there may be some circumstances in which the specialist's BBO is inferior to the Exchange's BBO. *See* Amendment No. 2, *supra* note 4.

[7] The designee would be a member of the Options Committee. Telephone conversation between Richard Rudolph, Counsel, Phlx, and Terri Evans, Special Counsel, Division, Commission, on November 24, 2000.

determines otherwise. AUTO–X automatically executes eligible orders using the Exchange disseminated quotation and then automatically routes execution reports to the originating member organization. AUTOM orders not eligible for AUTO–X are executed manually in accordance with Exchange rules. Manual execution may also occur when AUTO–X is not engaged. *An order may also be executed partially by AUTO–X and partially manually.*

The Options Committee may for any period restrict the use of AUTO–X on the Exchange in any option or series. Currently, orders up to 75 contracts, subject to the approval of the Options Committee, are eligible for AUTO–X. With respect to OTC Prime Index (''OTX'') options, orders of up to 100 contracts are eligible for AUTO–X.

The Options Committee may, in its discretion, increase the size of orders in one or more classes of multiply-traded equity options eligible for AUTO–X to the extent necessary to match the size of orders in the same options eligible for entry into the automated execution system of any other options exchange, provided that the effectiveness of any such increase shall be conditioned upon its having been filed with the Securities and Exchange Commission pursuant to Section 19(b)(3)(A) of the Securities Exchange Act of 1934.

(i) AUTO–X on the NBBO (NBBO Feature).—AUTO–X on the NBBO (the ''NBBO Feature'') is a feature of AUTOM that automatically executes at the National Best Bid or Offer (''NBBO''). NBBO Feature will execute AUTO–X eligible orders at the NBBO for certain options designated by the Options Committee as eligible for the NBBO Feature (''automatic step-up options''), provided that the NBBO does not differ from the specialist's best bid or offer by more than the ''step up parameter.''

(A) The ''step-up parameter'' for automatic step-up options shall be the minimum trading increment for options in that series established pursuant to Exchange Rule 1034, or any greater amount established by the Options Committee in respect of specified automatic step-up options or series of options.

(B) The Chairman of the Options Committee or his designee (or if the Chairman of the Options Committee or his designee is unavailable, two Floor Officials) may determine to disengage the NBBO Feature for orders in certain automatic step-up options after notice to AUTO users in situations in which the Exchange is experiencing communications or systems problems; fast markets; or delays in the dissemination of quotes because of queues on the Options Price Reporting Authority (''OPRA'') which would likely render such quotes stale, Where the NBBO Feature is disengaged, such orders shall be executed manually in accordance with Exchange rules.

(C) In respect of automatic step-up options (1) where the specialist's best bid or offer is inferior to the current best bid or offer in another market by more than the step-up parameter; or (2) where the NBBO for one of the series of automatic step-up options is crossed (i.e., 2⅛ bid, 2 asked) or locked (i.e., 2 bid 2 asked); or (3) in respect of equity options other than automatic step-up options where the specialist's best bid or offer is inferior to the current best bid or offer in another market by any amount, such orders shall be executed manually in accordance with Exchange rules. There may be circumstances in which the specialist's best bid or offer is inconsistent with the Exchange's best bid or offer. In such a circumstance, such an order shall be executed manually.

(D) Where the Chairman of the Options Committee or his designee (or if the Chairman of the Options Committee or his designee is unavailable, two Floor Officials), determines that quotes in options on the Exchange or other markets are deemed not to be reliable due to Exchange communications or systems problems; fast markets; delays in the dissemination of quotes because of queues on the Options Price Reporting Authority (''OPRA'') which would likely render such quotes stale; or if the Exchange is advised by another exchange that it is experiencing communication or system problems that would cause its disseminated quotes to be unreliable, customer market orders will receive an automatic execution at NBBO based on the best bid or offer in markets whose quotes are not deemed to be unreliable, AUTOM customers will be duly notified via electronic message from AUTOM that such quotes are excluded from the calculation of NBBO.

(E) Where the Chairman of the Options Committee or his designee (or if the Chairman of the Options Committee or his designee is unavailable, two Floor Officials), determines that quotes in options on the Exchange or other markets previously deemed not to be reliable pursuant to Section (D) of this paragraph are again reliable, such quotations will be included in the calculation of NBBO for such options. Factors to be considered in determining whether such quotes previously deemed not to be reliable are to be included in the calculation of NBBO include information via telephonic verification to the Exchange that such quotes are reliable; visual surveillance by Exchange staff or the specialist; and electronic messages from other markets. AUTOM customers will be duly notified via electronic message from AUTOM that such quotes are begin included in the calculation of NBBO.

(d) No change.

(e) Extraordinary Circumstances—In the event extraordinary circumstances with respect to a particular class of options exist, two Floor Officials may determine to disengage AUTO-X with respect to that option, in accordance with Exchange procedures. In the event extraordinary conditions exist floor-wide, two Exchange Floor Officials, the Chairperson of the options Committee or his designee may determine to disengage the AUTO-X feature floor-wide. *The NBBO Feature is always disengaged when AUTO-X is disengaged.*

(*i*) The Exchange's Emergency Committee, pursuant to Rule 98, may take other action respecting AUTOM in extraordinary circumstances.

(f)-(i) No change.

Commentary: No change.

II. Self-Regulatory Organization's Statements 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 and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the place 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 provide automatic executions for public customer orders at the NBBO. Currently, customer orders can be delivered electronically to the Exchange via AUTOM.[8] An option order that is automatically executed via AUTOM's automatic execution feature, AUTO–X, is priced at the prevailing market quote on the Phlx at the time the order is received by AUTOM. If another marketplace is displaying a better quote away from the Phlx at the time of the delivery of such an order, then that order would be handled manually by the specialist so that it would not be automatically executed at an inferior price. Under the current system, the specialist handling the order determines whether the order should be executed at the away price.[9] The Exchange believes

[8] AUTOM is the Exchange's electronic order delivery 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 feature, AUTO–X. 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.

[9] Under normal market conditions, the specialist will execute the manually handled order at the best available price, *i.e.*, the NBBO, unless the specialist

that adding a feature that provides automatic executions at the NBBO should minimize or eliminate any delays that are inherent in orders that are handled manually by the specialist, thus reducing the risk of an adverse movement in the market while such customer orders are being filled.

To increase the number of orders handled automatically, the Exchange is also proposing to partially execute AUTO–X eligible orders that have a size greater than the guaranteed size for automatic execution. Thus, if an order exceeds the size of the AUTO–X guarantee for a given option, the portion of such an order that is within the AUTO–X guaranteed size would be executed automatically, and the remainder would be executed manually.

The NBBO feature would execute AUTO–X eligible orders at the NBBO provided that the NBBO does not differ from the specialist's BBO by more than the step-up parameter. The proposed rule also provides that the step-up parameter for automatic step-up options would be equal to one tick, *i.e.*, the minimum trading increment for options in that series established pursuant to Exchange Rule 1034, or any greater amount established by the Options Committee. In the event that the NBBO is better than the specialist's BBO by more than one tick, the existing procedure will continue to apply whereby the order would be handled manually by the specialist in order to avoid execution at a price inferior to the NBBO.

The proposed rule states that there may be some circumstances in which the specialist's BBO is inconsistent with the Exchange's BBO. This would occur when the Exchange's BBO is composed of a quote of a Registered Option Trader (''ROT'') in a trading crowd or a customer limit order that improves the specialist's BBO. Due to the limitations of the Exchange's existing systems, the transactions would be executed manually to ensure that the specialist could execute an order at the Exchange's BBO and match it to the ROT quote or a customer limit order that posted it.

Under this proposal, the Exchange's Options Committee, upon the request of a specialist, would designate which options traded on the Exchange qualify as automatic step-up options. This is to ensure the orderly introduction of this change to the Exchange's AUTO–X feature. In determining which options qualify as step-up options, the Options Committee may consider such factors as the open interest in the requested option, the average daily volume of the option, customer requests, and any such other factors as the Options Committee deems appropriate. The Options Committee would also have the ability to delete options from the list of automatic step-up options upon the request of the specialist using the same criteria. The Exchange would publish a list of all automatic step-up options in memoranda circulated to the Exchange members and member organizations and on its web site, and would inform all AUTOM users of any changes in the list at least one business day prior to the time such changes become effective.[10]

The proposed rule change authorizes the Chairman of the Options Committee or his designee (or if the Chairman of the Options Committee or his designee is unavailable, two Floor Officials) to determine that quotes in specified options or series of options or in respect of specified markets are not reliable. This authority would be expected to be exercised only in circumstances such as communications or systems problems; fast markets; delays in the dissemination of quotes because of queues on the OPRA (in which case the Exchange would know that there is a delay in the dissemination of quotes from the other exchanges, which would likely render such quotes stale); or if the Exchange is advised by another exchange that it is experiencing communication or system problems that would cause its disseminated quotes to be unreliable.

In creating the NBBO Feature, the Exchange has sought to ensure that customer orders would not be disqualified from receiving an automatic execution due to another market's dissemination of unreliable quotes. When quotes in specified options or series of options or in respect of specified markets are deemed not to be reliable, such quotes would not be included in the calculation of the NBBO, and market orders would receive an automatic execution at the NBBO based on the best bid or offer in markets whose quotes are not deemed to be unreliable.

Where the Chairman of the Options Committee or his designee (or if the Chairman of the Options Committee or his designee is unavailable, two Floor Officials), determines that quotes in options on the Exchange or other markets previously deemed not to be reliable are again reliable, such quotations will be included in the calculation of the NBBO for such options. Factors to be considered in determining whether such quotes previously deemed not to be reliable are to be included in the calculation of the NBBO include information via telephonic verification to the Exchange that such quotes are reliable; visual surveillance by Exchange staff or the specialist; and electronic messages from other markets. AUTOM customers will be duly notified via electronic message from AUTOM that such quotes are again included in the calculation of NBBO.

The rule also provides that the NBBO Feature is always disengaged when AUTO–X is disengaged.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6 of the Act[11] in general, and with Section 6(b)(5) of the Act[12] specifically, in that it is designed to perfect the mechanisms of a free and open market and the national market system, protect investors and the public interest and promote just and equitable principles of trade, by enhancing the Exchange's ability to provide automatic execution of public customers' orders at the best available prices.

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

The Phlx 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

The Exchange has neither solicited nor received written comments.

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

determines that the superior price at the away market is not reliable due to fast market conditions; communications or other Exchange systems problems; delays in the dissemination of quotes because of queues on OPRA (in which case the specialist would know that there is a delay in the dissemination of quotes from the other exchanges, which likely would render such quotes stale); or if the specialist is advised by another exchange that it is experiencing communication or system problems that would cause its disseminated quotes to be unreliable.

[10] Currently, the Exchange publishes a list of all AUTO–X guarantees. It is anticipated that the publication of a list of options that qualify for the NBBO Feature will be published and disseminated in a similar fashion.

[11] 15 U.S.C. 78f.

[12] 15 U.S.C. 78f(b)(5).

(ii) as to which the Phlx consents, the Commission will:

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

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

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Phlx. All submissions should refer to File No. SR–Phlx–00–93 and should be submitted by January 4, 2001.

V. Commission's Findings and Order Granting Partial Accelerated Approval of the Proposed Rule Change

The Commission finds that the proposed rule change relating to the automatic step-up feature [13] is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that the proposal is consistent with the section 6(b)(5) [14] requirements that the rules of an exchange be designed to promote just and equitable principles of trade and to protect investors and the public interest.[15]

By providing an automatic step-up feature, the rule should help to insure that investors receipt prompt, automatic execution of AUTO–X eligible orders at the best available prices (subject to the step-up parameter), even if those prices are being quoted on a market other than the Phlx. As a result, this proposal should minimize the delay inherent in manually handling orders in this circumstance, and thereby reduce the risk to investors that, as a result of an adverse move in the market while their orders are being manually handled, they may receive an inferior execution.

The Commission finds good cause for approving this portion of the proposed rule change, prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. This will permit customers to receive the benefits of automatic price improvement under the proposed rule change more quickly. Further, the Exchange's proposed rule change regarding the automatic step-up feature is substantially similar to the Chicago Board Options Exchange Rule 6.8, Interpretations and Policies .02, which was approved in 1998.[16] The Commission is not aware of any problems with respect to CBOE's automatic step-up feature.

VI. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[17] that the portion of the proposed rule change (SR–Phlx–00–93), as amended, allowing AUTO–X eligible orders to be automatically executed at the NBBO, provided that the NBBO is not better than the specialist's BBO by a predetermined step-up parameter, is hereby approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[18]

Margaret McFarland,

Deputy Secretary.

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[13] The Commission is not approving Phlx Rule 1080(c)(i)(D), (E) at this time.

[14] 15 U.S.C. 78f(b)(5).

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

[16] *See* Securities Exchange Act Release No. 40096 (June 16, 1998), 63 FR 34209 (June 23, 1998).

[17] 15 U.S.C. 78s(b)(2).

[18] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34–43692; File No. SR–PHLX–00–20)

Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to Trading Certain Over-the-Counter Securities, Nasdaq National Market Securities

December 8, 2000.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on November 16, 2000, the Philadelphia Stock Exchange, Inc., (''Phlx'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Phlx proposes to trade certain over-the-counter (''OTC'') securities, Nasdaq National Market (''Nasdaq/NM'') securities, on the Exchange, pursuant to unlisted trading privileges (''UTP'') under Section 12(f) of the Act.[3] As discussed below, minor changes to Phlx rules are necessary to accommodate such trading, generally to revise the term ''Nasdaq/NM securities.'' The text of the proposed rule change is available at the Office of the Phlx, the Secretary, and at the Commission.

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 and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

In 1985, the Commission permitted the extension of UTP [4] by national securities exchanges in certain OTC securities, provided that certain terms and conditions were satisfied. In particular, the Commission's willingness to grant UTP was conditioned, in part, on the approval of

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

[2] 17 CFR 240.19b–4.

[3] 15 U.S.C. 781(f).

[4] Section 12(f) of the Act describes the circumstances under which an exchange may trade a security that is not listed on the exchange, *i.e.*, by extending UTP to the security. *See* 15 U.S.C. 781(f).