

Commission's view, as it conforms with the original purpose of this provision.

#### IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>11</sup> that proposed rule change (SR-PCX-2002-13) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

Margaret H. McFarland,

Deputy Secretary.

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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45931; File No. SR-Phlx-2001-35]

#### Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval To Proposed Rule Change, As Amended By Amendment Nos. 1, 2, 3, 4, and 5 Thereto, Relating To Providing Automatic Executions For Public Customer Orders When Another Market Is Disseminating Quotes Deemed Not To Be Reliable

May 15, 2002.

#### I. Introduction

On March 12, 2001, 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<sup>3</sup> relating to providing automatic executions for public customer orders at the national best bid or offer ("NBBO"). On September 19, 2001, January 11, 2002, March 1, 2002, March 8, 2002,

and April 3, 2002, Phlx submitted Amendment Nos. 1,<sup>4</sup> 2,<sup>5</sup> 3,<sup>6</sup> 4,<sup>7</sup> and 5,<sup>8</sup> respectively. The proposed rule change, as amended by Amendment Nos. 1, 2, 3, 4, and 5, was published for comment in the **Federal Register** on April 15, 2002.<sup>9</sup> The Commission received no comments on the amended proposal. This order approves the proposed rule change, as amended by Amendment Nos. 1, 2, 3, 4, and 5.

#### II. Description of the Proposal

The Phlx proposes to permit the Exchange to exclude from the calculation of the NBBO certain quotes from other markets that are deemed not to be reliable.<sup>10</sup> Upon the request of a specialist, the Chairman of the Options Committee or his designee<sup>11</sup> (or if the Chairman of the Options Committee or his designee is unavailable, two Floor Officials) would be authorized to determine that quotes in specified options or series of options or in respect of specified markets are not reliable under any of the following circumstances: notification from another market that its quotes are not firm or are

unreliable; administrative message from OPRA indicating that another market's quotes are unreliable; receipt of quotes from another market designated as "not firm" using the appropriate indicator; and/or telephonic or electronic inquiry to, and verification from, another market that its quotes are not firm.

The Exchange would be permitted to determine to exclude quotes from its calculation of the NBBO on a series-by-series basis or issue-by-issue basis, or would be permitted to determine to exclude all options quotes from an exchange, where appropriate.<sup>12</sup>

Phlx also proposes to amend the rule text to require the Exchange to maintain a record of each instance in which another exchange's quotes are excluded from the Exchange's calculation of the NBBO, and to notify such other exchange that its quotes have been so excluded.<sup>13</sup>

In addition, Phlx proposes to amend the rule text to provide that documentation of each instance in which another exchange's quotes are excluded from the Exchange's calculation of NBBO shall include: identification of the option(s) affected by such action; the date and time such action was taken and concluded; identification of the other exchange(s) whose quotes were excluded from the Exchange's calculation of NBBO; identification of the Chairman of the Options Committee, his designee, or two Floor Officials (as applicable) who approved such action; the reasons for which such action was taken; and identification of the specialist and the specialist unit. The Exchange would maintain these documents pursuant to the record retention requirements of the Act and the rules and regulations thereunder.<sup>14</sup> 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), would be authorized to determine that quotes in options on the Exchange or other markets previously deemed not to be reliable are again reliable, and such quotations would again be included in the calculation of NBBO for such options.

Such determination would be permitted to be made by way of notification from another market that its quotes are firm; administrative message from OPRA indicating that another market's quotes are no longer unreliable; and/or telephonic or electronic inquiry to, and verification from, another market

<sup>4</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated September 18, 2001 ("Amendment No. 1").

<sup>5</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated January 11, 2002 ("Amendment No. 2"). Amendment No. 2 supersedes and replaces Amendment No. 1 in its entirety.

<sup>6</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated February 28, 2002 ("Amendment No. 3").

<sup>7</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated March 7, 2002 ("Amendment No. 4").

<sup>8</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated April 2, 2002 ("Amendment No. 5").

<sup>9</sup> See Securities Exchange Act Release No. 45713 (April 9, 2002), 67 FR 18292 (April 15, 2002).

<sup>10</sup> Under current Exchange rules, certain AUTO-X eligible orders may be automatically executed at the NBBO disseminated by another options exchange, provided that the NBBO is not better than the specialist's best bid/offer by a predetermined "step-up parameter." The enhancement is known as the "NBBO Step-Up Feature." The NBBO Step-Up Feature would execute AUTO-X eligible orders at the NBBO for certain options designated by the Options Committee as eligible for the NBBO Step-Up Feature, called "automatic step-up options." See Exchange Rule 1080(c)(i). This proposal would apply to all situations in which the NBBO Step-Up Feature was not engaged. The Commission, in a separate order, is approving a related proposed rule change regarding the exclusion of certain quotes from the Phlx's calculation of the NBBO when the NBBO Step-Up Feature is engaged. See Securities Exchange Act Release No. 45932 (May 15, 2002) (File No. SR-Phlx-00-93).

<sup>11</sup> Such designee must be a member of the Options Committee.

<sup>12</sup> See Amendment No. 3, *supra* note 6.

<sup>13</sup> See Amendment No. 4, *supra* note 7.

<sup>14</sup> See Amendment No. 5, *supra* note 8.

<sup>11</sup> 15 U.S.C. 78s(b)(2).

<sup>12</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> The Exchange filed this proposed rule change pursuant to the requirements of Section IV.B.h.(i)(bb) of the Commission's September 11, 2000 Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Act, which required the Phlx (as well as the other floor-based options exchanges) to adopt new, or amend existing, exchange rules concerning automatic quotation and execution systems which specify the circumstances, if any, by which automatic execution systems would be disengaged or operated in any manner other than the normal manner set forth in the exchange's rules; and, requires the documentation of the reasons for each decision to disengage an automatic execution system or operate it in any manner other than the normal manner. See Securities Exchange Act Release No. 43268 (September 11, 2000), Administrative Proceeding File No. 3-10282.

that its quotes are firm. AUTOM customers would be duly notified via electronic message from AUTOM that such quotes are again included in the calculation of NBBO.

### III. Discussion

After careful review, the Commission finds that the proposed rule change, as amended by Amendment Nos. 2, 3, 4, and 5, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>15</sup> and, in particular, the requirements of Section 6 of the Act<sup>16</sup> and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change is consistent with Section 6(b)(5) of the Act<sup>17</sup> because it provides objective criteria and well-defined procedures for excluding another market's quote from the Phlx's determination of the NBBO, which should increase the likelihood that Phlx's NBBO will more accurately reflect the actual state of the market at a given time. Specifically, the Commission notes that the determination of 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 exclude unreliable quotes is limited to circumstances in which the away market has either directly communicated or confirmed that its quotes are unreliable. In this way, the discretion afforded to Phlx officials to determine that another market's options quotes are unreliable is appropriately limited. Moreover, the record keeping requirements and other proposed procedures are not unreasonable.

### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (SR-Phlx-2001-35), as amended by Amendment Nos. 1, 2, 3, 4, and 5, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

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

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<sup>15</sup> In approving this proposed rule change, the Commission notes that it has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>16</sup> 15 U.S.C. 78f.

<sup>17</sup> 15 U.S.C. 78f(b)(5).

<sup>18</sup> *Id.*

<sup>19</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45932; File No. SR-Phlx-00-93]

### Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval to that Portion of Proposed Rule Change Not Previously Granted Accelerated Approval, as Amended by Amendment Nos. 4, 5, 6, and 7 thereto, Relating to Providing Automatic Executions for Public Customer Orders at the NBBO

May 15, 2002.

#### I. Introduction

On September 18, 2001, January 15, 2002, March 1, 2002, March 8, 2002, and April 3, 2002, 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> Amendment Nos. 3,<sup>3</sup> 4,<sup>4</sup> 5,<sup>5</sup> 6,<sup>6</sup> and 7,<sup>7</sup> respectively, to a proposed rule change<sup>8</sup> relating to providing automatic executions for public customer orders at the national best bid or offer ("NBBO"). The Commission published for comment the

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

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

<sup>3</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated September 18, 2001 ("Amendment No. 3").

<sup>4</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated January 15, 2002 ("Amendment No. 4). Amendment No. 4 superseded and replaced Amendment No. 3 in its entirety.

<sup>5</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated February 28, 2002 ("Amendment No. 5").

<sup>6</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated March 7, 2002 ("Amendment No. 6").

<sup>7</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated April 2, 2002 ("Amendment No. 7").

<sup>8</sup> The Exchange filed this proposed rule change pursuant to the requirements of Section IV.B.h.(i)(bb) of the Commission's September 11, 2000 Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Act, which required the Phlx (as well as the other floor-based options exchanges) to adopt new, or amend existing, exchange rules concerning automatic quotation and execution systems which specify the circumstances, if any, by which automatic execution systems would be disengaged or operated in any manner other than the normal manner set forth in the exchange's rules; and, requires the documentation of the reasons for each decision to disengage an automatic execution system or operate it in any manner other than the normal manner. See Securities Exchange Act Release No. 43268 (September 11, 2000), Administrative Proceeding File No. 3-10282.

proposed rule change, along with Amendment Nos. 1 and 2, in the **Federal Register** on December 14, 2000,<sup>9</sup> and granted partial accelerated approval to those portions of the proposed rule change and Amendment Nos. 1 and 2 relating to the automatic execution of eligible orders at the NBBO, provided that the NBBO is not better than the specialist's best bid or offer ("BBO") by a predetermined "step-up parameter." Amendment Nos. 4, 5, 6, and 7, were published for comment in the **Federal Register** on April 15, 2002.<sup>10</sup> The Commission received no comments on Amendment Nos. 4, 5, 6, and 7. This order approves that portion of the proposed rule change not previously granted accelerated approval, as amended by Amendment Nos. 4, 5, 6, and 7.

#### II. Description of the Proposal

In the Original Filing, the Phlx proposed 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."<sup>11</sup> This enhancement is known as the "NBBO Step-Up Feature." The Commission granted accelerated approval to this part of the Original Filing. In addition, in the Original Filing, the Phlx proposed to permit 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, if the NBBO Step-Up Feature was activated and quotes in certain automatic step-up options on the Exchange or other markets were 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

<sup>9</sup> See Securities Exchange Act Release No. 43684 (December 6, 2000), 65 FR 78237 (December 14, 2000) ("Original Filing"). The Commission received one comment letter on the Original Filing. See letter from Edward J. Joyce, President and Chief Operating Officer, Chicago Board Options Exchange, Inc. ("CBOE"), to Mr. Jonathan G. Katz, Secretary, Commission, dated February 8, 2001. In its comment letter, CBOE recommended that the Phlx amend its rule to require the Exchange to make and keep a written record of decisions to remove an exchange from the Phlx's calculation of the National Best Bid or Offer ("NBBO") and to notify an exchange when its markets have been removed from the Phlx's NBBO calculation. In response to CBOE's comments, Phlx proposed Amendment Nos. 5 and 6.

<sup>10</sup> See Securities Exchange Act Release No. 45757 (April 9, 2002), 67 FR 19605 (April 15, 2002).

<sup>11</sup> For a full discussion of Phlx's proposal, see the Original Filing.