

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

The PCX does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

No written comments were either solicited or received.

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

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

- (A) By order approve such proposed rule change, or,
- (B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the proposed rule change and Amendment No. 1 thereto, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the proposed rule change and amendments will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR-PCX-2001-17 and should be submitted by July 18, 2002.

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

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

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SECURITIES AND EXCHANGE COMMISSION

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

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

June 20, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 15, 2002, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Phlx. On March 6, 2002, the Exchange filed Amendment No. 1 to the proposed rule change.³ On March 14, 2002, the Exchange filed Amendment No. 2 to the proposed rule change.⁴ On March 26, 2002, the Exchange filed Amendment No. 3 to the proposed rule change.⁵ On

²⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

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

⁵ See letter from Richard S. Rudolph, Director and Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated March 25, 2002 ("Amendment No. 3"). Amendment No. 3: (1) clarified that certain Phlx rules pertaining to the precedence of orders would not apply to allocation

April 2, 2002, the Exchange filed Amendment No. 4 to the proposed rule change.⁶ On May 16, 2002, the Exchange filed Amendment No. 5 to the proposed rule change.⁷ On June 12, 2002, the Exchange filed Amendment No. 6 to the proposed rule change. On June 19, 2002, the Exchange filed Amendment No. 7 to the proposed rule change.⁸ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange"), pursuant to Rule 19b-4 of Act, proposes to amend Phlx Rule 1080, *Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution*

of orders under the proposed rule change; and (2) corrected a typographical error in the proposed rule text.

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

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

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

System (AUTO-X),⁹ to enable a ROT¹⁰ or specialist to improve the Phlx bid or offer by means of enhanced access to place limit orders on the electronic limit order book¹¹ through electronic interface with AUTOM ("Price Improving ROT/Specialist").

Under the proposal, on-floor orders for the proprietary accounts of specialists and ROTs, up to 1,000 contracts, may be entered for delivery through AUTOM, through the use of Exchange approved proprietary systems to interface with AUTOM. The following types of orders for the proprietary account(s) of specialists and ROTs would be eligible for AUTOM: day and simple cancel. By January 2004, the Phlx's systems will be capable of automatically executing eligible incoming orders against Price-Improving ROT/Specialist orders entered via electronic interface with AUTOM. The system change necessary to facilitate the automatic execution of these orders will be fully deployed over a 15-month period.¹² Following full implementation of this system change, the proposed rule will apply to all series and classes of options traded on the exchange.¹³

In conjunction with the proposed rule change to Phlx Rule 1080, the Exchange also proposes to amend Phlx Rule 1014, *Obligations and Restrictions Applicable to Specialists and Registered Options Traders*, to provide for special parity and priority rules and procedures concerning orders for the account(s) of Phlx ROTs and specialists entered through electronic interface with AUTOM, where those orders are

⁹ 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.

¹⁰ A ROT is a regular member or a foreign currency options participant of the Exchange located on the trading floor who has received permission from the Exchange to trade in options for his own account. See Phlx Rule 1014(b).

¹¹ The electronic "limit order book" is the Exchange's automated specialist limit order book, which automatically routes all unexecuted AUTOM orders to the book and displays orders real-time in order of price-time priority. Orders not delivered through AUTOM may also be entered onto the limit order book. See Phlx Rule 1080, Commentary .02.

¹² See Amendments Nos. 3 and 4.

¹³ Telephone conversation between Richard Rudolph, Director and Counsel, Phlx, and Steven Johnston, Special Counsel, Division, Commission, March 21, 2002 ("March 21, 2002 Telephone Conversation").

submitted to either improve the Phlx bid or offer or to match such improved bid or offer.¹⁴

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

Rule 1080. Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)

(a) General—AUTOM is the Exchange's electronic order delivery and reporting system, which provides for the automatic entry and routing of Exchange-listed equity options and index options 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, in accordance with the provisions of this Rule. 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 member organizations into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor.

This Rule shall govern the orders, execution reports and administrative messages ("order messages") transmitted between the offices of member organizations and the trading floors of the Exchange through AUTOM.

All references to "ROTs" in this Rule 1080 are to Phlx Registered Options Traders as defined in Exchange Rule 1014(b).

(b) Eligible Orders [-]

(i) The following types of orders are eligible for entry into AUTOM: [(i) Generally, only agency orders may be entered.]

(A) Agency orders up to the maximum number of contracts permitted by the Exchange. Agency orders up to 1000 contracts, depending on the option, are eligible for AUTOM order delivery, subject to the approval of the Options Committee. The following types of agency orders are eligible for AUTOM: day, GTC, market, limit, stop, stop limit, all or none, or better, simple cancel, simple cancel to reduce size (cancel leaves), cancel to change price, cancel with replacement order, market close, market on opening, limit on opening, limit close, and possible duplicate orders.

(B) *On-floor orders for the proprietary account(s) of ROTs and specialists via electronic interface with AUTOM, up to the maximum number of contracts permitted by the Exchange, subject to the restrictions on order entry set forth*

in Commentary .04 of this Rule. Orders up to 1,000 contracts, depending on the option, are eligible for AUTOM order delivery. The following types of orders for the proprietary account(s) of ROTs and specialists are eligible for entry via electronic interface with AUTOM: day limit and simple cancel.

* * * * *

(ii) The Exchange's Options

Committee may determine to accept additional types of orders as well as to discontinue accepting certain types of orders.

(iii) Orders may not be unbundled for the purposes of eligibility for AUTOM and AUTO-X, nor may a firm solicit a customer to unbundle an order for this purpose.

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Commentary

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.04 *Price-improving ROT and specialist price-improving orders via electronic interface with AUTOM. On-floor orders for the proprietary accounts of ROTs or specialists that result in an improvement in the then prevailing market disseminated by the Exchange (i.e., raise the bid or lower the offer) may be entered for delivery through AUTOM, through the use of Exchange approved proprietary systems to interface with AUTOM to be placed on the specialist's limit order book. In order to be displayed, on-floor price improving orders for the proprietary accounts of ROTs or specialists delivered via electronic interface with AUTOM shall be for a minimum size of at least the lesser of the AUTO-X guarantee for the option that is the subject of such an order, or 20 contracts. Inbound orders eligible for execution against price-improving ROT or specialist price-improving orders entered into AUTOM via electronic interface and orders that match such price-improving orders via electronic interface with AUTOM, shall be executed by the specialist and shall be allocated by the person required to do so pursuant to Exchange rules. The Exchange will make electronic interface with AUTOM available to member firms, and will notify all members on the Options Floor when it has completed the development of appropriate interfaces for such proprietary systems on the Options Floor, and when the use of such electronic interfaces may commence. Thereafter, ROTs and specialists must connect with these interfaces with their own proprietary devices.*

The Exchange shall modify its AUTO-X system not later than January 2004, so that it shall automatically execute

eligible incoming orders against Phlx Price Improving ROT and specialist price improving orders and orders matching such price-improving orders entered via electronic interface with AUTOM resting on the limit order book. The Exchange will deploy the modified system over a 15-month period.

An ROT or specialist that posts a bid or offer through electronic interface with AUTOM and elects to cancel such a bid or offer must cancel such bid or offer through the electronic interface.

Rule 1014. Obligations and Restrictions Applicable to Specialists and Registered Options Traders

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(g) Equity Option and Index Option Priority and Parity

(i) (A) Exchange Rules 119 and 120 direct members in the establishment of priority of orders on the floor. In addition, equity option and index option orders of controlled accounts are required to yield priority to customer orders when competing at the same price, as described below.

For the purpose of paragraph (g) of this Rule, an account type is either a controlled account or a customer account. A controlled account includes any account controlled by or under common control with a broker-dealer. Specialist accounts of PHLX Option Specialists, however, are not subject to yielding requirements placed upon controlled accounts by this Rule. Customer accounts are all other accounts.

Orders of controlled accounts must yield priority to customer orders, except that PHLX ROTs closing in-person are not required to yield priority to orders of customer accounts.

Orders of controlled accounts are not required to yield priority to other controlled account orders, except that when both an order of a PHLX ROT closing in-person and some other order of a controlled account are established in the crowd at the same price, and then a customer order is established at that price, the order of the controlled account must yield to the customer order while the order of the PHLX ROT closing in-person does not have to so yield.

(B) ROT Access—Pursuant to Rule 1080(b)(i)(B) and Commentary .04 thereto, a Phlx ROT or specialist may enter an order that results in the improvement of the prevailing bid and/or offer disseminated by the Exchange through an electronic interface with AUTOM (“price improving order”) and must announce, loudly and audibly in the crowd, that he has improved the displayed market. Such ROT or

specialist is referred to, in this rule, as a Price Improving ROT/Specialist.

Matching—The other crowd participants, including ROT's and/or the specialist, may match such price improving order via electronic interface with AUTOM and by loudly and audibly announcing their intention to do so, and indicating their size, at any time. If Auto-Quote or Specialized Quote Feed matches the price associated with a price improving order, the specialist and crowd participants shall be deemed to be matching the price improving order under this paragraph.

Further Improvement—the other crowd participants may improve the price improving order by entering an order via an electronic interface with AUTOM.

Trade Allocation—Among the Price Improving ROT/Specialist and matching crowd participants, trades shall be allocated as follows:

(1) Special Allocation: a Price Improving ROT/Specialist shall be entitled to receive the largest number of contracts among all crowd participants that have matched such price improving order, subject to size, as follows:

(a) When a price improving order is matched by one single crowd participant via electronic interface with AUTOM, the Price Improving ROT/Specialist shall be entitled to receive 60% of an incoming order, and the matching crowd participant shall be entitled to receive 40% of an incoming order.

(b) When a price improving order is matched via electronic interface with AUTOM by two or more crowd participants, the Price-Improving ROT/Specialist shall be entitled to receive 40% of an incoming order. If one of the matching crowd participants is the specialist, the specialist shall be entitled to receive of 30% of an incoming order, and any other ROT(s) that matched the Price Improving ROT's order shall be entitled to receive 30% of an incoming order, in the aggregate.

(c) When a Price Improving ROT/Specialist's price improving order is matched via electronic interface with AUTOM by two or more other ROTs in the crowd, the Price Improving ROT/Specialist shall be entitled to receive 40% of an incoming order, and any other ROT(s) that matched the Price Improving ROT's order shall be entitled to receive 60% of an incoming order, in the aggregate.

(d) Any partial contracts shall be rounded up in favor of the Price Improving ROT/Specialist.

(2) The Special Allocation set forth in (a)-(c) above shall remain in effect until:

(a) the price improving order has been executed up to the minimum number of

contracts required under Rule 1080, Commentary .04;

(b) the Price Improving ROT/Specialist cancels the price improving order;

(c) the original price improving order is superseded by a new price improving order, unless that new price improving order is cancelled before at least one contract executes at that price (in which case the original price improving order remains subject to special allocation until one of these three conditions occur).

(3) Once the Special Allocation is no longer in effect, all contracts remaining to be executed at the originally improved price (including those remaining of the price improving order) shall be considered on parity and allocated in accordance with Exchange Rule 1014(g)(ii)-(iv). Thus, if the specialist is among the crowd participants remaining on parity, the specialist shall be entitled to receive an Enhanced Specialist Participation in eligible options. The Special Allocation may apply to part of an incoming order (up to the minimum number permitted by Rule 1080, Commentary .04 i.e., 20 contracts), with the rest of an incoming order subject to allocation under Rules 1014(g)(ii)-(iv).

(4) In no event shall a Price Improving ROT/Specialist or crowd participant that matches a price improving order be required to participate in a trade above such Price Improving ROT or crowd participant's stated size.

(5) Notwithstanding the first sentence of Rule 1014(g)(i), neither Rule 119(a)-(d) and (f), nor Rule 120 (insofar as it incorporates those provisions by reference) shall apply to the allocation of trades executed against price-improving orders and orders matching such price improving orders. The Special Allocation set forth above shall apply only to price improving orders and orders matching such price improving orders. No other rule relating to the allocation of contracts shall apply to price improving orders until the Special Allocation ends, which is determined above. The person responsible for allocation of orders shall use best efforts to ensure that price improving orders and crowd participants that match such price improving orders are allocated contracts in accordance with this Rule.

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

In its filing with the Commission, the self-regulatory organization included

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

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

1. Purpose and Overview

The purpose of the proposed rule change is to permit Phlx ROTs to place orders directly on the specialist's limit order book, and to encourage Phlx ROTs and specialists to quote competitively in options in which they are registered,¹⁵ by allowing such ROTs to interface electronically with, and to submit proprietary orders through, AUTOM.

Currently, Phlx Rule 1080 provides that, generally, only agency orders may be entered into AUTOM.¹⁶ The proposal would provide that on-floor orders for the proprietary account(s) of ROTs, up to the maximum number of contracts permitted by the Exchange, are eligible for delivery via AUTOM. This is intended to provide ROTs with additional means to enter orders while on the floor of the Exchange other than through open outcry while physically present in the trading crowd, or through a floor broker.

Currently, only Exchange options specialists may access the limit order book electronically. The Exchange believes that allowing Phlx ROTs to place orders directly on the limit order book via electronic interface with AUTOM should level the playing field by eliminating any actual or perceived technological advantage the specialist may have respecting the ability to place orders directly on the limit order book, and thus would provide incentives for all crowd participants to quote competitively.

¹⁵ The Exchange notes that the Commission has directed that the options markets adopt new, or amend existing, rules concerning its automated quotation and execution systems which substantially enhance incentives to quote competitively and reduce disincentives for market participants to act competitively. See Securities Exchange Act Release No. 43268 (September 11, 2000), Administrative Proceeding File No. 3-10282.

¹⁶ The Exchange has defined an agency order as any order entered on behalf of a public customer, and does not include any order entered for the account of a broker-dealer, or any account in which a broker-dealer or an associated person of a broker-dealer has any direct or indirect interest. See, e.g., Phlx Rule 229.02. See also, Securities Exchange Act Release No. 40970 (January 25, 1999), 64 FR 4922 (February 1, 1999) (File No. SR-Phlx-98-44).

The proposal would also allow specialists to improve the prevailing market by placing price-improving orders via a similar electronic interface with AUTOM as that used by ROTs. The use of a specific electronic interface is intended to distinguish the specialists' price improving orders under the instant proposed rule from their general two-sided quoting, including by Auto-Quote or specialized quote feed.¹⁷ The Exchange believes that this provision substantially enhances the incentives for all crowd participants engaged as options market-makers, including specialists, to quote competitively.

Under existing Phlx rules, Phlx ROTs are able to improve the Phlx market with respect to a given option series by verbally announcing their trading interest in a loud and audible fashion. A Phlx ROT (or a floor broker on the ROT's behalf) may also ask the specialist to place an order for an ROT's account on the limit order book maintained by the specialist. In either case, the Phlx ROT may establish priority with respect to an incoming order if the ROT's quote or order is first in time.¹⁸

Inbound orders eligible for execution against ROT or specialist orders entered into AUTOM via electronic interface would be executed by the specialist and allocated initially by the individual responsible for allocating trades under existing Exchange rules. Currently, under the Exchange's Option Floor Procedure Advice ("OFPA") F-2, the largest participant in a trade is responsible for allocating contracts to crowd participants. In a separate rule proposal, the Exchange has proposed amendments to OFPA F-2 and Rule 1014(g)(iv) that the Phlx represents would further delineate this responsibility.¹⁹ The person responsible for allocating orders would be required

¹⁷ A specialist may establish a specialized connection with AUTOM, known as a specialized quote feed, which enables the specialist to provide quotations based on a proprietary pricing model, by-passing the Exchange's Auto-Quote System. See Phlx Rule 1080, Commentary .01(c).

¹⁸ See Securities Exchange Act Release No. 35033 (November 30, 1994), 59 FR 63152 (December 7, 1994) (File No. SR-Phlx-94-32).

¹⁹ Under the separate rule proposal, if a trade involved a floor broker, the floor broker would be responsible for allocating contracts among crowd participants but could delegate the responsibility to the specialist or an assistant to the specialist under the specialist's supervision ("Assistant"), provided that the specialist (or Assistant) would be responsible for allocating trades. If neither the specialist nor floor broker is involved, but there is more than one buyer or seller, the largest participant would be responsible for allocating trades. If neither the specialist nor floor broker is involved, and there is only one buyer and seller, the seller would be responsible for allocating trades. See File No. SR-Phlx-2001-28.

to use his or her best efforts to ensure that price-improving orders and orders that match price-improving orders are allocated contracts pursuant to the allocation formula in the proposed rule.²⁰ No later than January 2004, the Exchange will modify the AUTO-X system and will automatically execute incoming orders against ROT and specialist orders that improve the disseminated price, as well as orders that match such price-improving orders.²¹

It is inherent in the specialist system (the Phlx uses the specialist system) that the specialist controls the limit order book and also the operation of the Auto-Quote.²² Currently, Phlx ROTs cannot directly place orders on the electronic limit order book or cause the displayed market to reflect a price-improving bid, offer or booked order of the ROT, except by asking the specialist to do so. Thus, specialists could be perceived to have a major technological advantage over ROTs, which could be seen as a competitive advantage. Because of the ROT's dependence on the hearing and reactions of the specialist, the absence of electronic interface with AUTOM for ROTs might be regarded as an impediment to vigorous quoting by ROTs, especially in busy trading crowds, where ROTs might be concerned that specialists might not hear them or properly recognize the time sequence in which an ROT has vocalized a quote. Moreover, this might be seen as an opportunity for a specialist who did not wish an ROT to better the market through price competition to consciously ignore an ROT's quote or order, even if properly verbalized.

The Exchange believes that the enhanced ROT access to the AUTOM system contemplated in this proposal would substantially enhance the incentives of ROTs to quote competitively because they will be able to improve the Phlx market electronically, and thereby increase their prospects for trade participation, rather than merely passively staying on the disseminated market and waiting to receive their allocated participation in AUTO-X trades on the "Wheel."²³ By

²⁰ See Amendments Nos. 4 and 5.

²¹ See Amendment No. 1. March 21, 2002 Telephone Conversation.

²² Auto-Quote is the Exchange's electronic options pricing system, which enables specialists to automatically monitor and instantly update quotations, based on incremental changes in the price of the security underlying the option. See Phlx Rule 1080, Commentary .01(a).

²³ The "Wheel" is a feature of AUTOM that provides an automated mechanism for assigning specialists and ROTs signed on the Wheel for a

Continued

providing a means of quote improvement that is not dependent on the hearing, reaction time, and perhaps “good will” of the specialist, the Exchange believes that the proposed rule change substantially reduces ROTs’ actual or perceived disincentives to act competitively.

Nothing in this proposal would eliminate the current ability of Phlx ROTs to price improve through the customary method of open outcry (or to submit orders through Phlx floor brokers) or alter the priority of Phlx ROT bids/offers verbalized in the crowd or submitted through floor brokers. Rather, the proposal offers Phlx ROTs an additional method of price competition, by means of order entry via electronic interfaces.

2. Procedural Requirements

The proposal provides for some procedural requirements and limitations applicable to orders entered via the electronic interface. The proposal also includes a rule pertaining to priority, parity, and precedence of orders, applicable *solely* to Phlx specialist and ROT orders that are entered via electronic interface and either improve the displayed Phlx marker or match another order that has improved the displayed market.²⁴

In order to be displayed, on-floor orders for the proprietary accounts of ROTs delivered via AUTOM must be for a minimum size of at least the lesser of the AUTO-X guarantee for the option that is the subject of such an order, or 20 contracts.²⁵ This is to reduce the potential logjam of orders entered electronically on the specialist’s limit order book. The Exchange believes that this requirement would enable specialists to continue to meet their obligation to make fair and orderly markets.

Paragraph (g) of Phlx Rule 1014 provides that a Price-Improving ROT/Specialist that enters an order through an electronic interface with AUTOM that results in an improvement in the then prevailing market disseminated by the Exchange (i.e., raises the bid or lowers the offer) must announce, loudly and audibly in the crowd, that he has improved the displayed market. The purpose of this provision is to ensure

given listed option, on a rotating basis, as contra-side participants to trades executed via AUTO-X. See Phlx Rule 1080(g) and Options Floor Procedure Advice F-24.

²⁴ March 21, 2002 Telephone Conversation.

²⁵ See Amendment No. 1. This requirement applies only to Phlx ROT and specialist orders entered via electronic interface. This requirement is distinguished from the display requirement for all other orders set forth in Options Floor Procedure Advice A-1.

that other crowd participants (including the specialist) are alerted to the fact that the specialist or an ROT in the crowd has improved the market, thus enabling such other crowd participants to quote competitively by entering matching orders through electronic interface with AUTOM and verbalizing their intention to join in such an improved market, or to better the price (see Section 3.C., below).

The proposal would require that an ROT or specialist that posts a bid or offer through electronic interface with AUTOM, and subsequently elects to cancel such a bid or offer, must cancel such bid or offer through the electronic interface. The purpose of this provision is to eliminate the necessity for a specialist to cancel such an order manually upon verbal notification of the cancellation, thereby freeing the specialist to continue maintaining fair and orderly markets.

3. Price-Improving, “Matching” and Special Parity Rule

The other crowd participants (including the specialist) may match a price-improving order through an electronic interface with AUTOM, but must loudly and audibly announce their intention to do so, as well as their size. If Auto-Quote or Specialized Quote Feed matches a price-improving order, the specialist and crowd participants on that quote would be deemed to be matching the price-improving order. In such a situation, the “Special Allocation” in proposed Phlx Rule 1014(g)(i)(B)(1) would apply until terminated as set forth in Rule 1014(g)(i)(B)(2). Specifically, a “Special Allocation” entitles the Price Improving ROT/Specialist to receive the largest number of contracts among all crowd participants that have matched a price-improving order, subject to size.²⁶ Any partial contracts would be rounded up in favor of the Price Improving ROT/Specialist. In no event shall a Price Improving ROT/Specialist or crowd

²⁶ The proposal would entitle a Price Improving ROT/Specialist to participate in at least 60% of the contracts in the transaction if his or her order is matched by one single crowd participant. If the Price Improving ROT/Specialist’s order is matched by two or more crowd participants (including the specialist), the Price Improving ROT/Specialist would be entitled to participate in at least 40% of the contracts in the transaction; a matching specialist would be entitled to participate in 30%, and other crowd participants on parity with the Price Improving ROT/Specialist would be entitled to participate in 60% of the contracts in the transaction, in the aggregate. If a Price Improving ROT/Specialist order is matched by two or more crowd participants (but not the specialist), the Price Improving ROT/Specialist would be entitled to participate in 60% of the contracts in the transaction, in the aggregate.

participant that matches a price-improving order be required to participate in a trade above that Price Improving ROT/Specialist’s crowd or participant’s size.²⁷

The Special Allocation would remain in effect until one of the following takes place: (1) the lesser of 20 contracts or the AUTO-X guarantee for the option that is the subject of the price-improving quote, have been executed against the price-improving quotes eligible to receive an allocation; (2) the ROT or specialist who improved the price cancels the price-improving order; or (3) the original price-improving order is superseded by a new price-improving order.²⁸ If any of those conditions are satisfied, the special allocation formula would no longer be in effect, and crowd members with orders that have not been filled would be considered to be on parity. If the specialist were one of the crowd members, the specialist would, consistent with applicable exchange rules, be entitled to receive an Enhanced Specialist Participation in eligible options.²⁹

Further, proposed Commentary .04 to Phlx Rule 1080 provides that the Exchange will notify all members on the Options Floor when it has completed the development of appropriate interfaces for such proprietary systems and/or deployed such terminals on the Options Floor, and when the use of such electronic interfaces and/or terminals may commence. This provision is included in the proposed rule change because, in the event that the Commission approves this proposal, the Exchange’s ability to deploy such interfaces may not coincide with the effective date of the rule. The Exchange believes that the interfaces should be able to be deployed in or around the third quarter 2002.

Finally, the Exchange has determined to work towards the development of a proposal for an alternative model for ROT access, which would involve giving ROTs the ability to electronically post their own quotations in competition with the specialist and to have their own quotation generation models (which might be supplied by the Exchange or third parties, or be independently developed), as opposed

²⁷ See Amendment No. 4.

²⁸ Unless the new price-improving order is cancelled before at least one contract executes at the price of the new price-improving order. See proposed Phlx Rule 1014(g)(B)(2). The Exchange represents that the purpose of this third condition is to eliminate the possibility that a crowd participant could, by placing and then immediately canceling a price-improving order, cause a Price Improving ROT/Specialist to lose their entitlement under the Special Allocation.

²⁹ See Amendment No. 5.

to having their electronic access be limited to sending limit orders on a strike-by-strike basis (the "Independent Quoting Model").³⁰

This Independent Quoting Model would involve the Exchange adopting a new trade allocation rule similar to that International Securities Exchange ("ISE") Rule 713. Subject to approval under the governance requirements set forth in the Exchange's rules and in the Act, the Exchange would, if so approved, submit the same to the Commission as the ultimate solution to compliance with Section IV.B.h.(aa) of the Order.³¹

4. Statutory Basis

For these reasons, the proposed rule change is consistent with Section 6 of the Act in general, and with Section 6(b)(5) of the Act 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 providing Phlx ROTs with increased electronic access to the specialist's limit order book, which should provide incentive for Phlx ROTs to quote competitively, and which in turn should result in competitive pricing and enhanced liquidity on the Exchange specifically, and in the options markets in general.

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

No written comments were either solicited or received.

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

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

³⁰ See Amendment No. 5.

³¹ Id.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the proposed rule change and Amendments Nos. 1-7 thereto. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. 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-2002-04 and should be submitted by July 18, 2002.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.³²

Margaret H. McFarland,

Deputy Secretary.

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DEPARTMENT OF STATE

[Public Notice 4055]

Bureau of Educational and Cultural Affairs Request for Grant Proposals: Mexico, Central America, and the Caribbean (MCAC) Regional Educational Advising Coordinator (REAC) Program

SUMMARY: The Educational Information and Resources Branch (ECA/A/S/A) of the Bureau of Educational and Cultural Affairs (ECA) announces an open competition for the Mexico, Central America, and the Caribbean (MCAC) Regional Educational Advising Coordinator (REAC) Program. Public and private non-profit organizations meeting the provisions described in Internal Revenue Code section 26 U.S.C. 501(c)(3) may submit proposals. The REAC organization facilitates the provision of expertise and information through the regional coordinator to educational advisers in the region in

consultation with U.S. Embassies and ECA. The REAC program works to support educational information centers in the region and to assist in their professional development. These activities include the sharing of information and materials with the region's advising centers, communicating trends in U.S. education and regional exchange, disseminating information on the latest developments in technology and providing direct guidance through site visits, internships, training and workshops in Mexico, Central America and the Caribbean. The region contains 46 advising centers in the U.S. Department of State-affiliated network. These centers provide comprehensive and unbiased information to interested students, scholars, and other individuals about study opportunities in the U.S.

Program Information

Overview

The Regional Educational Advising Coordinator (REAC) organization will be responsible for providing on-site technical assistance and training to centers in the Mexico, Central America, and the Caribbean Region (MCAC) and for coordinating the establishment of any new advising centers, as directed by individual embassies in consultation with the Branch. The REAC will support all U.S. Department of State-affiliated centers located in the following countries and locations: Mexico, Belize, Costa Rica, Cuba, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Guyana, Suriname, Anguilla, Antigua, Aruba, Bahamas, Barbados, British Virgin Islands, Cayman Islands, Dominica, Dominican Republic, Grenada, Haiti, Jamaica, Martinique, Montserrat, Nevis, St. Kitts, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago. The MCAC REAC organization should work impartially with all non-governmental organizations, binational centers (such as the Instituto Guatemalteco-American or Centro Cultural Costarricense-Norteamericano), Public Affairs Sections located in U.S. embassies and consulates overseas, universities, libraries, etc. involved in educational advising to enable advisers to provide accurate and timely information on U.S. higher educational opportunities. The REAC must work closely with the Branch and Public Affairs Sections throughout the region to help establish priorities for educational advising. Responsibilities for organization for the MCAC REAC will include:

³² 17 CFR 200.30-3(a)(12).