

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46407; File No. SR-Phlx-2002-17]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto by the Philadelphia Stock Exchange, Inc. Relating to Participation Rights in Trades Involving Crossing, Facilitation, and Solicited Orders

August 23, 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 March 18, 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 Phlx. On May 2, 2002, July 24, 2002, and August 20, 2002, Phlx submitted Amendment Nos. 1, 2, and 3 to the proposed rule change, respectively.³ 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 Commentary .02 to Phlx Rule 1064, Crossing, Facilitation and Solicited Orders, governing the crossing of equity option orders by floor brokers, to give the member firm from which an order originates a participation right in trades that are proposed to be crossed in

certain circumstances. The Exchange further proposes to adopt Commentary .03 to Phlx Rule 1064, setting forth a general requirement that a member or member organization facilitating a customer order pursuant to this rule shall disclose all securities that are components of the customer order which is subject to facilitation before requesting bids and offers for the execution of all components of the order.

The text of the proposed rule change follows. Additions are italicized.

* * * * *

Crossing, Facilitation and Solicited Orders

Rule 1064. (a)-(d) No change.

Commentary:

.01. No change.

.02. *Firm Participation Guarantees. (i) Notwithstanding the provisions of paragraphs (a) and (b) of this Rule, when a Floor Broker holds an equity option order of the eligible order size or greater ("original order"), the Floor Broker is entitled to cross a certain percentage of the original order with other orders that he is holding or in the case of a customer order, with a facilitation order of the originating firm (i.e., the firm from which the original customer order originated).*

(ii) The Options Committee may determine, on an option by option basis, the eligible size for an order that may be transacted pursuant to this Commentary, however, the eligible order size may not be less than 500 contracts. Orders for less than 500 contracts may be crossed pursuant to this rule but are not subject to subsection (iii) below pertaining to participation guarantees. In accordance with his responsibilities for due diligence, a Floor Broker representing an order of the eligible order size or greater which he wishes to cross shall request bids and offers for such option series and make all persons in the trading crowd aware of his request. In determining whether an order satisfies the eligible order size requirement, any multi-part or spread order must contain one leg alone which is for the eligible order size or greater. If the same member organization is the originating firm and also the specialist for the particular class of options to which the order relates, then the specialist is not entitled to any Enhanced Specialist Participation with respect to the particular cross transaction.

(iii) The percentage of the order which a Floor Broker is entitled to cross, after all public customer orders that were (1) on the limit order book and then (2)

represented in the trading crowd at the time the market was established have been satisfied, is determined as follows: (A) 20% of the remaining contracts in the order if the order is traded at the best bid or offer given by the crowd in response to the Floor Broker's initial request for a market; or (B) 40% of the remaining contracts in the order if the order is traded between the best bid or offer given by the crowd in response to the Floor Broker's initial request for a market.

(iv) When crossing an order pursuant to this Commentary, a Floor Broker must disclose on its order ticket for any order which is subject to crossing, all of the terms of such order, including any contingency involving, and all related transactions in, either options or underlying or related securities. The Floor Broker must disclose all securities that are components of the customer order which is subject to crossing before requesting bids and offers for the execution of all components of the order.

(v) Once the trading crowd has provided a quote, it will remain in effect until: (A) A reasonable amount of time has passed, or (B) there is a significant change in the price of the underlying security, or (C) the market given in response to the request has been improved. In the case of a dispute, the term "significant change" will be interpreted on a case-by-case basis by two Floor Officials based upon the extent of the recent trading in the option and in the underlying security, and any other relevant factors.

(vi) If a trade pursuant to this Commentary occurs when the specialist is on parity with one or more controlled accounts, then the Enhanced Specialist Participation which is established pursuant to Exchange Rule 1014(g)(ii)-(iv) shall apply only to the number of contracts remaining after the following orders have been satisfied: those public customer orders which trade ahead of the cross transaction, and any portion of an order being crossed against the original order being represented by the Floor Broker. The Enhanced Specialist Participation may only be 20% of the original order after customer orders have been executed for orders crossed pursuant to this paragraph unless the Floor Broker has chosen to cross less than its 20% entitlement, in which case the Enhanced Specialist Participation will be a percentage that combined with the percentage the firm crossed is no more than 40% of the original order. If the trade occurs at a price other than the specialist's disseminated bid or offer, the specialist is entitled to no guaranteed participation.

⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letters from Richard S. Rudolph, Director and Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated May 1, 2002 (Amendment No. 1); and to Ira Brandriss, Special Counsel, Division, Commission, dated July 23, 2002, and August 19, 2002 (Amendment Nos. 2 and 3). The proposal was originally filed to be immediately effective pursuant to Section 19(b)(3)(A) of the Act. In Amendment No. 1, Phlx changed its status to a proposal filed pursuant to Section 19(b)(2) of the Act and requested accelerated effectiveness. The changes made by Amendment Nos. 2 and 3 have been incorporated into this notice.

(vii) *The members of the trading crowd who established the market will have priority over all other orders that were not represented in the trading crowd at the time that the market was established (but not over customer orders on the book) and will maintain priority over such orders except for orders that improve upon the market. A Floor Broker who is holding a customer order and either a facilitation or solicited order and who makes a request for a market will be deemed to be representing both the customer order and either the facilitation order or solicited order, so that the customer order and the facilitation order or solicited order will also have priority over all other orders that were not being represented in the trading crowd at the time the market was established.*

(viii) *Nothing in this paragraph is intended to prohibit a Floor Broker or a specialist from trading more than their percentage entitlements if the other members of the trading crowd do not choose to trade the remaining portion of the order.*

(ix) *A Floor Broker may not cross an order that he is holding with an order from a Registered Options Trader that is then in the trading crowd.*

(x) *Spread, straddle, combination or hedge orders, as defined in Exchange Rule 1066, on opposite sides of the market may be crossed, provided that the Floor Broker holding such orders proceeds in the manner described in paragraphs (a) or (b) of this Rule as appropriate. Members may not prevent a spread, straddle, stock-option, or combination cross from being completed by giving a competing bid or offer for one component of such order. In determining whether an order satisfies the eligible order size requirement, any multi-part or spread order must contain one leg which, standing alone, is for the eligible order size or greater.*

.03 *A member or member organization facilitating a customer order pursuant to this rule shall disclose all securities that are components of the customer order which is subject to facilitation before requesting bids and offers for the execution of all components of the order.*

* * * * *

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, as amended, 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

The purpose of the proposed rule change is to give the member firm from which an order originates ("originating firm") a participation right in trades that are proposed to be crossed in certain circumstances, similar to existing rules on other options exchanges.⁴

Exchange Rule 1064 sets forth the procedures by which a floor broker holding a customer order ("original order") may cross it with either another customer order⁵ or orders from the same originating firm, or a contra side order provided by the originating firm from its own proprietary account ("facilitation order").⁶

Currently, under Exchange Rule 1064(a) and (b), a floor broker seeking to cross buy and sell orders for the same options series must first bring the transaction to the trading floor and request markets from the trading crowd for all components of the order. After providing the crowd with the opportunity to make such markets, the floor broker must announce that he holds an order subject to crossing or facilitation, and then must propose a price at which to cross the original order that improves upon the price provided by the crowd. However, before the floor broker can effect the cross, the market makers in the crowd are given the opportunity to take all or part of the transaction at the proposed price.

Under these rules, if the crowd does not want to participate in the trade, the floor broker may proceed with the cross. If the crowd wants to participate in part of the order, however, the crowd has priority and the floor broker may cross only that amount remaining after the crowd has taken its portion. If the crowd wants to participate in the entire order, the floor broker will not be able to cross or facilitate any part of the order.

The proposed rule change, adding new Commentary .02 to Exchange Rule 1064, would apply to transactions in

equity options, and would initially apply to customer orders of a minimum size of 500 contracts.⁷ The Options Committee may determine, on an option by option basis, the eligible size for an order that may be transacted pursuant to the proposal; however, the eligible order size may not be less than 500 contracts.⁸

The proposed rule change would entitle the floor broker, under certain conditions, to cross a specified percentage of the original order on behalf of the originating firm, before Registered Options Traders ("ROTs") in the crowd can participate in the transaction. The percentage of the floor broker's guarantee would depend upon whether the price at which the order is ultimately traded is at the crowd's best bid or offer in response to the floor broker's initial request, or at an improved price.

The proposed rule change provides that, where the floor broker proposes the cross at a price that improves the crowd's market, and the crowd then wants to take part in some or all of the order at the improved price, the floor broker would be entitled to cross 40% of the contracts before the crowd could participate in the transaction. For example, if the market provided by the crowd in response to a floor broker's request for a market in a particular option series is 1.00–1.15, and a crossing transaction for 500 contracts pursuant to the proposed rule takes place at the improved price of 1.10 (after public customer orders have been satisfied), the floor broker would be entitled to cross 200 contracts (40% of 500) at 1.10.

Under the proposal, and distinguished from current Phlx Rule 1064, the floor broker would be granted a right to cross even at a price that does not improve upon the best bid or offer provided by the crowd in response to his initial request for a market. The proposed rule change provides that where the trade takes place at the market provided by the crowd (which could include the Exchange's disseminated market determined by Auto-Quote,⁹ or specialized quote

⁷ See Amendment No. 2, clarifying that the proposal would include facilitation of all customer orders, not only public customer orders.

⁸ For instance, the Options Committee may determine, in administering this proposed rule, to limit its application to orders of 1,000 contracts or more; similarly, the Options Committee may determine to establish different minimum sizes for different options. However, a proposed rule change would be required to permit the application of this rule to orders for a size of less than 500 contracts.

⁹ Auto-Quote is the Exchange's electronic options pricing system, which enables specialists to automatically monitor and instantly update quotations. See Exchange Rule 1080, Commentary .01(a).

⁴ See, e.g., Chicago Board Options Exchange, Inc. Rule 6.74(d), American Stock Exchange LLC Rule 950(d), Commentary .02, and Pacific Exchange, Inc. Rule 6.47(b).

⁵ See Exchange Rule 1064(a).

⁶ See Exchange Rule 1064(b).

feed¹⁰ in the event that no crowd participant responds to the floor broker's request for a market¹¹), all public customer orders on the book and those represented in the trading crowd at the time the market was established must first be satisfied. Once these public customer orders are satisfied, the floor broker would be entitled to cross 20% of the contracts remaining in the original order. To continue with the above example, if the market provided by the crowd in response to a floor broker's request for a particular option series is 1.00–1.15, and a crossing transaction for 500 contracts pursuant to the proposed rule takes place at 1.00 (after public customer orders have been satisfied), the floor broker would be entitled to cross 100 contracts (20% of 500) at 1.00.

The proposed rule would provide that, once the trading crowd has provided a market, that market will remain in effect until a reasonable amount of time has passed, a significant change has occurred in the price of the underlying security of the option, or the market is improved. In case of a dispute, "significant change" would be determined on a case-by-case basis by two Floor Officials, based upon the extent of recent trading in the option and the underlying security and any other relevant factor. The Phlx states that the purpose of this provision is to ensure that the trading crowd is given an adequate opportunity to participate in the crossing transaction if it is not consummated immediately upon the floor broker's receipt of the crowd market.

In the case of a complex order such as a spread or straddle, the proposed rule would require that at least one leg of such an order, standing alone, would need to meet the eligible size requirement to qualify for the provisions of the proposed rule change. Thus, the aggregate size of all components of such an order would not be sufficient to qualify for the provisions of the proposed rule change unless one leg of the order is for the minimum size. The proposed rule change would provide that Members who wish to prevent a complex order from being crossed under the Commentary must bid or offer for all

components of the complex order, and may not prevent a spread, straddle, stock-option, or combination cross from being completed by giving a competing bid or offer for one component of such order. In determining whether an order satisfies the eligible order size requirement, any multi-part or spread order would be required to contain one leg which, standing alone, is for the eligible order size or greater.

The floor broker would be required to disclose on the order ticket for any order subject to crossing all terms of the order, including any contingency involving, and all related transactions in, either options or underlying or related securities. The floor broker would be required to disclose all securities that are components of the customer order which is subject to crossing before requesting bids and offers for the execution of all components of the order.¹² The Phlx states that the purpose of this provision is to eliminate any actual or perceived advantage that an originating firm may have over the trading crowd, since the originating firm (and its floor broker) would know the actual bid or offer price of the customer order it represents prior to requesting markets from the crowd under the proposal.

If the same member organization of the Exchange is both the originating firm and the specialist for the option in which the transaction takes place, and the floor broker acting on behalf of the originating firm crosses or facilitates under the proposed rule, the specialist would not be entitled to the Enhanced Specialist Participation with respect to the particular cross transaction.

However, if the specialist is not the same member organization as the originating firm, and the trade takes place at the specialist's disseminated bid or offer when the specialist is on parity with one or more controlled accounts, the specialist would be entitled to participate in a percentage of the contracts remaining after public customer orders have been executed and the originating firm's crossing rights have been exercised. The percentage that the specialist would receive is determined by reference to the Enhanced Specialist Participation established pursuant to Phlx Rule 1014(g)(ii)–(iv),¹³ subject to limitation.

If the floor broker crosses the full 20% of the originating firm's entitlement, the number of contracts guaranteed to the

specialist could not exceed 20% of the remainder of the order after the originating firm has taken its share. For example, if the crossing order is for 500 contracts, and the floor broker crosses 100 (20% of 500) on the specialist's bid or offer, the specialist would be entitled to receive a maximum of 100 contracts (20% of 500).

If the floor broker does not cross 20%, the specialist may be entitled to receive more contracts, but in no case would the specialist be guaranteed a percentage that, when combined with the percentage crossed by the floor broker, exceeds 40% of the original order (after relevant public customer orders have been satisfied). For example, if the crossing order is for 500 contracts, and the floor broker crosses 50 contracts (10% of 500) on the specialist's bid or offer, the specialist would be entitled to receive a maximum of 150 contracts (30% of 500). In this example, the specialist's participation, when combined with the floor broker's participation, does not exceed 40% of the order, or 200 contracts (50+150 = 200). Nothing in this proposal, however, would prohibit specialists from trading more than their percentage entitlements if the other members of the trading crowd do not choose to trade with the remainder of the order. If the trade takes place at a price other than that of the specialist's disseminated bid or offer, the specialist would not be entitled to any guaranteed participation.

A Floor Broker would not be able to cross an order that he is holding with an order from a ROT that is then in the trading crowd. The Phlx states that this provision is intended to prevent the situation in which such ROT would have his/her interest represented by two different crowd participants (him/herself and the Floor Broker) at the same time.¹⁴

The proposed rule change also provides that the members of the crowd who establish the market in response to the floor broker's initial request would have priority over all other orders that were not represented in the crowd at the time that market was established (but not over customer orders on the book), except for orders that improve upon those quotes. Further, a floor broker holding a customer order and either a facilitation order or a solicited order and who makes a request for a market would be deemed to be representing both the customer order and either the facilitation order or solicited order, so that the customer order, and the facilitation or solicited order would also have priority over all other orders that

¹⁰ A specialist may separately employ its own pricing models, by establishing a specialized interface with AUTOM known as a specialized quote feed, thus by-passing the Exchange's Auto-Quote System. See Exchange Rule 1080, Commentary .01(c).

¹¹ The Exchange's disseminated market (whether by Auto-Quote or specialized quote feed) is deemed to represent the quotations of all Registered Options Traders ("ROT's") in that option unless an ROT has expressly indicated otherwise in a clear and audible manner. See *id.*

¹² Telephone conversation between Richard S. Rudolph, Director and Counsel, Phlx, and Ira Brandiss, Special Counsel, and Frank N. Genco, Attorney, Division, Commission, August 22, 2002.

¹³ See Amendment No. 3.

¹⁴ See Amendment No. 3.

were not being represented in the trading crowd at the time the market was established.¹⁵

Proposed Commentary .03 would require a member or member organization facilitating a customer order pursuant to Rule 1064 to disclose all securities that are components of the customer order which is subject to facilitation before requesting bids and offers for the execution of all components of the order. The Phlx states that the purpose of this business-related provision is to avoid the situation in which a facilitating floor broker representing a firm and customer order enters a crowd and establishes the firm's own contra-side bid (in the case of the customer selling) or offer (in the case of a customer buying) before disclosing the customer's bid or offer to the crowd. The Phlx states that otherwise the floor broker would establish priority before the crowd is made aware of the terms of the customer's order. If the customer order is disclosed first, however, the crowd may be more likely to bid or offer competitively as contra side to that customer's order, thus benefiting the customer.¹⁶ The Exchange's Options Committee determined that informing the trading crowd of the customer component of the order first is fairer overall, because the contra-side is often merely a facilitation or response to that order.

2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act,¹⁷ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹⁸ in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect the investors and the public interest by providing incentives for crowd participants to quote competitively, and by making the Exchange more competitive by providing incentive to order flow providers to bring order flow to the Exchange. The Exchange believes

that the proposed rule change will result in tighter spreads, and thus benefit customers whose orders are subject to the new crossing rule. The Exchange further believes that allowing order flow providers a participation guarantee should provide incentive for such order flow providers to bring their order flow to the Exchange, making the Exchange a more competitive marketplace.

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

The Exchange does not believe that the proposed rule change, as amended, 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 solicited or received with respect to the proposed rule change, as amended.

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 such proposed rule change, as amended; 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, as amended, 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 the filing will also be

available for inspection and copying at the principal offices of the Exchange. All submissions should refer to File No. SR-Phlx-2002-17 and should be submitted by September 24, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁹

Margaret H. McFarland,
Deputy Secretary.

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SMALL BUSINESS ADMINISTRATION

[Declaration of Disaster #3438]

State of California (Corrected Copy)

San Diego County and the contiguous counties of Imperial, Orange and Riverside in the State of California constitute a disaster area as a result of a wildfire that occurred on July 29, 2002 and continued until the wildfire was contained on August 12, 2002. The wildfire occurred in the Banner Grade area of San Diego County and consumed 65,000 acres, destroying owner occupied homes, outbuildings and vehicles. Applications for loans for physical damage as a result of this disaster may be filed until the close of business on October 21, 2002 and for economic injury until the close of business on May 22, 2003 at the address listed below or other locally announced locations: Small Business Administration, Disaster Area 4 Office, PO Box 13795, Sacramento, CA 95853-4795.

The interest rates are:

	Percent
For Physical Damage:	
Homeowners with credit available elsewhere	6.625
Homeowners without credit available elsewhere	3.312
Businesses with credit available elsewhere	7.000
Businesses and non-profit organizations without credit available elsewhere	3.500
Others (including non-profit organizations) with credit available elsewhere	6.375
For Economic Injury:	
Businesses and small agricultural cooperatives without credit available elsewhere	3.500

The number assigned to this disaster for physical damage is 343805 and for economic damage is 9Q9300.

(Catalog of Federal Domestic Assistance Program Nos. 59002 and 59008.)

¹⁹ 17 CFR 200.30-3(a)(12).

¹⁵ See Amendment No. 2.

¹⁶ See Amendment No. 3. Commentary .03 would apply to the entire facilitation cross provision of Phlx Rule 1064, and is intended to require, among other things, that the Floor Broker make the crowd aware of which side of the crossing transaction (*i.e.*, buy or sell) is the customer order. Telephone conversation between Richard S. Rudolph, Director and Counsel, Phlx, and Ira Brandriss, Special Counsel, and Frank N. Genco, Attorney, Division, Commission, August 21, 2002.

¹⁷ 15 U.S.C. 78f(b).

¹⁸ 15 U.S.C. 78f(b)(5).