

## II. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>7</sup> that the proposed rule change (SR-Phlx-2002-11), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority,<sup>8</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47062; File No. SR-Phlx-2002-67]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Regarding Rules Implementing the Options Intermarket Linkage Plan

December 20, 2002.

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> notice is hereby given that on October 29, 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 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 adopt rules ("rules") implementing the Plan for the Purpose of Creating and Operating an Intermarket Options Linkage ("Plan").<sup>3</sup> The Exchange previously filed proposed rules adopting the Plan on August 16,

2001.<sup>4</sup> Below is the text of the proposed rule change; proposed new text is italicized.

#### Intermarket Linkage

##### Definitions

*Rule 1083. The following terms shall have the meaning specified in this rule solely for the purpose of rules 1083 through 1087:*

(a) "Aggrieved Party" means a member of a Participant Exchange whose bid or offer was traded-through.

(b) "Block Trade" means a trade on a Participant Exchange that:

(i) Involves 500 or more contracts and has a premium value of at least \$150,000;

(ii) Is effected at a price outside of the NBBO; and

(iii) Involves either:

(A) A cross (where a member of the Participant Exchange represents all or a portion of both sides of the trade), or

(B) Any other transaction (i.e., in which such member represents an order of block size on one side of the transaction only) that is not the result of an execution at the current bid or offer on the Participant Exchange.

Contemporaneous transactions at the same price on a Participant Exchange shall be considered a single transaction for the purpose of this definition.

(c) "Complex Trade" means the execution of an order in an options series in conjunction with the execution of one or more related orders(s) in different options series in the same underlying security occurring at or near the same time for the equivalent number of contracts and for the purpose of executing a particular investment strategy.

(d) "Crossed Market" means a quotation in which the Exchange disseminates a bid (offer) in a series of an Eligible Option Class at a price that is greater than (is less than) the price of the offer (bid) for the series then being displayed from another Participant Exchange.

(e) "Eligible Market Maker," with respect to an Eligible Option Class, means a specialist or ROT that:

(i) Is assigned to, and is providing two-sided quotations in, the Eligible Option Class;

(ii) Is in compliance with the requirements of rule 1087;

(iii) Is participating in the Exchange's AUTOM system (logged onto the Exchange's "Wheel") in such Eligible Option Class;

(iv) Has a clearing arrangement with a clearing firm that is a member of the exchange to which such specialist or ROT sends a Linkage Order (as defined below).

(f) "Eligible Option Class" means all option series overlying a security (as that term is defined in section 3(a)(10) of the Exchange Act) or group of securities, including both put options and call options, which class is traded on the Exchange and at least one other Participant Exchange.

(g) "Firm Customer Quote Size" with respect to a P/A Order means the lesser of (a) the number of option contracts that the Participant Exchange sending a P/A Order guarantees it will automatically execute at its disseminated price in a series of an Eligible Option Class for Public Customer orders entered directly for execution in that market; or (b) the number of option contracts that the Participant Exchange receiving a P/A Order guarantees it will automatically execute at its disseminated price in a series of an Eligible Option Class for Public Customer orders entered directly for execution in that market. This number shall be at least 10.

(h) "Firm Principal Quote Size" means the number of options contracts that a Participant Exchange guarantees it will execute at its disseminated price for incoming Principal Orders in an Eligible Option Class. This number shall be at least 10.

(i) "Linkage" means the systems and data communications network that link electronically the Participant Exchanges for the purposes specified in the Plan.

(j) "Linkage Order" means an order routed through the Linkage as permitted under the Plan. There are three types of Linkage Orders:

(i) "Principal Acting as Agent ("P/A") Order," which is an order for the principal account of a specialist (or equivalent entity on another Participant Exchange that is authorized to represent Public Customer orders), reflecting the terms of a related unexecuted Public Customer order for which the specialist is acting as agent;

(ii) "Principal Order," which is an order for the principal account of an Eligible Market Maker and is not a P/A Order; and

(iii) "Satisfaction Order," which is an order, for the principal account of a member who initiated a Trade-Through, sent through the Linkage to satisfy the liability arising from that Trade-Through.

(k) "Locked Market" means a quotation in which the Exchange disseminates a bid (offer) in a series of an Eligible Option Class at a price that

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

<sup>8</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> Securities Exchange Act Release Nos. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (approving the Plan), 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000) (approving Phlx joining the Plan); and 44482 (June 27, 2001), 66 FR 35470 (July 5, 2001) (approving amendment to Plan to conform to the requirements of rule 11Ac1-7 ("Amendment")).

<sup>4</sup> See SR-Phlx-2001-78, which has been withdrawn. The instant proposal is intended to replace the previous filing and amendment(s) in their entirety.

equals the price of the offer (bid) for the series then being displayed from another Participant Exchange.

(l) "NBBO" means the national best bid and offer in an options series as calculated by the Exchange.

(m) "Non-Firm" means, with respect to quotations, that members of a Participant Exchange are relieved of their obligation to be firm for their quotations pursuant to Rule 11Ac1-1 under the Exchange Act.

(n) "Participant Exchange" means a registered national securities exchange that is a party to the Plan.

(o) "Plan" means the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage, as such plan may be amended from time to time.

(p) "Public Customer" for purposes of these rules concerning Linkage, means a person that is neither a broker or dealer in securities nor an affiliate of a broker or dealer in securities.

(q) "Reference Price" means the limit price attached to a Linkage Order by the sending Participant Exchange. Except with respect to a Satisfaction Order, the Reference Price is equal to the bid disseminated by the receiving Participant Exchange at the time that the Linkage Order is transmitted in the case of a Linkage Order to sell and the offer disseminated by the receiving Participant Exchange at the time that the Linkage Order is transmitted in the case of a Linkage Order to buy. With respect to a Satisfaction Order, the Reference Price is the price that the member in the sending Participant Exchange is entitled to receive in satisfaction of a Trade-Through complaint under the Plan.

(r) "Trade-Through" means a transaction in an options series at a price that is inferior to the NBBO.

(s) "Third Participating Market Center Trade-Through" means a Trade-Through in a series of an Eligible Option Class that is effected by executing a Linkage Order, and such execution results in a sale (purchase) at a price that is inferior to the best bid (offer) being disseminated by another Participant Exchange.

(t) "Verifiable Number of Customer Contracts" means the number of Public Customer contracts in the book of a Participant Exchange.

#### Operation of the Linkage

Rule 1084. By subscribing to the Plan, the Exchange has agreed to comply with, and enforce compliance by its members with, the Plan. In this regard, the following shall apply:

(a) Pricing. Members may send P/A Orders and Principal Orders through the

Linkage only if such orders are priced at the NBBO.

#### (b) P/A Orders.

(1) Sending of P/A Orders for Sizes No Larger than the Firm Customer Quote Size. A specialist may send through the Linkage a P/A Order for execution in the automatic execution system of a Participant Exchange if the size of such P/A Order is no larger than the Firm Customer Quote Size. Except as provided in subparagraph (b)(2)(ii) below, a specialist may not break up an order of a Public Customer that is larger than the Firm Customer Quote Size into multiple P/A Orders, one or more of which is equal to or smaller than the Firm Customer Quote Size, so that such orders could be represented as multiple P/A Orders through the Linkage.

(2) Sending of P/A Orders for Sizes Larger than the Firm Customer Quote Size. If the size of a P/A Order is larger than the Firm Customer Quote Size, a specialist may send through the Linkage such P/A Order in one of two ways:

(i) The specialist may send a P/A Order representing the entire Public Customer order. If the receiving Participant Exchange's disseminated price is equal to or better than the Reference Price when the P/A Order arrives at that market, that exchange will execute the P/A Order at its disseminated price for at least the Firm Customer Quote Size. Within 15 seconds of receipt of such order, the receiving Participant Exchange will inform the specialist of the amount of the order executed and the amount, if any, that was canceled.

(ii) Alternatively, the specialist may send an initial P/A Order for the Firm Customer Quote Size pursuant to subparagraph (b)(1) above. If the Participant Exchange executes the P/A Order and continues to disseminate the same price at the NBBO 15 seconds after reporting the execution of the initial P/A Order, the specialist may send an additional P/A Order to the same Participant Exchange. If sent, such additional P/A Order must be for at least the lesser of 100 contracts or the entire remainder of the Public Customer order.

In any situation where a receiving Participant Exchange does not execute a P/A Order in full, such exchange is required to move its quotation to a price inferior to the Reference Price of the P/A Order.

#### (c) Principal Orders.

(1) Sending of an Initial Principal Order. An Eligible Market Maker may send a Principal Order through the Linkage at a price equal to the NBBO. Subject to the next paragraph, if the Principal Order is not larger than the

Firm Principal Quote Size, the receiving Participant Exchange will execute the order in its automatic execution system, if available, if its disseminated price is equal to or better than the price specified in the Principal Order when that order arrives at the receiving Participant Exchange. If the Principal Order is larger than the Firm Principal Quote Size, the receiving Participant will (a) execute the Principal order at its disseminated price for at least the Firm Principal Quote Size and (b) within 15 seconds of receipt of such order, reply to the sending Participant Exchange, informing such Participant Exchange of the amount of the order that was executed and the amount, if any, canceled. If the receiving Participant Exchange does not execute the Principal Order in full, it will move its quote to a price inferior to the Reference Price of the Principal Order.

(2) Receipt of Multiple Principal Orders. Once the Exchange provides an automatic execution of a Principal Order in a series of an Eligible Option Class (the "initial execution"), the Exchange may reject any Principal Order(s) in the same Eligible Option Class sent by the same Participant Exchange for 15 seconds after the initial execution unless: (a) There is a change of price in the Exchange's disseminated offer (bid) in the series of the Eligible Option Class in which there was the initial execution; and (b) such price continues to be the NBBO. After this 15 second period, and until the sooner of (y) one minute after the initial execution or (z) a change in the Exchange's disseminated bid (offer), the Exchange is not obligated to provide an automatic execution for any Principal Orders in the same Eligible Option Class received from the Participant Exchange that sent the order resulting in the initial execution, and thus may treat any such Principal Orders as being greater than the Firm Principal Quote Size.

#### (d) Responses to Linkage Orders.

(1) Failure to Receive a Timely Response. A Member who does not receive a response to a P Order or a P/A Order within 20 seconds of sending the order may reject any response received thereafter purporting to report an execution of all or part of that order. The Member so rejecting the response shall inform the Participant Exchange sending that response of the rejection within 15 seconds of receipt of the response.

(2) Failure to Send a Timely Response. If a Member responds to a P Order or P/A Order more than 20 seconds after receipt of that order, and the Participant Exchange to whom the Member responded cancels such

response, the Member shall cancel any trade resulting from such order and shall report the cancellation to the Option Price Reporting Authority ("OPRA").

(e) *Receipt of Linkage Orders.* The Exchange will provide for the execution of P/A Orders and Principal Orders if its disseminated price is (i) equal to or better than the Reference Price, and (ii) equal to the then-current NBBO. If the size of a P/A Order or Principal Order is not larger than the Firm Customer Quote Size or Firm Principal Quote size, respectively, the Exchange will provide for the execution of the entire order, and shall execute such order in its automatic execution system if such order is eligible for automatic execution and that system is available. Subject to paragraph (c) above, if the size of a P/A Order or Principal Order is larger than the Firm Customer Quote Size or Firm Principal Quote Size, respectively, or if the Linkage Order received is not eligible to be executed automatically via AUTO-X pursuant to Exchange rule 1080(c)(iv), the specialist must address the order within 15 seconds to provide an execution for at least the Firm Customer Quote Size or Firm Principal Quote Size, respectively. If the order is not executed in full, the Exchange will move its disseminated quotation to a price inferior to the Reference Price.

#### Order Protection

*Rule 1085. (a) Avoidance and Satisfaction of Trade-Throughs.*

(1) *General Provisions.* Absent reasonable justification and during normal market conditions, Members should not effect Trade-Throughs. Except as provided in paragraph (b) below, if a Member effects a Trade-Through with respect to the bid or offer of a Participant Exchange in an Eligible Option Class and the Exchange receives a Satisfaction Order from an Aggrieved Party, either:

(i) the Member who initiated the Trade-Through shall satisfy, or cause to be satisfied, the Aggrieved Party by filling the Satisfaction Order in accordance with subparagraph (a)(2) below; or

(ii) if the Member elects not to do so (and, in the case of Third Participating Market Center Trade-Through, the Member obtains the agreement of the contra party that received the Linkage Order that caused the Trade-Through), then the price of the transaction that constituted the Trade-Through shall be corrected to a price at which a Trade-Through would not have occurred. If the price of the transaction is corrected, the Member correcting the price shall report the corrected price to OPRA, notify the

Aggrieved Party of the correction and cancel the Satisfaction Order.

(2) *Price and Size.* The price and size at which the bid or offer traded through shall be filled is as follows:

(i) *Price.* A Satisfaction Order shall be filled at the reference price. However, if the Reference Price is the price of an apparent Block Trade that caused the trade-through, and such trade was not, in fact, a Block Trade, then the member may cancel the Satisfaction Order. In that case, the Member shall inform the Aggrieved Party within three minutes of receipt of the Satisfaction Order of the reason for the cancellation. Within three minutes of receipt of such cancellation, the Aggrieved Party may resend the Satisfaction Order with a Reference Price of the bid or offer that was traded through.

(ii) *Size.* An Aggrieved Party may send a Satisfaction Order up to the size of the Verifiable Number of Customer Contracts that were included in the disseminated bid or offer that was traded through, subject to the following limitations:

(A) If the number of contracts to be satisfied exceeds the size of the transaction that caused the Trade-Through, the size of the Satisfaction Order(s) that must be filled with respect to each Participant Exchange(s) shall be limited to the size of the transaction that caused the Trade-Through, and the remainder of any Satisfaction Order(s) shall be cancelled;

(B) If the transaction that caused the Trade-Through was for a size larger than the Firm Customer Quote Size with respect to any of the Participant Exchange(s) traded through, the total number of contracts to be filled, with respect to all Satisfaction Orders received, shall not exceed the size of the transaction that caused the Trade-Through. In that case, the Member shall fill the Satisfaction Orders pro rata based on the Verifiable Number of Customer Contracts traded through on each Participant Exchange, and shall cancel the remainder of such Satisfaction Orders; and

(C) Notwithstanding paragraphs A and B above, if the transaction that caused the Trade-Through occurred during the five minutes prior to the regularly-scheduled close of trading in the principal market in which the underlying security is traded, the maximum number of contracts to be satisfied with respect to any one Participant Exchange shall be 10 contracts.

(3) *Rejection of Fills of Satisfaction Orders.* Within 30 seconds of receipt of notification that another Participant Exchange has filled a Member's

Satisfaction Order, the member that sent the Satisfaction Order may reject such fill, but only to the extent that either: (1) the order(s) for the customer contracts underlying the Satisfaction Order already have been filled; or (2) the customer orders to buy (sell) the contracts underlying the Satisfaction Order were cancelled.

(4) *Protection of Customers.* Whenever subparagraph (a)(1) applies, if Public Customer orders (or P/A Orders representing Public Customer orders) constituted either or both sides of the transaction involved in the Trade-Through, each such Public Customer order (or P/A Order) shall receive:

(i) The price that caused the Trade-Through; or

(ii) The price at which the bid or offer traded through was satisfied, if it was satisfied pursuant to subparagraph (a)(1)(i), or the adjusted price, if there was an adjustment, pursuant to subparagraph (a)(1)(ii). Whichever price is most beneficial to the Public Customer order. Resulting differences in prices shall be the responsibility of the Member who initiated the Trade-Through.

(b) *Exceptions to Trade-Through Liability.* The provisions of paragraph (a) pertaining to the satisfaction of Trade-Throughs shall not apply under the following circumstances:

(1) The Member who initiated the Trade-Through made every reasonable effort to avoid the Trade-Through, but was unable to do so because of a systems/equipment failure or malfunction;

(2) The Member trades through the market of a Participant Exchange to which such Member had sent a P/A Order or Principal Order, and within 20 seconds of sending such order the receiving Participant Exchange had neither executed the order in full nor adjusted the quotation traded through to a price inferior to the Reference Price of the P/A Order or Principal Order;

(3) The bid or offer traded through was being disseminated from a Participant Exchange whose quotes were Non-Firm with respect to such Eligible Option Class;

(4) The Trade-Through was other than a Third Participating Market Center Trade-Through and occurred during a period when, with respect to the Eligible Option Class, the Exchange's quotes were Non-Firm; provided, however, that, unless one of the other conditions of this paragraph (b) applies, during any such period: (i) Members shall make every reasonable effort to avoid trading through the firm quotes of another Participant Exchange; and (ii) it shall not be considered an exception to

paragraph (a) if a Member regularly trades through the firm quotes of another Participant Exchange during such period;

(5) The bid or offer traded through was being disseminated by a Participant Exchange during a trading rotation in the Eligible Option Class;

(6) The transaction that caused the Trade-Through occurred during a trading rotation;

(7) The transaction that caused the Trade-Through was the execution of a Complex Trade;

(8) In the case of a Trade-Through other than a Third Participating Market Center Trade-Through, a Satisfaction Order with respect to the Trade-Through was not received by the Exchange from the Aggrieved Party promptly following the Trade-Through and, in any event, (i) except in the final five minutes of trading, within three minutes from the time the report of the transaction(s) that constituted the Trade-Through was disseminated over OPRA, and (ii) in the final five minutes of trading, within one minute from the time the report of the transaction(s) that constituted the Trade-Through was disseminated over OPRA; or

(9) In the case of a Third Participating Market Center Trade-Through, a Satisfaction Order with respect to the Trade-Through was not received by the Exchange promptly following the Trade-Through. In applying this provision, the Aggrieved Party must send the Exchange a Satisfaction Order within three minutes from the time the report of the transaction that constituted the Trade-Through was disseminated over OPRA. To avoid liability for the Trade-Through, the Member receiving such Satisfaction Order must cancel the Satisfaction Order and inform the Aggrieved Party of the identity of the Participant Exchange that initiated the Trade-Through within three minutes of the receipt of such Satisfaction Order (within one minute in the final five minutes of trading). The Aggrieved Party then must send the Participant Exchange that initiated the Trade-Through a Satisfaction Order within three minutes of receipt of the cancellation of the initial Satisfaction Order (within one minute in the final five minutes of trading).

(c) Responsibilities and Rights Following Trade-Through Complaints.

(1) When a Member receives a Satisfaction Order, that Member shall respond as promptly as practicable pursuant to Exchange procedures by either:

(i) Specifying that one of the exceptions to Trade-Through liability specified in paragraph (b) above is

applicable and identifying that particular exception; or

(ii) Taking the appropriate corrective action pursuant to paragraph (a) above.

(2) If the Member who initiated the Trade-Through fails to respond to a Satisfaction Order or otherwise fails to take the corrective action required under paragraph (a) within three minutes of receiving notice of a Satisfaction Order, and the Exchange determines that:

(i) There was a Trade-Through; and  
(ii) None of the exceptions to Trade-Through liability specified in paragraph (b) above were applicable, then, subject to the next paragraph, the Member who initiated the Trade-Through shall be liable to the Aggrieved Party for the amount of the actual loss resulting from non-compliance with paragraph (a) and caused by the Trade-Through.

If either (a) the Aggrieved Party does not establish the actual loss within 30 seconds from the time the Aggrieved Party received the response to its Satisfaction Order (or, in the event that it did not receive a response, within four minutes from the time the Aggrieved Party sent the Satisfaction Order), or (b) the Aggrieved Party does not notify the Participant Exchange that initiated the Trade-Through of the amount of such loss within one minute of establishing the loss, then the liability shall be the lesser of the actual loss or the loss caused by the Trade-Through that the Aggrieved Party would have suffered had that party purchased or sold the option series subject to the Trade-Through at the "mitigation price." For the purposes of this paragraph, the "mitigation price" is the highest reported bid (in the case where an offer was traded through) or the lowest reported offer (in the case where a bid was traded through), in the series in question 30 seconds from the time the Aggrieved Party received the response to its Satisfaction Order (or, in the event that it did not receive a response, within four minutes from the time the Aggrieved Party sent the Satisfaction Order). If the Participant Exchange receives a Satisfaction Order within the final four minutes of trading (on any day except the last day of trading prior to the expiration of the series which is the subject of the Trade-Through), then the mitigation price shall be the price established at the opening of trading in that series on the Aggrieved Party's Participant Exchange on the next trading day. However, if the price of the opening transaction is below the opening bid or above the opening offer as established during the opening rotation, then the mitigation price shall

be the opening bid (in the case where an offer was traded through) or opening offer (in the case where a bid was traded through). If the Trade-Through involves a series that expires on the day following the day of the Trade-Through and the Satisfaction Order is received within the last four minutes of trading, the "mitigation price" shall be the final bid (in the case where an offer was traded through) or offer (in the case where a bid was traded through) on the day of the trade that resulted in the Trade-Through.

(3) A Member that is an Aggrieved Party under the rules of another Participant Exchange governing Trade-Through liability must take steps to establish and mitigate any loss such Member might incur as a result of the Trade-Through of the Member's bid or offer. In addition, the Member shall give prompt notice to the other Participant Exchange of any such action in accordance with subparagraph (c)(2) above.

(d) Limitations on Trade-Throughs. Members may not repeatedly trade through better prices available on other exchanges, whether or not the exchange or exchanges whose quotations are traded through are Participant Exchanges, unless one or more of the provisions of paragraph (b) above are applicable. In applying this provision:

(1) The Exchange will consider there to have been a Trade-Through if a Member executes a trade at a price inferior to the NBBO even if the Exchange does not receive a Satisfaction Order from an Aggrieved Party pursuant to subparagraph (a)(1);

(2) The Exchange will not consider there to have been a Trade-Through if a Member executes a Block Trade at a price inferior to the NBBO if such Member satisfied all Aggrieved Parties pursuant to subparagraph (a)(2) following the execution of the Block Trade; and

(3) The Exchange will not consider there to have been a Trade-Through if a Member executes a trade at a price inferior to the quotation being disseminated by an exchange that is not a Participant Exchange if the Member made a good faith effort to trade against the superior quotation of the non-Participant Exchange prior to trading through that quotation. A "good faith effort" to reach a non-Participant Exchange's quotation requires that a Member at least had sent an order that day to the non-Participant Exchange in the class of options in which there is a Trade-Through, at a time at which such non-Participant Exchange was not relieved of its obligation to be firm for its quotations pursuant to Rule 11Ac1-

1 under the Exchange Act, and such non-Participant Exchange neither executed that order nor moved its quotation to a price inferior to the price of the Member's order within 20 seconds of receipt of that order.

#### Locked and Crossed Markets

**Rule 1086. (a) Eligible Market Maker Locking or Crossing a Market.** An Eligible Market Maker that creates a Locked Market or a Crossed Market shall unlock (uncross) that market or shall direct a Principal Order through the Linkage to trade against the bid or offer that the Eligible Market Maker locked (crossed).

(b) Members Other than an Eligible Market Maker Locking or Crossing a Market. A Member other than an Eligible Market Maker that creates a Locked Market or a Crossed Market shall unlock (uncross) the market.

#### Limitation on Principal Order Access

**Rule 1087.** A specialist or ROT shall not be permitted to send Principal Orders in an Eligible Option Class through the Linkage for a given calendar quarter if the specialist or ROT effected less than 80 percent of its volume in that Eligible Option Class on the Exchange in the previous calendar quarter (that is, the specialist or ROT effected 20 percent or more of its volume by sending Principal Orders through the Linkage). This "80/20" is represented as follows:

$$\frac{X}{X + Y}$$

"X" equals the total contract volume the specialist or market effects in an Eligible Option Class against orders of Public Customers on the Exchange during a calendar quarter (a) including contract volume effected by executing P/A Orders sent to the Exchange through the linkage, but (b) excluding contract volume effected by sending P/A Orders through the Linkage for execution on another Participant Exchange. "Y" equals the total contract volume the specialist or ROT effects in such Eligible Option Class by sending Principal Orders through the Linkage during that calendar quarter.

## 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 Phlx 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 Phlx has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

#### 1. Purpose

The purpose of the proposed rule change is to adopt rules implementing the Plan. The purpose of the Plan is to enable the Plan's Participants to act jointly in planning, developing, operating and regulating an Intermarket Options Linkage ("Linkage") so as to further the objectives of Congress as set forth in section 11A(a) of the Act.<sup>5</sup> These objectives include, but are not limited to, increasing market efficiency, enhancing competition, increasing the information available to brokers and dealers and investors, facilitating the offsetting of investors' orders and contributing to the best execution of such orders. Therefore, the Exchange proposes these rules, which if approved by the Commission, should implement the Plan on the Exchange and allow the Exchange to participate in the Linkage.

Capitalized terms used in this filing and not otherwise defined herein have the meaning set forth in the proposed rules and if not defined therein, as defined in the Plan. The Exchange represents the proposed rules are consistent with the amended Plan.

The proposed rules include the following provisions:

- Proposed Phlx rule 1083, Definitions: This proposed rule contains definitions unique to the Linkage; all other definitions in the Exchange's rules would continue to apply to this chapter. Generally, these definitions would incorporate into the Exchange's rules the definitions contained in the Plan.

- Proposed Phlx rule 1084, Operation of the Linkage: This proposed rule incorporates section 7 of the Plan into the Exchange's rules. It would establish the conditions pursuant to which market makers may enter Linkage orders and imposes obligations on the Exchange with respect to how it must process incoming Linkage orders. Pursuant to a recent proposed amendment to the Plan, it would provide that a member of the Exchange may reject an execution of certain Linkage orders received more than 20 seconds after sending the order. This would be a reduction from the 30 seconds currently provided for in the Plan.

Proposed Phlx rule 1084 would provide that if a Linkage Order received is not eligible to be executed automatically via AUTO-X pursuant to Exchange rule 1080(c)(iv),<sup>6</sup> the Linkage Order would be handled as though the size of such order is larger than the Firm Customer Quote Size or Firm Principal Quote Size, respectively (*i.e.*, the specialist must address the order within 15 seconds to provide an execution for at least the Firm Customer Quote Size or Firm Principal Quote Size, respectively).

- Rule 1085, Order Protection: This proposed rule contains the trade-through provisions required under section 8(c) of the Plan. First, it would establish a general standard that members should avoid trade-throughs (defined in proposed Phlx rule 1083 to be a trade at a price inferior to the National Best Bid and Offer ("NBBO")). If a member does effect a trade-through, the member would be responsible for satisfying a member of another exchange by way of a "Satisfaction Order." Both the satisfaction procedures and the exceptions to the satisfaction requirements would incorporate the relevant provision of the Plan.

Finally, the proposed rule would establish potential regulatory liability for members who repeatedly trade through other exchanges, whether or not the exchanges traded through participate in the Linkage. This rule also reflects two pending amendments to the Plan:

1. As with Proposed Phlx rule 1083, this proposed rule reflects the pending amendment to reduce from 30 seconds

<sup>6</sup>Proposed Exchange rule 1080(c)(iv) provides that an order otherwise eligible for AUTO-X would instead be manually handled by the specialist in the following circumstances:

(A) The Exchange's disseminated market is crossed (*i.e.*, 2-1/8 bid, 2 offer) or locked (*i.e.*, 2 bid, 2 offer), or crosses or locks the disseminated market of another options exchange;

(B) One of the following order types: stop, stop limit, market on closing, market on opening, or an all-or-none order where the full size of the order cannot be executed;

(C) The AUTOM System is not open for trading when the order is received (which is known as a pre-market order);

(D) The disseminated market is produced during an opening or other rotation;

(E) When the specialist posts a bid or offer that is better than the specialist's own bid or offer;

(F) If the NBBO Feature is not engaged, and the Exchange's bid or offer is not the NBBO;

(G) When the price of a limit order is not in the appropriate minimum trading increment pursuant to rule 1034;

(H) When the bid price is zero respecting sell orders; and

(I) When the number of contracts automatically executed within a 15 second period in an option exceeds the AUTO-X guarantee, a 30 second period ensues during which subsequent orders are handled manually.

<sup>5</sup> 15 U.S.C. 78k-1(a).

to 20 seconds the time period a member must wait for a response to a Linkage order. If the member does not receive the response within 30 seconds, the member would be permitted to trade through the non-responding exchange without liability.

2. In addition, this rule reflects a pending Plan amendment that would limit liability for trade-throughs in the last few minutes of a trading day to 10 contracts per exchange. The purpose of that amendment is to provide protection for small customer orders, but also to limit the potential risk to members who may not be able to hedge options positions they assume near the close of trading.

- Proposed Phlx Rule 1086, Locked and Crossed Markets: This proposed rule would implement section 7(a)(i)(C) of the Plan by indicating that locked and crossed markets should be avoided and providing procedures to unlock and uncross markets that do occur.

- Proposed Phlx Rule 1087, Limitation on Principal Order Access: This proposed rule would codify the "80/20 Test" contained in section 8(b)(iii) of the Plan. Specifically, a market maker on the Exchange would be restricted from sending Principal Orders (other than P/A orders, which reflect unexecuted customer orders) through the Linkage if the market maker effects less than 80 percent of specified order flow on the Exchange. The Exchange would apply this test on a calendar quarter basis.

2. Statutory Basis

The Exchange believes that the basis under the Act for this proposed rule change is the requirement under section 6(b)(5) of the Act<sup>7</sup> that a national securities exchange have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

*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.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, 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. 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-2002-67 and should be submitted by January 17, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 02-32794 Filed 12-26-02; 8:45 am]

**BILLING CODE 8010-01-U**

**SMALL BUSINESS ADMINISTRATION**

**[Declaration of Disaster #3475]**

**Territory of Guam**

As a result of the President's major disaster declaration for Public Assistance on December 8, 2002, and Amendment 1 adding Individual Assistance on December 19, 2002, I find that the Territory Of Guam constitutes a disaster area due to damages caused by Super Typhoon Pongsona occurring on December 8, 2002 and continuing. Applications for loans for physical damage as a result of this disaster may be filed until the close of business on February 18, 2003 and for economic injury until the close of business on September 19, 2003 at the address listed below or other locally announced locations: U.S. 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 .....	5.875
Homeowners without credit available elsewhere .....	2.937
Businesses with credit available elsewhere .....	6.648
Businesses and Non-profit Organizations without credit available elsewhere .....	3.324
Others (Including Non-Profit Organizations) with credit available elsewhere .....	5.500
For Economic Injury:	
Businesses and Small Agricultural Cooperatives without credit available elsewhere .....	3.324

The number assigned to this disaster for physical damage is 347508 and for economic injury the number is 9T6900. (Catalog of Federal Domestic Assistance Program Nos. 59002 and 59008).

Dated: December 20, 2002.

**Herbert L. Mitchell,**

*Associate Administrator, for Disaster Assistance.*

[FR Doc. 02-32802 Filed 12-26-02; 8:45 am]

**BILLING CODE 8025-01-P**

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> 17 CFR 200.30-3(a)(12).