

#### 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 such filings will also be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. SR-NYSE-2002-32 and should be submitted by June 30, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

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

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47955; File No. SR-Phlx-2003-29]

#### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendments No. 1 and 2 Thereto by the Philadelphia Stock Exchange, Inc. for a Six-Month Extension of its Pilot Systems Change to its Automatic Execution Feature (AUTO-X)

May 30, 2003.

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 April 18, 2003, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described

in Item I below, which was prepared by the Phlx. On May 5, 2003, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On May 30, 2003, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and to approve the proposal, on an accelerated basis, as amended, for an additional six-month period, to expire on November 30, 2003.

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

The Phlx proposes to extend, for an additional six months, its pilot program effecting a system change to the Exchange's Automated Options Market ("AUTOM") System,<sup>5</sup> whereby AUTO-X is disengaged for a period of 30 seconds

<sup>3</sup> See letter from Richard S. Rudolph, Director and Counsel, PHLX, to Marc McKayle, Special Counsel, Division of Market Regulation ("Division"), Commission, dated May 2, 2003. ("Amendment No. 1"). In Amendment No. 1 the Exchange, among other things, clarifies that it proposes to replace the phrase "AUTO-X guarantee" with the phrase "specified disengagement size." The Exchange also represents that, if the quotation in the option series that exhausts the specified disengagement size is revised (either by Auto-Quote or manually by the specialist) prior to the expiration of the 30-second period during which AUTO-X is disengaged, AUTO-X will be re-engaged for that option upon such revision. If the quotation in such an option series is not revised during the 30 second period during which AUTO-X is disengaged, the responsible broker or dealer is firm for the disseminated price, up to the disseminated size, pursuant to Exchange Rule 1082. In such a circumstance, AUTO-X is reengaged automatically after 30 seconds. The Exchange currently engages in surveillance for occurrences in which responsible brokers or dealers do not comply with the Firm Quotation requirements of Exchange Rule 1082, including during the 30-second AUTO-X disengagement period that is the subject of this proposed rule change.

<sup>4</sup> See letter from Richard S. Rudolph, Director and Counsel, PHLX, to Marc McKayle, Special Counsel, Division, Commission, dated May 29, 2003 ("Amendment No. 2"). In Amendment No. 2, the Exchange adds Commentary .07 to Phlx Rule 1080 to clarify that "[t]he specified disengagement size set forth in Rule 1080(c)(iv)(I) is subject to the approval of the Options Committee and shall not be for a number of contracts that is fewer than the highest quotation size for any series in the given option." Further, Commentary .07 states that "[t]he specified disengagement size for each option shall be posted on the Exchange's web site."

<sup>5</sup> AUTOM is the Exchange's electronic order delivery, routing, execution 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.

after the number of contracts automatically executed in a given option meets the specified disengagement size for the option (the "pilot"). As explained further below, the Exchange also proposes to amend the pilot by replacing the phrase "AUTO-X guarantee" with the phrase "specified disengagement size."<sup>6</sup> The text of the proposed rule change, as amended, is as follows:

Proposed new language is *italicized*; proposed deletions are in [brackets].

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

##### Rule 1080

- (a)-(b) No change.
- (c) (i)-(iii) No change.
- (iv) (A)-(H) No change.

(I) When the number of contracts automatically executed within a 15 second period in an option (subject to a pilot program until [May] November 30, 200[2]3) exceeds the [AUTO-X guarantee] *specified disengagement size*, a 30 second period ensues during which subsequent orders are handled manually.

(v) No change.

(d)-(j) No change.

\* \* \* Commentary:

.01-.05 No change.

.06 RESERVED

*.07 The specified disengagement size set forth in Rule 1080(c)(iv)(I) is subject to the approval of the Options Committee and shall not be for a number of contracts that is fewer than the highest quotation size for any series in the given option. The specified disengagement size for each option shall be posted on the Exchange's Web site.*

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

<sup>6</sup> See Amendment No. 1, note 3 *supra*.

<sup>16</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.

*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 extend the pilot for an additional six-month period. The pilot was originally approved on a six-month basis for a limited number of eligible options<sup>7</sup> and extended for an additional six-month period.<sup>8</sup> Subsequently, the number of options eligible for the pilot was expanded to include all Phlx-traded options.<sup>9</sup> In December 2001, the pilot was extended again for an additional six-month period;<sup>10</sup> and extended again in May 2002.<sup>11</sup> The current pilot was extended in November 2002, and is scheduled to expire on May 31, 2003.<sup>12</sup>

The pilot currently includes the following features:

- Once an automatic execution occurs via AUTO-X in an option, the system begins a "counting" program, which counts the number of contracts executed automatically for that option up to a certain size,<sup>13</sup> which causes AUTO-X to become disengaged for that option.

- When the number of contracts executed automatically for that option exhausts the maximum guaranteed AUTO-X size for the specific option

within a 15 second time frame, the system ceases to automatically execute for that option, and drops all AUTO-X eligible orders in that option for manual handling by the specialist for a period of 30 seconds in order to enable the specialist to refresh quotes in that option.

- Upon the expiration of 30 seconds, automatic executions resume, the "counting" program is set to zero and it begins counting the number of contracts executed automatically within a 15 second time frame again, up to the specified disengagement size.

- Again, when the number of contracts automatically exceeds the specified disengagement size within a 15 second time frame, the system drops all subsequent AUTO-X eligible orders for manual handling by the specialist for a period of 30 seconds. The system then continues to reset the "counting" program and drop to manual, etc.

Since the most recent extension of the pilot, the Exchange has undertaken to provide automatic executions for eligible inbound orders (for the account(s) of both customers and broker-dealers) at the Exchange's disseminated price, up to the disseminated size, subject to a maximum guaranteed AUTO-X size of 250 contracts.<sup>14</sup> Thus, the current AUTO-X guarantee for eligible orders on the Exchange is the disseminated size for the given series, instead of a pre-determined "maximum guaranteed AUTO-X size" for the given option. The "maximum guaranteed AUTO-X size" is no longer the appropriate term, because the Exchange's current guaranteed AUTO-X size for eligible orders is equal to the disseminated size, which may be for a different number of contracts each time the quote in a given series is revised; there is no longer a pre-determined "maximum guaranteed AUTO-X size" (other than the Exchange's maximum allowable AUTO-X size of 250 contracts for all options other than options on the Nasdaq-100 Index Tracking Stock ("QQQ"<sup>SM</sup>)).<sup>15</sup>

which have a maximum guaranteed AUTO-X size of 2,000 contracts in the first two near term expiration months, and 1,000 contracts for all other expiration months).<sup>16</sup>

Accordingly, the Exchange has filed this proposed rule change to accommodate intervening changes in the function of AUTO-X; the pilot has not been changed, only the terminology used to describe the number of contracts executed within 15 seconds that would result in the temporary disengagement of AUTO-X.

In order to account for the recent changes to the AUTO-X function (*i.e.*, automatic executions up to the Exchange's disseminated size, rather than up to a pre-set maximum guaranteed size determined by the specialist), the instant pilot renewal includes the term "specified disengagement size."<sup>17</sup> The specified disengagement size shall not be for a number of contracts that is fewer than the highest quotation size for any series in the given option.<sup>18</sup>

One significant purpose of the pilot is to enable the Exchange to continue to move towards the dissemination of options quotations with actual size.<sup>19</sup> As discussed above, the "counting" feature of the pilot functions to disengage AUTO-X for a period of 30 seconds in

determining, comprising, or calculating the Index in the future.

<sup>16</sup> See Securities Exchange Act Release No. 46531 (September 23, 2002), 67 FR 61370 (September 30, 2002) (SR-Phlx-2002-47).

<sup>17</sup> See Amendment No. 2, note 4 *supra*.

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

<sup>19</sup> In August 2002, the Commission approved amendments to the Exchange's definition of "disseminated size" to mean, with respect to the disseminated price for any quoted options series: (a) respecting options subject to the Auto-Quote technology operating as of May, 2002 ("current Auto-Quote") and scheduled to be phased-out by September 2002, the AUTO-X guarantee for the quoted option, except that the disseminated size of limit orders on the book shall be ten (10) contracts; or (b) respecting options subject to the Auto-Quote technology implemented after the effective date of this provision ("new Auto-Quote") and options subject to a proprietary quoting system provided for in Rule 1080.02 ("Specialized Quote Feed"), at least the sum of limit orders. The specialist and crowd may determine to disseminate a size greater than the sum of limit orders. See Securities Exchange Act Release No. 463425 (August 8, 2002), 67 FR 53376 (August 15, 2002) (SR-Phlx-2002-15) (Order approving amendments to Exchange Rule 1082(a)(ii) and Option Floor Procedure Advice F-7). The "current Auto-Quote" described in that Order has been phased out as of the time of the instant proposal. The "new Auto-Quote" is currently fully deployed. The Exchange recently filed a proposed rule change amending the rule to (i) reflect the full deployment of the "new Auto-Quote" and (ii) to add the specialist's size to the sum of the size of limit orders at the disseminated price to the Exchange's definition of "disseminated size" in Exchange Rule 1082. See SR-Phlx-2003-23. The Exchange expects to continue to amend its definition of "disseminated size" to reflect actual size as supporting systems become available.

<sup>7</sup> See Securities Exchange Act Release No. 43652 (December 1, 2000), 65 FR 77059 (December 8, 2000) (SR-Phlx-00-96).

<sup>8</sup> See Securities Exchange Act Release No. 44362 (May 29, 2001), 66 FR 30037 (June 4, 2001) (SR-Phlx-2001-56).

<sup>9</sup> See Securities Exchange Act Release No. 44760 (August 31, 2001), 66 FR 47253 (September 11, 2001) (SR-Phlx-2001-79).

<sup>10</sup> See Securities Exchange Act Release No. 45090 (November 21, 2001), 66 FR 59834 (November 30, 2001) (SR-Phlx-2001-100).

<sup>11</sup> See Securities Exchange Act Release No. 45862 (May 1, 2002), 67 FR 30990 (May 8, 2002) (SR-Phlx-2002-22).

<sup>12</sup> See Securities Exchange Act Release No. 46840 (November 15, 2002), 67 FR 70473 (November 22, 2002) (SR-Phlx-2002-59) ("Previous Pilot Extension").

<sup>13</sup> Currently, the rule refers to this size as the "AUTO-X guarantee." Under this proposal, the size would be referred to as the "specified disengagement size." In November 2002, the Commission approved amendments to Exchange Rule 1080(c) to provide automatic executions for eligible orders at the Exchange's disseminated size, subject to a minimum and maximum AUTO-X eligible size range, on an issue-by-issue basis. See Securities Exchange Act Release No. 46886 (November 22, 2002), 67 FR 72015 (December 3, 2002) (SR-Phlx-2002-39). That proposal provided that the maximum guaranteed AUTO-X size may be for a different number of contracts for customer orders than for broker-dealer orders. The previous pilot extension set forth that when the maximum guaranteed AUTO-X size in an option is for a different number of contracts for customer orders than for broker-dealer orders, AUTO-X would be disengaged when the larger of the two maximum guaranteed AUTO-X sizes for the particular option is exhausted.

<sup>14</sup> See Securities Exchange Act Release No. 47646 (April 8, 2003), 68 FR 17976 (April 14, 2003) (SR-Phlx-2003-18).

<sup>15</sup> The Nasdaq-1000<sup>®</sup>, Nasdaq-100 Index<sup>®</sup>, Nasdaq<sup>®</sup>, The Nasdaq Stock Market<sup>®</sup>, Nasdaq-100 Shares<sup>SM</sup>, Nasdaq-100 Trust<sup>SM</sup>, Nasdaq-100 Index Tracking Stock<sup>SM</sup>, and QQQ<sup>SM</sup> are trademarks or service marks of The Nasdaq Stock Market, Inc. ("Nasdaq") and have been licensed for use for certain purposes by the Exchange pursuant to a License Agreement with Nasdaq. The Nasdaq-100 Index<sup>®</sup> (the "Index" is determined, composed, and calculated by Nasdaq without regard to the Licensee, the Nasdaq-100 Trust<sup>SM</sup>, or the beneficial owners of Nasdaq-100 Shares<sup>SM</sup>. Nasdaq has complete control and sole discretion in determining, comprising, or calculating the Index or in modifying in any way its method for

a given option once the number of contracts automatically executed exhausts the specified disengagement size for that option within a 15-second time frame.

The Exchange believes that this has enabled specialists in such options to continue to provide fair and orderly markets during peak market activity by manually executing orders at correct market prices and refreshing quotations to reflect market demand.

Finally, the Exchange represents that,<sup>20</sup> if the quotation in the option series that exhausts the specified disengagement size is revised (either by Auto-Quote or manually by the specialist) prior to the expiration of the 30-second period during which AUTO-X is disengaged, AUTO-X will automatically re-engage for that option upon such revision. If the quotation in such an option series is not revised during the 30 second period during which AUTO-X is disengaged, the responsible broker or dealer is firm for the disseminated price, up to the disseminated size, pursuant to Exchange Rule 1082. In such a circumstance, AUTO-X is reengaged automatically after 30 seconds. The Exchange currently engages in surveillance for occurrences in which responsible brokers or dealers do not comply with the Firm Quotation requirements of Exchange Rule 1082, including during the 30-second AUTO-X disengagement period that is the subject of this proposed rule change.<sup>21</sup>

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>22</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>23</sup> in particular, 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 enabling the Exchange to prepare for the dissemination of option quotes with actual size, and by enabling Exchange specialists.

<sup>20</sup> See Amendment No. 1, note 3 *supra*.

<sup>21</sup> The Commission notes that the Exchange has represented that it will issue a circular to its members, member organizations, participants, and participant organizations explaining the pilot program and the circumstances in which the AUTO-X system will not be available for customer orders. Telephone conversation between Richard S. Rudolph, Counsel, Phlx and Marc McKayle, Special Counsel, Division, Commission, on May 13, 2003.

<sup>22</sup> 15 U.S.C. 78f(b).

<sup>23</sup> 15 U.S.C. 78f(b)(5).

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

The Exchange 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. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Phlx. All submissions should refer to File No. SR-Phlx-2003-29 and should be submitted by June 30, 2003.

## IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>24</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act, which requires that the rules of an exchange be designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national securities system, and protect investors and the public interest.<sup>25</sup>

<sup>24</sup> In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>25</sup> 15 U.S.C. 78f(b)(5).

The Commission believes that the extension of the pilot should assist specialists in maintaining fair and orderly markets during periods of peak market activity. In this regard, the Commission notes that since the previous extension of the pilot, in response to Commission concerns, the Exchange has automated the re-engaging of AUTO-X for a particular option issue prior to thirty seconds, if the specialist has revised the quote before that time period. The Commission believes that an extension of the pilot program for an additional six months should allow the Exchange to continue its efforts to deploy its new Auto-Quote system to prepare for the dissemination of quotes with actual size.

Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>26</sup> for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission recognizes that, according to the Phlx, no complaints from customers, floor traders, or member firms have been received during the entire period of the pilot program. The Commission believes that granting accelerated approval to extend the pilot program for an additional six months will allow Phlx to continue, without interruption, the existing operation of its AUTO-X system.

## V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>27</sup> that the proposed rule change (SR-Phlx-2003-29), as amended, is hereby approved on an accelerated basis, as a six-month pilot, scheduled to expire on November 30, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>28</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SMALL BUSINESS ADMINISTRATION

### [Declaration of Disaster #3500]

### State of Alabama; Amendment #3

In accordance with a notice received from the Department of Homeland Security—Federal Emergency Management Agency, effective May 30, 2003, the above numbered declaration is

<sup>26</sup> 15 U.S.C. 78s(b)(2).

<sup>27</sup> *Id.*

<sup>28</sup> 17 CFR 200.30-3(a)(12).