SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51544; File No. SR-Phlx-2005-03)

April 14, 2005

Self-Regulatory Organizations; Order Granting Accelerated Approval to Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. Relating to System Changes to the Exchange's Automated Options Market (AUTOM) System

I. Introduction

On January 10, 2005, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to reflect system changes to the Exchange's Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X) that are intended to increase the number of orders that are handled and executed automatically. On March 9, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.[3] The proposed rule change, as amended, was published for comment in the Federal Register on March 16, 2005.[4] The Commission received no comments on the proposal. This order approves the proposed rule change, as amended, on an accelerated basis.

II. Description of the Proposal

The Exchange proposes to amend Exchange Rule 1080, Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X), to reflect system changes to AUTOM that are intended to increase the number of orders that are

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Amendment No. 1 replaced the original filing in its entirety.

4 See Securities Exchange Act Release No. 51352 (March 9, 2005), 70 FR 12935.

handled and executed electronically on the Exchange and to specify when orders that are not executed automatically on the Exchange would be routed through the Intermarket Option Linkage ("Linkage").[5]

Proposed Exchange Rule 1080(c)(v) provides that if the Exchange receives a market order that is not eligible for automatic execution when any of the conditions described in Exchange Rule 1080(c)(iv) exist, such market order, if not already executed manually by the specialist, would be executed automatically in two situations. First, if a market order has not already been executed manually by the specialist, it would be automatically executed against a limit order on the limit order book or a quotation that becomes the national best bid or offer ("NBBO") while the market order is pending. Second, a market order that is being handled manually by the specialist would be automatically executed against an inbound limit order or quotation priced at or better than the NBBO.

Under proposed Exchange Rule 1080(c)(vi), when the Exchange's disseminated quotation is not the NBBO, marketable public customer limit orders would be exposed to the trading crowd and to participants in Phlx XL for a period of three seconds following receipt. At the end of this three-second exposure period, if the Exchange's disseminated price is still not the NBBO, any unexecuted contracts remaining in such an order would be automatically sent as

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5 See Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Linkage Plan"), Securities Exchange Act Release Nos. 44482 (June 27, 2001), 66 FR 35470 (July 5, 2001) (Amendment to Linkage Plan to Conform to the Requirements of Securities Exchange Act Rule 11Ac1-7; 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000) (Notice of Phlx Joining the Linkage Plan); and 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (Approval of the Linkage Plan).

Principal Acting as Agent ("P/A") Order[6] through the Linkage to an exchange whose disseminated price is the NBBO. If at the end of the three-second exposure period the Exchange's disseminated price is the NBBO, any unexecuted contracts remaining in the marketable public customer limit order would be automatically executed on the Exchange up to the Exchange's disseminated size. Any remaining contracts then would be sent as P/A Order(s) to the exchange(s) displaying the NBBO. If the marketable public customer limit order is canceled during the three-second period, no P/A Order would be sent and the marketable public customer limit order would not be executed.

Proposed Exchange Rule 1080(c)(vi)(A)(2) would require that a specialist submit prior written instructions to the Exchange regarding the routing of any P/A Orders that the specialist would send through the Linkage.[7] The AUTOM System would route P/A Orders on behalf of the specialist according to these instructions three seconds after receipt of the marketable public customer limit order if such order is not executed or is partially executed during the three-second period and the Exchange's disseminated price at the end of the three-second period is not the NBBO. In the case of a partial execution during the three-second period, the P/A Order that is routed to the market disseminating the NBBO would be for the size that is equal to the number of contracts remaining in the order.

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6 A P/A Order 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. See Exchange Rule 1083(k)(i).

7 The Exchanged stated that this requirement enables the specialist to carry out his or her agency responsibilities with respect to P/A Orders submitted through the Linkage.

Under proposed Exchange Rule 1080(c)(vi)(B), marketable limit orders for the proprietary account(s) of a broker-dealer (or any account in which a broker-dealer or an associated person of a broker-dealer has any direct or indirect interest) received when the Exchange's disseminated quotation is not the NBBO would be automatically cancelled by the AUTOM System. A message indicating the cancellation would be automatically sent to the sender of the order.

Proposed Exchange Rule 1080(i) would automate the handling of market orders to sell when the disseminated bid price is zero. Currently, Exchange Rule 1080(c)(vi)(G) provides that such orders are handled manually by the specialist. Under the proposed rule change, the AUTOM system would automatically convert market orders to sell when the bid price is zero to limit orders to sell with a limit price of $.05. Such market orders to sell, as well as limit orders to sell, would be placed on the limit order book in price-time priority. In the event that the bid price in the particular series becomes $.05 or greater, thus establishing a bid price that makes the booked limit orders to sell marketable, such orders to sell at the $.05 limit price or better would be executed in the order in which they were received (i.e., price-time priority).

The Exchange also proposed a technical change to an example noted in Exchange Rule 1080(c)(iv)(A) to reflect decimal pricing.

III. Discussion and Commission Findings

The Commission has reviewed carefully the proposed rule change, as amended, and finds that it is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[8] In particular, the Commission finds that the

8 In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

proposed rule change is consistent with Section 6(b)(5) of the Act,[9] 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, in general, protect investors and the public interest.

The Commission believes that the proposal automating the execution of certain market orders that currently are handled manually by the specialist will provide more efficient and immediate executions.[10] In addition, the Commission believes that the three-second order exposure feature for inbound limit orders when the Exchange's disseminated price is not the NBBO, along with the automatic execution of unexecuted contracts up to the Exchange's disseminated size when the Exchange's disseminated price becomes the NBBO and the automatic routing through Linkage of unexecuted contracts when the Exchange's disseminated price is not the NBBO, will provide an effective means for avoiding trade-throughs. The Commission further believes that it is consistent with the Act for the Exchange to cancel automatically broker-dealer marketable limit orders in instances where the Exchange's disseminated quote is not the NBBO.

Finally, the Commission believes that the automated handling of market orders to sell when the bid price is zero should also provide more efficient executions of such orders.

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9 15 U.S.C. 78f(b)(5).

10 The Commission notes that the proposed rule change does not alter the Exchange's rules on priority or trade allocation. According to the Exchange, orders that are executed automatically on the Phlx are allocated to participants on parity in accordance with the allocation algorithm set forth in Exchange Rule 1014(g)(vii). Telephone conversation between Richard S. Rudolph, Vice President and Counsel, Exchange, and Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, on April 11, 2005.

The Exchange has requested accelerated approval of the proposed rule change. The Commission notes that a portion of the proposed rule change is similar to rules previously approved by the Commission for another exchange.[11] The Commission also notes that the Exchange's proposed rule change was subject to the full comment period, with no comments received, and accelerated approval of the proposed rule change, by increasing the automation of order handling, should help facilitate more efficient and immediate executions of transactions on the Exchange.

Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act[12] for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice thereof in the Federal Register.

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11 See Securities Exchange Act Release No. 49068 (January 13, 2004) 69 FR 2775 (January 20, 2004)(SR-BSE-2002-15).

12 15 U.S.C. 78s(b)(2).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[13] that the proposed rule change (SR-Phlx-2005-03), as amended, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[14]

Margaret H. McFarland
Deputy Secretary

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13 15 U.S.C. 78s(b)(2).

14 17 CFR 200.30-3(a)(12).