

**SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51715; File No. SR-Phlx-2004-83)**

May 19, 2005

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 Thereto Relating to the Matching of Certain Incoming Orders with Certain Phlx Existing Orders Through the PACE System

I. Introduction

On November 26, 2004, 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 modify Phlx Rule 229 to permit the PACE System³ to match certain incoming orders with certain Phlx existing orders (the “Matching Rule”). On March 10, 2005, the Phlx filed Amendment No. 1 to the proposed rule change.⁴ The proposed rule change, as amended, was published for comment in the Federal Register on March 24, 2005.⁵

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ PACE is the Exchange’s automated order routing, delivery, execution and reporting system for equities. See Phlx Rule 229.

⁴ In Amendment No. 1, which replaced the original proposal in its entirety, Phlx modified two concepts contained in the original proposed rule change (those of the Midpoint Price and the Modified PACE Quote), clarified the operation of the proposed rule change, reorganized the rule text of proposed new Supplementary Material .04A to Phlx Rule 229 into subsections, and made corresponding changes to other portions of the Supplementary Material to Phlx Rule 229 to reflect the applicability of the proposed rule change.

⁵ See Securities Exchange Act Release No. 51394 (Mar. 18, 2005), 70 FR 15141 (Mar. 24, 2005) (“Notice”).

The Commission received no comments on the proposal. On May 6, 2005, the Phlx filed Amendment No. 2 to the proposed rule change.⁶ This order approves the proposed rule change as amended. Simultaneously, the Commission provides notice of filing of Amendment No. 2, grants accelerated approval to Amendment No. 2, and solicits comments from interested persons on Amendment No. 2.

II. Description of the Proposal

Under the proposal, the Phlx PACE System will check incoming orders against existing orders, and if possible, automatically execute those incoming orders against the existing orders prior to submitting them for execution by the specialist. The Phlx has represented that the purpose of the proposal is to help preserve the priority of orders and reduce incidents of inadvertent trading ahead of customer orders, and believes the proposal, among other things, will protect investors by increasing the number of orders that are matched without the participation of a dealer.

To this end, under the proposed rule change, as amended, round-lot market and limit orders and the round-lot portion of non-all-or-none PRL⁷ market and limit orders entered after the opening will generally execute against existing round-lot market and limit orders and the round-lot portion of existing non-all-or-none PRL market and limit orders that have not been marked for layoff, if executable within the Modified PACE Quote.⁸ Incoming round lot all-or-

⁶ In Amendment No. 2, which supplemented the proposal as noticed, the Phlx modified Supplementary Material .02 to Phlx Rule 229 to clarify that if specialists offer access to PACE for orders without participating in the PACE execution guarantees for agency orders, where the entering member organization has generally elected not to receive automatic execution or primary market print protection for electronically delivered limit orders, those orders will be eligible for enhanced matching under Supplementary Material .04A to Phlx Rule 229.

⁷ “PRL” refers to a combined round-lot and odd-lot order. See Phlx Rule 229.

⁸ The “PACE Quote” means the best bid/ask quote among the American, Boston, National, Chicago, New York, or Philadelphia Stock Exchanges, the Pacific Exchange, or the Intermarket

none orders will be eligible for matching only if the size of the incoming all-or-none order is equal to or smaller than the first existing order it would match against. Conversely, if the incoming all-or-none order is larger than the first existing order it could match against, the incoming order will not automatically match, but will be handled by the specialist.⁹

Under the Matching Rule, the price of the execution will be dependent on the Midpoint Price, meaning the midpoint of the Modified PACE Quote as rounded (if applicable),¹⁰ and the type of orders that are being matched.¹¹ Existing Phlx orders generally will be executed in price/time priority with the highest bid/lowest offer executed first, with existing market orders, for purposes of enhanced matching priority, being treated as limit orders priced at the Midpoint Price. As part of the proposed rule change, the Phlx is also modifying language in other sections of Phlx Rule 229 to reflect and account for the operation of the new Matching Rule.

Trading System/Computer Assisted Execution System (“ITS/CAES”) quote, as appropriate. See Phlx Rule 229. The “Modified PACE Quote” is defined in the proposed rule change to mean the PACE Quote, unless the PACE Quote is comprised of another market’s quote of 100 shares or less, in which case the Modified PACE Quote will be one cent away from such 100 share away quote.

⁹ Orders that have been marked for lay-off (i.e., orders that are being sent to other marketplaces for execution and appropriately marked by the specialist within PACE) would not be eligible under the proposal to be matched against an incoming order. Further, no order for which the entering member organization has elected primary market high-low protection (as provided in Phlx Rule 229, Supplementary Material .07(a)(ii)) would be matched if the execution price of such execution would be outside the primary market high-low range for the day. In addition, notwithstanding Phlx Rule 229, Supplementary Material .01 regarding priority, existing Phlx orders would be executed in price/time priority with the highest bid/lowest offer executed first, with existing market orders, for purposes of enhanced matching priority, being treated as limit orders priced at the Midpoint Price (defined below). See Notice for examples and further details.

¹⁰ Rounding of the Modified PACE Quote will be applicable if the midpoint of the Modified PACE Quote is not a penny increment, in which case the Midpoint Price shall be rounded down (up) to the nearest penny if the existing Phlx order is an order to buy (sell).

¹¹ When one or more of the orders to be matched are limit orders, the execution price would be the price closest to the Midpoint Price that will allow the limit order(s) to execute. See Notice for examples and further details.

III. Discussion and Commission Findings

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹² In particular, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act,¹³ which requires that the rules of an exchange be designed to promote just and equitable principles of trade, to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

Under the proposal, the PACE System will seek to execute eligible incoming customer orders against existing customer orders automatically, prior to submitting them for execution by the specialist. The Matching Rule will apply generally to non-all-or-none round-lot market and limit orders and the round-lot portions of non-all-or-none PRL orders entered after the opening, as well as to round-lot all-or-none orders and the round-lot portion of PRL all-or-none orders to the extent that such orders are smaller in size than an available contra-side order. Moreover, it will apply to non-agency orders in PACE securities, even in the event that the PACE specialist does not agree to provide PACE execution guarantees for such non-agency orders. The Commission believes that, by thus increasing the automated handling of customer orders and matching incoming orders with existing orders without the participation of the specialist, the proposed rule change should better facilitate a wide range of transactions, help preserve the priority of existing orders, and reduce incidents of inadvertent trading ahead of customer orders as contemplated by the Exchange.

¹² In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹³ 15 U.S.C. 78f(b)(5).

The Commission believes that the midpoint of the Modified PACE Quote, the best bid/ask quote among the equities exchanges except in the case where the best bid/ask quote is comprised of an away market quote of 100 shares or less, is a reasonable price upon which to base the price at which customer orders are executed pursuant to the Matching Rule, subject to the rounding principles and provisions designed to accommodate the matching of limit orders, as described above.¹⁴ Moreover, the proposed rule change sets forth in detail for investors the procedures by which orders will be matched in the PACE System and the basis upon which the execution prices for such transactions will be determined.

The Commission finds good cause for approving Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of the publication of notice thereof in the Federal Register. The Commission notes that Amendment No. 2 does not modify the proposed Matching Rule itself, but merely extends the improvements it offers to non-agency orders entered into the PACE System. The Commission therefore believes that it is appropriate to accelerate approval of Amendment No. 2 so that the proposed rule change, as amended, may be implemented without delay.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 2 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

¹⁴ See supra notes 10 and 11.

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2004-83 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-Phlx-2004-83. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal offices of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2004-83 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Conclusion

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

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-Phlx-2004-83), as amended, be, and it hereby is, approved, with Amendment No. 2 being approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland
Deputy Secretary

¹⁵ 15 U.S.C. 78s(b)(2).

¹⁶ 17 CFR 200.30-3(a)(12).