

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-63367; File No. SR-Phlx-2010-163)

November 23, 2010

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by NASDAQ OMX  
PHLX LLC Relating to Obvious Errors Respecting Complex Trades

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup>, and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on November 17, 2010, NASDAQ OMX PHLX LLC ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "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 Exchange, pursuant to Section 19(b)(1) of the Act<sup>3</sup> and Rule 19b-4 thereunder,<sup>4</sup> proposes to amend Rule 1092, Obvious Errors and Catastrophic Errors, to address obvious and catastrophic errors involving complex orders.

The text of the proposed rule change is available on the Exchange's website at <http://www.nasdaqtrader.com/micro.aspx?id=PHLXRulefilings>, at the principal office of the Exchange, on the Commission's website at [www.sec.gov](http://www.sec.gov), and at the Commission's Public Reference Room.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(1).

<sup>4</sup> 17 CFR 240.19b-4.

## 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 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 mitigate the risk to parties using complex orders, where part or all of a complex order traded at an erroneous price; specifically, the proposal addresses the situation where one component (or leg) of a complex order is deemed an obvious (or catastrophic) error but the other component(s) is (are) not.

#### Background

Complex orders are orders with more than one component, and take many forms, such as spreads and straddles.<sup>5</sup> Complex orders have been trading electronically on the Exchange's trading system since 2008.<sup>6</sup> At this time, the Exchange is proposing to amend its Rule 1092 to address complex orders that have at least one leg that trades at an erroneous price. Rule 1092 is the Exchange's rule that governs obvious errors and catastrophic errors in options. Most options exchanges have similar but not identical rules; this proposal would adopt a new process of

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<sup>5</sup> See Rule 1080.08.

<sup>6</sup> See Securities Exchange Act Release No. 58361 (August 14, 2008), 73 FR 49529 (August 21, 2008) (SR-Phlx-2008-50). Complex orders have long been executed on the trading floor verbally using contingent orders and the rules that apply to such executions.

determining how to deal with obvious/catastrophic errors when a complex order trades with another complex order.

Rule 1092 provides a framework for reviewing the price of a transaction to determine whether that price was an “obvious error”<sup>7</sup> pursuant to objective standards. When a participant believes he/she received one or more executions at an erroneous price, a participant may notify the Options Exchange Officials (“OEOs”) and request the review of a trade as a possible obvious error.<sup>8</sup> An obvious error will be deemed to have occurred when the execution price of a transaction is higher or lower than the theoretical price for a series by a certain amount depending on the type of option. OEOs use one of three criteria when determining the theoretical price of an options execution, which is enumerated in Rule 1092(b). The theoretical price is then compared to an obvious/catastrophic error chart within Rule 1092(a). If the transaction price meets this threshold, the transaction may be adjusted or nullified.

#### Proposal

The proposal at hand would permit all legs of a complex order execution to be nullified when one leg can be nullified under this Rule, only if the execution was a complex order versus a complex order (such that all of the same parties are involved in the trade).<sup>9</sup> This occurs when a complex order executes against another complex order, with each piece executing through the System against each other. For example, assume a customer trades a call spread at a net price of \$.50 by buying the January 50 calls at \$3.00 and selling the January 55 calls at \$2.50. If the January 50 calls should have been trading at \$7.00 and thus meet the obvious error threshold in

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<sup>7</sup> This proposal also covers catastrophic errors.

<sup>8</sup> See Rule 1092(e).

<sup>9</sup> See proposed Rule 1092(c)(v)(A).

Rule 1092, then the entire complex trade will be nullified only if the January 50 and 55 calls traded as a complex order against another complex order, rather than as two separate trades. Currently, once the trade involving the January 50 calls is nullified, both parties are stuck with a transaction in the January 55 calls, which was not intended by either. This proposal to nullify all the components of a complex order that traded with another complex order provides an important benefit to both parties, neither of whom intended to end up with just one option.

This proposal does not address complex orders that do not trade against other complex orders. Sometimes complex orders are executed by the System by “legging” or executing the component parts against other individual, unrelated orders/quotes rather than a single complex order with the same component parts.<sup>10</sup> The benefit of the legging feature of the Exchange’s complex order system is that it increases the likelihood that a complex order will be executed. Nevertheless, it is possible, at times, that after such a trade, only one leg of a complex order may meet the obvious error threshold; thus, this could result in a residual position of a single leg, rather than a complete complex order execution. This will not change under this proposal.

In sum, Rule 1092 is proposed to be amended as enumerated above in order to mitigate risk for parties of a complex order where a complex order traded with another complex order at an erroneous price. By creating uniformity for all trades that are “complex to complex,” parties will have less trading risk because all of the components will be nullified under the proposal.

In addition, the Exchange also proposes to make three minor corrections: (i) a reference in Rule 1092(b)(ii) to Rule 1014(c)(1)(A)(i)(a) is inverted and should instead say Rule 1014(c)(i)(A)(1)(a); (ii) the words “obvious error” in Rule 1092(e)(i)(B) are being capitalized to

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<sup>10</sup> In the example above, the January 50 calls would be purchased from seller A and the January 55 calls sold to buyer B, both of whom are just bidding/offering one option, not a complex order.

match the rest of the rule; and (iii) a reference to “AUTOM” in Rule 1092(e)(ii) is outdated and will be deleted, leaving reference to the “Help Desk.”

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>11</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>12</sup> 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 investors and the public interest, by improving the obvious error process for complex orders that trade with other complex orders. Recognition that a trade is part of a complex order should help add more certainty to the obvious/catastrophic error process and reduce the risk to parties trading on the Exchange.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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 45 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

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<sup>11</sup> 15 U.S.C. 78f(b).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

the Exchange consents, the Commission shall: (a) by order approve or disapprove 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 Exchange 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
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2010-163 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2010-163. 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 website (<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 website viewing and printing in the Commission's Public Reference Room, 100 F

Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office 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-2010-163 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Elizabeth M. Murphy  
Secretary

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<sup>13</sup> 17 CFR 200.30-3(a)(12).