

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- 64249; File No. SR-Phlx-2011-47)

April 7, 2011

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NASDAQ OMX PHLX LLC to Establish a Qualified Contingent Cross Order

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 1, 2011, NASDAQ OMX PHLX LLC ("Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II 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 proposes to amend PHLX Rule 1080 to establish a Qualified Contingent Cross Order ("QCC Order") for execution in the PHLX XL II System ("System" or "Exchange System"). The QCC Order will facilitate the execution of stock/option Qualified Contingent Trades that satisfy the requirements of the trade through exemption in connection with Rule 611(d) of Regulation NMS ("QCT Trade Exemption").<sup>3</sup> The text of the proposed rule change is below. Proposed new language is underlined; proposed deletions are in brackets.

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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> See Securities Exchange Act Release No. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006); Securities Exchange Act Release No. 57620 (April 4, 2008) 73 FR 19271 (April 9, 2008).

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**Rule 1080. PHLX XL and XL II**

(a) – (n) No Change.

**(o) Qualified Contingent Cross Order.**

A Qualified Contingent Cross Order is comprised of an order to buy or sell at least 1000 contracts that is identified as being part of a qualified contingent trade, as that term is defined in subsection (3) below, coupled with a contra-side order to buy or sell an equal number of contracts.

- (1) Qualified Contingent Cross Orders are immediately executed upon entry into the System by an Order Entry Firm provided that (i) no Customer Orders are at the same price on the Exchange’s limit order book and (ii) the price is at or between the NBBO.
  - (a) Qualified Contingent Cross Orders will be automatically rejected if they cannot be executed.
  - (b) Qualified Contingent Cross Orders may only be entered in the regular trading increments applicable to the options class under Rule 1034.
- (2) Qualified Contingent Cross Orders shall only be submitted electronically from off the Floor to the PHLX System. Order Entry Firms must maintain books and records demonstrating that each Qualified Contingent Cross Order was routed to the Exchange System from off of the Floor. Any Qualified Contingent Cross Order that does not have a corresponding record required by this subsection shall be deemed to have been entered from on the Floor in violation of this Rule.
- (3) A “qualified contingent trade” is a transaction consisting of two or more component orders, executed as agent or principal, where:
  - (a) At least one component is an NMS Stock, as defined in Rule 600 of Regulation NMS under the Exchange Act;
  - (b) all components are effected with a product or price contingency that either has been agreed to by all the respective counterparties or arranged for by a broker-dealer as principal or agent;
  - (c) the execution of one component is contingent upon the execution of all other components at or near the same time;

- (d) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined by the time the contingent order is placed;
- (e) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or cancelled; and
- (f) the transaction is fully hedged (without regard to any prior existing position) as a result of other components of the contingent trade.

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(b) Not applicable.

(c) Not applicable.

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## 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

On February 24, 2011, the Commission issued an order approving SR-ISE-2010-073, a proposal by the ISE to establish a Qualified Contingent Cross (“ISE QCC Proposal”).<sup>4</sup> The ISE

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<sup>4</sup> The Commission notes that the order approving the ISE QCC Proposal was published in the Federal Register on March 2, 2011. See Securities Exchange Act Release No. 63955 (February 24, 2011), 76 FR 11533 (“Approval Order”).

QCC Proposal was controversial, attracting opposition from multiple exchanges including PHLX. In its comment letter on the ISE QCC Proposal, PHLX asserted that the QCC Proposal deviated from “long-held principles in the options market by permitting the crossing of orders without requiring prior exposure” and that the ISE QCC Proposal failed adequately to protect customers with orders resting on the ISE limit order book.<sup>5</sup>

The Commission, in a thorough and thoughtful decision, concluded that the QCC Proposal - including the lack of prior order exposure - is consistent with the Act. With respect to order exposure, the Commission stated:

While the Commission believes that order exposure is generally beneficial to options markets in that it provides an incentive to options market makers to provide liquidity and therefore plays an important role in ensuring competition and price discovery in the options markets, it also has recognized that contingent trades can be “useful trading tools for investors and other market participants, particularly those who trade the securities of issuers involved in mergers, different classes of shares of the same issuer, convertible securities, and equity derivatives such as options [italics added].” and that “[t]hose who engage in contingent trades can benefit the market as a whole by studying the relationships between the prices of such securities and executing contingent trades when they believe such relationships are out of line with what they believe to be fair value.” As such, the Commission stated that transactions that meet the specified requirements of the NMS QCT Exemption could be of benefit to the market as a whole, contributing to the efficient functioning of the securities markets and the price discovery process.<sup>6</sup>

The Approval Order succinctly sets forth the material elements of ISE’s Qualified Contingent Cross:

Thus, as modified, an ISE member effecting a trade pursuant to the NMS QCT Exemption could cross the options leg of the trade on ISE as a QCC Order immediately upon entry, without exposure, only if there are no Priority Customer orders on the Exchange’s limit order book at the same price and if the order: (i) is for at least 1,000 contracts; (ii) meets the six requirements of the NMS QCT Exemption; and (iii) is executed at a price at or between the NBBO (“Modified QCC Order”). In the Notice, ISE stated that the modifications to the Original QCC Order (i.e., to prevent the execution of a QCC if there is a Priority Customer on its book and to increase the minimum size of a

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<sup>5</sup> See Letter, dated August 13, 2010, from Thomas Wittman, President, NASDAQ OMX PHLX to Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission.

<sup>6</sup> Approval Order at p. 28 (citing to Reg NMS QCT Exemption).

QCC Order) remove the appearance that such orders are trading ahead of Priority Customer orders or that the QCC Order could be used to disadvantage retail customers (citations omitted).<sup>7</sup>

The Commission, having considered and addressed all arguments in favor and in opposition to the QCC, has established binding precedent under which other exchanges can establish a QCC Order that is also consistent with the Act.<sup>8</sup>

In keeping with that precedent, PHLX hereby proposes to add PHLX Rule 1080(o) to establish a QCC Order based on the precedent of ISE's QCC Order. Specifically, PHLX proposes to amend Rule 1080 to provide that a PHLX Order Entry Firm effectuating a trade via the System pursuant to the Regulation NMS Qualified Contingent Trade Exemption to Rule 611(a) ("QCT Exemption") can cross the options leg of the trade on PHLX as a QCC Order immediately upon entry and without order exposure if no Customer Orders<sup>9</sup> exist on the Exchange's order book at the same price.

As set forth in proposed Rule 1080(o), the QCC Order must: (i) be for at least 1,000 contracts, (ii) meet the six requirements of Rule 1080(o)(3) which are modeled on the QCT Exemption, (iii) be executed at a price at or between the National Best Bid and Offer ("NBBO");

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<sup>7</sup> Id. at p. 18.

<sup>8</sup> The Exchange has filed its proposed rule change pursuant to Rule 19b-4(f)(6). The Commission notes that it has previously provided guidance regarding the appropriate analysis for when a self-regulatory organization may submit a proposed rule change under Rule 19b-4(f)(6) for immediate effectiveness. See Securities Exchange Act Release No. 58092 (July 3, 2008), 73 FR 40143 (July 11, 2008).

<sup>9</sup> PHLX will reject QCC Orders that attempt to execute when any Customer orders are resting on the Exchange limit order book at the same price. ISE QCC Orders will be cancelled only when they encounter resting orders of Priority Customers. The Commission has previously approved the rejection of crossing transactions when there is a customer order on the book at the same price. See, e.g., ISE Rule 721(a); and CBOE Rule 6.74A, Interpretations and Policies .08.

and (iv) be rejected if a Customer order is resting on the Exchange book at the same price.<sup>10</sup> As a result, the PHLX QCC Order proposed herein satisfies all of the requirements the Commission enumerated in the Approval Order.

Under this proposal, the Exchange would only permit QCCs to be submitted electronically from off the Floor through the Exchange System. In this regard, a Floor Broker located on the Floor of the Exchange would not be allowed to enter QCCs into the System, or otherwise effect them in open outcry. We plan to file a separate proposed rule change to address effecting QCCs in open outcry on the Floor of the Exchange.<sup>11</sup>

To provide a mechanism for the Exchange to review for whether QCC Orders have been entered from off of the Floor, the Exchange proposes to adopt proposed Rule 1080(o)(2). This provision would require members to maintain books and records demonstrating that each Qualified Contingent Cross Order was routed to the Exchange System from off of the Floor. Any Qualified Contingent Cross Order that does not have a corresponding record required by this provision would be deemed to have been entered from on the Floor in violation of Rule 1080(o).

The Exchange's proposal addresses the mechanics of executing the stock and options components of a net-price transaction. The Exchange believes that it is necessary that it provide members and their customers with the same trading capabilities available on other exchanges

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<sup>10</sup> While the QCC would not provide exposure for price improvement for the options leg of a stock-option order, the options leg must be executed at the NBBO or better. The Commission has previously approved crossing transactions with no opportunity for price improvement. See, e.g., ISE Rule 721(a) and Chicago Board Options Exchange Rule 6.74A, Interpretations and Policies .08.

<sup>11</sup> It is PHLX's position that the Approval Order contemplates the submission of QCC Orders from the Floor of the Exchange. Nothing in this filing should be construed as being inconsistent with that position.

with respect to QCCs, including the change proposed herein, which would permit members to execute the options legs of their customers' large complex orders on the Exchange.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>12</sup> in general, and furthers the objectives of Section 6(b)(5)<sup>13</sup> and 6(b)(8)<sup>14</sup> of the Act 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 and the rules of an exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. In addition, the proposed rule change is consistent with Section 11A(a)(1)(C) of the Act,<sup>15</sup> in which Congress found that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure, among other things, the economically efficient execution of securities transactions.

The statutory basis for PHLX's proposed QCC Order is identical to the Commission's basis for finding that the ISE's QCC Proposal is consistent with the Act "in that it would facilitate the execution of qualified contingent trades, for which the Commission found in the Original QCT Exemption to be of benefit to the market as a whole, contributing to the efficient functioning of the securities markets and the price discovery process. The QCC Order would provide assurance to parties to stock-option qualified contingent trades that their hedge would be maintained by allowing the options component to be executed as a clean cross." In addition, like

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

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> 15 U.S.C. 78f(b)(8).

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

the ISE's QCC Order, the Exchange's Modified QCC Order "is narrowly drawn to provide a limited exception to the general principle of exposure, and retains the general principle of customer priority."

PHLX's proposed QCC Order promotes the same Commission goals as or more effectively, and it is as or more narrowly drawn than ISE's QCC Order. Accordingly, the Exchange believes that the proposed rule change must also be consistent with the Act.

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

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

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the proposed rule change does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative prior to 30 days from the date on which it was filed, or such shorter time as the Commission may designate, if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>16</sup> and Rule 19b-4(f)(6) (iii) thereunder.<sup>17</sup>

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<sup>16</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>17</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires the self-regulatory organization to submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### 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. 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-2011-47 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-2011-47. 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 such 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 No. SR-Phlx-2011-47 and should be submitted on or before [insert date 21 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>18</sup>

Cathy H. Ahn  
Deputy Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).