

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66087; File No. SR-Phlx-2011-182)

January 3, 2012

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the PHLX Market Exhaust Functionality

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 22, 2011, 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 the Substance of the Proposed Rule Change

The Exchange proposes to amend Exchange Rule 1082, Firm Quotations, by modifying Exchange Rule 1082(a)(ii)(B)(4), Market Exhaust, to reflect the Exchange’s discontinuation of the Market Exhaust functionality (hereinafter, “Market Exhaust”), a feature of the Exchange’s PHLX XL[®] automated options trading system.³

The Exchange also proposes to amend Exchange Rule 1080 by deleting a reference to “Market Exhaust” from Rule 1080(c).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ This proposal refers to “PHLX XL” as the Exchange’s automated options trading system. In May 2009 the Exchange enhanced the system and adopted corresponding rules referring to the system as “Phlx XL II.” See Securities Exchange Act Release No. 59995 (May 28, 2009), 74 FR 26750 (June 3, 2009) (SR-Phlx-2009-32). The Exchange intends to submit a separate technical proposed rule change that would change all references to the system from “Phlx XL II” to “PHLX XL” for branding purposes.

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, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and the 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to reflect in the Exchange rules the discontinuation of the PHLX XL Market Exhaust functionality.

In June, 2009, the Exchange added several significant enhancements to its automated options trading platform (now known as PHLX XL), and adopted rules to reflect those enhancements.⁴ As part of the system enhancements, the Exchange proposed, among other things, Market Exhaust, which is defined below. Several elements of Market Exhaust have been part of a pilot (the "pilot") which was originally scheduled to expire November 30, 2009, and later extended through September 30, 2010.⁵ The Exchange subsequently modified the pilot to address the manner

⁴ See Securities Exchange Act Release No. 59995 (May 28, 2009), 74 FR 26750 (June 3, 2009) (SR-Phlx-2009-32).

⁵ See Securities Exchange Act Release No. 60951 (November 6, 2009), 74 FR 59275 (November 17, 2009) (SR-Phlx-2009-95).

in which the PHLX XL system disseminates quotes during and after the Market Exhaust process.⁶ That modification was implemented on a pilot basis, scheduled to expire November 30, 2010,⁷ and the pilot was then extended through March 31, 2011.⁸ The pilot was then extended through July 31, 2011,⁹ November 30, 2011,¹⁰ and its current expiration date of February 29, 2012.¹¹

Market Exhaust Functionality

The PHLX XL system initiates Market Exhaust when there are no PHLX XL participant quotations in the Exchange's disseminated market for a particular series and an initiating order in the series is received.¹² The PHLX XL system initiates a "Market Exhaust Auction" for the initiating order, and then goes through a series of steps depending on the market conditions present for the affected series, including a broadcast to PHLX XL participants, execution of all or part of the initiating order, routing the initiating order (or remaining contracts following execution) to better priced away markets, and a "Provisional Auction," after which any unexecuted contracts from the initiating order will be subject to, and not executable outside of, an Auction Quote Range ("AQR"). During the Provisional Auction, any unexecuted contracts from the initiating order are displayed in the Exchange quote for the remaining size for a brief period not to exceed ten seconds and

⁶ See Securities Exchange Act Release No. 63024 (September 30, 2010), 75 FR 61799 (October 6, 2010) (SR-Phlx-2010-134).

⁷ Id.

⁸ See Securities Exchange Act Release No. 63350 (November 19, 2010), 75 FR 73150 (November 29, 2010) (SR-Phlx-2010-156).

⁹ See Securities Exchange Act Release No. 64056 (March 8, 2011), 76 FR 13678 (March 14, 2011) (SR-Phlx-2011-29).

¹⁰ See Securities Exchange Act Release No. 64833 (July 7, 2011), 76 FR 41317 (July 13, 2011) (SR-Phlx-2011-95).

¹¹ See Securities Exchange Act Release No. 65670 (November 2, 2011), 76 FR 69308 (November 8, 2011) (SR-Phlx-2011-144).

¹² See Exchange Rule 1082(a)(ii)(B)(4).

subsequently cancelled back to the entering participant if they remain unexecuted, unless the member that submitted the original order has instructed the Exchange in writing to re-enter the remaining size, in which case the remaining size will be automatically submitted as a new order.

Discontinuation of Market Exhaust

The Exchange proposes to discontinue the application of Market Exhaust on PHLX XL. The Exchange has determined that Market Exhaust has only affected a small number of orders, given the specific set of circumstances that must occur in order for Market Exhaust to be initiated. Market Exhaust, which was originally intended to protect against erroneous executions when there are no participant quotes on the Exchange, may actually result in a customer missing the opportunity to access liquidity present on the order book and/or on other exchanges while their order is involved in the Market Exhaust process. Once Market Exhaust is discontinued on the Exchange, orders received when there are no PHLX XL participant quotations in the Exchange's disseminated market for the affected series will be handled in accordance with existing Exchange rules regarding electronic order entry, execution, routing, trade reporting, and firm quotations.¹³

The Exchange proposes to amend Rule 1082(a)(ii)(B)(4) by adopting Rule 1082(a)(ii)(B)(4)(a), which would state that, if there are no offers both on the Exchange and on away markets in the affected series, market orders to buy in the affected series will be cancelled immediately, and an electronic report of such cancellation will be transmitted to the sender. The Exchange would cancel such a market order because in this rare circumstance there would be no disseminated market on the Exchange and no disseminated market on any away market against which such market order could be routed and executed, and there would be no price at which the Exchange could place such a market order on the Exchange's limit order book.

¹³ See, e.g., Exchange Rules 1014, 1051, 1080, and 1082.

Upon the discontinuation of Market Exhaust, orders that would have been handled under Market Exhaust will be handled according to Exchange rules that address specific market conditions. Proposed Rule 1082(a)(ii)(B)(4)(b) would address the PHLX XL system's functionality in the circumstance where there are no offers on the Exchange and there are offers on away markets in the affected series. In such a circumstance, market orders to buy will be handled pursuant to Exchange Rule 1080(m).¹⁴

Proposed Rule 1082(a)(ii)(B)(4)(c) would address the PHLX XL system's functionality in the circumstance where there are no bids or a zero priced bid on the Exchange and there are no bids on away markets in the affected series. In such a circumstance, the Exchange will disseminate a bid price of zero, and market orders to sell will be handled pursuant to Exchange Rule 1080(i).¹⁵

Proposed Rule 1082(a)(ii)(B)(4)(d) would address the PHLX XL system's functionality in the circumstance where there are no bids or a zero priced bid on the Exchange and there are bids on away markets in the affected series. In such a circumstance, market orders to sell will be handled pursuant to Exchange Rule 1080(m).

The Exchange believes that the proposed rule change benefits customers and the marketplace as a whole by simplifying the order handling process and enabling customers to

¹⁴ Rule 1080(m), Order Routing, describes the PHLX XL functionality by which eligible orders are routed to away markets for possible execution.

¹⁵ Rule 1080(i) states that the system will convert market orders to sell a particular option series to limit orders to sell with a limit price of the minimum trading increment applicable to such series that are received when: (A) For options listed only on the Exchange: (1) the Exchange's disseminated bid price in such option series is zero; and (2) the Exchange's disseminated quotation in the series has a bid/ask differential less than or equal to \$0.25; or (B) For options that are listed on multiple exchanges: (1) the disseminated NBBO includes a bid price of zero in the series; and (2) the Exchange's disseminated quotation in the series has a bid/ask differential less than or equal to \$0.25. Such orders will be automatically placed on the limit order book in price-time priority.

immediately access posted liquidity on the Exchange and away markets even when there may not be PHLX participant quotes present.¹⁶

The Exchange also proposes to amend Exchange Rule 1080 by deleting a reference to “Market Exhaust” from Rule 1080(c).

The Exchange will complete the discontinuation of the Market Exhaust functionality on or before January 31, 2012.¹⁷

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act¹⁸ in general, and furthers the objectives of Section 6(b)(5) of the Act¹⁹ 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.

Specifically, the Exchange believes that the proposed discontinuation of Market Exhaust protects investors and the public interest by ensuring that customers have the opportunity to access liquidity present on the order book and/or on other exchanges quickly, instead of foregoing such opportunity while their order is involved in the Market Exhaust process. In the rare set of circumstances that give rise to Market Exhaust, investors should continue to receive quality executions on PHLX and at away markets (following routing if appropriate).

¹⁶ Additionally, the Exchange notes that the deletion of the rules concerning Market Exhaust effects consistency between the rules and the PHLX XL functionality in compliance with the Act.

¹⁷ The Exchange will issue a circular to membership describing the discontinuation of Market Exhaust prior to the effectiveness of such discontinuation.

¹⁸ 15 U.S.C. 78f(b).

¹⁹ 15 U.S.C. 78f(b)(5).

Moreover, the proposed discontinuation of Market Exhaust removes impediments and perfects the mechanism of a free and open market and a national market system by expediting the PHLX execution, routing and trade reporting process, all to the benefit of the markets as a whole.

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

Because the foregoing 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 for 30 days after the date of the filing, or such shorter time as the Commission may designate, it has become effective pursuant to 19(b)(3)(A) of the Act²⁰ and Rule 19b-4(f)(6)²¹ thereunder.

At any time within 60 days of the filing of the 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. If the Commission takes such action, the

²⁰ 15 U.S.C. 78s(b)(3)(A).

²¹ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file 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.

Commission shall institute proceedings to determine whether the proposed rule should be approved or 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 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. Please include File Number SR-Phlx-2011-182 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-2011-182. 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 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 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-2011-182, 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.²²

Kevin M. O'Neill
Deputy Secretary

²² 17 CFR 200.30-3(a)(12).