

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52239; File No. SR-Phlx-2005-14)

August 11, 2005

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Order Matching at the Opening in PACE

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹, and Rule 19b-4² thereunder, notice is hereby given that on March 10, 2005, the Philadelphia Stock Exchange, Inc. (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Phlx. On July 28, 2005, the Phlx submitted Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Phlx proposes to amend Phlx Rule 229 to permit PACE⁴ to modify the opening process to match certain orders, described below, to each other, where possible, instead of matching such orders with the specialist. Specifically, the Exchange proposes to modify Phlx Rule 229, Supplementary Materials .06 and .10(a)-(b), to effect the matching of such orders. The Exchange also proposes to delete Phlx Rule 229, Supplementary Material .11.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1, which replaced and superseded the original filing in its entirety, included additional text in the purpose section to further clarify the description and operation of the proposed rule change, and also included a minor edit to the text of Phlx Rule 229.

⁴ PACE is the Exchange’s automated order routing, delivery, execution and reporting system for equities. See Phlx Rule 229.

The text of amended Phlx Rule 229 is set forth below. Brackets indicate deletions; italics indicate proposed new text.

Rule 229, Supplementary Material:

.01 - .05 No change.

.06 Market orders [(round-lots, odd-lots and PRL's up to 2099 shares)] entered prior to the opening will be executed at the New York market opening price, unless such order is marked sell short or is laid off at another market center prior to the actual New York market opening. [To be guaranteed an execution at the New York market opening price, such orders must be received at least two minutes prior to the actual New York market opening.] Market orders that are equal to or smaller than the Directed Specialist's automatic execution guarantee size, or larger orders entered two minutes or more (or such shorter time, for example, one minute or more, as chosen by the Directed Specialist for all securities traded by the Directed Specialist) prior to the actual New York market opening will be executed automatically against:

- (a) available contra-side orders received by the same Directed Specialist that are to be executed at the opening, otherwise they will be executed automatically against the Directed Specialist; or
- (b) the Directed Specialist, if such orders are odd-lot orders, partial round lot all-or-none orders, round lot all-or-none orders when a single contra-side order with sufficient volume is not available and the odd lot portion of PRL orders executed in (a) above.

In the case of delayed openings, execution will occur at the New York opening price. Market orders not executed automatically, as above, will be available, after the opening, to be executed as an existing order pursuant to Supplementary Material .04A(b)(i) above, or receive a

professional execution in accordance with Supplementary Material, .10(b) below. [Execution of market orders of a size greater than 2099 shares and up to 5000 shares which the specialist agrees to accept must be received at least three minutes prior to the actual New York Market opening price.]

.07-.09 No change.

.10(a)(i)-(iii) No change.

[In order for round-lot limit orders up to 500 shares and the round-lot portion of PRL limit orders up to 599 shares to be guaranteed an execution at the New York opening price, such orders must be received at least two minutes prior to the actual New York market opening and 1000 or more shares must open on the New York market at the limit price. The obligations of a specialist under the Rule for the execution of round-lot limit orders up to 500 shares and the round-lot portion of PRL limit orders up to 599 shares shall not be altered by the acceptance of any other limit orders by such specialist.]

(iv) Limit orders, unless such orders are marked sell short or laid off at another market center prior to the actual New York market opening, that are traded through by the New York market opening price and that are entered two minutes or more (or such shorter time, for example, one minute or more, as chosen by the Directed Specialist for all securities traded by the Directed Specialist) prior to the actual New York market opening will be executed automatically, at the New York market opening price, against:

- (A) available contra-side orders received by the same Directed Specialist that are to be executed at the opening, otherwise they will be executed automatically against the Directed Specialist; or
- (B) the Directed Specialist, if such orders are odd-lot orders, partial round lot all-or-none orders, round lot all-or-none orders when a single contra-side order with sufficient volume is not available and the odd lot portion of PRL orders executed in (A) above.

Limit orders not executed automatically, as above, will be available, after the opening, to be executed as an existing order pursuant to Supplementary Material .04A(b)(i) above, or receive a professional execution in accordance with Supplementary Material, .10(b) below.

Remainder of **.10(a)** No change.

.10(b) Professional Execution Standards –[Market orders and round-lot limit orders of 600 to 2000 shares, and PRL’s of 601 to 2099 shares and such limit orders of greater size up to 5000 shares that the specialist may accept must be entered at least three (3) minutes prior to the opening in order to be guaranteed the opening price.]

Remainder of **.10(b)** No change.

.10(c) No change.

.11 [Upon written approval of a Floor Procedure Committee member, the specialist will have the right to refuse prior to the actual New York opening, round-lot and PRL orders which create a net long or net short position in excess of 1000 shares. Prior to granting such approval, however, the alternate specialists in such security must be requested to accept a portion of such orders as may be deemed appropriate by the Floor Procedure Committee member.] Reserved.

.12-.22 No change.

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 Phlx 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 Phlx 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 increase automated order handling and remove the specialist in situations where orders could otherwise match at the opening. Currently, when PACE automatically executes certain orders received before the opening at the opening price, all such orders are matched with the specialist to whom the order is directed. The net result of this is that all such orders receive an execution (against the Directed Specialist⁵) and the Directed Specialist may be left with a position, which is the result of the specialist’s interaction with the imbalance of buy or sell orders, as applicable.

The Exchange proposes to modify the matching functionality so that certain Eligible Orders, described below, received by each Directed Specialist that could be matched against each other would do so instead of matching with the Directed Specialist. In other words, such Eligible Orders would still receive an execution, but the execution would not involve the

⁵ The term “Directed Specialist” has the same meaning as in Phlx Rule 229A(b)(3), when there is more than one specialist assigned in a security. When there is only one specialist assigned in a security, the term Directed Specialist means that sole specialist.

participation of a dealer. Directed Specialists would continue to match against other Eligible Orders, as described below, as well as any imbalance of their directed orders that could not match against other orders. Additionally, the Exchange is proposing to modify the text of Phlx Rule 229 to depict how the proposed matching functionality will operate, including clearly indicating what orders would be eligible for matching at the opening price and indicating against whom such orders would be matched.

Market Orders. Under this proposal, certain market and limit orders received before the opening will be matched at the New York market⁶ opening price.⁷ In order to be matched at the New York opening price, market orders could not be marked sell short or laid off⁸ (i.e., orders that are being sent to other marketplaces for execution and appropriately marked by the specialist within PACE) before the actual opening. In addition, if they are equal to or smaller than the Directed Specialist's automatic execution guarantee size, they would need to be entered before the actual New York market opening. If they are larger than the Directed Specialist's automatic execution guarantee size, they would need to be entered two minutes or more (or such shorter time, for example, one minute or more, as chosen by the Directed Specialist for all securities traded by the Directed Specialist) prior to the actual New York market opening.⁹ (Market orders

⁶ The "New York market" refers to the listing market.

⁷ See Phlx Rule 229, Supplementary Material .06.

⁸ See 17 CFR 240.11Ac1-4(c)(5).

⁹ The PACE system historically only executed market orders equal to or smaller than the Directed Specialist's automatic execution guarantee size entered before the opening at the New York opening price. As the PACE functionality evolved, certain limit orders and larger sizes were executed at the opening price, but the Phlx determined to limit those additional sizes and the additional type to those entered a specific time before the opening in order to give the Directed Specialist time to assess and handle the risk associated with executing those orders. At this time, the Phlx has determined not to change the type and size of orders that are subject to a time restriction, only to change the party against whom those orders match against.

that are eligible to be matched as described in this paragraph are referred to as “Eligible Market Orders”). The Phlx also proposes to add language to the text of Phlx Rule 229, Supplementary Material .06, to implement the preceding standards and proposes to remove certain existing language relating to the size of market orders and the receipt time required to receive the New York opening price that conflicts with the proposed language.

Limit Orders. The Exchange’s proposal would also provide that limit orders, in order to be matched at the New York opening price, could not be marked sell short or laid off before the actual opening.¹⁰ In addition, they would have to be traded through by the New York market opening price and must be entered two minutes or more (or such shorter time, for example, one minute or more, as chosen by the Directed Specialist for all securities traded by the Directed Specialist) prior to the actual New York market opening.¹¹ (Limit orders that are eligible to be matched as described in this paragraph, along with Eligible Market Orders, are “Eligible Orders”). The Phlx proposes to add language to the text of Phlx Rule 229, Supplementary Material .10(a), to implement the preceding standards and proposes to remove certain existing language relating to the size of limit orders, the receipt time required, and the number of shares needed to print on the New York market to receive the New York opening price, which all conflict with the proposed language.

¹⁰ See Phlx Rule 229, Proposed Supplementary Material .10(a)(iv).

¹¹ The Exchange understands that limit orders priced at the opening price are not guaranteed an execution at the opening on the primary market. See, e.g., American Stock Exchange Rule 108(a) and (b)(1) (providing that market orders, which must receive an execution at the opening price, have precedence over limit orders and that only limit orders that are priced better than the opening price are to be treated as market orders). The Exchange has determined not to extend the guarantee under this proposed rule change to limit orders priced at the opening price.

Matching. The Exchange proposes to match Eligible Orders received by each Directed Specialist as follows: odd-lot orders, partial round lot (“PRL”)¹² all-or-none (“AON”) orders, round lot AON orders when a single contra-side order with sufficient volume is not available, and the odd lot portion of PRL Eligible Orders would all be matched against the Directed Specialist. The Phlx is not proposing to match odd-lot orders, PRL AON orders, and the odd-lot portion of PRL Eligible Orders against other Eligible Orders because the Phlx wishes to prevent the creation of yet further orders with odd-lot portions as the Phlx believes that order entry firms prefer not to have their round lot orders broken into odd-lots and receive odd-lot executions. The remaining Eligible Orders received by a Directed Specialist would be matched against each other, with any imbalance matching against the Directed Specialist.

The Exchange’s matching algorithm would operate in such a way as to minimize the number of different orders that any one order will match against. The algorithm would build buy side and sell side order lists from the Eligible Orders, sorting them by descending volume with AON orders first. After the lists are built, matching would be initiated with the largest volume AON order first (buy or sell). The first order would then be matched against opposing orders, in order, or if mandated by the rule, against the Directed Specialist. This process would then be repeated by selecting the next order in volume priority until all Eligible Orders are filled. If two orders have the same volume, market orders would receive priority before limit orders and if both orders are the same type (market or limit), then priority would be based on time of entry. The Exchange believes that this matching algorithm should minimize the number of customer reports that any one order will receive, which the Exchange believes should help to keep the costs associated with such multiple reports to a minimum. However, regardless of the particular

¹² “Partial round lot” means a combined round-lot and odd-lot order. See Phlx Rule 229.

method employed to match these orders, all Eligible Orders would be matched at the opening price immediately following the New York opening.

Further, the Exchange proposes to delete existing language in Phlx Rule 229, Supplementary Material .10(b), relating to the size of market and limit orders and the receipt time required to receive the New York opening price as the treatment of such orders will be covered in Supplementary Materials .06 and .10(a). Finally, the Exchange proposes to delete Supplementary Material .11 of Phlx Rule 229, relating to the refusal of orders, as the Phlx believes that specialists today have sufficient methods available to them to manage the risk associated with orders received before the opening.

2. Statutory Basis

The Exchange believes that its proposal, as amended, is consistent with Section 6(b) and Section 11A(a)(1)(C) of the Act¹³ in general, and furthers the objectives of Section 6(b)(5) and Section 11A(a)(1)(C)(v) of the Act¹⁴ in particular, in that it should promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market, and protect investors and the public interest by increasing the number of investors' orders that are executed at the opening without the participation of a dealer.

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

The Exchange does not believe that the proposed rule change, as amended, will impose any inappropriate burden on competition.

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.

¹³ 15 U.S.C. 78f(b) and 15 U.S.C. 78k-1(a)(1)(C).

¹⁴ 15 U.S.C. 78f(b)(5) and 15 U.S.C. 78k-1(a)(1)(C)(v).

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

Within 35 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 the Exchange consents, the Commission will:

- (A) by order approve such proposed rule change, as amended, or
- (B) institute proceedings to determine whether the proposed rule change, as amended, 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, as amended, 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-2005-14 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-Phlx-2005-14. 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 the filing also will be available for inspection and copying at the principal office of the Phlx. 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-2005-14 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(12).