

specialist had been on parity with three ROTs.

(B) In the event that one or more ROTs on parity with the specialist effect a Total Waiver of their respective entitlements such that the specialist is on parity with two ROTs, the number of contracts to be allocated to each crowd participant shall be determined as provided in sub-paragraph (c)(i) above, provided that the maximum number of contracts to be allocated to the specialist shall be that which the specialist would be entitled to receive under this Advice as if the specialist had been on parity with two ROTs.

(C) In the event that one or more ROTs on parity with the specialist effect a Total Waiver of their respective entitlements such that the specialist is on parity with one ROT, the number of contracts to be allocated to each crowd participant shall be determined as provided in sub-paragraph (c)(i) above, provided that the maximum number of contracts to be allocated to the specialist shall be that which the specialist would be entitled to receive under this Advice as if the specialist had been on parity with one ROT. In no event shall any non-waiving ROT be required to participate in fewer contracts than he/she would have received absent the Waiver(s).

(iii) *Partial Waiver.* In the case of an option which is subject to an Enhanced Specialist Participation, in the event that one or more ROTs effect a Waiver of a portion of their respective entitlements, but not a Total Waiver, in the manner provided above (a "Partial Waiver"), the number of contracts to be allocated to each crowd participant shall be determined as provided in sub-paragraph (c)(i) above, provided that the specialist shall not be entitled to receive a number of contracts that is greater than 40% of the Remainder of the Order except in the situation referred to in the following sentence, unless all remaining crowd participants on parity have waived their entitlements or have been satisfied. In the case of the specialist being on parity with only one ROT, the specialist shall not be entitled to receive a number of contracts that is greater than 60% of the Remainder of the Order unless all remaining crowd participants on parity have waived their entitlements or have been satisfied.

In no event shall any non-waiving ROT be required participate in fewer contracts than he/she would have received absent the Partial Waiver(s).

(iv) In no event shall two or more crowd participants enter into any agreement regarding the number of contracts to be waived by any crowd participant (i.e., subject to the

provisions of sub-paragraph (D)(1)(b) above, any decision by a crowd participant to waive all or a portion of such crowd participant's entitlement must be an individual decision, and not the subject of an agreement among crowd participants).

(E) *Rounding.* In situations where the allocation of contracts pursuant to this Rule result in fractional amounts of contracts to be allocated to crowd participants, the number of contracts to be allocated shall be rounded in a fair and equitable manner.

(F) *Just and Equitable Principles of Trade.* (1) It shall be considered conduct inconsistent with just and equitable principles of trade for a member: (a) to allocate initiating orders other than in accordance with this Advice; (b) to enter into any agreement with another member concerning allocation of trades; or (c) to harass, intimidate or coerce any member to enter into any Waiver, or to make or refrain from making any complaint or appeal.

(2) A pattern or practice of waiving all or a portion of a crowd participant's entitlement, with the result that such crowd participant receives no allocation or a lesser allocation than he or she would otherwise have been entitled to, may be considered conduct inconsistent with just and equitable principles of trade.

(G) Notwithstanding the first sentence of this Advice, neither Rule 119(b) and (c) concerning precedence based on the size of bids on parity, nor Rule 120 (insofar as it incorporates those provisions by reference) shall apply to the allocation of orders covered by this Advice.

Fine Schedule (Implemented on a Two-Year Running Calendar Basis) B-6

Section A:

No fine applicable. Matters subject for review by the Business Conduct Committee.

Section B:

1st Occurrence—\$500.00
2nd Occurrence—\$1,000.00
3rd Occurrence—\$2,000.00
4th Occurrence and thereafter—
Sanction is discretionary with
Business Conduct Committee.

Section C:

Fine not applicable.

Section D:

Fine not applicable.

Section E:

Fine 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, as amended, 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 codify certain practices that have developed respecting the allocation of trades on the Exchange's options floor and the Exchange's parity and priority rule, Phlx rule 1014, "Obligations And Restrictions Applicable To Specialists And Registered Options Traders." The proposed rule change also would make certain other changes to Phlx rule 1014 that would generally clarify option trade allocation procedures and make them easier to apply.⁵

As a general principle, in an auction market for standardized options like Phlx and other national securities exchanges operating a floor-based options marketplace, the first participant to quote the best price (highest bid or lowest offer) is entitled to priority, which refers to the right to participate fully in a contra-side order before anyone else. Phlx rules 119 and 120 and rule 1014(g) are the general rules concerning establishment of parity and priority in the execution of orders

⁵ On September 11, 2000, the Commission issued an order in relation to settling *In the Matter of Certain Activities of Options Exchanges*, which requires the Exchange (among other respondent options exchanges) to implement certain undertakings. Order Instituting Public Administrative Proceedings Pursuant to section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions, Securities Exchange Act Release No. 43268 (September 11, 2000) ("Order"). One such undertaking is to adopt new or amend existing rules to include any practice or procedure, not currently authorized by rule, whereby market makers trading any particular option class determine by agreement the spreads or option prices at which they will trade any option, or the allocation of orders in that option class. The proposed rule change, as amended, is intended to respond to this undertaking.