

basis, each crowd participant to state a size for which they are firm at any time prior to an execution.

In the context of this proposed rule change, "stated size" means, in the case of orders handled manually by the specialist (for example, in the case of an order that is delivered via AUTOM but is not eligible for execution via AUTO-X<sup>26</sup>) if a crowd participant (including the specialist) has actually stated a size ("Actual Size"), such crowd participant's stated size shall be his or her Actual Size.

Unless the specialist has an Actual Size, the stated size of the specialist shall be the amount (if any) by which the disseminated size<sup>27</sup> exceeds the sum of (x) the aggregate size of limit orders included in the disseminated size and (y) the aggregate sizes of the quotations at the disseminated price of all ROTs who have Actual Sizes.

The proposal further would provide that the stated size of an ROT who does not have an Actual Size is zero. Therefore, in the case of an order handled manually by the specialist and that is subject to allocation under Phlx rule 1014(g), if an ROT does not actually state the size for which he or she is firm at the disseminated price, such ROT would not be entitled to receive any contracts in such an order.

The proposed rule would also provide that, in the case of floor-brokered orders, each crowd participant's stated size shall be his or her Actual Size. Thus, when a floor broker enters a crowd and asks for a market, the specialist and ROTs would be required to state, along with the price for which they are firm, an Actual Size for which they are firm in order to be entitled to be allocated contracts resulting from the execution of the order. Again, in the case of orders represented in the crowd by a floor broker, if a crowd participant does not have an Actual Size, such crowd participant would not be entitled to receive any contracts.

contracts. If the specialist states a size prior to the execution of such excess contracts, the specialist's entitlement would be limited by that size. See subparagraph b. below.

<sup>26</sup> Phlx represents that other examples of orders handled manually by the specialist include orders delivered by the Floor Broker Order Entry system and orders placed manually on the limit order book.

<sup>27</sup> Currently, Phlx rule 1082(a)(ii) defines "disseminated size" as, respecting options subject to new technology (the "new Auto-Quote") and options subject to a proprietary quoting system provided for in Phlx rule 1080.02 ("Specialized Quote Feed"), at least the sum of limit orders at the Exchange's disseminated price. The specialist and crowd may determine to disseminate a size greater than the sum of limit orders. For instance, the disseminated size may include additional size disseminated by the specialist, one or more ROTs, or the total crowd size.

Once the stated size of the specialist and ROTs has been established under proposed Phlx rule 1014(g)(v)(B), the allocation of contracts would take place in accordance proposed sub-paragraph (g)(v)(C), "Defined Participation."

b. *Defined Participation.* Under the proposal, "Defined Participation" would mean the portion of the Remainder of the Order to which a crowd participant is entitled.

In the case of a specialist entitled to an Enhanced Specialist Participation, the Defined Participation would mean the Enhanced Specialist Participation, up to the specialist's stated size. This means that if the specialist's stated size is for a number of contracts that is less than the size of the Enhanced Specialist Participation, the specialist would be entitled to receive a number of contracts that is limited to the specialist's stated size, and not the full Enhanced Specialist Participation *unless* the situation described in Phlx rule 1014(g)(v)(C)(3) applies.<sup>28</sup>

The Defined Participation for other crowd participants on parity would mean, where all participants have equal stated sizes, an equal share of the Remainder of the Order to be allocated after the specialist receives the Enhanced Specialist Participation, if applicable. Where participants have unequal stated sizes, the Defined Participations would equal their "Base Participations," defined as the stated size of the smallest participant (provided that, if the sum of all Base Participations would exceed the number of contracts in the Remainder of the Order, then the Remainder of the Order would be divided equally among crowd participants on parity, subject to rounding) plus their "Supplemental Participations." After the allocation of the Base Participation, the smallest participant would not be entitled to receive a Supplemental Participation, since that participant would have been allocated contracts equaling such participant's stated size. The other crowd participants who are on parity and who would be entitled to receive additional contracts would be entitled to receive Supplemental Participations.

Supplemental Participations would be equal to the remaining stated size, after the allocation of the Base Participation, of the smallest remaining participant entitled to receive such a Supplemental Participation (provided that, if the sum of all initial Supplemental Participations would exceed the number of contracts remaining to be allocated, then such contracts would be divided equally among crowd participants on

parity, subject to rounding). If the remaining stated sizes of all participants entitled to receive initial Supplemental Participations is equal, then their initial Supplemental Participations would be equal. The allocation of the Supplemental Participations would continue in this manner until the number of contracts to be allocated is exhausted.

The proposed rule would provide that the specialist may decline to receive the Enhanced Specialist Participation, in which case the specialist would be entitled to participate as one crowd participant, up to (*i.e.*, limited by) the specialist's stated size. The Exchange believes that this limitation should provide incentives for specialists to bid for and offer options contracts reflecting their true size, resulting in greater transparency in the Exchange's markets.

When a market or marketable limit order is received with a size greater than the Exchange's disseminated size, some crowd participants may be willing to execute a larger size than the disseminated size.<sup>29</sup> Where the Remainder of the Order is greater than the portion of the disseminated size that is attributable to the specialists and ROTs,<sup>30</sup> the proposed rule change would provide that participation in additional contracts in excess of such size among willing crowd participants shall be allocated under the otherwise applicable provisions of Phlx rule 1014.<sup>31</sup>

Specifically, once the disseminated size is executed and allocated among crowd participants on parity, any crowd participants who wish to execute additional contracts in excess of the disseminated size may participate in a

<sup>29</sup> Phlx rule 1082(e), Firm Quotations, provides that, if responsible brokers or dealers receive an order to buy or sell a listed option at the disseminated price in an amount greater than the disseminated size (for customer orders) or the quotation size (for broker-dealer orders), such responsible broker or dealer shall, within thirty (30) seconds of receipt of the order, (i) execute the entire order at the disseminated price (or better), or (ii) execute that portion of the order equal to the disseminated size (in the case of a customer order) or the quotation size (in the case of a broker-dealer order) at the disseminated price (or better), and revise its bid or offer. The Exchange filed with the Commission on October 4, 2002, a proposed rule change to codify the situation in which responsible brokers or dealers elect to execute a number of contracts greater than the disseminated size but not necessarily the size of the entire order. See File No. SR-Phlx-2002-60.

<sup>30</sup> Phlx defines disseminated size as, with respect to the disseminated price for any quoted options series, at least the sum of limit orders; however, the proposal would permit the specialist and crowd to disseminate a size greater than the sum of the limit orders. See Securities Exchange Act Release No. 46325, (August 8, 2002), 67 FR 53376 (August 15, 2002) (approving File No. SR-Phlx-2002-15).

<sup>31</sup> Telephone conversation with Phlx.

<sup>28</sup> See discussion, *infra* page 16.