

parity with only one ROT, 60%, unless all other ROTs on parity have waived their entitlements or have received a number of contracts equal to their remaining size after the Partial Waiver(s). The proposal would provide, however, for the reasons stated above, that in no event shall a ROT be required to participate in fewer contracts than he/she would have received absent the Partial Waiver(s).

f. *Other Provisions.* The proposal would provide that, in situations where the allocation of contracts result in fractional amounts of contracts to be allocated to crowd participants, the number of contracts to be allocated would be rounded in a fair and equitable manner.

The proposal would also provide that 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 Phlx rule 1014; (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 or revoke any Waiver, or to make or refrain from making any complaint or appeal. 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. The Exchange notes that although it is proposing to expressly reference "just and equitable principles of trade" ³⁸ in this proposed rule, ³⁹ it does not intend to create an inference, with respect to other Exchange rules that do not contain such an express reference, that violations of such rules could not in appropriate instances also violate just and equitable principles of trade. The Exchange may, in the case of other Exchange rules where there is no express reference to "just and equitable principles of trade," nonetheless determine that a violation of such other rules also constitutes conduct inconsistent with just and equitable principles of trade.⁴⁰ The Exchange

believes that this provision of the proposed rule is consistent with the requirement in the Order to promptly stop any practice or procedure relating to the allocation of orders if neither it nor a related practice or procedure that would supercede the existing practice or procedure has been submitted for approval or is not already authorized by rule.

Finally, the proposal would provide that, notwithstanding the first sentence of Phlx rule 1014(g)(i), neither Phlx rule 119(b) and (c) concerning precedence based on the size of bids at parity, nor Phlx rule 120 (insofar as it incorporates those provisions by reference) shall apply to the allocation of orders covered by this Phlx rule 1014(g)(v).

2. Statutory Basis

The Exchange believes that the proposed rule change would codify existing practices concerning options trade allocation where ROTs and specialists are on parity, and would provide a fair process for trade allocation among floor traders (specialists and ROTs). It would provide for the waiver of minimum trade allocation entitlements where appropriate while establishing a process that would help ensure fair and equitable trade allocation in such case.⁴¹ This process would include, for instance, the requirement that Offers to Waive be vocalized and accepted. Further, the Exchange believes that trade allocation is, in part, a process in the functioning of an auction market. In its role as a facility for options trading, the Exchange believes that the approach proposed herein is appropriate and consistent with the Act.⁴² The Exchange believes that the approach represents a codification of practices that have developed as the options markets have evolved and changed.

In addition to being necessary and appropriate, the Exchange believes that its approach has certain benefits and results that would foster and achieve the objectives of section 6(b)(5) of the Act.⁴³ Specifically, proposed Phlx rule 1014(g)(v) expressly would provide a

a violation of Phlx rule 1014(g)(v), for instance, can be in and of itself a stand-alone violation.

⁴¹ Telephone conversation with Phlx.

⁴² The Exchange notes that the Commission has previously acknowledged that granting benefits like the Enhanced Specialist Participation is within the business judgment of the Exchange, as long as such advantages do not restrain competition and do not harm investors. See Securities Exchange Act Release No. 42700 (April 18, 2000), 65 FR 24246 (April 25, 2000) (SR-Phlx-99-39); see also Securities Exchange Act Release No. 43100 (July 31, 2000), 65 FR 48778 (August 9, 2000) (publishing for notice and comment File No. SR-Phlx-00-01).

⁴³ 15 U.S.C. 78f(b)(5).

fair and equitable mechanism to allocate trades among floor traders on parity.⁴⁴ Such a mechanism is necessary to the functioning of a trading crowd in an auction market and, thus, to the maintenance of deep, liquid and orderly options markets.

The Exchange states that its ability to attract order flow hinges to a great extent on its ability to execute a large number of trades of various sizes, including very large trades, efficiently and expeditiously. The Exchange states that trading crowds facilitate those executions far better than could individual market makers, because a trading crowd usually represents much more liquidity than an individual market maker. The proposed rule would codify certain trade allocation entitlements, and the ability of crowd participants to waive such entitlements where appropriate, but not to the extent that such waiver becomes a pattern or practice. This, in turn, would maximize smooth functioning of trading crowds and efficient executions.⁴⁵

Phlx believes that the proposed rule should promote fair and orderly markets by: (1) Establishing clear trade allocation rules; and (2) specifying when and how floor traders may decline to receive any part of a trade to which they otherwise would have been entitled.

For these reasons, the Exchange believes that its proposal is consistent with section 6(b) of the Act,⁴⁶ in general, and section 6(b)(5) of the Act,⁴⁷ in particular, in that it is designed to 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 codifying a trade allocation approach that best facilitates fair and orderly markets.

⁴⁴ The Exchange believes that self-regulatory organizations ("SROs") should be afforded the broadest latitude to adopt trading rules that its governing bodies determine are most appropriate to the needs of the marketplace and its competitive position, and notes that, in its recent proposal to promulgate new rule 19b-6 under the Act, SROs would be permitted to file "trading rules" as effective upon filing, without staff review or Commission order, unless such a trading rule would "make fundamental structural changes to the market." For purposes of the proposed rule, the term "trading rule" includes rules governing member trading * * * such as rules governing * * * priority of orders, bids and offers. See proposed rule 19b-6(b)(6) and (g)(1) at Securities Exchange Act Release No. 43860 (January 19, 2001), 65 FR 8912 (February 5, 2001). The Commission notes that it has not taken final action on proposed rule 19b-6.

⁴⁵ Telephone conversation with Phlx.

⁴⁶ 15 U.S.C. 78f(b).

⁴⁷ 15 U.S.C. 78f(b)(5).

³⁸ See Phlx rule 707.

³⁹ Other Exchange rules expressly reference just and equitable principles of trade. See, e.g., Phlx rules 1015(b), 1042.02 and 1051(a).

⁴⁰ The lack of express reference in other Phlx rules should not be construed as waiving the ability to make a violation of Phlx rule 707 co-exist with any other violation, depending on the facts and circumstances of the case. The Exchange believes that a violation of the existing parity/priority provisions of its rules could be a violation of just and equitable principles of trade and could be subject to disciplinary action as such. In addition,