

traded and may execute the inbound order prior to the expiration of the 10-second timer. The Exchange states that the purpose of the timer is to enable the specialist to ascertain whether a member of the trading crowd is in the process of executing the booked customer limit order (thus providing the opportunity for the booked customer limit order to be executed at a better price). In that situation, if the specialist determines that the booked customer limit order is in the process of being executed in the crowd, the specialist would be able to execute the inbound order.¹² Today, because the inbound order is not eligible for automatic execution against a booked limit order and is handled manually by the specialist, there is an opportunity to ascertain this. Under the proposal, if the specialist determines that the booked customer limit order is not in the process of being executed in the crowd, the inbound order would be matched with the booked customer limit order and automatically executed after 10 seconds.

Another purpose of the timer is to allow the specialist to seek price improvement on behalf of the booked customer limit order, both in the crowd and on away markets. Once a customer limit order is booked, a fiduciary responsibility devolves upon the specialist to execute such an order at the best price available, subject to the customer's limit price, when the order becomes marketable. In order to enable the specialist to carry out that fiduciary responsibility, the Exchange believes the specialist should be given a period of time (*i.e.*, 10 seconds) to determine whether there is a better price available at which to execute the booked customer limit order.

a. Off-Floor Broker-Dealer Limit Orders Delivered by the Same Broker-Dealer that Delivered the Customer Limit Order on the Book

The Exchange believes that the Book Match proposal could create an opportunity for off-floor member

organizations to internalize orders (*i.e.*, submit a proprietary order as contra-side to their customers' limit orders on the book) without providing the specialist and trading crowd with a sufficient time period to determine to execute the customer limit order.

In order to address this potential issue, the Exchange proposes to establish by rule that member organizations that seek to submit a related proprietary contra-side order (*i.e.*, their own order or that of an affiliate) via AUTOM in conjunction with a customer limit order they deliver to the limit order book, would be required to designate such orders with a special indicator ("K" for the customer limit order, and "L" for the proprietary order). Such orders would not be eligible for AUTO-X or Book Match, and the customer limit order labeled "K" must be exposed to the crowd for a period of 30 seconds before it is eligible to be executed against the proprietary order labeled "L." The proposal would provide that the customer limit order on the book may be executed by the specialist or crowd prior to the expiration of 30 seconds.

The Exchange believes that these new order types, to be delivered via AUTOM in the unique situation where a broker-dealer submits a customer limit order onto the book with an accompanying proprietary contra-side order, combined with the 30-second crowd exposure requirement for the customer limit order, should provide the specialist and trading crowd with a sufficient time frame within which to determine to execute the customer limit order on the book, thus maintaining fairness and orderliness in the Exchange's markets.

b. Linkage Orders

The Exchange further believes that the Book Match function will enable the Exchange to promptly execute orders delivered to the Exchange pursuant to the Plan for the Purpose of Creating and Operating an Intermarket Options Linkage (the "Plan")¹³ and PHLX rules 1083–1087 adopted to implement the Plan,¹⁴ by matching eligible inbound linkage orders in a timely fashion. The Exchange represents that its systems are capable of recognizing inbound Linkage Principal Acting as Agent Orders ("P/A

Orders")¹⁵ and Principal Orders ("P Orders"),¹⁶ and that Book Match would execute eligible linkage orders at the Firm Customer Quote Size¹⁷ in the case of P/A Orders, and at the Firm Principal Quote Size¹⁸ in the case of P Orders.

c. Yielding Requirements

The Exchange is proposing to match both inbound marketable customer and off-floor broker-dealer limit orders with customer limit orders on the book at the NBBO. In the case of inbound non-marketable limit orders, the Exchange's rules concerning the establishment of a bid or offer, and yielding requirements in parity situations would apply. Currently, PHLX rule 1080, Commentary .05(ii) provides that off-floor broker-dealer limit orders entered via AUTOM establishing a bid or offer may establish priority, and the specialist and crowd may match such a bid or offer and be at parity, subject to the yield provisions set forth in PHLX rule 1014, which require "controlled accounts"¹⁹ to yield priority to customer orders when bidding or offering at the same price for the same series.

Orders of controlled accounts must yield priority to customer orders (except that PHLX ROTs closing in-person are not currently required to yield priority to orders of customer accounts). Off-floor broker-dealer accounts, a subset of "controlled accounts," must yield priority to customer orders at the same

¹⁵ Phlx rule 1083(j)(i) defines a "P/A Order" as an order for the principal account of a specialist (or equivalent entity on another exchange that is authorized to represent Public Customer orders), reflecting the terms of a related unexecuted Public Customer order for which the specialist is acting as agent.

¹⁶ Phlx rule 1083(j)(ii) defines a "P Order" as an order for the principal account of an eligible market maker and is not a P/A Order.

¹⁷ "Firm Customer Quote Size" with respect to a P/A Order means the lesser of (a) the number of option contracts that the exchange sending a P/A Order guarantees it will automatically execute at its disseminated price in a series of an eligible option class for public customer orders entered directly for execution in that market; or (b) the number of option contracts that the exchange receiving a P/A Order guarantees it will automatically execute at its disseminated price in a series of an eligible option class for public customer orders entered directly for execution in that market. This number shall be at least 10. See Phlx rule 1083(g).

¹⁸ "Firm Principal Quote Size" means the number of options contracts that an exchange guarantees it will execute at its disseminated price for incoming Principal Orders in an eligible option class. This number shall be at least 10. See Phlx rule 1083(h).

¹⁹ Phlx rule 1014(g)(i)(A) provides that an account type is either a controlled account or a customer account. A controlled account includes any account controlled by or under common control with a broker-dealer (specialist accounts of Phlx option specialists, however, are not subject to yielding requirements placed upon controlled accounts by this rule). Customer accounts are all other accounts.

¹² See rule 11Ac1-1(c)(3)(ii)(B) under the Act provides that no responsible broker or dealer shall be obligated to execute a transaction for any subject security if, at the time the order sought to be executed is presented, such responsible broker or dealer is in the process of effecting a transaction in such subject security, and, immediately after the completion of such transaction, such responsible broker or dealer communicates to its exchange or association pursuant to paragraph (c)(1) of this section, a revised bid or offer; provided, however, that such responsible broker or dealer shall nonetheless be obligated to execute any such order in such subject security as provided in paragraph (c)(2) of this section at its revised bid or offer in any amount up to its published quotation size or revised quotation size.

¹³ See Securities Exchange Act Release Nos. 44482 (June 27, 2001), 66 FR 35470 (July 5, 2001); 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000) (Notice of Phlx Joining the Plan); and 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (Approval of the Plan).

¹⁴ See Securities Exchange Act Release No. 47296 (January 31, 2003), 68 FR 6528 (February 7, 2003) (SR-Phlx-2002-67).