

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 better allow members to compete for new and retain existing order flow in large crossed orders on the Phlx equity floor through use of the Alternative Procedures.<sup>3</sup> The Alternative Procedures would allow a member with an order to buy and an order to sell the identical number of shares of the same security to cross those orders without interference by another member under certain circumstances.<sup>4</sup> In order to use the Alternative Procedures, the member attempting to cross without interference by another member must satisfy a number of preconditions. First, the potential cross must involve orders of greater than 10,000 shares. Second, prior to introducing the cross, the member attempting to cross must request that the specialist in the security post the current market for the security (the "Updated Quotation"). Upon receiving the Updated Quotation, the member may execute the cross transaction without interference by another member either (1) at the Updated Quotation, if both sides of the cross transaction are agency orders<sup>5</sup> and the Updated Quotation contains no agency orders or (2) between the Updated Quotation in any other case.<sup>6</sup> If either side of the cross would take place outside the Updated Quotation or at the Updated Quotation, for crosses where one or both sides of the cross transaction are non-agency orders or the Updated Quotation contains an agency

order, then member may not cross utilizing the Alternative Procedures.<sup>7</sup>

In addition, the Exchange intends to permit members to enter crosses electronically subject to the Alternative Procedures. Upon electronic notification of the cross, the specialists in that security will be requested to submit an Updated Quotation.<sup>8</sup> The member's cross will be compared with the Updated Quotation, if any, and will either be executed pursuant to the Alternative Procedures or the member will be notified that the cross did not take place.

In contrast to this proposal, under current Phlx Rules pertaining to priority, if a member presents a crossing transaction, another member may participate, or "break up," the transaction, by offering (after presentation of the proposed crossing transaction) to improve one side of the transaction by the minimum price variation. The member presenting the cross is then effectively prevented from consummating the transaction as a "clean cross," which may be to the detriment of the member's customer.<sup>9</sup> The Exchange notes that the minimum price variation is one penny, making it relatively inexpensive for another Exchange member to break up the crossing transaction by simply improving one side or the other by one penny.

In a decimal pricing environment, the Exchange's Floor Procedure Committee is concerned that a portion of the crossing business and corresponding Exchange volume could evaporate unless members and their customers receive the protection offered by the Alternative Procedures. The Exchange believes that the Alternative Procedures

strike a balance of interests of those members who are impacted by crossing transactions. Members attempting to execute crosses for their customers may be interested, on behalf of their customers, in obtaining a rapid execution of their order at a single price. Members submitting Updated Quotations may be interested in executing against with a portion of one side or the other of the cross because they see this as a favorable trade. This proposal allow both interests to be fulfilled by streamlining the crossing procedures while retaining the right of members to represent their best bid or offer through their response to the request for an Updated Quotation. It also protects the priority of agency orders by requiring that requiring that in no event shall an agency order in the book, having time priority, remain unexecuted after any other order at its price has been effected.

##### **2. Statutory Basis**

The Exchange believes that its proposal to amend certain Phlx Rules governing participation in crossing transactions effected on the Exchange is consistent with Section 6(b) of the Act<sup>10</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>11</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and to perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change 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.

### **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

<sup>3</sup> Crossed orders or crosses are two orders, one to buy and one to sell the identical number of shares of the same security, which a member is brokering for his or her customers. This proposed rule change effects crosses of 10,000 shares or larger.

<sup>4</sup> The proposed addition of Supplementary Material (h) to Phlx Rule 126 does not preclude Exchange members from choosing to cross such orders under another provision of Phlx Rule 126.

<sup>5</sup> Agency orders are orders that are not for the account of brokers or dealers.

<sup>6</sup> As with all other trading on the Exchange, members must adhere to the trading restrictions contained in Section 11(a) of the Act, 15 U.S.C. § 78k(a), and Rules 11a-1 *et. seq.*, 17 CFR 240.11a-1 *et. seq.*, pertaining to members trading on the Exchange floor for their own account.

<sup>7</sup> The unavailability of the Alternative Procedures does not restrict how a member may then continue to represent the orders that otherwise would have been crossed. For instance, a member may choose to execute part of one of the cross against the trading interest that caused the unavailability of the Alternative Procedures and then attempt to execute the remaining portion of the cross using the Alternative Procedures. A member could also decide to seek execution for the cross in another market.

<sup>8</sup> In a telephone conference between John Dayton, Assistant Secretary and Counsel, Phlx, and Alton Harvey, Chief, Office of Market Watch, and Mary N. Simpkins, Special Counsel, Division of Market Regulation, Commission, on January 7, 2003, the Phlx clarified that as with manual, in-person use of the Alternative Procedures, a member attempting to cross electronically using the Alternative Procedures will use the Exchange's trading systems to request that the specialists submit an Updated Quotation.

<sup>9</sup> Some institutional customers prefer executing large crossing transactions at a single price and are willing to forego the opportunity to achieve the piecemeal price improvement that might result from the break up of the cross transaction by another Exchange member. Of course, the member will still retain the ability to present both sides of the order at the post if the customers so desire.

<sup>10</sup> 15 U.S.C. 78f(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).