

The text of the proposed rule change is set forth below. Additions are in italics. Deletions are in brackets.

**Rule 229. Philadelphia Stock Exchange Automated Communication and Execution System (PACE)**

\* \* \* \* \*

**Supplementary Material**

\* \* \* \* \*

.01-.06 No Change

.07 (a)-(b) No Change

(c) Price Improvement for PACE Orders

(i) Automatic Price Improvement—Where the specialist voluntarily agrees to provide automatic price improvement to all customers and all eligible market orders in a security, automatically executable market and marketable limit orders in New York Stock Exchange and American Stock Exchange listed securities received through PACE for 599 shares or less shall be provided with automatic price improvement from the PACE Quote when received either \$.01 or a percentage of the PACE Quote when the order is received for equities trading in decimals beginning at 9:30 a.m., except where:

(A) A buy order would be improved to a price less than the last sale (*except as provided in (F) below*) or a sell order would be improved to a price higher than the last sale (except as provided in (E) below); or

(B) A buy order would be improved to the last sale price which is a downtick (*except as provided in (F) below*) or a sell order would be improved to the last sale price which is an uptick (except as provided in (E) below). The PACE System will determine whether the last sale price is a downtick or an uptick. The [Pace] PACE System does not recognize changes from the previous day's close.

In these situations, the order is not eligible for automatic price improvement, and is, instead, automatically executed at the PACE Quote. A specialist may voluntarily agree to provide automatic price improvement to larger orders in a particular security to all customers under this provision.

A specialist may choose to provide automatic price improvement of: (i) \$.01 where the PACE Quote is either \$.05 or greater, or \$.03 or greater, or (ii) where the PACE Quote is \$.02 or greater, a percentage of the PACE Quote when the order is received, up to 50%, rounded to the nearest penny, and at least \$.01, in a particular security to all customers.

(C) Automatic price improvement will not occur for odd-lot orders, nor where the execution price before or after the

application of automatic price improvement would be outside the primary market high/low range for the day, if so elected by the entering member organization.

(D) The POES window of Supplementary Material .05 above does not apply where an order is subject to automatic price improvement or manual price protection.

(E) Sell Order Enhancement I—A specialist may choose to give automatic price improvement to all sell orders of 100 shares or more, as determined by the specialist, in a particular security which would be improved to the last sale on an uptick; or

Sell Order Enhancement II—A specialist may choose to give automatic price improvement to all sell orders of 100 shares or more, as determined by the specialist, in a particular security which would be improved to a price higher than the last sale.

(F) *Buy Order Enhancement—A specialist may choose to give automatic price improvement to all buy orders, as determined by the specialist, in any security that is exempted from or otherwise not subject to Securities Exchange Act rule 10a-1.*

.08-.22 No Change.

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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 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 expand the number of orders eligible to receive price improvement by allowing Exchange equity specialists to offer API to all buy orders in securities that are exempted from or otherwise not subject to the Short Sale rule.<sup>4</sup> The Exchange's API

<sup>4</sup> The Exchange also proposes to correct a typographical error in the presentation of the word "PACE" in Supplementary Material .07(c)(i)(B) to Phlx rule 229.

program allows specialists to provide automatic price improvement to automatically executable market and marketable limit orders in New York Stock Exchange, Inc. and American Stock Exchange LLC listed securities received through Phlx's Automated Communication and Execution System ("PACE")<sup>5</sup> for 599 shares or less of either \$.01 or a percentage of the PACE Quote when the order is received.<sup>6</sup> Specialists may choose to offer API in each individual specialty security. If API is offered in an individual security, then it must offer it to all customers and all eligible market orders in that security.

Currently, API is not available to certain buy orders if the execution price of those buy orders would be less than the last sale or at the last sale, provided such execution would create a downtick.<sup>7</sup> The purpose of these restrictions is to prevent the possibility of a violation of the Short Sale rule on the part of a specialist selling against the buy order. In securities that are exempted from or otherwise not subject to the Short Sale rule (such as many of the Index Fund Shares, Trust Shares and Trust Issued Receipts that are traded or may be traded on the Phlx),<sup>8</sup> the Exchange believes that there is no possibility of a violation of the Short Sale rule by the specialist when selling to buy orders in these securities.<sup>9</sup> By allowing API for buy orders in these securities, the Exchange believes that customers should receive more opportunities for price improvement. While specialists in such securities may choose to give price improvement to all such buy orders under this proposal, this is a voluntary additional feature of API. The Exchange states that participation in the API program will remain voluntary, as is participation in PACE.<sup>10</sup>

**2. Statutory Basis**

The Exchange believes that the proposed rule change is consistent with the Act, including section 6(b) of the

<sup>5</sup> PACE is the Exchange's automated order routing, delivery, execution and reporting system for listed securities. See Phlx rule 229.

<sup>6</sup> See Supplementary Material .07 to Phlx rule 229.

<sup>7</sup> See Supplementary Material .07(c)(i)(A) to Phlx rule 229.

<sup>8</sup> See Phlx rule 803(i)-(j), (l).

<sup>9</sup> The Exchange states that it would issue a regulatory circular to its members informing them of which securities are exempt from the Short Sale rule, and thus available for API under the proposed rule change. Telephone conversation between John Dayton, Assistant Secretary and Counsel, Phlx, and Christopher Solgan, Attorney, Division, Commission, on April 16, 2003.

<sup>10</sup> See Phlx rule 229.