

dealer to offset odd-lot orders for customers[, or];

(2) any purchase or sale of any security [, delivery of which is to be upon a day other than the day of delivery provided] upon terms for delivery other than those specified in such unexecuted market or limited price order;

(3) transactions by a member or member organization acting in the capacity of a specialist or market maker in a security listed or traded on the Exchange otherwise than on the Exchange; and

(4) transactions made to correct bona fide errors.

Supplementary Material:

.01 [A member who issues a commitment to trade from the Exchange through ITS or any other Application of the System shall, as a consequence thereof, be deemed to be initiating a purchase or a sale of a security on the Exchange as referred to in this Rule.] A member or member organization or employee thereof responsible for entering proprietary orders shall be presumed to have knowledge of a particular customer order unless the member organization has implemented a reasonable system of internal policies and procedures to prevent the misuse of information about customer orders by those responsible for entering such proprietary orders.

.02 This Rule 452 shall apply to any agency or proprietary transaction effected on the Exchange if such transaction ("Exchange transaction") is part of a group of related transactions that together have the effects prohibited by this Rule, regardless whether (i) one or more of the other related transactions were effected on other market centers; or (ii) the Exchange transaction by itself had such effects.

.03 This Rule 452 shall also apply to a member organization's member on the Floor, who may not execute a proprietary order at the same price, or at a better price, as an unexecuted customer order that he or she is representing, except to the extent the member organization itself could do so under this Rule.

.04 For purposes of paragraph (b) above, the term "account of an individual investor" shall mean an account covered by section 11(a)(1)(E) of the Securities Exchange Act of 1934. For purposes of paragraph (b)(1) above, the term "proprietary facilitation account" shall mean an account in which a member organization has a direct interest and which is used to record transactions whereby the member organization acquires positions in the

course of facilitating customer orders. Only those positions which are recorded in a proprietary facilitation account may be liquidated as provided in paragraph (b)(1). For purposes of paragraph (b)(2) and (b)(4) above, the terms "bona fide hedge", "bona fide arbitrage" and "risk arbitrage" shall have the meaning ascribed to such terms in Securities Exchange Act Release No. 15533, January 29, 1979. All transactions effected pursuant to paragraph (b)(4) above must be recorded in an arbitrage account.

.05 For purposes of paragraph (b)(2) above, a hedge will be deemed to be "clearly related" if either the first or last transaction comprising the hedge is executed on the same trade date as the transaction that precipitates such hedge. A member shall mark all memoranda of orders to identify each transaction creating or modifying a hedge as permitted under this Rule 452.

.06 A member who issues a commitment or obligation to trade from the Exchange through ITS or any other Application of the System shall, as a consequence thereof, be deemed to be initiating a purchase or sale of a security on the Exchange as referred to in this Rule 452.

* * * * *

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 Phlx 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 Exchange 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 amend Phlx Rule 452, which provides limitations on members' trading because of customer orders. The proposed revision would bring the rule into conformity with New York Stock Exchange, Inc. ("NYSE") Rule 92, which was recently approved by the Commission.⁵ The proposed revision to Phlx Rule 452 would clarify the

obligations of Exchange members regarding proprietary trading in instances where they or their member organization hold customer orders at the same or inferior prices.

In 1994, the NYSE proposed changes to NYSE Rule 92.⁶ According to the Phlx, these changes were meant to address various issues regarding an NYSE-member organization's trading when it was in possession of customer orders, including a member organization's regional specialist operations, block trading, arbitrage activity and hedge activity. The Commission approved the changes to NYSE Rule 92 in 2001.⁷ The revision would conform Phlx Rule 452 to NYSE Rule 92.⁸

Currently, sections (a) and (b) of Phlx Rule 452 contain the general prohibitions against trading ahead of customer market orders and customer limit orders, respectively. As revised, section (a) contains the general prohibitions against trading ahead of both customer market and limit orders.

The Exchange proposes to revise section (b) to create four exceptions to the general rule that may apply when the customer is not an individual investor and the customer knowingly consents: (1) Liquidation of a position held in a proprietary facilitation account so long as the customer's order is for 10,000 shares or more; (2) creation of a bona fide hedge under specified conditions; (3) modification of a bona fide hedge under certain conditions; and (4) engaging in bona fide arbitrage or risk arbitrage in an arbitrage account.

Section (c) currently contains two exceptions to the general rule; it does not apply: (i) To orders under 100 shares and (ii) when a customer order settles under different delivery terms than the proprietary order. As proposed, revised section (c) retains these two exceptions and adds the following two more: (1) It does not apply to transactions of a member organization's specialist unit on another exchange; and (2) it does not apply when transactions are made to correct bona fide errors.

Finally, the Supplementary Material currently contains a clarification that outbound Intermarket Trading System

⁵ See Securities Exchange Act Release No. 35139 (December 22, 1994), 60 FR 156 (January 3, 1995) (SR-NYSE-94-34).

⁷ See note 5 *supra*.

⁸ The Phlx had previously filed a proposed rule change, including several amendments, to conform Phlx Rule 452 to NYSE Rule 92, which was withdrawn in March, 2002. See Securities Exchange Act Release No. 37628 (September 3, 1996), 61 FR 47537 (September 9, 1996) (SR-Phlx-96-37).

⁵ See Securities Exchange Act Release No. 44139 (March 30, 2001), 66 FR 18339 (April 6, 2001) (SR-NYSE-94-34).