

proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Phlx proposes to amend Phlx Rule 1080, Philadelphia Stock Exchange Automated Options Market ("AUTOM") and Automatic Execution System ("AUTO-X"),⁴ to reflect a systems change to its pilot program concerning AUTO-X, whereby AUTO-X is disengaged for a period of 30 seconds after the number of contracts automatically executed in a given option meets the specified disengagement size for the option (the "pilot"). The text of the proposed rule change is set forth below. Brackets indicate deletions.

Philadelphia Stock Exchange
Automated Options Market (AUTOM)
and Automatic Execution System
(AUTO-X)

Rule 1080. (a)-(j) No change.

Commentary:

.01-.05 No change.

.06 Reserved.

.07 The specified disengagement size set forth in Rule 1080(c)(iv)(I) is subject to the approval of the Options Committee [and shall not be for a number of contracts that is fewer than the highest quotation size for any series in the given option]. The specified disengagement size for each option shall be posted on the Exchange's Web site.

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 Phlx has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

⁴ AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM's automatic execution feature, AUTO-X. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor. See Phlx Rule 1080.

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 1080, Commentary .07, to reflect a systems change to the pilot.⁵ The pilot was originally approved on a six-month basis for a limited number of eligible options⁶ and extended for an additional six-month period.⁷ Subsequently, the number of options eligible for the pilot was expanded to include all Phlx-traded options.⁸ In December 2001, the pilot was extended again for an additional six-month period;⁹ and extended again in May 2002,¹⁰ November, 2002,¹¹ and, most recently, in May 2003.¹²

The pilot currently includes the following features:

- Once an automatic execution occurs via AUTO-X in an option, the system begins a "counting" program, which counts the number of contracts executed automatically for that option up to a certain size,¹³ which causes AUTO-X to become disengaged for that option.
- When the number of contracts executed automatically for that option exhausts the specified disengagement size for the specific option within a 15 second time frame, the system ceases to automatically execute for that option, and drops all AUTO-X eligible orders in that option for manual handling by the specialist for a period of 30 seconds in order to enable the specialist to refresh quotes in that option.

⁵ See Amendment No. 1, *supra* note 3.

⁶ See Securities Exchange Act Release No. 43652 (December 1, 2000), 65 FR 77059 (December 8, 2000) (SR-Phlx-00-96).

⁷ See Securities Exchange Act Release No. 44362 (May 29, 2001), 66 FR 30037 (June 4, 2001) (SR-Phlx-2001-56).

⁸ See Securities Exchange Act Release No. 44760 (August 31, 2001), 66 FR 47253 (September 11, 2001) (SR-Phlx-2001-79).

⁹ See Securities Exchange Act Release No. 45090 (November 21, 2001), 66 FR 59834 (November 30, 2001) (SR-Phlx-2001-100).

¹⁰ See Securities Exchange Act Release No. 45862 (May 1, 2002), 67 FR 30990 (May 8, 2002) (SR-Phlx-2002-22).

¹¹ See Securities Exchange Act Release No. 46840 (November 15, 2002), 67 FR 70473 (November 22, 2002) (SR-Phlx-2002-59).

¹² See Securities Exchange Act Release No. 47955 (May 30, 2003), 68 FR 34458 (June 9, 2003) (SR-Phlx-2003-29).

¹³ Phlx Rule 1080(c)(iv)(I) provides that when the number of contracts automatically executed within a 15 second period in an option exceeds the specified disengagement size, a 30 second period ensues during which subsequent orders are handled manually. The specified disengagement size is determined by the specialist and subject to the approval of the Exchange's Options Committee. The specified disengagement size for each option is listed on the Exchange's Web site.

• Upon the expiration of 30 seconds, automatic executions resume, the "counting" program is set to zero and it begins counting the number of contracts executed automatically within a 15 second time frame again, up to the specified disengagement size.

Again, when the number of contracts automatically executed exhausts the specified disengagement size within a 15 second time frame, the system drops all subsequent AUTO-X eligible orders for manual handling by the specialist for a period of 30 seconds. The system then continues to reset the "counting" program and drop to manual, etc.

In April 2003, the Commission approved a proposal by the Exchange to provide automatic executions for eligible inbound orders (for the account(s) of both customers and broker-dealers) at the Exchange's disseminated price, up to the disseminated size, replacing the previous Exchange rule that allowed a pre-set "AUTO-X guarantee" size, in which eligible orders would be automatically executed up to that AUTO-X guarantee, regardless of the Exchange's disseminated size.¹⁴ Previously, if the Exchange's disseminated size in a particular series was greater than the AUTO-X guarantee, eligible orders delivered via AUTOM for a size greater than the AUTO-X guarantee would be automatically executed at the AUTO-X guaranteed size, and the remainder of the order would be executed manually by the specialist at the disseminated price, up to the remaining disseminated size, in accordance with the Exchange's rules regarding firm quotations.¹⁵

Because the Exchange currently guarantees automatic executions for eligible orders up to the Exchange's disseminated size, the most recent pilot extension included Commentary .07 to Rule 1080, prohibiting specialists from setting the specified disengagement size to a number of contracts that is fewer than their largest disseminated size.

The Exchange has developed a new system that will automatically execute eligible orders up to the disseminated size in a given series regardless of the specified disengagement size. Thus, if the disseminated size exceeds the specified disengagement size for the series, and an eligible order is delivered for a number of contracts that is greater than the specified disengagement size, the order will be executed up to the disseminated size, followed by an

¹⁴ See Securities Exchange Act Release No. 47646 (April 8, 2003), 68 FR 17976 (April 14, 2003) (SR-Phlx-2003-18).

¹⁵ See Phlx Rule 1082.