

price consists of a booked limit order. In that situation, inbound orders that would otherwise be eligible for automatic execution are matched manually by the specialist.¹⁵

The Exchange proposes, pursuant to proposed PHLX Rule 1080(g)(ii), that when the Exchange's disseminated price is equal to the National Best Bid or Offer ("NBBO"), and all or part of the Exchange's disseminated size at the NBBO disseminated price includes a customer limit order on the book, eligible inbound customer and off-floor broker-dealer limit orders would be automatically executed against booked customer limit orders at the NBBO, up to the size of the booked customer limit orders at the NBBO.¹⁶ If the inbound customer or off-floor broker-dealer limit order is for a greater size than the Exchange's disseminated size, the remaining portion of the order would be executed manually or placed on the limit order book by the specialist.¹⁷ The Exchange proposes to deploy Book Match, on an issue-by-issue basis, no later than October 1, 2003.¹⁸

a. Order Entry Firm Orders Delivered by Such Order Entry Firm, an Affiliated Firm, or a Solicited Party

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.

To address this potential issue, the Exchange originally proposed requiring 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, 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 would be 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.

In Amendment No. 4, the Exchange amended this aspect of its proposed rule change to broaden the application of the above exposure requirement to solicited party orders. As amended, the Exchange would require that member organizations that seek to submit a customer limit order and a related proprietary contra-side order (*i.e.*, their own order, an affiliate order, or a solicited party order as defined in PHLX Rule 1064(c)(ii)) delivered via AUTOM, to designate such orders with a special indicator ("K" for the customer limit order, and "L" for the proprietary order).¹⁹ 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 would be eligible to be executed, in whole or in part, against proprietary orders with labeled "L" indicator. The proposal would also provide that the customer limit order on the book may be executed by the specialist or crowd at anytime.

The Exchange also amended the proposed rule change, pursuant to Amendment No. 4, to prohibit an Exchange member or member organization from being a party to any arrangement designed to circumvent the crossing procedures discussed above, by providing an opportunity for a customer, member, member organization, or non-member broker-dealer, to execute immediately against agency orders delivered to the Exchange, whether such orders are delivered via AUTOM or represented in the trading crowd by a member or member organization.²⁰

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")²¹ and PHLX Rules

1083-1087 adopted to implement the Plan,²² 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")²³ and Principal Orders ("P Orders"),²⁴ and that Book Match would execute eligible linkage orders at the Firm Customer Quote Size²⁵ in the case of P/A Orders, and at the Firm Principal Quote Size²⁶ in the case of P Orders.

c. Yielding Requirements

The Exchange also proposed 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"²⁷ to yield priority to customer orders when bidding or

Plan); and 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (Approval of the Plan).

²² See Securities Exchange Act Release No. 47296 (January 31, 2003), 68 FR 6528 (February 7, 2003) (SR-PHLX-2002-67).

²³ 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.

²⁴ 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.

²⁵ "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).

²⁶ "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).

²⁷ 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.

¹⁵ PHLX Rule 1080(c)(iv) sets forth the various situations in which orders otherwise eligible for automatic execution via AUTO-X are handled manually by the specialist, including this situation, where there is a booked limit order. See Securities Exchange Act Release No. 45927 (May 15, 2002), 67 FR 36289 (May 23, 2002) (SR-PHLX-2001-24).

¹⁶ The disseminated price consisting of a booked limit order at which the eligible inbound order would be executed must be the NBBO. For instance, if the PHLX bid is the National Best Bid, but the PHLX offer is not the National Best Offer, an inbound buy order would not be subject to Book Match, but would instead be handled manually.

¹⁷ In Amendment No. 5, the Exchange proposes to delete the 10-second timer initially proposed. See Amendment No. 5, *supra* note 10.

¹⁸ See Amendment No. 5, *supra* note 10.

¹⁹ See Amendment No. 4, *supra* note 9.

²⁰ *Id.*

²¹ 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