

described below. The Pilot was originally approved on a six-month basis for a limited number of eligible options<sup>6</sup> and extended for an additional six-month period.<sup>7</sup> Subsequently, the number of options eligible for the Pilot was expanded to include all Phlx-traded options.<sup>8</sup> In December 2001, the Pilot was extended again for an additional six-month period;<sup>9</sup> and extended again in May 2002,<sup>10</sup> November 2002,<sup>11</sup> and May 2003.<sup>12</sup> In September 2003, the Exchange filed a proposed rule change reflecting a system change to the Pilot, which is described more fully below.<sup>13</sup> The instant proposed rule change would codify the functionality of the system change in Exchange Rule 1080(c)(iv)(I), and would extend the Pilot for an additional one-year period.

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,<sup>14</sup> 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.

- 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.<sup>15</sup> 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.<sup>16</sup>

Because the Exchange currently guarantees automatic executions for eligible orders up to the Exchange's disseminated size, the Exchange has developed a new system that automatically executes 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 AUTO-X disengagement period of 30 seconds.<sup>17</sup> If the specialist revises the

quote in the series prior to the expiration of 30 seconds, AUTO-X will be automatically re-engaged. The instant proposal would amend Rule 1080(c)(iv)(I) to reflect this enhancement to the system.

The Exchange believes that the system should enable specialists to continue to fulfill their obligations to make fair and orderly markets during periods of peak market activity, while simultaneously enabling them to meet the requirement to provide automatic executions up to the disseminated size, regardless of whether the specified disengagement size is for a number of contracts that is less than the disseminated size.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>18</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>19</sup> in particular, in that it is designed to perfect the mechanisms of a free and open market and the national market system, protect investors and the public interest and promote just and equitable principles of trade by providing automatic executions for eligible orders up to the Exchange's disseminated size, while continuing to enable Exchange specialists to maintain fair and orderly markets during periods of peak market activity.

### 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. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements

Exchange Rules. Telephone conversation between Richard S. Rudolph, Director and Counsel, Phlx, and Marc McKayle, Special Counsel, Division, Commission on November 26, 2003.

<sup>18</sup> 15 U.S.C. 78f(b).

<sup>19</sup> 15 U.S.C. 78f(b)(5).

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

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

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

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

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

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

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

<sup>13</sup> See *supra* note 5.

<sup>14</sup> Exchange 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.

<sup>15</sup> See Securities Exchange Act Release No. 47646 (April 8, 2003), 68 FR 17976 (April 14, 2003) (SR-Phlx-2003-18).

<sup>16</sup> See Exchange Rule 1082.

<sup>17</sup> If either a market order or a limit order is larger than the disseminated size, the remaining unexecuted portion of the order would be manually handled by the specialist in accordance with