

the Exchange proposes to increase Market Maker fees to \$1,750 per month per Market Maker, and proposes to eliminate the initial six-month waiver period. The Exchange proposes these changes to offset revenues lost from customer rate reductions.

LMM Book Charges. The Exchange charges each Lead Market Maker ("LMM") \$0.10 per Book contract for the first 15,000 contracts, \$0.20 for 15,001 to 30,000 Book contracts, \$0.30 for 30,001 to 55,000 Book contracts, and \$0.20 for all Book contracts over 55,000. These charges are applied to the monthly total of all Book contracts in all options issues collectively traded by an LMM under the program. The Exchange proposes to reduce its per Book contract rates to \$0.05 per Book contract for the first 15,000 contracts, \$0.10 for 15,001 to 30,000 Book contracts, \$0.15 for 30,001 to 55,000 Book contracts, and \$0.10 for all Book contracts over 55,000. The Exchange proposes these fee changes to reduce charges consistent with the reduction in Book execution fees for customers. In addition, the fee reduction is intended to attract LMMs to participate in the LMM Book Program.

Member dues. Currently, monthly dues for Exchange Members are \$250. The Exchange proposes to increase its monthly Member dues to \$750 per month to maintain a revenue base for the operations of the Exchange.

2. Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,⁷ in general, and furthers the objectives of Section 6(b)(4) of the Act,⁸ in particular, because it provides for the equitable allocation of reasonable dues, fees and other charges among its Members and issuers and other persons using its facilities.⁹

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The proposed rule change relating to membership fees, transaction charges for Market Makers, LMM Book charges, Market Maker fees, and member dues became effective upon filing pursuant to Section 19(b)(3)(A)(ii) of the Act¹⁰ and subparagraph (f)(2) of Rule 19b-4 thereunder.¹¹

The portion of the proposed rule regarding customer transaction charges have been filed by the Exchange as a "non-controversial" rule change pursuant to Section 19(b)(3)(A)(ii) of the Act¹² and subparagraph (f)(6) of Rule 19b-4 thereunder.¹³ Consequently, because the Exchange represents that the foregoing proposed rule change with respect to customer transaction charges: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and because the Exchange provided the Commission with written notice of its intent to file the proposed rule change at least five days prior to the filing date, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder. The Commission finds good cause to permit the proposed rule change relating to customer fees to become operative prior to thirty days from the date of filing¹⁴ because the Commission believes that those portions reducing the fees may increase competition between the options exchanges.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the

public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR-PCX-99-03, and should be submitted by April 22, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41210; File No. SR-Phlx-96-14]

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 3 and 4 to Proposed Rule Change Relating to the Establishment of a Daily Pre-Opening Session for the Matching of Orders at the Volume Weighted Average Price

March 24, 1999.

I. Introduction

On April 29, 1996, the Philadelphia Stock Exchange, Inc. ("Exchange" or "Phlx") submitted to the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change that would establish a daily pre-opening order matching session ("Session") for the execution of large-sized stock orders at the volume weighted average price ("VWAPTM").³ The Session would be conducted through the VWAP Trading System ("VTSTM"), which would be operated as a facility of the Exchange. The VTS is a system module of the Universal Trading System ("UTSTM")⁴ that was developed by Universal

¹⁰ 15 U.S.C. 78f(b)(3)(A)(ii).

¹¹ 17 CFR 240.19b-4(f)(2).

¹² 15 U.S.C. 78s(b)(3)(A)(ii).

¹³ 17 CFR 240.19b-4(f)(6).

¹⁴ The Exchange requested that the Commission waive the 30-day operative period under Rule 19b-4(f)(6) regarding the provision relating to customer fees. See footnote 5.

¹⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ VWAPTM is a registered trademark of the Dover Group, Inc.

⁴ The VTSTM and UTSTM trademarks are the property of Universal Trading Technologies Corporation.

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(4).

⁹ In reviewing this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

Trading Technologies Corporation ("UTTC").⁵

On July 26, 1996, the Exchange submitted Amendment No. 1 to the proposed rule change.⁶ The proposed rule change, including Amendment No. 1, was published for comment in the **Federal Register** on September 11, 1996.⁷ No comments were received on the proposal or Amendment No. 1. The Exchange submitted Amendment No. 2 to the proposed rule change on October 29, 1997.⁸ The proposed rule change, as modified by Amendment No. 2, was published for comment in the **Federal Register** on December 31, 1997.⁹ No comments were received on Amendment No. 2. On December 14, 1998, the Exchange submitted Amendment No. 3 to the proposed rule change.¹⁰ Finally, on February 12, 1999,

⁵ UTTC is a subsidiary of the Ashton Technology Group. UTTC has developed three electronic trading system modules as part of its UTS architecture: (i) the VWP Trading System ("VTS™"); (ii) the Electronic Auction System ("eASTM™"); and (iii) the Electronic Public Limit Order Book ("ePLOB™"). This proposed rule change relates only to the VTS.

⁶ Amendment No. 1 discussed then proposed reporting procedures and mechanisms relating to Nasdaq Stock Market issues that would be matched during the Session. See Letter from Gerald D. O'Connell, Senior Vice President, Market Regulation and Trading Operations, Exchange, to Jennifer Choi, Attorney, Division of Market Regulation ("Division"), Commission, dated July 26, 1996. Amendment No. 1 is of no import because the proposed rule change has been revised such that Nasdaq Stock Market issues are no longer eligible for matching during the Session.

⁷ Securities Exchange Act Release No. 37640 (Sept. 4, 1996), 61 FR 47993 (Sept. 11, 1996).

⁸ In Amendment No. 2, the Exchange: (1) clarified the responsibilities and functions of the Exchange and the VTS; (2) excluded over-the-counter securities (*i.e.*, Nasdaq Stock Market issues) from matching during the Session; (3) proposed that a VTS terminal be located on the Exchange's equity trading floor; (4) prohibited Exchange floor members from VTS matching in non-specialty issues; (5) revised and detailed matching priority provisions; (6) updated order types and order entry procedures; (7) clarified participation and subscriber access; (8) defined the "extraordinary circumstances" under which the Exchange may modify the order entry time period; and (9) specified the liability of the Exchange with respect to the operation of the VTS. See Letter and attachment from Philip H. Becker, Senior Vice President and General Counsel, Exchange, to Belinda Blaine, Associate Director, Division, Commission, dated October 28, 1997.

⁹ Securities Exchange Act Release No. 39481 (Dec. 22, 1997), 62 FR 68339 (Dec. 31, 1997).

¹⁰ In Amendment No. 3, the Exchange represented that UTTC agreed to operate the VTS through UTTC's wholly-owned broker-dealer subsidiary, REB Securities ("REB"), and that REB would be responsible for conducting compliance activities relating to the VTS. In addition, the Exchange: (1) agreed to operate the VTS as a facility of the Exchange for a one year pilot period; (2) agreed to limit the securities eligible for matching through the VTS to 300 of the most highly-liquid and highly-capitalized issues listed on the New York Stock Exchange; (3) proposed to delete the required dissemination of a single volume print at 9:20 A.M.;

the Exchange submitted Amendment No. 4.¹¹ This order approves the proposed rule change, as amended, and Amendment Nos. 3 and 4 on an accelerated basis.

Under separate cover, the Exchange has requested from the Commission exemptive and interpretive relief regarding Rules 10a-1, 10b-18, 11a2-2(T), 11Aa3-2, and 11Ac1-1 under the Act.¹² The Commission has issued a letter separate from this order that grants the Exchange exemptive relief from Rule 10a-1 and provides interpretive relief regarding Rule 11a2-2(T).¹³ In Section III of this order, the Commission addresses the Exchange's interpretive requests regarding Rules 11Aa3-2 and 11Ac1-1. With respect to the Exchange's request concerning Rule 10b-18, the Commission will respond to the Exchange at a later date.

II. Description of the Proposal

The Exchange seeks to adopt proposed Exchange Rule 237, "The Universal Trading System Morning Session," to govern the operation of the VTS or "System"¹⁴ for a one year pilot period. During the Session, the System will electronically accept large-sized stock orders and match the orders for execution according to an algorithm developed by UTTC. The matched and executed orders will be assigned a final VWP after the close of regular trading. UTTC developed the System pursuant to an agreement with the Exchange. The

(4) clarified the proposed definition of "institution"; (5) committed to prepare a report regarding the number of tape corrections and how they affect the VWP values calculated by the Exchange; and (6) modified from 4:02 P.M. to 4:01:30 P.M. the cut-off time that is designed to capture trade reporting run-off and any sales that occur at the close of regular trading. See Letter and attachment from Edith Hallahan, First Vice President and Deputy General Counsel, Exchange, to Michael Walinskas, Deputy Associate Director, Division, Commission, dated December 11, 1998.

¹¹ In Amendment No. 4, the Exchange agreed to report pre-opening VWP volumes for each eligible security in which matches had been effected during the Session. The Exchange also separately submitted confidential surveillance procedures. See Letter from Adrienne Y. Hart, Vice President, Market Surveillance, Exchange, to Michael Walinskas, Deputy Associate Director, Division, Commission, and John A. McCarthy, Assistant Director, Office of Compliance Inspections and Examinations ("OCIE"), Commission, dated February 8, 1999; and letter from Kenneth J. Meaden, Senior Vice President, Exchange, to John McCarthy, OCIE, Commission, dated February 1, 1999.

¹² See Letter from Edith Hallahan, Associate General Counsel, Exchange, to Larry E. Bergmann, Associate Director, Division, Commission, dated June 5, 1998.

¹³ See Letter from Larry E. Bergmann, Associate Director, Division, Commission, to Edith Hallahan, Associate General Counsel, Exchange, dated March 24, 1999 ("Exemptive Relief Letter").

¹⁴ For ease of reference, the term "System" shall be used in place of VTS and UTS.

System will operate as a facility of the Exchange under Section 3(a)(2) of the Act.¹⁵ Specifically, the System will utilize Exchange equipment and personnel,¹⁶ floor trader participation, and the Stock Clearing Corporation of Philadelphia ("SCCP") to process System trades. Matches performed during the Session will be regulated and reported as Exchange trades. In addition, matches performed by the System will be subject to transaction and access fees as established in the Exchange's fees schedule.¹⁷

A. Stocks Eligible for Matching During the Session

Approximately 300 of the most highly-capitalized and highly-liquid securities that trade on the New Stock Exchange ("NYSE") will be eligible for matching during the Session. To select these stocks, the Exchange will use Standard and Poor's market data to identify the top 400 NYSE-listed issues in terms of market capitalization. Each stock selected must have a market price below \$200 per share. Next, the Exchange will rank the 400 stocks according to their average dollar volumes over the previous 20 days of trading. The Exchange will designate the top 300 stocks as eligible for matching during the Session. The Exchange will repeat this screening process every six months to ensure that the stocks eligible for matching by the System are highly-capitalized and highly-liquid.

B. System Participants

Access to the System will be limited to "Committers" and "Users" (collectively "Participants"). Committers will be permitted to enter "Commitments" while Users will be allowed to enter "Orders." Although Exchange members may participate as either Committers or Users, they may not participate as both Committer and or Users, they may not participate as both Committer and User in the same security for the same account during the same Session.

1. Committer

"Committer" status will be restricted to Exchange members that are: (i) Phlx Floor Traders (*i.e.*, Phlx Specialist or Phlx Alternate Specialist in the eligible stock that is the subject of the

¹⁵ 15 U.S.C. 78c(a)(2).

¹⁶ UTTC technical personnel will assist the Exchange in operating the System.

¹⁷ Apart from adopting proposed Exchange Rule 237, the Exchange also seeks to make a conforming change to Exchange Rule 101, "Hours of Business" to include the Session as an exception to regular trading hours.

Commitment); or (ii) Phlx Off-Floor Liquidity Providers (members that commit to provide contra-side liquidity). Committers agree to provide on a proprietary basis contra-side liquidity by specifying their Commitments; however, Off-Floor Liquidity Providers can only engage as Committers for their proprietary accounts.

Exchange members must register with the Exchange prior to acting as a Committer. Committers will be permitted to designate the eligible issues for which they wish to make Commitments. For each eligible issue selected, Committers will be required to provide a minimum volume guarantee of 2,500 shares for each side of the market.¹⁸ All Commitments must be entered in 500 share increments.

Commitments must be entered directly by System subscribers or through the System's trading floor terminal at the Exchange.¹⁹ Commitments may be entered and modified during the "Order Entry Time Period" (5:00 A.M. to 9:15 A.M.),²⁰ and during any other periods the Exchange may specify.²¹ Commitments may be entered as "day-Commitments" or "good-till-canceled" ("GTC") Commitments.²² GTC Commitments remain in effect for each Session until canceled and must be established (and canceled) through the enrollment process.²²

Commitments may be restricted to execution against non-members only. At no time will Commitments may be matched with other Commitments. Commitments are executable only through the System.

¹⁸ Although the minimum Commitment size on each side of the market is 2,500 shares, a Committer need to make identical Commitments on both sides of the market. For example, a Committer could agree to buy 2,500 shares and sell 5,000 shares at VWAP.

¹⁹ To facilitate Floor Trader participation, the Exchange proposes to install a System terminal on the equity trading floor for the entry and reporting of Orders and Commitments.

²⁰ Unless otherwise indicated, all times referenced throughout this order are Eastern Standard Times.

²¹ For example, the Exchange may allow the entry and modification of Commitments during certain times the previous day, effective for the next day's Session. Because matching occurs only during the Session, the additional period would simply provide extra time for the entry of Commitments.

²² The enrollment process is the formal mechanism by which Participants enter into a contractual arrangement to use the System. System activation is dependent upon completing the enrollment process and submitting the requisite agreements and forms. Enrollment parameters, including GTC commitments, may be modified through procedures established by the Exchange. Prior to activation, all Users and Committers must provide proof of the review and approval of their enrollment parameters by their compliance officer.

2. User

"User" status would be available to Exchange members and non-members. However, Exchange floor members could participate as Users only in their specialty issues. Under the proposal, Orders may only be placed by and for enrolled Users. Users may enter Orders for customer or proprietary (dealer or principal) accounts.

Orders will be eligible for matching by the System only on the day the Order is entered. The minimum size for individual Orders is 5,000 shares. Like Commitments, all Orders must be entered in 500 share increments.

Users may enter Orders directly into System terminals as subscribers or through subscribing brokers; subscribing brokers may be members or non-members. The Exchange has noted, however, that participation through subscribing brokers may affect matching priority.

All non-member Orders entered through a broker must be entered through an Exchange member or through a non-member broker with the appropriate "give-up agreement"²³ and "three-way agreement"²⁴ in place. Non-member Orders also may be entered directly by subscribing non-members who have in place with an Exchange member give-up and three-way agreements.²⁵

²³ A clearing agreement or "give-up agreement" is intended to ensure that a SCCP member, who must also be an Exchange member, has assumed responsibility for the order. Give-up agreements with non-members must be submitted in advance to the Exchange's Examinations Department and must define the credit limits for the customer.

²⁴ The Exchange, the Exchange/SCCP member, and the non-member User are the parties to a "three-way agreement." Under the agreement, the Exchange member must agree to be jointly and severally liable for actions of the non-member User through the System. In return, the non-member User must agree to adhere to all applicable by-laws and rules of the Exchange. The Exchange clarified that neither it nor the SCCP approves credit limits established by an Exchange/SCCP member for its non-member customer as part of a three-way agreement. See Letter from Philip H. Becker, Senior Vice President and Chief Regulatory Officer, Exchange, to Ivette Lopez, Assistant Director, Division, Commission, dated December 10, 1996. The letter also clarified that an Exchange "clearing member" is an Exchange member that also is a member of the SCCP.

²⁵ The Exchange submitted to the Commission a letter stating that the Exchange did not intend for the sample three-way agreement, which was previously provided to the Commission, to be considered part of the Exchange's proposed rule change. See Letter from Edith Hallahan, First Vice President and Deputy General Counsel, Exchange, to Michael Walinskas, Deputy Associate Director, Division, Commission, dated March 24, 1999. The letter also represented that the Exchange will withdraw from any final three-way agreement language stating that the Exchange has the right to terminate a User's access to the System "without prior notice for any reasons or no reason whatsoever." The Commission notes that such

As with all Exchange trades, System matches will require both a Phlx and SCCP member to be involved. Therefore, all Committers and Users must specify both an executing and clearing account during the enrollment process. The Exchange and the SCCP will perform trade reconciliation and confirmation functions. System trades will then be forwarded to the National Securities Clearing Corporation ("NSCC") for clearance and settlement.²⁶

C. Entry of Orders and Commitments

Only Orders and Commitments that are entered through the System will be eligible for matching and execution by the System during the Session. Under no circumstances will Orders or Commitments migrate to the Exchange's regular equity trading session. Because all Orders and Commitments remain anonymous, the identity of Users and Committers will not be revealed to other Participants.

Orders and Commitments will only be accepted into the System from 5:00 A.M. to 9:15:00 A.M. ("Order Entry Time Period"). The Order Entry Time Period ends approximately 15 minutes prior to the opening of the Exchange's regular trading session (9:30 A.M.-4:00 P.M.). However, as previously mentioned, the Exchange may establish a different period for the entry of Orders and Commitments into System's equity trading floor terminal.²⁷ Orders and Commitments may be canceled²⁸ or modified before the end of the Order Entry Time Period. Confirmation of the placement and cancellation of an Order

language raises important issues concerning appropriate access to the System.

²⁶ The Exchange recently restructured the clearance and settlement business offered through its wholly owned subsidiary, SCCP. The SCCP no longer maintains its continuous net settlement system for conducting settlements between the SCCP and its members. As a result, the SCCP ceased providing the cash settlement services attendant to the settlement process of the Philadelphia Depository Trust Company. However, the SCCP continues to offer limited clearing and settlement services to Exchange members. See Securities Exchange Act Release No. 39444 (Dec. 11, 1997), 62 FR 66703 (Dec. 19, 1997).

²⁷ If the Exchange establishes any alternative time period for the entry of Orders and Commitments, the alternative time period should not allow Orders and Commitments placed through the System's equity trading floor terminal to be entered at a time after which all other methods of access to the System have been closed. For example, it would not be permissible to establish a general cut-off time for Order and Commitment entry of 9:15 A.M. but allow Orders and Commitments to be entered through the System's equity trading floor trading terminal until 9:16 A.M.

²⁸ Orders and Commitments may be canceled through the System until 9:15:00 A.M. by using the appropriate designator ("CXL").

or Commitment will occur electronically through the System.

When entering Orders or Commitments, Participants will be required to provide a description of the Order or Commitment, as well as account identification information needed to determine priority and eligibility. Participants must provide the following information when entering an Order or Commitment:

- Buy/Sell designation;
- Volume (number of shares). As previously stated, the minimum size for Commitments is 2,500 shares and the minimum size for Orders is 5,000 shares. All Commitments and Orders must be entered in 500 share increments;²⁹

- Stock symbol;
- Participant status: Committer or User;

- Committer account status: Off-Floor Liquidity Provider, Specialist, or Alternate Specialist;

- User account status: Member or non-member, and Order type (basic, cross, facilitation, also including any constraints or restrictions);

- Clearing account number;
- Trade account information (Exchange executing account number); and

- Subscriber identification number.

D. Types of Orders

Users may enter three types of Orders: (i) basic; (ii) cross; and (iii) facilitation. A User may designate its basic and facilitation Orders as either unconstrained (meaning executable to the extent possible) or constrained.

1. Constraints

Two constraints are available to Users in connection with basic and facilitation Orders: all-or-none ("AON") and minimum-or-none ("MON"). The AON constraint means that the User wants to execute all shares of the Order or none at all. The MON constraint means that the User wants to execute at least a specified number of shares of the Order or none at all.

2. Basic Order

A basic Order is a standard, one-sided Order to buy or sell. A basic Order may be restricted, meaning it is executable against non-members only.

3. Cross Order

A cross Order is a two-sided Order, with both sides comprised of non-member interest, with instructions to match the identified buy-side with the identified sell-side. The two sides making up a cross can be entered separately, with the contra-side identified. If the sizes do not match, the remainder is left unexecuted.

4. Facilitation Order

A facilitation Order is a two-sided Order, with an identified Phlx member on the contra-side to act as a facilitator for that Order, and is known as a "Guarantor." The contra-side may be entered together with, or separate from, the facilitation Order; if the sizes do not match, the remainder is left unexecuted. Facilitation Orders can be submitted on behalf of Phlx members or non-members. Unlike basic orders, facilitation Orders may not be restricted.

Three types of facilitation orders are available to Users: (i) Unconditional facilitation: execute against an identified Guarantor or not at all. This Order is a type of cross involving a Phlx member Guarantor; (ii) conditional facilitation: execute against an identified Guarantor after attempting to be executed against non-members to the extent possible; and (iii) last resort facilitation: execute against an identified Guarantor only after attempting to execute against all other Orders and Commitments to the extent possible.

E. Execution Priority Rules

Orders and Commitments will be matched for execution by the System at approximately 9:16 a.m. Trades matched and executed through the System are printed and cleared as Exchange transactions, executed on the Exchange and processed through SCCP.

1. Orders

Generally, Orders are afforded priority by: (i) Account type (account types are based on status as a Phlx member or non-member, type of non-member account, constraints, and direct subscription versus broker access); (ii) Order size (largest first); and (iii) chronological basis measured by time-of-entry (for Orders of the same account type and size).

2. Commitments

Commitments are prioritized based on: (i) Sub-account types (Phlx Off-Floor Liquidity Providers first, then Specialists, and Alternate Specialists); and (ii) Commitment size (largest first). For Commitments of the same size, priority rotates among Committers with

the fewest aggregate shares (in all eligible securities) matched through the System at that time.

3. Liquidity Rotation Parameter

Although priority is generally based on size, the "Liquidity Rotation Parameter" ("LRP") provides that Order and Commitment participation will rotate in 25,000 share increments, as opposed to filling the largest Order or Commitment first. The LRP is intended to ensure fair allocation. The LRP operates within each matching step (after Step 1) to match Orders/Commitments in 25,000 share increments, moving to the next Order/Commitment after 25,000 shares have been matched, and then, after all other Orders/Commitments have received their first 25,000 share match, returning to the unfilled portion of the first Order/Commitment. Under the proposal, the Exchange's Floor Procedure Committee may establish a different LRP size based on operational experience, practicality, and demonstrated market need.

F. The Matching Algorithm

Execution priority is determined in accordance with the matching algorithm that consists of 23 matching steps. In step 1, two-sided Orders are matched in the following order:

- Non-member/Non-member cross Orders.

- Non-member/Member unconditional facilitation Orders.

- Member/Member unconditional facilitation Orders.

- Any unmatched "residue" due to the excess size entered by one side remain unexecuted. It is important to remember that Step 1 matches unconditional facilitation Orders.

In step 2, non-member unconstrained Orders (basic and facilitation) are matched with non-member unconstrained Orders. As with all matching steps, priority is determined based on size and time of entry.

In step 3, remaining non-member unconstrained Orders are matched with non-member constrained (AON and MON) Orders. Any non-member constrained Orders not matched with the unconstrained Orders left over from step 1 are then matched with other non-member constrained Orders.

In step 4, remaining non-member Orders are matched with non-member institutions' ³⁰ Orders participating

²⁹ The Exchange's Floor Procedures Committee may determine whether to establish: (i) alternative minimum sizes for Commitments and Orders; or (ii) alternative minimum increment sizes. Any adjustments to Order, Commitment, or increment sizes are required to be based on market and participant need, and are subject to prior written notice.

³⁰ The proposal defines an institution as "an entity not registered as a broker-dealer or doing business as a hedge fund that serves in a fiduciary capacity." The Exchange believes such entities include, but are not limited to: qualified pension plans, investment companies registered under the Investment Company Act of 1940, bank trust

through a broker. Such non-member institutions' Orders are then matched with each other. (Non-member institutions entering Orders directly would have participated in steps 2 and 3). It should be noted that constraints are not relevant to determining priority in step 4 among institutions participating through a broker.

In step 5, remaining non-member Orders are matched with non-member non-institution Orders participating through a broker. After non-member non-institution Orders participating through a broker are matched against the unmatched Orders of non-members, such non-member non-institution Orders are matched with each other. (Non-member non-institution Orders include non-member broker-dealer Orders as well as non-member, non-broker-dealer, non-institution Orders, such as retail customers).

In step 6, remaining non-member Orders are matched with Orders of non-member broker-dealers that subscribe directly. Orders of non-member broker-dealers that subscribe directly are then matched with each other. Thus, step 6 matches non-member Orders (both constrained and unconstrained) for non-member broker-dealers. (As opposed to dealer activity, if a non-member broker-dealer is acting as a broker, the Order would already be matched in steps 4 and 5).

By step 7, the matching process is ended with respect to non-member Orders. Any remaining non-member Orders that are restricted to matching with other non-members only are removed. The removed unmatched Orders may be matched later according to step 23.

In step 8, remaining non-member conditional facilitation Orders are matched with their conditional Guarantors (facilitating members). These conditional Orders—which were first subject to matching against other non-member Orders in prior steps—are now eligible for matching against the identified Guarantor (a Phlx member).

In step 9, remaining non-member Orders are matched with member Orders participating through brokers. Any unmatched member Orders participating through brokers are removed.

In step 10, remaining non-member Orders are matched with Orders of off-floor members. Any unmatched off-floor members' Orders are removed.

In step 11, remaining non-member Orders are matched with Orders of Exchange floor members. Any

unmatched Exchange floor members' Orders are removed. This includes one-sided Orders (as opposed to Commitments) of Specialists and Alternate Specialists.

In step 12, remaining non-member Orders are matched with Commitments of Exchange Off-Floor Liquidity Providers. Any unmatched Commitments of Exchange Off-Floor Liquidity Providers are removed.

In step 13, remaining non-member Orders are matched with Commitments of Specialists. Any unmatched Specialist Commitments are removed.

In step 14, remaining non-member Orders are matched with Commitments of Alternate Specialists. Any unmatched Alternate Specialist Commitments are removed.

In step 15, remaining non-member Orders are matched with member facilitation Orders (those with conditional or last resort Guarantors). Note that unconditional facilitation Orders previously were matched in step 1.

In step 16, non-member last resort facilitation Orders are matched with their identified last resort Guarantors.

In step 17, non-member matching ends. Any remaining non-member Orders are unmatched, except as provided in step 23.

In step 18, Exchange member conditional facilitation Orders are matched with their identified conditional Guarantors.

In step 19, all remaining Exchange member Orders are matched with each other, provided they are not restricted to matching against non-members only. This includes the following Phlx member Orders: Phlx member Orders participating through brokers, Phlx off-floor member Orders, Phlx floor member Orders, and Phlx member last resort facilitation Orders.

In step 20, remaining Exchange member Orders are matched with Commitments that have not been restricted to matching against non-members only. First, remaining Exchange member Orders are matched with Commitments of Off-Floor Liquidity Providers, and then with Commitments of Specialists and Alternate Specialists. Unmatched Commitments are removed.

In step 21, Exchange member last resort facilitation Orders are matched with their identified last resort Guarantors.

In step 22, the whole matching "round" in an eligible security ends. Any remaining Exchange member Orders and Commitments are unmatched, except as provided in step 23.

In step 23, if any unmatched Orders remain, the largest unsatisfied constrained Order is permanently removed, the matches after step 1 are unmatched and the matching process starts again. Among unsatisfied Orders of the same size, Exchange member Orders would be removed before non-member Orders. Among two Exchange members, or among two non-members, the last in time would be removed first. Additional matching rounds would occur, each removing another unsatisfied constrained Order, until no unsatisfied constrained Orders remained. Matching rounds are intended to maximize the number of executions.

G. Calculation of VWAP

The exchange shall calculate a final VWAP value for each eligible security by: (i) using all regular way trades (including sold sales and late sales)³¹ reported by the appropriate reporting authority from the opening of the regular trading session and printed prior to 4:15:00 P.M.,³² (ii) multiplying each respective reported price by the total number of shares traded at that price; (iii) adding together each of these calculated values to compile an aggregate sum; and (iv) dividing the aggregate sum by the total number of reported shares that appear in the prints included in step (i) of the VWAP calculation process. The resulting VWAP value will be reported in the form of a fraction and will be rounded to the nearest 1/256th.³³ Any proposed changes that impact the manner in which the official VWAP is calculated are required to be submitted to the Commission for review under Section 19(b) of the Act.³⁴

The exchange shall calculate and assign a final VWAP value to each security subject to a match during the Session.³⁵ The final VWAP value that the Exchange calculates and assigns to each eligible security shall be reported and publicly disseminated at 4:20 P.M. promptly following calculation. The

³¹ A "late sale" is a transaction which is a correct last sale but is publicly disseminated later than is required. Generally, transactions are required to be publicly disseminated within 90 seconds of execution. A "sold sale" refers to a transaction appearing on the CTS out of its proper sequence.

³² It should be noted that prints representing trades executed after regular trading hours (9:30 A.M. to 4:00 P.M.), such as prints reflecting trades executed during the Exchange's Post Primary Session, will only be included in the VWAP calculation until 4:01:30 P.M.

³³ The System software also allows Participants to convert VWAP prices into decimal form.

³⁴ 15 U.S.C. 78s(b).

³⁵ In addition, the Exchange will continuously calculate a non-final VWAP value throughout the trading day for each eligible issue.

final VWAP value will be available through the System to all Participants that had a commitment or Order matched during the Session.

The final VWAP value calculated and reported by the Exchange shall be the official VWAP value. Unless the Exchange directs otherwise, every VWAP value as initially reported by the reporting authority is conclusively presumed to be accurate and deemed to be final, even if the VWAP value is revised or subsequently determined to have been inaccurate.

Generally, all System matches create a binding contract. However, in the case where a match occurs during the Session in an eligible security that has not opened for primary market trading by 3:00 P.M., the match will be voided and a report to that effect will immediately be sent through the System to the Participants to the voided match. If an eligible security opens for trading but is the subject of a trading halt and does not resume trading for the remainder of the day, the final VWAP value for any match in that eligible security on that day will be based on the prints that occurred before the trading halt.

H. Reporting of System Transactions and VWAP

All System matches will first be reported to the reporting authority (*i.e.*, Consolidated Tape System or "CTS") at 9:20 A.M. as separate volume prints for each eligible security in which matching occurred. The morning print for all System matches will occur by way of an administrative message over the CTS reflecting the VWAP volume in each of the eligible securities. The morning print is intended to provide market participants with VWAP volumes before regular trading commences.

Under normal circumstances, Users and Committers will be notified of their matches by 9:20 A.M. System matches will be reported to the entering subscriber in the form of automated reports reflecting the number of shares matched for each Participant by the System in each issue.

Once the Exchange calculates and assigns a final VWAP value, each Session match constitutes a completed transaction for the purpose of reporting the trade to the appropriate reporting authority. End-of-day prints will normally be reported at 4:20 P.M. following calculation of the final VWAP at 4:15 P.M. The end-of-day prints will be printed on a trade-by-trade basis representing all matches made that morning. Each print will reflect a matched trade and the corresponding VWAP. These trades will be reported to

the CTS with the sale condition "B" to indicate volume weighted average pricing (the "B" will distinguish VWAP trades from other transactions that may possibly be reported after the close such as after-hours, crossing session, or late sales transactions). The Exchange has represented that VWAP trades matched and executed through the System will not impact the determination of the last sale price in an eligible security listed on the NYSE.

The System will not disseminate or disclose Orders or Commitments, including System bid/ask sizes, prior to the Session match, nor System imbalances remaining after the Session match, except to entering Participants.

Because reporting is performed on a trade-by-trade basis, if no System match occurs in an eligible security, a final VWAP for that particular security will not be reported to the CTS for that day.

I. Access to the System

Access to the System for subscribers (both direct subscribers and subscribers acting as brokers) will be available by dial-up into the System utilizing software and log-on procedures that vary depending on whether the subscriber is accessing the System through a personal computer or a main-frame system. System access may include various types of computer hardware, software, and handheld devices.

J. Resolutions of Disputes

Disputes regarding Session participation or the eligibility of Orders, Commitments, or Participants will be resolved by the Exchange in accordance with Exchange Rule 124.

K. Liability of the Exchange

The Exchange shall not be liable for any damages, claims, losses or expenses sustained by a member or member organization caused by any errors, omissions or delays resulting from any act, condition or cause beyond the reasonable control of the Exchange, including but not limited to, an act of God; fire; flood; extraordinary weather conditions; war; insurrection; riot; strike; accident; action of government; communications or power failure; equipment or software malfunction arising from the use of the System, the calculation of the VWAP or any and all other matters respecting the operation of the System or Session.

L. Trading Halts in Eligible Securities

The proposed rule change does not limit the ability of the Exchange to otherwise halt or suspend trading in any

eligible stock matched through the System.

M. Extraordinary Circumstances

In the case of "extraordinary circumstances," the Exchange's Floor Procedure Committee may determine to adjust or modify any of the times relating to Order Entry Time Period, the matching period, or any aspect of the transaction reporting procedures. The proposal defines "extraordinary circumstances" to include fast market conditions, systems malfunctions, and other circumstances that limit the Exchange's ability to receive, disseminate, or report System information in a timely and accurate manner.

N. Short Sales

Orders and Commitments must be appropriately marked pursuant to Exchange Rule 455 to indicate whether they are short sales. In addition, Orders and Commitments will be exempt from the short sale "tick test" restrictions of Exchange Rule 455. Positions resulting from Session matches will be effective for the purpose of determining long or short status for the remainder of the trading day, immediately upon notification of the Participant to a System match, notwithstanding that the VWAP has not yet been determined.

III. Discussion

For the reasons discussed below, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and with the requirements of Sections 6(b) and 11A under the Act.³⁶ In particular, the Commission believes the proposed rule change is consistent with the Section 6(b)(5) requirements that the rules of an exchange be designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest.³⁷

The Commission believes the Exchange's proposed System will serve as an innovative complement to the Exchange's existing auction market. The Commission historically has encouraged innovation and the creation of new electronic trading systems so that investors are provided access to a variety of execution alternatives. At the

³⁶ 15 U.S.C. 78f(b) and 78k-1.

³⁷ In approving this proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

same time, the Commission believes it is important to ensure that a trading system which operates as a facility of a national securities exchange complies with the Act's standards regarding investor protection and fair and orderly markets. The Commission believes that the Exchange's proposal achieves this objective.

Some aspects of the proposal raise complicated regulatory issues. For example, the matching of Orders and Commitments during the Session includes some characteristics of a unitary call market and, therefore, represents a departure from the traditional auction market trading conducted on the Exchange floor. In addition, the System allows non-Exchange members to enter Orders. Other aspects of the proposal raise concerns regarding surveillance, reporting, transparency, control and access, and priority principles of an auction market. After careful review, and for the reasons discussed in more detail below, the Commission believes the proposal adequately addresses the areas of concern and is consistent with the maintenance of free and open markets and investor protection in accordance with Section 6(b)(5) of the Act.³⁸

The Commission believes that the System is properly regulated as a facility of the Exchange.³⁹ The System will use Exchange equipment and personnel, involve the participation of Exchange floor traders, and rely on the SCCP to clear System trades. Furthermore, matches performed during the Session will be regulated and reported as Exchange trades. The Commission believes that because the System will be using the Exchange's premises, property, and services for effecting and reporting System matches, it will be using the facilities of an exchange as defined in Section 3(a)(2) of the Act.⁴⁰

The Commission notes that the Exchange's use of UTTC personnel and equipment in operating the System does not alter the Commission's determination that the System is properly regulated as a facility of the Exchange. The Exchange retains regulatory control over the System and is fully responsible for ensuring that the System complies with the federal securities laws and all applicable rules and regulations. Although UTTC personnel shall assist the Exchange in operating the System, these assistants will be acting as agents of the Exchange. Therefore, the Exchange will maintain control of the System and will exercise authority over the non-Exchange employees that help operate the System.

The Commission believes that operation of the System as a facility of the Exchange raises important issues regarding surveillance of the System,⁴¹ UTTC personnel, and Exchange personnel. The Commission believes the Exchange has adequately addressed these surveillance issues. In particular, the Exchange's surveillance group will be equipped with technology to create detailed audit trails that will track Orders and Commitments from entry to the confirmation of matching. The Exchange also will use technology to track Orders and Commitments through the matching algorithm; this will identify the exact point at which Orders and Commitments are matched, or alternatively, not matched. In addition, a corrections alert mechanism will provide notice of all corrections that occur in the CTS after the VWAP calculation period. Finally, Exchange surveillance personnel will use an electronic surveillance system to identify aberrant trading behavior in any eligible stock matched through the System.

The Commission also believes that operation of the System as a facility of the Exchange raises unique concerns regarding access to, and control of, the System.⁴² For several reasons, the

Commission believes that the Exchange the UTTC have adequately addressed these access and control concerns. First, the Commission notes that the Exchange will retain regulatory control over the System and that the Exchange will remain fully responsible for ensuring that the System complies with the federal securities laws and all applicable rules and regulations. Although the Exchange will use UTTC personnel and equipment to assist in operating the System, such UTTC assistance will be provided on an agency basis. More specifically, this assistance will be provided by REB securities, a wholly owner broker-dealer subsidiary of UTTC. REB will be assigned certain responsibilities for ensuring compliance with the monitoring and reporting of System access and control parameters. The Exchange represented that REB has developed a special compliance program to address these issues. Second, REB will not conduct any other securities business outside of its oversight of System access and control. This limitation on business activity will help focus REB's scrutiny on important compliance issues. This limitation on business activity will help focus REB's scrutiny on important compliance issues. The Exchange will require REB to conduct annual independent audits regarding the System compliance program. Finally, because REB is a broker-dealer registered under the Act, the Commission will have the authority to inspect and examine REB. For these reasons, the Commission believes the Exchange and UTTC have adequately addressed issues relating to control and access.

The Commission believes that in providing non-Exchange members limited access to the System, the Exchange's proposal does not contravene the Act. The Act contemplates that transactions on a national securities exchange will be conducted by "members."⁴³ In

³⁸ 15 U.S.C. 78f(b)(5).

³⁹ Section 3(a)(2) of the Act states that "[t]he term 'facility' when used with respect to an exchange includes its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service." 15 U.S.C. 78c(a)(2).

⁴⁰ Regulating the System as a facility of the Exchange is consistent with the Commission's approach towards similar electronic matching systems. For example, the Chicago Stock Exchange ("CHX") operated the Chicago Match as a facility of the CHX. See Securities Exchange Act Release No. 35030 (Nov. 30, 1994), 59 FR 63141 (Dec. 7, 1994). The Chicago Match, which integrated an electronic order match system with a facility for

brokering trades, no longer operates as a facility of the CHX.

⁴¹ The System will link off-floor and on-floor computer terminals to the System's communications base unit. This unit will: (i) accept Orders and Commitments; (ii) match buyers with sellers; (iii) give execution reports to matched Participants; (iv) calculate the back-up VWAP for each matched security (separate Exchange systems will calculate the official VWAP; (v) report VWAP matches to the entering Participants (separate Exchange systems will report VWAP matches to the appropriate reporting authorities); and (vi) create an audit trail by recording Order and Commitment entry and execution.

⁴² The VTS is the first electronic system offering VWAP that will operate as a facility of a national securities exchange. Although the Commission previously reviewed electronic systems that offered

volume weighted average pricing features, they were operated as proprietary trading systems. See Letter from Alden S. Adkins, Chief, Office of Automation and International Markets, Division, Commission, to Charles R. Hood, Vice President and General Counsel, Instinet Corporation (Dec. 6, 1991) (providing no-action relief to Instinet's Market March crossing service) and letter from Alden S. Adkins, Chief, Office of Automation and International Markets, Division, Commission, to Lloyd H. Feller, Morgan, Lewis & Bockius (Oct. 28, 1991) (providing no-action relief to POSIT regarding its volume weighted average pricing mechanism).

⁴³ Section 3(a)(3)(A) of the Act describes a member in terms of effecting transactions on a national securities exchange. The pertinent text defines a member as "any natural person permitted to effect transactions on the floor of the exchange

addition, Section 6(c)(1) of the Act states that a national securities exchange shall deny membership to any natural person who is not, or is not associated with, a registered broker or dealer.⁴⁴ The Commission believes the Exchange has established adequate controls over non-member access to the System. Specifically, a non-member may enter Orders through the System only after entering into a "give-up" agreement with an Exchange clearing member (*i.e.*, such Exchange member also is a SCCP member). The give-up agreement requires the Exchange clearing member to assume legal responsibility for the Orders of the non-member. The Exchange clearing member must submit the give-up agreement to the Exchange in advance of any activity by the non-member and must also specify the credit limits for the non-member.

Moreover, prior to obtaining permission to enter Orders through the System, each non-member must enter into a "three-way agreement" with the Exchange and an Exchange clearing member. The three-way agreement requires the non-member to agree to adhere to the applicable rules of the Exchange. Because the access of non-member Users is limited by the requirement that such Users be parties to valid give-up and three-way agreements,⁴⁵ and because the behavior of non-member Users is governed by the affirmative obligations contained in the mandated give-up and three-way agreements, the Commission believes the participation of non-members in the System does not violate the Act.

The Commission also believes that the Exchange's proposal is consistent with Section 11A of the Act.⁴⁶ Specifically, the Commission believes that the System will further the purposes of Section 11A and the development of a national market system by promoting economically efficient execution of securities transactions, fair competition among markets, best execution of customer orders, and an opportunity for orders to be executed without the participation of a dealer. The System provides a new and potentially efficient way to match and execute trading interests. It is principally designed to meet the demands of institutional traders and other market professionals that desire VWAP-based transactions. Use of the System may result in enhanced liquidity for investors and

increase the ability of investor orders to interact directly with other investor orders.

The Commission believes the System may provide benefits to market participants, especially those who trade in large blocks. Specifically, Participants will enjoy complete end-to-end anonymity in their Orders and Commitments; as a result, their proprietary trading strategies will not be revealed to other market participants. Furthermore, because Participants receive notice of Order and Commitment matches before the NYSE opens for trading, those Participants not receiving matches will have the opportunity to enter orders during regular trading hours.

The Commission believes the proposal is consistent with Rule 11Aa3-1 of the Act.⁴⁷ Promptly after the System matches Orders and Commitments, each Participant will be notified of the issues and number of shares matched for that Participant. The Exchange also will report to the CTS at 9:20 A.M. the VWAP transaction volume in each eligible issue. For example, if during the Session matches were effected in all 300 eligible securities, the Exchange would report to the CTS the matched volume for each of the 300 securities (*i.e.*, 300 separate volume prints). Although the Final VWAP value for each eligible security will not be calculated until after the closing of trading, the Commission believes it is important that market participants have access to matched VWAP volume before regular trading begins.⁴⁸ Once of the final VWAP value has been calculated, each transaction will immediately be reported on a trade-by-trade basis, including the size and final VWAP value, over the Tape B network of the CTS⁴⁹ and to the Participants. Thus, the

Exchange will provide for the collection and dissemination of transaction reports containing, among other things, the price of the security. The display of Orders and Commitments prior to matching would be impractical; in particular, it would counter the benefits of anonymity afforded by the System.⁵⁰ The Commission believes that the System's reporting mechanisms will provide investors with adequate transaction price information in accordance with Rule 11Aa3-1 under the Act.

In response to the Exchange's request for interpretive relief, the Commission confirms that the Exchange will not violate Rule 11Aa3-2 under the Act⁵¹ if the Exchange disseminates last sale data for System matches at 4:20 P.M. Rule 11Aa3-2(d) requires self-regulatory organizations to comply with the terms of any effective national market system plan of which it is a sponsor or participant. The Commission believes that the Exchange will continue to comply with the terms of the CTS national market system plan if the Exchange disseminates reports containing price and volume information for System matches at 4:20 P.M. The Commission notes that a national market system plan is designed to ensure timely dissemination of last sale data. The Commission believes that the Exchange has reporting procedures in place to ensure the timely dissemination of preliminary and last sale data for System matches. In particular, as soon as the matching process has been completed at the end of the Session, the Exchange will report to the CTS the matched VWAP volumes for each eligible security. Furthermore, immediately after the final VWAP values have been determined and assigned, the Exchange will report to the CTS each transaction on a trade-by-trade basis, including the final VWAP value. In each instance, the Exchange has committed to make timely dissemination of important market information. Because the Exchange has arranged for the timely dissemination of preliminary and last sale data, the Commission believes the Exchange will remain in compliance with the CTS national market system plan and will not violate Rule 11Aa3-2.

The Commission believes that the System does not violate Rule 11Ac1-1

without the services of another person acting as broker." 15 U.S.C. 78c(a)(3)(A).

⁴⁴ 15 U.S.C. 78f(c)(1).

⁴⁵ If a non-member User's give-up or three-way agreement was terminated, the non-member User would not be permitted to access the System.

⁴⁶ 15 U.S.C. 78k-1.

⁴⁷ Rule 11Aa3-1, "Dissemination of Transaction Reports and Last Sale Data with Respect to Transactions in Reported Securities," governs the dissemination of transaction reports that contain price and volume information with respect to purchase or sale transactions involving one or more round lots of a security. See 17 CFR 240.11Aa3-1.

⁴⁸ The Exchange has informed the Commission that the operator of the CTS, the Consolidated Tape Authority ("CTA"), will not permit trade messages to be delivered over the CTS prior to the start of regular trading on the U.S. equities markets (*i.e.*, before 9:30 A.M.). Therefore, the pre-opening VWAP volumes reported over the CTS must take the form of administrative messages. The Commission urges the Exchange to work with the primary information vendors to ensure that the vendors disseminate the VWAP volumes as administrative message before the opening of trading.

⁴⁹ As presently configured, the CTS consists of two tape systems: Tape A and Tape B. The Tape A network displays only NYSE symbol information while Tape B displays information for issue listed on all other exchanges. Although each of the

securities eligible for matching during the Session are listed on the NYSE, the VWAP matches will be reported on the Tape B network due to programming difficulties and project priorities.

⁵⁰ *Cf.* The OptiMark System. See Securities Exchange Act Release No. 39086 (Sept. 17, 1997), 62 FR 50036 (Sept. 24, 1997).

⁵¹ 17 CFR 240.11Aa3-2.

under the Act ("Quote Rule").⁵² The Quote Rule requires a national securities exchange to collect bids, offers, quotation sizes, and aggregate quotation sizes from "responsible brokers or dealers,"⁵³ for each reported security listed or admitted to unlisted trading privileges and to make them available to quotation vendors.⁵⁴ A bid or offer is defined in the Quote Rule as the "bid price and offer price communicated by an exchange member or OTC market maker to any broker or dealer, or to any customer."⁵⁵ To constitute a bid or offer, therefore, the underlying trading interest must have been communicated to at least one other potential counterparty. Bids and offers are intended to attract other parties to deal with the person publishing the bid or offer at the quoted price. In contrast, the essence of the System is its anonymity. Only the System is aware of the expressed trading interest until the matching and trade execution occur. Therefore, the System is not a mechanism by which Participants broadcast prices to other Participants and trade with one another at those prices. Accordingly, the Commission believes that the System does not violate the Quote Rule.

The Commission also believes that the matching algorithm and Liquidity Rotation Parameter are appropriate ways to ensure that Orders and Commitments are matched in accordance with the priority principles of an auction market. The Commission believes that the priority principles of the matching algorithm will not give rise to practices that are inconsistent with Section 11(a) of the Act.⁵⁶ Specifically, the matching algorithm is designed to provide public order preference and public order protection such that Exchange members must yield priority to non-members.

Moreover, the Exchange has represented that Exchange Specialists will not be permitted to trade ahead of customers because Exchange Floor Traders will be last in terms of priority (e.g., Off-Floor Liquidity Providers receive priority over Floor Traders). In addition, the Liquidity Rotation Parameter, or "anti-bully" rule is designed to ensure that order flow is fairly allocated. The LRP will include more Participants in the matching process because the largest Orders and Commitments will be filled in the course of several rotations rather than a single match.

The Commission believes the market characteristics of the eligible stocks will make it difficult to influence their intraday prices and thus their final VWAP values. Specifically, the 300 stocks eligible for System matching during the one year pilot are among the most highly-capitalized and highly-liquid stocks listed on the NYSE. The significant daily transaction activity in each eligible stock should help to make it difficult and economically impractical to influence their prices. As a caveat, the Commission observes that manipulation concerns would be heightened in the VWAP transaction volume in an eligible security came to represent a substantial portion of the overall transaction volume in such security. The Commission expects the Exchange to closely monitor the VWAP trading volumes for each eligible security in relation to their overall trading volumes. The Commission believes that legitimate manipulation concerns would arise if the VWAP transaction volume in an eligible security exceeded 20% of the security's daily transaction volume.

Finally, the Commission believes it is appropriate that Orders and Commitments will be exempt from the short sale "tick test" restrictions of Exchange Rule 455. Separate from this approval order, the Commission has granted the Exchange exemptive relief from Rule 10a-1 under the Act.⁵⁷ Under the terms of the Rule 10a-1 exemptive relief, Participants may enter Commitments and Orders to sell short eligible securities provided that certain conditions are satisfied. Therefore, the Commission believes it is appropriate for the Exchange to likewise exempt Participants from the short sale restrictions that appear in Exchange Rule 455.

For the reasons discussed above, the Commission believes it is appropriate to approve the Exchange's proposal for a one year pilot period. As part of the pilot process, the Commission expects

the Exchange to collect information pertaining to the operation and effectiveness of the System. The Commission requests that the Exchange use its ongoing research and surveillance to prepare a comprehensive report that: (i) addresses the overall reliability of the System and identifies any System outages or other technical problems; (ii) provides a summary of the Exchange's surveillance efforts regarding the System and identifies any Exchange investigations or enforcement actions involving the System; (iii) discusses the strategies employed by Users and Committers and evaluates whether the System is useful to market participants; (iv) provides feedback from Exchange members and non-members regarding their experiences with the System; and (v) measures the System's impact and effect on trading in the primary market of the eligible securities. In addition, because the Exchange has independently committed to prepare a report regarding the number of tape corrections and how they affect the final VWAP values calculated by the Exchange, that analysis should be included in the report. The Exchange is requested to submit its report on the System no later than two months before the end of the pilot period.

The Commission finds good cause for approving proposed Amendment Nos. 3 and 4 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. The Commission notes that Amendment No. 3 revised the proposed rule change in several ways. First, the Exchange agreed to operate the System as a facility of the Exchange for a one year pilot period. The Commission believes it is appropriate for the Exchange to operate the System on a pilot basis for one year. The pilot period will provide the Exchange with the time necessary to evaluate the effectiveness of the System and to identify and remedy any problems or difficulties that may develop in its operation. Based on the results of the pilot period, the Exchange may propose an extension of the pilot period or seek permanent approval of the System. Second, the Exchange agreed to limit the securities eligible for matching through the System to 300 of the most highly-liquid and highly-capitalized issues listed on the NYSE. The Commission believes it is reasonable for the Exchange to limit the universe of eligible securities to highly-liquid and highly-capitalized securities. The Commission believes that the prices of large, actively traded securities are difficult to impact, and that as a result, the System's VWAP values should be

⁵² 17 CFR 240.11Ac1-1.

⁵³ Rule 11Ac1-1 defines the term "responsible broker or dealer," when used with respect to bids or offers communicated on an exchange, to mean "any member of such exchange who communicates to another member on such exchange, to the location (or locations) designated by such exchange for trading in a covered [period] security, a bid or offer for such covered [reported] security, as either principal or agent." The Rule provides, however, that if "two or more members of an exchange have communicated on such exchange bids or offers for a covered [reported] security at the same price, each such member shall be considered, a 'responsible broker or dealer' for that bid or offer, subject to the rules of priority and precedence then in effect on that exchange." Furthermore, if a member of the exchange represents as agent the transmitted bid or offer of another exchange member, only the member representing the bid or offer as agent shall be considered the "responsible broker or dealer" for that bid or offer. 17 CFR 240.11Ac1-1(a)(21)(i).

⁵⁴ See 17 CFR 240.11Ac1-1(b).

⁵⁵ See 17 CFR 240.11Ac1-1(a)(4).

⁵⁶ 15 U.S.C. 78k(a).

⁵⁷ See Exemptive Relief Letter *supra* note 13.

less susceptible to manipulation. Third, the Exchange clarified the definition of an "institution," committed to prepare a report regarding the number of tape corrections and how they affect the VWAP values calculated by the Exchange, and modified from 4:02 P.M. to 4:01:30 P.M. the cut-off time designed to capture trade reporting run-off and sales that occur at the close of regular trading. Because each of these revisions strengthens the proposal, the Commission believes they are appropriate modifications.

In Amendment No. 4, the Exchange agreed to report pre-opening VWAP volumes for each eligible security in which matches have been effected during the Session. The Commission believes it is appropriate for the Exchange to report VWAP volumes for eligible securities individually before the start of regular trading. Despite the absence of a final price, the Commission believes that pre-opening volume prints will improve transparency and provide valuable information to market participants. The Commission continues to believe that a single, aggregate VWAP volume print encompassing all eligible securities, as previously proposed by the Exchange, provides little benefit to market participants. Amendment No. 4 also provided improved surveillance procedures. Although the surveillance measures cannot be discussed in specific terms because of their confidential nature, the Commission believes the measures will strengthen the oversight of the System and improve the proposal.

Based on the above, the Commission believes good cause exists, consistent with Sections 6(b) and 19(b) of the Act,⁵⁸ to accelerate approval of Amendment Nos. 3 and 4 to the proposed rule change.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 3 and 4 to the proposal, including whether the proposed rule change as amended 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 submissions, all subsequent amendment, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any persons, other

than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-Phlx-96-14 and should be submitted by April 22, 1999.

V. Conclusion

The Commission believes the Exchange's proposal satisfies the standards of the Act that apply to national securities exchanges. The Commission recognizes that investors desire to trade large blocks of securities anonymously and free of the price movements that often accompany such transactions. By operating a facility that allows investors to anonymously effect block-sized trades at the day's volume weighted average price, the Exchange will be able to better accommodate the needs of investors.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁵⁹ that the proposed rule change (SR-Phlx-96-14), as amended, is approved for a pilot period ending March 24, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁶⁰

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 99-8061 Filed 3-31-99; 8:45 am]

BILLING CODE 8010-01-M

DEPARTMENT OF TRANSPORTATION

Office of the Secretary

[Docket No. OST-98-3648]

Reports, Forms and Recordkeeping Requirements; Agency Information Collection Activity Under OMB Review

AGENCY: Office of the Secretary, DOT.

ACTION: Notice of request for comments.

SUMMARY: Under the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35, as amended), before an agency submits a proposed collection of information to OMB for approval, it must publish a document in the **Federal Register** providing a 60-day comment period and otherwise consult with members of the public and affected agencies concerning each proposed collection of information. This notice

announces the Department of Transportation's (DOT) intention to request approval of the following collection of information. Interested parties are invited to send comments regarding any aspect of this information collection, including: (1) the necessity and utility of the information collection; (2) the accuracy of the estimated burden; (3) ways to enhance the quality, utility, and clarity of the collected information; and (4) ways to minimize the collection burden without reducing the quality of the collected information. Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval of this information collection.

DATES: Comments must be received on or before June 1, 1999.

ADDRESSES: Comments must refer to the docket and notice numbers cited at the beginning of this notice and be submitted to OST's Docket Management Facility, located on the Plaza Level of the Nassif Building at the U.S. Department of Transportation, Room PL-401, 400 Seventh Street, SW., Washington, DC 20590-0001. The DOT Docket is open to the public from 10 am to 5 pm, Monday through Friday.

FOR FURTHER INFORMATION CONTACT: Blane A. Workie, Office of the General Counsel, Department of Transportation, 400 7th Street, SW., Room 10424, Washington, D.C. 20590, (202) 366-4723.

SUPPLEMENTARY INFORMATION:

Office of the Secretary

Title: The DOT Final Rule on Accessibility of Over-the-Road Buses.

OMB Control Number: 2100-NEW.

Type of Request: Approval of a New Information Collection.

Abstract: The Department of Transportation (DOT), in conjunction with the U.S. Architectural and Transportation Barriers Compliance Board, issued final access regulations for privately-operated over-the-road buses (OTRBs) as required by the Americans with Disability Act (ADA) of 1990. The final rule has four different recordkeeping/reporting requirements. The first has to do with 48 hour advance notice and compensation. The second has to do with equivalent service and compensation. The third has to do with reporting information on ridership on accessible fixed-route buses. The fourth has to do with reporting information on the purchase and lease of accessible and inaccessible new and used buses. The purpose of the information collection requirements is to provide data that the Department can use in its regulatory review and to assist the Department in

⁵⁸ 15 U.S.C. 78f(b) and 78s(b).

⁵⁹ 15 U.S.C. 78s(b)(2).

⁶⁰ 17 CFR 200.30-3(a)(12).