IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 NASD. All submissions should refer to File No. SR–NASD–97–98 and should be submitted by February 13, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[5]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–1645 Filed 1–22–98; 8:45 am]

BILLING CODE 8010–01–M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39548; File No. SR–Phlx–97–23]

Self-Regulatory Organizations: Philadelphia Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 Relating to the Treatment of PACE Orders in Double-up/Double-down Tick Situations

January 13, 1998.

I. Introduction

On May 2, 1997, the Philadelphia Stock Exchange, Inc. (''Phlx'' or ''Exchange'') submitted to the Securities and Exchange Commission (''SEC'' or ''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 relating to double-up/double-down automatic price improvement and manual price protection. On August 4, 1997, the Exchange submitted to the Commission Amendment No. 1 to the proposed rule change.[3]

The proposed rule change was published for comment in Securities Exchange Act Release No. 39000 (September 2, 1997), 62 FR 47865 (September 11, 1997). No comments were received on the proposal. On October 20, 1997, the Exchange submitted to the Commission Amendment No. 2 to the proposed rule change.[4] This order approves the proposal, including Amendment No. 2 on an accelerated basis.

II. Description

A. Background

The Exchange, pursuant to Rule 19b–4 of the Act, proposes to adopt Supplementary Material .07(c) to Phlx Rule 229, Philadelphia Stock Exchange Automatic Communication and Execution (''PACE'') System, relating to automatic double-up/double-down price improvement and manual double-up/double-down price protection. The PACE System accepts orders for automatic or manual execution in accordance with the provisions of Phlx Rule 229, which governs the operation of the PACE System and defines its objectives and parameters. Agency orders received through PACE are subject to certain minimum execution parameters and non-agency orders are subject to the provisions of Supplementary Material .02 of Rule 229. In addition, Rule 229 establishes execution parameters for orders depending on type (market or limit), size, and the guarantees offered by specialists.[5]

B. Automatic Double-up/Double-down Price Improvement

The Exchange proposes to adopt Rule 2929.07(c)(i), Automatic Double-up/Double-down Price Improvement, which would state that where the specialist voluntarily agrees to provide automatic double-up/double-down price improvement to all customers and all eligible orders in a security, in any instance where the bid/ask spread of the PACE Quote[6] is a 1⁄4 point or greater, market and marketable limit orders[7] in NYSE-listed or Amex-listed securities for 599 shares or less that are received through PACE in double-up/double-down situations shall be provided with automatic price improvement of 1⁄8 of a point, beginning at 9:45 a.m.

Under the proposal, a ''double-up/double-down situation'' is defined as a trade that would be at least: (i) 1⁄4 point (up or down) from the last regular way sale on the primary market; or (ii) 1⁄4 point from the regular way sale that was the previous intra-day change on the primary market. The term ''double'' originated with two 1⁄8 point ticks, meaning 1⁄4 of a point. Under the proposal, a down tick of 1⁄16 of a point followed by a down tick of 3⁄16 of a point would be a double-down situation, because it equals 1⁄4 of a point.

As an example of the part (i) of the definition of a double up/double-down situation, assuming that the specialist has agreed to participate in this feature, where the PACE Quote is 22 1⁄2–22 3⁄4, if the last sales on the primary market were 22 3⁄4 followed by a down tick at 22 5⁄8, a double-up/double-down situation would not occur for a market order to buy, because buying at 22 3⁄4 is a single up tick of 1⁄8 of a point and,

---

[5] 17 CFR 200.30-3(a)(12).

[1] 15 U.S.C. § 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Letter from Philip H. Becker, Senior Vice President and Chief Regulatory Officer, Phlx, to Michael Walinskas, Senior Special Counsel, Division of Market Regulation, SEC, dated August 1, 1997 (''Amendment No. 1'').

[4] *See* Letter from Philip H. Becker, Senior Vice President, Phlx, to Michael Walinskas, Senior Special Counsel, SEC, dated October 17, 1997 (''Amendment No. 2''). Amendment No. 2 revises the proposal to provide that relief from the requirements concerning double-up/down guarantee sizes may be granted pursuant to the extraordinary circumstances language contained in the text of proposed Rule 229.07(c)(iii), rather than that of existing Rule 229.13. Moreover, the text of Rule 229.07(c)(iii) is proposed to be amended to state that extraordinary circumstances also include situations where the Exchange is unable to receive market quotations in a timely and accurate manner. In addition, while the Form 19b–4 filing containing the proposed rule change stated that member organizations may decline to participate in both double-up/down automatic price improvement and manual price protection, the text of proposed Rule 229.07(c)(i)(D) did not reflect this option. Amendment No. 2 adds such language to the text.

[5] Rule 229.05 provides that round-lot market orders up to 500 shares and partial round-lot (''PRL'') market orders of up to 599 shares, which combine a round-lot with an odd-lot, are stopped at the PACE Quote at the time of their entry into PACE (''Stop Price'') for a 30 second delay to provide the Phlx specialist with the opportunity to effect price improvement when the spread between the PACE Quote exceeds 1⁄8 of a point. This feature is known as the Public Order Exposure System (''POES'') ''window.'' Rule 229.05 further provides that market orders for more than 599 shares that a specialist voluntarily has agreed to execute automatically also are entitled to participation in POES. If orders eligible for POES are not executed within the POES 30 second window, the order is automatically executed at the Stop Price.

[6] The PACE Quote consists of the best bid/offer among the American Stock Exchange (''Amex''); New York Stock Exchange (''NYSE''); Pacific Exchange; Phlx, Boston Stock Exchange, Cincinnati Stock Exchange, and Chicago Stock Exchange, as well as the Intermarket Trading System/Computer Assisted Execution System (''ITS/CAES''). *See* Rule 229.

[7] A market order is an order to buy or sell a stated amount of a security at the best price obtainable when the order is received. A marketable limit order is an order to buy or sell a stated amount of a security at a specified price, which is received at a time when the market is trading at or better than such specified price.

thus, does not meet the 1/4 point requirement. Under the proposal, because no double-up/double-down situation occurred, no automatic price improvement would be afforded. However, applying part (ii) of the definition, a double-up/double-down situation would occur for a sell order, because a sale at 22 1/2 is a 1/4 point away from the next-to-last intra-day change, executed at 22 3/4. Under the proposal, the market order to sell would be automatically executed at 22 5/8, providing an 1/8 point price improvement over the otherwise-automatic execution at 22 1/2.

Where the PACE Quote is 22 1/4–22 3/4, with the last sale at 22 1/2, part (i) of the definition would apply to a market order to buy or sell, because buying at 22 3/4 creates a double-up tick (1/4 of a point away from 22 1/2) and selling at 22 1/4 creates a double-down tick (also 1/4 of a point away from 22 1/2).

If the last sale was at 22 3/4 and the next-to-last sale was at 22 1/2, part (i) of the definition would apply to a market order to sell, because selling at 22 1/4 creates a double-down tick 1/2 of a point away from 22 3/4, and part (ii) of the definition would apply to a buy order, because buying at 22 3/4, although not an up or down tick from the last sale of 22 3/4, is 1/4 of a point away from the next to last change, executed at 22 1/2.

If the last sale was at 22 5/8 and the next-to-last sale was at 22 1/2, part (ii) of the definition would apply to a market order to buy, because buying at 22 3/4 creates a double-up tick (1/4 of a point away) from 22 1/2, as well as to a market order to sell, because selling at 22 1/4 creates a double-down tick (1/4 of a point away) from 22 1/2.

Pursuant to part (ii) of the definition of a double-up/double-down situation, this term includes qualifying changes from the last change, not just the two previous last sales. For example, where the last sales on the primary market were: 22 1/2; 22 3/8; and 22 3/8, with the PACE Quote at 22 1/4–22 1/2, a market order to sell that would otherwise be executable at 22 1/4 should be price-improved to 22 3/8, because it is a double-down tick (1/4 of a point away) from the last "change" or sale that was the previous change (meaning the change from 22 1/2 to 22 3/8).[8] Under part (i) of the definition, this order would not qualify as a double-up/double-down situation, because an execution at 22 1/4 would be only 1/8 of a point away from the last sale of 22 3/8.

To explain the interaction between the POES window and the automatic double-up/double-down price improvement feature, assuming that the PACE Quote is 15 1/2–3/4 and the last sale was at 15 1/2, an order to buy 500 shares would be subject to automatic price improvement, because buying at 15 3/4 creates a double up tick (1/4 of a point away) from the last sale at 15 1/2. The order would be automatically executed under the proposal at 15 5/8 (giving 1/8 of a point price improvement over the PACE Quote of 15 3/4) and no POES window would occur. The proposed automatic double-up/double-down price improvement feature results in an automatic execution, with no window, timer or delay. If, on the other hand, the order was to sell 500 shares, a double-up/double-down situation would not occur, because selling at 15 1/2 is not a double-up/double-down situation (not 1/4 of a point away from the last sale); this order would be POES-eligible such that the POES window would apply. At the expiration of the POES window, absent manual specialist intervention, this order would be manually executed at 15 1/2, its Stop Price.

Automatic double-up/double-down price improvement also would be available for marketable limit orders. As an example, assuming that the specialist has agreed to participate in this feature, where the PACE Quote is 15 1/2–15 3/4, and the last sale was at 15 1/2, an order to buy 500 shares at 15 3/4 would be subject to automatic price improvement, because buying at 15 3/4 creates a double up tick (1/4 of a point away) from the last sale at 15 1/2. The order to buy 500 shares at 15 3/4 is a marketable limit order, because it is immediately executable on the offer. Under this proposal, this order would be automatically executed at 15 5/8, receiving price improvement of 1/8 of a point.

The Exchange notes that the execution resulting from the automatic price improvement feature can *create* a double-up/double-down situation; for instance, where the PACE Quote is 32–32 1/4 and the last sale was at 32 3/8, a sell order that would be executable at 32 would be improved to 32 1/8, which is a double-down tick (1/4 point from 32 3/8 to 32 1/8).

Automatic double-up/double-down price improvement will not occur where the execution price would be outside the primary market high/low range for the day, if out-of-range protection was elected by the member organization entering the order pursuant to Rule 229.07(a). The following example illustrates how the execution price before automatic price improvement can be out-of-range. Where the primary market high and low for the day are 22 1/2 and 22 1/4, the last sale was at 22 3/8 and the PACE Quote is 22 5/8–22 7/8, an incoming market order to sell would revert to manual status since an execution at 22 5/8 (or 22 3/4, if automatic price improvement would have been applied) would constitute an out-of-range execution (*i.e.*, an execution at 22 5/8 would have been at a price about the 22 1/2 high for the day). The next example illustrates how the execution price could be out-of-range as a result of automatic price improvement. Where the primary market high and low for the day are 22 5/8 and 22 1/4, the last sale was at 22 3/8 and the PACE Quote is 22 5/8–22 7/8, an incoming sell order executable at 22 5/8 would *not* be improved to 22 3/4, because such price would be out-of-range (*i.e.*, an execution at 22 3/4 would have been at a price above the 22 5/8 high for the day). Instead, the order would revert to manual status, and the specialist would either stop the order or execute if at 22 5/8. Absent out-of-range protection, the 22 5/8 execution would have been a double-up situation (1/4 of a point away from the last sale of 22 3/8).

The Exchange represented that it is proposing to extend its price improvement initiative to double-up/double-down situations, because these are particularly suitable for price improvement. Instead of affording an automatic execution at the PACE Quote, the proposal results in an automatic execution that improves on that price by an 1/8 of a point.

The Exchange has determined that, as with many PACE features and participation in the PACE System itself, automatic double-up/double-down price improvement should be made available on a voluntary, symbol-by-symbol basis, so that specialists can determine which securities are suitable for the program. Moreover, the Exchange has asserted that the availability of a price improvement feature benefits the specialist function, especially in high-volume securities, where stopping orders and effecting manual intervention are time-consuming, can delay execution, and do not necessarily result in price improvement.

C. Manual Double-up/Double-down Price Protection

The Exchange also proposes to adopt a manual double up/double-down price protection provision as Rule 229.07(c)(ii). Currently, a form of manual double-up/double-down price protection is a feature of the PACE System, but is neither mandatory, nor

[8] The first down tick was from 32 1/2 to 32 3/8, and the second down tick would have been from 32 3/8 to 32 1/4 had the order been executed. The intervening sale at 32 3/8 does not change this result.

available in all securities.[9] Nor has it been incorporated into Exchange rules. Thus, the Exchange is proposing to replace the existing voluntary feature with the proposed mandatory feature. This aspect of the proposal is intended to impose a double-up/double-down price protection requirement upon specialists that choose not to participate in the automatic price improvement feature. Manual price protection would apply in ⅛ point-wide markets or greater in double-up/double-down situations; thus, unlike automatic price improvement, which is triggered only by ¼ point-wide or greater markets, a 3⁄16 point-wide market would trigger manual price protection. Further, the Exchange has represented that in situations where both manual double-up/double-down price protection and POES would otherwise apply, an order will receive manual price protection, but will not be eligible for POES.[10]

The proposed manual double-up/double-down price protection provision would stop eligible orders (*i.e.*, automatically executable market and marketable limit orders of 599 shares or less in NYSE- or Amex-listed securities received through PACE in double-up/double down situations, beginning at 9:45 a.m.) to give such orders the possibility of receiving manual price improvement from the specialist. Under this proposal, an eligible order would be ''stopped'' by the specialist at the PACE Quote at the time of its entry into PACE, meaning that the order is guaranteed to receive at least the price by the end of the trading day. Consistent with Phlx Equity Floor Procedure Advice A–2 (''Advice A–2'') specialists are required to display stopped orders at an improved price and any contra-side orders received by the specialist will be taken into account for purposes of determining when to execute a stopped order and at what price.

The Exchange has represented that the purpose of a manual price protection provision is to provide an alternative double-up/double-down feature, which allows for price improvement, albeit not automatic, for securities which the specialist has determined are not appropriate for the automatic feature, due to, for example, liquidity, trading patterns, and volatility. In this regard, the Exchange has stated that less liquid stocks may trade in sizes that render it unfair to specialists to afford automatic price improvement to such orders and manage the resulting positions.[11]

D. Both Features

For both automatic price improvement and manual price protection, specialists may establish higher sizes than the 599 share minimum (but less than or equal to the specialist's automatic execution guarantee), which may be changed effective the next day. Member organizations entering PACE orders (''PACE Users'') will be notified of any such changes.

Specialists choosing to activate the automatic feature would also be subject to the procedure described above (*i.e.*, it would become effective the next day). In addition, switching between the automatic and manual features triggers this procedure. Signing up for the manual price protection feature is not required, because all specialists will be required to participate.

PACE Users entering orders may decline to participate in the automatic and manual double-up/double-down features; however, they may not choose to participate in only one of the two features. Moreover, odd-lot orders are not eligible for either proposed feature. Further, the proposed features are available only for orders that are eligible for automatic execution. For instance, non-marketable limit orders and orders exceeding a specialist's automatic execution guarantee size are not eligible for either proposed feature, because the features depend upon either stopping or automatically improving orders guaranteed a certain automatic execution price.

Finally, the proposed rule change provides that both proposed features may be disengaged in a security or floor-wide in extraordinary circumstances. In addition to fast market conditions, extraordinary circumstances also include systems malfunctions and other circumstances that limit the Exchange's ability to receive, disseminate, or update market quotations in a timely and accurate manner.

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, in particular, with the requirements of Section 6(b).[12] In particular, the Commission believes the proposal is consistent with the Section 6(b)(5) requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.[13]

Over the years, the Commission has recognized that the increased competition for order flow that results from permitting regional specialists to attract orders from other markets by providing price improvement opportunities and superior quotations enhances market making ability and the quality of customer order execution. The Commission has approved proposals by national securities exchanges to integrate price improvement opportunities, on both an automatic and manual basis, into their automatic execution systems. Accordingly, the Commission believes that the Exchange's present proposal, which would adopt both automatic price improvement and manual price protection features in double-up/double-down situations, may enhance both intermarket competition and order execution quality on the Exchange. In addition, the Commission believes that both features should contribute to the maintenance of orderly markets by Phlx specialists because they help to reduce the price variations occurring from trade to trade on low volume.

A. Automatic Double-up/Double-down Price Improvement

Under the proposal, specialists voluntarily may agree to provide automatic price improvement of ⅛ of a point from the PACE Quote to all customers and all market and marketable limit orders of up to 599 (or higher, if elected by the specialist)

[9] The Exchange has represented that the current double-up/down price protection feature has been in use since 1991. If elected by the entering member organization in a security selected by the specialist as eligible for this feature, orders within the specialist's automatic execution guarantee size are stopped in double/up/down situations.

[10] Telephone conversation between Philip Becker, Senior Vice President and Chief Regulatory Officer, Phlx, and Jon Kroeper, Special Counsel, Division of market Regulation, SEC, dated November 7, 1997. The Phlx proposal also states that the POES window is not applicable where the automatic double up/down price improvement feature is applicable.

[11] Specifically, the Exchange has stated that its reference to trading patterns may cover stocks where the spread between the bid and offer is very narrow, with little trading occurring between such bid/offer spread, or very wide, with most trading on the bid/offer. Moreover, the Exchange has stated its belief that low volatility stocks may not be appropriate for automatic price improvement, because little movement in the stock may also indicate that little trading is occurring between the bid and offer price.

[12] 15 U.S.C. § 78f(b).

[13] In approving the proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. § 78c(f).

shares in a particular security on a stock-by-stock basis, in any instance where the bid/ask spread of the PACE Quote is ¼ point or greater and an automatic execution at the PACE Quote would create a double-up/double-down situation from the last primary market sale. The Commission believes that the adoption of this proposed feature by the Exchange is appropriate in that its use by Phlx specialists should increase the likelihood that eligible customer orders, particularly marketable limit orders, will be executed at an improved price over the PACE Quote. As stated above, certain market orders already are stopped in the POES window for 30 seconds to give the specialist the opportunity to provide price improvement to such orders.[14] The Commission's Division of Market Regulation previously has noted that price improvement windows, such as POES, by themselves rarely provide an execution that betters the quoted market.[15] The Exchange's proposal should enhance the price improvement opportunities available for such orders as it will provide automatic price improvement to eligible orders in double-up/double-down situations.

The Commission's recent Report on the Practice of Preferencing found that the frequency of price improvement for marketable limit orders was significantly lower than that for market orders when measured across exchanges, spreads, and order size ranges.[16] As marketable limit orders currently are not eligible for the POES window, the Commission finds that the proposed automatic price improvement feature should have a beneficial impact, in that it should increase significantly the price improvement opportunities available to marketable limit orders, as such orders otherwise would be executed automatically at the PACE Quote upon their entry into PACE.

B. Manual Double-up/Double-down Price Protection

The Exchange also has proposed to adopt a mandatory manual double-up/double-down price protection feature.[17] In situations where a specialist has not agreed to provide automatic double-up/double-down price improvement, this feature would stop all market and marketable limit orders of up to 599 shares (or higher, if elected by the specialist) to all customers in all stocks in instances where the bid/ask spread of the PACE Quote is ⅛ or greater in double-up/double-down situations, making it possible for the specialist to provide price improvement to such orders.

The Commission historically has been concerned that the practice of stopping stock may compromise the specialist's fiduciary duties to unexecuted limit orders on the specialist's limit order book.[18] The Commission, however, has approved the practice in instances where the harm to existing orders on the specialist's limit order book was believed to be offset by the resulting reduced spread and possibility of price improvement for the stopped order. The Commission believes that the instances in which the Exchange's proposal is intended to apply are appropriate for the use of stopping stock procedures.

Further, the Commission notes that the proposal and existing Phlx procedures provide for the display of stopped orders by Phlx specialists. Specifically, Advice A–2, which governs the handling of stopped orders on the Phlx equity floor, requires a Phlx specialist who stops an order pursuant to the feature to display such an order in his or her quote at an improved price.[19]

Moreover, as was stated above in connection with double-up/double-down price improvement, the proposed manual double-up/double-down price protection feature gives the specialist the opportunity to provide price improvement to orders that would otherwise be subject to immediate automatic execution at the PACE Quote. Additionally, a specialist voluntarily may extend automatic price improvement or manual price protection in double-up/double-down situations to orders for more than 599 shares, provided the level is at or below the specialist's automatic execution guarantee. This aspect of the proposal should have a beneficial impact as it appears to be specifically targeted to provide the possibility of price improvement by the specialist to orders currently lacking such opportunities.

The Commission also believes that the proposal, taken together with Advice A–2, the proposal provides adequate guidelines for a specialist's handling of orders that are stopped in double-up/double-down situations in a manner consistent with his or her obligation to maintain fair and orderly markets.[20] In particular, proposed Rule 229.07(c)(ii) provides that orders that are stopped for manual double-up/double-down price protection are guaranteed to receive at least the Stop Price by the end of the trading day. While the specialist's provision of this guarantee is implicit in the concept of stopping stock, it is not stated explicitly in Advice A–2.[21]

---

[14] *See supra* note 5.

[15] *See*, Division of Market Regulation, SEC, *Market 2000: An Examination of Current Equity Market Developments* (January 1994), at Study V, n.19.

[16] *See* SEC, *Report on the Practice of Preferencing* (April 11, 1997) at Tables V–8A to V–8C.

[17] As stated above, the Exchange has represented that its existing manual double-up/double-down price improvement feature has been in use since 1991. *See supra* note 9 and accompanying text.

The Commission notes that Section 19(b) of the Act provides that each self-regulatory organization is required to file any proposed rule change with the Commission and that no proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with its provisions.

[18] *See* SEC, Report of Special Study of Securities Markets, 88th Cong., 1st Sess., H.R. Doc. No. 95, pt. 2, at 150–154; Preferencing Report, *supra* note 16, at Part II.B.4. For example, in a market quoted 20–20⅛ (with a minimum variation of 1⁄16 of a point), 1000 shares bid and offered, the offer representing a customer limit order, the specialist receives a market order to buy 500 shares. If the specialist decides to stop the market order, the specialist will change his or her quote to 20 1⁄16–20⅛, 500 shares bid and 1000 shares offered, the bid representing the stopped market order. If the specialist subsequently receives a market order to sell 500 shares, the specialist will execute the sell order against the stopped order at 20 1⁄16, improving the price for the stopped order. However, the sell limit order at 20⅛ with priority on the book is bypassed and does not receive the execution it would have had if the stop had not been granted. In addition, if the market turns away from the limit price (*i.e.*, moves to 20–20 1⁄16 or lower), the limit order may never be executed.

The Commission notes, however, that because manual double-up/double-down price protection only is available in ⅛ point markets and greater, and the minimum trading variation on the Phlx currently is 1⁄16, the proposal does not implicate the Commission's particular and continuing concerns with the practice of stopping stock in minimum variation markets that were set forth in the Preferencing Report. *See* Preferencing Report, *supra* note 16, at Part II.B.4.

[19] The Commission notes that the Exchange has represented that in situations where both manual double-up/double-down price protection and POES would otherwise apply, an order will receive manual price protection, but will not be eligible for POES. *See supra* note 9. The Commission believes that this aspect of the proposal should increase order exposure on the Exchange, as orders stopped for manual price protection will be required to be displayed in the specialist's quote, whereas orders eligible for POES are displayed only to the specialist. *See supra* note 5.

[20] *See* Phlx Rule 203.

[21] In approving the Phlx's adoption of Advice A–2 in 1994, the Commission stated its belief that "further action could be taken [by the Exchange] to ensure proper handling of stopped stock." *See* Securities Exchange Act Release No. 34614 (August 30, 1994), 59 FR 46280 (September 7, 1994) (File No. SR–Phlx–93–41). Specifically, the Commission stated that it expected the Phlx to submit a proposed rule change to complement its floor procedure advice. The Commission set forth a number of elements that the Exchange should consider including in such a rule, namely: a definition of the agreement to "stop" stock and the obligations of the member who agrees to grant the stop; the market conditions under which a stop should be granted; a policy for the execution of stopped stock and, in particular, for determining the price at which the order should be executed; and pilot procedures for minimum variation

Continued

C. Provisions Common to Both Proposed Features

Under Rule 229.07(a), PACE Users may elect that if an automatic execution of their orders at the PACE Quote would result in an execution price that is outside the primary market high-low range for that trading day, such orders would be routed to the specialist for manual execution at or within the high-low range of the day. The proposal provides that PACE Users may elect that neither automatic double-up/double-down price improvement nor manual double-up/double-down price protection will occur where the execution price (before or after the application of automatic price improvement) or Stop Price, respectively, would be outside the high-low range for the day. In such instances, orders would be handled manually by the specialist and be subject to an execution at or within the primary market high-low range of the day. The Commission believes that this aspect of the proposal is appropriate in that it provides PACE Users with greater flexibility as to the disposition of their orders. Moreover, providing such flexibility could enhance the Exchange's competitive position among firms seeking an appropriate venue for the execution of their order flow.

In addition, under proposed Rule 229.07(c)(i)(D), PACE Users may decline to participate in the automatic and manual double-up/double-down features; however, they may not choose to participate in only one of the two features.[22] The Commission believes that such a provision is appropriate in that it should offer a preferred alternative to PACE Users for whom a prompt execution at a definitive price is most important. As described above, when the manual double up/double down price protection feature is applicable, a significant time delay may occur when an order is stopped and price improvement is attempted. In addition, as with offering PACE Users the alternative between double-up/double-down features and out-of-range services, offering PACE Users the option to decline both features may enhance its competitive position among order execution venues. The Commission further believes that the Exchange's decision to require that PACE Users only may decline to participate in both features, not a particular one, is a decision that appropriately falls within the business judgment of the Exchange.

Further, proposed Rule 229.07(c)(i) and (c)(ii) set forth procedures through which specialists may activate automatic double-up/double-down price improvement in a particular stock, switch between the automatic and manual features, and change the size of the orders that will be eligible for either feature. In each instance, the change will be effective the next trading day, and PACE Users will be notified of any such changes. The Commission believes the proposal provides satisfactory procedures in this regard. In particular, the Commission believes that making these changes effective on the next trading day is appropriate in that it grants specialists the necessary flexibility to manage the proposed features in light of changing market conditions. At the same time, it alleviates concerns that specialists potentially may take advantage of their unique knowledge with respect to incoming PACE order flow to make intra-day modifications to the double-up/double-down features that would be to the detriment of other market participants.

Finally, proposed PACE Rule 229.07(c)(iii) provides that both double-up/double-down features may be disengaged in one or more securities, upon the presence of extraordinary circumstances, as determined by two Phlx Floor Officials. Extraordinary circumstances are defined to include fast market conditions, systems malfunctions and other circumstances that limit the Exchange's ability to receive, disseminate, or update market quotations in a timely manner. The Commission believes that this aspect of the proposal is appropriate in that it provides sufficient guidance to the Phlx membership by clearly delineating the circumstances under which the double-up/double down features may be disengaged and the procedure to be followed in seeking such disengagement. The Commission further believes that the provision requiring two Floor Officials to approve the disengagement of both double-up/double-down features is important. Specifically, while the particular categories of events covered in the proposed paragraph generally are appropriate grounds for the disengagement of the double-up/double-down features, the Commission believes that requiring Floor Officials to confirm that such conditions exists is a necessary safeguard to ensure the appropriate treatment of PACE orders eligible for these features.[23]

The Commission finds good cause for approving Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 2 revises the proposals to provide that relief from the requirements concerning double-up/double-down guarantee sizes may be granted pursuant to the extraordinary circumstances language contained in the text of proposed Rule 229.07(c)(iii) to the PACE Rule, rather than that of existing PACE Rule 229.13. The Commission believes that amending the proposal to utilize Rule 229.07(c)(iii) for this purpose is a reasonable approach, as this provision has been formulated specifically for use in double-up/double-down situations, whereas Rule 229.13 was developed to apply in the context of specialist performance obligations. In addition, Amendment No. 2 revises the text of proposed Rule 229.07(c)(iii) to state that extraordinary circumstances also include situations where the Exchange is unable to receive market quotations in a timely and accurate manner, as well as where it is unable to disseminate or update such quotations. The Commission finds that the addition of this provision is appropriate in that such instances may interfere with the ability of PACE to determine whether a double-up/double-down situation actually has occurred, and the ability of specialists to handle orders stopped pursuant to the manual feature. Further, Amendment No. 2 adds language to the text of proposed Rule 229.07(c)(i)(D) to state specifically that member organizations may decline to participate in both double-up/double-down features. While this alternative was set forth in the Form 19b–4 filing containing the proposed rule change, it was not reflected in the text of proposed Rule 229.07(c)(i)(D). The Commission finds that this aspect of the change is appropriate in that it will serve as a reminder to member organizations of the availability of this alternative. Finally, the Commission notes that the proposed rule change was noticed previously in the **Federal Register** for the full statutory period and the Commission did not receive any comments on it. Therefore, the Commission believes that it is

markets that are consistent with the rules of priority, parity, and precedence. The Commission continues to believe strongly that the Exchange should submit a proposed rule change pursuant to Section 19(b) of the Act and Rule 19b-4 thereunder to adopt such a stopping stock rule.

[22] A firm's election to not participate in the double up/double down features will apply to trading in all Phlx stocks; the firm will not be able to make separate elections on a security by security basis. Phone conversation between Michael Walinskas, SEC and Edith Hallahan, Phlx, January 13, 1998.

[23] In addition, the Commission expects the Exchange to monitor the performance of Floor Officials in granting any requests by specialists to disengage the double-up/double-down features.

consistent with Section 6(b)(5) of the Act to approve Amendment No. 2 to the proposed rule change on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 2 to the proposed rule change. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules changes that are filed with the Commission, and all written communications relating to Amendment No. 2 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 at the principal office of the Exchange. All submissions should refer to File No. SR–Phlx–97–23 and should be submitted by February 13, 1998.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[24] that the proposed rule change (SR–Phlx–97–23), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[25]

Jonathan G. Katz,

Secretary.

[FR Doc. 98–1551 Filed 1–22–98; 8:45 am]

BILLING CODE 8010–01–M

[24] 15 U.S.C. § 78s(b)(2).

[25] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39549; File No. SR–Phlx–96–38]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 2, 4 and 5 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to the Listing of Flexible Exchange Traded Equity and Index Options

January 14, 1998.

I. Introduction

On August 21, 1996, the Philadelphia Stock Exchange, Inc. (''Phlx'' or ''Exchange'') filed a proposed rule change with the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] to provide for the listing and trading of Flexible Exchange Options (''FLEX options'') on specified indexes (''FLEX index options'') and equity securities (''FLEX equity options'').

Notice of the proposal was published for comment and appeared in the **Federal Register** on September 24, 1996.[3] The Phlx submitted to the Commission Amendment No. 1 to its proposal on March 6, 1997.[4] Notice of Amendment No. 1 was published for comment and appeared in the **Federal Register** on April 24, 1997.[5] The Phlx submitted to the Commission Amendment No. 2 to its proposal on July 1, 1997.[6] The Phlx submitted Amendment No. 3, on August 27, 1997,[7] which was subsequently replaced in its entirety by Amendment No. 4, which the Phlx submitted to the Commission on November 7, 1997.[8]

The Phlx submitted Amendment No. 5 to the Commission on January 6, 1998.[9]

No comment letters were received on the proposed rule change or on Amendment No. 1 to the proposed rule change. This order approves the Exchange's proposal, as amended by Amendment Nos. 1 through 5.

II. Background

The purpose of the Exchange's proposal is to provide a framework for the Exchange to list and trade equity and index options that give investors the ability, within specified limits, to designate certain of the terms of the options. In recent years, an over-the-counter (''OTC'') market in customized options has developed which permits participants to designate the basic terms of the options, including size, term to expiration, exercise style, exercise price, and exercise settlement value, in order to meet their individual investment needs. Participants in this OTC market are typically institutional investors, who buy and sell options in large-size transactions through a relatively small number of securities dealers. To compete with this growing OTC market in customized options, the Exchange

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 37691 (September 17, 1996), 61 FR 50060.

[4] In Amendment No. 1 to its proposed rule change, the Phlx restated the original proposal and proposed several changes as set forth in detail in Section III of this release.

[5] *See* Securities Exchange Act Release No. 38519 (April 17, 1997), 62 FR 20048.

[6] In Amendment No. 2, the Exchange amended the Request for Quote process to require a Requesting Member to indicate the size of an order and the intention to cross, if applicable. In addition, the Phlx proposes specific position limits of 22,000 contracts for Super Cap Index options. *See* Letter from Edith Hallahan, Director and Special Counsel, Regulatory Services, Phlx, to Sharon Lawson, Senior Special Counsel, Office of Market Supervision (''OMS''), Division of Market Regulation (''Market Regulation''), Commission, dated June 25, 1997 (''Amendment No. 2'').

[7] *See* Letter from Theresa McCloskey, Vice President, Phlx, to Sharon Lawson, Senior Special Counsel, OMS, Market Regulation, Commission, dated August 26, 1997 (''Amendment No. 3'').

[8] The Phlx replaces Amendment No. 3, in its entirety, with Amendment No. 4, and proposes to: (1) eliminate the application of position and exercise limits to FLEX equity options; (2) reduce the minimum size applicable to a Request-for-Quote for a closing transaction in already-opened FLEX equity options from 100 to 25 contracts; (3) clarify the parity and priority principles for FLEX options transactions; (4) amend the proposed rule change to refer consistently to ''FLEX index and equity options'' (as opposed to index FLEX options); (5) correct the text of proposed Rule 1079(b)(6) regarding the crossing procedure to reflect that the crossing intention has already been announced as part of the RFQ, as amended by Amendment No. 2; and (6) amend proposed Rule 1079(a)(1) to clearly state that any options-eligible security pursuant to Rule 1009 is eligible to underlie FLEX equity options trading and any index underlying Non-FLEX options trading is also eligible for FLEX index options trading. These proposed changes are described more fully herein. *See* Letter from Philip H. Becker, Senior Vice President, General Counsel and Chief Regulatory Officer, Phlx, to Sharon Lawson, Senior Special Counsel, OMS, Market Regulation, Commission, dated November 3, 1997.

[9] The Phlx proposes in Amendment No. 5 to replace section 3 of Amendment No. 4 and withdraw the examples provided in Amendment 4. In Amendment No. 5, the Phlx clarifies: (1) the parity and priority principles for FLEX options transactions; and (2) that each assigned ROT or assigned Specialist is not required to respond with a quote in every instance, unless requested by a Floor Official. *See* Letter from Michele R. Weisbaum, Vice President and Associate General Counsel, Phlx, to Sharon Lawson, Senior Special Counsel, OMS, Market Regulation, Commission, dated December 9, 1997 (''Amendment No. 5'').