

*Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2009-021. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2009-021 and should be submitted on or before May 5, 2009.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

[FR Doc. E9-8420 Filed 4-13-09; 8:45 am]

**BILLING CODE 8010-01-P**

**SECURITIES AND EXCHANGE COMMISSION**

**Release No. 34-59721; File No. SR-Phlx-2009-32**

**Self-Regulatory Organizations; NASDAQ OMX PHLX, Inc.; Notice of Filing of Proposed Rule Change Relating to the Exchange's Enhanced Electronic Trading Platform for Options, Phlx XL II**

April 7, 2009.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on April 3, 2009, NASDAQ OMX PHLX, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to implement several enhancements to its electronic options trading system, Phlx XL. The enhanced system will be known as Phlx XL II and will reflect enhancements to the opening, linkage and routing, quoting, and order management processes.

The text of the proposed rule change is available on the Exchange's Web site at <http://nasdaqomxphlx.cchwallstreet.com/NASDAQOMXPHLX/Filings/>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

*A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

**1. Purpose**

The purpose of the proposed rule change is to implement several enhancements to the Phlx electronic options trading platform, Phlx XL.<sup>3</sup> The system that includes these enhancements will be referred to as Phlx XL II. These enhancements should improve the execution quality for its Phlx users by improving a number of processes, including the opening process, the order handling process and the execution of orders process. The changes to the opening process should provide better executions to users, more consistent prices on executions and a smoother transition from the opening to the regular trading day. The changes to the order handling process will improve routing to liquidity available at other exchanges while preventing non-exempt trade-throughs of other markets, and will provide users with increased flexibility and control in how their orders are handled. Execution of order processing will become more consistent, with greater continuity in prices as a result of these changes, because several of the changes are intended to introduce a price check to limit executions at far away prices (which are known as outliers). The Exchange believes that these changes benefit investors and users through better and more consistent system behavior and resulting prices. These modifications and enhancements are outlined below.<sup>4</sup>

*New Opening Process*

The Exchange proposes to improve its opening process for options in several ways. Currently, Exchange Rule 1017 provides that the system will open an option series for trading once certain conditions have been met. Specifically, Rule 1017(a) currently states that the system will automatically open a series in equity options when a quote or trade has been disseminated by the market for the underlying security, and there is a specialist quote or a defined number of Phlx XL participants<sup>5</sup> quoting after a certain time period has elapsed. Provided there is no order imbalance,

<sup>3</sup> See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 44612 [sic] (August 3, 2004) (SR-Phlx-2003-59).

<sup>4</sup> The Exchange acknowledges that the proposed Options Order Protection and Locked/Crossed Market Plan may necessitate modifications.

<sup>5</sup> Phlx XL and Phlx XL II participants are specialists, Streaming Quote Traders ("SQTs") and Remote Streaming Quote Traders ("RSQTs"), as defined in Phlx Rule 1014(b), assigned to an option.

<sup>12</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

the system will automatically open an option series under these conditions.

As outlined in more detail below, Phlx proposes to introduce opening process enhancements under Phlx XL II that will: (1) Ensure that an option will open within a reasonable period of time after the underlying security is open and do so within an appropriate Phlx opening price range; (2) allow Phlx to now route,<sup>6</sup> if necessary, to other same or better-priced markets contemporaneously with its opening of an option series so as to maximize the number of contracts executing at the open; and (3) allow quoting market participants to enter trading interest at multiple price levels.

#### *Beginning of Opening Process*

In order to ensure that there will be liquidity on the Exchange at the beginning of the trading day, the proposal will require the specialist assigned in a particular equity option to enter opening quotes not later than one minute following the dissemination of a quote or trade by the market for the underlying security or, in the case of index options, following the receipt of the opening price in the underlying index. The specialist assigned in a particular U.S. dollar-settled Foreign Currency Option ("FCO") must enter opening quotes not later than 30 seconds after the announced market opening.<sup>7</sup>

Under the proposal, the Phlx XL II system will begin the opening process only when certain conditions are present. Specifically, the automated opening process can only begin when either (A) the specialist's quote has been submitted; (B) the quotes of at least two Phlx XL II participants have been submitted within two minutes (or such shorter time established by the Exchange)<sup>8</sup> of the opening trade or quote on the market for the underlying security in the case of equity options;<sup>9</sup> or (C) if neither the specialist's quote<sup>10</sup>

nor the quotes of two Phlx XL II participants have been submitted within two minutes of the opening trade or quote on the market for the underlying security in the case of equity options, one Phlx XL II participant has submitted their quote. This is consistent with the current opening process on Phlx XL, which is described in Phlx Rule 1017.

Furthermore, a Phlx XL II participant that submits a quote in any series when the specialist's quote has not been submitted will be required to submit continuous, two-sided quotes in such series until such time as the specialist submits his/her quote, after which the Phlx XL II participant that submitted such quote shall be obligated to submit quotations pursuant to Rule 1014(b)(ii)(D).

#### *Opening Process*

Proposed Rule 1017(l)(i) would state that, if there are no opening quotes or orders that lock or cross each other, the system will open by disseminating the Exchange's best bid and offer among quotes and orders that exist in the Phlx XL II system at that time (because if no quotes or orders lock/cross each other, nothing matches and there is no trade).

Under proposed Rule 1017(l)(ii), if there are opening quotes or orders that lock or cross each other, the Phlx XL II system will take the lowest bid and the highest offer among quotations received that have a bid/ask differential that is compliant with Rule 1014(c)(i)(A)(1)(a)<sup>11</sup> to determine the lowest quote bid and highest quote offer.<sup>12</sup> To calculate the opening price,

or, in the case of index options, following the receipt of the opening price in the underlying index. There may be circumstances where the specialist is unable to disseminate an opening quote due to, for example, a system malfunction. In such a circumstance, these current and proposed rules provide for the Exchange to open upon the receipt of quotes from participants other than the specialist.

<sup>11</sup> Rule 1014(c)(i)(A)(1)(a) requires that quotes in equities and index options create differences of no more than \$.25 between the bid and the offer for each option contract for which the prevailing bid is less than \$2; no more than \$.40 where the prevailing bid is \$2 or more but less than \$5; no more than \$.50 where the prevailing bid is \$5 or more but less than \$10; no more than \$.80 where the prevailing bid is \$10 or more but less than \$20; and no more than \$1 where the prevailing bid is \$20 or more, provided that, in the case of equity options, the bid/ask differentials stated above shall not apply to in-the-money series where the market for the underlying security is wider than the differentials set forth above. For such series, the bid/ask differentials may be as wide as the quotation for the underlying security on the primary market, or its decimal equivalent rounded up to the nearest minimum increment. The Exchange may establish differences other than the above for one or more series or classes of options.

<sup>12</sup> The Phlx XL II system will not consider orders, nor will it consider quotations that do not comply with such bid/ask differential (quotations that are too "wide"), in its calculation of the lowest quote bid and the highest quote offer.

the Phlx XL II system will take into consideration all valid Phlx quotes, sweeps (as defined more fully below)<sup>13</sup> and orders, together with other exchanges' markets for the series and identify the price at which the maximum number of contracts can trade. If that price is within the lowest quote bid and highest quote offer and leaves no imbalance,<sup>14</sup> the Exchange will open at that price, executing marketable trading interest, as long as the opening price includes only Phlx interest. Proposed Rule 1017(l)(ii)(A) provides that an "imbalance" occurs where there is unexecutable trading interest at a certain price.

Under proposed Rule 1017(l)(ii)(B), when two or more prices within the range of the lowest quote bid and highest quote offer for the affected series would satisfy the maximum quantity criterion, the Phlx XL II system takes the highest and lowest of those prices and takes the mid-point for the opening price; if such mid-point is not expressed as a permitted minimum price variation, it will be rounded to the minimum price variation that is closest to the closing price for the affected series from the immediately prior trading session to determine the opening price. If there is no closing price from the immediately prior trading session, the Phlx XL II system will round up to the minimum price variation to determine the opening price.

#### *Route Timer*

Generally, the automated opening process logic seeks to first route away all contracts executable at a better price than the Exchange's opening price, then executes all contracts available on the Exchange at the opening price and, lastly, routes away all contracts available at other exchanges at the Exchange's opening price. The foregoing processes occur contemporaneously.

Specifically, under proposed Rules 1017(l)(ii)(C) and (D), if the opening price included interest other than solely Phlx interest, the system will initiate a "Route Timer,"<sup>15</sup> not to exceed one second.<sup>16</sup> If no new interest is received during the Route Timer, the Phlx XL II system will route to other markets disseminating prices better than Phlx's

<sup>13</sup> See proposed Rule 1017(l)(vi)(A).

<sup>14</sup> An "imbalance" occurs when there is unexecutable trading interest at a certain price. See proposed Rule 1017(l)(ii)(A).

<sup>15</sup> All references to a "Route Timer" in the Phlx XL II system and in the proposed rules mean a system pause for a brief period. Phlx XL II participants will not receive any notification that a Route Timer has been initiated.

<sup>16</sup> The duration of the Route Timer will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>6</sup> Similar to the Exchange's current routing methodology under the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (the "Linkage Plan"), the Exchange will only route customer, non-contingency orders.

<sup>7</sup> See Exchange Rule 1017(b)(ii) and proposed Rule 1017(k).

<sup>8</sup> Such time will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>9</sup> In the case of index options, the quotes must be submitted within two minutes of the receipt of the opening price in the underlying index or within two minutes of market opening in the case of U.S. dollar-settled foreign currency options.

<sup>10</sup> The specialist is required under current Rule 1017(b), and would be required under proposed Rule 1017(k), to enter opening quotes not later than one minute following the dissemination of a quote or trade by the market for the underlying security

opening price, execute marketable interest at the opening price on Phlx, and route to other markets disseminating prices equal to the Phlx opening price if necessary. Orders that are routed and executed may receive executions at multiple prices. Orders will be routed as Immediate or Cancel ("IOC") orders with a limit price equal to the Exchange's opening price. If interest is received during the Route Timer, the Phlx XL II system will recalculate the opening price taking such new interest into account.<sup>17</sup> Then, if there is no imbalance, the system will execute marketable interest at the opening price on the Phlx and route the remainder to other markets.

#### Opening Quote Range

Where there is an imbalance at the price at which the maximum number of contracts can trade that is also at or within the lowest quote bid and highest quote offer, the Phlx XL II system will calculate an Opening Quote Range ("OQR") for a particular series.<sup>18</sup> To determine the minimum value for the OQR, an amount, as defined in a table to be determined by the Exchange, will be subtracted from the lowest quote bid. To determine the maximum value for the OQR, an amount, as defined in a table to be determined by the Exchange,<sup>19</sup> will be added to the highest quote offer.

If there is sufficient size on the Exchange and on away markets on the opposite side of the market from the imbalance to execute all opening marketable interest at a price that is at or within the established OQR and the Away Best Bid/Offer ("ABBO") without leaving an imbalance, the Phlx XL II system will open the affected series for trading at that price by executing opening marketable interest on the Phlx XL II system, as long as the system does not trade through the ABBO.<sup>20</sup> If it would trade through the ABBO, the Phlx XL II system will initiate a "Route Timer," not to exceed one second.<sup>21</sup> If no new interest is received during the

Route Timer, the Phlx XL II system will then route to other markets disseminating prices better than Phlx's opening price, execute marketable interest at the opening price on Phlx and, route to other markets disseminating prices equal to the Phlx opening price if necessary. If there is an imbalance, the Phlx XL II system will begin the imbalance process.

#### Imbalance Process

If all opening marketable size cannot be completely executed at or within the OQR without trading through the ABBO, the Phlx XL II system will automatically institute an imbalance process.<sup>22</sup>

Phlx XL II will broadcast an Imbalance Message<sup>23</sup> to Phlx XL II participants,<sup>24</sup> and begin an "Imbalance Timer," not to exceed three seconds,<sup>25</sup> as determined by the Exchange.<sup>26</sup> Phlx XL II participants may enter opening quotes, Opening Sweeps and orders during the Imbalance Timer. If such opening quotes, Opening Sweeps (as defined below) and orders, or other changes to the ABBO, would allow the entire imbalance amount to trade at the Exchange at or within the OQR without trading through the ABBO, the Imbalance Timer will end and the Phlx XL II system will execute at the appropriate opening price.

If opening quotes, Opening Sweeps and orders submitted during the Imbalance Timer, or other changes to the ABBO, would not allow the entire imbalance amount to trade at the Exchange at or within the OQR without trading through the ABBO, the Phlx XL II system will send a new Imbalance Message to Phlx XL II participants, indicating that marketable trading interest may be routed to markets disseminating a price better than or equal to the Exchange opening price and the Phlx XL II system will initiate a Route Timer, not to exceed one second.<sup>27</sup> If during the Route Timer, interest is received by the Phlx XL II system which would allow all interest to trade on the Phlx XL II system (*i.e.*,

there is no longer an imbalance) at the opening price without trading through other markets, the Phlx XL II system will trade and the Route Timer will end. The Phlx XL II system will monitor quotes received during the Route Timer period and make ongoing corresponding changes to the permitted OQR to reflect them.<sup>28</sup>

Under proposed Rule 1017(l)(iv)(C)(3), if the Route Timer expires, the End of Route Timer Process will ensue, as follows. The Phlx XL II system will determine if the total number of contracts displayed at better prices than the Exchange's potential opening price<sup>29</sup> on away markets ("better priced away contracts") would satisfy the number of marketable contracts available on the Exchange. If it does, the Phlx XL II system will route a number of contracts with a size equal to the size of the interest at other markets at prices better than interest on the Exchange, and determine an opening Phlx Best Bid/Offer ("PBBO") that reflects the interest remaining on the Exchange. In this situation, the Phlx XL II system will price any contracts routed to other markets at the better away market price(s).

Under proposed Rule 1017(l)(iv)(C)(4), if the total number of better priced away contracts would not satisfy the number of marketable contracts the Exchange has, the Phlx XL II system will determine how many contracts it has available at the Exchange opening price. If the total number of better priced away contracts plus the number of contracts available at the Exchange opening price would satisfy the number of marketable contracts the Exchange has, the Phlx XL II system will contemporaneously route a number of contracts that will satisfy interest at other markets at prices better than the Phlx opening price, and trade available contracts on the Exchange at the Exchange opening price.<sup>30</sup> In this situation, the Phlx XL II system will price any contracts routed to other markets at the Exchange opening price.

Under proposed Rule 1017(l)(iv)(C)(5), if the total number of better priced away contracts plus the number of contracts available at the Exchange opening price would not satisfy the number of marketable contracts the Exchange has, the Phlx XL II system will determine how many contracts are available at other markets at the Exchange opening price. If the

<sup>17</sup> The Phlx XL II system continuously recalculates the opening price during the opening process. At this point in the process, the opening price may be different from the original opening price calculated by the Phlx XL II system. A different opening price will not require the Phlx XL II system to repeat the entire opening process.

<sup>18</sup> See proposed Rule 1017(l)(iii).

<sup>19</sup> The initial table, and any subsequent modifications thereto, will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>20</sup> If the ABBO is crossed, it will not be taken into consideration by the system and the system will immediately execute.

<sup>21</sup> The duration of the Route Timer will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>22</sup> See proposed Rule 1017(l)(iv).

<sup>23</sup> The Imbalance Message will contain the option symbol, buy/sell, size of matched contracts, the size of the imbalance, and price, such as "ABC Jan 50 calls, match 0, 10 to buy at 2.40."

<sup>24</sup> Phlx XL II participants may disclose the contents of the Imbalance Message to their customers.

<sup>25</sup> Currently, the Exchange intends to set the number of seconds system-wide, rather than option-by-option.

<sup>26</sup> The number of seconds will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>27</sup> The duration of the Route Timer will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>28</sup> See proposed Rules 1017(l)(v)(C)(1) and (2).

<sup>29</sup> The Phlx XL II system will continually recalculate the opening price based on interest received during the Route Timer and changes to the ABBO.

<sup>30</sup> See proposed Rule 1017(l)(v)(C)(5).

total number of better priced away contracts plus the number of contracts available on the Exchange at the Exchange opening price plus the contracts available at other markets at the Exchange opening price would satisfy the number of marketable contracts the Exchange has, the Phlx XL II system will contemporaneously route a number of contracts that will satisfy interest at other markets at prices better than the Phlx opening price, trade available contracts on the Exchange at the Exchange opening price, and route a number of contracts that will satisfy interest at other markets at prices equal to the Phlx opening price. In this situation, the Phlx XL II system will price any contracts routed to other markets at the Exchange opening price.

This is illustrated in the following example:

#### Example I

##### *Assume the Following Facts*

The initiating order is a market order to buy 150 contracts;

The specialist submits a quote of 2.20 bid, 2.40 offer, with a size of 10x10;

Market Maker 1 submits a quote of 2.15 bid, 2.45 offer, with a size of 10x10;

Market Maker 2 submits a quote of 2.00 bid, 2.50 offer, with a size of 25x25. The Phlx XL II system will not consider this quote because it is wider than the permitted bid/ask differential set forth in Rule 1014(c)(i)(A)(1)(a).

The away market is 2.20 bid, 2.40 offer, with a size of 20x10.

##### *The Following Events Will Occur Concurrently*

An Imbalance timer will be initiated;

The Phlx XL II system will send an Imbalance Message, indicating 20 matched contracts 130 contracts to buy at 2.45.

##### *Assume During the Imbalance Timer*

Market Maker 1 sends two sweeps; sell 30 at 2.50 and sell 50 at 3.00;

The specialist sends two sweeps; sell 50 at 2.50 and sell 50 at 2.60.

##### *After the Imbalance Timer*

The Phlx XL II system will initiate a Route Timer and send a new Imbalance Message, match 150, 00 to buy at 2.60.

##### *After the Route Timer*

The Phlx XL II system will open 140 contracts at 2.60. The initiating order buys 100 contracts from the Specialist and 40 from Market Maker 1, and will route 10 to the away market to buy at 2.60 (the Phlx Opening Price). The away market should execute the 10 contracts at its 2.40 offer.

Under proposed Rule 1017(l)(iv)(C)(6), if the total number of better priced away contracts plus the number of contracts available at the Exchange opening price plus the contracts available at other markets at the Exchange opening price would not satisfy the number of marketable contracts the Exchange has, the Phlx XL II system will repeat the Imbalance Process. The Phlx XL II system may repeat the Imbalance Process up to three times (as established by the Exchange).<sup>31</sup>

Under proposed Rule 1017(l)(iv)(C)(7), if after that number of times, the Phlx XL II system still cannot route and/or trade the entire imbalance amount, the Phlx XL II system will conduct a Provisional Opening by routing to other markets at prices better than the Exchange opening price for their disseminated size, trading available contracts on the Exchange at the Exchange opening price, and routing contracts to other markets at prices equal to the Phlx opening price at their disseminated size. In this situation, the Phlx XL II system will price any contracts routed to other markets at the Exchange opening price. The Exchange opening price will always be equal to or better than the OQR.

The opening process is now complete. Accordingly, unexecuted Opening Sweeps (as defined below) will be cancelled. Any unexecuted contracts from the imbalance not traded or routed will be displayed in the Exchange quote at the opening price for a period not to exceed ten seconds<sup>32</sup> and subsequently cancelled back to the entering participant if they remain unexecuted and priced through the opening price. During this display time period, the Phlx XL II system will disseminate a bid and offer that is equal to the opening price, with a size of zero on the opposite side of the market from remaining unexecuted contracts.

Under proposed Rule 1017(l)(iv)(C)(8), the Phlx XL II system will execute orders at the opening price that have contingencies (such as, without limitation, All-or-None) and non-routable orders, such as "Do Not Route" or "DNR" Orders,<sup>33</sup> to the extent possible. The Phlx XL II system will only route non-contingency customer orders.

The Phlx XL II system will: (i) Re-price Do Not Route orders (that would

otherwise have to be routed to the exchange(s) disseminating the ABBO for an opening to occur) to a price that is one minimum trading increment inferior to the ABBO, and (ii) disseminate the re-priced DNR Order as part of the new PBBO.<sup>34</sup>

During the Opening Process, permitted responses to an Imbalance Message are quotes, Opening Sweeps (as defined more fully below), and orders. Specialists, Streaming Quote Traders ("SQTs"),<sup>35</sup> Remote Streaming Quote Traders ("RSQTs"),<sup>36</sup> may submit quotes, Opening Sweeps and orders in response to an Imbalance Message. Non-SQT ROTs<sup>37</sup> may submit orders in response to an Imbalance Message.

An Opening Sweep is a one-sided electronic quotation submitted for execution against opening trading interest in the Phlx XL II system.<sup>38</sup> A Phlx XL II participant assigned in a particular option may only submit an Opening Sweep if, at the time of entry of the Opening Sweep, they have already submitted and maintained a valid opening-width quote. All Opening Sweeps in the affected series entered by a Phlx XL II participant will be cancelled immediately if that Phlx XL II participant fails to maintain a continuous quote with a permitted opening bid/ask differential in the affected series.

Under proposed Rule 1017(l)(v)(B), Opening Sweeps may be entered at any price with a minimum price variation applicable to the affected series, on either side of the market, at single or multiple price level(s), and may be cancelled and re-entered. A single Phlx XL II participant may enter multiple Opening Sweeps, with each Opening Sweep at a different price level. If a Phlx XL II participant submits multiple Opening Sweeps, the Phlx XL II system will consider only the most recent Opening Sweep at each price level submitted by such Phlx XL II

<sup>34</sup> See proposed Rule 1017(l)(v)(D).

<sup>35</sup> An SQT is an Exchange Registered Options Trader ("ROT") who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such SQT is assigned. An SQT may only submit such quotations while such SQT is physically present on the floor of the Exchange. See Exchange Rule 1014(b)(ii)(A).

<sup>36</sup> An RSQT is an ROT that is a member or member organization with no physical trading floor presence who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such RSQT has been assigned. An RSQT may only submit such quotations electronically from off the floor of the Exchange. See Exchange Rule 1014(b)(ii)(B).

<sup>37</sup> A non-SQT ROT is an ROT who is neither an SQT nor an RSQT. See Exchange Rule 1014(b)(ii)(C).

<sup>38</sup> See proposed Rule 1017(l)(v)(A).

<sup>31</sup> The number of times will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>32</sup> The number of seconds will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>33</sup> See proposed Exchange Rule 1080(m).

participant in determining the opening price. The Phlx XL II system will aggregate the size of all Opening Sweeps (*i.e.*, for all Phlx XL II participants) at a particular price level for trade allocation purposes. The Phlx XL II system will not cancel Opening Sweeps until the end of the opening process. Unexecuted Opening Sweeps will be cancelled once the affected series is open.

Under proposed Rule 1017(l)(vi), the Phlx XL II system will give priority to market orders first in time priority (including limit orders that are treated as market orders), then to resting limit orders at the opening price.

Under proposed Rule 1017(l)(vii), inbound orders, Opening Sweeps and quotes will not be included in the calculation of the opening price for a brief period established by the Phlx XL II system while the Phlx XL II system is in the process of completing the opening trade. After such brief period, inbound orders, Opening Sweeps and quotes received during the period will be entered into the Phlx XL II system in order of their arrival.<sup>39</sup>

#### *Amendments to the Exchange's Firm Quote Rule*

The Exchange also proposes to adopt amendments to its Rule 1082, Firm Quotations, that would reflect system improvements that should enhance the ability for Phlx XL II participants (*i.e.*, specialists, SQTs and RSQTs) to refresh, and potentially improve, their quotations when their option quotation size is exhausted at a particular price level, and that would reflect the Exchange's ability to refresh its disseminated market following the exhaustion of the Exchange's disseminated size.

Current Rule 1082(a)(ii)(B)(1) generally provides that if an SQT or RSQT's (other than a Directed SQT or RSQT)<sup>40</sup> quotation size in a particular series in a Streaming Quote Option<sup>41</sup> is exhausted or removed by the Risk Monitor Mechanism,<sup>42</sup> such SQT or RSQT's quotation is deleted from the Exchange's disseminated quotation until

the time the SQT or RSQT revises his/her quotation.

Rule 1082(a)(ii)(B)(2) currently states that, if the Exchange's disseminated size in a particular series is exhausted at that particular price level, and no specialist, SQT or RSQT has revised their quotation immediately following the exhaustion of the Exchange's disseminated size at such price level, the Exchange shall automatically provide two-sided quotes that comply with the Exchange's rules concerning quote spread parameters on behalf of the specialist until such time as the specialist revises the quotation, with a size of one contract.

The instant proposed rule change to Rule 1082 is intended to reflect Phlx XL II system improvements that should enhance the ability of Phlx XL II participants and the Exchange to refresh exhausted quotes while offering the maximum opportunity for better prices when remaining contracts from quotes or orders that exhaust the Exchange disseminated market are marketable and due for execution. The enhancements, discussed in detail below, are referred to as "Quote Exhaust" and "Market Exhaust," respectively.

#### *IOC Orders*

Proposed Rule 1066(c)(8) defines an Immediate-or-Cancel ("IOC") order as a limit order that is to be executed in whole or in part upon receipt. Any portion not so executed shall be cancelled. IOC Orders are not routable and will not be subject to any routing process or timer described in the Exchange's rules. If not executed immediately, an IOC Order will be cancelled by the Phlx XL II system. Contracts remaining in an IOC Order following a partial execution will be cancelled. IOC Orders will not be subject to any Route Timer and will not be included in the Quote Exhaust and Market Exhaust processes described below.

#### *Quote Exhaust*

The Exchange proposes to adopt Rule 1082(a)(ii)(B)(3) to codify the Quote Exhaust feature of the Phlx XL II system. Quote Exhaust occurs when the Exchange's disseminated market at a particular price level includes a quote, and such market is exhausted by an inbound contra-side quote or order ("initiating quote or order"), and following such exhaustion, contracts remain to be executed from the initiating quote or order through the initial execution price. For purposes of the proposed rule change and the proposed rule text, the initial execution

price that gives rise to Quote Exhaust will be known as the "reference price."

Rather than immediately executing at the next available price, the system will employ a timer not to exceed one second<sup>43</sup> in order to allow market participants to refresh their quotes.

#### *Quote Exhaust Timer*

Proposed Rules 1082(a)(ii)(B)(3)(a) and (b) describe the Quote Exhaust Timer. When a Quote Exhaust occurs, the Phlx XL II system will initiate a "Quote Exhaust Timer" that will apply to all options traded on the Phlx XL II system, not to exceed one second<sup>44</sup> during which any Phlx XL II participant (including any participant(s) whose size was exhausted) may submit quotes, sweeps or orders at any price level. This gives the Phlx XL II participant who initially attracted the initiating quote or order to the Exchange, together with other Phlx XL II participants who wish to join, the ability to refresh his/her quote and thus provide an opportunity for better prices to be submitted on the Exchange before trading at the next available price or routing the order to an away market.<sup>45</sup>

During the Quote Exhaust Timer, the Exchange will disseminate the reference price, provided that such price does not lock an away market, in which case, the Exchange will disseminate a bid and offer that is one Minimum Price Variation ("MPV") from the away market price, with a size of zero on the opposite side of the market from remaining unexecuted contracts.

If the remaining contracts in the initiating quote or order are either traded or cancelled during the Quote Exhaust Timer, the Quote Exhaust Timer will be terminated and normal trading will resume.

#### *New Interest on the Opposite Side of the Market*

Proposed Rule 1082(a)(ii)(B)(3)(c) describes what happens in the Phlx XL II system when interest is received on the opposite side of the market from the initiating quote or order during the Quote Exhaust Timer. If the Exchange receives an order, quote or sweep on the opposite side of the market from the initiating quote or order during the Quote Exhaust Timer that locks or crosses the reference price at any time

<sup>39</sup> This brief period will not exceed .25 of one second. The duration of the brief period will be published in an Options Trader Alert, which will be available on the Exchange's Web site. This brief period is similar to the current brief period during the opening. See Exchange Rule 1017(c)(iv).

<sup>40</sup> See Rule 1080(l).

<sup>41</sup> As a technical matter, the Exchange proposes to delete references to "Streaming Quote Options," because all options traded on the Exchange are now "Streaming Quote Options" and therefore it is not necessary to distinguish them from other options traded on the Exchange.

<sup>42</sup> See Exchange Rule 1093.

<sup>43</sup> The duration of the timer will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>44</sup> The duration of the Quote Exhaust Timer will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>45</sup> In keeping with the Exchange's current practice, Phlx XL II will not route non-customer and contingency orders.

during the Quote Exhaust Timer, it will execute immediately against the initiating quote or order at the reference price. If the initiating quote or order that caused the Quote Exhaust is exhausted, the Quote Exhaust Timer will be terminated.

With respect to any order, quote or sweep received on the opposite side of the market from the initiating quote or order during the Quote Exhaust Timer that is inferior to the reference price, the system will place any non-IOC order onto the book and cancel all non-marketable sweeps and IOC orders. IOC Orders will be cancelled immediately if not executed and will not participate in the Quote Exhaust process.

#### *New Interest on the Same Side of the Market*

Proposed Rule 1082(a)(ii)(B)(3)(d) describes what happens in the Phlx XL II system when interest is received on the same side of the market as the initiating quote or order during the Quote Exhaust Timer. If the Exchange receives an order, quote or sweep on the same side of the market as the initiating

quote or order during the Quote Exhaust Timer, the Phlx XL II system will cancel any sweep or IOC order. If such new quote or order, other than an IOC order, is a market or marketable limit order or marketable quote (*i.e.*, priced at or through the reference price) the Phlx XL II system will display it at the reference price, with a disseminated size that is the sum of such order and/or quote plus the remaining contracts in the initiating order or quote. The purpose of this provision is to enhance liquidity on the Exchange by adding all available liquidity received during the Quote Exhaust Timer to the PBBO at the reference price.

#### *End of the Quote Exhaust Timer*

Proposed Rule 1082(a)(ii)(B)(3)(e) describes what happens in the Phlx XL II system at the end of the Quote Exhaust Timer. If there are still unexecuted contracts remaining in the initiating quote or order or any new interest on the same side of the market, the Phlx XL II system will calculate a new PBBO.<sup>46</sup> The Phlx XL II system will conduct an Acceptable Range price

“test” to determine whether there is a valid next available price at which the Phlx XL II system may execute the remaining unexecuted contracts. Passing the test is required to establish a valid price and proceed to execution processing. The Exchange believes that executions should not occur at prices outside of the Acceptable Range. The Quote Exhaust feature provides an opportunity for additional price discovery both on the Exchange and at away markets to which the remaining contracts could be routed.

#### *Acceptable Range Test*

Proposed Rule 1082(a)(ii)(B)(3)(f) describes the Phlx XL II system’s “Acceptable Range Test.” The Acceptable Range Test determines if such next available price is within an Acceptable Range. The Acceptable Range for the next available price will be calculated by the Phlx XL II system by taking the reference price, plus or minus a value to be determined by the Exchange (*i.e.*, the reference price – (x) for sell orders and the reference price + (x) for buy orders).

EXAMPLE TABLE \*

Bid price = or > than	Bid price < than	Acceptable Bid/ Ask Differential— less than 9 months to expiration	Acceptable Bid/ Ask Differential—9 Months or more expiration multiplier
\$0.00 .....	\$2.00	\$0.40	X
\$2.00 .....	5.00	0.80	2X
\$5.00 .....	10.00	1.00	2X
\$10.00 .....	20.00	1.60	2X
\$20.00 .....	n/a	2.00	2X

\* **Note:** The table presented here is for example purposes only. The Exchange may modify the Bid Price ranges, the Differential values and the Multipliers and will announce such changes on its Web site.<sup>47</sup>

The purpose of this provision is to ensure that remaining contracts from the initiating quote or order do not execute at a price that is outside the Acceptable Range due to the potential for wide markets at the next price level.

#### *Quote Exhaust Resolution*

Proposed Rule 1082(a)(ii)(B)(3)(g) describes Quote Exhaust Resolution. The Phlx XL II system will first determine whether to trade at the next

available Phlx price by comparing it to the Acceptable Range price<sup>48</sup> and the ABBO price<sup>49</sup> to establish a Best Price. The Phlx XL II system then considers whether the price of the initiating quote or order locks or crosses the Best Price, which, in turn, determines whether the initiating quote or order trades, is routed or is posted. This occurs as follows:

First, under proposed Rule 1082(a)(ii)(B)(3)(g)(i), the Phlx XL II system establishes the Best Price as the best of: The next available Phlx price, the Acceptable Range price and the ABBO price. The best of these three

prices (“Best Price”) is, with respect to an initiating buy order, the lowest price of: (A) The next available Phlx offer; (B) the ABBO offer; or (C) the Acceptable Range price on the offer side of the market; and, with respect to an initiating sell order, the highest price of: (A) The next available Phlx bid; (B) the ABBO bid; or (C) the Acceptable Range price on the bid side of the market. Once the Best Price is established, the Phlx XL II system will consider whether the price of the initiating quote or order locks or crosses the Best Price. Under proposed Rule 1082(a)(ii)(B)(3)(g)(ii), if the price of the initiating quote or order (if a limit order) does not lock or cross the Best Price, the Phlx XL II system will post the remaining portion of the initiating quote or order at its limit price and normal trading will resume.

<sup>46</sup> The PBBO will include the remaining unexecuted portion of the initiating quote or order plus any new interest received on the same side of the market at the reference price, or if locking or crossing the ABBO, at one minimum trading increment away from the ABBO, for the full available size. The other side of the PBBO will be the actual Exchange interest at the best price.

<sup>47</sup> The initial table, and any subsequent modifications thereto, will be published in an Options Trader Alert, which will be available on the Exchange’s Web site.

<sup>48</sup> The Acceptable Range price is, with respect to an initiating buy order, the highest price of the Acceptable Range, and, with respect to an initiating sell order, the lowest price of the Acceptable Range.

<sup>49</sup> Similarly to the Acceptable Range price, because the ABBO consists of a bid and an offer price, the ABBO price is, with respect to an initiating buy order, the away best offer, and, with respect to an initiating sell order, the away best bid.

*Initiating Quote or Order Locks Best Price*

Proposed Rule 1082(a)(ii)(B)(3)(g)(iii) describes what happens in the Phlx XL II system when the initiating quote or order locks the Best Price. If the initiating quote or order locks the Best Price, the system will execute, route if a routable order, and/or post the initiating quote or order as described below:

If the Best Price is the next Phlx price, the system will execute a trade up to its disseminated size. If this Best Price (next Phlx price) is equal to the ABBO price, any remaining unexecuted routable order volume from the execution on the Phlx will be routed away. After such routing, any remaining unexecuted contracts will be posted on the Exchange at the ABBO price. If this Best Price (next Phlx price) is equal to the Acceptable Range price, any remaining unexecuted routable order volume from the execution on the Phlx will be posted on the Exchange at the Acceptable Range price. Lastly, if this Best Price (next Phlx price) is equivalent to *both* the ABBO and the Acceptable Range price, any remainder order volume from the execution on the Phlx will be routed away, and if after routing there still remains open contracts, the remainder will be posted on the Phlx at the Acceptable Range price.

If the Best Price is the ABBO, where the ABBO is not equal to the next Phlx price, the initiating order will be routed away up to the size of the ABBO and, after routing, any remaining unexecuted contracts from the initiating order will be posted on the Exchange at the ABBO price. If the Best Price (ABBO is not equal to the next Phlx price) equals the Acceptable Range price, the initiating order will be routed away and after such routing, any remaining unexecuted contracts will be posted on the Exchange at the ABBO price.

If the Best Price is the Acceptable Range Price, where the Acceptable Range Price is not equal to either the next Phlx price or the ABBO, the initiating order or quote will be posted at the Acceptable Range Price.

*Initiating Quote or Order Crosses Best Price*

Proposed Rule 1082(a)(ii)(B)(3)(g)(iv) describes what happens in the Phlx XL II system when the initiating quote or order crosses the Best Price. If the initiating quote or order crosses the Best

Price, the Phlx XL II system will execute, route, and/or post the initiating quote or order as described below:

If the Best Price is the next Phlx price, the Phlx XL II system will execute a trade at the Exchange's next available price up to the Exchange's disseminated size. If this Best Price (next Phlx price) is equal to the ABBO price, any remaining order volume from the execution on the Exchange will be routed away and, after such routing, any remainder volume will be posted on the Exchange at the ABBO price. If this Best Price (next Phlx price) is equal to the Acceptable Range price, any remaining volume from the execution on the Phlx will be posted at the Acceptable Range Price for a period not to exceed ten seconds<sup>50</sup> and cancelled after this time has elapsed. During this period, the Phlx XL system will disseminate a bid and offer that is one minimum variation from the away market price with a size of zero on the opposite side of the market from remaining unexecuted contracts.

Lastly, if this Best Price (next Phlx price) is equal to *both* the ABBO and the Acceptable Range price, any remainder order volume from the execution on the Phlx will be routed away, and if after routing there still remain unexecuted contracts, the remainder will be posted on the Phlx at the Acceptable Range price for a period not to exceed ten seconds,<sup>51</sup> and cancelled after this time has elapsed. During this period, the Phlx XL system will disseminate a bid and offer at the Acceptable Range price, with a size of zero on the opposite side of the market from remaining unexecuted contracts.

The purpose of the posting period is to expose the initiating quote or order at the Exchange-determined Acceptable Range price so that interested participants have the opportunity to trade against such initiating quote or order. The purpose of the cancellation following the posting period is to return any unexecuted portion of the initiating quote or order to the sender so that the sender may determine how they want the remainder handled (e.g., re-price the initiating quote or order, trade at the next available price on the Exchange, or route to another market center).

<sup>50</sup> The posting time will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>51</sup> The posting time will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

If the Best Price is the ABBO, where the ABBO is not equal to the next Phlx price, the initiating order will be routed away and if after routing there remain unexecuted contracts, the remainder of the initiating order will be posted on the Phlx at the ABBO price. If this Best Price (ABBO is not equal to the next Phlx price) equals the Acceptable Range price, the initiating order will be routed away and if after routing there remain unexecuted contracts, the remainder of the order will be posted on the Phlx at the ABBO price for a period not to exceed ten seconds,<sup>52</sup> and cancelled after this time has elapsed. During this period, the Phlx XL II system will disseminate a bid and offer at the Acceptable Range price, with a size of zero on the opposite side of the market from remaining unexecuted contracts.

If the Best Price is the Acceptable Range price, where the Acceptable Range price is not equal to either the next Phlx price or the ABBO, the initiating quote or order will be posted on the Exchange at the Acceptable Range price for a period not to exceed ten seconds,<sup>53</sup> and cancelled after this time has elapsed. During this period, the Phlx XL II system will disseminate a bid and offer at the Acceptable Range price, with a size of zero on the opposite side of the market from remaining unexecuted contracts.

Under proposed Rule 1082(a)(ii)(B)(3)(g)(v), if the initiating order is non-routable, when the order would otherwise route according to the process described above, the order will be posted on the Phlx at a price one minimum trading increment inferior to the Best Price so as not to lock an away market.

Under proposed Rule 1082(a)(ii)(B)(3)(g)(vi), if, after trading at the Phlx and/or routing, the remainder of the initiating order is still marketable, the entire process of evaluating the best Phlx price and the ABBO will continue until: (A) The order size is exhausted, (B) the order reaches its limit price, or (C) the order is posted at the original Acceptable Range price.

These order handling processes are illustrated in the chart below:

<sup>52</sup> The posting time will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>53</sup> The posting time will be published in an Options Trader Alert, which will be available on the Exchange's Web site.



Identify the best of (1) Next Phlx price or (2) Acceptable range (AR) or (3) ABBO	Test Initiating order or quote		
	Does not lock or cross the best	Locks the best	Crosses the best
Next Phlx price .....	Post at limit price .....	Trade .....	Trade.
Next Phlx price = ABBO .....	Post at limit price .....	Trade, will route if Phlx exhausted	Trade, will route if Phlx exhausted.
Next Phlx price = Acceptable Range.	Post at limit price .....	Trade and post any remainder balance.	Trade, post any remainder balance at AR price, cancel after timer.
Next Phlx price = Acceptable Range = ABBO.	Post at limit price .....	Trade, will route if Phlx exhausted, post any remainder balance.	Trade, will route if Phlx exhausted, post any remainder balance at AR price, cancel after timer.
ABBO .....	Post at limit price .....	Route and post any remainder balance.	Route and/or post.
ABBO = Acceptable Range .....	Post at limit price .....	Route and/or post .....	Route and/or post cancel after timer.
Acceptable Range .....	Post at limit price .....	Post at Acceptable Range .....	Post at Acceptable Range, cancel after timer.

\* Non-routable orders will be handled according to the above table unless routing would occur. At such point, the non-routable order will be posted at one minimum trading increment away from the established Best Price.

\*\* After routing, any unexecuted portions of routed order will be posted on the Phlx in accordance with current Phlx rules.

The purpose of Quote Exhaust is to enhance the process for refreshing a participant's quote that has been fully exhausted by an incoming quote or order that has, after exhausting the Phlx quote at a particular price level, remaining size to be executed at a price through the reference price. In addition, Quote Exhaust is intended to provide an opportunity for such quote or order to receive a price for that order better than the next available price. This process is illustrated in the example below.

### Example II

#### Assume the Following Facts

The initiating order is a market order to buy 40 contracts;

The specialist submits a quote of 2.20 bid, 2.40 offer, with a size of 10x10;

Market Maker 1 submits a quote of 2.20 bid, 2.70 offer, with a size of 25x25;

The Away Market is 2.20 bid, 2.65 offer, with a size of 20x10;

The PBBO is 2.20 bid, 2.40 offer, with a size of 35x10.

#### The Following Events Will Occur Concurrently

The initiating order buys 10 contracts from the specialist at 2.40, exhausting the 2.40 quote;

The Phlx XL II system will start the Quote Exhaust Timer;

The Phlx XL II system will disseminate a PBBO of 2.40 bid, 2.40 offer, with a size of 30x0.

#### After the Quote Exhaust Timer

The initiating order buys 20 contracts from Market Maker 1 at 2.70 and the Phlx XL II system will contemporaneously route the unexecuted balance of the initiating

order to the away market, 10 to buy at 2.70. This should result in a buy of 10 contracts at 2.65 on the away market.

The disseminated PBBO is 2.20 bid, 2.70 offer, with a size of 20x5.

The Exchange believes that Quote Exhaust provides the best opportunity for remaining portions of incoming quotes or orders to be executed on the Exchange at prices that are better than away markets by allowing Phlx XL II participants to refresh their quotes before routing away, thus potentially providing better prices at which to execute such remaining portions.

#### Exchange-Generated Quote

In Phlx XL II, if the Exchange's disseminated size in a particular series is exhausted at that particular price level, and no specialist, SQT or RSQT has revised their quotation immediately following the exhaustion of the Exchange's disseminated size at such price level, in Phlx XL II, the Exchange will not, as it currently does in Phlx XL under Rule 1082(a)(ii)(B)(2), automatically provide two-sided quotes that comply with the Exchange's rules concerning quote spread parameters on behalf of the specialist with a size of one contract. Instead, the Exchange will disseminate a bid of zero and an offer of \$200,000, each for a size of one contract.<sup>54</sup> This system generated quote

<sup>54</sup> See proposed Rule 1082(a)(ii)(B)(4)(a). This would replace the Exchange's current practice of automatically providing two-sided quotes that comply with the Exchange's rules concerning quote spread parameters on behalf of the specialist until such time as the specialist revises the quotation, with a size of one contract. The Exchange represents that it will, as it does today, surveil for compliance on the part of specialists (and SQTs and

will indicate that the Exchange has no better priced interest and will typically be generated only in Market Exhaust scenarios (see below). The Exchange believes that this quote is preferable to a 0 X 0 quote, because an offer of 0 could be misinterpreted by a system as the best offer.

#### Market Exhaust

Proposed Rule 1082(a)(ii)(B)(4) describes the Phlx XL II system's Market Exhaust feature. Market Exhaust occurs when there are no Phlx XL II participant (specialist, SQT or RSQT) quotations in the Exchange's disseminated market for a particular series and an initiating order in the series is received.<sup>55</sup> In such a circumstance, the Phlx XL II system, using Market Exhaust, will initiate a Market Exhaust Auction for the initiating order.

#### Market Exhaust Auction

Proposed Rule 1082(a)(ii)(B)(4)(b) describes the Market Exhaust Auction. When an initiating order is received when there are no quotations in the Exchange market, the Phlx XL II system will immediately broadcast a notification (an "Auction Notification") to Phlx XL II participants; the purpose of the auction is to seek participation and determine the best price at which the contracts in the initiating order may be executed (the "Auction Price"). The Auction Notification will include the series, size and side of the market of the initiating order. The Auction Notification will not include a price.

RSQTs) with the Exchange's continuous quoting requirements. See Exchange Rule 1014(b)(ii)(D).

<sup>55</sup> Market Exhaust can only be triggered by an initiating order.



The Auction will be for a period of time not to exceed three seconds<sup>56</sup> (the "Auction Period"). The Market Exhaust Auction is used to determine the best price at which the contracts in the initiating order may be executed (the "Auction Price").

#### *During the Auction Period*

Proposed Rule 1082(a)(ii)(B)(4)(c) describes the responses that Phlx XL II participants may submit during the Auction Period. Phlx XL II participants may submit bids and offers in response to the Auction Notification into the system until the end of the Auction Period. Such responsive bids and offers may be submitted to the system for the auction in three ways. First, Phlx XL II participants may submit a two-sided quote in response to the Auction

Notification. Secondly, Phlx XL II participants may submit a single-sided, single-priced quotation for the auction to be known as "Auction Sweep"<sup>57</sup> that will be effective only for the Auction Period and cancelled at the end of that period if not executed.<sup>58</sup> Auction sweeps may be entered at any price consistent with the minimum price variation applicable to the affected series, at single or multiple price level(s), and may be cancelled and re-entered. Finally, they may submit limit orders. IOC Orders will be cancelled immediately if not executed and will not participate in the Market Exhaust process. Any quote, Auction Sweep or order can be cancelled and/or replaced during the Auction Period. In addition, incoming orders from non-Phlx XL II

participants and existing orders on the book will be eligible to participate at the end of the Auction Period, together with responses to the Auction Notification.

#### *End of the Auction Period*

Proposed Rule 1082(a)(ii)(B)(4)(d) describes what happens at the end of the Auction Period. If at the end of the Auction Period there are no quotes in the Exchange market that have a bid/ask differential that complies with the following table (a "valid-width auction quote"), the initiating order, plus all other Auction Sweeps and orders received during the Auction Period will be cancelled.<sup>59</sup> Quotes that are not valid-width auction quotes will remain and a new PBBO will be calculated and disseminated.

EXAMPLE TABLE\*

Valid width auction quote table

Bid price = or > than	Bid price < than	Acceptable bid/ask differential—less than 9 months to expiration	Acceptable bid/ask differential—9 months or more to expiration multiplier
\$0.00 .....	\$2.00	\$0.40	2X
2.00 .....	5.00	0.80	2X
5.00 .....	10.00	1.00	2X
10.00 .....	20.00	1.60	2X
20.00 .....	n/a	2.00	2X

\*NOTE: The table presented here is for example purposes only. The Exchange may modify the Bid Price ranges, the Differential values and the Multipliers and will announce such changes on its Web site.<sup>60</sup>

If at the end of the Auction Period there are valid-width auction quotes, the Phlx XL II system will determine the allowable executable price range from the lowest valid-width auction quote bid and the highest valid-width auction quote ask; this is the Auction Quote Range ("AQR").

If the initiating order can be completely executed at or within the AQR and the ABBO, using contracts available from all available quotes, Auction Sweeps or orders priced at or within the AQR, a trade will be executed at the Exchange at the Auction Price.

If quotes, Auction Sweeps and orders submitted during the Auction Period would not allow the entire initiating order to trade at a price within the AQR without trading through the ABBO, the Phlx XL II system will determine if the

total number of contracts displayed at the ABBO price on away markets would satisfy the number of marketable contracts available on the Exchange. If it does, the Phlx XL II system will route a number of contracts that will satisfy interest at other markets at the ABBO price, and determine a PBBO that reflects the remaining Phlx interest without locking the away market. In this situation, the Phlx XL II system will price any contracts routed to other markets at the ABBO price.

If the total number of contracts priced at the ABBO would not satisfy the number of marketable contracts the Exchange has, the Phlx XL II system will determine how many contracts it has available on the Exchange at a price equal to the ABBO. If the total number of ABBO contracts plus the number of contracts available on the Exchange at

the ABBO price would satisfy the number of marketable contracts the Exchange has, the ABBO price becomes the Exchange Auction Price and the Phlx XL II system will trade available contracts on the Exchange at the Exchange Auction Price and contemporaneously route a number of contracts that will satisfy interest at other markets at prices better than the Exchange Auction Price. In this situation, the Phlx XL II system will price any contracts routed to other markets at the away market price. The Exchange Auction Price will always be at or within the AQR.

If the total number of ABBO contracts plus the number of contracts available on the Exchange at the ABBO price would not satisfy the number of marketable contracts the Exchange has, the Phlx XL II system will determine

<sup>56</sup> The duration of the Auction Period will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>57</sup> See proposed Rule 1082(a)(ii)(B)(4)(c)(i).

<sup>58</sup> A single Phlx XL II participant may enter multiple Auction Sweeps, with each Auction Sweep at a different price level. If a Phlx XL II participant submits multiple Auction Sweeps, the

Phlx XL II system will consider only the most recent Auction Sweep at each price level submitted by such Phlx XL II participant in determining the Auction Price. The Phlx XL II system will aggregate the size of all Auction Sweeps (*i.e.*, for all Phlx XL II participants) at a particular price level for trade allocation purposes.

<sup>59</sup> Inbound marketable orders received during the Auction Period would also be cancelled in this

situation at the end of the Auction Period, because, since there are still no valid-width quotes at the end of the Auction Period, the Phlx XL II system has no basis on which to determine what is an acceptable range within which to trade.

<sup>60</sup> The initial table and any modifications thereto will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

how many contracts are available on the Exchange at a price that is one Minimum Price Variation ("MPV") through the ABBO price. If the total number of ABBO contracts plus the number of contracts available on the Exchange at the ABBO price plus the number of contracts available on the Exchange at a price that is one MPV through the ABBO price would satisfy the number of marketable contracts the Exchange has, the price that is one MPV through the ABBO becomes the Exchange Auction Price. The system will contemporaneously route a number of contracts that will satisfy interest at the ABBO and trade a number of contracts that will satisfy interest on the Exchange at the Exchange Auction Price.<sup>61</sup> In this situation, the Phlx XL II system will price any contracts routed to other markets at the Exchange Auction Price.

If the total number of ABBO contracts plus the number of contracts available on the Exchange at the ABBO price plus the number of contracts available on the Exchange at a price that is one MPV through the ABBO price would not satisfy the number of marketable contracts the Exchange has, the system may repeat the auction process.

The Phlx XL II system may repeat this process up to three times.<sup>62</sup> If after that number of times, the Phlx XL II system still cannot either route and/or trade the entire initiating order, the Phlx XL II system will conduct a Provisional Auction by routing to markets at the ABBO for their disseminated size, and trading as many contracts as possible on the Exchange at the ABBO price and at a price that is one MPV through the ABBO price. In this situation, the Phlx XL II system will price any contracts routed to other markets at the ABBO price. The Auction is now complete. Accordingly, unexecuted Auction Sweeps will be cancelled by the Phlx XL II system.

Any unexecuted contracts from the initiating order will be displayed in the Exchange quote at the Auction Price for a brief period not to exceed ten seconds<sup>63</sup> and subsequently cancelled back to the entering participant if they remain unexecuted and priced through the Auction Price. During the brief period, the Phlx XL II system will disseminate a bid and offer that is equal

to the Auction Price, with a size of zero on the opposite side of the market from remaining unexecuted contracts. The purpose of the posting period is to expose the initiating order at the Auction Price so that interested participants have the opportunity to trade against such initiating order. The purpose of the cancellation following the posting period is to return any unexecuted portion of the initiating order to the sender so that the sender may determine how they want the remainder handled (e.g., re-price the initiating order, trade at the next available price on the Exchange, or route to another market center).

This process is illustrated in the following example:

### Example III

#### *Assume the Following Facts*

There is an order ("Order 1") on the book to sell 20 contracts at 8.00;

The Phlx XL II system receives another order ("Order 2") to buy 100 contracts at the market;

The specialist's quote in the affected series has been purged;

There are no Market Maker quotes in the affected series;

The away market is disseminating a market of 2.20 bid, 2.65 offer, with a size of 20x10;

The Phlx XL II system will disseminate a PBBO of 0.00 bid, 8.00 offer, with a size of 1x20;

The number of times the process will repeat is set to zero.

#### *The Phlx XL II System Sends an Auction Notification*

Assume, in response to the Auction Notification during the Auction Period:

The specialist submits a quote of 2.20 bid, 2.50 offer, with a size of 10x10;

Market Maker 1 submits a quote of 2.25 bid, 2.90 offer, with a size of 20x20;

The Phlx XL II system receives a market order ("Order 3") to sell 50 contracts in the affected series;

The specialist submits an Auction Sweep to sell 30 contracts at 2.70;

The specialist submits another Auction Sweep to sell 60 contracts at 3.00.

#### *At the End of the Auction Period*

Order 2 buys 50 from Order 3 at 2.70; Order 2 buys 40 from the specialist at 2.70;

The Phlx XL II system will route the balance of Order 2 (10 contracts) to the away market, to buy at 2.70. This should result in a buy of 10 contracts on the away market at 2.65;

The Exchange will disseminate a PBBO of 2.25 bid, 2.90 offer, with a size of 20x20.

In summary, the automated auction process logic seeks to first route away all contracts executable at a better price than the Exchange's Auction Price, then executes all contracts available on the Exchange at the Auction Price or one MPV through the NBBO and, lastly, routes away all contracts available at other exchanges at the Exchange's Auction Price. The foregoing processes occur contemporaneously.

The Exchange will execute orders at the Auction Price that have contingencies (such as All-or-None) and non-routable orders (such as a "Do Not Route" or "DNR" Orders), to the extent possible. Consistent with its routing approach, the Exchange will only route non-contingency customer orders. Thus, in a Provisional Auction, even orders priced at or through the Auction Price may not be executed because of insufficient size.

If a Market Exhaust Auction is in progress at (1) the close of the trading day or (2) at the time of a trading halt, the Auction will be immediately terminated and no trades would occur.

#### *Priority at the End of the Auction*

Just as provided in current Exchange Rule 1017(c)(i), the system will give priority to market orders first (including limit orders that are treated as market orders), then to resting limit orders at the Auction Price.<sup>64</sup> In order to preserve an orderly auction on the Exchange, inbound orders and quotes will not be included in the calculation of the Auction Price for a brief period established by the Phlx XL II system<sup>65</sup> while the Phlx XL II system is in the process of completing the auction trade. During this period, inbound orders and quotes will be queued on the Phlx XL II system in the order in which they are received. After this period once the auction is complete, such inbound orders, sweeps and quotes will be processed by the Phlx XL II system in order of their arrival.

#### *Permitted Responses to Auction Notification*

Permitted responses to an Auction Notification include quotes, Auction Sweeps (as defined more fully below), and orders.

An Auction Sweep is a proposed new method for entering electronic quotations by specialists, SQTs and RSQTs assigned to a particular option. An Auction Sweep is an electronic quotation submitted for execution

<sup>61</sup> The Phlx XL II system will route contracts to the ABBO when the next Phlx price is greater than one MPV through the ABBO.

<sup>62</sup> The number of times it will be repeated will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>63</sup> The duration of the brief period will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>64</sup> See proposed Rule 1082(a)(ii)(B)(4)(d)(v).

<sup>65</sup> This brief period will not exceed .25 of one second. This brief period is similar to the brief period during the opening. See Exchange Rule 1017(c)(iv).

against trading interest in the system. Auction Sweeps may be entered at any price, at single or multiple price level(s), and may be cancelled and re-entered. A single Phlx XL II participant may enter multiple Auction Sweeps, with each Auction Sweep at a different price level. If a Phlx XL II participant submits multiple Auction Sweeps at different price levels, the Phlx XL II system will consider only the most recent Auction Sweep at each price level submitted by such Phlx XL II participant in determining the Exchange Auction Price. The Phlx XL II system will aggregate the size of all Auction Sweeps (*i.e.*, for all Phlx XL II participants) at a particular price level for trade allocation purposes. Contracts will be allocated pursuant to Exchange rules concerning trade allocation.<sup>66</sup> Unexecuted Auction Sweeps will be cancelled once the auction is complete.

#### Order Routing

The Phlx XL II system will route only customer FIND and SRCH Orders (as defined below) with no other contingencies. Under proposed Rule 1080(m), customer FIND and SRCH Orders will first be checked by the Phlx XL II system for available contracts for potential execution. After checking the Phlx XL II system for available contracts, orders are sent to other available market centers for potential execution. When checking the book, the Phlx XL II system will seek to execute at the price at which it would send the order to a destination market center. In situations where the Exchange's disseminated bid or offer is one MPV inferior to the NBBO price, the Phlx XL II system will contemporaneously route to the away market(s) disseminating the NBBO at such away market's size, and execute remaining contracts at the Exchange's disseminated bid or offer up to its disseminated size.

If contracts remain unexecuted after routing, they are posted on the book. Once on the book, should the order subsequently be locked or crossed by another market center, the Phlx XL II system will not route the order to the locking or crossing market center, except as specified below.

Proposed Rule 1080(m)(i) provides that orders sent to other markets do not retain time priority with respect to other orders in the Phlx XL II system and the Phlx XL II system will continue to execute other orders while routed orders are away at another market center. Once routed by the Phlx XL II system, an order becomes subject to the rules and procedures of the destination market

including, but not limited to, order cancellation. If a routed order is subsequently returned, in whole or in part, that order, or its remainder, shall receive a new time stamp reflecting the time of its return to the Phlx XL II system.

Proposed Rule 1080(m)(ii) provides that entering member organizations whose orders are routed to away markets shall be obligated to honor such trades that are executed on away markets to the same extent they would be obligated to honor a trade executed on the Exchange.

The Exchange proposes to adopt proposed Rule 1080(m)(iii)(A) to establish Nasdaq Options Services LLC ("NOS") as the Exchange's exclusive order router. NOS is a member of an SRO unaffiliated with the Exchange that is its designated examining authority. NOS will serve as the Routing Facility of the Exchange (the "Routing Facility"). The sole use of the Routing Facility by the Phlx XL II system will be to route orders in options listed and open for trading on the Phlx XL II system to away markets pursuant to Exchange rules on behalf of the Exchange.

Proposed Rule 1080(m)(iii)(B) would provide that the use of NOS to route orders to other market centers is optional. Parties that do not desire to use NOS must designate orders as not available for routing (*i.e.*, a Do Not Route Order, as described in proposed Rule 1080(m)(iv)(A)).

Proposed Rule 1080(m)(iii)(C) would provide that the Exchange will establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between the Exchange and the Routing Facility, and any other entity, including any affiliate of the Routing Facility, and, if the Routing Facility or any of its affiliates engages in any other business activities other than providing routing services to the Exchange, between the segment of the Routing Facility or affiliate that provides the other business activities and the routing services.

Finally, proposed Rule 1080(m)(iii)(D) would state that the books, records, premises, officers, directors, agents, and employees of the Routing Facility, as a facility of the Exchange, will be deemed to be the books, records, premises, officers, directors, agents, and employees of the Exchange for purposes of and subject to oversight pursuant to the Act. The books and records of the Routing Facility, as a facility of the Exchange, will be subject at all times to

inspection and copying by the Exchange and the Commission.

#### Phlx Affiliation With NOS

Exchange Rule 985(b) generally prohibits the Phlx or an entity with which it is affiliated from acquiring or maintaining an ownership interest in, or engaging in a business venture<sup>67</sup> with a Phlx member or an affiliate of a Phlx member in the absence of an effective filing with the Commission under Section 19(b) of the Act. However, Rule 985(b) also states Phlx or an entity affiliated with Phlx could acquire or maintain an ownership interest in, or engage in a business venture with, an affiliate of a Phlx member without the need for the Exchange to file such affiliation under Section 19(b) of the Act, if there were information barriers between the member and Phlx and its facilities.

NOS is a member of Phlx. In July, 2008, the Commission approved NOS as an affiliate of Phlx for the limited purpose of providing routing services for NASDAQ Exchange for orders that first attempt to access liquidity on NASDAQ Exchange's systems before routing to Phlx.<sup>68</sup>

The Exchange requests that the Commission provide a further exemption from the restrictions on affiliation by allowing Phlx to use NOS to provide routing services for orders that first attempt to access liquidity on the Phlx's systems before routing to other exchanges.

#### Expanded Order Types

**DNR Order.** Proposed Rule 1080(m)(iv)(A) describes a Do Not Route ("DNR") Order. A DNR order will never be routed outside of Phlx regardless of the prices displayed by away markets. A DNR order may execute on the Exchange at a price equal to or better than, but not inferior to, the best away market price but, if that best away market remains, the DNR order will remain in the Phlx book and be displayed at a price one minimum price variation inferior to that away best bid/offer. Any incoming order interacting with such a resting DNR order will receive the best away market price. Should the best away market change its price, or move to an inferior price level, the DNR order will automatically re-

<sup>67</sup> Rule 985(b)(i)(B) defines a "business venture" as an arrangement under which (A) the Exchange or an entity with which it is affiliated, and (B) an Exchange member or an affiliate of an Exchange member, engage in joint activities with an expectation of shared profit and a risk of shared loss from common entrepreneurial efforts.

<sup>68</sup> See Securities Exchange Act Release No. 58179 (July 17, 2008), 73 FR 42874 (July 23, 2008) (SR-Phlx-2008-31).

<sup>66</sup> See Exchange Rules 1014(g)(vii) and (g)(viii).

price from its one minimum price variation inferior to the original away best bid/offer price to one minimum trading increment away from the new away best bid/offer price or its original limit price. Once priced at its original limit price, it will remain at that price until executed or cancelled. Should the best away market improve its price such that it locks or crosses the DNR order limit price, the Exchange will execute the resulting incoming order that is routed from the away market that locked or crossed the DNR order limit price.

**FIND Order.** Proposed Rule 1080(m)(v)(B) describes a FIND Order. A FIND order is an order that is routable upon receipt, or any time the option goes through an opening process. A FIND order on the Phlx XL II book during an opening, whether it is received prior to the opening or it is a good til cancelled ("GTC") FIND order from a prior day, may be routed as part of the Opening Process. Once the Opening Process is complete, the FIND order is either eligible to trade at the Phlx price or placed on the Phlx book either at its limit price or at a price that is one Minimum Price Variation ("MPV") from the ABBO price if it would otherwise lock or cross the ABBO. A FIND order will not be eligible for routing until the next time the option series is subject to a new Opening Process.

A FIND order received during open trading that is not marketable against the PBBO or the ABBO will be entered into the Phlx XL II book at its limit price. The FIND order will not be eligible for routing until the next time the option series is subject to a new Opening Process.

A FIND order received during open trading that is marketable against the PBBO when the ABBO is inferior to the PBBO will be traded at the Exchange at the PBBO price. If the FIND order has size remaining after exhausting the PBBO, it may (1) trade at the next PBBO price (or prices) if the order price is locking or crossing that price (or prices) up to and including the ABBO price, or (2) be entered into the Phlx XL II book at its limit price, or entered into the Phlx XL II book at one MPV away from the ABBO if locking or crossing the ABBO. The FIND order will not be eligible for routing until the next time the option series is subject to a new Opening Process.

A FIND order received during open trading that is marketable against the PBBO when the ABBO is equal to the PBBO will be traded at the Exchange at the PBBO. If the FIND order has size remaining after exhausting the PBBO, it will initiate a Route Timer not to exceed

one second<sup>69</sup> in order to allow Phlx XL II participants and other market participants an opportunity to interact with the remainder of the FIND order. During the Route Timer, the FIND order will be included in the PBBO at a price one MPV away from the ABBO. If, during the Route Timer, any new interest arrives opposite the FIND order that is equal to or better than the ABBO price, the FIND order will trade against such new interest at the ABBO price.

What happens to a FIND order after the Route Timer expires depends on the ABBO price at that time. If, at the end of the Route Timer, the ABBO is still at the same or a better price, the FIND order will route to the away market up to a size equal to the lesser of either: (a) The away market's size, or (b) the remaining size of the FIND order. If the FIND order still has remaining size after routing, it will be entered into the Phlx XL II book and posted at the same price at which it was routed. The FIND order will not be eligible for routing until the next time the option series is subject to a new Opening Process.

A FIND order received during open trading that is marketable against the ABBO when the ABBO is better than the PBBO will initiate a Route Timer not to exceed one second<sup>70</sup> in order to allow Phlx XL II participants and other market participants an opportunity to interact with the FIND order. During the Route Timer, the FIND order will be included in the PBBO at a price one MPV away from the ABBO. If, during the Route Timer, any new interest arrives opposite the FIND order that is equal to or better than the ABBO price, the FIND order will trade against such new interest at the ABBO price.

What happens to a FIND order after the Route Timer expires depends on the ABBO price at that time. If, at the end of the Route Timer, the ABBO is still the best price, the FIND order will route to the away market up to a size equal to the lesser of either (a) the away market's size, or (b) the remaining size of the FIND order. If the FIND order still has remaining size, it will (i) trade at the next PBBO price up to one MPV through the ABBO price, subject to the order's limit price;<sup>71</sup> or (ii) be entered into the

Phlx XL II book and posted at: (A) its limit price, or (B) one MPV inferior to the ABBO price if its limit price is equal to or through the ABBO price. The Phlx XL II system will route and execute contracts contemporaneously at the end of the Route Timer. The FIND order will not be eligible for routing until the next time the option series is subject to a new Opening Process.

**SRCH Order.** Proposed Rule 1080(m)(v)(C) describes a SRCH Order. A SRCH order is an order that is routable at any time.

A SRCH order on the Phlx XL II book during an opening, whether it is received prior to the opening or it is a GTC SRCH order from a prior day, may be routed as part of the Opening Process. Once the Opening Process is complete, a SRCH order is eligible either to: (1) Trade at the Phlx price, if that price is equal to or better than the ABBO or, if the ABBO is better than the Phlx price, orders have been routed to the ABBO markets for their full size; or (2) be routed to the ABBO if the ABBO price is the best price, and/or (3) be placed on the Phlx XL II book at its limit price if not participating in the Phlx opening at the opening price and not locking or crossing the ABBO. Once on the book, the SRCH order is eligible for routing if it is locked or crossed by an away market (see below).

A SRCH order received during open trading that is not marketable against the PBBO or the ABBO will be entered into the Phlx XL II book. Once on the book, the SRCH order is eligible for routing if it is locked or crossed by an away market.

A SRCH order received during open trading that is marketable against the PBBO when the ABBO is inferior to the PBBO will be traded at the Exchange at the PBBO price. If the SRCH order has size remaining after exhausting the PBBO, it may (1) trade at the next PBBO price (or prices) if the order price is locking or crossing that price (or prices) up to and including the price equal to the ABBO price, and/or (2) be routed, subject to a Route Timer not to exceed one second,<sup>72</sup> to the ABBO markets if all Phlx interest at better or equal prices has been exhausted, and/or (3) be entered into the Phlx XL II book at its limit price if not locking or crossing the Phlx price or the ABBO. Once on the book, the SRCH order is eligible for

<sup>69</sup> The duration of the Route Timer and all timers relating to FIND and SRCH orders will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>70</sup> The duration of the Route Timer and all timers relating to FIND and SRCH orders will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>71</sup> This is consistent with the provisions contained in the current Linkage Plan ("Plan") and Phlx Rule 1083(t), reflecting that the definition of a "trade-through" does not include an order executed at a price that is one MPV inferior to the

NBBO if a Linkage Order is transmitted to the Participant Exchange(s) that are disseminating the NBBO to satisfy all interest at the NBBO price ("trade and ship").

<sup>72</sup> The duration of the Route Timer and all timers relating to FIND and SRCH orders will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

routing if it is locked or crossed by an away market.

A SRCH order received during open trading that is marketable against the PBBO when the ABBO is equal to the PBBO will be traded at the Exchange at the PBBO. If the SRCH order has size remaining after exhausting the PBBO, it will initiate a Route Timer not to exceed one second<sup>73</sup> in order to allow Phlx XL II participants and other market participants an opportunity to interact with the SRCH order. During the Route Timer, the SRCH order will be included in the PBBO at a price one MPV away from the ABBO. If, during the Route Timer, any new interest arrives opposite the SRCH order that is equal to or better than the ABBO price, the SRCH order will trade against such new interest at the ABBO price.

What happens to a SRCH order after the Route Timer expires depends on the ABBO price at that time. If, at the end of the Route Timer, the ABBO is still the best price, the SRCH order will route to the away market up to a size equal to the lesser of either (a) the away market's size, or (b) the remaining size of the SRCH order. If the SRCH order still has remaining size after routing, it may: (1) Trade at the next PBBO price (or prices) if the order price is locking or crossing that price (or prices) up to one MPV through the ABBO price, and/or (2) be routed, subject to a Route Timer not to exceed one second,<sup>74</sup> to the ABBO markets if all Phlx interest at better or equal prices has been exhausted, and/or (3) be entered into the Phlx XL II book at its limit price if not locking or crossing the Phlx price or the ABBO. The Phlx XL II system will route and execute contracts contemporaneously at the end of the Route Timer. Once on the book, the SRCH order is eligible for routing if it is locked or crossed by an away market.

A SRCH order received during open trading that is marketable against the ABBO when the ABBO is better than the PBBO will initiate a Route Timer not to exceed one second<sup>75</sup> in order to allow Phlx XL II participants and other market participants an opportunity to interact with the remainder of the SRCH order. During the Route Timer, the SRCH order will be included in the PBBO at a price

one MPV inferior to the ABBO. If, during the Route Timer, any new interest arrives opposite the SRCH order that is equal to or better than the ABBO price, the SRCH order will trade against such new interest at the ABBO price.

What happens to a SRCH order after the Route Timer expires depends on the ABBO price at that time. If, at the end of the Route Timer, the ABBO is still the best price, the SRCH order will route to the away market up to a size equal to the lesser of either: (a) The away market's size or (b) the remaining size of the SRCH order. If the SRCH order still has remaining size, it may: (1) Trade at the next PBBO price (or prices) if the order price is locking or crossing that price (or prices) up to one MPV through the ABBO price, and/or (2) be routed, subject to a Route Timer not to exceed one second,<sup>76</sup> to the ABBO markets if all Phlx interest at better or equal prices has been exhausted, and/or (3) be entered into the Phlx XL II book at its limit price if not locking or crossing the Phlx price or the ABBO. Once on the book, the SRCH order is eligible for routing if it is locked or crossed by an away market.

A SRCH order on the Phlx XL II book may be routed to an away market if it is locked or crossed by an away market. If an ABBO locks or crosses the PBBO which includes a SRCH order, the Phlx XL II system will initiate a Route Timer not to exceed one second<sup>77</sup> in order to allow Phlx users an opportunity to interact with the SRCH order. During the Route Timer, the SRCH order remains in the PBBO at its posted price. If, during the Route Timer, any new interest arrives opposite the SRCH order that is equal to or better than the ABBO price, the SRCH order will trade against such new interest at the ABBO price.

What happens to a SRCH order after the Route Timer expires depends on the ABBO price at that time. If, at the end of the Route Timer, the ABBO is still the best price, the SRCH order will route to the away market up to a size equal to the lesser of either: (a) The away market's size, or (b) the remaining size of the SRCH order. If the SRCH order still has remaining size, that size will remain on the book.

#### *New Sweeps*

In addition to the Opening Sweep described above, the Phlx will also

introduce other new sweep capabilities. The Market Sweep<sup>78</sup> in Phlx XL II will replace the Phlx XL's current Book Sweep<sup>79</sup> order processing, and allow a Phlx user the ability to automatically execute multiple order price levels and a single quote price level. A Market Sweep will execute against both quotes and orders, but when a quote level is exhausted, the system will cancel the balance of the Market Sweep back to the entering party to allow quotes to be updated. Market Sweeps are processed on an immediate-or-cancel basis, may not be routed, may be entered only at a single price, and may not trade through the ABBO.

The Auction Sweep described above may be entered only during the auction process and will remain in effect only until the auction is completed. A single Phlx XL II participant may enter multiple Auction Sweeps, with each Auction Sweep at a different price level. If a Phlx XL II participant submits multiple Auction Sweeps at different price levels, the Phlx XL II system will consider only the most recent Auction Sweep at each price level submitted by such Phlx XL II participant in determining the Auction Price. The Phlx XL II system will aggregate the size of all Auction Sweeps (*i.e.*, for all Phlx XL II participants) at a particular price level for trade allocation purposes.

Sweeps of any type may only be entered by entities permitted to enter quotes in the class and series being swept. Unlike other types of sweeps, all Opening Sweeps in a series will be cancelled immediately if that Phlx XL II participant fails to maintain a continuous quote with a permitted opening bid/ask differential in the affected series.

#### *Complex Order Live Auction Order Cancellation*

Phlx also proposes to remove the prohibition in Rule 1080.08(e)(iii) on order cancellation in Complex Order Live Auction ("COLA") and now allow the cancellation of any order in such auction including the original order that caused the auction to commence.<sup>80</sup> This is to allow customers greater flexibility to manage their orders during a COLA.

In addition, the Phlx XL II system will also execute the individual components of a Complex Order against sweeps that are executable.<sup>81</sup> This provision would

<sup>73</sup> The duration of the Route Timer and all timers relating to FIND and SRCH orders will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>74</sup> The duration of the Route Timer and all timers relating to FIND and SRCH orders will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>75</sup> The duration of the Route Timer and all timers relating to FIND and SRCH orders will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>76</sup> The duration of the Route Timer and all timers relating to FIND and SRCH orders will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>77</sup> The duration of the Route Timer and all timers relating to FIND and SRCH orders will be published in an Options Trader Alert, which will be available on the Exchange's Web site.

<sup>78</sup> See proposed Rule 1080(c)(iii)(B).

<sup>79</sup> A Book Sweep is a one-sided single-priced quote that may only trade with an order on the book. See Exchange Rule 1080(c).

<sup>80</sup> See Exchange Rule 1080.08(e)(iii).

<sup>81</sup> The Phlx XL Complex Order system currently executes only quotes and orders on the limit order

allow additional opportunity for Phlx XL II participants to trade with existing liquidity on the Exchange.

#### *Miscellaneous Rule Changes*

The Exchange proposes to make various updates to Rule 1080 to delete obsolete provisions and generally update the rule. For example, the Exchange proposes to add the terms “Phlx XL” and “Phlx XL II” to the rule to more clearly identify the new features and to expressly begin replacing the outdated term “AUTOM.”<sup>82</sup> The Exchange also proposes to delete the requirement in Rule 1080.05 that off-floor broker-dealer limit orders delivered through the system must be represented on the Exchange floor by a floor member, as this provision is outdated. The Exchange believes that other forms of communication, such as telephone, are sufficient. The Exchange proposes to delete Rule 1080.03, which refers to a technology arrangement no longer in place. Similarly, the Exchange proposes to delete certain options floor procedure advices, such as Advice G–2, which duplicate existing rules<sup>83</sup> and do not impose any fines under the minor rule violation enforcement and reporting plan. In Rules 1014, 1080(k) and (l) and 1082, the Exchange proposes to delete the outdated term “Streaming Quote Options.” The Exchange also proposes to place a cross-reference to Rule 1017 in Rule 1080 to make clear that Rule 1080(a) applies to openings. The Exchange proposes to amend Rule 1047 to add new text stating that the Phlx XL II system will automatically halt trading in an equity option when the underlying security is subject to a regulatory halt on the primary market for such underlying security.

In addition, the Exchange proposes to replace numerous references to the Options Committee and the Foreign Currency Options Committee, and their respective Chairs, with “the Exchange” to reflect that the Exchange will have direct responsibility over these matters, consistent with a separate proposed rule change to make similar changes throughout the Exchange’s rules.<sup>84</sup>

Finally, the Exchange proposes the following specific miscellaneous rule changes:

- Rule 1014(b)(ii)(E) would be amended to delete obsolete portions of the rule concerning expired dates of effectiveness for a 90-day effective

period following commencement of the original Phlx XL system, and a one-year effective period for a requirement that non-SQT ROTs quote electronically in options in which they trade a certain percentage electronically;

- Rules 1017(b)–(f) would be amended to reflect that the rules will continue to apply to options traded on the original Phlx XL system, and to reflect that notification to membership of various time periods will be made on the Exchange’s Web site. Any quantified term determined by the Exchange will be disseminated as an Options Trader Alert on the Exchange’s Web site and will be retained on the Web site indefinitely so that persons may review such determinations as necessary

- Rules 1017(g)–(i) would be amended to reflect the applicability of each paragraph to options traded exclusively on the original Phlx XL system, and to options traded on the original Phlx XL system and the Phlx XL II system;

- Commentaries .01–.03 to Rule 1017 would be amended to state that Commentaries apply to the original Phlx XL system;

- Rule 1080(b) would be amended to reflect that DNR, SRCH and FIND orders are eligible for entry into the Phlx XL II system as agency orders and as orders for the proprietary accounts of SQTs, RSQTs, non-SQT ROTs, specialists, and off-floor broker-dealers;

- Rule 1080(c)(iv) would be amended to (i) reflect that orders in options traded on the original Phlx XL system will be handled manually by the specialist in certain situations, and (ii) to add new sub-paragraph (G) to the Rule stating that, respecting options traded on the Phlx XL II system, no orders will be executed manually;

- Rule 1080(c)(v) would be amended to reflect that it will apply to options traded on the Phlx XL system;

- Rule 1080, Commentary .06 would be amended to delete obsolete references to the deployment schedule for the Options Floor Broker Management System, which was completed in November 2003;

- Options Floor Procedure Advice (“OFPA”) A–12 would be amended to delete redundant references to the opening price acceptable range for options traded on the original Phlx XL system which are already included in Rule 1017;

- OFPA A–14, which has a fine schedule, would be amended to reflect that, respecting openings on the Phlx XL II system, the price of an opening transaction in an option series may only be arranged at a price that is within an acceptable OQR (as determined by the

Exchange and announced to the membership on the Exchange’s Web site), and to include identical language to proposed Rule 1017(l)(iii) concerning the calculation of the OQR;

- OFPA G–2, which has no fine schedule and which duplicates existing Exchange Rule 1047A, would be deleted.

#### *Rollout and Deployment*

The Exchange expects to roll out the Phlx XL II system over a period of 12 weeks following Commission approval of this proposal (the “rollout period”), beginning with one single option traded on the Phlx XL II system, while other options traded on the Exchange will continue to trade on the original Phlx XL system (the “legacy system”) during the rollout period. The Exchange will continue to delete options from the legacy system and place such options on the Phlx XL II system during the rollout period, while other options continue to trade on the legacy system. Eventually all options traded on the Exchange will be traded on the Phlx XL II system, and no options will be traded on the legacy system. Accordingly, the Exchange proposes to distinguish the proposed rules applicable to options traded on the Phlx XL II system from existing Exchange rules applicable to options traded on the legacy system.

Within 90 days following the completion of the rollout of the Phlx XL II system, the Exchange will offer a data feed to all market participants, which will include disseminated Exchange top-of-market data (including orders, quotes and trades). The new data feed will also include all information that is included in the Exchange’s Specialized Order Feed (“SOF”), which provides information concerning simple orders, complex orders and complex strategies to Exchange quoting members. With respect to the speed with which users will receive this information, SOF users will receive this information no sooner than users of the new data feed.

#### *Conclusion*

All of the above proposals are designed to improve the speed, efficiency and quality of Exchange options executions and to provide greater flexibility for Exchange users in how they quote and trade, while also enhancing overall market quality by expanded protection of better displayed prices in the market.

#### *2. Statutory Basis*

The Exchange believes that its proposal is consistent with Section 6(b)

book against the individual components of a Complex Order. See Exchange Rule 1080.08(f)(iii)(A).

<sup>82</sup> See Exchange Rule 1080.

<sup>83</sup> See Exchange Rule 1047A.

<sup>84</sup> See Securities Exchange Act Release No. 59697 (April 2, 2009) (SR-Phlx–2009–23).

of the Act<sup>85</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>86</sup> in particular, in that it is designed 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. In particular, the Exchange believes that the proposals will improve the speed, efficiency and quality of Exchange options executions and to provide greater flexibility for Exchange users in how they quote and trade, while also enhancing overall market quality by expanded protection of better displayed prices in the market.

#### *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 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*

No written comments were either solicited or received.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) By order approve such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File

Number SR-Phlx-2009-32 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-Phlx-2009-32. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-Phlx-2009-32 and should be submitted on or before May 5, 2009.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>87</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

[FR Doc. E9-8422 Filed 4-13-09; 8:45 am]

**BILLING CODE 8010-01-P**

## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-59723; File No. SR-NSX-2009-02]

### **Self-Regulatory Organizations; National Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend the Fee and Rebate Schedule Relating to Liquidity Adding Rebates**

April 7, 2009.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 31, 2009, National Stock Exchange, Inc. filed with the Securities and Exchange Commission ("Commission") the proposed rule change, as described in Items I, II and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

National Stock Exchange, Inc. ("NSX®" or "Exchange") is proposing to (i) amend the Fee and Rebate Schedule (the "Fee Schedule") issued pursuant to Exchange Rule 16.1(c) in order to increase the displayed order liquidity adding rebate for Tape A and C securities executed at one dollar or above in the Automatic Execution Mode of order interaction in the event that certain volume thresholds are achieved, (ii) provide a rebate for adding liquidity in displayed orders at one dollar or above in the Order Delivery Mode of order interaction in the event that certain volume thresholds are achieved and (iii) establish a new Rule 16.3 to provide that, for purposes of applying the provisions of the Fee Schedule and Exchange Rule 16, an ETP Holder may request that the Exchange aggregate its activity with the activity of its affiliates.

The text of the proposed rule change is available on the Exchange's Web site at <http://www.nsx.com>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

#### **II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for

<sup>85</sup> 15 U.S.C. 78f(b).

<sup>86</sup> 15 U.S.C. 78f(b)(5).

<sup>87</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.