Proposed Rule Change by Philadelphia Stock Exchange

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial Amendment Withdrawal Section 19(b)(2) Section 19(b)(3)(A) Section 19(b)(3)(B)

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Pilot Extension of Time Period for Commission Action Date Expires

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Rule


Description

Provide a brief description of the proposed rule change (limit 250 characters).

Proposed rule change relating to the automated delivery and handling of stop and stop-limit orders.

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Richard Last Name Rudolph

Title Vice President and Counsel

E-mail Richard.Rudolph@phlx.com

Telephone (215) 496-5074 Fax (215) 496-6729

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 12/15/2005

By Richard S. Rudolph Vice President and Counsel (Name) (Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed. Richard Rudolph.
If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.
1. **Text of the Proposed Rule Change**

The Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") \(^1\) and Rule 19b-4 thereunder, \(^2\) proposes to amend Exchange Rules 1080(b)(i)(A) and (C), and 1066(c)(1), and to delete Options Floor Procedure Advices ("OFPAs") A-5 and A-6, to permit customer and off-floor broker-dealer stop \(^3\) and stop-limit \(^4\) orders in options to be delivered via the Exchange’s Automated Options Market ("AUTOM") System \(^5\) and to be handled electronically.

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1. The text of the proposed rule change is set forth below.

Brackets indicate deletions; underlining indicates new text.

**Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)**

**Rule 1080.** (a) No change.


\(^3\) A stop order is a contingency order to buy or sell when the market for a particular option contract reaches a specified price. A stop order to buy becomes a market order when the option contract trades or is bid at or above the stop price. A stop order to sell becomes a market order when the option contract trades or is offered at or below the stop price. See Exchange Rule 1066(c)(1).

\(^4\) A stop-limit order is a contingency order to buy or sell at a limited price when the market for a particular option contract reaches a specified price. A stop limit order to buy becomes a limit order executable at the limit price or better when the option contract trades or is bid at or above the stop-limit price. A stop limit order to sell becomes a limit order executable at the limit price or better when the option contract trades or is offered at or below the stop limit price. \textit{Id.}

\(^5\) AUTOM is the Exchange’s electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM’s automatic execution features, AUTO-X, Book Sweep and Book Match. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor. See Exchange Rule 1080.
(b) Eligible Orders

(i) The following types of orders are eligible for entry into AUTOM:

(A) Agency orders may be entered. The following types of agency orders are eligible for AUTOM: day, GTC, Immediate or Cancel (“IOC”), market, limit, stop, stop limit, all or none, or better, simple cancel, simple cancel to reduce size (cancel leaves), cancel to change price, cancel with replacement order, and possible duplicate orders.

(B) No change.

(C) Off-floor broker-dealer limit orders, subject to the restrictions on order entry set forth in Commentary .05 of this Rule, may be entered. The following types of broker-dealer limit orders are eligible for AUTOM: day, GTC, IOC, stop, stop limit, simple cancel, simple cancel to reduce size (cancel leaves), cancel to change price, cancel with replacement order. For purposes of this Rule 1080, the term “off-floor broker-dealer” means a broker-dealer that delivers orders from off the floor of the Exchange for the proprietary account(s) of such broker-dealer, including a market maker located on an exchange or trading floor other than the Exchange's trading floor who elects to deliver orders via AUTOM for the proprietary account(s) of such market maker.

(ii) – (iii) No change.

(c) – (k) No change.

(l) Directed Orders. For a one-year pilot period, beginning on the date of approval of this Rule by the Securities and Exchange Commission, respecting Streaming Quote Options traded on Phlx XL, specialists, RSQTs and SQTs may receive Directed Orders (as defined in this Rule) in accordance with the provisions of this Rule 1080(l).

(i) (A) The term “Directed Order” means any customer order (other than a stop or stop-limit order as defined in Rule 1066) to buy or sell which has been directed to a particular specialist, RSQT, or SQT by an Order Flow Provider, as defined below. To qualify as a Directed Order, an order must be delivered to the Exchange via AUTOM.

(B) – (C) No change.

(ii) – (iv) No change.

Commentary: No change.
Certain Types of Orders Defined

Rule 1066. (a) – (b) No change.

(c) Contingency Order. A contingency order is a limit or market order to buy or sell that is contingent upon a condition being satisfied while the order is at the post.

(1) Stop-Limit Order. A stop-limit order is a contingency order to buy or sell at a limited price when [the market] a trade or quote on the Exchange for a particular option contract reaches a specified price. A stop-limit order to buy becomes a limit order executable at the limit price or better when the option contract trades or is bid on the Exchange at or above the stop-limit price [after the offer is represented in the trading crowd]. A stop-limit order to sell becomes a limit order executable at the limit price or better when the option contract trades or is offered on the Exchange at or below the stop-limit price [after the order is represented in the trading crowd].

Stop (stop-loss) Order. A stop order is a contingency order to buy or sell when [the market] a trade or quote on the Exchange for a particular option contract reaches a specified price. A stop order to buy becomes a market order when the option contract trades or is bid on the Exchange at or above the stop price [after the order is represented in the trading crowd]. A stop order to sell becomes a market order when the option contract trades or is offered on the Exchange at or below the stop price [after the order is represented in the trading crowd].

Notwithstanding the foregoing, a stop or stop-limit order shall not be elected by a trade that is reported late or out of sequence.

[Stop and stop-limit orders elected by a quotation must be given floor official approval prior to execution or, if circumstances make it impractical for prior approval, promptly following the execution. The facts surrounding each instance when retroactive approval is requested must be documented in writing, signed by the specialist and floor official, and submitted to the Surveillance Department on the day of the trade.]

(2) – (7) No change.

(d) – (g) No change.

Commentary: No change.

A-5 RESERVED [Execution of Stop and Stop Limit Orders]

Stop and stop-limit orders are contingency orders to buy or sell when the market for a particular option reaches a specified price.
Stop and stop-limit orders to buy become eligible for execution when the option trades at or above the stop price or when the bid price for the option is at or above the stop price. Stop and stop-limit orders to sell become eligible for execution when the option trades at or below the stop price or when the offer price for the option is at or below the stop price. A stop or stop-limit order which will be made eligible by an opening sale should be executed as the opening trade or included with the opening trade.

Stop and stop-limit orders elected by a quotation must be given Floor Official approval prior to execution or, if circumstances make it impractical for prior approval, promptly following the execution. The facts surrounding each instance where retroactive approval is requested must be documented in writing, signed by the Specialist and Floor Official, and submitted to the Surveillance Department on the day of the trade.

A Specialist may refuse to accept stop and/or stop limit orders on the book if he has received the approval of one Floor Official no later than 30 minutes before the opening, or such orders shall be accepted throughout the day. Notification of such approval will be posted on the Exchange floor one-half hour before the opening. All stop or stop-limit orders which have been entrusted to the Specialist shall be returned to the responsible member immediately upon Floor Official approval for the return of such orders.

FINE SCHEDULE

A-5

Fine not applicable

A-6 RESERVED [Cancel/Replacement Process]

It is the responsibility of the Specialist to notify the appropriate brokers when orders they placed on the Specialist book become subject to a cancel/replacement process. This process shall normally be required when: (1) there is a change in the contract terms of an option, (2) there is a transfer of the Specialist book, or (3) in any other instance where two Floor Officials approve a cancel/replacement of orders on the book.

In all instances where a required cancel/replacement of all orders on the book occurs, it is the responsibility of the Specialist to ensure that, to the extent possible, any such replacement order will not incur a loss of the priority it established prior to the cancel/replacement process.

FINE SCHEDULE (Implemented on a two-year running calendar basis)

A-6 1st Occurrence $250.00
2. **Procedures of the Self-Regulatory Organization**

The Exchange’s Executive Committee, pursuant to delegated authority, approved the proposal for filing with the Securities and Exchange Commission (“SEC” or “Commission”) on December 12, 2005.

Questions and comments on the proposed rule change may be directed to Richard S. Rudolph, Vice President and Counsel, at (215) 496-5074, or Edith Hallahan, Senior Vice President and Deputy General Counsel, at (215) 496-5179.

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

   a. **Purpose**

The purpose of the proposed rule change is to increase the number of option transactions on the Exchange that are handled automatically by establishing rules that permit the electronic delivery and handling of stop and stop limit orders on the Exchange, and to delete certain provisions in the Exchange’s rules concerning stop and stop limit orders that are either redundant or no longer practical.

Currently, stop and stop limit orders in options are not deliverable electronically via AUTOM. The proposal would amend the Exchange’s rules to permit the electronic delivery of stop and stop limit orders to the Exchange via AUTOM.
Election of Stop and Stop-Limit Orders

Stop orders delivered electronically on the Exchange’s AUTOM System would be handled in the system as market orders once elected by a trade or quote on the Exchange. Stop limit orders delivered electronically to the limit order book would become live limit orders in the system once elected by a quotation, and would be placed on the limit order book in price-time priority as of the time of election.

The proposed rule change would provide that, notwithstanding the foregoing, a stop or stop-limit order would not be elected by a trade that is reported late or out of sequence. The purpose of this provision is to ensure systemically that a stop or stop-limit order would be elected on the Exchange by the execution price at the actual time of the execution, instead of at the time of a late or out-of-sequence report. Absent this provision, it would be possible for a stop order to be elected by a trade that is reported late or out-of-sequence, which could result in such stop order being converted into a market order and executed at a significantly inferior price than the election price of the stop order.

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6 A stop or stop limit order is “elected” when the market (i.e., a trade or quotation) for a particular option contract reaches a specified price. Under the proposal, such orders would be elected when a trade or quote occurs on the Exchange that causes the Exchange’s market to reach the specified price of the stop or stop-limit order.

7 See Exchange Rule 1080, Commentary .02.

8 For example, if a stop order to sell at $3.00 is elected by a trade reported late or out-of-sequence with an execution price of $3.00 when the actual bid price at the time of the report is $1.00, the stop order would be converted into a market order and executed at $1.00.
Eligible Order Types

Rules 1080(b)(i)(A) and (C) would be amended to include agency⁹ and off-floor broker-dealer¹⁰ stop and stop limit orders as order types that are eligible for electronic delivery on the Exchange’s systems.

Floor Official Approval Requirement

OFPA A-5 and Rule 1066(c)(1) currently provide that stop and stop-limit orders elected by a quotation must be given Floor Official approval prior to execution. Under the instant proposal, stop and stop-limit orders would be entered electronically and executed and handled automatically on the Exchange’s electronic trading platform for options, Phlx XL.¹¹ The Exchange believes that it would be impractical in an electronic trading environment to require Floor Official approval prior to the execution of each stop and stop-limit order that is entered onto the system.

Accordingly, the Exchange proposes to delete the provision from Rule 1066(c)(1) requiring Floor Official approval prior to the execution of stop and stop-limit orders. The provision would also be deleted from OFPA A-5, which is proposed to be deleted in its entirety, as set forth more fully below.

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⁹ The Exchange has defined an agency order as any order entered on behalf of a public customer, and does not include any order entered for the account of a broker-dealer, or any account in which a broker-dealer or an associated person of a broker-dealer has any direct or indirect interest. See Securities Exchange Act Release Nos. 46763 (November 1, 2002), 67 FR 68898 (November 13, 2002) (SR-Phlx-2002-04); and 40970 (January 25, 1999), 64 FR 4922 (February 1, 1999) (File No. SR-Phlx-98-44).

¹⁰ The term “off-floor broker-dealer” means a broker-dealer that delivers orders from off the floor of the Exchange for the proprietary account(s) of such broker-dealer, including a market maker located on an exchange or trading floor other than the Exchange’s trading floor who elects to deliver orders via the Exchange’s electronic order routing, delivery, execution and reporting system, AUTOM, for the proprietary account(s) of such market maker. See Exchange Rule 1080(b)(i)(C).

In-Crowd Representation Requirement

Rule 1066(c)(1) currently provides that stop and stop-limit orders are elected only after the order is represented in the trading crowd. The Exchange believes that, with the advent of Phlx XL and increasingly automated quoting, trading and order handling in options obviates the need for the requirement that a stop order be represented in the crowd prior to execution. A stop order (or a stop-limit order that becomes a marketable limit order) that is elected by a quotation would be executed, reported and allocated automatically by the Exchange’s systems. Thus, there could be no “representation in the crowd” prior to such an execution. The Exchange therefore proposes to delete the requirement that such orders be represented in the crowd as a prerequisite to their election.

Exclusion From the Definition of “Directed Orders”

In May, 2005, the Exchange adopted rules that permit Exchange specialists, Streaming Quote Traders (“SQTs”),12 and Remote Streaming Quote Traders (“RSQTs”)13 to receive Directed Orders, and to provide a participation guarantee to specialists, SQTs and RSQTs that receive Directed Orders.14

Currently, Exchange Rule 1080(l) defines the term “Directed Order” as any customer order to buy or sell that has been directed to a particular specialist, SQT, or

12 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).

13 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).

RSQT by an order flow provider. The Exchange proposes an amendment to Rule 1080(l) that would specifically exclude stop and stop-limit orders from the definition of a Directed Order. Directed Orders must be executed and allocated electronically in accordance with the Exchange’s rules that provide the participation guarantee described above.\(^{15}\) Because a stop or stop limit order that is elected on the Exchange might not be eligible for automatic execution (and instead would be handled manually by the specialist),\(^{16}\) a stop or stop-limit order that is designated as a Directed Order might not be executed and allocated in accordance with Exchange rules. Therefore, the Exchange proposes to exclude stop and stop-limit orders from the definition of “Directed Order.”

**Deletion of OFPA A-5 in its Entirety**

OFPA A-5 currently includes a provision that a specialist may refuse to accept stop and/or stop limit orders on the book if he has received the approval of one Floor Official no later than 30 minutes before the opening. The original purpose of this provision was to allow the specialist to manage his or her risk of missing, or not timely executing, elected stop and stop-limit orders in options that are expected to be volatile during the trading day due to, for example, pending news or other event-driven changes in the market for the particular option. The Exchange believes that, because the order handling process for stop and stop-limit orders would be completely automated under the proposal, specialists would no longer be subject to such risks. The Exchange therefore proposes to delete the provision permitting specialists to refuse to accept stop and stop-limit orders with the proper Floor Official approval.

\(^{15}\) See Exchange Rule 1014(g)(viii).

\(^{16}\) For example, an order is not eligible for automatic execution on the Exchange when the Exchange’s bid or offer is not the National Best Bid or Offer. See Exchange Rule 1080(c)(iv)(E).
The Exchange proposes to delete OFPA A-5 in its entirety. The descriptive language of stop and stop limit orders contained in OFPA A-5 is currently contained in Rule 1066, and would remain in Rule 1066. The remaining sections of OFPA A-5 regarding the requirement to obtain Floor Official approval prior to election, and permitting specialists to refuse to accept stop and stop-limit orders with prior Floor Official approval, would be deleted for the reasons stated above. In addition, the Exchange historically adopted some OFPAs to conveniently reprint them in a pocket format; this rationale is outdated and no longer applies.

Deletion of OFPA A-6 in its Entirety

Currently, OFPA A-6, Cancel/Replacement Process, requires the specialist to notify “the appropriate brokers” when orders they placed on the limit order book become subject to a cancel/replacement process. Notification of the cancel/replacement process is now provided systemically, except with respect to stop and stop-limit orders placed with the specialist. Stop and stop-limit orders are the only order types for which the specialist is currently responsible to notify the appropriate Exchange member or member organization when stop and stop-limit orders they placed with the specialist become subject to a cancel/replacement process (due to, for example, a transfer or an adjustment for a dividend). Once stop and stop-limit orders are automated the specialist would no longer responsible for notification of cancel/replacement activity for any order type. Therefore the OFPA is proposed to be deleted in its entirety.

b. **Statutory Basis**
The Exchange believes that its proposal is consistent with Section 6(b) of the Act\textsuperscript{17} in general, and furthers the objectives of Section 6(b)(5) of the Act\textsuperscript{18} 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, by increasing the number of orders handled electronically and establishing rules that permit the electronic delivery and handling of stop and stop-limit orders via the Exchange’s AUTOM System.

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

The Phlx 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.

5. 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.

6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

\textsuperscript{17} 15 U.S.C. 78f(b).

\textsuperscript{18} 15 U.S.C. 78f(b)(5).
The Exchange requests accelerated effectiveness pursuant to Section 19(b)(2) of the Act\(^\text{19}\) in order to compete with other exchanges that have similar rules in effect, as cited below.

8. **Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission**

The proposed rule change is based on International Securities Exchange, Inc. ("ISE") Rules 715(d) and (e).\(^\text{20}\)

9. **Exhibits**

1. Notice of proposed rule for publication in the *Federal Register*.


Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to the Automated Delivery and Handling of Stop and Stop-Limit Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) 1, and Rule 19b-4 thereunder, notice is hereby given that on ______________________ 2005, the Philadelphia Stock Exchange, 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 Phlx. 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 Phlx, pursuant to Section 19(b)(1) of the Act 3 and Rule 19b-4 thereunder, 4 proposes to amend Exchange Rules 1080(b)(i)(A) and (C), and 1066(c)(1), and to delete Options Floor Procedure Advices (“OFPAs”) A-5 and A-6, to permit customer and off-floor broker-dealer stop 5 and stop-limit 6 orders in options to be delivered via the

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5 A stop order is a contingency order to buy or sell when the market for a particular option contract reaches a specified price. A stop order to buy becomes a market order when the option contract trades or is bid at or above the stop price. A stop order to sell becomes a market order when the option contract trades or is offered at or below the stop price. See Exchange Rule 1066(c)(1).
6 A stop-limit order is a combination of a stop order and a limit order.
Exchange’s Automated Options Market (“AUTOM”) System and to be handled electronically.

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1. The text of the proposed rule change is set forth below.

Brackets indicate deletions; underlining indicates new text.

**Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)**

**Rule 1080.** (a) No change.

(b) Eligible Orders

(i) The following types of orders are eligible for entry into AUTOM:

(A) Agency orders may be entered. The following types of agency orders are eligible for AUTOM; day, GTC, Immediate or Cancel (“IOC”), market, limit, stop, stop limit, all or none, or better, simple cancel, simple cancel to reduce size (cancel leaves), cancel to change price, cancel with replacement order, and possible duplicate orders.

(B) No change.

(C) Off-floor broker-dealer limit orders, subject to the restrictions on order entry set forth in Commentary .05 of this Rule, may be entered. The following types of broker-dealer limit orders are eligible for AUTOM: day, GTC, IOC, stop, stop limit, simple cancel, simple cancel to reduce size (cancel leaves), cancel to change price, cancel with replacement order. For purposes of this Rule 1080, the term “off-floor broker-dealer” means a broker-dealer that delivers orders from off the floor of the Exchange for the proprietary account(s) of such broker-dealer,

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6 A stop-limit order is a contingency order to buy or sell at a limited price when the market for a particular option contract reaches a specified price. A stop limit order to buy becomes a limit order executable at the limit price or better when the option contract trades or is bid at or above the stop-limit price. A stop limit order to sell becomes a limit order executable at the limit price or better when the option contract trades or is offered at or below the stop limit price. *Id.*

7 AUTOM is the Exchange’s electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM’s automatic execution features, AUTO-X, Book Sweep and Book Match. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor. *See Exchange Rule 1080.*
including a market maker located on an exchange or trading floor other than the
Exchange's trading floor who elects to deliver orders via AUTOM for the
proprietary account(s) of such market maker.

(ii) – (iii) No change.

(c) – (k) No change.

(l) **Directed Orders.** For a one-year pilot period, beginning on the date of approval of
this Rule by the Securities and Exchange Commission, respecting Streaming Quote
Options traded on Phlx XL, specialists, RSQTs and SQTs may receive Directed Orders
(as defined in this Rule) in accordance with the provisions of this Rule 1080(l).

(i) (A) The term “Directed Order” means any customer order (other than a
stop or stop-limit order as defined in Rule 1066) to buy or sell which has been
directed to a particular specialist, RSQT, or SQT by an Order Flow Provider, as
defined below. To qualify as a Directed Order, an order must be delivered to the
Exchange via AUTOM.

(B) – (C) No change.

(ii) – (iv) No change.

Commentary: No change.

**Certain Types of Orders Defined**

**Rule 1066.** (a) – (b) No change.

(c) Contingency Order. A contingency order is a limit or market order to buy or sell that
is contingent upon a condition being satisfied while the order is at the post.

(1) Stop-Limit Order. A stop-limit order is a contingency order to buy or sell at a
limited price when [the market] a trade or quote on the Exchange for a particular option
contract reaches a specified price. A stop-limit order to buy becomes a limit order
executable at the limit price or better when the option contract trades or is bid on the
Exchange at or above the stop-limit price [, after the offer is represented in the trading
crowd]. A stop-limit order to sell becomes a limit order executable at the limit price or
better when the option contract trades or is offered on the Exchange at or below the stop-
limit price [, after the order is represented in the trading crowd].

Stop (stop-loss) Order. A stop order is a contingency order to buy or sell when [the
market] a trade or quote on the Exchange for a particular option contract reaches a
specified price. A stop order to buy becomes a market order when the option contract
trades or is bid on the Exchange at or above the stop price[, after the order is represented
in the trading crowd]. A stop order to sell becomes a market order when the option
contract trades or is offered on the Exchange at or below the stop price[, after the order is represented in the trading crowd].

Notwithstanding the foregoing, a stop or stop-limit order shall not be elected by a trade that is reported late or out of sequence.

[Stop and stop-limit orders elected by a quotation must be givenfloor official approval prior to execution or, if circumstances make it impractical for prior approval, promptly following the execution. The facts surrounding each instance when retroactive approval is requested must be documented in writing, signed by the specialist and floor official, and submitted to the Surveillance Department on the day of the trade.]

(2) – (7) No change.

(d) – (g) No change.

Commentary: No change.

A-5 RESERVED [Execution of Stop and Stop Limit Orders]

Stop and stop-limit orders are contingency orders to buy or sell when the market for a particular option reaches a specified price.

Stop and stop-limit orders to buy become eligible for execution when the option trades at or above the stop price or when the bid price for the option is at or above the stop price. Stop and stop-limit orders to sell become eligible for execution when the option trades at or below the stop price or when the offer price for the option is at or below the stop price. A stop or stop-limit order which will be made eligible by an opening sale should be executed as the opening trade or included with the opening trade.

Stop and stop-limit orders elected by a quotation must be given Floor Official approval prior to execution or, if circumstances make it impractical for prior approval, promptly following the execution. The facts surrounding each instance where retroactive approval is requested must be documented in writing, signed by the Specialist and Floor Official, and submitted to the Surveillance Department on the day of the trade.

A Specialist may refuse to accept stop and/or stop limit orders on the book if he has received the approval of one Floor Official no later than 30 minutes before the opening, or such orders shall be accepted throughout the day. Notification of such approval will be posted on the Exchange floor one-half hour before the opening. All stop or stop-limit orders which have been entrusted to the Specialist shall be returned to the responsible member immediately upon Floor Official approval for the return of such orders.

FINE SCHEDULE
It is the responsibility of the Specialist to notify the appropriate brokers when orders they placed on the Specialist book become subject to a cancel/replacement process. This process shall normally be required when: (1) there is a change in the contract terms of an option, (2) there is a transfer of the Specialist book, or (3) in any other instance where two Floor Officials approve a cancel/replacement of orders on the book.

In all instances where a required cancel/replacement of all orders on the book occurs, it is the responsibility of the Specialist to ensure that, to the extent possible, any such replacement order will not incur a loss of the priority it established prior to the cancel/replacement process.

**FINE SCHEDULE (Implemented on a two-year running calendar basis)**

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<th>Category</th>
<th>Amount</th>
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<tr>
<td>4th Occurrence and Thereafter</td>
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**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 Phlx 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 Phlx 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 increase the number of option transactions on the Exchange that are handled automatically by establishing rules that permit the electronic delivery and handling of stop and stop limit orders on the Exchange, and to delete certain provisions in the Exchange’s rules concerning stop and stop limit orders that are either redundant or no longer practical.

Currently, stop and stop limit orders in options are not deliverable electronically via AUTOM. The proposal would amend the Exchange’s rules to permit the electronic delivery of stop and stop limit orders to the Exchange via AUTOM.

**Election of Stop and Stop-Limit Orders**

Stop orders delivered electronically on the Exchange’s AUTOM System would be handled in the system as market orders once elected by a trade or quote on the Exchange.\(^8\) Stop limit orders delivered electronically to the limit order book would become live limit orders in the system once elected by a quotation, and would be placed on the limit order book\(^9\) in price-time priority as of the time of election.

The proposed rule change would provide that, notwithstanding the foregoing, a stop or stop-limit order would not be elected by a trade that is reported late or out of sequence. The purpose of this provision is to ensure systemically that a stop or stop-limit order would be elected on the Exchange by the execution price at the actual time of the election.

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\(^8\) A stop or stop limit order is “elected” when the market (i.e., a trade or quotation) for a particular option contract reaches a specified price. Under the proposal, such orders would be elected when a trade or quote occurs on the Exchange that causes the Exchange’s market to reach the specified price of the stop or stop-limit order.

\(^9\) See Exchange Rule 1080, Commentary .02.
execution, instead of at the time of a late or out-of-sequence report. Absent this provision, it would be possible for a stop order to be elected by a trade that is reported late or out-of-sequence, which could result in such stop order being converted into a market order and executed at a significantly inferior price than the election price of the stop order.\(^\text{10}\)

**Eligible Order Types**

Rules 1080(b)(i)(A) and (C) would be amended to include agency\(^\text{11}\) and off-floor broker-dealer\(^\text{12}\) stop and stop limit orders as order types that are eligible for electronic delivery on the Exchange’s systems.

**Floor Official Approval Requirement**

OFPA A-5 and Rule 1066(c)(1) currently provide that stop and stop-limit orders elected by a quotation must be given Floor Official approval prior to execution. Under the instant proposal, stop and stop-limit orders would be entered electronically and executed and handled automatically on the Exchange’s electronic trading platform for options, Phlx XL.\(^\text{13}\) The Exchange believes that it would be impractical in an electronic

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\(^\text{10}\) For example, if a stop order to sell at $3.00 is elected by a trade reported late or out-of-sequence with an execution price of $3.00 when the actual bid price at the time of the report is $1.00, the stop order would be converted into a market order and executed at $1.00.

\(^\text{11}\) The Exchange has defined an agency order as any order entered on behalf of a public customer, and does not include any order entered for the account of a broker-dealer, or any account in which a broker-dealer or an associated person of a broker-dealer has any direct or indirect interest. See Securities Exchange Act Release Nos. 46763 (November 1, 2002), 67 FR 68898 (November 13, 2002) (SR-Phlx-2002-04); and 40970 (January 25, 1999), 64 FR 4922 (February 1, 1999) (File No. SR-Phlx-98-44).

\(^\text{12}\) The term “off-floor broker-dealer” means a broker-dealer that delivers orders from off the floor of the Exchange for the proprietary account(s) of such broker-dealer, including a market maker located on an exchange or trading floor other than the Exchange’s trading floor who elects to deliver orders via the Exchange’s electronic order routing, delivery, execution and reporting system, AUTOM, for the proprietary account(s) of such market maker. See Exchange Rule 1080(b)(i)(C).

trading environment to require Floor Official approval prior to the execution of each stop and stop-limit order that is entered onto the system.

Accordingly, the Exchange proposes to delete the provision from Rule 1066(c)(1) requiring Floor Official approval prior to the execution of stop and stop-limit orders. The provision would also be deleted from OFPA A-5, which is proposed to be deleted in its entirety, as set forth more fully below.

In-Crowd Representation Requirement

Rule 1066(c)(1) currently provides that stop and stop-limit orders are elected only after the order is represented in the trading crowd. The Exchange believes that, with the advent of Phlx XL and increasingly automated quoting, trading and order handling in options obviates the need for the requirement that a stop order be represented in the crowd prior to execution. A stop order (or a stop-limit order that becomes a marketable limit order) that is elected by a quotation would be executed, reported and allocated automatically by the Exchange’s systems. Thus, there could be no “representation in the crowd” prior to such an execution. The Exchange therefore proposes to delete the requirement that such orders be represented in the crowd as a prerequisite to their election.

Exclusion From the Definition of “Directed Orders”

In May, 2005, the Exchange adopted rules that permit Exchange specialists, Streaming Quote Traders (“SQTs”),\textsuperscript{14} and Remote Streaming Quote Traders

\textsuperscript{14} 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. \textit{See} Exchange Rule 1014(b)(ii)(A).
to receive Directed Orders, and to provide a participation guarantee to specialists, SQTs and RSQTs that receive Directed Orders.\textsuperscript{16}

Currently, Exchange Rule 1080(l) defines the term “Directed Order” as any customer order to buy or sell that has been directed to a particular specialist, SQT, or RSQT by an order flow provider. The Exchange proposes an amendment to Rule 1080(l) that would specifically exclude stop and stop-limit orders from the definition of a Directed Order. Directed Orders must be executed and allocated electronically in accordance with the Exchange’s rules that provide the participation guarantee described above.\textsuperscript{17} Because a stop or stop limit order that is elected on the Exchange might not be eligible for automatic execution (and instead would be handled manually by the specialist),\textsuperscript{18} a stop or stop-limit order that is designated as a Directed Order might not be executed and allocated in accordance with Exchange rules. Therefore, the Exchange proposes to exclude stop and stop-limit orders from the definition of “Directed Order.”

Deletion of OFPA A-5 in its Entirety

OFPA A-5 currently includes a provision that a specialist may refuse to accept stop and/or stop limit orders on the book if he has received the approval of one Floor Official no later than 30 minutes before the opening. The original purpose of this provision was to allow the specialist to manage his or her risk of missing, or not timely

\textsuperscript{15} 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).


\textsuperscript{17} See Exchange Rule 1014(g)(viii).

\textsuperscript{18} For example, an order is not eligible for automatic execution on the Exchange when the Exchange’s bid or offer is not the National Best Bid or Offer. See Exchange Rule 1080(c)(iv)(E).
executing, elected stop and stop-limit orders in options that are expected to be volatile during the trading day due to, for example, pending news or other event-driven changes in the market for the particular option. The Exchange believes that, because the order handling process for stop and stop-limit orders would be completely automated under the proposal, specialists would no longer be subject to such risks. The Exchange therefore proposes to delete the provision permitting specialists to refuse to accept stop and stop-limit orders with the proper Floor Official approval.

The Exchange proposes to delete OFPA A-5 in its entirety. The descriptive language of stop and stop limit orders contained in OFPA A-5 is currently contained in Rule 1066, and would remain in Rule 1066. The remaining sections of OFPA A-5 regarding the requirement to obtain Floor Official approval prior to election, and permitting specialists to refuse to accept stop and stop-limit orders with prior Floor Official approval, would be deleted for the reasons stated above. In addition, the Exchange historically adopted some OFPAs to conveniently reprint them in a pocket format; this rationale is outdated and no longer applies.

Deletion of OFPA A-6 in its Entirety

Currently, OFPA A-6, Cancel/Replacement Process, requires the specialist to notify “the appropriate brokers” when orders they placed on the limit order book become subject to a cancel/replacement process. Notification of the cancel/replacement process is now provided systemically, except with respect to stop and stop-limit orders placed with the specialist. Stop and stop-limit orders are the only order types for which the specialist is currently responsible to notify the appropriate Exchange member or member organization when stop and stop-limit orders they placed with the specialist become
subject to a cancel/replacement process (due to, for example, a transfer or an adjustment for a dividend). Once stop and stop-limit orders are automated the specialist would no longer responsible for notification of cancel/replacement activity for any order type. Therefore the OFPA is proposed to be deleted in its entirety.

b. **Statutory Basis**

The Exchange believes that its proposal is consistent with Section 6(b) of the Act\(^ \text{19} \) in general, and furthers the objectives of Section 6(b)(5) of the Act\(^ \text{20} \) 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, by increasing the number of orders handled electronically and establishing rules that permit the electronic delivery and handling of stop and stop-limit orders via the Exchange’s AUTOM System.

2. **Statutory Basis**

The Exchange believes that its proposal is consistent with Section 6(b) of the Act\(^ \text{21} \) in general, and furthers the objectives of Section 6(b)(5) of the Act\(^ \text{22} \) 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, by increasing the number of orders handled electronically and establishing rules that permit the...

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\(^ {19} \) 15 U.S.C. 78f(b).


\(^ {22} \) 15 U.S.C. 78f(b)(5).
electronic delivery and handling of stop and stop-limit orders via the Exchange’s AUTOM System.

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

The Exchange requests accelerated effectiveness pursuant to Section 19(b)(2) of the Act in order to compete with other exchanges that have similar rules in effect.

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. Please include File Number SR-Phlx-2005-80 on the subject line.

Paper comments:

• Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-Phlx-2005-80. 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. Copies of the filing also will be available for inspection and copying at the principal office of the Phlx. 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-2005-80 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority. 24

Margaret H. McFarland
Deputy Secretary