

MEMORANDUM

TO: Members, Member Organizations, Participants, Participant Organizations

FROM: Edith Hallahan, Senior Vice President and Deputy General Counsel
Legal Department

DATE: April 4, 2007

RE: Rapid Opening System
Rule 1017(b)

The following is the text of a proposed rule change that has become effective and was implemented today. Exchange Rule 1017, Openings in Options, was amended to provide for a delay in the automated opening of an equity option series for up to five seconds following: (1) respecting equity options, the dissemination of an opening quote or trade in the primary market for the underlying security; or (2) respecting index options, following the dissemination of a quote or trade by the primary markets for underlying securities constituting 100% of the index value. The delay has been set at 1 second.

Summary: Currently, the Exchange's systems immediately open a series when the following conditions are met:

(i) the Exchange has received market orders, or the book is crossed (highest bid is higher than the lowest offer) or locked (highest bid equals the lowest offer); and either:

(ii) (A) the specialist's quote has been submitted;

(B) the quotes of at least two Phlx XL participants have been submitted within two minutes of the opening trade or quote on the primary market for the underlying security; or

(C) if neither the specialist's quote nor the quotes of two Phlx XL participants have been submitted within two minutes of the opening trade or quote on the primary market for the underlying security, one Phlx XL participant has submitted their quote.

Once these conditions are satisfied, the system will automatically open the series **immediately** upon the dissemination of an opening trade or quote in the primary market for the underlying.

Under the new rule, the system will delay opening the series for up to five seconds from the dissemination of an opening quote or trade in the primary market for the underlying security or, respecting index options, following the dissemination of a quote or trade by the primary markets for underlying securities constituting 100% of the index value.

The five-second delay should enable Exchange specialists, SQTs and RSQTs to better manage this risk and to maintain fair and orderly markets by pricing options series accurately on the opening. The text of the new rule is set forth below.

Questions concerning the new rule may be addressed 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.

New Rule Text

Brackets indicate deletions; underlining indicates new text.

Openings In Options

Rule 1017. (a) No change.

(b) The system will calculate an Anticipated Opening Price (“AOP”) and Anticipated Opening Size (“AOS”) in equity options when a quote or trade has been disseminated by the primary market for the underlying security, or, in the case of index options, securities, and under the conditions set forth below. The specialist assigned in the particular option must enter opening quotes not later than one minute following the dissemination of a quote or trade by the primary market for the underlying security or, in the case of index options, following the dissemination of a quote or trade by the primary markets for underlying securities constituting 100% of the index value. The system will calculate an AOP and AOS in U.S. dollar-settled FCO under the conditions specified below. The specialist assigned in the particular U.S. dollar-settled FCO must enter opening quotes not later than 30 seconds after the announced market opening. An AOP may only be calculated if: (i) the Exchange has received market orders, or the book is crossed (highest bid is higher than the lowest offer) or locked (highest bid equals the lowest offer); and (ii) either (A) the specialist's quote has been submitted; (B) the quotes of at least two Phlx XL participants have been submitted within two minutes of the opening trade or quote on the primary market for the underlying security in the case of equity options or, in the case of index options, within two minutes of the opening trades or quotes on the primary markets for underlying securities constituting 100% of the index value (or such shorter time as determined by the Options Committee and disseminated to membership via Exchange Circular), or within two minutes of market opening in the case of U.S. dollar-settled FCO (or such shorter time as determined by the FCO Committee and disseminated

to membership via Exchange circular); or (C) if neither the specialist's quote nor the quotes of two Phlx XL participants have been submitted within two minutes of the opening trade or quote on the primary market for the underlying security in the case of equity options or, in the case of index options, within two minutes of the opening trades or quotes on the primary markets for underlying securities constituting 100% of the index value (or such shorter time as determined by the Options Committee and disseminated to membership via Exchange circular), or within two minutes of market opening in the case of U.S. dollar-settled FCO (or such shorter time as determined by the FCO Committee and disseminated to membership via Exchange circular), one Phlx XL participant has submitted their quote.

(iii) When the conditions described in sub-paragraph (b)(i) and in sub-paragraph (b)(ii)(A), (B) or (C) above are satisfied, the system will open the series for trading within a time period not to exceed 5 seconds (as determined by the Exchange and disseminated to membership via Exchange circular) following: (A) respecting equity options, the dissemination of an opening quote or trade in the primary market for the underlying security; or (B) respecting index options, following the dissemination of a quote or trade by the primary markets for underlying securities constituting 100% of the index value.

A Phlx XL participant that submits a quote pursuant to this Rule 1017(b) in any series when the specialist's quote has not been submitted shall 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 participant that submitted such quote shall be obligated to submit quotations pursuant to Rule 1014(b)(ii)(D).

In situations where an AOP may be calculated and there is an order/quote imbalance, the system will immediately send an imbalance notice indicating the imbalance side (buy or sell) and the AOP and AOS (an "Imbalance Notice") to Phlx XL participants provided that, in the case of equity options, the primary market for the underlying security has disseminated the opening quote or trade or, in the case of index options, provided that the primary markets for underlying securities constituting 100% of the index value have disseminated opening quotes or trades. Phlx XL participants that have not submitted opening quotes will then submit their opening quotes, and Phlx XL participants that have submitted opening quotes may submit revised opening quotes; thereafter the system will disseminate an updated Imbalance Notice every five seconds (or such shorter period as determined by the Options Committee and disseminated to membership via Exchange Circular) until the series is open. If no imbalance exists, no Imbalance Notice will be sent, and the system will establish an opening price as described in paragraph (c) below.

(c) – (j) No change.

Commentary: No change.