Exchange believes the benefits to market participants from the more objective clearly erroneous executions rule should be approved to continue on a pilot basis.

2. Statutory Basis

The statutory basis for the proposed rule change is Section 6(b)(5) of the Act,[5] which requires the rules of an exchange 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. The Exchange believes that the proposed rule meets these requirements in that it promotes transparency and uniformity across markets concerning review of transactions as clearly erroneous.

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

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

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

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

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

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act[6] and Rule 19b–4(f)(6)(iii) thereunder.[7] The Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver will allow the pilot program to continue uninterrupted and help ensure uniformity among the national securities exchanges and FINRA with respect to the treatment of clearly erroneous transactions.[8] Accordingly, the Commission waives the 30-day operative delay requirement and designates the proposed rule change as operative upon filing with the Commission.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

**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–EDGX–2010–23 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–EDGX–2010–23. 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 Web site viewing and printing 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 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 publicly available. All submissions should refer to File Number SR–EDGX–2010–23 and should be submitted on or before January 5, 2011.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[9]

**Florence E. Harmon,**

*Deputy Secretary.*

[FR Doc. 2010–31490 Filed 12–14–10; 8:45 am]

**BILLING CODE 8011–01–P**

[5] 15 U.S.C. 78f(b)(5).

[6] 15 U.S.C. 78s(b)(3)(A).

[7] 17 CFR 240.19b–4(f)(6)(iii). In addition, Rule 19b–4(f)(6)(iii) requires that a self- regulatory organization submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the filing of the proposed rule change, or such shorter time as designated by the Commission. The Commission notes that the Exchange has satisfied this requirement.

[8] For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[9] 17 CFR 200.30–3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–63509; File No. SR–Phlx–2010–157]**

## Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Relating to Complex Orders

December 9, 2010.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b–4[2] thereunder, notice is hereby given that on November 29, 2010, NASDAQ OMX PHLX LLC ("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. On December 6, 2010, the Exchange filed Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as modified by Amendment No. 1, from interested persons.

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

[2] 17 CFR 240.19b–4.

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

The Exchange, pursuant to Section 19(b)(1) of the Act [3] and Rule 19b–4 thereunder,[4] proposes to amend Rule 1080.08 to change the following aspects of its Complex Orders System: (i) Permit Complex Orders where one of the components of the Complex Order is the underlying security (stock or Exchange Traded Fund Share ("ETF")); (ii) permit Complex Orders with more than two components; (iii) add a "Do Not Auction" condition for Complex Orders that prevents orders so marked from triggering (or joining) a Complex Order Live Auction; [5] (iv) permit day orders to be sent by certain participants; (v) add an execution priority provision that clarifies execution priority respecting current Complex Orders and establishes the execution priority of the proposed new Complex Orders; and (vi) revise the definition section.

The text of the proposed rule change is available on the Exchange's Website at *http://www.nasdaqtrader.com/micro.aspx?id=PHLXRulefilings*, 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

In 2008, the Exchange automated the handling of Complex Orders on its electronic trading platform for options, Phlx XL.[6] Currently, the Exchange's Complex Orders functionality is limited to Complex Orders consisting solely of two option components. The Exchange proposes to add Complex Orders where one component is the underlying stock or ETF. The Exchange also proposes to permit Complex Orders consisting of up to six components. The purpose of the proposed rule change is to more efficiently handle these new Complex Orders on the Exchange by establishing rules and systems that would enable the Exchange to handle such orders electronically.[7]

Definitions

The Exchange is proposing to revise the definition of Complex Order in Rule 1080.08(a)(i) to provide that a Complex Order is any order involving the simultaneous purchase and/or sale of two or more different options series in the same underlying security, priced at a net debit or credit based on the relative prices of the individual components, for the same account, for the purpose of executing a particular investment strategy.[8] Furthermore, a Complex Order can also be a stock-option order, which is an order to buy or sell a stated number of units of an underlying stock or ETF coupled with the purchase or sale of options contract(s).[9] Accordingly, the Exchange is now permitting one component of a Complex Order to consist of the underlying stock or ETF.[10] A Complex Order with one component that is the underlying stock or ETF is also referred to as a stock-option order. The underlying stock or ETF must be the deliverable for the options component of that Complex Order and represent exactly 100 shares per option for regular way delivery.[11] In the case of Complex Orders with a stock or ETF component, these cannot be executed against orders for the individual legs; stock-option orders in the System can only be executed against other stock-option orders. The Exchange is proposing to state that the maximum number of components will be six, including both options and stock components. For example, under the proposal, a Complex Order could consist of up to five options series plus the underlying security. Or, a Complex Order could consist of up to six options series.

This revision of the definition of a Complex Order is intended to simplify the rule and recognizes that there are many types and permutations possible, as strategies develop and become more sophisticated.[12] As a result of this revision of the definition of a Complex Order, several subparagraphs are being deleted because they are too specific and no longer needed, as they are covered under the new, broader definition; these include the definition of a spread order, a straddle order, a combination order, a ratio order, a collar order, and a tied hedge order.[13]

In Rule 1080.08(a)(ii), the Exchange is also revising the definition of Complex Order Strategy, in addition to moving the pricing language, as explained above, to expressly state in the rule that each such strategy is assigned a strategy identifier by the System.[14] This is intended to make the program clearer in the rules. The Exchange is also proposing to better state that a Complex Order Strategy means a particular combination of components and their ratios to one another.

In conjunction with permitting one of the components of a Complex Order to be the underlying security, the

[3] 15 U.S.C. 78s(b)(1).

[4] 17 CFR 240.19b–4.

[5] *See* Rule 1080.08(e).

[6] Securities Exchange Act Release No. 58361 (August 14, 2008), 73 FR 49529 (August 21, 2008) (SR–Phlx–2008–50). Since that time, the Exchange has enhanced its options trading platform, now known as Phlx XL II. *See* Securities Exchange Act Release No. 59995 (May 28, 2009), 74 FR 26750 (June 3, 2009) (SR–Phlx–2009–32).

[7] Currently, complex orders also trade on the floor of the Exchange pursuant to various rules, including Rule 1033; this proposal does not impact such manual trading.

[8] This includes additional language that provides that a Complex Order is priced at a net debit or credit based on the relative prices of the individual components, which is currently in the definition of Complex Order Strategy in Rule 1080.08(a)(ii), but fits better in the definition of Complex Order.

[9] This definition is similar to ISE Rule 722(a).

[10] The term "stock" is used interchangeably with "underlying security" herein. In addition, in the case of foreign currency options and index options, the underlying cannot be a component of a Complex Order, because such underlying instrument is not a security and instead consists of actual foreign currency and an index, respectively, which are not currently included in the program the Exchange has developed.

[11] Because it must represent exactly 100 shares, there can be no cash component. For example, XRX bought ACS, resulting in an adjusted option trading under the symbol AGY; AGY options settle into 4.935 XRX shares plus $18.60 cash. *See e.g., http://www.theocc.com/components/docs/market-data/infomemos/2010/feb/26947.pdf.* Accordingly, because AGY options settle through delivery of XRX shares and cash rather than AGY shares, it would not possible to enter a AGY stock-option order. Instead, AGY Complex Orders can only consist of options components to be traded on the Exchange.

[12] The ISE has adopted a similar generic provision. *See* Securities Exchange Act Release No. 59021 (November 26, 2008), 73 FR 74545 (December 8, 2008) (SR–ISE–2008–91).

[13] *See* current Phlx Rule 1080.08(a)(i)(A)–(F).

[14] For example, a Complex Order Strategy might be "buy one XYZ January 20 call, sell one XYZ January 20 put." The System would assign this Complex Order Strategy a specific identification number or code that would be used in the System to identify this Complex Order Strategy. Hypothetically, the identification number for this particular Complex Order Strategy could be "Complex Order Strategy #12345." Complex Order Strategy #12345 would have a bid price and an offer price. If an investor wishes to purchase or sell, for example, 10 Complex Order Strategy 12345, such an investor would be bidding for or offering to buy 10 XYZ January 20 calls and sell 10 XYZ January 20 puts. This is not a new feature and was included in the original proposal. *See* Securities Exchange Act Release No. 58361 (August 14, 2008), 73 FR 49529 (August 21, 2008) (SR–Phlx–2008–50).

Exchange proposes to amend subparagraphs (a)(iv) and (vi) to update the definitions of cPBBO and cNBBO, respectively, to include the underlying security. Specifically, both would be amended to state that the best net debit or credit price for a Complex Order Strategy that includes a stock/ETF component includes the national best bid or offer for the underlying security.

The Exchange also proposes to adopt, in new subparagraph (a)(viii), a new order condition called "Do Not Auction," or DNA, which causes an order to not be eligible to begin a Complex Order Live Auction ("COLA").[15] DNA Orders cannot join a COLA in progress. These orders can avoid an auction and, instead, be either executed immediately or cancelled.[16] DNA Orders received prior to the opening or when the Complex Order Strategy is not available for trading will be cancelled. DNA Orders will initially only be available for Complex Orders consisting of more than two option components or where the underlying security is a component; once the Exchange has fully rolled out its enhanced Complex Order System, which will be announced in an Options Trader Alert, DNA Orders will also become available for Complex Orders consisting of two option components.

Priority

The Exchange proposes to clarify and expand upon the trade-through and execution priority provisions applicable to Complex Orders, including the expanded definition of Complex Orders. Accordingly, the Exchange, first, proposes to add to the definitions section of the rule, Rule 1080.08(a), the definition of a conforming ratio. A conforming ratio, in proposed Rule 1080.08(a)(ix), is essentially a permissible ratio, renamed. Specifically, it is where the ratio between the sizes of the options components of a Complex Order is equal to or greater than one-to-three (.333) and less than or equal to three-to-one (3.00). For example, a one-to-two (.5) ratio, a two-to-three (.667) ratio, or a two-to-one (2.00) ratio is a conforming ratio,[17] whereas a one-to-four (.25) ratio or a four-to-one (4.0) ratio is not.[18]

Where one component of the Complex Order is the underlying security, the ratio between any options component and the underlying security component must be eight contracts to 100 shares of the underlying security or less.[19] One example of a two-legged ratio order with a stock component that is conforming is: B 400 GE Dec 16.50 calls, S 400 Dec 17.50 calls and S 12,000 shares of GE at 16.50; after comparing the largest option leg (400) to each 100 lot of shares (100 × 120 = 12,000 shares, or 120 lots of 100), the ratio is 3.33 (400 divided by 120) options per 100 shares, which is less than the maximum allowable 8 options per 100 shares, which is a conforming ratio. In contrast, B 200 GE Dec 16.50 calls, S 400 GE Dec 17.50 calls and S 3,000 shares of GE at 16.50 is a nonconforming ratio, because comparing the largest leg of the options trade (400) to 30 lots of 100 (3,000 shares) equals 13.33 (400 divided by 30) options per 100 shares, which is greater than the maximum allowable 8 options per 100 shares and thus nonconforming. Currently, the same ratio appears in Rule 1080.08(a)(i)(D), within the definition of a Ratio Order; that provision is proposed to be deleted and replaced by the new definition of conforming ratio to make the rule clearer.[20]

Today, Complex Orders consisting of permissible (now called conforming) ratios are excepted from the trade-through prohibitions of the Options Order Protection and Locked/Crossed Market Plan ("Options Linkage Plan"), because the Plan contains an exception for Complex Orders with a certain ratio. Accordingly, these orders can be executed without regard to prices for the individual legs on other exchanges, meaning trading through possibly better prices.[21] The Exchange now proposes to codify this in new subparagraph (c)(iii)(C).

In addition to trade-through provisions, whether a Complex Order has a conforming ratio is also relevant in determining how the Exchange's spread priority rules apply. Today, Rule 1033(d) applies to executions of Complex Orders.[22] Throughout Rule 1080.08, there are cross references to Rule 1033(d), which will now be deleted and replaced with new paragraph (c)(iii), which is the spread priority provision applicable to Complex Orders executed on Phlx XL II. The spread priority provisions in new subparagraph (c)(iii) provide the same priority under the same conditions to a broader class of Complex Orders under this proposal.

Spread priority refers to the priority of orders and quotes on the Exchange's own market and permits part of an eligible Complex Order to have priority over other bids and offers in the marketplace. Today, for a Complex Order consisting of two options components, if the ratio between those options components is a permissible (now called conforming) ratio, then if one option "leg" or component improves the Exchange's market for that option series, then the other option leg can be executed with priority over existing bids/offers (including customers), provided that neither option leg is executed at a price outside of the established bid or offer for that option contract.[23] For example, if a Complex Order is received to buy one option A contract and sell one option B contract for a net debit of .65, where option A has a PBBO of 1.00–1.20 with a 1.00 customer limit order to buy on the book and option B has a PBBO of .45–.50 with a .50 customer limit order to sell on the book, permissible trade prices could be 1.15 for option A and .50 for option B. Option B is allowed to execute at .50 because option A executed at a price that improved the Exchange's market in that option. The application of spread priority to Complex Orders consisting only of options is not changing and will now be covered by new Rule 1080.08(c)(iii)(A).

Furthermore, under this proposal, because Complex Orders with a stock

[15] *See* Rule 1080.08(e).

[16] DNA orders can be marked IOC, which means that the order cannot start an auction (whereas an IOC order can), and get rejected if there is an auction in progress.

[17] One example of a conforming five-legged ratio is: B 100 GE Dec 12.50 calls for 4.00, S 200 GE Dec 15.00 calls for 2.00, B 100 GE Dec 17.50 calls for .60 and also S 100 Dec 17.50/Dec 16.50 put spreads at .60; because the highest volume to the lowest volume is in a ratio of 2:1 (200 versus 100 options), this order is conforming.

[18] One example of a non-conforming five-legged ratio is: B 100 GE Dec 12.50 calls for 4.00, S 200 GE Dec 15.00 calls for 2.00, B 100 GE Dec 17.50 calls for .60 and also S 400 Dec 17.50/Dec 16.50 put spreads at .60; because the highest volume to the lowest volume is in a ratio of 4:1 (400 versus 100 options), this order is not conforming.

[19] These are the same ratios found in ISE Rule 722(a)(4). If the largest option leg versus stock meets the conforming ratio, then, necessarily, all smaller legs would also meet the definition of conforming ratio.

[20] Complex orders consisting of a nonconforming ratio will not be accepted.

[21] *See* Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) Options Linkage Plan at Section 5(b)(viii), which prohibits trading through a better price of another exchange unless an exception applies. Phlx Rule 1084(b)(viii) provides an exception for complex orders. This exception applies to Complex Orders executed as such, and not those executed by legging, such as pursuant to Rule 1080.08(e)(vi)(A).

[22] Exchange Rule 1033(d) affords priority to spread type orders over either the bid or the offer established in the marketplace that is not better than the bids or offers comprising such total credit or debit, provided that, the member executes at least one option leg at a better price than established bid or offer for that option contract AND no option leg is executed at a price outside of the established bid or offer for that option contract.

[23] This applies to both trading in the complex orders automated functionality as well as manual trading on the floor. *See* Rule 1033(d).

component will now be permitted on Phlx XL II, priority provisions similar to Rule 1033 will now also apply to Complex Orders on Phlx XL II where one component is the underlying stock or ETF. Today, this is true for Complex Orders with a stock component executed manually on the trading floor, which are subject to Rule 1033(e). Thus, new subparagraph (c)(iii)(B) will govern the execution priority of the new stock-option Complex Orders on Phlx XL II. Specifically, it provides that where a conforming Complex Order consists of the underlying stock or ETF and one options leg, such options leg does not have priority over bids and offers established in the marketplace, including customer orders. Where a conforming Complex Order consists of the underlying stock or ETF and more than one options leg, the options legs have priority over bids and offers established in the marketplace, including customer orders, if at least one options leg improves the existing market for that option.

For example, where there is a conforming Complex Order to buy 1 option A, sell 1 option B, and sell 50 shares of the underlying stock for a net debit of 9.55 where the PBBO of option A is 1.00–1.20 with a customer 1.00 bid, the PBBO of option B is .40–.50, and the stock NBBO is 20.10–20.20, the following trade prices would be permissible: Option A could execute at 1.00, option B at .45, and the stock at 20.20. Option A is able to trade on the PBBO at the same price as the customer because option B improved the PBBO. The price of the stock portion is not relevant in applying the Exchange's option execution priority rules. As a second example, if a conforming Complex Order consists of only one option component and stock, then the option component may not be allowed to be executed at the same price as any existing bid/offer including customer bids/offers. For example, a conforming Complex Order to sell 1 option A and buy 100 shares, with option A having a PBBO of 2.00–2.20 and the stock having a NBBO of 10.00–10.20, for a net debit of 7.90 could receive the following permissible trade prices: Option A could execute at 2.10 with the stock execution occurring at 10.00. Option A could not execute at 2.20, because the option component does not have priority over existing bids/offers.

Order Entry

Currently, under subparagraph (b)(ii), Streaming Quote Traders ("SQTs"),[24] Remote Streaming Quote Traders ("RSQTs"),[25] non-SQT ROTs,[26] specialists and non-Phlx market makers on another exchange are permitted to enter Complex Orders as IOC only. However, for Complex Orders consisting of more than two option components or where the underlying security is a component, SQTs, RSQTs, non-SQT ROTs, specialists and non-Phlx market makers on another exchange may also enter Day orders;[27] once the Exchange has fully rolled out its enhanced Complex Order System, which will be announced in an Options Trader Alert, Day orders will become available for Complex Orders consisting of two option components. The Exchange expects that adding Day orders here should encourage more orders from this group of participants.

Currently, pursuant to subparagraph (b)(iii), Floor Brokers using the Options Floor Broker Management System may enter Complex Orders into the Exchange's electronic Complex Orders System as Day, GTC or IOC on behalf of non-broker-dealer customers and non-market maker off-floor broker-dealers, and as IOC only on behalf of broker-dealers or affiliates of broker-dealers. The Exchange proposes to amend this subparagraph to reflect that DNA orders and orders with more than two legs or a stock/ETF component (which are new) cannot be entered by Floor Brokers at this time. The Exchange believes that Floor Brokers are able to and use other, non-Exchange systems to access Phlx XL II, such that the FBMS, which is primarily intended to capture brokered orders into the options audit trail system, is not the sole method for them to submit orders to the Exchange. In addition, complex orders can be handled manually on the Exchange trading floor today. The Exchange believes that Floor Brokers are not likely to need or request these changes to FBMS, because they execute far more complex orders in the trading crowd today than through FBMS.

Rule 1080.08(c) currently provides that a Complex Order is eligible to trade only when each component of the Complex Order is open for trading on the Exchange. The Exchange proposes to add the word "option" in certain places in this provision, because one component of a Complex Order can now be the underlying security. The Exchange also proposes to require that the underlying security be open for trading on its primary market[28] if such underlying security is a component of a Complex Order.

Complex Order Processing and Execution

Currently, pursuant to Rule 1080.08(e)(i)(B)(2), a Complex Order that would otherwise be a COLA-eligible order that is received in the System during the final ten seconds of any trading session shall not be COLA-eligible. The Exchange proposes to make this time configurable, not to exceed the current ten seconds. The Exchange will issue an Options Trader Alert when the number of seconds changes.

COLA-eligible orders, COLA Sweeps, and responsive Complex Orders trade first based on the best price or prices available at the end of the COLA Timer. If no COLA Sweeps or responsive Complex Orders for the same Complex Order Strategy as the COLA-eligible order that improve the initial cPBBO were received during the COLA Timer, each component of the COLA-eligible order may trade at the PBBO with existing quotes and/or limit orders on the limit order book for the individual components of the Complex Order, provided that each component is executed such that the components comprise the Complex Order Strategy with the correct ratio for the desired net debit or credit. This is known as "legging," and the Exchange proposes to label subparagraph (e)(vi)(A)(1) as such. The Exchange is proposing to add that legging only occurs where there is no underlying security as a component of the Complex Order. If a COLA-eligible order cannot be filled in its entirety, any remaining balance would be placed on the CBOOK unless the COLA-eligible order has been submitted with other instructions (i.e., cancel).

Currently, Complex Orders are automatically executed against orders on the CBOOK in price priority and in

[24] An SQT is a Registered Options Trader ("ROT") who has received permission from the Exchange to generate and submit options quotations electronically through an electronic interface via an Exchange approved proprietary electronic quoting device in eligible options to which such SQT is assigned. *See* Rule 1014(b)(ii)(A).

[25] 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 options quotations electronically 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* Rule 1014(b)(ii)(B).

[26] A non-SQT ROT is an ROT who is neither an SQT nor an RSQT. *See* Rule 1014(b)(ii)(C).

[27] As a result of adding Day orders for this category of users, the Exchange also proposes to amend Rule 1080.08(f)(i) to eliminate reference to the types of orders on the Complex Limit Order Book, because it is too specific.

[28] The Exchange intends to consider the primary market for the underlying security to be the listing market; if the Exchange determines to use a market other than the listing market, the Exchange will issue an Options Trader Alert announcing any such change.

time priority at the same price, as described in subparagraph (f)(iii). Specifically, a Complex Order resting on the CBOOK will execute automatically against: (i) Quotes or orders on the limit order book for the individual components of the order (allocated in accordance with Exchange Rule 1014(g)(vii), and an SQT or RSQT quoting on all components of the Complex Order will have priority over SQTs and RSQTs quoting a single component, but not over customer orders); or (ii) an incoming marketable Complex Order that does not trigger a COLA Timer, whichever arrives first. At this time, the Exchange proposes to delete the provision that an SQT or RSQT quoting on all components of the Complex Order will have priority over SQTs and RSQTs quoting a single component in order to simplify the allocation process as the Exchange begins to accept more Complex Order types. Instead, an SQT or RSQT quoting on all components of the Complex Order will be on parity with SQTs and RSQTs quoting a single component.[29] This is being deleted from Rule 1080.08(e)(vi)(A)(1), (f)(iii)(A) and (f)(iii)(B)(1). The Exchange is deleting this provision to simplify system processing and does not believe, currently, that the benefits are material or being realized intentionally by participants. Furthermore, in Rule 1080.08(f)(iii), the Exchange proposes to state that the execution against orders on the limit order book for the individual components means the options components, such that "legging" will not occur where any of the components is the underlying security.

The Exchange proposes to add the word "options" in various places where the provision clearly applies only to the options component. For example, in subparagraph (c)(ii), most of the reasons why Complex Orders would not trade on the System relate to the options components. Similarly, in subparagraph (f)(i) governing what orders go on the CBOOK, "options" is being added to several of the provisions.

Underlying Stock/ETF Component

In addition to making the various new references to the underlying stock/ETF as a component of a Complex Order, the Exchange also proposes to adopt new subparagraph (h), which will state that where one component of a Complex Order is the underlying stock/ETF, the Exchange shall electronically communicate the underlying stock/ETF component of a Complex Order to Nasdaq Options Services LLC ("NOS"), its designated broker-dealer, for execution; this occurs once the Phlx trading System determines that a Complex Order trade is possible and at what prices. Specifically, NOS will act as agent for such stock/ETF orders; NOS will match those orders, which always consist of both a buy and sell order for the stock/ETF, because the System has determined that two Complex Orders can trade with each other.[30] NOS will match these orders not on an exchange, but rather "over-the-counter." Accordingly, the Exchange proposes to permit NOS to perform this function, in addition to its approved routing functions.[31]

NOS is a broker-dealer and member of various exchanges and the Financial Industry Regulatory Authority ("FINRA"). As discussed in detail below, NOS, under this proposal, would be responsible for the proper execution, trade reporting and submission to clearing of the stock/ETF trade that is part of a Complex Order. Because these trades will occur off-exchange, the principal regulator is FINRA, rather than Phlx or NASDAQ. Furthermore, NOS is responsible for compliance with FINRA rules generally and is subject to examination by FINRA. Specifically, NOS is subject to NASD Rule 3010,[32] which generally requires that the policies and procedures and supervisory systems be reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable NASD and FINRA rules, including those relating to the misuse of material non-public information. To this end, NOS intends to have in place policies related to confidentiality and the potential for informational advantages relating to its affiliates, intended to protect against the misuse of material nonpublic information.[33]

In addition, because the execution and reporting of the stock/ETF piece will occur otherwise than on this Exchange or any other exchange, it will be handled by NOS pursuant to applicable rules regarding equity trading,[34] including the rules governing trade reporting, trade throughs and short sales. Specifically, NOS will report the trades to the Trade Reporting Facility.[35] Firms that are members of FINRA or the NASDAQ Stock Market ("NASDAQ") are required to have a Uniform Service Bureau/Executing Broker Agreement ("AGU") with NOS in order to trade Complex Orders containing a stock/ETF component. Firms that are not members of FINRA or NASDAQ are required to have a Qualified Special Representative ("QSR") arrangement with NOS in order to trade Complex Orders containing a stock/ETF component. This requirement is codified in proposed Rule 1080.08(a)(i). Accordingly, this process is available to all Phlx member organizations and the stock/ETF component of a Complex Order, once executed, will be properly processed for trade reporting purposes.

With respect to trade throughs, the Exchange believes that the stock/ETF component of a Complex Order is eligible for the Qualified Contingent Trade Exemption from Rule 611(a) of Regulation NMS. A Qualified Contingent Trade is a transaction consisting of two or more component orders, executed as agent or principal, that satisfy the six elements in the Commission's order exempting Qualified Contingent Trades ("QCTs") from the requirements of Rule 611(a),[36] which requires trading centers to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-

[29] This change will initially only apply to Complex Orders consisting of more than two options components or where the underlying stock/ETF is a component; once the Exchange has fully rolled out its enhanced Complex Order System, which will be announced in an Options Trader Alert, it will apply to Complex Orders consisting of two options components.

[30] This is because Complex Orders consisting of the underlying stock or ETF can only trade with other Complex Orders. *See* proposed Rule 1080.08(a)(i), which reads as follows: Stock-option orders can only be executed against other stock-option orders and cannot be executed by the System against orders for the individual components.

[31] Securities Exchange Act Release Nos. 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR–NASDAQ–2007–004 and SR–NASDAQ–2007–080); and 59995 (May 28, 2009), 74 FR 26750 (June 3, 2009) (SR–Phlx–2009–32).

[32] FINRA was created in July 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the NYSE. The FINRA rulebook currently consists of both NASD Rules and certain NYSE Rules that FINRA has incorporated ("Incorporated NYSE Rules").

[33] Similarly, pursuant to Phlx Rule 1080(m)(iii)(C), the Exchange must 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.

[34] *See* Securities Exchange Act Release No. 49023 (January 5, 2004) (SR–ISE–2003–37) ("Once the orders are communicated to the broker-dealer for execution, the broker-dealer has complete responsibility for determining whether the orders may be executed in accordance with all of the rules applicable to execution of equity orders, * * *").

[35] Specifically, the trades will be reported to the FINRA/Nasdaq TRF, which is a facility of FINRA that is operated by The NASDAQ OMX Group, Inc. ("NASDAQ OMX") and utilizes Automated Confirmation Transaction ("ACT") Service technology. *See e.g.,* Securities Exchange Act Release No. 61817 (March 31, 2010) (SR–FINRA–2010–011).

[36] 17 CFR 242.611(a).

throughs.[37] The Exchange believes that the stock/ETF portion of a Complex Order under this proposal complies with all six requirements. Moreover, as explained below, the Phlx trading System will validate compliance with each requirement such that any matched order received by NOS under this proposal has been checked for compliance with the exemption, as follows:

(1) At least one component order is in an NMS stock: The stock/ETF component must be an NMS stock, which is validated by the System;

(2) all components are effected with a product or price contingency that either has been agreed to by the respective counterparties or arranged for by a broker-dealer as principal or agent: A Complex Order, by definition consists of a single net/debit price and this price contingency applies to all the components of the order, such that the stock price computed and sent to NOS allows the stock/ETF order to be executed at the proper net debit/credit price based on the execution price of each of the option legs, which is determined by the Phlx System;

(3) the execution of one component is contingent upon the execution of all other components at or near the same time: Once a Complex Order is accepted and validated by the System, the entire package is processed as a single transaction and each of the option leg and stock/ETF components are simultaneously processed;

(4) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined at the time the contingent order is placed: Complex Orders, upon entry, must have a size for each component and a net debit/credit, which the System validates and processes to determine the ratio between the components; an order is rejected if the net debit/credit price and size are not provided on the order;

(5) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or since cancelled: under this proposal, the stock/ETF component must be the underlying security respecting the option legs, which is validated by the System; and

(6) the transaction is fully hedged (without regard to any prior existing position) as a result of the other components of the contingent trade: Under this proposal, the ratio between the options and stock/ETF must be a conforming ratio (8 contracts per 100 shares), which the System validates, and which under reasonable risk valuation methodologies, means that the stock/ETF position is fully hedged.[38]

Furthermore, proposed Rule 1080.08(a)(i) provides that member organizations may only submit Complex Orders with a stock/ETF component if such orders comply with the Qualified Contingent Trade Exemption. Member organizations submitting such Complex Orders with a stock/ETF component represent that such orders comply with the Qualified Contingent Trade Exemption.[39] Thus, the Exchange believes that Complex Orders consisting of a stock/ETF component will comply with the exemption and that the Phlx trading System will validate such compliance to assist NOS in carrying out its responsibilities as agent for these orders.

With respect to short sale regulation, the proposed handling of the stock/ETF component of a Complex Order under this proposal does not raise any issues of compliance with the currently operative provisions of Regulation SHO.[40] When a Complex Order has a stock/ETF component, member organizations must indicate, pursuant to Regulation SHO, whether that order involves a long or short sale. The System will accept Complex Orders with a stock/ETF component marked to reflect either a long or short position; specifically, orders not marked as buy, sell or sell short will be rejected by the Phlx trading System. The Phlx trading System will electronically deliver the stock/ETF component to NOS for execution. Simultaneous to the options execution on the Phlx trading System, NOS will execute and report the stock/ETF component, which will contain the long or short indication as it was delivered by the member organization to the Phlx trading System. Accordingly, NOS, as a trading center under Rule 201, will be compliant with the requirements of Regulation SHO. Of course, broker-dealers, including both NOS and the member organizations submitting orders to the Phlx with a stock/ETF component, must comply with Regulation SHO; various surveillance and examination regulatory programs check for compliance thereto.

Earlier this year, the Commission amended Rule 201 and Rule 200(g) of Regulation SHO under the Act to adopt a short sale-related circuit breaker that, if triggered, imposes a restriction on the price at which securities may be sold short ("short sale price test restriction"); the amendments to Rule 200(g) provide that a broker-dealer may mark certain qualifying short sale orders "short exempt."[41] Recently, the Commission extended the compliance date for the amendments to Rule 201 and Rule 200(g) until February 28, 2011.[42] Once the new provisions of Regulation SHO become operative, NOS will accept orders marked "short exempt." The Exchange intends to file a proposed rule change addressing the new provisions.

For these reasons, the processing of the stock/ETF component of a Complex Order under this proposal will comply with applicable rules regarding equity trading, including the rules governing trade reporting, trade throughs and short sales. NOS' responsibilities respecting these equity trading rules will be documented in NOS' written policies and procedures. NOS compliance with these policies and procedures is monitored, reviewed, and updated as part of NOS' regular and routine regulatory program.

As part of the execution of the stock/ETF component, the Exchange intends to ensure that the execution price is within the intraday high-low range in that stock at the time the Complex Order is processed and within a certain price range from the current market, which the Exchange will establish in an Options Trader Alert. If the stock price is not within these parameters, the Complex Order is not executable.

The Exchange believes that electronic submission of the stock/ETF piece of the Complex Order should help ensure that the Complex Order, as a whole, is executed timely and at the desired price.[43] In addition, electronic communication eliminates the need for each party to separately manually submit the stock component to a broker-dealer for execution. The Exchange

[37] *See* Securities Exchange Act Release No. 57620 (April 4, 2008), 73 FR 19271 (April 9, 2008) ("QCT Release"). *See also* Securities Exchange Act Release No. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006).

[38] A trading center may demonstrate that an Exempted NMS Stock Transaction is fully hedged under the circumstances based on the use of reasonable risk-valuation methodologies. The release approving the original exemption stated: To effectively execute a contingent trade, its component orders must be executed in full or in ratio at its predetermined spread or ratio * * * "In ratio" clarifies that component orders of a contingent trade do not necessarily have to be executed in full, but any partial executions must be in a predetermined ratio.

[39] *See* Amendment No. 1.

[40] 17 CFR 242.200 *et seq.*

[41] *See* Securities Exchange Act Release No. 61595 (February 26, 2010), 75 FR 11232 (March 10, 2010) ("Rule 201 Adopting Release").

[42] *See* Securities Exchange Act Release No. 63247 (November 4, 2010), 75 FR 68702 (November 9, 2010) (File No. S7–08–09) (Order extending the compliance date until February 28, 2011).

[43] For a similar process, *see* ISE Rule 722.02.

emphasizes that the execution of the stock/ETF portion of a Complex Order will be immediate; the Exchange's System will calculate the stock price based on the net debit/credit price of the Complex Order,[44] while also calculating and determining the appropriate options price(s), all electronically and immediately. The Exchange believes that this is a superior approach and would not require the Exchange to later nullify options trades if the stock price cannot be achieved. Accordingly, the Exchange is not proposing to adopt a rule permitting such option trade nullification, like other exchange rules, because the trade would not occur at a price that required later nullification due to the unavailability of the stock/ETF price.[45] The Exchange further believes that the certainty associated with such electronic calculations and processing should be an attractive feature for users of Complex Orders with a stock or ETF component.

The Exchange also believes that it is appropriate to construct a program wherein its affiliate, NOS, is the exclusive conduit for the execution of the stock/ETF component of a Complex Order under this proposal, similar to the routing functionality of several options and equities exchanges.[46] As a practical matter, complex order programs on other exchanges necessarily involve specific arrangements with a broker-dealer to facilitate prompt execution. NOS does not intend to charge a fee for the execution of the stock/ETF component of a Complex Order, nor does Phlx.[47] The Exchange believes that is consistent with the Act for such an arrangement to involve one broker-dealer, even one that is an affiliate, particularly to offer the aforementioned benefits of a prompt, electronic execution for Complex Orders involving stock/ETFs. Specifically, offering a seamless, automatic execution for both the options and stock/ETF components of a Complex Order is an important feature that should promote just and equitable principles of trade and remove impediments to and perfect the mechanism of a free and open market and a national market system by deeply enhancing the sort of complex order processing available on options exchanges today. Nevertheless, users of Phlx's proposed new Complex Orders system could, in lieu of this proposed arrangement with NOS, choose, instead, the following alternatives: (i) Avoid using Complex Orders that involve stock/ETFs, (ii) use the trading floor manual method of executing complex orders with stock, or (iii) go to another venue, several of which offer a similar feature, as described further below.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act[48] in general, and furthers the objectives of Section 6(b)(5) of the Act[49] 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 enhancing its System and rules governing Complex Orders, by adding additional order types and components. These additional order types and components should provide market participants with trading opportunities more closely aligned with their investment or risk management strategies. Noting that complex orders, including those with a stock/ETF component are widely recognized and utilized by market participants, this proposal to offer new order types and components on an electronic system should provide a more efficient mechanism for carrying out these strategies.

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

The proposed rule change does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Rather, this proposal enhances competition by providing an additional alternative to the existing methods of trading complex orders, including the stock/ETF component, in a single, seamless transaction. Member use of the Exchange's proposed Complex Order processing is entirely voluntary.

The Exchange competes vigorously for complex orders among several options exchanges that offer a stock-option order type. The Exchange's proposed new alternative differs from and competes against existing Complex Order mechanisms by offering fully electronic processing. Existing Complex Order mechanisms at Chicago Board Options Exchange, Incorporated ("CBOE") and International Securities Exchange, LLC ("ISE") offer a similar end result—execution of paired option and stock orders—using different, less automated means.

Market participants that prefer not to use the stock/ETF functionality offered herein through NOS have a variety of alternatives; stock-option orders can be executed on other options exchanges via various electronic methods, on various options trading floors or on the Exchange, without employing a stock/ETF component.

Accordingly, in light of these various alternatives and the keen competition among options exchanges for complex order flow, the processing method selected by the Exchange, including the use of NOS, presents no burden on competition. In fact, the Exchange's proposal will likely promote competition for the most efficient means to execute complex orders with a stock/ETF component. The Exchange fully expects that other exchanges will mimic the proposed processing if it succeeds in attracting order flow for which many markets compete.

*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 45 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 or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

[44] The stock/ETF price is, of course, included within the net debit/credit price of the Complex Order. *See e.g.* examples, *infra,* at 36.

[45] *See e.g.,* ISE Rule 722.02 (A trade of a stock-option order will be automatically cancelled if market conditions prevent the execution of the stock or option leg(s) at the prices necessary to achieve the agreed upon net price.).

[46] *See also* Phlx Rule 985(c)(1), which provides that The NASDAQ OMX Group, Inc., which owns NOS and the Exchange, shall establish and maintain procedures and internal controls reasonably designed to ensure that NOS does not develop or implement changes to its system on the basis of non-public information regarding planned changes to the Exchange's systems, obtained as a result of its affiliation with the Exchange, until such information is available generally to similarly situated Exchange members and member organizations in connection with the provision of inbound routing to the Exchange.

[47] However, Trade Reporting Facility and clearing fees, not charged by Phlx or NOS, may result. NSCC and ACT will bill firms directly for their use of the NSCC and ACT systems, respectively. To the extent that NOS is billed by NSCC or ACT, it will not pass through such fees to firms for the stock/ETF portion of a Complex Order under this proposal. Phlx's fees applicable to Complex Orders appear in its Fee Schedule and may change from time to time.

[48] 15 U.S.C. 78f(b).

[49] 15 U.S.C. 78f(b)(5).

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as modified by Amendment No. 1, 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–2010–157 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–2010–157. 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 website viewing and printing 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 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–2010–157 and should be submitted on or before January 5, 2011.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[50]

**Florence E. Harmon,**

*Deputy Secretary.*

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[50] 17 CFR 200.30–3(a)(12).

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–63488; File No. SR–BATS–2010–036]**

## Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Extend Pilot Program Related To Clearly Erroneous Execution Reviews

December 9, 2010.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on December 2, 2010, BATS Exchange, Inc. (the "Exchange" or "BATS") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II 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 is filing with the Commission a proposal to extend a pilot program previously approved by the Commission related to Rule 11.17, entitled "Clearly Erroneous Executions." The Exchange proposes to extend both pilot programs through April 11, 2011.

The text of the proposed rule change is available at the Exchange's Web site at *http://www.batstrading.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 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 parts 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 this filing is to extend the effectiveness of the Exchange's current rule applicable to Clearly Erroneous Executions, Rule 11.17. The rule, explained in further detail below, was approved to operate under a pilot program set to expire on December 10, 2010. The Exchange proposes to extend the pilot program to April 11, 2011.

On September 10, 2010, the Commission approved, on a pilot basis, changes to BATS Rule 11.17 to provide for uniform treatment: (1) Of clearly erroneous execution reviews in multi-stock events involving twenty or more securities; and (2) in the event transactions occur that result in the issuance of an individual stock trading pause by the primary market and subsequent transactions that occur before the trading pause is in effect on the Exchange.[3] The Exchange also adopted additional changes to Rule 11.17 that reduced the ability of the Exchange to deviate from the objective standards set forth in Rule 11.17.[4] The Exchange believes the benefits to market participants from the more objective clearly erroneous executions rule should be approved to continue on a pilot basis.

2. Statutory Basis

The Exchange believes that its proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.[5] In particular, the proposal is consistent with Section 6(b)(5) of the Act,[6] because it would promote just and equitable principles of trade, remove impediments to, and perfect the mechanism of, a free and open market and a national market system. The Exchange believes that the pilot program promotes just and equitable principles of trade in that it promotes transparency and uniformity across

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

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 62886 (September 10, 2010), 75 FR 56613 (September 16, 2010) (SR–BATS–2010–016).

[4] *Id.*

[5] 15 U.S.C. 78f(b).

[6] 15 U.S.C. 78f(b)(5).