

Required fields are shown with yellow backgrounds and asterisks.

Filing by NASDAQ OMX PHLX LLC.  
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) *
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
			Rule		
Pilot	Extension of Time Period for Commission Action *	Date Expires *	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="text"/>	<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 Section 806(e)(1) <input type="checkbox"/> Section 806(e)(2) <input type="checkbox"/>	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 Section 3C(b)(2) <input type="checkbox"/>
----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	-----------------------------------------------------------------------------------------------------------------------------

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
-----------------------------------------------------------	-----------------------------------------------------------

**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

A proposal to provide for how the Exchange will treat obvious and catastrophic options errors in response to the Regulation NMS Plan to Address Extraordinary Market Volatility.

**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 action.

First Name * Edith	Last Name * Hallahan
Title * Principal Associate General Counsel	
E-mail * edith.hallahan@nasdaqomx.com	
Telephone * (215) 496-5179	Fax

**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.

(Title \*)

Date 03/11/2013	Executive Vice President and General Counsel
By Edward S. Knight	<div style="border: 1px solid black; width: 100%; height: 20px;"></div>
(Name *)	<div style="border: 1px solid black; width: 100%; height: 20px; background-color: #ccc;">Edward S Knight,</div>

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.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies**

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

Add Remove View

Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

Add Remove View

Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

Add Remove View

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 Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder<sup>2</sup>, NASDAQ OMX PHLX LLC ("Exchange" or "Phlx"), is filing with the Securities and Exchange Commission ("Commission") a proposed rule change to adopt new Exchange Rule 1047(f)(v) to provide for how the Exchange proposes to treat obvious and catastrophic options errors in response to the Regulation NMS Plan to Address Extraordinary Market Volatility.

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 below. Proposed new language is underlined.

\* \* \* \* \*

**Rule 1047. Trading Rotations, Halts and Suspensions**

(a) – (e) No change.

(f) This paragraph shall be in effect during a pilot period to coincide with the pilot period for the Plan to Address Extraordinary Market Volatility Pursuant to Rule 608 of Regulation NMS, as it may be amended from time to time ("LULD Plan"). Capitalized terms used in this paragraph shall have the same meaning as provided for in the LULD Plan. During a Limit State and Straddle State in the Underlying NMS stock:

(i) - (iv) No change.

(v) Trades are not subject to an obvious error or catastrophic error review:

(I) pursuant to Rule 1092(b)(ii);

(II) pursuant to Rule 1092(c)(ii)(E); or

(III) pursuant to Rule 1092(b)(i).

(g) No change.

---

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

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

**••• Commentary :**

**.01 - .03** No change.

\* \* \* \* \*

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of the Exchange on February 22, 2013. No other action by the Exchange is necessary for the filing of the rule change.

Questions regarding this rule filing may be directed to Edith Hallahan, Principal Associate General Counsel, The NASDAQ OMX Group, Inc., 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 Exchange proposes to adopt Exchange Rule 1047(f)(v) to provide for how the Exchange will treat options obvious and catastrophic options errors in response to the Regulation NMS Plan to Address Extraordinary Market Volatility (the "Plan"), which is applicable to all NMS stocks, as defined in Regulation NMS Rule 600(b)(47). The Exchange proposes to adopt new Rule 1047(f)(v) for a pilot period that coincides with the pilot period for the Plan.<sup>3</sup>

Background

Since May 6, 2010, when the markets experienced excessive volatility in an abbreviated time period, i.e., the "flash crash," the equities exchanges and the Financial

---

<sup>3</sup> The Exchange will provide the Commission with data and analysis during the duration of this pilot.

Industry Regulatory Authority (“FINRA”) have implemented market-wide measures designed to restore investor confidence by reducing the potential for excessive market volatility. Among the measures adopted include pilot plans for stock-by-stock trading pauses,<sup>4</sup> related changes to the equities market clearly erroneous execution rules,<sup>5</sup> and more stringent equities market maker quoting requirements.<sup>6</sup> On May 31, 2012, the Commission approved the Plan, as amended, on a one-year pilot basis.<sup>7</sup> In addition, the Commission approved changes to the equities market-wide circuit breaker rules on a pilot basis to coincide with the pilot period for the Plan.<sup>8</sup>

The Plan is designed to prevent trades in individual NMS stocks from occurring outside of specified Price Bands.<sup>9</sup> As described more fully below, the requirements of the Plan are coupled with Trading Pauses to accommodate more fundamental price moves (as opposed to erroneous trades or momentary gaps in liquidity). All trading centers in NMS stocks, including both those operated by Participants and those operated by members of Participants, are required to establish, maintain, and enforce written policies and

---

<sup>4</sup> See e.g., Exchange Rule 3100.

<sup>5</sup> See e.g., Exchange Rule 3312.

<sup>6</sup> See e.g., NASDAQ Rule 4613.

<sup>7</sup> See Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (File No. 4-631) (Order Approving the Plan on a Pilot Basis).

<sup>8</sup> See Securities Exchange Act Release No. 67090 (May 31, 2012), 77 FR 33531 (June 6, 2012) (SR-BATS-2011-038; SR-BYX-2011-025; SR-BX-2011-068; SR-CBOE-2011-087; SR-C2-2011-024; SR-CHX-2011-30; SR-EDGA-2011-31; SR-EDGX-2011-30; SR-FINRA-2011-054; SR-ISE-2011-61; SR-NASDAQ-2011-131; SR-NSX-2011-11; SR-NYSE-2011-48; SR-NYSEAmex-2011-73; SR-NYSEArca-2011-68; SR-Phlx-2011-129).

<sup>9</sup> Unless otherwise specified, capitalized terms used in this rule filing are based on the defined terms of the Plan.

procedures that are reasonably designed to comply with the requirements specified in the Plan.

As set forth in more detail in the Plan, Price Bands consisting of a Lower Price Band and an Upper Price Band for each NMS Stock are calculated by the Processors.<sup>10</sup> When the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band, the Processors shall disseminate such National Best Bid (Offer) with an appropriate flag identifying it as unexecutable. When the National Best Bid (Offer) is equal to the Upper (Lower) Price Band, the Processors shall distribute such National Best Bid (Offer) with an appropriate flag identifying it as a Limit State Quotation.<sup>11</sup> All trading centers in NMS stocks must maintain written policies and procedures that are reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for NMS stocks. Notwithstanding this requirement, the Processor shall display an offer below the Lower Price Band or a bid above the Upper Price Band, but with a flag that it is non-executable. Such bids or offers shall not be included in the National Best Bid or National Best Offer calculations.<sup>12</sup> Trading in an NMS stock immediately enters a Limit State if the National Best Offer (Bid) equals but does not cross the Lower (Upper) Price Band.<sup>13</sup> Trading for an NMS stock exits a Limit State if, within 15 seconds of entering the Limit State, all Limit State Quotations were executed or canceled in their entirety. If the market does not exit a Limit State within 15 seconds, then the Primary

---

<sup>10</sup> See Section V(A) of the Plan.

<sup>11</sup> See Section VI(A) of the Plan.

<sup>12</sup> See Section VI(A)(3) of the Plan.

<sup>13</sup> See Section VI(B)(1) of the Plan.

Listing Exchange would declare a five-minute trading pause pursuant to Section VII of the Plan, which would be applicable to all markets trading the security.<sup>14</sup> In addition, the Plan defines a Straddle State as when the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band and the NMS stock is not in a Limit State. For example, assume the Lower Price Band for an NMS Stock is \$9.50 and the Upper Price Band is \$10.50, such NMS stock would be in a Straddle State if the National Best Bid were below \$9.50, and therefore unexecutable, and the National Best Offer were above \$9.50 (including a National Best Offer that could be above \$10.50). If an NMS stock is in a Straddle State and trading in that stock deviates from normal trading characteristics, the Primary Listing Exchange may declare a trading pause for that NMS stock if such Trading Pause would support the Plan's goal to address extraordinary market volatility.

#### Proposal

The Exchange proposes to adopt new subparagraph (f)(v) to provide that trades are not subject to an obvious error and catastrophic error review if: (i) pursuant to Rule 1092(b)(ii), there was no quote for comparison purposes or the bid/ask differential was wide; (ii) pursuant to Rule 1092(c)(ii)(E), the trade resulted in an execution price in a series quoted no bid; or (iii) the trade occurred at a price that is deemed to be an obvious or catastrophic error pursuant to Rule 1092(a) based on a Theoretical Price determined pursuant to Rule 1092(b)(i).

---

<sup>14</sup> The primary listing market would declare a Trading Pause in an NMS stock; upon notification by the primary listing market, the Processor would disseminate this information to the public. No trades in that NMS stock could occur during the trading pause, but all bids and offers may be displayed. See Section VII(A) of the Plan.

Nevertheless, trades will continue to be subject to an obvious error or catastrophic error review in a Limit State or Straddle State if:

- (A) The trade resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system that caused a quote/order to trade in excess of its disseminated size (e.g. a quote/order that is frozen, because of an Exchange system error, and repeatedly traded) in which case trades in excess of the disseminated size may be nullified;<sup>15</sup> or
- (B) The trade resulted from a verifiable disruption or malfunction of an Exchange dissemination or communication system that prevented a member from updating or canceling a quote/order for which the member is responsible where there is Exchange documentation providing that the member sought to update or cancel the quote/order;<sup>16</sup> or
- (C) The trade resulted from an erroneous print disseminated by the underlying market which is later cancelled or corrected by the underlying market where such erroneous print resulted in a trade higher or lower than the average trade in the underlying security during the time period encompassing two minutes before and after the erroneous print, by an amount at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after the erroneous print. For purposes of this Rule, the average

---

<sup>15</sup> See Rule 1092(c)(ii)(A).

<sup>16</sup> See Rule 1092(c)(ii)(B).

trade in the underlying security shall be determined by adding the prices of each trade during the four minute time period referenced above (excluding the trade in question) and dividing by the number of trades during such time period (excluding the trade in question);<sup>17</sup> or

- (D) The trade resulted from an erroneous quote in the Primary Market for the underlying security that has a width of at least \$1.00 and that width is at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after the dissemination of such quote. For the purposes of this Rule, the average quote width shall be determined by adding the quote widths of sample quotations at regular 15-second intervals during the four minute time period referenced above (excluding the quote in question) and dividing by the number of quotes during such time period (excluding the quote in question).<sup>18</sup>

Currently, Rule 1092 governs obvious and catastrophic errors in options.

Obvious errors are calculated under the rule by determining a theoretical price and determining, based on objective standards, whether the trade should be nullified or

adjusted. The rule also contains a process for requesting an obvious error review.

Certain more substantial errors may fall under the category of a catastrophic error, for which a longer time period is permitted to request a review and for which trades can

---

<sup>17</sup> See Rule 1092(c)(ii)(C).

<sup>18</sup> See Rule 1092(c)(ii)(D).

currently only be adjusted (not nullified).<sup>19</sup> Trades are adjusted pursuant to an adjustment table that, in effect, assesses an adjustment penalty. By adjusting trades above or below the theoretical price, the Rule assesses a “penalty” in that the adjustment price is not as favorable as the amount the party making the error would have received had it not made the error.

Pursuant to Rule 1092(b), the Theoretical Price of an option is determined in one of three ways: (i) if the series is traded on at least one other options exchange, the last National Best Bid price with respect to an erroneous sell transaction and the last National Best Offer price with respect to an erroneous buy transaction, just prior to the trade; (ii) if there are no quotes for comparison purposes, or if the bid/ask differential of the National Best Bid and Offer ("NBBO") for the affected series, just prior to the erroneous transaction, was at least two times the permitted bid/ask differential under Rule 1014(c)(i)(A)(1)(a), as determined by an Options Exchange Official; or (iii) for transactions occurring as part of the Exchange’s automated opening system, the Theoretical Price shall be the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s).

The Exchange recognizes that the second method affords discretion to the Options Exchange Official in determining the theoretical price and thereby, ultimately, whether a trade is busted or adjusted and to what price. The Exchange has determined that it would be difficult to exercise such discretion in periods of extraordinary market volatility and in particular when the price of the underlying security is unreliable. Moreover, the theoretical price would be subjective. Thus, the Exchange has determined not to permit

---

<sup>19</sup> But see SR-Phlx-2013-05.

an obvious or catastrophic error review if there are no quotes for comparison purposes, or if the bid/ask differential of the NBBO for the affected series, just prior to the erroneous transaction, was at least two times the permitted bid/ask differential. The Exchange believes that adding certainty to the execution of orders in these situations should encourage market participants to continue to provide liquidity to the Exchange and thus promote a fair and orderly market.

In addition, the Exchange proposes to provide that trades are not subject to an obvious error and catastrophic error review if pursuant to Rule 1092(c)(ii)(E) the trade resulted from an execution price in a series quoted no bid. Specifically, under this provision, where the trade resulted in an execution price in a series quoted no bid and for 5 seconds prior to the execution remained no bid (excluding the quote in question; bids and offers of the parties to the subject trade that are in any of the series in the same options class shall not be considered) *and* at least one strike price below (for calls) or above (for puts) in the same class were quoted no bid at the time of the erroneous execution (in which case the trade shall be nullified). The Exchange believes that these situations are not appropriate for an error review because they are more likely to result in a windfall to one party at the expense of another, in a Limit State or Straddle State, because the criteria for meeting the no-bid provision are more likely to be met in a Limit State or Straddle State, and unlike normal circumstances, may not be a true reflection of the value of the series being quoted. For example, in a series quoted \$1.95-\$2.00 on multiple exchanges prior to the Limit or Straddle State, an order to B10@ \$2.00 is likely a reasonably priced trade because the buyer attempted to pay \$2.00 with a limit price. However, if that series and the series one strike below are both quoted \$0.00- \$5.00, then

both the seller and the buyer at \$2.00 would have an opportunity to dispute the trade.

This would create uncertainty to both parties and an advantage to one participant if the underlying stock moved significantly in their direction.

Lastly, the Exchange proposes to provide that trades are not subject to an obvious error and catastrophic error review if the trade occurred at a price that is deemed to be an obvious or catastrophic error pursuant to Rule 1092(a) based on a Theoretical Price determined pursuant to Rule 1092(b)(i). Specifically, if the execution price was higher than the National Best Bid for sell orders (or lower than the National Best Offer for buy orders) by an amount greater than the amounts in Rule 1092(a), there would be no obvious or catastrophic error if the underlying security is in a Limit State or Straddle State. The Exchange believes that this is appropriate because while in a Limit or Straddle State, only limit orders will be accepted by the Exchange, affirming that the participant is willing to accept an execution up to the limit price. Further, because the Exchange system will only trade through the Theoretical bid or offer if the Exchange or the participant (via an ISO order) has accessed all better priced interest away in accordance the Options Order Protection and Locked/Crossed Markets Plan, the Exchange believes potential trade reviews of executions that occurred at the participant's limit price and also in compliance with aforementioned Plan could result in uncertainty that could harm liquidity and also could create an advantage to either side of an execution depending on the future movement of the underlying stock.

#### Purpose

When Rule 1092 was first adopted, the Commission stated that it "...considers that in most circumstances trades that are executed between parties should be honored. On

rare occasions, the price of the executed trade indicates an ‘obvious error’ may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission’s view, the determination of whether an ‘obvious error’ has occurred, and the adjustment or nullification of a transaction because an obvious error is considered to exist, should be based on specific and objective criteria and subject to specific and objective procedures... The Commission believes that Phlx’s proposed obvious error rule establishes specific and objective criteria for determining when a trade is an ‘obvious error.’ Moreover, the Commission believes that the Exchange’s proposal establishes specific and objective procedures governing the adjustment or nullification of a trade that resulted from an ‘obvious error.’”<sup>20</sup>

In 2008, the Exchange amended Rule 1092 to adopt the catastrophic error provision. In doing so, the Exchange stated that it had “...weighed carefully the need to assure that one market participant is not permitted to receive a windfall at the expense of another market participant that made an Obvious Error, against the need to assure that market participants are not simply being given an opportunity to reconsider poor trading decisions. The Exchange states that, while it believes that the Obvious Error Rule strikes the correct balance in most situations, in some extreme situations, trade participants may not be aware of errors that result in very large losses within the time periods currently required under the rule. In this type of extreme situation, the Exchange believes its members should be given more time to seek relief so that there is a greater opportunity to mitigate very large losses and reduce the corresponding large wind-falls. However, to

---

<sup>20</sup> See Securities Exchange Act Release No. 49785 (May 28, 2004), 69 FR 32090 (June 8, 2004) (SR-Phlx-2003-68).

maintain the appropriate balance, the Exchange believes members should only be given more time when the execution price is much further away from the theoretical price than is required for Obvious Errors so that relief is only provided in extreme circumstances.”<sup>21</sup>

The Exchange believes that this proposal is consistent with those principles because it strikes the aforementioned balance. The Exchange is proposing to decline to review certain trades, which is specific and objective. Furthermore, the proposal more fairly balances the potential windfall to one market participant against the potential reconsideration of a trading decision under the guise of an error, and thereby results in more certainty during periods of extreme market volatility. Trades are nevertheless subject to an obvious error or catastrophic review under other sections of the Rule, because those continue to be an objective method of determining the value of an option, even during periods of extraordinary market volatility.

b. Statutory Basis

The Exchange believes the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>22</sup> in general and with Section 6(b)(5) of the Act,<sup>23</sup> in particular, which requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, remove

---

<sup>21</sup> See Securities Exchange Act Release No. 58002 (June 23, 2008), 73 FR 36581 (June 27, 2008)(SR-Phlx-2008-42)(Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Catastrophic Errors).

<sup>22</sup> 15 U.S.C. 78f.

<sup>23</sup> 15 U.S.C. 78f(b)(5).

impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest, because it should provide certainty about how errors involving options orders and trades will be handled during periods of extraordinary volatility in the underlying security. The Exchange believes that this proposal regarding obvious and catastrophic errors should protect investors and the public interest by ensuring that Exchange officials do not have discretion with respect to handling such errors, thereby providing greater certainty to participants, and by ensuring that the aforementioned balance does not result in an inappropriate windfall to one party.

Accordingly, the Exchange believes that the proposed rule change is consistent with these requirements in that it should reduce the negative impacts of sudden, unanticipated volatility in individual options, and serve to preserve an orderly market in a transparent and uniform manner, enhance the price-discovery process, increase overall market confidence, and promote fair and orderly markets and the protection of investors.

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

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. Specifically, the proposal does not impose an intra-market burden on competition, because it will apply to all members. Nor will the proposal impose a burden on competition among the options exchanges, because, in addition to the vigorous competition for order flow among the options exchanges, the proposal addresses a regulatory situation common to all options exchanges. To the extent that market participants disagree with the particular approach taken by the Exchange herein, market participants can easily and readily direct order flow to competing venues. The Exchange

believes this proposal will not impose a burden on competition and will help provide certainty during periods of extraordinary volatility in an NMS stock.

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

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

Not applicable.

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

Not applicable.

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

The proposal is similar to SR-NYSEMKT-2013-10, except that NYSE MKT will not conduct obvious or catastrophic error reviews during such a state, while the Exchange will in certain circumstances.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advanced Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

1. Completed notice of proposed rule change for publication in the Federal

Register.

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. \_\_\_\_\_ ; File No. SR-Phlx-2013-25)

March \_\_, 2013

Self-Regulatory Organizations; NASDAQ OMX PHLX LLC; Notice of Filing of Proposed Rule Change to Address Obvious and Catastrophic Options Errors in Response to the Regulation NMS Plan to Address Extraordinary Market Volatility

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 11, 2013, 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. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to adopt new Exchange Rule 1047(f)(v) to provide for how the Exchange proposes to treat obvious and catastrophic options errors in response to the Regulation NMS Plan to Address Extraordinary Market Volatility.

The text of the proposed rule change is below; proposed new language is underlined.

\* \* \* \* \*

**Rule 1047. Trading Rotations, Halts and Suspensions**

(a) – (e) No change.

---

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

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

(f) This paragraph shall be in effect during a pilot period to coincide with the pilot period for the Plan to Address Extraordinary Market Volatility Pursuant to Rule 608 of Regulation NMS, as it may be amended from time to time (“LULD Plan”). Capitalized terms used in this paragraph shall have the same meaning as provided for in the LULD Plan. During a Limit State and Straddle State in the Underlying NMS stock:

(i) - (iv) No change.

(v) Trades are not subject to an obvious error or catastrophic error review:

(I) pursuant to Rule 1092(b)(ii);

(II) pursuant to Rule 1092(c)(ii)(E); or

(III) pursuant to Rule 1092(b)(i).

(g) No change.

••• **Commentary :**

**.01 - .03** No change.

\* \* \* \* \*

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

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

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

1. Purpose

The Exchange proposes to adopt Exchange Rule 1047(f)(v) to provide for how the Exchange will treat options obvious and catastrophic options errors in response to the Regulation NMS Plan to Address Extraordinary Market Volatility (the “Plan”), which is applicable to all NMS stocks, as defined in Regulation NMS Rule 600(b)(47). The Exchange proposes to adopt new Rule 1047(f)(v) for a pilot period that coincides with the pilot period for the Plan.<sup>3</sup>

Background

Since May 6, 2010, when the markets experienced excessive volatility in an abbreviated time period, i.e., the “flash crash,” the equities exchanges and the Financial Industry Regulatory Authority (“FINRA”) have implemented market-wide measures designed to restore investor confidence by reducing the potential for excessive market volatility. Among the measures adopted include pilot plans for stock-by-stock trading pauses,<sup>4</sup> related changes to the equities market clearly erroneous execution rules,<sup>5</sup> and more stringent equities market maker quoting requirements.<sup>6</sup> On May 31, 2012, the Commission approved the Plan, as amended, on a one-year pilot basis.<sup>7</sup> In addition, the

---

<sup>3</sup> The Exchange will provide the Commission with data and analysis during the duration of this pilot.

<sup>4</sup> See e.g., Exchange Rule 3100.

<sup>5</sup> See e.g., Exchange Rule 3312.

<sup>6</sup> See e.g., NASDAQ Rule 4613.

<sup>7</sup> See Securities Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (File No. 4-631) (Order Approving the Plan on a Pilot Basis).

Commission approved changes to the equities market-wide circuit breaker rules on a pilot basis to coincide with the pilot period for the Plan.<sup>8</sup>

The Plan is designed to prevent trades in individual NMS stocks from occurring outside of specified Price Bands.<sup>9</sup> As described more fully below, the requirements of the Plan are coupled with Trading Pauses to accommodate more fundamental price moves (as opposed to erroneous trades or momentary gaps in liquidity). All trading centers in NMS stocks, including both those operated by Participants and those operated by members of Participants, are required to establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with the requirements specified in the Plan.

As set forth in more detail in the Plan, Price Bands consisting of a Lower Price Band and an Upper Price Band for each NMS Stock are calculated by the Processors.<sup>10</sup> When the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band, the Processors shall disseminate such National Best Bid (Offer) with an appropriate flag identifying it as unexecutable. When the National Best Bid (Offer) is equal to the Upper (Lower) Price Band, the Processors shall distribute such National Best Bid (Offer) with

---

<sup>8</sup> See Securities Exchange Act Release No. 67090 (May 31, 2012), 77 FR 33531 (June 6, 2012) (SR-BATS-2011-038; SR-BYX-2011-025; SR-BX-2011-068; SR-CBOE-2011-087; SR-C2-2011-024; SR-CHX-2011-30; SR-EDGA-2011-31; SR-EDGX-2011-30; SR-FINRA-2011-054; SR-ISE-2011-61; SR-NASDAQ-2011-131; SR-NSX-2011-11; SR-NYSE-2011-48; SR-NYSEAmex-2011-73; SR-NYSEArca-2011-68; SR-Phlx-2011-129).

<sup>9</sup> Unless otherwise specified, capitalized terms used in this rule filing are based on the defined terms of the Plan.

<sup>10</sup> See Section V(A) of the Plan.

an appropriate flag identifying it as a Limit State Quotation.<sup>11</sup> All trading centers in NMS stocks must maintain written policies and procedures that are reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for NMS stocks. Notwithstanding this requirement, the Processor shall display an offer below the Lower Price Band or a bid above the Upper Price Band, but with a flag that it is non-executable. Such bids or offers shall not be included in the National Best Bid or National Best Offer calculations.<sup>12</sup> Trading in an NMS stock immediately enters a Limit State if the National Best Offer (Bid) equals but does not cross the Lower (Upper) Price Band.<sup>13</sup> Trading for an NMS stock exits a Limit State if, within 15 seconds of entering the Limit State, all Limit State Quotations were executed or canceled in their entirety. If the market does not exit a Limit State within 15 seconds, then the Primary Listing Exchange would declare a five-minute trading pause pursuant to Section VII of the Plan, which would be applicable to all markets trading the security.<sup>14</sup> In addition, the Plan defines a Straddle State as when the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band and the NMS stock is not in a Limit State. For example, assume the Lower Price Band for an NMS Stock is \$9.50 and the Upper Price Band is \$10.50, such NMS stock would be in a Straddle State if the National Best Bid were below

---

<sup>11</sup> See Section VI(A) of the Plan.

<sup>12</sup> See Section VI(A)(3) of the Plan.

<sup>13</sup> See Section VI(B)(1) of the Plan.

<sup>14</sup> The primary listing market would declare a Trading Pause in an NMS stock; upon notification by the primary listing market, the Processor would disseminate this information to the public. No trades in that NMS stock could occur during the trading pause, but all bids and offers may be displayed. See Section VII(A) of the Plan.

\$9.50, and therefore unexecutable, and the National Best Offer were above \$9.50 (including a National Best Offer that could be above \$10.50). If an NMS stock is in a Straddle State and trading in that stock deviates from normal trading characteristics, the Primary Listing Exchange may declare a trading pause for that NMS stock if such Trading Pause would support the Plan's goal to address extraordinary market volatility.

#### Proposal

The Exchange proposes to adopt new subparagraph (f)(v) to provide that trades are not subject to an obvious error and catastrophic error review if: (i) pursuant to Rule 1092(b)(ii), there was no quote for comparison purposes or the bid/ask differential was wide; (ii) pursuant to Rule 1092(c)(ii)(E), the trade resulted in an execution price in a series quoted no bid; or (iii) the trade occurred at a price that is deemed to be an obvious or catastrophic error pursuant to Rule 1092(a) based on a Theoretical Price determined pursuant to Rule 1092(b)(i).

Nevertheless, trades will continue to be subject to an obvious error or catastrophic error review in a Limit State or Straddle State if:

- (A) The trade resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system that caused a quote/order to trade in excess of its disseminated size (e.g. a quote/order that is frozen, because of an Exchange system error, and repeatedly traded) in which case trades in excess of the disseminated size may be nullified;<sup>15</sup> or

---

<sup>15</sup> See Rule 1092(c)(ii)(A).

- (B) The trade resulted from a verifiable disruption or malfunction of an Exchange dissemination or communication system that prevented a member from updating or canceling a quote/order for which the member is responsible where there is Exchange documentation providing that the member sought to update or cancel the quote/order;<sup>16</sup> or
- (C) The trade resulted from an erroneous print disseminated by the underlying market which is later cancelled or corrected by the underlying market where such erroneous print resulted in a trade higher or lower than the average trade in the underlying security during the time period encompassing two minutes before and after the erroneous print, by an amount at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after the erroneous print. For purposes of this Rule, the average trade in the underlying security shall be determined by adding the prices of each trade during the four minute time period referenced above (excluding the trade in question) and dividing by the number of trades during such time period (excluding the trade in question);<sup>17</sup> or
- (D) The trade resulted from an erroneous quote in the Primary Market for the underlying security that has a width of at least \$1.00 and that width is at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after

---

<sup>16</sup> See Rule 1092(c)(ii)(B).

<sup>17</sup> See Rule 1092(c)(ii)(C).

the dissemination of such quote. For the purposes of this Rule, the average quote width shall be determined by adding the quote widths of sample quotations at regular 15-second intervals during the four minute time period referenced above (excluding the quote in question) and dividing by the number of quotes during such time period (excluding the quote in question).<sup>18</sup>

Currently, Rule 1092 governs obvious and catastrophic errors in options. Obvious errors are calculated under the rule by determining a theoretical price and determining, based on objective standards, whether the trade should be nullified or adjusted. The rule also contains a process for requesting an obvious error review. Certain more substantial errors may fall under the category of a catastrophic error, for which a longer time period is permitted to request a review and for which trades can currently only be adjusted (not nullified).<sup>19</sup> Trades are adjusted pursuant to an adjustment table that, in effect, assesses an adjustment penalty. By adjusting trades above or below the theoretical price, the Rule assesses a “penalty” in that the adjustment price is not as favorable as the amount the party making the error would have received had it not made the error.

Pursuant to Rule 1092(b), the Theoretical Price of an option is determined in one of three ways: (i) if the series is traded on at least one other options exchange, the last National Best Bid price with respect to an erroneous sell transaction and the last National Best Offer price with respect to an erroneous buy transaction, just prior to the trade; (ii) if

---

<sup>18</sup> See Rule 1092(c)(ii)(D).

<sup>19</sup> But see SR-Phlx-2013-05.

there are no quotes for comparison purposes, or if the bid/ask differential of the National Best Bid and Offer ("NBBO") for the affected series, just prior to the erroneous transaction, was at least two times the permitted bid/ask differential under Rule 1014(c)(i)(A)(1)(a), as determined by an Options Exchange Official; or (iii) for transactions occurring as part of the Exchange's automated opening system, the Theoretical Price shall be the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s).

The Exchange recognizes that the second method affords discretion to the Options Exchange Official in determining the theoretical price and thereby, ultimately, whether a trade is busted or adjusted and to what price. The Exchange has determined that it would be difficult to exercise such discretion in periods of extraordinary market volatility and in particular when the price of the underlying security is unreliable. Moreover, the theoretical price would be subjective. Thus, the Exchange has determined not to permit an obvious or catastrophic error review if there are no quotes for comparison purposes, or if the bid/ask differential of the NBBO for the affected series, just prior to the erroneous transaction, was at least two times the permitted bid/ask differential. The Exchange believes that adding certainty to the execution of orders in these situations should encourage market participants to continue to provide liquidity to the Exchange and thus promote a fair and orderly market.

In addition, the Exchange proposes to provide that trades are not subject to an obvious error and catastrophic error review if pursuant to Rule 1092(c)(ii)(E) the trade resulted from an execution price in a series quoted no bid. Specifically, under this provision, where the trade resulted in an execution price in a series quoted no bid and for

5 seconds prior to the execution remained no bid (excluding the quote in question; bids and offers of the parties to the subject trade that are in any of the series in the same options class shall not be considered) *and* at least one strike price below (for calls) or above (for puts) in the same class were quoted no bid at the time of the erroneous execution (in which case the trade shall be nullified). The Exchange believes that these situations are not appropriate for an error review because they are more likely to result in a windfall to one party at the expense of another, in a Limit State or Straddle State, because the criteria for meeting the no-bid provision are more likely to be met in a Limit State or Straddle State, and unlike normal circumstances, may not be a true reflection of the value of the series being quoted. For example, in a series quoted \$1.95-\$2.00 on multiple exchanges prior to the Limit or Straddle State, an order to B10@ \$2.00 is likely a reasonably priced trade because the buyer attempted to pay \$2.00 with a limit price. However, if that series and the series one strike below are both quoted \$0.00- \$5.00, then both the seller and the buyer at \$2.00 would have an opportunity to dispute the trade. This would create uncertainty to both parties and an advantage to one participant if the underlying stock moved significantly in their direction.

Lastly, the Exchange proposes to provide that trades are not subject to an obvious error and catastrophic error review if the trade occurred at a price that is deemed to be an obvious or catastrophic error pursuant to Rule 1092(a) based on a Theoretical Price determined pursuant to Rule 1092(b)(i). Specifically, if the execution price was higher than the National Best Bid for sell orders (or lower than the National Best Offer for buy orders) by an amount greater than the amounts in Rule 1092(a), there would be no obvious or catastrophic error if the underlying security is in a Limit State or Straddle

State. The Exchange believes that this is appropriate because while in a Limit or Straddle State, only limit orders will be accepted by the Exchange, affirming that the participant is willing to accept an execution up to the limit price. Further, because the Exchange system will only trade through the Theoretical bid or offer if the Exchange or the participant (via an ISO order) has accessed all better priced interest away in accordance the Options Order Protection and Locked/Crossed Markets Plan, the Exchange believes potential trade reviews of executions that occurred at the participant's limit price and also in compliance with aforementioned Plan could result in uncertainty that could harm liquidity and also could create an advantage to either side of an execution depending on the future movement of the underlying stock.

#### Purpose

When Rule 1092 was first adopted, the Commission stated that it "...considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an 'obvious error' may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether an 'obvious error' has occurred, and the adjustment or nullification of a transaction because an obvious error is considered to exist, should be based on specific and objective criteria and subject to specific and objective procedures... The Commission believes that Phlx's proposed obvious error rule establishes specific and objective criteria for determining when a trade is an 'obvious error.' Moreover, the Commission believes that the Exchange's proposal establishes specific and objective

procedures governing the adjustment or nullification of a trade that resulted from an ‘obvious error.’”<sup>20</sup>

In 2008, the Exchange amended Rule 1092 to adopt the catastrophic error provision. In doing so, the Exchange stated that it had “...weighed carefully the need to assure that one market participant is not permitted to receive a windfall at the expense of another market participant that made an Obvious Error, against the need to assure that market participants are not simply being given an opportunity to reconsider poor trading decisions. The Exchange states that, while it believes that the Obvious Error Rule strikes the correct balance in most situations, in some extreme situations, trade participants may not be aware of errors that result in very large losses within the time periods currently required under the rule. In this type of extreme situation, the Exchange believes its members should be given more time to seek relief so that there is a greater opportunity to mitigate very large losses and reduce the corresponding large wind-falls. However, to maintain the appropriate balance, the Exchange believes members should only be given more time when the execution price is much further away from the theoretical price than is required for Obvious Errors so that relief is only provided in extreme circumstances.”<sup>21</sup>

The Exchange believes that this proposal is consistent with those principles because it strikes the aforementioned balance. The Exchange is proposing to decline to review certain trades, which is specific and objective. Furthermore, the proposal more fairly balances the potential windfall to one market participant against the potential

---

<sup>20</sup> See Securities Exchange Act Release No. 49785 (May 28, 2004), 69 FR 32090 (June 8, 2004) (SR-Phlx-2003-68).

<sup>21</sup> See Securities Exchange Act Release No. 58002 (June 23, 2008), 73 FR 36581 (June 27, 2008)(SR-Phlx-2008-42)(Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Catastrophic Errors).

reconsideration of a trading decision under the guise of an error, and thereby results in more certainty during periods of extreme market volatility. Trades are nevertheless subject to an obvious error or catastrophic review under other sections of the Rule, because those continue to be an objective method of determining the value of an option, even during periods of extraordinary market volatility.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>22</sup> in general and with Section 6(b)(5) of the Act,<sup>23</sup> in particular, which requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest, because it should provide certainty about how errors involving options orders and trades will be handled during periods of extraordinary volatility in the underlying security. The Exchange believes that this proposal regarding obvious and catastrophic errors should protect investors and the public interest by ensuring that Exchange officials do not have discretion with respect to handling such errors, thereby providing greater certainty to participants, and by ensuring that the aforementioned balance does not result in an inappropriate windfall to one party.

---

<sup>22</sup> 15 U.S.C. 78f.

<sup>23</sup> 15 U.S.C. 78f(b)(5).

Accordingly, the Exchange believes that the proposed rule change is consistent with these requirements in that it should reduce the negative impacts of sudden, unanticipated volatility in individual options, and serve to preserve an orderly market in a transparent and uniform manner, enhance the price-discovery process, increase overall market confidence, and promote fair and orderly markets and the protection of investors.

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

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. Specifically, the proposal does not impose an intra-market burden on competition, because it will apply to all members. Nor will the proposal impose a burden on competition among the options exchanges, because, in addition to the vigorous competition for order flow among the options exchanges, the proposal addresses a regulatory situation common to all options exchanges. To the extent that market participants disagree with the particular approach taken by the Exchange herein, market participants can easily and readily direct order flow to competing venues. The Exchange believes this proposal will not impose a burden on competition and will help provide certainty during periods of extraordinary volatility in an NMS stock.

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

Written comments were neither solicited nor 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.

#### IV. Solicitation of Comments

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

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2013-25 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-2013-25. 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 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-Phlx-2013-25 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>24</sup>

Kevin M O'Neill  
Deputy Secretary

---

<sup>24</sup> 17 CFR 200.30-3(a)(12).