

May 17, 2006

Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

**Re: Proposed Rule Change by the Philadelphia Stock Exchange to
Establish a Neutral Referee, File No. SR-Phlx-2005-42**

Dear Ms. Morris:

The Philadelphia Stock Exchange, Inc. (“Phlx” or “Exchange”) welcomes the opportunity to offer our response to the comments made to the Securities and Exchange Commission (“Commission”) by Citadel Investment Group, L.L.C. on behalf of Citadel Derivatives Group LLC (“Citadel”) concerning the above-referenced proposed rule change.¹ The proposed rule change would establish a neutral “Referee,” an Exchange employee or independent contractor who would have authority to review and rule on appeals from Floor Official rulings concerning the nullification and adjustment of trades, and would authorize the Referee to make certain other initial rulings currently made only by Floor Officials.

The Citadel Letter expresses Citadel’s overall support for the proposed rule change as a positive initiative to introduce a fully independent and professional appellate official into the dispute resolution process.

Citadel does not, however, support the automatic imposition of a proposed \$250 fee which would apply to a member or member organization seeking the Referee’s review of a Floor Official ruling concerning the nullification or adjustment of a trade if the Referee upholds the initial Floor Official decision; nor does Citadel support a proposed provision that decisions of the Referee would be final and may not be appealed to the Exchange’s Board of Governors.

The \$250 Fee

The Citadel Letter states that the imposition of the \$250 fee is “a bad idea” and fundamentally unfair because, Citadel somehow concludes, initial decisions regarding trade disputes are made by Floor Officials who are “not independent, well-trained, professional adjudicatory officials.” Citadel also claims that the existence of a rule that imposes a \$250 fine for non-frivolous but unsuccessful appeals will harm the credibility of the Phlx with customers and market makers on other exchanges.

¹ See letter from Matthew Hinerfeld, Managing Director and Deputy General Counsel, Citadel, to Jonathan G. Katz, Secretary, Commission, dated April 21, 2006 (the “Citadel Letter”).

Under current Exchange rules, any person who appeals an Options Floor Official ruling concerning a trading dispute and loses will be subject to a \$250 fee upon a finding by a Review Panel,² that such appeal is frivolous.³ The determination of whether such an appeal is “frivolous” is solely within the discretion of the Review Panel.

Under the proposal, in order to minimize the likelihood of frivolous appeals from Floor Official rulings, a member or member organization seeking the Referee’s review of a Floor Official ruling concerning the nullification or adjustment of a trade would be assessed a fee of \$250 for each Floor Official ruling they seek to have reviewed if the Referee upholds the Floor Official decision. No fee would be assessed to the member or member organization seeking a review if the Floor Official decision is overturned or modified.

The Exchange believes that the proposed \$250 fee provides an objective standard for imposition of the fee (*i.e.*, the fee would be imposed in situations where the Referee sustains a Floor Official ruling on the nullification or adjustment of a trade), in contrast to the subjective discretion currently exercised by the Review Panel. Exchange members and member organizations would thus have actual notice of the circumstances giving rise to the imposition of the fee. Moreover, the Exchange believes that the fee is fair and consistent with the Act; because it is proposed to be applied to all appeals, it is neither discriminatory nor arbitrary, and it provides for the equitable allocation of reasonable dues, fees, and other charges among its members and is therefore consistent with Section 6(b)(4).⁴

Decisions of the Referee Final

Citadel argues that the proposal providing that decisions of the Referee would be final and may not be appealed to the Exchange’s Board of Governors would eliminate an important safeguard and an incentive for the Referee to rule fairly.

Currently, decisions of the Review Panel are considered final decisions of the standing committee and may be appealed to an Advisory Committee on Appeals of the Board of Governors.⁵ Initial rulings to grant or deny relief from the requirements of certain rules are not currently considered final decisions of a standing committee and are thus not currently appealable to the Exchange’s Board of Governors.

² Currently, Floor Official rulings may be appealed to a Review Panel consisting of three members of the Options Subcommittee on Rules and Rulings (the “Subcommittee”), or the Chairperson of the standing committee (or his designee) if three Subcommittee members cannot be promptly convened. *See* Exchange Rule 124(d). Under the proposal, the Referee would replace the Review Panel.

³ *See* Exchange Rule 124(d).

⁴ 15 U.S.C. 78f(6)(b)(4).

⁵ *See supra* note 3. *See also* Exchange By-Law Article XI.

The proposed rule change would provide that decisions of the Referee concerning the review of Floor Official rulings relating to the nullification or adjustment of transactions, and initial requests for relief, would be final and may not be appealed to the Exchange's Board of Governors. The Exchange does not believe that these are the types of decisions that are appropriate for such appeals particularly because, as a matter of practicality concerning trading disputes, the need for speedy resolution and certainty are important, whereas other standing committee decisions are often prospectively applied. Additionally, this provision would not operate to preclude any aggrieved member or member organization from proceeding with any other legal remedy to which such member or member organization might be entitled (*e.g.*, arbitration or appeal to the Commission if allowable by law).

Finally, the proposed rule change specifically requires the Chairman of the Options Committee, Foreign Currency Options Committee, or of the Floor Procedure Committee, or their respective designees, to refer a Referee that fails to make any ruling in accordance with Exchange rules to the Exchange's Audit Committee for possible disciplinary action, including removal. The Exchange believes that this is an important and sufficient safeguard and an incentive for the Referee to rule fairly.

The Exchange believes that its proposed process for the resolution of trading disputes is fair and consistent with the Act, which does not mandate any specified process within an exchange. Instead, the statutory standard applicable to the proposed rules is found in Section 6(b)(5) of the Act,⁶ which among other things requires that such rules be designed to promote just and equitable principles of trade and to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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 proposed rule change clearly meets this standard and therefore should be approved.

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For the foregoing reasons, the Exchange believes that the proposed rule change is consistent with the Act in general, and particularly with Section 6(b)(4)⁷ in that it provides for an equitable allocation of reasonable dues, fees, and other charges among its members, and with Section 6(b)(5)⁸ as described above. Therefore, the Exchange respectfully submits that the Commission should approve SR-Phlx-2005-42.

⁶ 15 U.S.C. 78f(6)(b)(5).

⁷ 15 U.S.C. 78f(6)(b)(4).

⁸ 15 U.S.C. 78f(6)(b)(5).

Please contact Richard S. Rudolph, Vice President and Counsel, Phlx Legal Department, at (215) 496-5074 with any questions or comments you may have.

Very truly yours,

Richard S. Rudolph
Vice President and Counsel

cc: Elizabeth King, Esquire
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