

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53228; File No. SR-Phlx-2005-91)

February 6, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto to Amend the Equity Option Specialist Deficit (Shortfall) Fee

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 29, 2005, the Philadelphia Stock Exchange, Inc. (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Phlx. On February 1, 2006, the Phlx filed Amendment No. 1 to the proposed rule change.³ The Phlx filed the proposal pursuant to Section 19(b)(3)(A)(ii) of the Act⁴ and Rule 19b-4(f)(2) thereunder,⁵ which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Phlx proposes to amend its Specialist Deficit (Shortfall) Fee (“shortfall fee”) in two ways: (1) eliminate the DROT Exemption (as defined herein), so that a specialist⁶ will be

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No.1, the Exchange made additional changes to the proposed rule text to clarify the assessment of the shortfall fee and the application of the shortfall credit.

⁴ 15 U.S.C. 78s(b)(3)(A)(ii).

⁵ 17 CFR 240.19b-4(f)(2).

⁶ The Exchange uses the terms “specialist” and “specialist unit” interchangeably herein.

assessed a shortfall fee, subject to the maximum caps currently in effect,⁷ even when one or more Streaming Quote Traders (“SQTs”)⁸ or Remote Streaming Quote Traders (“RSQTs”)⁹

⁷ Certain shortfall fee caps apply to transactions in any of the top 120 equity options pursuant to the following: (1) If Phlx volume in any top 120 equity option, except options on Nasdaq-100 Index Tracking StockSM (traded under the symbol “QQQQ”), is less than or equal to 50 percent of the current threshold volume (presently 6 percent), a cap of \$10,000 will apply; (2) If Phlx volume in any top 120 equity option, except options on QQQQ, is greater than 50 percent of the current threshold volume (presently 6 percent) and less than 12 percent of the total national monthly contract volume, a cap of \$5,000 will apply; (3) If Phlx volume in options on QQQQ is less than or equal to 50 percent of the current threshold volume (presently 6 percent), a cap of \$20,000 will apply; and (4) If Phlx volume in options on QQQQ is greater than 50 percent of the current threshold volume (presently 6 percent) and less than 12 percent of the total national monthly contract volume, a cap of \$10,000 will apply. The Nasdaq-100®, Nasdaq-100 Index®, Nasdaq®, The Nasdaq Stock Market®, Nasdaq-100 SharesSM, Nasdaq-100 TrustSM, Nasdaq-100 Index Tracking StockSM, and QQQQSM are trademarks or service marks of The Nasdaq Stock Market, Inc. (“Nasdaq”) and have been licensed for use for certain purposes by the Phlx pursuant to a License Agreement with Nasdaq. The Nasdaq-100 Index® (the “Index”) is determined, composed, and calculated by Nasdaq without regard to the Licensee, the Nasdaq-100 TrustSM, or the beneficial owners of Nasdaq-100 SharesSM. Nasdaq has complete control and sole discretion in determining, comprising, or calculating the Index or in modifying in any way its method for determining, comprising, or calculating the Index in the future.

⁸ An SQT is an Exchange Registered Options Trader (“ROT”) who has received permission from the Exchange to generate and submit option quotations electronically through an electronic interface with AUTOM via an Exchange approved proprietary electronic quoting device in eligible options to which such SQT is assigned. See Phlx Rule 1014(b)(ii)(A). AUTOM is the Exchange’s electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. See Phlx Rule 1080(a).

⁹ An RSQT is a ROT that is a member or member organization of the Exchange with no physical trading floor presence who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such RSQT has been assigned. An RSQT may only submit such quotations electronically from off the floor of the Exchange. An RSQT may only trade in a market making capacity in classes of options in which he is assigned. See Phlx Rule 1014(b)(ii)(B). See generally Securities Exchange Act Release Nos. 51126 (February 2, 2005), 70 FR 6915 (February 9, 2005) (SR-Phlx-2004-90) and 51428 (March 24, 2005), 70 FR 16325 (March 30, 2005) (SR-Phlx-2005-12).

trading on the Exchange's electronic options trading platform, Phlx XL,¹⁰ have been designated to receive Directed Orders¹¹ from Order Flow Providers¹² for the same top 120 equity option¹³ in which that specialist unit is acting as the specialist; and (2) establish a shortfall credit of \$0.35 per contract in any top 120 equity option for each specialist unit whose trading volume for such equity option effected on the Exchange in one month exceeds 15% of the total national monthly contract volume for such equity option in that same month, up to the total amount of the shortfall fee, if any, that is incurred in connection with the trading of other top 120 equity options that has not met the volume threshold, which is currently set at 12% of the total national monthly contract volume.

The Exchange also proposes to make a minor, technical change to the shortfall fee section in its Summary of Equity Option Charges by inserting the word "equity" in the phrase "top 120 options" to clarify the type of options to which the Exchange is referring in the shortfall fee section. In addition, the Exchange proposes to clarify that the reference to "transition period" in the first paragraph of the shortfall fee section refers to the transition period set forth for any top 120 equity option listed after February 1, 2004 and for any top 120 equity option acquired by

¹⁰ In July 2004, the Exchange began trading equity options on Phlx XL, followed by index options in December 2004. See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 46612 (August 3, 2004) (SR-Phlx-2003-59).

¹¹ The term "Directed Order" means any customer order to buy or sell which has been directed to a particular specialist, RSQT, or SQT by an Order Flow Provider (as defined herein). See Phlx Rule 1080(l)(i)(A). The provisions of Phlx Rule 1080(l) are in effect for a one-year pilot period to expire on May 27, 2006. See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005) (SR-Phlx-2004-91).

¹² The term "Order Flow Provider" means any member or member organization that submits, as agent, customer orders to the Exchange. See Phlx Rule 1080(l)(i)(B).

¹³ The Exchange defines a top 120 equity option as one of the 120 most actively traded equity options in terms of the total number of contracts in that option that were traded nationally for a specified month, based on volume reflected by The Options Clearing Corporation.

a new specialist unit within the first 60 days of operations and which is described at the end of the shortfall fee section. The Exchange considers these changes to be minor, technical changes because they are consistent with current Exchange practice and should help to clarify the assessment of the shortfall fee.

The proposed rule change is scheduled to become effective for transactions settling on or after January 2, 2006. The text of the proposed rule change is available on the Phlx's Internet Web site (<http://www.phlx.com>), at the Phlx's Office of the Secretary, 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 Phlx included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Phlx has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange currently charges specialist units a shortfall fee of \$0.35 per contract, to be paid monthly in connection with transactions in any top 120 equity option, in most cases, if at least 12% of the total national monthly contract volume in that equity option is not effected by that specialist unit on the Exchange in that month.¹⁴ Effective for trades settling on or after June

¹⁴ An exception to the 12% volume threshold amount relates to a transition period for newly listed top 120 equity options or for any top 120 equity option (including those equity options listed on the Exchange before February 1, 2004) acquired by a new specialist

6, 2005, the Exchange amended its shortfall fee to no longer charge the shortfall fee when one or more SQTs or RSQTs trading on Phlx XL have been designated to receive Directed Orders from Order Flow Providers (“Directed Order Flow Program”) for the same option in which that specialist unit is acting as the specialist (collectively, the “DROT Exemption”).¹⁵ At that time, the Exchange believed that it would not be reasonable to impose a shortfall fee on specialists when SQTs and RSQTs would be competing for market share with respect to the same equity options on a relatively equal basis, as the shortfall fee was designed, in part, to create an incentive for specialists to promote the equity options they have been allocated. Thus, given that the Directed Order Flow Program was a new program, the Exchange believed it was important to see how such program would affect the specialists’ market share, as well as how the Directed Order Flow Program might influence order routing decisions by Order Flow Providers.

However, the specialists’ market share in certain top 120 equity options currently remains well below the targeted shortfall fee volume threshold of 12% of the total national monthly contract volume effected on the Exchange. Although the Exchange recognizes that the specialists are competing for market share with the SQTs and RSQTs, it believes that obtaining 12% market share, which would include SQT and RSQT volume, is not unreasonable and wants to encourage specialists to compete in garnering greater market share. Thus, the purpose of this proposal is to encourage equity option specialist units to increase their respective market shares and create an incentive, by way of a credit, for such specialists to trade on the Exchange in any

unit. These transition periods are not affected by the current proposal. See Securities Exchange Act Release No. 49324 (February 26, 2004), 69 FR 10089 (March 3, 2004) (SR-Phlx-2004-08).

¹⁵ See Securities Exchange Act Release No. 51947 (June 30, 2005), 70 FR 39542 (July 8, 2005) (SR-Phlx-2005-39).

top 120 equity option in excess of 15% of the total national monthly contract volume for such top 120 equity option in one month.

Under the proposal, when a specialist unit's trading volume in any top 120 equity option effected on the Exchange in one month exceeds 15% of the total national contract volume for such top 120 equity option in that same month, a shortfall credit of \$0.35 per contract would be applied to such specialist unit's invoice, the dollar amount of which would (i) directly correspond to the number of contracts of such top 120 equity option in excess of 15% of the total national contract volume for such top 120 equity option, and (ii) offset any shortfall fee charged to such specialist unit with respect to any other top 120 equity option traded in that same month.

However, the amount of any shortfall credit may not (a) exceed the total amount of any shortfall fee charged to such specialist unit with respect to any other top 120 equity option traded in that same month, and (b) be applied against any other Exchange charges on the invoice(s) of such specialist unit or subsidiary of such specialist unit. Finally, any excess shortfall credit would not be carried over to subsequent months. Should the total amount of the shortfall credit exceed the total amount of the shortfall fee due, no shortfall fee would be due to the Exchange.¹⁶

¹⁶ For example, if the total national monthly contract volume was 8,000,000 contracts for one equity option, and the Exchange's market share in that option was 18% or 1,440,000 contracts, the specialist unit would receive a credit based on the number of contracts in excess of the 15% threshold, up to the total amount of the shortfall fee that was incurred in connection with the trading of other top 120 equity options that did not meet the current 12% volume threshold. In this example, the amount of 1,200,000 contracts represents 15% of the total national monthly contract volume of 8,000,000. Thus, a shortfall credit of \$84,000 (derived from the product of the difference between 1,200,000 contracts and 1,440,000 contracts and \$0.35) would be applied against any other shortfall fees incurred by that specialist unit in that month. If the amount of the shortfall fees totaled less than the amount of the shortfall credit (e.g., the shortfall fees totaled \$25,000 and the shortfall credit was \$84,000), no shortfall fee would be due the Exchange that month. The excess credit of \$59,000 would not carry over to subsequent months.

According to the Exchange, the purpose of making the minor, technical changes to the proposed text of the shortfall fee, including the addition of the caption “Transition Period,” is to more clearly describe current Exchange practice, which should, in turn, help to avoid confusion regarding the implementation of the shortfall fee.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the requirements of Section 6(b) of the Act,¹⁷ in general, and furthers the objectives of Section 6(b)(4) of the Act,¹⁸ in particular, because it is designed to provide for the equitable allocation of reasonable dues, fees, and other charges among members of the Exchange. All specialist units competing in the top 120 equity options would be assessed the same shortfall fee and would be given the same shortfall fee credit.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition 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 Phlx has neither solicited nor received written comments on the proposed rule change.

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

The foregoing proposed rule change has been designated as a fee change pursuant to

¹⁷ 15 U.S.C. 78f(b).

¹⁸ 15 U.S.C. 78f(b)(4).

Section 19(b)(3)(A)(ii) of the Act¹⁹ and Rule 19b-4(f)(2)²⁰ thereunder. Accordingly, the proposed rule change is effective upon filing with the Commission. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate 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.²¹

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 amended, 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 No. SR-Phlx-2005-91 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. SR-Phlx-2005-91. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments

¹⁹ 15 U.S.C. 78s(b)(3)(A)(ii).

²⁰ 17 CFR 19b-4(f)(2).

²¹ The effective date of the original proposed rule change is December 29, 2005, and the effective date of Amendment No. 1 is February 1, 2006. For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposed rule change under Section 19(b)(3)(C) of the Act, the Commission considers such period to commence on February 1, 2006, the date on which the Exchange filed Amendment No. 1. See 15 U.S.C. 78s(b)(3)(C).

more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Phlx. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-Phlx-2005-91 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²²

Nancy M. Morris
Secretary

²² 17 CFR 200.30-3(a)(12).