

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53822; File No. SR-Phlx-2006-32)

May 17, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Zero Bid Options

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 May 16, 2006, 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 and II below, which Items have been prepared by the Exchange. The Exchange filed the proposed rule change as a “non-controversial” rule change under Rule 19b-4(f)(6) under the Act,³ which renders the proposal effective upon filing with the Commission. 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 Phlx proposes to amend Exchange Rule 1080(i) to provide that the Exchange’s Automated Options Market (AUTOM) System⁴ will only convert a market order to sell in a

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

⁴ 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. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM’s automatic execution features, AUTO-X, Book Sweep and Book Match. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor. AUTOM is today more commonly referred to as Phlx XL. See Exchange Rule 1080.

“zero-bid option”⁵ into a limit order to sell such option at \$0.05 if the Exchange’s best bid/offer (the “PBBO”) has a bid/ask differential of less than or equal to \$0.25 and (i) the National Best Bid or Offer (“NBBO”) reflects a zero bid in an option listed on multiple exchanges or (ii) the Exchange’s disseminated bid is zero for an option listed only on the Exchange.

The text of the proposed rule change is set forth below. Underlining indicates new text; deletions are bracketed

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Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)

Rule 1080. (a) – (h) No change.

(i) Zero-bid option series. The AUTOM System will convert market orders to sell a particular option series to limit orders to sell with a limit price of \$.05 that are received when:

- (A) For options listed only on the Exchange:
 - (1) the Exchange’s disseminated bid price in such option series is zero;[,] and
 - (2) the Exchange’s disseminated quotation in the series has a bid/ask differential less than or equal to \$0.25; or
- (B) For options that are listed on multiple exchanges:
 - (1) the disseminated NBBO includes a bid price of zero in the series; and
 - (2) the Exchange’s disseminated quotation in the series has a

⁵ A “zero-bid option” is an option with a bid price of zero, meaning the option is virtually worthless. According to the Exchange, a bid price of zero typically occurs in situations

bid/ask differential less than or equal to \$0.25.

[to limit orders to sell with a limit price of \$.05] Such orders will be automatically placed on the limit order book in price-time priority.

(j) – (l) No change.

Commentary: No change.

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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, Proposed Rule Change

1. Purpose

According to the Exchange, the purpose of the proposed rule change is to modify Exchange Rule 1080(i) so as to limit the circumstances in which AUTOM will convert a market order to sell into a limit order to sell a zero-bid option at \$0.05. The Exchange adopted Rule 1080(i) as a means of automating the handling of these orders.⁶ Currently, Exchange Rule

where there is no intrinsic value in the series quoted (*i.e.*, where an option series is out-of-the-money by a relatively large amount and such series is close to expiration).

⁶ See Securities Exchange Act Release No. 51544 (April 14, 2005), 70 FR 20613 (April 20, 2005) (SR-Phlx-2005-03).

1080(i) provides for the conversion of all market orders to sell that are received when the Exchange is disseminating a bid of zero in that option.

Since the adoption of Exchange Rule 1080(i), the Exchange has concluded that not all options with a zero bid are the same. The Exchange currently treats options that have an offer price of a few dollars on the Exchange, as well as options that are not “zero-bid” on other exchanges, as zero-bid options. Accordingly, this proposal outlines additional factors that the Exchange would consider when determining whether an option is a zero-bid option for purposes of Rule 1080(i), including the Exchange’s spread and the NBBO. The Exchange believes that the new criteria would clarify when an option is truly a zero-bid option for which orders in that option should be subject to automated handling versus orders for non-zero-bid options that would require manual handling.

The Exchange believes that taking the spread into consideration would help limit the conversion of market orders to sell to only those for true zero-bid options, because options with an offer much higher than above \$0.25 are likely not to be worthless options. Similarly, for options traded on more than one exchange, the NBBO is relevant for validating whether an option truly is a zero-bid option.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act⁷ in general, and furthers the objectives of Section 6(b)(5) of the Act⁸ 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 limiting the instances in which the Exchange’s

⁷ 15 U.S.C. 78f(b).

AUTOM system converts a market order to sell an option that is not a zero-bid option series under Rule 1080(i).

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

Written comments on the proposed rule change were neither solicited nor received.

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

Because the proposed rule change: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of filing, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act⁹ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁰ 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.

The Exchange has requested that the Commission waive the five-day pre-filing notice requirement and the 30-day operative delay. The Commission believes waiving the five-day pre-filing notice and the 30-day operative delay is consistent with the protection of investors and the public interest. Such waivers would allow the Exchange to implement, without undue delay, the

⁸ 15 U.S.C. 78f(b)(5).

⁹ 15 U.S.C. 78s(b)(3)(A).

¹⁰ 17 CFR 240.19b-4(f)(6).

proposed amendment to Exchange Rule 1080(i), which would clarify when an option is truly a zero-bid option for which orders in that option should be subject to automated handling versus orders for non-zero-bid options that would require manual handling. For this reason, the Commission designates the proposal to be effective and operative upon filing with the Commission.¹¹

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-Phlx-2006-32 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-Phlx-2006-32. 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

¹¹ For purposes only of waiving the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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 Section. 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-2006-32 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.¹²

Nancy M. Morris
Secretary

¹² 17 CFR 200.30-3(a)(12).