

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54050; File No. SR-Phlx-2006-37)

June 27, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Extension of a Pilot Program Concerning Split Price Priority in Open Outcry

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 June 8, 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 pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6)⁴ thereunder, which renders the proposed rule change 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 extend, for a one-year period, a pilot program (the “pilot”) set forth in Phlx Rule 1014(g)(i)(C) relating to priority on split-price transactions in open outcry.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

Under the pilot, a member with an order for at least 100 contracts⁵ who buys (sells) at least 50 contracts at a particular price has priority over all others in purchasing (selling) up to an equivalent number of contracts of the same order at the next lower (higher) price without being required to yield priority, including to existing customer interest in the limit order book. The pilot also establishes priority for in-crowd participants in split price transactions represented in open outcry over the quotations of participants that are not located in the crowd (*i.e.*, out-of-crowd Streaming Quote Traders (“SQTs”)⁶ and Remote Streaming Quote Traders (“RSQTs”)⁷) even where the market has a bid/ask differential of one minimum trading increment.⁸ The current pilot is scheduled to expire June 30, 2006. The extended pilot would expire June 30, 2007. The text of the proposed rule change is available on the Phlx Web site (<http://www.phlx.com>),

⁵ Orders for a size of less than 100 contracts are not affected by the current pilot and would not be affected by this proposed rule change.

⁶ An SQT is an Exchange Registered Options Trader (“ROT”) who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such SQT is assigned. (AUTOM is Phlx’s Automated Options Market.) An SQT may submit such quotations only while such SQT is physically present on the floor of the Exchange. See Phlx Rule 1014(b)(ii)(A).

⁷ An RSQT is an ROT that is a member or member organization with no physical trading floor presence who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such RSQT has been assigned. An RSQT may submit such quotations electronically only from off the floor of the Exchange. See Phlx Rule 1014(b)(ii)(B).

⁸ Generally, all options on stocks, indexes, and Exchange Traded Funds quoting in decimals at \$3.00 or higher have a minimum increment of \$.10, and those quoting in decimals under \$3.00 have a minimum increment of \$.05. See Phlx Rule 1034(a).

at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.⁹

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 purpose of the proposed rule change is to extend the pilot concerning priority in split-price transactions, which by virtue of their size and the need to execute them at multiple prices, may be difficult to execute without a limited exception to current Exchange priority rules, as described below. The pilot is scheduled to expire June 30, 2006.

The pilot was originally adopted in June 2005,¹⁰ and subsequently extended in December 2005.¹¹ In May 2006, the pilot was expanded to include priority for in-crowd

⁹ The proposed rule change amends the current text of Phlx Rule 1014(g)(i)(C) by changing the expiration date from June 30, 2006 to June 30, 2007.

¹⁰ See Securities Exchange Act Release No. 51820 (June 10, 2005), 70 FR 35759 (June 21, 2005) (SR-Phlx-2005-28).

¹¹ See Securities Exchange Act Release No. 53021 (December 23, 2005), 70 FR 77435 (December 30, 2005) (SR-Phlx-2005-86).

participants in both trades of the split price transaction where there is a minimum trading increment market, but only over RSQTs and out-of-crowd SQTs in such circumstance.¹²

The current pilot, applicable to equity options (including options overlying Exchange Traded Fund Shares (“ETFs”)), permits a member with an order for at least 100 contracts¹³ who buys (sells) at least 50 contracts at a particular price to have priority over all others in purchasing (selling) up to an equivalent number of contracts of the same order at the next lower (higher) price without being required to yield priority, including to existing customer interest in the limit order book. Absent this rule, such orders would be required to yield priority.¹⁴

For example, where the market is \$.25 - \$.35, a Floor Broker representing an order to purchase 100 contracts that executes a purchase of 50 of those contracts at a price of \$.30 has priority over all market participants to purchase the remaining 50 contracts in the order at \$.25. Two trades would be reported to the tape, one a purchase of 50 contracts at \$.30, and the other a purchase of 50 contracts at \$.25. The effect to that Floor Broker’s customer would be a net purchase price of \$.275 for 100 contracts.

The pilot, as recently modified,¹⁵ also affords priority to members physically located in the crowd where the market has a bid/ask differential of one minimum trading increment and the bid and/or ask represent quotations of members located outside of the

¹² See Securities Exchange Act Release No. 53874 (May 25, 2006), 71 FR 32171 (June 2, 2006) (SR-Phlx-2006-18).

¹³ Orders for a size of less than 100 contracts are not affected by the current pilot and would not be affected by this proposed rule change.

¹⁴ See, e.g., Phlx Rule 119(a).

¹⁵ See supra, note 12.

crowd (i.e., out-of-crowd SQTs and RSQTs).¹⁶ The Exchange believes that this provision should enable it to continue to compete for order flow in situations where Floor Brokers seek split price executions in open outcry when the market consists of RSQT quotations and/or SQT quotations where the SQT is located out of that trading crowd with a bid/ask differential of one minimum trading increment.

For example, assume a Floor Broker represents an order to purchase 100 contracts in a series where the market is \$.25 - \$.30, and both the bid and offer represent quotations submitted by out-of-crowd SQTs¹⁷ or RSQTs. Under the pilot, the Floor Broker and contra-side participant in the trading crowd are afforded priority over the out-of-crowd SQT or RSQT at both \$.25 and \$.30, even though the bid/ask differential is one minimum trading increment (\$.05). This would enable the Floor Broker to execute a split-price order at a net price (\$.275) that improves the market. According to Phlx, the effect (and ultimate benefit) to that Floor Broker's customer would be a net purchase price of \$.275 for 100 contracts. This provision applies only with respect to quotations submitted by out-of-crowd SQTs and RSQTs, and thus does not operate to afford priority over, for example, customer or broker-dealer orders or in-crowd SQT quotes.

The Exchange believes that, in situations where the market has a bid/ask differential of one minimum trading increment, it is potentially difficult for the Floor Broker to achieve price improvement for the Floor Broker's customer on the Phlx.

¹⁶ Clarified in telephone conference on June 21, 2006, among Richard Rudolph, Vice President and Counsel, Phlx; and Ira Brandriss, Special Counsel, and Mitra Mehr, Special Counsel, Division of Market Regulation, Commission.

¹⁷ The specialist and/or SQTs participating in a trading crowd may, in response to a verbal request for a market by a Floor Broker, state a bid or offer that is different than their electronically submitted bid or offer, provided that such stated bid or offer is not inferior to such electronically submitted bid or offer. See Phlx Rule 1014, Commentary .05(c).

Instead, the order might trade at another exchange that has no impediments, i.e., rules that afford priority to in-crowd participants over out-of-crowd participants generally, regardless of split price priority.¹⁸ The pilot therefore was modified to include this provision.¹⁹

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act²⁰ in general, and furthers the objectives of Section 6(b)(5) of the Act²¹ 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, enabling Floor Brokers representing split price orders in open outcry to provide split-price executions at improved prices on behalf of customers by establishing a limited priority rule regarding split-price transactions.

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.

¹⁸ The Phlx cites to Chicago Board Options Exchange, Incorporated (“CBOE”) Rule 6.45A, which provides that only in-crowd market participants are eligible to participate in open outcry trade allocations. See Securities Exchange Act Release No. 51366 (March 14, 2005), 70 FR 13217 (March 18, 2005) (SR-CBOE-2004-75). The Phlx notes that CBOE Rule 6.45A affords priority over out-of-crowd participants even where there is no split price priority situation. CBOE Rule 6.47 contains CBOE’s split price provision, which is similar to current Phlx Rule 1014(g)(i)(C).

¹⁹ See supra, note 12.

²⁰ 15 U.S.C. 78f(b).

²¹ 15 U.S.C. 78f(b)(5).

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

No written comments were either solicited or received.

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

Because the foregoing proposed rule change does not:

(i) significantly affect the protection of investors or the public interest;

(ii) impose any significant burden on competition; and

(iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to Section 19(b)(3)(A) of the Act,²² and Rule 19b-4(f)(6) thereunder.²³ 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.

A proposed rule change filed under Rule 19b-4(f)(6)²⁴ normally does not become operative prior to 30 days after the date of filing. However, pursuant to Rule 19b-4(f)(6)(iii),²⁵ the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the

²² 15 U.S.C. 78s(b)(3)(A).

²³ 17 CFR 240.19b-4(f)(6).

²⁴ 17 CFR 240.19b-4(f)(6).

²⁵ 17 CFR 240.19b-4(f)(6)(iii).

Commission to waive the 30-day pre-operative delay. The Commission believes that such waiver is consistent with the protection of investors and the public interest because it would allow the Phlx to extend its pilot without interruption.²⁶ For this reason, the Commission designates the proposed rule change to be effective upon filing with the Commission.²⁷

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-2006-37 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-2006-37. This file number should be included on the subject line if e-mail is used. To help the Commission process and

²⁶ At the Exchange's request, the Commission has waived the five-day pre-notice filing requirement for "non-controversial" proposals. See 17 CFR 240.19b-4(f)(6)(iii).

²⁷ For purposes only of accelerating the operative date of this proposal, the Commission has considered the rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

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 inspection and copying in the Commission's Public Reference Room. Copies of the filing also will 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 Number SR-Phlx-2006-37 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.²⁸

Nancy M. Morris
Secretary

²⁸ 17 CFR 200.30-3(a)(12).