

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53514; File No. SR-Phlx-2005-80)

March 17, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto Relating to the Automated Delivery and Handling of Stop and Stop-Limit Orders

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 15, 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 Exchange. Phlx filed Amendment No. 1 with the Commission on March 6, 2006.³ 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 Phlx Rules 1066(c)(1) and 1080(b)(i)(A) and (C), and to delete Options Floor Procedure Advices (“OFPAs”) A-5 and A-6, to permit customer and off-

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1, which replaced the original filing in its entirety, adds clarifying language to the description of the proposed rule change and adopts a definition of “agency order” in Phlx Rule 1080(b)(i)(A).

floor broker-dealer stop⁴ and stop-limit⁵ orders in options to be delivered via the Exchange's Automated Options Market ("AUTOM") System⁶ and to be handled electronically. The Exchange also proposes to amend Phlx Rule 1080(b)(i)(A) to include the definition of "agency order" in the rule. The text of the proposed rule change is set forth below. Proposed new language is underlined; deletions are in [brackets].

* * * * *

Rule 1066. Certain Types of Orders Defined

(a) – (b) No change.

(c) Contingency Order. A contingency order is a limit or market order to buy or sell that is contingent upon a condition being satisfied while the order is at the post.

(1) Stop-Limit Order. A stop-limit order is a contingency order to buy or sell at a limited price when [the market] a trade or quote on the Exchange for a particular option contract reaches a specified price. A stop-limit order to buy becomes a limit order executable at the limit price or better when the option contract trades or is bid on the Exchange at or above the stop-limit price [, after the offer is represented in the trading crowd]. A stop-limit order to sell becomes a limit

⁴ A stop order is a contingency order to buy or sell when the market for a particular option contract reaches a specified price. A stop order to buy becomes a market order when the option contract trades or is bid at or above the stop price. A stop order to sell becomes a market order when the option contract trades or is offered at or below the stop price. See Phlx Rule 1066(c)(1).

⁵ A stop-limit order is a contingency order to buy or sell at a limited price when the market for a particular option contract reaches a specified price. A stop limit order to buy becomes a limit order executable at the limit price or better when the option contract trades or is bid at or above the stop-limit price. A stop limit order to sell becomes a limit order executable at the limit price or better when the option contract trades or is offered at or below the stop limit price. See id.

⁶ See Phlx Rule 1080.

order executable at the limit price or better when the option contract trades or is offered on the Exchange at or below the stop-limit price [, after the order is represented in the trading crowd].

Stop (stop-loss) Order. A stop order is a contingency order to buy or sell when [the market] a trade or quote on the Exchange for a particular option contract reaches a specified price. A stop order to buy becomes a market order when the option contract trades or is bid on the Exchange at or above the stop price[, after the order is represented in the trading crowd]. A stop order to sell becomes a market order when the option contract trades or is offered on the Exchange at or below the stop price[, after the order is represented in the trading crowd].

Notwithstanding the foregoing, a stop or stop-limit order shall not be elected by a trade that is reported late or out of sequence.

[Stop and stop-limit orders elected by a quotation must be given floor official approval prior to execution or, if circumstances make it impractical for prior approval, promptly following the execution. The facts surrounding each instance when retroactive approval is requested must be documented in writing, signed by the specialist and floor official, and submitted to the Surveillance Department on the day of the trade.]

(2) – (7) No change.

(d) – (g) No change.

Commentary: No change.

* * * * *

**Rule 1080. Philadelphia Stock Exchange Automated Options Market (AUTOM)
and Automatic Execution System (AUTO-X)**

(a) No change.

(b) Eligible Orders

(i) The following types of orders are eligible for entry into AUTOM:

(A) Agency orders may be entered. The following types of agency orders are eligible for AUTOM: day, GTC, Immediate or Cancel (“IOC”), market, limit, stop, stop-limit, all or none, or better, simple cancel, simple cancel to reduce size (cancel leaves), cancel to change price, cancel with replacement order, and possible duplicate orders. For purposes of Exchange options trading, an agency order is any order entered on behalf of a public customer, and does not include any order entered for the account of a broker-dealer, or any account in which a broker-dealer or an associated person of a broker-dealer has any direct or indirect interest.

(B) No change.

(C) Off-floor broker-dealer limit orders, subject to the restrictions on order entry set forth in Commentary .05 of this Rule, may be entered. The following types of broker-dealer limit orders are eligible for AUTOM: day, GTC, IOC, stop, stop-limit, simple cancel, simple cancel to reduce size (cancel leaves), cancel to change price, cancel with replacement order. For purposes of this Rule 1080, the term “off-floor broker-dealer” means a broker-dealer that delivers orders from off the floor of the Exchange for the proprietary account(s) of such broker-dealer, including a market maker located on an exchange or trading floor other than the Exchange's trading floor who elects to deliver orders via AUTOM for the proprietary account(s) of such market maker.

(ii) – (iii) No change.

(c) – (k) No change.

(l) Directed Orders. For a one-year pilot period, beginning on the date of approval of this Rule by the Securities and Exchange Commission, respecting Streaming Quote Options traded on Phlx XL, specialists, RSQTs and SQTs may receive Directed Orders (as defined in this Rule) in accordance with the provisions of this Rule 1080(l).

(i) (A) The term “Directed Order” means any customer order (other than a stop or stop-limit order as defined in Rule 1066) to buy or sell which has been directed to a particular specialist, RSQT, or SQT by an Order Flow Provider, as defined below. To qualify as a Directed Order, an order must be delivered to the Exchange via AUTOM.

(B) – (C) No change.

(ii) – (iv) No change.

Commentary: No change.

* * * * *

A-5 RESERVED [Execution of Stop and Stop Limit Orders

Stop and stop-limit orders are contingency orders to buy or sell when the market for a particular option reaches a specified price.

Stop and stop-limit orders to buy become eligible for execution when the option trades at or above the stop price or when the bid price for the option is at or above the stop price. Stop and stop-limit orders to sell become eligible for execution when the option trades at or below the stop price or when the offer price for the option is at or below the stop price. A stop or stop-limit order which will be made eligible by an opening sale should be executed as the opening trade or included with the opening trade.

Stop and stop-limit orders elected by a quotation must be given Floor Official approval prior to execution or, if circumstances make it impractical for prior approval, promptly following the execution. The facts surrounding each instance where retroactive approval is requested must be documented in writing, signed by the Specialist and Floor Official, and submitted to the Surveillance Department on the day of the trade.

A Specialist may refuse to accept stop and/or stop limit orders on the book if he has received the approval of one Floor Official no later than 30 minutes before the opening, or such orders shall be accepted throughout the day. Notification of such approval will be posted on the Exchange floor one-half hour before the opening. All stop or stop-limit orders which have been entrusted to the Specialist shall be returned to the responsible member immediately upon Floor Official approval for the return of such orders.

FINE SCHEDULE

A-5

Fine not applicable]

* * * * *

A-6 RESERVED [Cancel/Replacement Process

It is the responsibility of the Specialist to notify the appropriate brokers when orders they placed on the Specialist book become subject to a cancel/replacement process. This process shall normally be required when: (1) there is a change in the contract terms of an option, (2) there is a transfer of the Specialist book, or (3) in any other instance where two Floor Officials approve a cancel/replacement of orders on the book.

In all instances where a required cancel/replacement of all orders on the book occurs, it is the responsibility of the Specialist to ensure that, to the extent possible, any such replacement order will not incur a loss of the priority it established prior to the cancel/replacement process.

FINE SCHEDULE (Implemented on a two-year running calendar basis)

A-6

1st Occurrence: \$250.00

2nd Occurrence: \$500.00

3rd Occurrence: \$1,000.00

4th Occurrence and Thereafter: Sanction is discretionary with Business Conduct Committee]

* * * * *

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 proposal and discussed any comments it received on the proposal. 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 purpose of the proposed rule change is to increase the number of option transactions on the Exchange that are handled automatically by establishing rules that permit the electronic delivery and handling of stop and stop-limit orders on the Exchange, and to delete certain provisions in the Exchange's rules concerning stop and stop-limit orders that are either redundant or no longer practical. Currently, stop and stop-limit orders in options are not deliverable electronically via AUTOM. The proposal would amend the Exchange's rules to permit the electronic delivery of stop and stop-limit orders to the Exchange via AUTOM.

Election of Stop and Stop-Limit Orders

Stop orders delivered electronically on the Exchange's AUTOM System would be handled in the system as market orders once elected by a trade or quote on the Exchange.⁷ Stop-limit orders delivered electronically to the limit order book would become live limit orders in the system once elected by a trade or quotation on the Exchange, and would be placed on the limit order book⁸ in price-time priority as of the time of election.⁹

The proposed rule change would provide that, notwithstanding the foregoing, a stop or stop-limit order would not be elected by a trade that is reported late or out of sequence. The purpose of this provision is to ensure systemically that a stop or stop-limit order would be elected on the Exchange by the execution price at the actual time of the execution, instead of at the time of a late or out-of-sequence report. Absent this provision, it would be possible for a stop or stop-limit order to be elected by a trade that is reported late or out-of-sequence, which could result in such stop or stop-limit order being converted into a market or limit order and, in the case of a stop order, executed at a significantly different price than the election price of the stop order.¹⁰

⁷ A stop or stop-limit order is "elected" when the market (i.e., a trade or quotation) for a particular option contract reaches a specified price. Under the proposal, such orders would be elected when a trade or quote occurs on the Exchange that causes the Exchange's market to reach the specified price of the stop or stop-limit order. See Phlx Rule 1066(c)(1).

⁸ See Phlx Rule 1080, Commentary .02.

⁹ An opening trade or quotation would also elect a stop or stop-limit order. A stop or stop-limit order that is elected by an opening trade or quotation is treated as a market or limit order for purposes of the Exchange's rules concerning openings. See Phlx Rule 1017.

¹⁰ For example, if a stop order to sell at \$3.00 is elected by a trade reported late or out-of-sequence with an execution price of \$3.00 when the actual bid price at the time of the report is \$1.00, the stop order would be converted into a market order and executed at \$1.00.

A stop-limit order that is elected out-of-sequence could be converted incorrectly into a live limit order that has a price that is significantly different than the then-current market price.

Eligible Order Types

Phlx Rules 1080(b)(i)(A) and (C) would be amended to include agency¹¹ and off-floor broker-dealer¹² stop and stop-limit orders as order types that are eligible for electronic delivery on the Exchange's systems.

Floor Official Approval Requirement

OFPA A-5 and Phlx Rule 1066(c)(1) currently provide that stop and stop-limit orders elected by a quotation must be given floor official approval prior to execution or, if circumstances make it impractical for prior approval, promptly following the execution. The facts surrounding each instance when retroactive approval is requested must be documented in writing, signed by the specialist and floor official, and submitted to the Surveillance Department on the day of the trade.

Under the instant proposal, stop and stop-limit orders would be entered electronically and executed and handled automatically on the Exchange's electronic trading platform for options,

¹¹ The Exchange has defined an agency order as any order entered on behalf of a public customer, excluding any order entered for the account of a broker-dealer, or any account in which a broker-dealer or an associated person of a broker-dealer has any direct or indirect interest. See Securities Exchange Act Release Nos. 46763 (November 1, 2002), 67 FR 68898 (November 13, 2002) and 40970 (January 25, 1999), 64 FR 4922 (February 1, 1999). The Exchange proposes to codify this definition in Phlx Rule 1080(b)(i)(A).

¹² The term "off-floor broker-dealer" means a broker-dealer that delivers orders from off the floor of the Exchange for the proprietary account(s) of such broker-dealer, including a market maker located on an exchange or trading floor other than the Exchange's trading floor who elects to deliver orders via the Exchange's electronic order routing, delivery, execution and reporting system, AUTOM, for the proprietary account(s) of such market maker. See Phlx Rule 1080(b)(i)(C).

Phlx XL.¹³ The Exchange believes that it would be impractical in an electronic trading environment to require Floor Official approval prior to the execution of each stop and stop-limit order that is entered onto the system.

Accordingly, the Exchange proposes to delete the provision from Phlx Rule 1066(c)(1) requiring Floor Official approval prior to the execution of stop and stop-limit orders. The provision would also be deleted from OFPA A-5, which is proposed to be deleted in its entirety, as set forth more fully below.

In-Crowd Representation Requirement

Phlx Rule 1066(c)(1) currently provides that stop and stop-limit orders are elected only after the order is represented in the trading crowd. The Exchange believes that, with the advent of Phlx XL and increasingly automated quoting, trading and order handling in options obviates the need for the requirement that a stop order be represented in the crowd prior to execution. A stop order (or a stop-limit order that becomes a marketable limit order) that is elected by a quotation would be executed, reported and allocated automatically by the Exchange's systems. Thus, there could be no "representation in the crowd" prior to such an execution. The Exchange therefore proposes to delete the requirement that such orders be represented in the crowd as a prerequisite to their election.

¹³ See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 44612 (August 3, 2004).

Exclusion From the Definition of “Directed Orders”

In May 2005, the Exchange adopted rules that permit Exchange specialists, Streaming Quote Traders (“SQTs”),¹⁴ and Remote Streaming Quote Traders (“RSQTs”)¹⁵ to receive Directed Orders, and to provide a participation guarantee to specialists, SQTs and RSQTs that receive Directed Orders.¹⁶

Currently, Phlx Rule 1080(l) defines the term “Directed Order” as any customer order to buy or sell that has been directed to a particular specialist, SQT, or RSQT by an order flow provider. The Exchange proposes an amendment to Phlx Rule 1080(l) that would specifically exclude stop and stop-limit orders from the definition of a Directed Order. Directed Orders must be executed and allocated electronically in accordance with the Exchange’s rules that provide the participation guarantee described above.¹⁷ A stop or stop-limit order that is elected on the Exchange might not be eligible for automatic execution¹⁸ and instead would be handled manually by the specialist and allocated in accordance with Phlx Rule 1014(g)(v), which governs

¹⁴ 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. An SQT may only submit such quotations while such SQT is physically present on the floor of the Exchange. See Phlx Rule 1014(b)(ii)(A).

¹⁵ 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 only submit such quotations electronically from off the floor of the Exchange. See Phlx Rule 1014(b)(ii)(B).

¹⁶ See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005). See also Phlx Rule 1014(g)(viii) (setting forth the automatic trade allocation algorithm for Directed Orders).

¹⁷ See Phlx Rule 1014(g)(viii).

¹⁸ For example, an order is not eligible for automatic execution on the Exchange when the Exchange’s bid or offer is not the National Best Bid or Offer. See Phlx Rule 1080(c)(iv)(E).

manual trade allocation and does not provide a participation guarantee to the recipient of a Directed Order. Such a stop or stop-limit order that is allocated manually would not be allocated pursuant to Phlx Rule 1014(g)(viii), the trade allocation algorithm applicable to Directed Orders. Therefore, the Exchange proposes to exclude stop and stop-limit orders from the definition of “Directed Order.”

Deletion of OFPA A-5 in its Entirety

OFPA A-5 currently includes a provision that a specialist may refuse to accept stop and/or stop-limit orders on the book if he has received the approval of one Floor Official no later than 30 minutes before the opening. The original purpose of this provision was to allow the specialist to manage his or her risk of missing, or not timely executing, elected stop and stop-limit orders in options that are expected to be volatile during the trading day due to, for example, pending news or other event-driven changes in the market for the particular option. The Exchange believes that, because stop and stop-limit orders would be elected automatically under the proposal, specialists would no longer be subject to such risks. The Exchange therefore proposes to delete the provision permitting specialists to refuse to accept stop and stop-limit orders with the proper Floor Official approval.

The Exchange proposes to delete OFPA A-5 in its entirety. The descriptive language of stop and stop-limit orders contained in OFPA A-5 is currently contained in Phlx Rule 1066, and would remain in Rule 1066. Additionally, the provision that a stop or stop-limit order which will be made eligible by an opening sale should be executed as the opening trade or included with the opening trade is addressed in Phlx Rule 1017, which includes market orders (such as those that are the result of a stop order being elected) and limit orders (such as those resulting from a limit

order being elected) that are treated as market orders under that rule, in the opening of trading in a particular series.

The remaining sections of OFPA A-5 regarding the requirement to obtain Floor Official approval prior to election, and permitting specialists to refuse to accept stop and stop-limit orders with prior Floor Official approval, would be deleted for the reasons stated above. In addition, the Exchange historically adopted some OFPAs in order to reprint them in a pocket format; this rationale is outdated and no longer applies.

Deletion of OFPA A-6 in its Entirety

Currently, OFPA A-6, Cancel/Replacement Process, requires the specialist to notify “the appropriate brokers” when orders they placed on the limit order book become subject to a cancel/replacement process. Notification of the cancel/replacement process is now provided systemically, except with respect to stop and stop-limit orders placed with the specialist. Stop and stop-limit orders are the only order types for which the specialist is currently responsible to notify the appropriate Exchange member or member organization when stop and stop-limit orders they placed with the specialist become subject to a cancel/replacement process (due to, for example, a transfer or an adjustment for a dividend). Once stop and stop-limit orders are automated the specialist would no longer responsible for notification of cancel/replacement activity for any order type. Therefore the OFPA is proposed to be deleted in its entirety.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act¹⁹ in general, and furthers the objectives of Section 6(b)(5) of the Act²⁰ in particular, in that it is

¹⁹ 15 U.S.C. 78f(b).

²⁰ 15 U.S.C. 78f(b)(5).

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 increasing the number of orders handled electronically and establishing rules that permit the electronic delivery and handling of stop and stop-limit orders via the Exchange's AUTOM System.

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

The Exchange does not believe that the proposed rule change would 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 Exchange neither solicited nor received comments with respect to the proposed rule change.

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

Within 35 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 self-regulatory organization consents, the Commission will:

(A) by order approve 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, 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 Number SR-Phlx-2005-80 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 Number SR-Phlx-2005-80. 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 inspection and copying in the Commission's Public Reference Room. 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-2005-80 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.²¹

Nancy M. Morris
Secretary

²¹ 17 CFR 200.30-3(a)(12).