SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54070; File No. SR-Phlx-2005-73)

June 29, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval of a Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to the Exchange's Obvious Error Rule

I. Introduction

On November 14, 2005, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend Phlx Rule 1092 with respect to: (1) the definition of "obvious error" and (2) the definition of "Theoretical Price." On November 18, 2005, the Phlx submitted Amendment No. 1 to the proposed rule change.[3] On April 6, 2006, the Phlx submitted Amendment No. 2 to the proposed rule change.[4] The proposed rule change and Amendment Nos. 1 and 2 were published for comment in the Federal Register on May 15, 2006.[5] The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Amendment No. 1 corrected technical errors in the proposed rule text.

4 Amendment No. 2 deleted the proposed revisions to Phlx Rule 1092(c) that related to an erroneous print disseminated by the underlying market that is later cancelled or corrected by the underlying market and an erroneous quote in the underlying market. Thus, the Exchange does not propose to make any changes to Phlx Rule 1092(c).

5 Securities Exchange Act Release No. 53776 (May 9, 2006).

II. Description fo the Proposed Rule Change

The Phlx proposes to amend its Obvious Error Rule, Phlx Rule 1092. Currently, Phlx Rule 1092(a) defines “obvious error” as the execution price of a transaction that is higher or lower than the Theoretical Price (if the Theoretical Price is less than $3.00) for the series by an amount of 35 cents or more, or, during unusual market conditions (i.e., the Exchange has declared an unusual market condition status for the option in question), by an amount of 50 cents or more. Where the Theoretical Price is $3.00 or more, “obvious error” is defined as the execution price of a transaction that is higher or lower than the Theoretical Price for the series by an amount equal to at least two times the allowable maximum bid/ask spread for the series, so long as the amount is 50 cents or more, and three times the allowable bid/ask spread during unusual market conditions.

The proposed rule change would revise the definition of “obvious error” by deeming an “obvious error” to have occurred when the execution price of a transaction is higher or lower than the Theoretical Price for a series by an amount equal to at least the amount shown below:

Theoretical Price	**Minimum Amount**
Below $2	$.25
$2 to $5	$.40
Above $5 to $10	$.50
Above $10 to $20	$.80
Above $20	$1.00

The Exchange believes that the proposed new definition of “obvious error” would facilitate the efficient determination by Floor Officials regarding whether a trade resulted from an obvious error by setting minimum amounts by which the transaction price differs from the Theoretical Price without requiring such Floor Officials to conduct an inquiry into the volume of all exchanges each time they review a transaction under the rule. The proposed definition of "obvious error" would apply during both normal and unusual market conditions, which in the Exchange's view would further streamline the Floor Officials' process of determining whether an obvious error exists.[6]

Phlx Rule 1092(b) defines "Theoretical Price" as the last bid or offer, just prior to the transaction, on the exchange that has the most total volume in that option over the most recent 60 calendar days; or, if there are no quotes for comparison purposes, as determined by two Floor Officials and designated personnel in the Exchange's Market Surveillance Department.
The proposed rule change would revise the definition of "Theoretical Price" as, respecting series traded on at least one other options exchange, the mid-point of the National Best Bid and Offer ("NBBO") just prior to the transaction.

According to the Exchange, currently all options exchanges, including the Phlx, have rules permitting specialists and market makers to disseminate electronic quotations with a bid/ask differential of up to $5.00, regardless of the price of the bid.[7] For the most part, the Phlx believes that such quotations do not reflect the NBBO. Under current Phlx Rule 1092, the Theoretical Price, defined as the last bid or offer just prior to the transaction on the market with the highest volume, could differ from the NBBO by a significant amount if the bid/ask differential on such market in the series is $5.00 wide. To account for this potential discrepancy

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6 The Commission recently approved the Exchange's proposal to establish the position of neutral Referee who, among other things, would review Floor Officials' obvious error rulings. See Securities Exchange Act Release No. 53548 (March 24, 2006), 71 FR 16389 (March 31, 2006) (SR-Phlx-2005-42).

7 See, e.g., Exchange Rule 1014(c)(i)(A)(2).

between the Theoretical Price as established by rule and the actual NBBO, the proposal would revise the definition of the term “Theoretical Price” to mean the mid-point of the NBBO just prior to the transaction. The Exchange believes that this new definition should provide Exchange Floor Officials with a more accurate measure of the price on which to base their determination that a transaction resulted from an obvious error. The Exchange also proposes to delete Commentary .02 to Phlx Rule 1092 from the Rule.[8] This Commentary sets forth how Theoretical Price would be determined under current Phlx Rule 1092(c).

. III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange[9] and, in particular, the requirements of Section 6(b) of the Act[10] and the rules and regulations thereunder. Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,[11] in that the proposal promotes just and equitable principles of trade, removes impediments to and perfects the mechanism of a free and open market and a national market system, and protects investors and the public interest.

The Commission considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an "obvious error" may exist, suggesting that it is unrealistic to expect that the parties to the trade

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8 Phlx Rule 1092(b) would retain the provision that if there are no quotes for comparison purposes, two Floor Officials and designated personnel in the Exchange’s Market Surveillance Department would determine Theoretical Price.

9 In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

10 15 U.S.C. 78f(b).

11 15 U.S.C. 78f(b)(5).

had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether an "obvious error" has occurred should be based on specific and objective criteria and subject to specific and objective procedures. The Phlx's proposal would provide specific and objective numerical criteria to be used by Floor Officials to determine whether a particular transaction involved an obvious error. In addition, the Exchange's proposal to base the definition of Theoretical Price on the midpoint of the NBBO would ensure that the Phlx's obvious error rule is consistent with the Options Intermarket Linkage Plan, which requires exchanges to avoid trade-throughs. Accordingly, the Commission finds that the Exchange's proposal is consistent with the Act.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[12] that the proposed rule change (SR-Phlx-2005-73), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[13]

Nancy M. Morris
Secretary

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12 15 U.S.C. 78f(b)(2).

13 17 CFR 200.30-3(a)(12).