

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53874; File No. SR-Phlx-2006-18)

May 25, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendment No. 1 Thereto Relating to Split Price Priority in Options

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹, and Rule 19b-4² thereunder, notice is hereby given that on March 2, 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. On May 9, 2006, Phlx filed an amendment to the proposed rule change ("Amendment No. 1").³ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal on an accelerated basis.

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

The Exchange proposes to amend Phlx Rule 1014(g)(i)(C)⁴ to adopt a new split price priority provision that establishes priority for in-crowd participants in split price transactions over the quotations of participants that are not located in the crowd (i.e., out-

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, the Exchange revised the rule text of the proposed rule change to clarify its meaning and revised the purpose section to clarify the operation of the Exchange's current split price priority rule and the proposed modification to that rule.

⁴ Phlx Rule 1014(g)(i)(C) is subject to a pilot program scheduled to expire on June 30, 2006. See infra Section II. A.1.

of-crowd Streaming Quote Traders (“SQTs”)⁵ and Remote Streaming Quote Traders (“RSQTs”)⁶) even where the market has a bid/ask differential of one minimum trading increment.⁷ The text of the proposed rule change, as amended, is set forth below.

Proposed new language is underlined; deleted language is in brackets.⁸

* * * * *

Obligations and Restrictions Applicable to Specialists and Registered Options Traders

Rule 1014. (a) – (f) No change.

(g) Equity Option and Index Option Priority and Parity

(i) (A) – (B)

(C) Purchase or sale priority for orders of 100 contracts or more. If a member purchases (sells) 50 or more option contracts of a particular series at a particular price or prices, he shall, at the next lower (higher) price have priority in purchasing (selling) up to the equivalent number of option contracts of the same

⁵ An SQT is an 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).

⁶ 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).

⁷ 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).

⁸ The bracketed word “and” in the final sentence of the rule text set forth below is indicated in Exhibit 4 of the proposed rule change.

series that he purchased (sold) at the higher (lower) price or prices, but only if his bid (offer) is made promptly and the purchase (sale) so effected represents the opposite side of a transaction with the same order or offer (bid) as the earlier purchase or purchases (sale or sales).

When the market has a bid/ask differential of one minimum trading increment and the bid and/or offer represent the quotation of an out-of-crowd SQT or an RSQT, such member shall have priority over such SQT and/or RSQT with respect to both the bid and the offer.

The Options Committee may increase the “minimum qualifying order size” above 100 contracts for all products under its jurisdiction. Announcements regarding changes to the minimum qualifying order size shall be made via an Exchange circular. This paragraph is subject to a pilot scheduled to expire June 30, 2006, and shall only apply to transactions in equity options (including [and] options overlying Exchange Traded Fund Shares (“ETFs”)) and only to such transactions that are effected in open outcry.

(h) No change.

Commentary: No change.

* * * * *

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, as amended, 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 III 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 modify an existing pilot program concerning split-price transactions (“pilot”),⁹ 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 on June 30, 2006.

The Exchange proposes to modify the pilot such that when the market has a bid/ask differential of one minimum trading increment and the bid and/or offer represent the quotation of an out of-crowd SQT or an RSQT, the rule would apply to grant priority over such SQT and/or RSQT with respect to the bid and/or the offer. Thus, the Exchange is expanding the pilot to include priority in both trades of the split price transaction where there is a minimum trading increment market, but only over an out of-crowd SQT or an RSQT. Such priority would apply only when the bid and/or ask, as applicable, represent the quotation of an out of-crowd SQT or an RSQT.

Current Pilot

The current pilot, applicable to equity options (including options overlying Exchange Traded Fund Shares, permits a member with an order for at least 100

⁹ See Securities Exchange Act Release No. 53021 (December 23, 2005), 70 FR 77435 (December 30, 2005) (SR-Phlx-2005-86).

contracts¹⁰ 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.¹¹

For example, where the market is \$.25 - \$.35, a Floor Broker who is representing an order to purchase 100 contracts and 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 Floor Broker's customer thus would receive a net purchase price of \$.275 for 100 contracts.

In this example, the Floor Broker would not be able to use this provision in a minimum increment market (e.g., \$.25 - \$.30), because he or she could not execute the first trade at \$.30 at all, regardless of the current split price priority provision, because that provision does not give priority over whoever is offering at \$.30 until the second trade. Accordingly, the Exchange is proposing to amend the split price priority provision, as described below.

Proposed Modification to the Current Pilot

As stated above, the current pilot contemplates that a member who purchases (sells) 50 or more option contracts of a particular series at a particular price or prices has priority at the next lower (higher) price in purchasing (selling) up to the equivalent

¹⁰ Orders for a size of less than 100 contracts are not eligible for the current pilot and would not be affected by this proposed rule change.

¹¹ See Phlx Rule 119(a).

number of option contracts of the same series that he or she purchased (sold) at the higher (lower) price or prices. The proposed rule change would afford priority to members physically located in the crowd with respect to split price transactions in those instances when the market has a bid/ask differential of one minimum trading increment and the bid and/or ask represent quotations of members physically located outside of the crowd. The Exchange believes that this provision should enable it to compete for order flow in situations where Floor Brokers seek split price executions in open outcry when the bid and/or ask consists of RSQT quotations and/or the quotations of an out-of-crowd SQT and there is a bid/ask differential of one minimum trading increment.

The Exchange provides the following example: assume a Floor Broker represents an order to purchase 100 contracts in a series where the market is \$0.25 bid, \$0.30 offer, and both the bid and offer represent quotations submitted by out of-crowd SQTs¹² or RSQTs. Under the proposal, the Floor Broker and contra-side participant in the trading crowd would be afforded priority over the out-of-crowd SQT or RSQT at both \$0.25 and \$0.30, because 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 (\$0.275) that improves the market. According to the Phlx, the effect (and ultimate benefit) to that Floor Broker's customer would be a net purchase price of \$.275 for 100 contracts. The proposed rule change would apply only with respect to quotations submitted by out-of-

¹² 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).

crowd SQTs and RSQTs, and thus would 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. 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.¹³ Accordingly, the Exchange has proposed a limited exception to its priority rule in the context of split price transactions.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act¹⁴ in general, and furthers the objectives of Section 6(b)(5) of the Act¹⁵ 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. According to the Exchange, the rule would enable Floor Brokers representing split price orders in open outcry to provide split-price executions at improved prices on behalf of customers by

¹³ 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).

¹⁴ 15 U.S.C. 78f(b).

¹⁵ 15 U.S.C. 78f(b)(5).

establishing a limited priority rule regarding split-price transactions when the bid/ask differential is one minimum trading increment and the bid and/or ask represent the quotation of an out-of-crowd participant.

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

No written comments were either solicited or received.

III. 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-2006-18 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-2006-18. 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 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-2006-18 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Approval of the Proposed Rule Change

After careful consideration, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder, applicable to a national securities exchange, and, in particular with the requirements of Section 6(b)(5) of the Act.¹⁶ The proposed rule change would provide a limited exception to the Exchange's split price priority rule by allowing a Floor Broker

¹⁶ In approving this proposed rule change, as amended, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

and a contra-side participant in the trading crowd to have priority over an out-of-crowd SQT or an RSQT when there is a bid/ask differential of one minimum trading increment that is established by the quotes of such SQT or RSQT. The Commission believes that the proposed rule change should help facilitate better priced executions for larger-sized orders on the floor of the Exchange. The Commission notes that it has previously approved rule proposals that permit an exchange to grant priority to in-crowd participants in open outcry auctions on its floor over market participants who are not physically present in the crowd.¹⁷

The Exchange has requested accelerated approval of the proposed rule change. The Commission finds good cause, consistent with Section 19(b)(2) of the Act, to approve the proposed rule change, as amended, prior to the 30th day after the date of publication of the notice of filing thereof in the Federal Register. As noted above, the Exchange's proposal yields a result similar to that of CBOE rules previously approved by the Commission that permit a Floor Broker and a contra-side participant in the trading crowd to have priority in split price transactions over out-of-crowd participants when there is a bid/ask differential of one trading increment.¹⁸ Accordingly, the Commission

¹⁷ See supra note 13.

¹⁸ Id.

believes that it is appropriate to approve the proposed rule change on an accelerated basis to allow the Phlx to compete more effectively for larger-sized orders in open outcry transactions on the floor of the Exchange.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of Act,¹⁹ that the proposed rule change, as amended (Phlx-2006-18), is hereby approved on an accelerated basis until the expiration of the current split price priority pilot program on June 30, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Nancy M. Morris
Secretary

¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).