

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51947; File No. SR-Phlx-2005-39)

June 30, 2005

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Equity Option Specialist Deficit (Shortfall) Fee

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 6, 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 Phlx. The Exchange filed this proposal pursuant to Section 19(b)(3)(A)(ii) of the Act,³ and Rule 19b-4(f)(2) thereunder,⁴ 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 its Equity Option Specialist Deficit (Shortfall) Fee ("shortfall fee") to no longer charge the equity option specialist the shortfall fee when one or

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(ii).

⁴ 17 CFR 240.19b-4(f)(2).

more Streaming Quote Traders ("SQTs")⁵ or Remote Streaming Quote Traders ("RSQTs")⁶ trading on the Exchange's electronic options trading platform, Phlx XL⁷, have been designated to receive Directed Orders⁸ from Order Flow Providers⁹ for the same option in which that specialist unit is acting as the specialist.

Currently, the Exchange charges equity options specialist units¹⁰ a shortfall fee of \$0.35

⁵ An SQT is an Exchange Registered Options Trader ("ROT") who has received permission from the Exchange to generate and submit option quotations electronically through an electronic interface with AUTOM via an Exchange approved proprietary electronic quoting device in eligible options to which such SQT is assigned. 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. See Exchange Rules 1014(b)(ii) and 1080.

⁶ An RSQT is an Exchange ROT that is a member or member organization of the Exchange 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. An RSQT may only trade in a market making capacity in classes of options in which he is assigned. See Exchange Rule 1014(b)(ii)(B). See Securities Exchange Act Release Nos. 51126 (February 2, 2005), 70 FR 6915 (February 9, 2005) (SR-Phlx-2004-90) and 51428 (March 24, 2005) (SR-Phlx-2005-12).

⁷ In July 2004, the Exchange began trading equity options on Phlx XL, followed by index options in December 2004. See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 46612 (August 3, 2004) (SR-Phlx-2003-59).

⁸ The term "Directed Order" means any customer order to buy or sell which has been directed to a particular specialist, RSQT, or SQT by an Order Flow Provider (defined below in footnote 9). See Exchange Rule 1080(l). The provisions of Rule 1080(l) are in effect for a one-year pilot period to expire on May 27, 2006. See Securities Exchange Act Release No. 51759 (May 27, 2005) (SR-Phlx-2004-91).

⁹ An "Order Flow Provider" is any member or member organization that submits, as agent, customer orders to the Exchange. See Exchange Rule 1080(l).

¹⁰ The Exchange uses the terms "specialist unit" and "specialist" interchangeably herein.

per contract to be paid monthly in connection with transactions in any top 120 equity option,¹¹ including Streaming Quote Options traded on Phlx XL,¹² in most cases,¹³ if at least 12 percent of the total national monthly contract volume in that option is not effected on the Exchange in that month.

A shortfall fee cap is applied to transactions in any of the top 120 equity options pursuant to the following schedule: (1) If Phlx volume in any top 120 equity option, except options on Nasdaq-100 Index Tracking StockSM (traded under the symbol "QQQQ"),¹⁴ is less than or equal to 50 percent of the current threshold volume (presently six percent), a cap of \$10,000 will apply; (2) If Phlx volume in any top 120 equity option, except options on QQQQ, is greater than 50

¹¹ A top 120 equity option is defined as one of the 120 most actively traded equity options in terms of the total number of contracts in that option that were traded nationally for a specified month, based on volume reflected by The Options Clearing Corporation.

¹² See Securities Exchange Act Release No. 51096 (January 28, 2005), 70 FR 6495 (February 7, 2005) (SR-Phlx-2004-96).

¹³ An exception to the 12 percent volume threshold amount relates to a transition period for newly listed top 120 options or for any top 120 option (including those equity options listed on the Exchange before February 1, 2004) acquired by a new specialist unit. During the transition period, the shortfall fee is imposed in stages such that the requisite volume threshold is zero percent for the first full calendar month of trading, three percent for the second full calendar month of trading, six percent for the third full calendar month of trading, nine percent for the fourth full calendar month of trading and 12 percent for the fifth full calendar month of trading (and thereafter). See Securities Exchange Act Release No. 49324 (February 26, 2004), 69 FR 10089 (March 3, 2004) (SR-Phlx-2004-08).

¹⁴ The Nasdaq-100®, Nasdaq-100 Index®, Nasdaq®, The Nasdaq Stock Market®, Nasdaq-100 SharesSM, Nasdaq-100 TrustSM, Nasdaq-100 Index Tracking StockSM, and QQQSM are trademarks or service marks of The Nasdaq Stock Market, Inc. ("Nasdaq") and have been licensed for use for certain purposes by the Exchange pursuant to a License Agreement with Nasdaq. The Nasdaq-100 Index® ("Index") is determined, composed, and calculated by Nasdaq without regard to the Licensee, the Nasdaq-100 TrustSM, or the beneficial owners of Nasdaq-100 SharesSM. Nasdaq has complete control and sole discretion in determining, comprising, or calculating the Index or in modifying in any way its method for determining, comprising, or calculating the Index in the future.

percent of the current threshold volume (presently six percent) and less than 12 percent of the total national monthly contract volume, a cap of \$5,000 will apply; (3) If Phlx volume in options on QQQQ is less than or equal to 50 percent of the current threshold volume (presently six percent), a cap of \$20,000 will apply; and (4) If Phlx volume in options on QQQQ is greater than 50 percent of the current threshold volume (presently six percent) and less than 12 percent of the total national monthly contract volume, a cap of \$10,000 will apply.

Any applicable cap will be pro rated in the month that the Exchange's system designates the option(s) to be directed to a specific SQT or RSQT.

The amount of the shortfall fee and the applicable caps as described above, as well as all other aspects of the shortfall fee, will remain unchanged.¹⁵

This proposal is scheduled to apply to for trades settling on or after June 6, 2005.

The text of the proposed rule change is available on the Exchange's Web site (<http://www.phlx.com>), at the Phlx's Office of the Secretary, and at the Commission's Public Reference Room.

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

¹⁵ For example, the total volume calculation for purposes of determining the requisite threshold will continue to be based on the current month's volume and the three-month differentiation to determine whether an equity option is considered a top 120 option will also remain in effect, *i.e.* December's top 120 options are based on September's volume. In addition, the \$10,000 cap applied in connection with the tiered threshold schedule for any newly listed top 120 option and any top 120 option acquired by a new specialist unit, not affiliated with an existing Phlx options specialist unit will remain unchanged. See Securities Exchange Act Release No. 49324 (February 26, 2004), 69 FR 10089 (March 3, 2004) (SR-Phlx-2004-08).

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 shortfall fee is designed to create an incentive for options specialists to promote the options for which they are the designated specialists. The purpose of this proposal is to address the effect of the shortfall fee as it relates to options traded by SQTs or RSQTs. The Exchange believes that it would be unreasonable to impose a shortfall fee on specialists when SQTs or RSQTs will be competing for market share on a relatively equal basis, as the shortfall fee was designed, in part, to create an incentive for specialists to promote the options they have been allocated.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,¹⁶ in general, and furthers the objectives of Section 6(b)(4) of the Act,¹⁷ in particular, in that it provides for the equitable allocation of reasonable dues, fees, and other charges among its members.

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

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.

¹⁶ 15 U.S.C. 78f(b).

¹⁷ 15 U.S.C. 78f(b)(4).

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

The foregoing proposed rule change has become immediately effective pursuant to Section 19(b)(3)(A)(ii) of the Act¹⁸ and subparagraph (f)(2) of Rule 19b-4 thereunder,¹⁹ in that it establishes or changes a due, fee or other charge imposed by the Exchange. At any time within 60 days of the filing of such 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.

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-2005-39 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-Phlx-2005-39. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

¹⁸ 15 U.S.C. 78s(b)(3)(A)(ii).

¹⁹ 17 CFR 240.19b-4(f)(2).

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 Section. 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-2005-39 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.²⁰

Margaret H. McFarland
Deputy Secretary

²⁰ 17 CFR 200.30-3(a)(12).