SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53449; File No. SR-Phlx-2005-45)

March 8, 2006

**Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving
Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of
Amendment No. 1 Thereto Relating to the Automatic Execution of Option Transactions
During Crossed Markets**

I.   Introduction

On July 12, 2005, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed

with the Securities and Exchange Commission ("SEC" or "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 relating to the automatic execution of options transactions during crossed

markets. The proposed rule change was published for comment in the Federal Register on July

27, 2005.[3] The Exchange filed Amendment No. 1 to this proposal on December 9, 2005.

The Commission received no comments regarding the proposal. This notice and order

approve the proposed rule change and solicit comments from interested persons on Amendment

No. 1, and approve Amendment No. 1 on an accelerated basis.

II.   Description of the Proposal

Currently, Phlx Rule 1080(c)(iv)(A) states that an order otherwise eligible for automatic

execution will instead be manually handled by the specialist when the Exchange's disseminated

market is crossed or crosses the disseminated market of another options exchange.[4] The

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

[2]   17 CFR 240.19b-4.

[3]   Securities Exchange Act Release No. 52082 (July 20, 2005), 70 FR 43493.

[4]   Eligible orders are currently executed automatically on the Exchange during locked markets (i.e., 2 bid, 2 offer). See Securities Exchange Act Release No. 47359 (February 12, 2003), 68 FR 8322 (February 20, 2003) (SR-Phlx-2003-03).

proposed rule change would limit the specialist's manual handling of orders during crossed markets to situations where the market is crossed by more than one minimum trading increment (i.e., 2.10 bid, 2 offer). The proposed rule would provide that an order otherwise eligible for automatic execution would instead be handled manually by the specialist when the Exchange's disseminated market is crossed by more than one minimum trading increment, or crosses the disseminated market of another options exchange by more than one minimum trading increment. Thus, the effect of the proposal is that orders would be eligible for automatic execution when the Exchange's disseminated market is crossed or crosses another exchange's market by just one minimum trading increment (and where the Exchange's disseminated market is the NBBO).[5]

In Amendment No. 1, the Exchange proposes to amend Phlx Rule 1085, Order Protection, to provide a new exception to liability for the satisfaction of trade-throughs. Specifically, the Exchange proposes to add as a new exception to liability the situation when a trade-through is the result of an automatic execution when the Exchange's disseminated market is the NBBO and is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment.

Lastly, as a housekeeping matter, the Exchange proposes to delete Phlx Rule 1080(c)(iv)(G), a reference to an expired pilot program relating to the disengagement of AUTO-

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[5]   Orders otherwise eligible for automatic execution will instead be handled manually by the specialist when the Exchange's disseminated market is not the NBBO. See Exchange Rule 1080(c)(iv)(E). Therefore, for an order to be eligible for automatic execution during a crossed market, the Exchange's disseminated market must be the NBBO.

X for "non-Streaming Quote Options."[6]   There are no longer any non-Streaming Quote Options

traded on the Exchange; therefore Phlx Rule 1080(c)(iv)(G) is no longer applicable.

III.   Discussion

The Commission finds that the proposal is consistent with the requirements of the Act.[7]

In particular, the Commission finds that the proposed rule change furthers the objectives of

Section 6(b)(5),[8] in that it is designed to prevent fraudulent and manipulative acts and practices,

to promote just and equitable principles of trade, to foster cooperation and coordination with

persons engaged in facilitating transactions in securities, and to remove impediments to and

perfect the mechanism of a free and open market and national market system.

The Commission recognizes that markets that are crossed by only one minimum trading

increment in today's increasingly electronic marketplace reflect the number and speed of

electronic quotations and the number of market makers submitting such quotations, and,

therefore, do not necessarily indicate system errors that may result in unusual risk to market

makers, making automatic execution undesirable.

The Commission believes that by permitting automatic executions during crossed

markets in such limited situations as proposed by the Exchange, orders should be handled more

promptly and Exchange specialists and Registered Options Traders ("ROTs") should still have

sufficient ability to manage their market risk during times of crossed markets.   A market crossed

by an amount greater than one minimum trading increment may be an indication that one or

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[6]   A "non-Streaming Quote Option" was previously defined as an option that is not traded on the Exchange's electronic trading platform for options, "Phlx XL." See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 46612 (August 3, 2004) (SR-Phlx-2003-59). All options traded on the Exchange are now traded on Phlx XL.

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

[8]   15 U.S.C. 78f(b)(5).

more options market(s) or market makers may be experiencing quotation system issues that do not reflect current market conditions and consequently orders on the Exchange would be handled manually by the specialist in such circumstances.

The Commission notes, however, that in the event Phlx automatically executes orders when the Exchange's disseminated market is crossed, or crosses the disseminated market of another options exchange, by one minimum trading increment, the Exchange would be permitting trade-throughs[9] in contravention of Section 8(c) of the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Linkage Plan") and Exchange Rule 1085.[10] The Commission believes that it is appropriate and in the public interest for Phlx to except members from trade-through liability in the event that the trade-through occurred as a result of an automatic execution when the Exchange's disseminated market is the NBBO and is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment. The Commission believes that, in this limited circumstance, the benefit of providing an automatic execution outweighs the harm of the resultant trade-through. Therefore, concurrent with this order, the Commission is granting Phlx an exemption from the requirement under Exchange Act Rule 608(c) that Phlx comply with, and enforce compliance by its members with, Section 8(c) of the Linkage Plan, which provides that, "absent reasonable justification and during normal market conditions, members in [Participants'] markets should not effect Trade-Throughs"[11] and from

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[9]   A "Trade-Through" is defined in Section 2(29) of the Linkage Plan as "a transaction in an options series at a price that is inferior to the NBBO."

[10]   The Linkage Plan is a national market system plan approved by the Commission pursuant to Section 11A of the Exchange Act, 15 U.S.C. 78k-1, and Exchange Act Rule 608. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000).

[11]   See letter from Robert L.D. Colby, Acting Director, Division of Market Regulation, Commission, to Meyer S. Frucher, Chairman and Chief Executive Officer, Phlx, dated March 8, 2006.

Section 4(b) of the Linkage Plan, which requires the Exchange to enforce compliance by its members with Section 8(c) of the Linkage Plan.

The Commission finds good cause for approving Amendment No. 1 prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. In Amendment No. 1, the Exchange proposes to modify Phlx Rule 1085 to include a new exception to liability for the satisfaction of trade-throughs under the Linkage Plan. Specifically, the Exchange proposes that when a trade-through is the result of an automatic execution when the Exchange's disseminated market is the NBBO and is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment, the Exchange member that effected the trade-through should not be liable for satisfaction of such trade-through. Because the Phlx's proposal, which was published for comment, to permit automatic executions in certain, limited crossed market situations would inevitably result in trade-throughs and the proposal, therefore, could not be implemented without the changes to Phlx Rule 1085 proposed in Amendment No. 1, the Commission finds that good cause exists to accelerate approval of Amendment No. 1 to permit the proposed rule change to be implemented on an expedited basis.

Therefore, the Commission finds that granting accelerated approval to Amendment No. 1 is appropriate and consistent with Section 19(b)(2) of the Act.[12]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether the Amendment is consistent with the Act. Comments may be submitted by any of the following methods:

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[12]   15 U.S.C. 78s(b)(2).

<u>Electronic comments:</u>

- 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-2005-45 on the subject line.

<u>Paper comments:</u>

- 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-2005-45. 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 Section. Copies of such filing also will be available for inspection and copying at the principal offices 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-2005-45 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V.   Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[13] that the

proposed rule change (SR-Phlx-2005-45) is approved, and Amendment No. 1 thereto is approved

on an accelerated basis.

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

authority.[14]

Nancy M. Morris
Secretary

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[13]   15 U.S.C. 78s(b)(2).

[14]   17 CFR 200.30-3(a)(12).