

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53776; File No. SR-Phlx-2005-73)

May 9, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing of a Proposed Rule Change and Amendments No. 1 and 2 Thereto Relating to the Exchange's Obvious Error Rule

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 November 14, 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. 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 Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Phlx proposes to amend Exchange Rule 1092 (Obvious Errors). The proposed amendments to Phlx Rule 1092 would: (1) change the definition of "obvious error" to mean a transaction that occurs at an execution price that differs from the Theoretical Price by at least

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 Rule 1092(c) that related to an erroneous print disseminated by the underlying market which 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 Rule 1092(c).

the maximum allowable bid/ask differential; and (2) change the definition of “Theoretical Price” for purposes of determining whether an execution price constitutes an “obvious error.”

Below is the text of the proposed rule change, as amended. Proposed new language is underlined; proposed deletions are in [brackets].

* * * * *

Obvious Errors

Rule 1092. The Exchange shall either nullify a transaction or adjust the execution price of a transaction that results in an Obvious Error as provided in this Rule.

(a) Definition of Obvious Error. For purposes of this Rule only, an Obvious Error will be deemed 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:

<u>Theoretical Price</u>	<u>Minimum Amount</u>
<u>Below \$2</u>	<u>\$.25</u>
<u>\$2 to \$5</u>	<u>\$.40</u>
<u>Above \$5 to \$10</u>	<u>\$.50</u>
<u>Above \$10 to \$20</u>	<u>\$.80</u>
<u>Above \$20</u>	<u>\$1.00</u>

[(i) If the Theoretical Price of the option is less than \$3.00:

(A) during regular market conditions (including rotations), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount of 35 cents or more; or,

(B) during unusual market conditions (i.e., the Exchange has declared an unusual market condition status for the option in question), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount of 50 cents or more.

(ii) If the Theoretical Price of the option is \$3.00 or more:

(A) during regular market conditions (including rotations), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount equal to at least two times the maximum bid/ask spread allowed for the series, so long as such amount is 50 cents or more; or

(B) during unusual market conditions (i.e., the Exchange has declared an unusual market condition status for the option in question), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount equal to at least three times the maximum bid/ask spread allowed for the series, so long as such amount is 50 cents or more.]

(b) Definition of Theoretical Price. For purposes of this Rule only, the [t] Theoretical Price of an option is:

(i) if the series is traded on at least one other options exchange, the [last bid or offer] mid-point of the National Best Bid and Offer (“NBBO”), 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

(ii) if there are no quotes for comparison purposes, as determined by two Floor Officials and designated personnel in the Exchange's Market Surveillance Department.

(c) - (f) No change.

Commentary:

.01 No change.

.02 [The Theoretical Price will be determined under paragraph (b)(i) of this Rule as follows: (i) the bid price from the exchange providing the most total volume in the option over the most recent 60 calendar days will be used with respect to an erroneous bid price entered on the Exchange, and (ii) the offer price from the exchange providing the most total volume in the option over the most recent 60 calendar days will be used with respect to an erroneous offer price entered on the Exchange.

.03] The price to which a transaction is adjusted under paragraph (c)(ii) of this Rule will be determined as follows: (i) the bid price from the exchange disseminating the National Best Bid for the series at the time of the transaction that was the result of an obvious error will be used with respect to an erroneous offer price entered on the Exchange, and (ii) the offer price from the exchange disseminating the National Best Offer for the series at the time of the transaction that was the result of an obvious error will be used with respect to an erroneous bid price entered on the Exchange. If there are no quotes for comparison purposes, the adjustment price will be determined by two Floor Officials and Market Surveillance.

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 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 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 Exchange states that the purpose of the proposed rule change, as amended, is to modernize the Exchange’s Obvious Error rule so that it addresses issues raised by the increasingly electronic options marketplace.

Definition of Obvious Error

Currently, Exchange 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 re-define “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 as to 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, thus further streamlining the Floor Officials’ review process.

Definition of Theoretical Price

Currently, 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 define “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.

The Phlx notes that 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.⁵ For the most part, the Phlx believes that such quotations do not reflect the NBBO. Under the current Exchange rule, 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. In order to account for this potential discrepancy between the Theoretical Price as established by rule and the actual NBBO, the proposal would re-define the term “Theoretical Price” to mean the mid-point of the NBBO just prior to the transaction. This 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, based on the actual NBBO instead of a quotation with a bid/ask differential of \$5.00.

For consistency, the Exchange proposes to delete Commentary .02 to Phlx Rule 1092, which references the Theoretical Price as currently defined, from the Rule.

2. Statutory Basis

The Exchange believes that this proposal is consistent with Section 6(b) of the Act⁶, in general, and furthers the objectives of Section 6(b)(5) of the Act,⁷ 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 national market system, and, in general, to protect investors and the public interest, by establishing objective definitions of Theoretical Price and “obvious error” that address issues raised by the increasingly electronic options marketplace.

⁵ See, e.g., Exchange Rule 1014(c)(i)(A)(2).

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

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

The Exchange does not believe that the proposed rule change, as amended, 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 solicited or received by the Exchange on this proposal, as amended.

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 Exchange consents, the Commission will:

- (A) by order approve the proposed rule change, as amended, or
- (B) institute proceedings to determine whether the proposed rule change, as amended, 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-2005-73 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-2005-73. 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 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-2005-73 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.⁸

Nancy M. Morris
Secretary

⁸ 17 CFR 200.30-3(a)(12).