

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54009; File No. SR-Phlx-2005-42)

June 16, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving Proposed Rule Change and Amendment Nos. 1, 2 and 3 Thereto Relating to Establishment of a Neutral “Referee”

I. Introduction

On June 10, 2005, the Philadelphia Stock Exchange, Inc. (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² to establish a neutral “Referee.” The Phlx filed Amendment Nos. 1, 2, and 3 to the proposed rule change on June 20, 2005, February 16, 2006 and March 10, 2006, respectively. The proposed rule change, as amended, was published for comment in the Federal Register on March 31, 2006.³ The Commission received one comment letter on the proposal.⁴ On May 19, 2006, the Phlx submitted a response to the comment letter.⁵ This order approves the proposed rule change, as amended.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 53548 (March 24, 2006), 71 FR 16389.

⁴ See letter to Jonathan G. Katz, Secretary, Commission from Matthew B. Hinerfeld, Managing Director and Deputy General Counsel, Citadel Investment Group, L.L.C., on behalf of Citadel Derivatives Group LLC (“Citadel”), dated April 21, 2006 (“Citadel Letter”).

⁵ See letter to Nancy M. Morris, Secretary, Commission from Richard S. Rudolph, Vice President and Counsel, Phlx, dated May 17, 2006 (“Phlx Response Letter”).

II. Description of the Proposed Rule Change

The Exchange proposes to create the new regulatory position of “Referee” to improve the process of resolving trading disputes and Floor Official rulings. This neutral Referee would be either an Exchange employee or an independent contractor. The Referee would have the authority to: (1) review and rule on appeals from Floor Official rulings concerning the nullification or adjustment of trades; and (2) act in the capacity of a Floor Official respecting initial rulings concerning requests for relief from the requirements of certain Exchange rules, Equity Floor Procedure Advices,⁶ and Option Floor Procedure Advices.⁷

Current Floor Official Program

Pursuant to Exchange By-Law Article VIII, Floor Officials, as designees⁸ of the Chairmen of the Options Committee,⁹ Floor Procedure Committee,¹⁰ and Foreign Currency Options Committee,¹¹ respectively, are authorized to administer the provisions of Exchange By-

⁶ The Exchange clarified that the Referee also may have the authority to act in the capacity of a Floor Official respecting initial rulings concerning requests for relief from the requirements of Equity Floor Procedure Advices. Telephone conversation between Richard Rudolph, Vice President and Counsel, Phlx, and Jennifer Dodd, Special Counsel, Division of Market Regulation (“Division”), Commission, on March 10, 2006 (“March 10 Telephone Conversation”).

⁷ Floor Officials would retain their authority to make such initial rulings. The Referee simply would have the same authority as a Floor Official concerning such initial rulings.

⁸ The designees of the respective floor Committee Chairmen are generally members of the respective committees and subcommittees thereof.

⁹ The Options Committee has general supervision of the dealings of members on the options trading floor. See Exchange By-Law Article X, Section 10-20.

¹⁰ The Floor Procedure Committee has general supervision of the dealings of members on the equity trading floor. See Exchange By-Law Article X, Section 10-16.

¹¹ The Foreign Currency Options Committee has general supervision of the dealings of members on the foreign currency options trading floor. See Exchange By-Law Article X, Section 10-17.

Laws and Rules of the Exchange pertaining to the respective trading floors and the immediately adjacent premises of the Exchange. Floor Officials may impose penalties, as applicable, for breaches of the Exchange's rules or regulations relating to order, decorum, health, safety and welfare on the respective trading floors. Additionally, they may rule to nullify, or adjust the terms of, executed trades under specific and limited conditions contained in Exchange rules, and may grant relief from certain Exchange requirements imposed on on-floor members and member organizations, if authorized to do so by rule.

Currently, Floor Official rulings and appeals for review from such rulings are governed by Exchange Rule 124, Disputes. Rule 124(d) provides that Options Floor Official rulings may be appealed to a Review Panel consisting of three members of the Options Subcommittee on Rules and Rulings ("Subcommittee"),¹² or the Chairperson of the Standing Committee (or his designee) if three Subcommittee members cannot be promptly convened, and Equity Floor Official rulings may be appealed to a Review Panel consisting of three members of the Floor Procedure Committee, or the Chairperson of the Floor Procedure Committee (or his designee) if three members cannot be promptly convened.¹³ Decisions of the Review Panel are considered

¹² Each Standing and Special Committee may appoint such subcommittees as it may deem necessary for the efficient discharge of its duties. See Exchange By-Law Article X, Section 10-3(b). The Options Committee has appointed the Subcommittee to review and recommend the adoption of new rules or the amendment of current rules to the full Options Committee, and to discuss rulings made on the floor of the Exchange by Floor Officials. The Exchange clarified that the Subcommittee also would discuss initial rulings on requests for relief made by the Referee acting in the capacity of a Floor Official. Telephone conversation between Richard Rudolph, Vice President and Counsel, Phlx, and Nancy Sanow, Assistant Director, and Kate Robbins, Attorney, Division, Commission, on June 12, 2006 ("June 12 Telephone Conversation").

¹³ The Exchange clarified the current process for Equity Floor Official rulings. March 10 Telephone Conversation.

final decisions of the Standing Committee and may be appealed to an Advisory Committee on Appeals of the Board of Governors (“Board”).

Floor Officials also are authorized to rule on requests for relief from the requirements of rules pertaining to quote spread parameters,¹⁴ disengagement of Exchange automatic execution systems under extraordinary circumstances,¹⁵ determinations with respect to the Exchange’s Quote Rule,¹⁶ and trading halts, opening and reopenings.¹⁷

The Referee

The Referee would be either an Exchange employee or an independent contractor who is not an employee of the Exchange but who has entered into an employment contract with the Exchange for a fixed period of time. The Referee would be appointed by the Exchange’s Board pursuant to the recommendation of the Audit Committee. Candidates for the Referee position would be recruited in the same fashion as candidates for other Exchange positions through the Exchange’s Human Resources Department. After conducting an interview process with the various candidates, the Audit Committee would recommend its selection to the Board, who then would vote on the Audit Committee’s recommendation. The Exchange notes that, upon the Commission’s approval of this proposal, the Referee would be appointed to the new position.

To ensure the neutrality of the Referee, the Referee would report to the Exchange’s Audit Committee,¹⁸ which would have supervision over the Referee. The Exchange’s General Counsel

¹⁴ Relief from the established bid/ask differentials may be granted upon the receipt of an approval of two Floor Officials. See OFPA F-6.

¹⁵ See Exchange Rule 1080(e) and OFPA A-13.

¹⁶ See Exchange Rule 1080(c)(i).

¹⁷ See Exchange Rules 1017, 1047 and 1047A and OFPA G-2.

¹⁸ See proposed Exchange By-Law Article X, Section 10-9.

or his/her designee would be responsible for purely administrative matters such as, without limitation, personnel issues and vacation. Additionally, based on the advice of the Exchange's General Counsel and Human Resources management, the Audit Committee may recommend the level of compensation of the Referee to the Board, and may establish other conditions of employment of the Referee. The Audit Committee or its designee¹⁹ would conduct annual performance evaluations, and would consider any written complaints from members and member organizations concerning the Referee. The Audit Committee would not, however, have the authority to overrule or modify any ruling made by the Referee. The Audit Committee would have the authority to terminate the employment of the Referee for good cause shown, and to otherwise discipline the Referee as appropriate for good cause shown.

The Referee would have jurisdiction over all Exchange trading floors and systems, except with regard to issues of order and decorum pursuant to Exchange Rule 60. The Options Committee would continue to have jurisdiction over order and decorum issues on the options floor;²⁰ the Floor Procedure Committee would continue to have jurisdiction over order and decorum issues on the equity floor;²¹ and the Foreign Currency Options Committee would continue to have jurisdiction over order and decorum issues on the foreign currency options floor.²²

The Audit Committee would recommend for appointment by the Board other Exchange

¹⁹ The Exchange clarified that the Audit Committee's designee may include the Exchange's General Counsel. June 12 Telephone Conversation

²⁰ See Exchange By-Law Article X, Section 10-20.

²¹ See Exchange By-Law Article X, Section 10-16.

²² See Exchange By-Law Article X, Section 10-17.

employee(s) or independent contractor(s) to function as the Referee in the event that the Referee is unavailable (“Backup Referees”). The Exchange’s rules and procedures, including qualifications, applicable to the Referee also would apply to Backup Referees, and any reference to the Referee in the proposed rules would be deemed to include Backup Referees. The Exchange states that having Backup Referees is necessary if the Referee is not available due to, for example, a ruling on another matter that is in progress, vacation, or illness.

Under the proposal, the Market Surveillance staff would assign available Floor Officials to rule on disputes. The Exchange believes that this provision should ensure the neutrality of Floor Officials by assigning the next available Floor Official to rule on a particular matter.

Qualifications of the Referee

Under the proposal, the Referee would be required to have sufficient expertise in the area of trading to act in the capacity of a Floor Official concerning initial requests for relief and to conduct reviews of Floor Official rulings concerning the nullification and adjustment of trades. The Referee must possess sufficient knowledge of Exchange rules and the relevant sections of the Act and the rules thereunder to administer the Referee’s responsibilities and authority.

To ensure the Referee’s neutrality, the proposal would provide that the Referee may not be a member of the Exchange, may not be directly or indirectly affiliated with any Exchange member or member organization, and may not be an immediate family member of any Exchange member. The Referee may not be a debtor or creditor of any Exchange member or member organization.

Duties of the Referee

The primary responsibility of the Referee would be to rule on appeals from Floor Official decisions concerning the nullification and adjustment of trades, and to have the same authority as

Floor Officials concerning rulings on member requests for relief from the requirements of specified rules, as set forth in proposed Commentary .02(a) to Exchange Rule 124.²³ The Referee would replace the current three-member Review Panel, which is currently composed of Floor Officials, and would be authorized to review Floor Official rulings concerning the adjustment of the terms of a trade or the nullification of a trade, and either uphold, overturn, or modify such Floor Official rulings. If the Referee is unavailable or unable to make a ruling for any reason (including, without limitation, absence from the Exchange trading floor, vacation, illness, or in the process of making another Referee ruling), the proposal would require Market Surveillance staff to immediately notify the Exchange's General Counsel or his or her designee, who then would designate a Backup Referee to make such a ruling.

The Exchange's General Counsel or his or her designee may assign additional duties and responsibilities to the Referee not related to Referee rulings. In order to ensure the Referee's neutrality respecting any matter on which he or she is to rule, and to avoid the possibility that the Referee could be biased as a result of his or her knowledge of any pending investigation or disciplinary action concerning a person that is a party to a dispute or that requests relief from the requirements of an Exchange rule, the proposal would prohibit the Referee from: (i) participating in any Exchange enforcement action, investigation, market surveillance activity, hearing (other than as a witness) or other activity related to disciplinary matters; (ii) issuing citations for violations of Exchange rules; (iii) ruling on any matter concerning order and decorum pursuant to Exchange Rule 60 and the regulations thereunder; and (iv) preparing,

²³ See Section II, Rulings on Requests for Relief, infra.

researching, drafting, reviewing, or filing of a proposed rule change with the Commission pursuant to the Act and the rules thereunder concerning the Exchange's disciplinary rules.

The proposed rules would require the Referee to make fair and impartial decisions in accordance with the Exchange's rules and By-Laws.

Procedures for Review of Floor Official Rulings

Under the proposed amendments to Exchange Rule 124(d), OFPA F-27, and EFPA F-27, Market Surveillance staff must be advised within 15 minutes of a Floor Official ruling concerning the nullification or adjustment of a trade that a party to such ruling has determined to seek the Referee's review of such ruling. The purpose of the notification requirement is to provide reasonably prompt notice to Market Surveillance and to participants in a trade that such ruling is subject to appeal and that the process set forth in the proposed rule amendments has begun, and ultimately a decision to sustain, overturn, or modify the initial Floor Official decision concerning the trade will be made.²⁴

As appropriate, the Chairman of the Options Committee, the Foreign Currency Options Committee or of the Floor Procedure Committee, or their respective designees,²⁵ would be required to refer a Referee that fails to make any ruling in accordance with Exchange rules to the Audit Committee for possible disciplinary action, including removal. A Floor Official that fails

²⁴ The Exchange advises that this notification requirement is consistent with Exchange Rule 1092, Obvious Errors, which establishes a similar notice period. Under the proposal, Floor Official rulings made pursuant to Exchange Rule 1092 would be reviewed by the Referee, provided that the party seeking the review requests such a review within the time frame required. See proposed Exchange Rule 1092(f).

²⁵ The Exchange clarified that the Chairman of the Foreign Currency Options Committee, or his designee, also would be required to refer a Referee to the Audit Committee for disciplinary action, if appropriate. March 10 Telephone Conversation.

to make any ruling in accordance with Exchange rules may be subject to possible disciplinary action by the Exchange.

To minimize the likelihood of frivolous appeals from Floor Official rulings, a member or member organization seeking the Referee's review of a Floor Official ruling concerning the nullification or adjustment of a trade would be assessed a fee of \$250 for each Floor Official ruling they seek to have reviewed if the Referee upholds the Floor Official decision. No fee would be assessed to the member or member organization seeking a review if the Floor Official decision is overturned or modified. This fee is currently imposed on options floor appeals that are found by the Review Panel to be frivolous.²⁶ The Exchange believes that the proposed \$250 fee provides an objective standard for imposition of the fee (i.e., the fee would be imposed in situations where the Referee sustains a Floor Official ruling on the nullification or adjustment of a trade). According to the Exchange, the Referee would not have the discretion to impose the fee that the Review Panel²⁷ currently has, and Exchange members and member organizations would have actual notice of the circumstances giving rise to the imposition of the fee.

Rulings on Requests for Relief

Proposed Commentary .02(a) to Exchange Rule 124 would authorize the Referee to act in the capacity of a Floor Official respecting initial rulings concerning requests for relief from the requirements of Exchange Rules relating to: (i) bid/ask differentials pursuant to Exchange Rule 1014(c) and OFPA F-6; (ii) disengagement of Exchange automatic execution systems pursuant to

²⁶ This fee is not currently imposed on equity floor appeals. March 10 Telephone Conversation.

²⁷ The Exchange clarified that the Review Panel currently has the discretion to impose the \$250 fee. June 12 Telephone Conversation.

Exchange Rule 1080(e) and OFPA A-13; (iii) the determination pursuant to Exchange Rule 1080(c)(i) that quotes in options on the Exchange or another market or markets are subject to relief from the firm quote requirement set forth in the SEC Quote Rule,²⁸ as defined in Exchange Rule 1082(a)(iii), and that quotes in options on the Exchange or another market or markets previously subject to such relief are no longer subject to such relief; and (iv) trading halts, openings and re-openings pursuant to Exchange Rules 1017, 1047 and 1047A and OFPAs A-12, A-14 and G-2.²⁹

Exchange Rule 1014(c) and OFPA F-6 set forth the maximum allowable bid/ask differentials, or quote widths, that may be disseminated by specialists and Registered Options Traders on the Exchange, depending on the price of the series to be quoted. The Exchange believes that these requirements can have the unintended consequence of requiring those making markets to quote at prices that are unnecessarily narrow, thereby exposing them to great risk if markets move quickly.³⁰ The Exchange has indicated that, under OFPA F-6, two Floor Officials may grant relief from these differentials during times of peak market activity where options markets and/or the market for securities underlying the option move quickly. Under the

²⁸ Rule 602 of Regulation NMS, 17 CFR 242.602.

²⁹ If the Referee acts in the capacity of a Floor Official and makes an initial ruling on a request for relief from the requirements of Exchange rules, as set forth in proposed Commentary .02(a) to Exchange Rule 124, its decision would be final, as described below.

³⁰ See, e.g., Securities Exchange Act Release No. 50728 (November 23, 2004), 69 FR 69982 (December 1, 2004) (SR-Phlx-2004-74) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 by the Philadelphia Stock Exchange, Inc. Relating to \$5 Bid/Ask Differentials).

proposal, the Referee would have the same authority as a Floor Official to make such a ruling under OFPA F-6.³¹

Exchange Rule 1080(e) and OFPA A-13 provide that, in the event extraordinary circumstances with respect to a particular class of options exist, two Floor Officials may determine to disengage automatic execution systems with respect to that option, in accordance with Exchange procedures. Exchange Rule 1080(e) and OFPA A-13 describe the procedures to be followed to effect such disengagement. Under the proposal, the Referee would have the same authority as a Floor Official to make such a determination under Exchange Rule 1080(e) and OFPA A-13.³²

Exchange Rule 1080(c)(i) provides that the Chairman of the Exchange's Options Committee or his designee (or if neither is available, two Floor Officials) may determine that quotes in options on the Exchange or another market or markets are subject to relief from the firm quote requirement set forth in the SEC Quote Rule, (thereby excluding such quotes from the Exchange's calculation of the National Best Bid/Offer ("NBBO")) and that quotes in options on the Exchange or another market or markets previously subject to such relief are no longer subject to such relief. The Referee would have the same authority as a Floor Official in making such determinations under Exchange Rule 1080(c)(i).

³¹ The Exchange clarified that the Referee would not be able to act in the capacity of a Floor Official in calling upon a ROT to make a market pursuant to Exchange Rule 1014(c). Telephone conversation between Richard Rudolph, Vice President and Counsel, Phlx, and Kate Robbins, Attorney, Division, Commission, on June 15, 2006 ("June 15 Telephone Conversation").

³² This authority also would extend to the re-engagement of the Exchange's automatic execution systems. June 15 Telephone Conversation.

Exchange Rules 1017, 1047 and 1047A and OFPAs A-12, A-14³³ and G-2 govern trading halts, openings and re-openings on the Exchange.³⁴ Under the proposal, the Referee would have the same authority as a Floor Official respecting initial rulings concerning requests for relief from the requirements of Exchange Rules 1017, 1047, 1047A and OFPAs A-12, A-14 and G-2 when Floor Official approval is required.³⁵

Referee's Decision Final

Currently, the decisions of the Review Panel are considered final decisions of the Standing Committee and may be appealed to an Advisory Committee on Appeals of the Board. Initial rulings to grant or deny relief from the requirements of certain Exchange rules are not currently considered final decisions of a Standing Committee and thus are not currently appealable to the Exchange's Board.³⁶

The proposed rule change would provide that decisions of the Referee concerning the review of Floor Official rulings relating to the nullification or adjustment of transactions, and initial requests for relief from the requirements of the rules specified in Commentary .02(a) to Exchange Rule 124, shall be final and may not be appealed to the Exchange's Board. The Exchange does not believe that these are the types of decisions that are appropriate for such

³³ The Exchange clarified that the Referee also would have the same authority as a Floor Official to make rulings in the capacity of a Floor Official with respect to the requirements in OFPA A-14. March 10 Telephone Conversation.

³⁴ For consistency, the Exchange is proposing a conforming amendment to OFPA G-2, as described below.

³⁵ The Exchange clarified that the Referee would have the authority to make any ruling that a Floor Official may currently make pursuant to these rules. June 12 Telephone Conversation.

³⁶ These rules are set forth in proposed Commentary .02(a) to Exchange Rule 124.

appeals, particularly because of the need for speedy resolution and certainty in resolving trading disputes, whereas other Standing Committee decisions are often prospectively applied.

The Exchange notes that this provision would not operate to preclude any aggrieved member or member organization from proceeding with any other legal remedy to which such member or member organization might be entitled (e.g., arbitration or appeal to the Commission if allowable by law).

Obvious Errors

The Exchange also proposes to amend Exchange Rule 1092, Obvious Errors. Currently, Exchange Rule 1092(f), Request for Review, provides that a Review Panel of Floor Officials will review decisions made under Exchange Rule 1092 in accordance with Exchange Rule 124(d). For consistency, the Exchange proposes to amend Rule 1092(f) to provide that the Referee will review such decisions.

Conforming Amendment to OFPA G-2

As a housekeeping matter, the Exchange proposes to amend OFPA G-2(c), to reflect that trading on the Exchange in any option may be halted with the approval of two Floor Officials, with the concurrence of a Market Surveillance officer. Current Exchange Rule 1047A(c) includes this provision, and the Exchange proposes to amend OFPA G-2 for consistency.

III. Comment Letter and Phlx's Response

The Commission received one comment letter with respect to the proposed rule change.³⁷ In its letter, Citadel applauded the Phlx's proposal to introduce a neutral Referee into the review process and noted that the proposal is a "welcome one" with the "laudable" goal of providing

³⁷ See Citadel Letter, supra note 4.

more fair and professional reviews that could result in substantively better decisions and more fundamentally equitable treatment for users of the Exchange who are not members. Citadel asserted that the success of the proposal would depend on the Referee's ability, neutrality and training. Although Citadel expressed its preference for having neutral decisionmakers make initial rulings on trading disputes, it surmised that having an independent Referee act in an appellate role might also lead to more thorough, objective and fair decisions by Floor Officials.

Citadel, however, expressed some concerns with the proposal. Citadel stated that the proposal to impose a fine of \$250 for unsuccessful but non-frivolous appeals is "fundamentally unfair." In support of its argument, Citadel noted that initial decisions regarding trade disputes are made by Floor Officials, who are not independent and can lack proper training. Also, Citadel asserted that persons who are not Exchange members may not be able to assess on their own whether an Exchange-specific error has occurred.

In addition, Citadel believes that it is unwise to not permit the right to appeal the Referee's decision to the Exchange's Board. Citadel acknowledged that the importance of the Board's role in the review of any specific ruling might be diminished by an independent Referee providing appellate review. Citadel, however, believes that because there is no guarantee that the Referee would always meet the high standards the Exchange hopes to achieve, the ability to appeal to the Board would remain an "important safeguard" and would give the Referee an incentive to make fair rulings. Citadel noted that, if the Exchange were to permit the Referee's rulings to be appealed to the Board, it would indicate that the Exchange takes trading disputes seriously and would allow the Board to timely address potential problems.

In its response letter, the Phlx noted its view that the \$250 fee for unsuccessful appeals is an "objective standard" to replace the Review Panel's current "subjective discretion" over the

imposition of fees.³⁸ The Phlx further asserted that the \$250 fee for unsuccessful appeals is fair and consistent with Section 6(b)(4) of Act.³⁹

In addressing Citadel's concerns regarding the right to appeal the Referee's ruling, the Phlx remarked that the types of rulings the Referee would make are not appropriate for appeals to the Exchange's Board because of the need for "speedy resolution and certainty." The Exchange noted that an aggrieved member or member organization would not be precluded from proceeding with any other legal remedy to which such member or member organization might be entitled. The Exchange further noted that there is a safeguard and an incentive for the Referee to make fair rulings, citing the requirement that the Chairmen of the various floor committees, or their respective designees, must refer a Referee that fails to make any ruling in accordance with Exchange rules to the Audit Committee for possible disciplinary action, including removal. Finally, the Exchange stated its view that its proposed process for resolving trading disputes is fair and consistent with the Act.

IV. Discussion

After careful review, 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.⁴⁰ In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(1) of the Act,⁴¹ which requires an exchange

³⁸ See Phlx Response Letter, *supra* note 5.

³⁹ 15 U.S.C. 78f(b)(4).

⁴⁰ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴¹ 15 U.S.C. 78f(b)(1).

be so organized and have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange. In addition, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(4) of the Act,⁴² which requires that the rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members. Furthermore, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,⁴³ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, 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.

The Commission believes that the Exchange's proposal to establish an independent Referee to rule on appeals from Floor Official rulings regarding the nullification or adjustment of trades is designed to bring promptness, certainty and objectivity to the Exchange's process of resolving disputes. In addition, the Commission believes that replacing the Review Panel with an independent Referee should help improve the decisionmaking process regarding appeals from trading disputes, because potential conflicts of interest that may occur when members are tasked with ruling on appeals of trading disputes involving other members would be eliminated. Furthermore, the Commission notes that having an independent Referee rule on such appeals

⁴² 15 U.S.C. 78f(b)(4).

⁴³ 15 U.S.C. 78f(b)(5).

should help foster fair and neutral decisions with respect to the resolution of trading disputes. The Commission also notes that replacing the Review Panel with a Referee should help to streamline the Exchange's process for review of Floor Official rulings, thereby making the process for settling trading disputes more efficient. In addition, the Commission believes that allowing the Referee to act in the capacity of a Floor Official in making initial rulings on requests for relief from the requirements of those Exchange rules set forth in proposed Commentary .02(a) to Exchange Rule 124 should help promote prompt and efficient rulings on such requests.

The Commission has carefully considered the comments raised in the Citadel Letter. Specifically, the Citadel Letter asserts that the \$250 fee for unsuccessful appeals is unfair. The Commission notes, however, that the proposed \$250 fee would employ an objective standard with respect to the imposition of fees on unsuccessful appeals, rather than retaining the current method that permits such a fee to be imposed at the discretion of the Review Panel upon a finding that such appeal is frivolous. The Commission believes that the Exchange's proposal to impose a \$250 fee on unsuccessful appeals is consistent with the Act.

The Citadel Letter also expressed concern that the decisions of the Referee would be final and not appealable to the Exchange's Board. The Commission notes that the Exchange's proposal is intended to provide for expeditious resolution of trading disputes and believes that the proposal is a reasonable effort to ensure prompt, efficient, and fair review of Floor Officials' decisions. The Commission further notes that the proposal does not alter any right that a member or member organization may have to pursue any other legal remedy that may be available, such as arbitration. In the Commission's view, the Exchange's proposal contains appropriate safeguards, including the requirement that the Chairmen of the respective committees or their designees must refer a Referee to the Exchange's Audit Committee if he or she fails to make a

ruling in accordance with Exchange rules. Moreover, the requirements that the Referee may not be a member of the Exchange, may not be directly or indirectly affiliated with any Exchange member or member organization, may not be an immediate family member of any Exchange member and may not be a debtor or creditor of any Exchange member or member organization, should help to ensure that the Referee is neutral and that his or her rulings are fair and objective. In addition, the restrictions that provide that duties and responsibilities relating to disciplinary matters, that the issuance of citations for violations of Exchange rules, and that matters relating to order and decorum may not be assigned to the Referee should also further the goal of impartial, unbiased, and objective rulings on the part of the Referee. Finally, the Commission notes that, with respect to the Referee acting in the capacity of a Floor Official and making initial rulings to grant or deny relief from the requirements of the Exchange rules specified in proposed Commentary .02(a) to Exchange Rule 124, such Floor Official rulings currently are not considered final decisions of the Standing Committee and thus are not currently appealable to the Exchange's Board. For such initial rulings, the proposed rule change would not change the Exchange's current process with respect to such rulings. Based on these considerations, the Commission believes that the Citadel Letter has not raised any concerns that would preclude approval of the Exchange's proposal.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴⁴ that the proposed rule change (SR-Phlx-2005-42), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴⁵

Nancy M. Morris
Secretary

⁴⁴ 15 U.S.C. 78s(b)(2).

⁴⁵ 17 CFR 200.30-3(a)(12).