Proposed Rule Change by Philadelphia Stock Exchange

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial Amendment Withdrawal

Section 19(b)(2)

Section 19(b)(3)(A) Section 19(b)(3)(B)

Rule

Pilot Extension of Time Period for Commission Action Date Expires

19b-4(f)(1) 19b-4(f)(4)

19b-4(f)(2) 19b-4(f)(5)

19b-4(f)(3) 19b-4(f)(6)

Proposed rule change to establish a neutral "Referee" to rule on appeals from Floor Official rulings.

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Richard Last Name Rudolph

Title Vice President and Counsel

E-mail Richard.Rudolph@phlx.com

Telephone (215) 496-5074 Fax (215) 496-6729

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

Richard S. Rudolph, Vice President and Counsel

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.
### Form 19b-4 Information

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

### Exhibit 1 - Notice of Proposed Rule Change

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3).

### Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

### Exhibit 3 - Form, Report, or Questionnaire

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

### Exhibit 4 - Marked Copies

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

### Exhibit 5 - Proposed Rule Text

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

### Partial Amendment

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission’s permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.
1. **Text of the Proposed Rule Change**

The Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") and Rule 19b-4 thereunder, proposes to adopt proposed rules and By-Laws that would establish a neutral "Referee," an Exchange employee who would have authority to review and rule on appeals from Floor Official rulings, and to make other initial rulings currently made by Floor Officials.

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1. The text of the proposed rule change is set forth below.

**Proposed By-Law Change**

Brackets indicate deletions; underlining indicates new text

**Audit Committee**

**Sec. 10-9.** (a) The Audit Committee shall consist of three (3) members, who shall all be public Governors. Audit Committee members shall not serve in a management capacity with the Exchange or any affiliate thereof and must be free of any other relationships that, by decision of the Board of Governors, would interfere with the exercise of independent judgment.

(b) The Committee shall have responsibility for dealings with the Exchange's independent public accountants including: (i) making recommendations to the Board of Governors as to retention and dismissal of such public accountants; (ii) reviewing the scope of their services and fees; (iii) reviewing the audit plan; (iv) reviewing internal controls; (v) reviewing the "management letter" and reply thereto; and (vi) having the ability to meet with the public accountants without Exchange officers or employees.

The Committee shall have responsibility for the Exchange Internal Audit Department, which shall report to the Committee. Such responsibility will include review of policies and procedures for and significant reports produced by the Internal Audit Department.

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The Committee shall review any legal matters that may materially impact the Exchange's financial statements and all examination, inspection or other reports made by any regulatory agency with regulatory oversight for the Exchange and the Exchange's responses thereto.

The Committee shall review, at least annually, compliance with the Exchange's Code of Conduct with the assistance of the General Counsel's office.

The Committee shall have the authority to conduct special reviews of any alleged improper conduct with respect to Exchange related activity, operations, finance or regulation. The Committee may select and engage its own counsel, consultants, accountants or other experts to assist in such reviews.

The Committee shall have the authority to compel to appear and/or provide documents or other information, by members, member organizations, associated persons of member organizations, members of the Board of Governors, committee members, Exchange officers or Exchange employees.

(c) The Committee shall meet at least once every calendar quarter.

(d) The Committee shall recommend for appointment by the Board of Governors a qualified Referee to review Floor Official rulings, and to consider and rule upon member and member organization requests for relief from the requirements of Exchange rules. The Referee shall have jurisdiction over all Exchange trading floors and systems, except with regard to issues of order and decorum as described in Rule 60.

Proposed rules

Disputes

Rule 124 (a) Disputes occurring on and relating to the trading floor, if not settled by agreement between the members interested, shall be settled, if practicable, by vote of the members knowing of the transaction in question; if not so settled, they shall be settled by a Floor Official [summoned to the trading crowd] designated by Market Surveillance to rule on the dispute.

In issuing decisions for the resolution of trading disputes, Floor Officials [may] shall institute the course of action deemed to be most fair to all parties under the circumstances at the time. A Floor Official may direct the execution of an order on the floor, or adjust the transaction terms or participants to an executed order on the floor. However, two Option Floor Officials may nullify a transaction if they determine the transaction to have been in violation of Rules 1014 (Obligations and Restrictions Applicable to Specialist and ROTs), 1015 (Quotation Guarantees), 1017 (Priority and Parity at Openings in Options), 1033 (Bids and Offers) or 1080 (AUTOM). Two Equity Floor Officials may nullify a transaction if they determine the transaction to have been in violation of Rules 110 (Bids and Offers --Precedence), 111 (Bids and Offers --Binding), 118 (Bids and Offers Outside Best Bid and Offer), 119 (Precedence of Highest Bid), 120 (Precedence of...
Offers at Same Price), 126 (Crossing), 203 (Agreement of Specialists), 218 (Customer Order Receives Priority), 229 (PACE System), 232 (Handling Orders When the Primary Market is Not Open for Free Trading), or 455 (Short Sales).

(b) All rulings rendered by Floor Officials or the Referee (as defined in Commentary .01 to this Rule) are effective immediately and must be complied with promptly. Failure to promptly comply with a Floor Official or Referee ruling concerning a trading dispute may result in referral to the Business Conduct Committee. Failure to promptly comply with other Floor Official or Referee rulings issued pursuant to Order and Decorum Regulations (Rule 60) or Floor Procedure Advices (Rule 970) and not concerning a trading dispute may result in an additional violation.

c) Review – Floor Official Rulings issued pursuant to Order and Decorum Regulations are reviewable pursuant to Rule 60. Floor Official rulings issued pursuant to Floor Procedure Advices are reviewable pursuant to Rule 970. All other Floor Official rulings are reviewable pursuant to paragraph (d) of this Rule.

d) Review of Floor Official Rulings (Trading Disputes) – [Options] All Floor Official rulings are reviewable by [a] the Referee. [minimum of three members of the Sub-Committee on Rules and Rulings, a sub-committee of the standing committee, which shall be empowered to review such rulings, or the Chairperson of the standing committee (or his designee) if three Sub-Committee members cannot be promptly convened. Equity Floor Official Rulings are reviewable by a minimum 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. This constitutes a Review Panel for Floor Official rulings.]

(i) Market Surveillance staff must be advised within 15 minutes of a Floor Official's ruling that a party to such ruling has determined to appeal from such ruling to the Referee. The Referee may sustain, overturn, or modify a Floor Official ruling. The Exchange may establish the procedures for the submission of a request for a review of a Floor Official ruling. [Floor Official rulings may be sustained, overturned or modified by [a majority vote of the Review Panel members present.] In making a determination, the [Review Panel] Referee may consider facts and circumstances not available to the ruling Floor Official as well as action taken by the parties in reliance on the Floor Official's ruling (e.g., cover, hedge and related trading activity). [Decisions of the Review Panel will be considered final decisions of a standing floor committee and may be appealed to the Exchange's Board of Governors pursuant to Exchange By-Law Article XI.

(ii) All decisions made by the Referee in connection with the review of a Floor Official ruling shall be documented in writing and maintained by the Exchange in accordance with the record keeping requirements set forth in the Securities Exchange Act of 1934, as amended, and the rules thereunder.
(iii) A member or member organization seeking the Referee’s review of a Floor Official ruling shall be assessed a fee of $250.00 for each Floor Official ruling to be reviewed that is sustained and not overturned or modified by the Referee.

(iv) Decisions of the Referee shall be final and may not be appealed to the Exchange’s Board of Governors.

(v) As appropriate, the Chairman of the Options Committee or of the Floor Procedure Committee, or their respective designees, shall refer a Referee or Floor Official that fails to make any ruling in accordance with Exchange rules to the Business Conduct Committee for possible disciplinary action, including removal.

(vi) Failure to promptly comply with a Floor Official or Referee decision under this Rule may result in referral to the Business Conduct Committee.

[Any person who appeals an Options Floor Official ruling concerning a trading dispute and loses will be subject to a $250.00 fee upon a finding by the Review Panel, that such appeal is frivolous.].

Commentary .01. The Referee.

(a) A Referee shall be appointed by the Board of Governors on the recommendation of the Audit Committee to review Floor Official rulings concerning disputes in accordance with Rule 124. The Referee shall have jurisdiction over all Exchange trading floors and systems. The Referee may sustain, overturn, or modify a Floor Official ruling.

(b) The Audit Committee shall recommend for appointment by the Board of Governors a qualified Referee. The Committee shall determine that the Referee has sufficient expertise in the area of securities trading to conduct reviews of Floor Official Rulings, and possesses sufficient knowledge of Exchange rules and the relevant sections of the Securities Exchange Act of 1934, as amended, and the rules thereunder.

(c) The Referee shall not be a member of the Exchange nor affiliated with any Exchange member or member organization and shall not be an immediate family member of any Exchange member. The Referee shall not be a debtor or creditor of any Exchange member or member organization.

(d) The Audit Committee shall have supervision over the Referee, and, based on the advice of the Exchange's General Counsel and Human Resources Department, may recommend the level of compensation of the Referee to the Compensation Committee, and may establish other conditions of employment of the Referee. The Audit Committee shall conduct regular reviews of the activities of the Referee, including annual performance evaluations, and shall consider any written complaints from members and member organizations concerning the Referee. The Audit Committee shall not have the
authority to overrule or modify any ruling made by the Referee. The Audit Committee may appoint additional Referees as deemed necessary in the Committee's discretion. The Audit Committee may terminate the employment of the Referee for good cause shown, and may otherwise discipline the Referee as appropriate for good cause shown.

(e) The Exchange’s General Counsel or his or her designee may assign additional duties and responsibilities to the Referee not related to Referee 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), Market Surveillance staff will immediately notify the Exchange’s General Counsel, or his designee, who would designate a person not affiliated with a member or member organization to make such a ruling.

(f) The Referee shall make fair and impartial rulings in accordance with Exchange rules and By-Laws.

**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) - (e) No change.

(f) Request for Review. If a party affected by a determination made under this Rule so requests within the time permitted, [a Review Panel of Floor Officials] the Referee will review decisions made under this Rule in accordance with Exchange Rule 124(d). A request for review under this paragraph must be made within thirty minutes after a party receives verbal notification of a final determination by the Floor Official(s) under this Rule, except that if such notification is made after 3:30 p.m. Eastern Time, either party has until 9:30 a.m. Eastern Time on the next trading day to request a review. Such a request for review must be in writing or otherwise documented. The [Review Panel] Referee shall review the facts and render a decision on the day of the transaction, or the next trade day in the case where a request is properly made after 3:30 p.m. on the day of the transaction or where the request is properly made the next trade day.

2. **Procedures of the Self-Regulatory Organization**

The Exchange’s Executive Committee, pursuant to delegated authority, approved the proposed rules for filing with the Securities and Exchange Commission (“SEC” or “Commission”) on May 20, 2005. The Exchange’s Board of Governors is to consider the proposed By-Law change on June 15, 2005.
Questions and comments on the proposed rule change may be directed to Richard S. Rudolph, Vice President and Counsel, at (215) 496-5074, or Edith Hallahan, Senior Vice President and Deputy General Counsel, at (215) 496-5179.

3. **Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

   **a. Purpose**

   The purpose of the proposed rule change is to create the new staff position of a neutral “Referee,” who would have the authority to rule on appeals from Floor Official decisions concerning disputes and requests for relief from the requirements of certain Exchange rules.

**Current Floor Official Program**

Pursuant to Exchange By-Law Article VIII, Floor Officials, as designees of the Chairmen of the Options Committee, Floor Procedure Committee, and Foreign Currency Options Committee, respectively, are authorized to administer the provisions of Exchange By-Laws and Rules of the Exchange pertaining to the respective trading floors and the immediately adjacent premises of the Exchange. They may impose penalties as applicable, for breaches of their 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

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3 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.

4 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.

5 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.
conditions contained in Exchange rules, and may grant relief from certain requirements of 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 Floor Official rulings may be appealed to a Review Panel consisting of three members of the Options Subcommittee on Rules and Rulings (the “Subcommittee”), or the Chairperson of the standing committee (or his designee) if three Subcommittee members cannot be promptly convened. 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 of Governors.

Floor Officials are also authorized to rule on requests for relief from the requirements of certain rules, including, without limitation, the on-floor dress code, quote spread parameters, and disengagement of Exchange automatic execution systems under extraordinary circumstances.

The Referee

The Referee would be an Exchange employee who would have authority to review and rule on appeals from Floor Official disputes, and to make other initial rulings

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6 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.

7 Exchange Order and Decorum Regulation 6, Dress, provides that any provision of the rule may be waived for a specific period of time by the chairperson of the appropriate floor standing committee or his designee.

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

9 See Exchange Rule 1080(e).
currently made by Floor Officials. The Referee would also grant or deny requests for relief currently handled by Floor Officials. The proposal would provide that decisions of the Referee are final and may not be appealed to the Board of Governors. The Referee would report to the Exchange’s Audit Committee,\textsuperscript{10} thereby ensuring that the Referee is completely neutral and accountable to the Audit Committee alone. The Referee would report for simple administrative purposes (such as payroll issues, vacation, etc) to the General Counsel or his or her designee.

The proposal would also provide that 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**

The Referee must have sufficient expertise in the area of trading to make rulings on appeals and other matters currently handled by Floor Officials, and must possess adequate knowledge of Exchange rules and the relevant sections of the Act (and the rules thereunder) to administer the Referee’s responsibilities and authority.

In order to ensure 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.

\textsuperscript{10} See Exchange By-Law Article X, Section 10-9.
Duties of the Referee

The primary responsibility of the Referee would be to rule on appeals from Floor Official decisions, and on member requests for relief from the requirements of certain rules. The Referee would replace the current three-member Review Panel, which is currently comprised of Floor Officials, and would be authorized to review Floor Official rulings concerning the adjustment of the terms of a trade, or the nullification or “bust” of trades on appeal, and either uphold, overturn, or modify appealed Floor Official rulings pursuant to proposed amended Rule 124. 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), Market Surveillance staff would be required to immediately notify the Exchange’s General Counsel, who would designate a person not affiliated with a member or member organization to make such a ruling.

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

Procedures for Review of Floor Official Rulings

Proposed amended Rule 124(d) would require that Market Surveillance staff be advised within 15 minutes of a Floor Official ruling 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 transaction subject to this rule that such ruling is subject to appeal and
that the process set forth in the proposed rule has begun, and ultimately a decision concerning the transaction will be made.\footnote{This is consistent with Exchange Rule 1092, Obvious Errors, which establishes a similar notice period. Under the proposal, Floor Official rulings made pursuant to Rule 1092 would be reviewed by the Referee. \textit{See} Rule 1092(f).}

In order 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 would be assessed a fee of $250.00 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 appeals. Decisions of the Referee would be final and would not be eligible for appeal to the Exchange’s Board of Governors.

The Exchange also proposes to amend Exchange Rule 1092, Obvious Errors. Currently, Rule 1092(f), Requests for Review, provides that a Review Panel of Floor Officials will review decisions made under the Rule 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.

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

b. \textbf{Statutory Basis}

The Exchange believes that its proposal is consistent with Section 6(b) of the Act\footnote{in general, and furthers the objectives of Section 6(b)(5) of the Act\footnote{in particular,} in particular,} in general, and furthers the objectives of Section 6(b)(5) of the Act in particular,
in that it is designed to perfect the mechanisms of a free and open market and the national market system, protect investors and the public interest and promote just and equitable principles of trade, eliminating any potential conflict of interest by establishing a neutral Referee to rule on appeals from Floor Official decisions and to rule initially on requests for relief from certain requirements under Exchange rules. The Exchange further believes that the proposal is consistent with 6(b)(1) of the Act,\textsuperscript{14} in that the proposal is designed to enable the Exchange to continue 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.

4. **Self-Regulatory Organization’s Statement on Burden on Competition**

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

5. **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.

6. **Extension of Time Period for Commission Action**

   The Exchange consents to an extension of the time period for Commission action until at least 35 days after the Phlx has filed an appropriate amendment setting forth the completion of all action required to be taken under its constitution, articles of incorporation, bylaws, rules or instruments corresponding thereto.

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\textsuperscript{12} 15 U.S.C. 78f(b).

\textsuperscript{13} 15 U.S.C. 78f(b)(5).

\textsuperscript{14} 15 U.S.C. 78f(b)(1).
7. **Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

   Not applicable.

8. **Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission**

   The proposed rule change is not based on the rules of another self-regulatory organization or of the Commission.

9. **Exhibits**

   1. Notice of proposed rule for publication in the Federal Register.
Exhibit 1

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

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to the Establishment of a Neutral “Referee” to Rule on Appeals From Floor Official Rulings

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), 1 and Rule 19b-4 2 thereunder, notice is hereby given that on ______________________ 2005, the Philadelphia Stock Exchange, Inc. (“Phlx” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Phlx. 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, pursuant to Section 19(b)(1) and Rule 19b-4 thereunder, 3 proposes to adopt proposed rules and By-Laws that would establish a neutral “Referee,” an Exchange employee who would have authority to review and rule on appeals from Floor Official rulings, and to make other initial rulings currently made by Floor Officials. The text of the proposed rule change is set forth below.

Proposed By-Law Change

Brackets indicate deletions; underlining indicates new text

Audit Committee

Sec. 10-9. (a) The Audit Committee shall consist of three (3) members, who shall all be public Governors. Audit Committee members shall not serve in a management capacity with the Exchange or any affiliate thereof and must be free of any other relationships that, by decision of the Board of Governors, would interfere with the exercise of independent judgment.

(b) The Committee shall have responsibility for dealings with the Exchange's independent public accountants including: (i) making recommendations to the Board of Governors as to retention and dismissal of such public accountants; (ii) reviewing the scope of their services and fees; (iii) reviewing the audit plan; (iv) reviewing internal controls; (v) reviewing the “management letter” and reply thereto; and (vi) having the ability to meet with the public accountants without Exchange officers or employees.

The Committee shall have responsibility for the Exchange Internal Audit Department, which shall report to the Committee. Such responsibility will include review of policies and procedures for and significant reports produced by the Internal Audit Department.

The Committee shall review any legal matters that may materially impact the Exchange's financial statements and all examination, inspection or other reports made by any regulatory agency with regulatory oversight for the Exchange and the Exchange’s responses thereto.

The Committee shall review, at least annually, compliance with the Exchange's Code of Conduct with the assistance of the General Counsel's office.

The Committee shall have the authority to conduct special reviews of any alleged improper conduct with respect to Exchange related activity, operations, finance or regulation. The Committee may select and engage its own counsel, consultants, accountants or other experts to assist in such reviews.

The Committee shall have the authority to compel to appear and/or provide documents or other information, by members, member organizations, associated persons of member organizations, members of the Board of Governors, committee members, Exchange officers or Exchange employees.

(c) The Committee shall meet at least once every calendar quarter.
(d) The Committee shall recommend for appointment by the Board of Governors a qualified Referee to review Floor Official rulings, and to consider and rule upon member and member organization requests for relief from the requirements of Exchange rules. The Referee shall have jurisdiction over all Exchange trading floors and systems, except with regard to issues of order and decorum as described in Rule 60.

Proposed rules

Disputes

Rule 124 (a) Disputes occurring on and relating to the trading floor, if not settled by agreement between the members interested, shall be settled, if practicable, by vote of the members knowing of the transaction in question; if not so settled, they shall be settled by a Floor Official [summoned to the trading crowd] designated by Market Surveillance to rule on the dispute.

In issuing decisions for the resolution of trading disputes, Floor Officials [may] shall institute the course of action deemed to be most fair to all parties under the circumstances at the time. A Floor Official may direct the execution of an order on the floor, or adjust the transaction terms or participants to an executed order on the floor. However, two Option Floor Officials may nullify a transaction if they determine the transaction to have been in violation of Rules 1014 (Obligations and Restrictions Applicable to Specialist and ROTs), 1015 (Quotation Guarantees), 1017 (Priority and Parity at Openings in Options), 1033 (Bids and Offers) or 1080 (AUTOM). Two Equity Floor Officials may nullify a transaction if they determine the transaction to have been in violation of Rules 110 (Bids and Offers --Precedence), 111 (Bids and Offers --Binding), 118 (Bids and Offers Outside Best Bid and Offer), 119 (Precedence of Highest Bid), 120 (Precedence of Offers at Same Price), 126 (Crossing), 203 (Agreement of Specialists), 218 (Customer Order Receives Priority), 229 (PACE System), 232 (Handling Orders When the Primary Market is Not Open for Free Trading), or 455 (Short Sales).

(b) All rulings rendered by Floor Officials or the Referee (as defined in Commentary .01 to this Rule) are effective immediately and must be complied with promptly. Failure to promptly comply with a Floor Official or Referee ruling concerning a trading dispute may result in referral to the Business Conduct Committee. Failure to promptly comply with other Floor Official or Referee rulings issued pursuant to Order and Decorum Regulations (Rule 60) or Floor Procedure Advices (Rule 970) and not concerning a trading dispute may result in an additional violation.

(c) Review – Floor Official Rulings issued pursuant to Order and Decorum Regulations are reviewable pursuant to Rule 60. Floor Official rulings issued pursuant to Floor Procedure Advices are reviewable pursuant to Rule 970. All other Floor Official rulings are reviewable pursuant to paragraph (d) of this Rule.

(d) Review of Floor Official Rulings (Trading Disputes) – [Options] All Floor Official rulings are reviewable by [a] the Referee. [minimum of three members of the Sub-
Committee on Rules and Rulings, a sub-committee of the standing committee, which shall be empowered to review such rulings, or the Chairperson of the standing committee (or his designee) if three Sub-Committee members cannot be promptly convened. Equity Floor Official Rulings are reviewable by a minimum 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. This constitutes a Review Panel for Floor Official rulings.

(i) Market Surveillance staff must be advised within 15 minutes of a Floor Official’s ruling that a party to such ruling has determined to appeal from such ruling to the Referee. The Referee may sustain, overturn, or modify a Floor Official ruling. The Exchange may establish the procedures for the submission of a request for a review of a Floor Official ruling. [Floor Official rulings may be sustained, overturned or modified by [a majority vote of the Review Panel members present.] In making a determination, the [Review Panel] Referee may consider facts and circumstances not available to the ruling Floor Official as well as action taken by the parties in reliance on the Floor Official's ruling (e.g., cover, hedge and related trading activity). [Decisions of the Review Panel will be considered final decisions of a standing floor committee and may be appealed to the Exchange's Board of Governors pursuant to Exchange By-Law Article XI.

(ii) All decisions made by the Referee in connection with the review of a Floor Official ruling shall be documented in writing and maintained by the Exchange in accordance with the record keeping requirements set forth in the Securities Exchange Act of 1934, as amended, and the rules thereunder.

(iii) A member or member organization seeking the Referee’s review of a Floor Official ruling shall be assessed a fee of $250.00 for each Floor Official ruling to be reviewed that is sustained and not overturned or modified by the Referee.

(iv) Decisions of the Referee shall be final and may not be appealed to the Exchange’s Board of Governors.

(v) As appropriate, the Chairman of the Options Committee or of the Floor Procedure Committee, or their respective designees, shall refer a Referee or Floor Official that fails to make any ruling in accordance with Exchange rules to the Business Conduct Committee for possible disciplinary action, including removal.

(vi) Failure to promptly comply with a Floor Official or Referee decision under this Rule may result in referral to the Business Conduct Committee.

[Any person who appeals an Options Floor Official ruling concerning a trading dispute and loses will be subject to a $250.00 fee upon a finding by the Review Panel, that such appeal is frivolous.]
Commentary .01. The Referee.

(a) A Referee shall be appointed by the Board of Governors on the recommendation of the Audit Committee to review Floor Official rulings concerning disputes in accordance with Rule 124. The Referee shall have jurisdiction over all Exchange trading floors and systems. The Referee may sustain, overturn, or modify a Floor Official ruling.

(b) The Audit Committee shall recommend for appointment by the Board of Governors a qualified Referee. The Committee shall determine that the Referee has sufficient expertise in the area of securities trading to conduct reviews of Floor Official Rulings, and possesses sufficient knowledge of Exchange rules and the relevant sections of the Securities Exchange Act of 1934, as amended, and the rules thereunder.

(c) The Referee shall not be a member of the Exchange nor affiliated with any Exchange member or member organization and shall not be an immediate family member of any Exchange member. The Referee shall not be a debtor or creditor of any Exchange member or member organization.

(d) The Audit Committee shall have supervision over the Referee, and, based on the advice of the Exchange’s General Counsel and Human Resources Department, may recommend the level of compensation of the Referee to the Compensation Committee, and may establish other conditions of employment of the Referee. The Audit Committee shall conduct regular reviews of the activities of the Referee, including annual performance evaluations, and shall consider any written complaints from members and member organizations concerning the Referee. The Audit Committee shall not have the authority to overrule or modify any ruling made by the Referee. The Audit Committee may appoint additional Referees as deemed necessary in the Committee’s discretion. The Audit Committee may terminate the employment of the Referee for good cause shown, and may otherwise discipline the Referee as appropriate for good cause shown.

(e) The Exchange’s General Counsel or his or her designee may assign additional duties and responsibilities to the Referee not related to Referee 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), Market Surveillance staff will immediately notify the Exchange’s General Counsel, or his designee, who would designate a person not affiliated with a member or member organization to make such a ruling.

(f) The Referee shall make fair and impartial rulings in accordance with Exchange rules and By-Laws.

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) - (e) No change.

(f) Request for Review. If a party affected by a determination made under this Rule so requests within the time permitted, [a Review Panel of Floor Officials] the Referee will review decisions made under this Rule in accordance with Exchange Rule 124(d). A request for review under this paragraph must be made within thirty minutes after a party receives verbal notification of a final determination by the Floor Official(s) under this Rule, except that if such notification is made after 3:30 p.m. Eastern Time, either party has until 9:30 a.m. Eastern Time on the next trading day to request a review. Such a request for review must be in writing or otherwise documented. The [Review Panel] Referee shall review the facts and render a decision on the day of the transaction, or the next trade day in the case where a request is properly made after 3:30 p.m. on the day of the transaction or where the request is properly made the next trade day.

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 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 purpose of the proposed rule change is to create the new staff position of a neutral “Referee,” who would have the authority to rule on appeals from Floor Official decisions concerning disputes and requests for relief from the requirements of certain Exchange rules.
**Current Floor Official Program**

Pursuant to Exchange By-Law Article VIII, Floor Officials, as designees of the Chairman of the Options Committee,\(^4\) Floor Procedure Committee,\(^5\) and Foreign Currency Options Committee,\(^6\) respectively, are authorized to administer the provisions of Exchange By-Laws and Rules of the Exchange pertaining to the respective trading floors and the immediately adjacent premises of the Exchange. They may impose penalties as applicable, for breaches of their 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 requirements of 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 Floor Official rulings may be appealed to a Review Panel consisting of three members of the Options Subcommittee on Rules and Rulings (the “Subcommittee”),\(^7\) or the Chairperson of the standing committee (or his designee) if three Subcommittee members cannot be promptly convened. Decisions of the Review Panel are considered final decisions of the standing committee.

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\(^4\) 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.

\(^5\) 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.

\(^6\) 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.

\(^7\) 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.
committee and may be appealed to an Advisory Committee on Appeals of the Board of Governors.

Floor Officials are also authorized to rule on requests for relief from the requirements of certain rules, including, without limitation, the on-floor dress code, quote spread parameters, and disengagement of Exchange automatic execution systems under extraordinary circumstances.

The Referee

The Referee would be an Exchange employee who would have authority to review and rule on appeals from Floor Official disputes, and to make other initial rulings currently made by Floor Officials. The Referee would also grant or deny requests for relief currently handled by Floor Officials. The proposal would provide that decisions of the Referee are final and may not be appealed to the Board of Governors. The Referee would report to the Exchange’s Audit Committee, thereby ensuring that the Referee is completely neutral and accountable to the Audit Committee alone. The Referee would report for simple administrative purposes (such as payroll issues, vacation, etc) to the General Counsel or his or her designee.

The proposal would also provide that the Market Surveillance staff would assign available Floor Officials to rule on disputes. The Exchange believes that this provision

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8 Exchange Order and Decorum Regulation 6, Dress, provides that any provision of the rule may be waived for a specific period of time by the chairperson of the appropriate floor standing committee or his designee.

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

10 See Exchange Rule 1080(e).

should ensure the neutrality of Floor Officials by assigning the next available Floor Official to rule on a particular matter.

Qualifications of the Referee

The Referee must have sufficient expertise in the area of trading to make rulings on appeals and other matters currently handled by Floor Officials, and must possess adequate knowledge of Exchange rules and the relevant sections of the Act (and the rules thereunder) to administer the Referee’s responsibilities and authority.

In order to ensure 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, and on member requests for relief from the requirements of certain rules. The Referee would replace the current three-member Review Panel, which is currently comprised of Floor Officials, and would be authorized to review Floor Official rulings concerning the adjustment of the terms of a trade, or the nullification or “bust” of trades on appeal, and either uphold, overturn, or modify appealed Floor Official rulings pursuant to proposed amended Rule 124. 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), Market Surveillance staff would be required to immediately notify the Exchange’s General
Counsel, who would designate a person not affiliated with a member or member organization to make such a ruling.

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

**Procedures for Review of Floor Official Rulings**

Proposed amended Rule 124(d) would require that Market Surveillance staff be advised within 15 minutes of a Floor Official ruling 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 transaction subject to this rule that such ruling is subject to appeal and that the process set forth in the proposed rule has begun, and ultimately a decision concerning the transaction will be made.12

In order 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 would be assessed a fee of $250.00 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 appeals. Decisions of the Referee would be final and would not be eligible for appeal to the Exchange’s Board of Governors.

The Exchange also proposes to amend Exchange Rule 1092, Obvious Errors. Currently, Rule 1092(f), Requests for Review, provides that a Review Panel of Floor

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12 This is consistent with Exchange Rule 1092, Obvious Errors, which establishes a similar notice period. Under the proposal, Floor Official rulings made pursuant to Rule 1092 may be reviewed by the Referee. See Rule 1092(f).
Officials will review decisions made under the Rule 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.

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

2. **Statutory Basis**

The Exchange believes that its proposal is consistent with Section 6(b) of the Act in general, and furthers the objectives of Section 6(b)(5) of the Act in particular, in that it is designed to perfect the mechanisms of a free and open market and the national market system, protect investors and the public interest and promote just and equitable principles of trade, eliminating any potential conflict of interest by establishing a neutral Referee to rule on appeals from Floor Official decisions and to rule initially on requests for relief from certain requirements under Exchange rules. The Exchange further believes that the proposal is consistent with 6(b)(1) of the Act, in that the proposal is designed to enable the Exchange to continue 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.

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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**

No written comments were either solicited or received.

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 Phlx consents, the Commission shall: (a) by order approve such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change 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 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](http://www.sec.gov/rules/sro.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2005-42 on the subject line.

**Paper comments:**
- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-Phlx-2005-42. 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-2005-42 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. 16

Margaret H. McFarland
Deputy Secretary

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