Proposed Rule Change by Philadelphia Stock Exchange

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

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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)

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Proposed rule change relating to split price priority when the market has a bid/ask differential of one minimum trading increment.

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,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 03/02/2006
By Richard S. Rudolph  Vice President and Counsel

(Name)  (Title)

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.
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”)\(^1\) and Rule 19b-4 thereunder,\(^2\) proposes to amend Exchange Rule 1014(g)(i)(C) to adopt a new split price priority rule that establishes priority for in-crowd participants in split price transactions over participants that are not located in the crowd (i.e., out-of-crowd Streaming Quote Traders (“SQTs”)\(^3\) and Remote Streaming Quote Traders (“RSQTs”)\(^4\)) in the limited circumstance where the market has a bid/ask differential of one minimum trading increment.

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. Underlining indicates new text

**Obligations and Restrictions Applicable to Specialists and Registered Options Traders**

**Rule 1014.** (a) – (f) No change.

(g) Equity Option and Index Option Priority and Parity

(i) (A) – (B)

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\(^3\) An SQT is an ROT who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such SQT is assigned. An SQT may only submit such quotations while such SQT is physically present on the floor of the Exchange. *See* Exchange Rule 1014(b)(ii)(A).

\(^4\) An RSQT is an ROT that is a member or member organization with no physical trading floor presence who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such RSQT has been assigned. An RSQT may only submit such quotations electronically from off the floor of the Exchange. *See* Exchange Rule 1014(b)(ii)(B).
(C) Purchase or sale priority for orders of 100 contracts or more. If a member purchases (sells) 50 or more option contracts of a particular series at a particular price or prices, he shall, at the next lower (higher) price have priority in purchasing (selling) up to the equivalent number of option contracts of the same series that he purchased (sold) at the higher (lower) price or prices, but only if his bid (offer) is made promptly and the purchase (sale) so effected represents the opposite side of a transaction with the same order or offer (bid) as the earlier purchase or purchases (sale or sales). When the market has a bid/ask differential of one minimum trading increment, he shall also have priority over SQTs located out of the trading crowd and over RSQTs. The Options Committee may increase the “minimum qualifying order size” above 100 contracts for all products under its jurisdiction. Announcements regarding changes to the minimum qualifying order size shall be made via an Exchange circular. This paragraph is subject to a pilot scheduled to expire June 30, 2006, and shall only apply to transactions in equity options and options overlying Exchange Traded Fund Shares (“ETFs”) and only to such transactions that are effected in open outcry.

(h) No change.

Commentary: No change.

2. Procedures of the Self-Regulatory Organization

The Exchange’s Executive Committee, pursuant to delegated authority, approved the proposal for filing with the Securities and Exchange Commission (“SEC” or “Commission”) on February 28, 2006.

Questions and comments on the proposed rule change may be directed to Richard S. Rudolph, Vice President and Counsel, 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 modify an existing pilot (“pilot”) concerning priority in open outcry concerning split-price transactions, which establishes

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rules that facilitate the execution of large orders, which by virtue of their size and the need to execute them at multiple prices may be difficult to execute without a limited exception to current Exchange priority rules, by establishing priority for in-crowd participants in split price transactions over participants that are not located in the crowd (i.e., out-of-crowd SQTs and RSQTs) in the limited circumstance where the market has a bid/ask differential of one minimum trading increment. The pilot is scheduled to expire June 30, 2006.

Current Pilot

The current pilot establishes a priority rule regarding open outcry split price transactions in equity options and options overlying Exchange Traded Fund Shares (“ETFs”) generally to permit a member with an order for at least 100 contracts who buys (sells) at least 50 contracts at a particular price to have priority over all others in purchasing (selling) up to an equivalent number of contracts of the same order at the next lower (higher) price without being required to yield to existing customer interest in the limit order book. Absent this proposed rule, such orders would be required to yield priority.

For example, a Floor Broker representing an order to purchase 100 contracts that executes a purchase of 50 of those contracts at a price of $.30 has priority over all market participants to purchase the remaining 50 contracts in the order at $.25. Two trades

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6 Generally, all options on stocks, index options, and Exchange Traded Options quoting in decimals at $3.00 or higher have a minimum increment of $.10, and all options on stocks and index options quoting in decimals under $3.00 have a minimum increment of $.05. See Exchange Rule 1034(a).

7 Orders for a size of less than 100 contracts are not affected by the current pilot and would not be affected by this proposed rule change.

8 See, e.g., Exchange Rule 119(a).
would be reported to the tape, one a purchase of 50 contracts at $.30, and the other a purchase of 50 contracts at $.25. The effect to the customer would be a net purchase price of $.275 for 100 contracts.

Proposed Modification to the Current Pilot

As stated above, the current pilot contemplates that a member who purchases (sells) 50 or more option contracts of a particular series at a particular price or prices has priority at the next lower (higher) price in purchasing (selling) up to the equivalent number of option contracts of the same series that he purchased (sold) at the higher (lower) price or prices. The instant proposal would, respecting split price transactions, afford priority to members physically located in the crowd in the limited circumstance where the market has a bid/ask differential of one minimum trading increment. The Exchange believes that this provision should enable it to compete for order flow in situations where Floor Brokers seek split price executions in open outcry when the market has a bid/ask differential of one minimum trading increment.

For example, assume a Floor Broker represents an order to purchase 100 contracts in a series where the market is $0.25 bid, $0.30 offer, and both the bid and offer represent quotations submitted by out-of-crowd SQTs or RSQTs. Under the proposal, the Floor Broker would be afforded priority over the out-of-crowd SQT or RSQT at both $0.25 and $0.30, because the bid/ask differential is one minimum trading increment ($.05). This would enable the Floor Broker to execute a split-price order at a net price ($0.275) that

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9 The specialist and/or SQTs participating in a trading crowd may, in response to a verbal request for a market by a floor broker, state a bid or offer that is different than their electronically submitted bid or offer, provided that such stated bid or offer is not inferior to such electronically submitted bid or offer. See Exchange Rule 1014, Commentary .05(c).
improves the market. The effect (and ultimate benefit) to the customer would be a net purchase price of $.275 for 100 contracts.

The Exchange believes that, in situations where the market has a bid/ask differential of one minimum trading increment, it is potentially difficult for the Floor Broker to achieve price improvement for the Floor Broker’s customer on the Phlx. Instead, the order might trade at another exchange that has no impediments, i.e., rules that afford priority to in-crowd participants over out-of-crowd participants.10

One possible limitation on the ability of crowd participants to use the split price priority rule is the current requirement that orders for controlled accounts11 must yield priority to orders for customer accounts. The Exchange believes that, in the context of the split-price priority rule and the instant proposed modification to the rule, this could compromise the Floor Broker’s ability to execute split price orders when the market has a bid/ask differential of one minimum trading increment, and one or both of the quotations in such a market is the quotation of an out-of-crowd SQT or an RSQT (which are both controlled accounts). This could also make it difficult to achieve price improvement for the Floor Broker’s customer on the Phlx. Accordingly, one significant purpose of this proposal is to adopt a limited exception to the existing priority requirement concerning controlled accounts respecting out-of-crowd SQTs and RSQTs.

10 In March 2005, the Commission approved revisions to Chicago Board Options Exchange, Inc. (“CBOE”) Rule 6.45A related to the introduction of Remote Market-Makers. Among other things, the Rule, pertaining to the allocation of orders represented in open outcry in equity options classes traded on the CBOE Hybrid System, was amended to clarify that only in-crowd market participants would be eligible to participate in open outcry trade allocations. See Securities Exchange Act Release No. 51366 (March 14, 2005), 70 FR 13217 (March 18, 2005) (SR-CBOE-2004-75).

11 A controlled account includes any account controlled by or under common control with a broker-dealer. Customer accounts are all other accounts. Equity option and index option orders of controlled accounts are required to yield priority to customer orders when competing at the same price. Orders of controlled accounts generally are not required to yield priority to other controlled account orders. See Exchange Rule 1014(g)(i)(A).
b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act\textsuperscript{12} in general, and furthers the objectives of Section 6(b)(5) of the Act\textsuperscript{13} 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 a national market system and, in general, to protect investors and the public interest, enabling Floor Brokers representing split price orders in open outcry to provide split-price executions at improved prices on behalf of customers by establishing a limited priority rule regarding split-price transactions when the bid/ask differential is one minimum trading increment.

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

The Phlx does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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 does not consent to an extension of the time period for Commission action.

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

\textsuperscript{13} 15 U.S.C. 78f(b)(5).
7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The Exchange requests accelerated effectiveness pursuant to Section 19(b)(2) of the Act\textsuperscript{14} in order to compete with other exchanges that have similar rules in effect, as cited below.

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

The proposed rule change is based on CBOE Rule 6.45A(b)(ii)(B)(1).\textsuperscript{15}

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-2006-18)

Self-Regulatory Organizations; Notice of Filing and Accelerated Approval of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Split Price Priority in Options

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 ______________________ 2006, 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) of the Act\(^3\) and Rule 19b-4 thereunder,\(^4\) proposes to amend Exchange Rule 1014(g)(i)(C) to adopt a new split price priority rule that establishes priority for in-crowd participants in split price transactions over participants that are not located in the crowd (i.e., out-of-crowd Streaming Quote Traders (“SQTs”))\(^5\) and Remote Streaming Quote Traders (“RSQTs”)\(^6\) in the limited


\(^5\) An SQT is an ROT who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such SQT is assigned. An SQT may
circumstance where the market has a bid/ask differential of one minimum trading increment.

The text of the proposed rule change is set forth below.

Underlining indicates new text.

**Obligations and Restrictions Applicable to Specialists and Registered Options Traders**

**Rule 1014.** (a) – (f) No change.

(g) Equity Option and Index Option Priority and Parity

(i) (A) – (B)

(C) **Purchase or sale priority for orders of 100 contracts or more.** If a member purchases (sells) 50 or more option contracts of a particular series at a particular price or prices, he shall, at the next lower (higher) price have priority in purchasing (selling) up to the equivalent number of option contracts of the same series that he purchased (sold) at the higher (lower) price or prices, but only if his bid (offer) is made promptly and the purchase (sale) so effected represents the opposite side of a transaction with the same order or offer (bid) as the earlier purchase or purchases (sale or sales). **When the market has a bid/ask differential of one minimum trading increment, he shall also have priority over SQTs located out of the trading crowd and over RSQTs.** The Options Committee may increase the “minimum qualifying order size” above 100 contracts for all products under its jurisdiction. Announcements regarding changes to the minimum qualifying order size shall be made via an Exchange circular. This paragraph is subject to a pilot scheduled to expire June 30, 2006, and shall only apply to transactions in equity options and options overlying Exchange Traded Fund Shares (“ETFs”) and only to such transactions that are effected in open outcry.

(h) No change.

Commentary: No change.

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only submit such quotations while such SQT is physically present on the floor of the Exchange. See Exchange Rule 1014(b)(ii)(A).

An RSQT is an ROT that is a member or member organization with no physical trading floor presence who has received permission from the Exchange to generate and submit option quotations electronically through AUTOM in eligible options to which such RSQT has been assigned. An RSQT may only submit such quotations electronically from off the floor of the Exchange. See Exchange Rule 1014(b)(ii)(B).
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 modify an existing pilot (“pilot”) concerning priority in open outcry concerning split-price transactions,7 which establishes rules that facilitate the execution of large orders, which by virtue of their size and the need to execute them at multiple prices may be difficult to execute without a limited exception to current Exchange priority rules, by establishing priority for in-crowd participants in split price transactions over participants that are not located in the crowd (i.e., out-of-crowd SQTs and RSQTs) in the limited circumstance where the market has a bid/ask differential of one minimum trading increment.8 The pilot is scheduled to expire June 30, 2006.

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For example, a Floor Broker representing an order to purchase 100 contracts that executes a purchase of 50 of those contracts at a price of $.30 has priority over all market participants to purchase the remaining 50 contracts in the order at $.25. Two trades would be reported to the tape, one a purchase of 50 contracts at $.30, and the other a purchase of 50 contracts at $.25. The effect to the customer would be a net purchase price of $.275 for 100 contracts.

Proposed Modification to the Current Pilot

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9 Orders for a size of less than 100 contracts are not affected by the current pilot and would not be affected by this proposed rule change.

10 See, e.g., Exchange Rule 119(a).
(lower) price or prices. The instant proposal would, respecting split price transactions, afford priority to members physically located in the crowd in the limited circumstance where the market has a bid/ask differential of one minimum trading increment. The Exchange believes that this provision should enable it to compete for order flow in situations where Floor Brokers seek split price executions in open outcry when the market has a bid/ask differential of one minimum trading increment.

For example, assume a Floor Broker represents an order to purchase 100 contracts in a series where the market is $0.25 bid, $0.30 offer, and both the bid and offer represent quotations submitted by out-of-crowd SQTs or RSQTs. Under the proposal, the Floor Broker would be afforded priority over the out-of-crowd SQT or RSQT at both $0.25 and $0.30, because the bid/ask differential is one minimum trading increment (.05). This would enable the Floor Broker to execute a split-price order at a net price ($0.275) that improves the market. The effect (and ultimate benefit) to the customer would be a net purchase price of $.275 for 100 contracts.

The Exchange believes that, in situations where the market has a bid/ask differential of one minimum trading increment, it is potentially difficult for the Floor Broker to achieve price improvement for the Floor Broker's customer on the Phlx. Instead, the order might trade at another exchange that has no impediments, i.e., rules that afford priority to in-crowd participants over out-of-crowd participants.12

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11 The specialist and/or SQTs participating in a trading crowd may, in response to a verbal request for a market by a floor broker, state a bid or offer that is different than their electronically submitted bid or offer, provided that such stated bid or offer is not inferior to such electronically submitted bid or offer. See Exchange Rule 1014, Commentary .05(c).

12 In March 2005, the Commission approved revisions to Chicago Board Options Exchange, Inc. (“CBOE”) Rule 6.45A related to the introduction of Remote Market-Makers. Among other things, the Rule, pertaining to the allocation of orders represented in open outcry in equity options classes traded on the CBOE Hybrid System, was amended to clarify that only in-crowd market participants would be eligible to
One possible limitation on the ability of crowd participants to use the split price priority rule is the current requirement that orders for controlled accounts\(^{13}\) must yield priority to orders for customer accounts. The Exchange believes that, in the context of the split-price priority rule and the instant proposed modification to the rule, this could compromise the Floor Broker’s ability to execute split price orders when the market has a bid/ask differential of one minimum trading increment, and one or both of the quotations in such a market is the quotation of an out-of-crowd SQT or an RSQT (which are both controlled accounts). This could also make it difficult to achieve price improvement for the Floor Broker’s customer on the Phlx. Accordingly, one significant purpose of this proposal is to adopt a limited exception to the existing priority requirement concerning controlled accounts respecting out-of-crowd SQTs and RSQTs.

2. **Statutory Basis**

The Exchange believes that its proposal is consistent with Section 6(b) of the Act\(^{14}\) in general, and furthers the objectives of Section 6(b)(5) of the Act\(^{15}\) 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 a national market system and, in general, to protect investors and the public interest, enabling Floor Brokers representing split price orders in open outcry to provide split-price executions at participate in open outcry trade allocations. See Securities Exchange Act Release No. 51366 (March 14, 2005), 70 FR 13217 (March 18, 2005) (SR-CBOE-2004-75).

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improved prices on behalf of customers by establishing a limited priority rule regarding split-price transactions when the bid/ask differential is one minimum trading increment.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition 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 either solicited or received.

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

The Exchange requests accelerated effectiveness pursuant to Section 19(b)(2) of the Act16 in order to compete with other exchanges that have similar rules in effect.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission’s Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2006-18 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-2006-18. 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-2006-18 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.¹⁷

Nancy M. Morris
Secretary