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)

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

Zero Bid Options

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 Edith Last Name Hallahan
Title Deputy General Counsel
E-mail Edith.hallahan@phlx.com
Telephone (215) 496-5179 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 05/16/2006
By Cynthia Hoekstra Director

(Note)

(Circle)

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.

Cynthia H Oeokstra,
### 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")\(^1\) and Rule 19b-4\(^2\) thereunder, proposes to amend Exchange Rule 1080(i) to provide that the Exchange’s Automated Options Market (AUTOM) System\(^3\) will only convert a market order to sell in a “zero-bid option”\(^4\) into a limit order to sell such option at $0.05 if the Exchange’s best bid/offer (the “PBBO”) has a bid/ask differential of less than or equal to $0.25 and (i) the National Best Bid or Offer (“NBBO”) reflects a zero bid in an option listed on multiple exchanges, or (ii) the Exchange’s disseminated bid is zero for an option listed only on the Exchange.

A notice of the proposed rule change for publication in the Federal Register is attached hereto as [Exhibit 1](#) and the text of the proposed rule change is set forth below.

---


\(^3\) AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM's automatic execution features, AUTO-X, Book Sweep and Book Match. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor. AUTOM is today more commonly referred to as Phlx XL. [See](#) Exchange Rule 1080.

\(^4\) A “zero-bid option” is an option with a bid price of zero, meaning the option is virtually worthless. A bid price of zero typically occurs in situations where there is no intrinsic value in the series quoted (i.e., where an option series is out-of-the-money by a relatively large amount and such series is close to expiration).
Underlining indicates new text; deletions are bracketed

Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)

Rule 1080.  (a) – (h) No change.

(i) Zero-bid option series. The AUTOM System will convert market orders to sell a particular option series to limit orders to sell with a limit price of $.05 that are received when:

(A) For options listed only on the Exchange:

(1) the Exchange’s disseminated bid price in such option series is zero\[.\] and

(2) the Exchange’s disseminated quotation in the series has a bid/ask differential less than or equal to $0.25; or

(B) For options that are listed on multiple exchanges:

(1) the disseminated NBBO includes a bid price of zero in the series; and

(2) the Exchange’s disseminated quotation in the series has a bid/ask differential less than or equal to $0.25.

[to limit orders to sell with a limit price of $.05] Such orders will be automatically placed on the limit order book in price-time priority.

(j) – (l) No change.

Commentary: No change.

2. Procedures of the Self-Regulatory Organization

The Executive Committee, pursuant to delegated authority, approved the proposal for filing with the Securities and Exchange Commission ("SEC" or "Commission") on May 4, 2006.
Questions and comments on the proposed rule change may be directed to 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 Exchange Rule 1080(i) so as to limit the circumstances in which AUTOM will convert a market order to sell into a limit order to sell a zero-bid option at $0.05. The Exchange adopted Rule 1080(i) as a means of automating the handling of these orders. Currently, Exchange Rule 1080(i) provides for the conversion of all market orders to sell that are received when the Exchange is disseminating a bid of zero in that option.

Since the adoption of Exchange Rule 1080(i), the Exchange has concluded that not all options with a zero bid are the same. The Exchange currently treats options that have an offer price of a few dollars on the Exchange, as well as options that are not “zero-bid” on other exchanges, as zero-bid options. Accordingly, this proposal outlines additional factors that the Exchange will consider when determining whether an option is a zero-bid option for purposes of Rule 1080(i) including the Exchange’s spread and the NBBO. The Exchange believes that the new criteria will clarify when an option is truly a zero-bid option for which orders in that option should be subject to automated handling versus orders for non-zero-bid options that need manual handling.

The Exchange believes that taking the spread into consideration will help limit the conversion of market orders to sell to only those for true zero-bid options, because

---

options with an offer much higher than above $0.25 are likely not to be worthless options. Similarly, for options traded on more than one exchange, the NBBO is relevant for validating whether an option truly is a zero-bid option.

b. **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 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, by limiting the instances in which the Exchange’s AUTOM system converts a market order to sell an option that is not a zero-bid option series under Rule 1080(i).

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.

---


7. **Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

Because the foregoing rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.  

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii) permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. Furthermore, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file a proposed rule change under that subsection at least five business days prior to the date of filing, or such shorter time as designated by the Commission. The Exchange is requesting that the Commission waive the 30-day operative delay and the five-day pre-filing notice requirement, as specified in Rule 19b-4(f)(6)(iii), and designate the proposed rule change immediately operative. The Exchange believes that waiving the 30-day operative delay and the five-day pre-filing notice requirement is consistent with the protection of investors and the public interest. The proposed amendment to Exchange Rule 1080(i) does not impose any significant burden on competition and does not have the effect of limiting the access to or availability of the system.

---


By waiving the 30-day operative delay and the five-day pre-filing notice requirement, the Exchange may implement, without undue delay, the proposed amendment to Exchange Rule 1080(i), which effects a change in the Exchange’s AUTOM trading system.

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.
SECURITIES AND EXCHANGE COMMISSION
(Release No. ; File No. SR-Phlx-2006-32)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Zero Bid 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 1080(i) to provide that the Exchange’s Automated Options Market (AUTOM) System\(^5\) will only convert a market order to sell in a “zero-

---

\(^5\) AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM's automatic execution features, AUTO-X, Book Sweep and Book Match. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate
bid option" into a limit order to sell such option at $0.05 if the Exchange’s best bid/offer (the “PBBO”) has a bid/ask differential of less than or equal to $0.25 and (i) the National Best Bid or Offer (“NBBO”) reflects a zero bid in an option listed on multiple exchanges, or (ii) the Exchange’s disseminated bid is zero for an option listed only on the Exchange.

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

Underlining indicates new text; deletions are bracketed

Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)

Rule 1080. (a) – (h) No change.

(i) Zero-bid option series. The AUTOM System will convert market orders to sell a particular option series to limit orders to sell with a limit price of $.05 that are received when:

(A) For options listed only on the Exchange:

(1) the Exchange’s disseminated bid price in such option series is zero[,] and

(2) the Exchange’s disseminated quotation in the series has a bid/ask differential less than or equal to $0.25; or

(B) For options that are listed on multiple exchanges:

(1) the disseminated NBBO includes a bid price of zero in the series; and

(2) the Exchange’s disseminated quotation in the series has a bid/ask differential less than or equal to $0.25.

[to limit orders to sell with a limit price of $.05] Such orders will be automatically placed on the limit order book in price-time priority.

specialist unit on the Exchange trading floor. AUTOM is today more commonly referred to as Phlx XL. See Exchange Rule 1080.

6 A “zero-bid option” is an option with a bid price of zero, meaning the option is virtually worthless. A bid price of zero typically occurs in situations where there is no intrinsic value in the series quoted (i.e., where an option series is out-of-the-money by a relatively large amount and such series is close to expiration).
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 Exchange Rule 1080(i) so as to limit the circumstances in which AUTOM will convert a market order to sell into a limit order to sell a zero-bid option at $0.05. The Exchange adopted Rule 1080(i) as a means of automating the handling of these orders.7 Currently, Exchange Rule 1080(i) provides for the conversion of all market orders to sell that are received when the Exchange is disseminating a bid of zero in that option.

Since the adoption of Exchange Rule 1080(i), the Exchange has concluded that not all options with a zero bid are the same. The Exchange currently treats options that have an offer price of a few dollars on the Exchange, as well as options that are not “zero-bid” on other exchanges, as zero-bid options. Accordingly, this proposal outlines additional factors that the Exchange will consider when determining whether an option is

---

a zero-bid option for purposes of Rule 1080(i) including the Exchange’s spread and the 
NBBO. The Exchange believes that the new criteria will clarify when an option is truly a 
zero-bid option for which orders in that option should be subject to automated handling 
versus orders for non-zero-bid options that need manual handling.

The Exchange believes that taking the spread into consideration will help limit the 
conversion of market orders to sell to only those for true zero-bid options, because 
options with an offer much higher than above $0.25 are likely not to be worthless 
options. Similarly, for options traded on more than one exchange, the NBBO is relevant 
for validating whether an option truly is a zero-bid option.

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 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, by limiting the instances in which 
the Exchange’s AUTOM system converts a market order to sell an option that is not a 
zero-bid option series under Rule 1080(i).

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

Because the foregoing rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act\textsuperscript{10} and Rule 19b-4(f)(6) thereunder.\textsuperscript{11}

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii) permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. Furthermore, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file a proposed rule change under that subsection at least five business days prior to the date of filing, or such shorter time as designated by the Commission. The Exchange is requesting that the Commission waive the 30-day operative delay and the five-day pre-filing notice requirement, as specified in Rule 19b-4(f)(6)(iii), and designate the proposed rule change immediately operative. The Exchange believes that waiving the 30-day


\textsuperscript{11} 17 CFR 240.19b-4(f)(6).
operative delay and the five-day pre-filing notice requirement is consistent with the protection of investors and the public interest. The proposed amendment to Exchange Rule 1080(i) does not impose any significant burden on competition and does not have the effect of limiting the access to or availability of the system.

By waiving the 30-day operative delay and the five-day pre-filing notice requirement, the Exchange may implement, without undue delay, the proposed amendment to Exchange Rule 1080(i), which effects a change in the Exchange’s AUTOM trading system.

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-2006-32 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-2006-32. 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-2006-32 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.¹²

Nancy M. Morris
Secretary