

proposal to revise the definition of Theoretical Price²³ to account for the situation when the Amex disseminates an erroneous quote that is then reflected in the quote of a competing exchange. The Citadel Letter contended that it will generally be impossible to discern whether another exchange widened its quotes as a result of an Amex erroneous quote. The Citadel Letter noted that allowing the Amex to determine whether another Exchange's quotes were erroneous and thus remove them from the calculation of Theoretical Price would inject uncertainty and unpredictability into the determination of obvious error.

In Amendment No. 4, the Exchange revised the definition of Theoretical Price by adding quantifiable standards to better indicate how the Exchange will determine when a quote is "erroneous" and thus should be disregarded for purposes of calculating Theoretical Price. The Commission believes that the proposed rule change, as amended, addresses the concerns raised by the Citadel Letter that pertain to the proposed rule change.²⁴ Amex's proposal to add numerical criteria to assess when another exchange's quote is erroneous should help to ensure that the Exchange's obvious error determinations with respect to erroneous quotes are objective.

The Commission also finds good cause to approve Amendment Nos. 4 and 5 to the proposed rule change prior to the thirtieth day after the amendment is published for comment in the **Federal Register** pursuant to Section 19(b)(2) of the Act.²⁵ Amendment No. 4 bases the definition of Theoretical Price on the midpoint of the NBBO, ensuring that the Amex's obvious error rule is consistent with the Options Intermarket Linkage Plan, which requires exchanges to avoid trade-throughs. This revision is also consistent with recent changes to the obvious error rule of the Philadelphia Stock Exchange that were approved by the Commission.²⁶ Amendment No. 5 simply clarifies that the process for calculating average quote width set forth in Amex Rules 936(a)(5) and 936(a)(5)—ANTE (relating to equity options) also applies to the calculation of average quote width for purposes of Amex Rules 936C(a)(5) and 936C(a)(5)—ANTE (relating to index options). The Commission believes that accelerated

approval of Amendment Nos. 4 and 5 would enable investors to benefit from the changes in the proposed rule change without further delay. Therefore, for these reasons, the Commission believes that good cause exists to accelerate approval of Amendment Nos. 4 and 5.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 4 and 5, including whether Amendment Nos. 4 and 5 are 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 No. SR-Amex-2005-060 on the subject line.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-Amex-2005-060. 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 such filing also will be available for inspection and copying at the principal office of the Amex. 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-Amex-2005-060 and should be submitted on or before November 13, 2006.

V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Section 6(b)(5) of the Act²⁷ in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²⁸ that the proposed rule change (SR-Amex-2005-060) and Amendment Nos. 1, 2 and 3 thereto are approved, and that Amendment Nos. 4 and 5 thereto are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁹

Jill M. Peterson,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54603; File No. SR-ISE-2006-62]

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change To Implement a Pilot Program To Quote and To Trade Certain Options in Pennies

October 16, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 11, 2006, the International Securities Exchange, LLC (the "Exchange" or the "ISE") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the ISE. 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 ISE is proposing to implement a pilot program to quote and to trade

²⁷ 15 U.S.C. 78f(b)(5).

²⁸ 15 U.S.C. 78s(b)(2).

²⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

²³ In Amex's Obvious Error Rules relating to index options, Theoretical Price is referred to as Fair Market Value.

²⁴ See Amendment No. 4, *supra* note 9.

²⁵ 15 U.S.C. 78s(b)(2).

²⁶ Securities Exchange Act Release No. 54070 (June 29, 2006), 71 FR 38441 (July 6, 2006) (SR-Phlx-2005-73).

certain options in pennies. The text of the proposed rule change is available on the ISE's Web site at <http://www.iseoptions.com>, at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.³

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The ISE 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 proposed rule change will implement a pilot program (the "Pilot") for the quoting and trading of specified options contracts in \$.01 increments. In a letter dated June 7, 2006, Chairman Cox of the Commission encouraged the six options exchanges to commence the Pilot. ISE proposes the following rule changes and related actions to implement the Pilot:

- To amend ISE Rule 710, regarding trading increments, to specify that the Exchange: (i) Will participate in the Pilot; and (ii) will identify the specific options to be included in the Pilot, as well as the increments for the quoting and trading of such options, in circulars that the Exchange will file with the Commission as proposed rule changes and will distribute to its members.

- To issue the proposed regulatory information circular attached as Exhibit 5 to the proposed rule change, identifying the initial Pilot options. These options are the NASDAQ 100 Trust, for which all series will be quoted and traded in pennies, and 12 other options, for which series trading at less than \$3.00 will be quoted and traded in penny increments, and series trading at \$3.00 or more will be quoted and traded in nickel increments.

- To amend ISE Rule 716, which currently permits trades in the Exchange's Block, Facilitation and Solicitation Mechanisms to be effected at "split prices," which are the mid-

points of the current standard trading increments. The Exchange proposes that options trading in penny increments not be eligible for such split pricing.

- To codify certain ISE "quote mitigation" actions. In proposing the Pilot, Chairman Cox noted that the Pilot "is almost certain to increase demands on all market participants' systems" and that "it is essential that any exchange proposal also include a workable strategy for quote mitigation." The Exchange believes that it currently has an effective quote mitigation strategy in place. Specifically:

- API Fees: The ISE has implemented a fee program that requires market makers to purchase more APIs as the market maker generates more quotes, providing economic incentives on market makers to limit the number of quotations they disseminate.⁴

- Monitoring: The ISE submits that it actively monitors the quotation activity of its market makers. When the Exchange detects that a market maker is disseminating significantly more quotes than an average market maker, the Exchange contacts that market maker and alerts it to such activity. Often such monitoring reveals that the market maker may have internal system issues or has incorrectly-set system parameters that were not immediately apparent to it. The Exchange believes that, even without uncovering problems, alerting a market maker to possible excessive quoting usually leads the market maker to take steps to reduce the number of its quotes.

- Holdback Timer: The ISE has the systemic ability to limit the dissemination of quotations and other changes to the ISE best bid and offer according to prescribed time criteria (a "holdback timer"). For example, if there is a change in the price of a security underlying an option, multiple market makers likely will adjust the price or size of their quotes. Rather than disseminating each individual change, the holdback timer permits the Exchange to wait until all market makers have adjusted their quotes and then to disseminate a new quotation. This helps prevent the "flickering" of quotations. The ISE proposes to codify the holdback timer in this rule filing. As proposed in ISE Rule 804, the ISE will utilize a holdback timer that delays quotation updates for no longer than one second.

- Delisting: The ISE has committed to the Commission that it will delist options with average daily volume

("ADV") of less than 20 contracts.⁵ However, it has been the ISE's policy to be much more aggressive in delisting relatively inactive options, thereby eliminating the quotation traffic attendant to such listings. Currently, it is the ISE's policy to delist options with ADV of less than 50, even with the advent of the Exchange's new "Second Market,"⁶ which provides liquidity for less-active options.

- To submit certain reports. The Commission staff has asked the options exchanges to prepare reports regarding the first three months' experience under the Pilot and to submit such reports by the end of the fourth month of the Pilot. The reports will compare quotation and trading activity in the three months prior to the Pilot (October 26, 2006 through January 25, 2007), to the first three months of the Pilot (January 26, 2007 through April 25, 2007). The ISE will submit the following reports to the Commission pursuant to this timetable:

- Quality of Markets: This report will focus on quotation spread and size of quotations, as well as a number of other factors, including average daily volume.

- Capacity: This report will focus on the number of quotations in the Pilot options and the effect on the ISE's system's capacity.

- Linkage: This report will focus on trade-throughs, Satisfaction orders the ISE sends and receives, the number of Linkage Orders that "time out" without a response and the flickering of quotations.

2. Statutory Basis

The Exchange believes that its proposed rule change is consistent with Section 6(b) of the Act,⁷ in general, and furthers the objectives of Section 6(b)(5) of the Act,⁸ in particular, in that the proposed rule change 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. In particular, the proposed rule change will permit the pilot quoting and trading of certain options in pennies to help determine whether such quoting and trading increments benefit investors.

⁵ See Securities Exchange Act Release No. 47483 (March 11, 2003), 68 FR 13352 (March 19, 2003) (SR-ISE-2003-04).

⁶ See Securities Exchange Act Release No. 54340 (August 21, 2006), 71 FR 51240 (August 29, 2006)(SR-ISE-2006-40).

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

³ Exhibit 5 to the proposed rule change contains a proposed Regulatory Information Circular that also is part of the text of the proposed rule change.

⁴ See Securities Exchange Act Release No. 53522 (March 20, 2006), 71 FR 14975 (March 24, 2006) (SR-ISE-2006-09).

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 that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

Written comments on the proposed rule change were neither solicited nor 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 the Exchange consents, the Commission will:

(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>; or
- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-ISE-2006-62 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-ISE-2006-62. 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 such filing also will be available for inspection and copying at the principal office of the ISE. 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-ISE-2006-62 and should be submitted on or before November 13, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Jill M. Peterson,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54607; File No. SR-NASD-2005-094]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto Relating to Amendments to the Classification of Arbitrators Pursuant To Rule 10308 of the NASD Code of Arbitration Procedure

October 16, 2006.

I. Introduction

On June 17, 2005, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend NASD Rule 10308 relating to the classification of arbitrators as non-public or public.³ On August 5, 2005,

NASD filed amendment No. 1 to the proposed rule.⁴ The proposed rule change, as amended, was published for comment in the **Federal Register** on August 30, 2005,⁵ and the Commission received 65 comments on the proposal.⁶

(SR-NYSE-2005-43) (the "NYSE Rule Change"), which also governs securities industry and public arbitrators. The NYSE Rule Change will become effective on Dec. 13, 2006, which is 90 days after the Commission's approval order was published in the **Federal Register**. See Exchange Act Release No. 54407 (Sept. 6, 2006), 71 FR 54102 (Sept. 13, 2006).

⁴ The amendment clarified the rule's text and purpose, and revised the effective date of the rule. NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 30 days following Commission approval. The effective date will be no later than 60 days following publication of the Notice to Members announcing Commission approval.

⁵ See Exchange Act Release No. 52332 (Aug. 24, 2005), 70 FR 51395 (Aug. 30, 2005) (the "Notice").

⁶ Richard H. Levenstein, Kramer, Sopko & Levenstein, P.A., Feb. 1, 2006 ("Levenstein"); Les Greenberg, Law Offices of Les Greenberg, Oct. 9 2005 ("Greenberg"); Bradford D. Kaufman, Greenberg Traurig, Oct. 7, 2005 ("Kaufman"); Jonathan L. Hochman, Schindler Cohen & Hochman LLP, Sept. 30, 2005 ("Hochman"); Jonathan W. Evans, Jonathan W. Evans and Associates, Sept. 21, 2005 ("Evans"); Scot Bernstein, Sept. 21, 2005 ("Bernstein"); John W. Barnes, Sept. 21, 2005 ("Barnes"); L. Jerome Stanley, Sept. 20, 2005 ("Stanley"); Dale Ledbetter, Ardorno & Yoss, Sept. 20, 2005 ("Ledbetter"); Randall R. Heiner, Sept. 20, 2005 ("Heiner"); Sam T. Brannan, Page Perry, LLC, Sept. 20, 2005 ("Brannan"); Jason R. Doss, Page Perry, LLC, Sept. 20, 2005 ("Doss"); William B. Langenbacher, Sept. 20, 2005 ("Langenbacher"); Steve Parker, Page Perry, LLC, Sept. 20, 2005 ("Parker"); Jeffrey D. Pederson, Sept. 20, 2005 ("Pederson"); Martin Seiler, Sept. 20, 2005 ("Seiler"); Brian Greenman, Sept. 20, 2005 ("Greenman"); Teresa M. Gillis, Shustak Jilil & Heller, Sept. 20, 2005 ("Gillis"); William F. Davis, Sept. 20, 2005 ("Davis"); David Harrison, Spivak & Harrison, Sept. 20, 2005 ("Harrison"); Susan N. Perkins, Sept. 20, 2005 ("Perkins"); Mitchell S. Ostwald, Law Offices of Mitchell S. Ostwald, Sept. 20, 2005 ("Ostwald"); Scot D. Bernstein, Law Offices of Scot D. Bernstein, Sept. 20, 2005 ("Bernstein"); William F. Galvin, Commonwealth of Massachusetts, Sept. 20, 2005 ("Galvin"); William P. Torngren, Law Offices of William P. Torngren, Sept. 20, 2005 ("Torngren"); Charles C. Mihalek and Steven M. McCauley, Charles C. Mihalek, P.S.C., Sept. 20, 2005 ("Mihalek"); Timothy A. Canning, Sept. 20, 2005 ("Canning"); Laurance M. Landsman, Block & Landsman, Sept. 20, 2005 ("Landsman"); Steven J. Gard, Gard Smiley Bishop & Dovin LLP, Sept. 20, 2005 ("Gard"); Scott L. Silver, Blum & Silver, P.A., Sept. 20, 2005 ("Silver"); G. Mark Brewer, Brewer Carlson, LLP, Sept. 20, 2005 ("Brewer"); John D. Hudson, Sept. 20, 2005 ("Hudson"); Joel A. Goodman, Kalju Nekvasil, Steven Krosschell, and Jennifer Newsom, Goodman & Nekvasil, P.A., Sept. 20, 2005 ("Goodman"); Jill I. Gross, Barbara Black, and Per Jepsen, Pace Investor Rights Project, Sept. 20, 2005 ("Gross"); Royal B. Lea, III, Bingham & Lea, and Randall A. Pulman, Pulman, Bresnahan & Pullen, LLP, Sept. 19, 2005 ("Lea"); Richard P. Ryder, Securities Arbitration Commentator, Inc., Sept. 19, 2005 ("Ryder"); Alan C. Friedberg, Pendelton, Friedberg, Wilson & Hennessey, P.C., Sept. 19, 2005 ("Friedberg"); Robert K. Savage, Savage Law Firm, P.A., Sept. 19, 2005 ("Savage"); Michael Chasen, Sept. 19, 2005 ("Chasen"); Adam S. Doner, Sept. 19, 2005 ("Doner"); Jan Graham, Graham Law Offices, Sept. 19, 2005 ("Graham"); Frederick W. Rosenberg,

⁹ 17 CFR 200.30-3(a)(12).

¹⁵ U.S.C. 78s(b)(1).

²⁷ 17 CFR 240.19b-4.

³ On September 6, 2006, the Commission approved similar amendments to NYSE Rule 607