March 8, 2006

Meyer S. Frucher
Chairman and Chief Executive Officer
Philadelphia Stock Exchange, Inc.
1900 Market Street
Philadelphia, PA 19103-5000

> Re: Philadelphia Stock Exchange Inc.'s Request for Exemption from
> Trade-Through Provisions of the Plan for the Purpose of Creating
> and Operating an Intermarket Option Linkage

Dear Mr. Frucher:

Rule 608(e) of Regulation NMS under the Securities Exchange Act of 1934 ("Exchange Act") provides that the Securities and Exchange Commission ("Commission") may exempt from the provisions of Rule 608 of Regulation NMS, either unconditionally or on specified terms and conditions, any self-regulatory organization, if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets, and the removal of impediments to, and perfection of the mechanisms of, a national market system.[1] As discussed below, the Commission is exempting the Philadelphia Stock Exchange, Inc. ("Phlx") from Rule 608(c) of Regulation NMS, which requires Phlx to comply with, and enforce compliance by its members with, certain provisions of the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Linkage Plan").[2]

Exemption from Section 8(c) of the Linkage Plan

In the Exchange's letter, dated February 28, 2006, Phlx seeks an exemption from Rule 608(c) of Regulation NMS, which requires Phlx to comply with, and enforce compliance by its members with, the terms of the Linkage Plan regarding Trade-Throughs.[3] Specifically, Phlx

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[1]   17 CFR 242.608. The Division of Market Regulation has delegated authority to grant an exemption pursuant to 17 CFR 200.30-3(a)(42).

[2]   The Linkage Plan is a national market system plan approved by the Commission pursuant to Section 11A of the Exchange Act, 15 U.S.C. 78k-1, and Rule 608 of Regulation NMS. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000).

[3]   A "Trade-Through" is defined in Section 2(29) of the Linkage Plan as "a transaction in an options series at a price that is inferior to the NBBO."

requests that the Commission, pursuant to Rule 608(e) of Regulation NMS, exempt Phlx from the requirement of Rule 608(c) of Regulation NMS that Phlx comply, and enforce compliance by its members, with Section 8(c) of the Linkage Plan when trades are executed while the Phlx's disseminated price is crossed, or crosses the disseminated market of another options exchange, by one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the National Best Bid or Offer ("NBBO").[4]

Section 8(c) of the Linkage Plan provides that, "absent reasonable justification and during normal market conditions, members in [Participants'] markets should not effect Trade-Throughs." Section 8(c) of the Linkage Plan also requires the Participants to the Linkage Plan to file with the Commission for its consideration uniform rules which, among other things, provide that, "[w]hen purchasing or selling, either as principal or agent, any options series of an Eligible Options Class, or when sending a Linkage Order, members of a Participant should avoid initiating a Trade-Through" unless an exception applies. In accordance with this provision of the Linkage Plan, Phlx submitted, and the Commission approved, Phlx Rule 1085, which provides that absent reasonable justification and during normal market conditions, Phlx members should not effect Trade-Throughs, unless an exception applies.[5]

Phlx automatically executes orders when the Exchange's disseminated market is crossed, or crosses the disseminated market of another options exchange, by one minimum trading increment (i.e., $1.05 bid, $1.00 offer or $3.10 bid, $3.00 offer), and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO.[6] Thus, Phlx rules allow an automatic execution that trades through one side

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[4] "NBBO" is defined in Section 2(19) of the Linkage Plan as the national best bid and offer in an options series calculated by a Participant.

[5] See Phlx Rule 1085.

[6] Concurrent with the grant of this exemption, the Commission is approving a proposed rule change filed by Phlx to permit automatic executions during a crossed market in limited circumstances and to provide an exception from the prohibition on effecting trade-throughs in the event that Phlx's disseminated market is crossed, or crosses the disseminated market of another options exchange, by one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO. See Securities Exchange Act Release No. 53449 (March 8, 2006) (order approving SR-Phlx-2005-45).

of the market. Accordingly, you request an exemption from the requirement in Rule 608(c) of Regulation NMS that Phlx comply, and enforce compliance by its members, with Section 8(c) of the Linkage Plan when orders are automatically executed when the Exchange's disseminated price is crossed, or crosses the disseminated market of another options exchange, by one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO.

Exemption from Section 4(b) of the Linkage Plan

Section 4(b) of the Linkage Plan requires each Participant to enforce compliance with the provisions of the Plan by its members in their use of Linkage through its facilities. You have requested that the Commission, pursuant to Rule 608(e) of Regulation NMS, exempt Phlx from the requirement in Rule 608(c) of Regulation NMS that Phlx comply with Section 4(b) of the Linkage Plan by enforcing members' compliance with Section 8(c) of the Linkage Plan when orders are automatically executed when the Exchange's disseminated price is crossed, or crosses the disseminated market of another options exchange, by one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO.

Response to Request for Exemption

On the basis of the representations and facts presented in your letter, the Commission grants an exemption to Phlx from the requirement under Rule 608(c) of Regulation NMS that Phlx comply with Section 8(c) of the Linkage Plan, which provides in part that, "absent reasonable justification and during normal market conditions, members in [Participants'] markets should not effect Trade-Throughs." This exemption is expressly conditioned on Phlx automatically executing orders when its disseminated price is crossed, or crosses the disseminated market of another options exchange, by one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO.

In addition, the Commission grants an exemption to Phlx from the requirement in Rule 608(c) of Regulation NMS that Phlx comply with Section 4(b) of the Linkage Plan by enforcing its members' compliance with the requirements of Section 8(c) when orders are automatically executed when the Exchange's disseminated price is crossed, or crosses the disseminated market of another options exchange, by one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO.

The Commission finds that it is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system to grant the exemption described above because it will facilitate the resolution of crossed markets.

This exemption is conditioned solely on the facts and representations presented in your letter. In the event that any material change occurs with respect to any of the facts or representations presented, the exemption will expire and Phlx must immediately resume operating in accordance with all provisions of the Linkage Plan.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority,[7]

Robert L.D. Colby
Acting Director

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[7]   17 CFR 200.30-3(a)(42).

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February 28, 2006

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

> **Re:** **Philadelphia Stock Exchange, Inc. – Request for Exemption Under Rule 608(e) of Regulation NMS Under the Securities Exchange Act of 1934 from Certain Provisions of the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage Relating to the Automatic Execution of Option Transactions During Crossed Markets**

Dear Ms. Morris:

The Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") respectfully requests that the Commission grant a partial exemption from Rule 608(c) of Regulation NMS under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which requires the Exchange to comply with and enforce compliance by its members with the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (the "Plan"). As set forth more fully below, the Exchange seeks an exemption from liability for the satisfaction of trade-throughs under the Plan when a trade-through was the result of an automatic execution when the Exchange's disseminated market is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the National Best Bid or Offer ("NBBO").

<u>Commission's Exemptive Authority</u>

Rule 608(e) of Regulation NMS authorizes the Commission to issue exemptions from the provisions of Rule 608. In particular, Rule 608(e) provides:

> The Commission may exempt from the provisions of this rule, either unconditionally or on specific terms and conditions, any self-regulatory organization... if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanism of, a national market system.

17 CFR 242.608(e). The Plan is an effective national market system plan pursuant to Rule 608 of Regulation NMS, and the Exchange is a participant in the Plan. Rule 608(e) of Regulation NMS authorizes the Commission to issue an exemption to the Exchange from

Rule 608(c), which requires the Exchange to comply with and to enforce compliance by the Exchange's members with the terms of the Plan.[1]

Background

The Exchange seeks this exemption in order to facilitate a rule that would permit automatic executions in option transactions when the Exchange's disseminated market is crossed, or crosses another market, by one minimum trading increment (*i.e.*, $ 1.05 bid, $ 1.00 offer or $ 3.10 bid, $ 3.00 offer), and the Exchange's disseminated price is the NBBO.[2]

The purpose of the proposed rule change is to increase the automated handling and execution of option orders on the Exchange by establishing that orders are eligible for automatic execution during crossed markets when such markets are crossed by one minimum trading increment.

The Exchange believes that the proposed rule change would also facilitate the prompt resolution of crossed markets by permitting automatic executions when the Exchange's disseminated market is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO.

Provisions of the Plan Requiring Exemption

Section 8(c) of the Plan, Order Protection, generally provides that, absent reasonable justification, and during normal market conditions, members should not effect Trade-Throughs in their markets. The Plan also requires each participant to the Plan to file with the Commission uniform rules which, among other things, provide that, "[w]hen purchasing or selling, either as principal or agent, any options series of an Eligible Option Class, or when sending a Linkage Order, members of a Participant should avoid initiating a Trade-Through" unless one or more of the enumerated exceptions to Trade-Through liability contained in the Plan are applicable.

In accordance with this provision, the Exchange submitted, and the Commission approved, Exchange Rule 1085, which provides that, absent reasonable justification and during normal market conditions, Exchange members should not effect Trade-Throughs unless an exception applies.

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[1] Rule 608(c) requires each self-regulatory organization to "comply with the terms of any effective national market system plan of which it is a sponsor or a participant [, and] absent reasonable justification or excuse, enforce compliance with any such plan by its members." 17 CFR 242.608(c).

[2] *See* Securities Exchange Act Release No. 52082 (July 20, 2005), 70 FR 43493 (July 27, 2005) (SR-Phlx-2005-45).

As stated above, the Exchange has proposed to permit automatic executions when the Exchange's disseminated market is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO.[3] However, such a transaction would result in a Trade-Through. An exemption from Section 8(c) of the Plan is needed in order to permit Exchange specialists to automatically execute orders received when the Exchange's disseminated market is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO.

In addition, Section 4(b) of the Plan requires the Exchange to enforce compliance by its members in their use of the Linkage through the Exchange's facilities. Because the Exchange is seeking an exemption from the requirement that it enforce compliance with certain provisions of the Plan, it will necessarily need an exemption from Section 4(b) of the Plan as well.

Exemption Request

In connection with the Commission's approval of the Exchange's proposal to permit automatic executions in option transactions when the Exchange's disseminated market is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO, the Exchange respectfully requests an exemption, pursuant to Rule 608(e) of Regulation NMS, from the requirement of Rule 608(c) of Regulation NMS that the Exchange comply with and enforce compliance by its members with the requirements of Section 8(c) of the Plan in the limited circumstance where a Trade-Through occurs due to an automatic execution when the Exchange's disseminated market is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO.

To the same extent and subject to the same limitations, the Exchange requests exemptive relief from the requirement in Rule 608(c) of Regulation NMS that the Exchange comply with Section 4(b) of the Plan by enforcing compliance by its members with the provisions of Section 8(c) of the Plan, as discussed above.

The exemption the Exchange requests satisfies the requirements of Rule 608(e) of Regulation NMS, in that the exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments
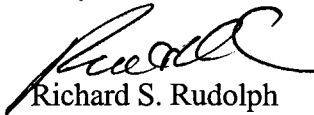
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[3] *Id.*

to, and perfection of the mechanisms of, a national market system. Specifically, the Exchange believes that such an exemption would enable the Exchange to facilitate the prompt resolution of crossed markets. The Exchange further believes that the proposed rule change would ultimately benefit customers, who would receive automatic executions and instant reports of such transactions when the Exchange's disseminated market is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment, and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO.

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For the foregoing reasons, the Exchange respectfully requests that the Commission grant an exemption to the Exchange from Rule 608(c) of Regulation NMS, which requires the Exchange to comply with, and enforce compliance with, Sections 8(c) and 4(b) of the Plan, under the terms and conditions specified above. Please feel free to contact me at (215) 496-5074 with any questions or comments you may have.

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Very truly yours,

Richard S. Rudolph
Vice President and Counsel

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cc: Elizabeth King, Esquire
        Deborah Lassman Flynn, Esquire
        Jennifer Colihan, Esquire