SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54608; File No. SR-Amex-2005-060)

October 16, 2006

Self-Regulatory Organizations; American Stock Exchange LLC.; Order Approving a Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 4 and 5 Thereto Relating to Amendments to the Obvious Error Rules

I. Introduction

On June 1, 2005, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("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 the Exchange's equity and index options obvious error rules. On September 21, 2005, the Amex submitted Amendment No. 1 to the proposed rule change.[3] On October 4, 2005, the Amex submitted Amendment No. 2 to the proposed rule change.[4] On October 27, 2005, the Amex submitted Amendment No. 3 to the proposed rule change.[5] The proposed rule change, as amended by Amendment Nos. 1, 2, and 3 was published for comment in the Federal Register on November 8, 2005.[6]

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Form 19b-4 dated September 21, 2005, which replaced the original filing in its entirety ("Amendment No. 1").

4 Amendment No. 2 corrected technical errors in the proposed rule text.

5 Amendment No. 3 clarified the definition of "Fair Market Value" for purposes of Amex Rules 936C and 936C—ANTE and made technical corrections to those rules with respect to references to "Fair Market Value."

6 See Securities Exchange Act Release No. 52718 (November 2, 2005), 70 FR 67765 ("Notice").

The Commission received one comment letter[7] regarding the proposed rule change. The Exchange responded to the comment letter on February 6, 2006.[8] On August 16, 2006, the Amex filed Amendment No. 4 to the proposed rule change.[9] On October 13, 2006, the Amex filed Amendment No. 5 to the proposed rule change.[10] This order approves the proposed rule change, as amended by Amendment Nos. 1, 2, and 3, publishes notice of Amendment Nos. 4 and 5 to the proposed rule change, and grants accelerated approval to Amendment Nos. 4 and 5.

II. Description of the Proposal

Amex proposes to amend Amex Rules 936(a)(1) and 936(a)(1)—ANTE that pertain to equity options ("Equity Options Obvious Error Rules") and Amex Rules 936C(a)(1) and 936C(a)(1)—ANTE pertaining to index options ("Index Options Obvious Error Rules") (collectively, "Obvious Error Rules").

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7 See letter to Jonathan G. Katz, Secretary, Commission, from Matthew B. Hinerfeld, Managing Director and Deputy General Counsel, Citadel Investment Group, L.L.C. on behalf of Citadel Derivatives Group LLC (collectively "Citadel"), dated November 28, 2005 ("Citadel Letter").

8 See letter to Nancy M. Morris, Secretary, Commission, from Neal L. Wolkoff, Chairman and Chief Executive Officer, Exchange, dated February 6, 2006.

9 Amendment No. 4 revised the definition of "Theoretical Price," with respect to multiply-traded options, to refer to the midpoint of the national best bid or national best offer ("NBBO") just prior to the trade that does not reflect the erroneous quote. Quantifiable standards were also added to indicate more clearly how the Exchange would determine when a quote is "erroneous." Amendment No. 4 also revised the definition of Theoretical Price for transactions occurring as part of an opening to state that Theoretical Price is the midpoint of the NBBO after the transaction(s) in question that does not reflect the erroneous transaction(s). In addition, Amendment No. 4 made minor technical revisions to the proposed rule text.

10 Amendment No. 5 clarified that the process for calculating average quote width set forth in Amex Rules 936(a)(5) and 936(a)(5)—ANTE also applies to the determination of average quote width for purposes of Amex Rules 936C(a)(5) and 936C(a)(5)—ANTE.

The Exchange proposes to amend Amex Rules 936C(a)(1) and 936C(a)(1)—ANTE to revise the definition of Theoretical Price; provide for the cancellation of a transaction resulting from a verifiable disruption or malfunction of an Exchange system, unless the parties agree to a price adjustment; permit additional types of electronic trades resulting from an erroneous quote in the underlying security to be adjusted or cancelled; revise the provision relating to "no bid series"; and add a new provision for transactions executed outside of trading hours.

In addition, the Exchange proposes to amend Amex Rules 936(C)(a)(1) and 936(C)(a)(1)—ANTE to revise the definition of Fair Market Value; provide for the cancellation of a transaction resulting from a verifiable disruption or malfunction of an Exchange system, unless the parties agree to a price adjustment; permit additional types of electronic trades resulting from an erroneous quote in the underlying security to be adjusted or cancelled; revise the provision relating to "no bid series"; and add a new provision for transactions executed outside of trading hours.

Erroneous Quotes

The Exchange's Obvious Error Rules set forth several types of transactions that may qualify as an obvious error. If the transaction meets the appropriate Rule's conditions, it is subject to either adjustment or cancellation, as specified in the Rule. The proposal, as amended, would revise the Obvious Error Rules to account for the situation where the Amex posts an erroneous quote and subsequently a competing options exchange, in direct response to the erroneous quote, widens its quote to incorporate the prior erroneous quote of the Amex.

Equity Options

Amex Rules 936(a)(1) and 936(a)(1)—ANTE currently provide that, in the case of equity options, an obvious pricing error will be deemed to have occurred when the execution price of an electronic transaction (i.e., not open outcry) varies from the option's Theoretical Price by the requisite amount set forth in the chart contained in these Rules.[11] For multiply-traded equity options, the Theoretical Price is the last bid (offer) price with respect to an erroneous sell (buy) transaction just prior to the trade that is disseminated by the competing options exchange with the most liquidity in that class over the preceding two (2) calendar months. If there are no quotes for comparison purposes, then trading officials will determine the Theoretical Price. For transactions occurring as part of an opening, the Theoretical Price is the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s). When an obvious price error occurs, the Amex either will adjust or cancel the transaction pursuant to Amex Rules 936(a)(1)(i) and 936(a)(1)(i)—ANTE.

The proposed rule change, as amended, revises the definition of Theoretical Price with respect to multiply-traded options to refer to the midpoint of the NBBO just prior to the erroneous trade. Under the proposal, Theoretical Price will not include the national best bid (in case of a request for review by a seller) or national best offer (in case of a request for review by a buyer) of the competing options exchange(s) if such competing options exchange(s) widened its quote(s) to incorporate the prior erroneous quote of the Exchange. In such a case, the Theoretical Price will be the mid-point of the NBBO just

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11 The requisite amount is: $0.25 for options below $2; $0.40 for options priced from $2 to $5; $0.50 for options priced above $5 to $10; $0.80 for options priced above $10 to $20; and $1.00 for options priced above $20.

prior to the trade that does not reflect the erroneous quote. If there are no competing options exchanges left without an erroneous quote, the Theoretical Price will be the mid-point of the NBBO after the transaction(s) in question that does not reflect the erroneous quote. For this purpose, an erroneous quote is a bid and/or offer that is above or below the midpoint of the NBBO immediately preceding the quote by at least the amount set forth in the chart contained in Amex Rules 936(a)(1) and 936(a)(1)—ANTE.[12]

Index Options

Currently, Amex Rules 936C(a)(1) and 936C(a)(1)—ANTE provide that an obvious pricing error will be deemed to have occurred when the execution price of an electronic transaction (i.e., not open outcry) varies from the option's Fair Market Value by a prescribed amount.[13] For multiply-traded options, the Fair Market Value is the midpoint of the national best bid for erroneous sell transactions or national best offer for erroneous buy transactions. If there are no quotes for comparison purposes, then Amex Trading Officials will determine the Fair Market Value. For both singly-listed options and transactions occurring as part of an opening, Fair Market Value is the midpoint of the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s).

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12 See id. for a description of the requisite amount set forth in Amex Rules 936(a)(1) and 936(a)(1)—ANTE.

13 For index options series trading with normal bid-ask differentials as established in Amex Rule 958(c), the prescribed amount is: (a) the greater of $0.10 or 10% for index options trading under $2.50; (b) 10% for index options trading at or above $2.50 and under $5; or (c) $0.50 for index options trading at $5 or higher. For index options series trading with bid-ask differentials that are greater than the widths established in Amex Rule 958(c), the prescribed amount is: (a) the greater of $0.20 or 20% for index options trading under $2.50; (b) 20% for index options trading at or above $2.50 and under $5; or (c) $1.00 for index options trading at $5 or higher.

The Exchange proposes to revise the rule text to state that the Fair Market Value will not include the national best bid price (erroneous sell transaction) or national best offer price (erroneous buy transaction) of competing options exchange(s) if such competing options exchange(s) widen their quote(s) to incorporate the prior erroneous quote of the Amex. In such a case, the Fair Market Value will be the midpoint of the first quote after the transaction(s) in question that does not reflect the erroneous quote. When an obvious price error occurs, Amex will either adjust or cancel the transaction pursuant to Amex Rules 936C(c) and 936C(c)—ANTE. For this purpose, an erroneous quote is a bid and or offer that is above or below the midpoint of the NBBO immediately preceding the quote by at least the amount set forth in Amex Rules 936C(a)(1) and 936C(a)(1)—ANTE.[14]

Erroneous Quote in Underlying Security

As set forth in the Obvious Error Rules, under certain conditions a transaction resulting from an erroneous quote in the underlying security may be adjusted or cancelled. However, a quote in an underlying security that is declared "erroneous" by the exchange that trades the security may not necessarily qualify for cancellation or adjustment under the current Obvious Error Rules.[15] Therefore, the Exchange proposes

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14 See id. for a description of the prescribed amount set forth in Amex Rules 936C(a)(1) and 936C(a)(1)—ANTE.

15 The Obvious Error Rules define an erroneous quote as a quote that occurs when the underlying security has a width of at least $1.00 and a width at least five times greater than the average quote width for such underlying security on the primary market (as defined in Amex Rule 900 (b)(26) and Rule 900 (b)(26)—ANTE) during the time period encompassing two minutes before and after the dissemination of such quote. The average quote width is determined by adding the quote widths of each separate quote during the four minute time period referenced above (excluding the quote in question) and dividing the number of quotes during such time period (excluding the quote in question).

to amend Amex Rules 936(a)(5), 936(a)(5)—ANTE, 936C(a)(5), and 936C(a)(5)—ANTE so that when an exchange trading the underlying security declares its quote(s) “non-firm,” or when an exchange communicates to the Amex that it is experiencing systems or other problems affecting the reliability of its disseminated quotes, an electronic options trade on Amex resulting from such “erroneous” underlying quote could be cancelled or adjusted. For such a trade to be cancelled or adjusted, the Exchange would have to have proper documentation of the underlying exchange’s non-firm declaration or notification of unreliable quotes, as applicable.

Transactions Executed Outside of Trading Hours

The Exchange further proposes that any equity options or index options transaction that occurs outside normal trading hours (currently, 9:30 a.m. until 4:00 p.m. Eastern time (“ET”) for equity options and 9:30 a.m. until 4:15 p.m. ET for broad-based index options and options on select Exchange-Traded Fund Shares) would be cancelled if the Trading Officials determine that the transaction took place outside of Amex trading hours, except as set forth in Commentary .02 to Amex Rule 1.[16]

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[16] Amex Rule 1 sets forth the hours of business at the Exchange. Commentary .02 to Amex Rule 1 provides that no option series may freely trade after 4:00 p.m. ET except that broad stock index group options and options on select Exchange-Traded Fund Shares shall freely trade until 4:15 p.m. ET each business day. Three exceptions to the general rule are provided in Commentary .02, so that a trading rotation in any class of options may be effected even though the transaction will occur after 4:00 p.m. as follows: (i) trading in the underlying security opens or re-opens after 3:30 p.m. ET; (ii) such rotation was initiated due to unusual market conditions pursuant to Amex Rule 918 and notice of such rotation is publicly disseminated no later than the commencement of the rotation or 4:00 p.m. whichever is earlier or notice of such rotation is publicly disseminated after 4:00 p.m. and the rotation does not commence until five minutes after news of such rotation is publicly disseminated; or (iii) for option classes trading on ANTE, an automated trading rotation is held at the close of trading as soon as practicable after 4:00 p.m. ET.

Verifiable Disruptions or Malfunctions of Exchange Systems

In connection with transactions arising out of ‘‘verifiable disruptions or malfunctions of Exchange systems,’’ the Obvious Error Rules provide that those transactions that qualify for price adjustment will be adjusted to the Theoretical Price for equity options or Fair Market Value for index options. The Exchange proposes to add that, unless the parties agree to a price adjustment, the transaction would be cancelled.

No Bid Series

Under the "no bid series" provisions of the Obvious Error Rules, electronic transactions in option series quoted "no bid at a nickel" (i.e., $0.05 offer) will be cancelled, provided at least one strike price below (for calls) or above (for puts) in the same options class was quoted "no bid at a nickel" at the time of execution. A "no bid" option refers to an option where the bid price is $0.00.[17] The proposal seeks to revise the "no bid series" provision in the Obvious Error Rules to specify that the option series must be quoted no bid, rather than "no bid at a nickel." According to the Exchange, the reason for this proposed change is that options that are priced at "no bid," regardless of the offer, are typically deep out-of-the-money series that are perceived as having little, if any, chance of expiring in-the-money. The Exchange notes that this is especially the case when the series below (for calls) or above (for puts) in the same option class similar is quoted no bid. The Amex remarks that, in this situation, the offer price is irrelevant. The Exchange states that transactions in series that are quoted "no bid at a dime," for example, are just as likely to be the result of an obvious error as are transactions in series

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[17] If the bid price is $0.00, the offer price is typically $0.05. In this instance, the option typically is referred to as "no bid at a nickel."

that are quoted no bid at a nickel when the series below (for calls) or above (for puts) in the same option series similarly is quoted no bid.

III. Discussion

After careful consideration of the comments, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[18] In particular, the Commission finds that, the proposed rule change, as amended, is consistent with Section 6(b) of the Act,[19] in general, and furthers the objectives of Section 6(b)(5) of the Act,[20] in particular, 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.

The Commission considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an "obvious error" may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether an "obvious error" has occurred should be based on specific and objective criteria and subject to specific and objective procedures. The Commission believes that the proposed rule change provides objective guidelines for the determination of whether an obvious price error has occurred. In addition, the Exchange's proposal to base the definition of Theoretical Price on the

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18 In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

19 15 U.S.C. 78f(b).

20 15 U.S.C. 78f(b)(5).

midpoint of the NBBO would ensure that the Amex's Obvious Error Rules are consistent with the Options Intermarket Linkage Plan, which requires exchanges to avoid trade throughs.

The Commission also believes that the proposal sets forth specific objective criteria for the determination of obvious error transactions when a competing options exchange has widened its quote to incorporate an erroneous quote of the Amex. The proposal also establishes specific and objective procedures with respect to trades executed outside of the Exchange's trading hours and trades resulting from an erroneous quote in the underlying security when an exchange trading the underlying security directly communicates or disseminates a message that its quotes are not firm or directly communicates or confirms that it is experiencing systems or other problems affecting the reliability of its disseminated quotes. For these reasons, the Commission believes that the proposal, as amended, is consistent with the Act.

The Commission has carefully considered the comments in the Citadel Letter.[21] The Citadel Letter raised several concerns about Amex's current Obvious Error Rules and the Exchange's application of those rules.[22] With respect to the proposed rule change, the Citadel Letter objected to the Exchange's proposal to revise the definition of Theoretical Price[23] to account for the situation when the Amex disseminates an erroneous

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21 See Citadel Letter, supra note 7.

22 The Citadel Letter asserts that: (1) Amex rules are biased against other market participants; (2) Amex forces the rest of the market to bear the cost of alleged problems with its computer systems; and (3) Amex rules permitting the Exchange to nullify trades that are not numerical obvious errors should be abolished as a means to force Amex to internalize the costs of its allegedly defective computer systems. See Citadel Letter, supra note 7.

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

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

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[24] See Amendment No. 4, supra note 9.

[25] 15 U.S.C 78s(b)(2).

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.

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

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 [insert date 21 days from the date of publication in the Federal Register].

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 Act[27] in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just

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[27] 15 U.S.C. 78f(b)(5).

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]

Nancy M. Morris
Secretary

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[28] 15 U.S.C. 78s(b)(2).

[29] 17 CFR 200.30-3(a)(12).