

1900 Market Street
Philadelphia, PA 19103-3584
Telephone: 215-496-5406
Fax: 215-496-6729
e-mail: robert.paul@phlx.com

C. Robert Paul
Executive Vice President
and General Counsel

September 20, 2006

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

**Re: Proposed Rule Change by the Philadelphia Stock Exchange
relating to Its New Equity Trading System, XLE**

Dear Ms. Morris:

The Philadelphia Stock Exchange, Inc. (“Phlx” or “Exchange”) welcomes the opportunity to respond to the comments made by PennMont Securities (“PennMont”) concerning the above-referenced proposed rule change.¹ The proposed rule change would implement a new trading model, XLE, for equity securities that provides the opportunity for entirely automated executions to occur within a central matching system accessible by Exchange members and member organizations and their Sponsored Participants. In addition, the proposed rule change would allow member organizations to become Market Makers on XLE, while at the same time discontinuing equity specialists on the Exchange. The PennMont Letters criticize the Exchange’s process in adopting the proposed rules as well as the decision to discontinue equity specialists in XLE.

In the September 13 Letter, PennMont alleged that the process through which the Exchange adopted the proposed rule change “. . . fall[s] short of what is expected of an organization [like Phlx] . . . under the securities laws and regulations.” Phlx disagrees.

Phlx believes it complied with the applicable securities laws and regulations regarding proposed rule changes, namely Form 19b-4 and the instruction thereto,² and the By-laws of the Exchange. Section E of the instructions to Form 19b-4 states that the Securities and Exchange Commission (“Commission”) “will not approve a proposed rule change before the self-regulatory organization has completed all action required to be

¹ See Letters from Joseph D. Carapico, G.P., PennMont, to Robert Miller, Reg NMS Consultant, Phlx, dated May 15, 2006 (“May 15 Letter”), from Joseph D. Carapico, G.P., PennMont, to C. Robert Paul, Chief Counsel, Phlx, dated September 5, 2006 (“September 5 Letter”) and September 13, 2006 (“September 13 Letter”) (together, the May 15 Letter, the September 5 Letter and the September 13 Letter are hereinafter referred to as the “PennMont Letters”).

² See Securities Exchange Act Release No. 50486 (October 4, 2004), 69 FR 60287 (October 8, 2004).

taken under its constitution, articles of incorporation, bylaws, rules or instruments corresponding thereto.” Phlx By-Law Article IV, Section 4-4(a) states that the “Board of Governors shall be vested with all the powers necessary for the management of the business of the Exchange In exercise of its powers it may adopt such rules . . . as it may deem appropriate.” As stated in the proposed rule change, the Board of Governors³ and the Executive Committee, pursuant to delegated authority⁴, approved the proposed rule change for filing with the Commission. Therefore, the Exchange did comply with the applicable securities laws and regulations, including Phlx By-Laws, regarding the adopting of the proposed rule change.

The PennMont Letters also expressed PennMont’s objection to the discontinuance of equity specialists in XLE. In the May 15 Letter, PennMont states that “[a]ny attempt to re-write or re-define [Phlx] rules” regarding equity specialists “must consider . . . the potential tax consequences to the members and member firms of PHLX.” Further, in the September 13 Letter PennMont claimed that the discontinuance of specialists on XLE “offers huge risks to PHLX, its members and customers, and to the investing public at large.” Phlx also disagrees with these broad assertions.

The discontinuance of equity specialists and introduction of an electronic trading platform is hardly novel, either legally or operationally. A national securities exchange is permitted, but not required, by law to create or maintain a category for specialists.⁵ Further, the Securities Exchange Act of 1934 (the “Act”) does not mandate any particular market structure, floor-based, hybrid or electronic, for national securities exchanges. For example, other national securities exchanges already are operating or are proposing to operate electronic trading platforms without specialists. The Pacific Exchange, Inc. (now NYSE Arca) began trading on an electronic platform without specialists in 2001.⁶ In 2006, six other national securities exchanges (the Boston Stock Exchange, the Chicago Board Options Exchange, the Chicago Stock Exchange, the International Securities Exchange, the Nasdaq Stock Market, LLC and the National Stock Exchange) have either begun or proposed to begin trading equity securities on electronic trading platforms without specialists.⁷ Several of these exchanges discontinued their floor-based programs with equity specialists in favor of their new electronic, non-specialist platforms. Finally, any effect that a proposed rule change may have on a particular member or member organization’s tax status is collateral to the legality and operation of the proposed rule

³ The members of the Exchange choose five of the 23 members of the Board of Governors.

⁴ See Phlx By-Law Article X, Section 10-14(b).

⁵ See 15 U.S.C. 78k(b) (This section states “. . . the rules of a national securities exchange **may** permit . . . a member to be registered as a specialist.” Emphasis added).

⁶ See Securities Exchange Act Release No. 44983 (October 21, 2001), 66 FR 55225 (October 25, 2001). In fact, NYSE Arca’s web site, www.archipelago.com, lists the commenter, PennMont, as a Market Maker and an Equity Trading Permit holder on NYSE Arca.

⁷ See Securities Exchange Act Release Nos. 54291 (August 8, 2006), 71 FR 47264 (August 16, 2006) (SR-BSE-2006-30); 54422 (September 11, 2006), 71 FR 54537 (September 15, 2006) (SR-CBOE-2004-21); 54301 (August 10, 2006), 71 FR 47836 (August 18, 2006) (SR-CHX-2006-05); 54287 (August 8, 2006) 71 FR 46947 (August 15, 2006) (SR-ISE-2006-48); 53128 (January 13, 2006) 71 FR 3550 (January 23, 2006) (File10-131, Approval of Nasdaq as a national securities exchange) and 54391 (August 31, 2006) 71 FR 52836 (September 7, 2006) (SR-NSX-2006-08).

change. Therefore, the Phlx's proposed rule change is well within both current law and industry practice.

For the foregoing reasons, the Exchange believes that the proposed rule change is consistent with the Act in general, and particularly with Section 11(b)⁸ of the Act as described above and with Section 19(b)(1)⁹ and the rules thereunder in that the proposed rule change was adopted pursuant to the Form 19b-4 and the instruction thereto¹⁰, and the By-laws of the Exchange. Therefore, the Exchange respectfully submits that the Commission should approve SR-Phlx-2006-43.

Should you have any questions or comments, please do not hesitate to call John Dayton at (215) 496-5162 or me.

Yours truly,



C. Robert Paul
General Counsel

cc: Richard Holley, Securities and Exchange Commission

⁸ 15 U.S.C. 78k(b).

⁹ 15 U.S.C. 78s(b)(1).

¹⁰ See Securities Exchange Act Release No. 50486 (October 4, 2004), 69 FR 60287 (October 8, 2004).