Mr. John Dayton
Director and Counsel
Philadelphia Stock Exchange
1900 Market Street
Philadelphia, PA 19103

Dear Mr. Dayton:

In your letter dated November 9, 2006, you requested on behalf of the Phlx that the Commission grant a limited exemption ("Exemption") pursuant to Rule 608(e) under the Securities Exchange Act of 1934 ("Act") from certain trade-through provisions of the Intermarket Trading System ("ITS") Plan, in connection with implementation of Phlx’s new equity trading system, XLE.

In addition, you requested relief on behalf of the Exchange from the requirement that Phlx enforce compliance with Phlx Rule 2001A(b)(1) adopted pursuant to Section 8(d) of the ITS Plan with respect to trade-throughs during a crossed market and the use of ISOs and private linkages.

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See letter from John Dayton, Director and Counsel, Philadelphia Stock Exchange ("Phlx" or the "Exchange"), to Nancy M. Morris, Secretary, Securities and Exchange Commission ("Commission"), dated November 9, 2006 ("Phlx Exemption Request").

17 C.F.R. § 242.608(e). Rule 608(c) requires each participant in a national market system plan to comply, and enforce compliance with, the plan by its members and their associated persons. Rule 608(e) establishes the Commission’s authority to exempt any self-regulatory organization ("SRO") or SRO member from the requirements of the Rule.


Section 8(d)(ii), from which the Exchange was exempted by the ITS Exemption Letter, requires each ITS Plan participant to adopt a “trade-through rule” substantially the same as Exhibit B to the ITS Plan in order to implement the intent of Section 8(d)(i). The Phlx adopted Rule 2001A(b)(1) in compliance with this provision. See letter from David Shillman, Associate Director, Division of Market Regulation ("Division"), Commission, to Robert Hill, Chairman, ITS Operating Committee, dated September 29, 2006.
In light of the fact that today the Commission granted the requested Exemption\textsuperscript{5} pursuant to Rule 608(e) under the Act,\textsuperscript{6} and based on the facts and representations set forth in the Phlx Exemption Request, the staff of the Division of Market Regulation will not recommend enforcement action to the Commission under Section 19(g)(1) of the Act, if the Exchange does not enforce compliance with provisions of Phlx Rule 2001A(b)(1) with respect to trade-throughs during a crossed market and the use of ISOs and private linkages, to the extent permitted by the Exemption.

This staff position is limited to enforcement action under Section 19(g)(1) of the Act and does not purport to express any legal conclusions with respect to the applicability of the statutory or regulatory provisions of the federal securities laws. Moreover, this response is based upon the representations you have made in the Phlx Exemption Request, and any different facts or conditions may require a different response. The Staff's position is subject to modification or revocation at any time if the Commission or the Staff determines that such action is necessary or appropriate, in furtherance of the purposes of the Act.

Sincerely,

David Shillman
Associate Director

\textsuperscript{5} See letter from David Shillman, Associate Director, Division, Commission, to John Dayton, Director and Counsel, Phlx, dated November 14, 2006.

\textsuperscript{6} 17 C.F.R. § 242.608(e).
November 9, 2006

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


Dear Ms. Morris:

The Philadelphia Stock Exchange, Inc. ("Phlx" or the "Exchange") respectfully requests that the Securities and Exchange Commission ("Commission") grant exemptions pursuant to Rule 608(e) under the Securities Exchange Act of 1934 ("1934 Act") from Section 8(d)(i) and Exhibit B, Section (b)(1) of the Intermarket Trading System ("ITS") Plan, subject to certain conditions, in connection with implementation of Phlx's new equity trading system, XLE. In addition, Phlx requests corresponding relief from the requirement that it enforce compliance with Phlx Rule 2001A(b)(1) which embodies those provisions of the ITS Plan. This exemption and request for relief are being requested in order to ensure that the operation of XLE is consistent with the ITS Plan.

Background

The Commission has approved the Exchange’s new automated trading system, XLE. XLE is an automated, order-driven system for the entry and execution of orders in NMS Stocks. With the introduction of XLE, the Exchange will no longer continue to operate a physical equities trading floor, nor will it operate its Philadelphia Stock Exchange Automated Communication and Execution ("PACE") System through which Phlx member organizations currently can send orders to the Exchange electronically.

XLE is a system that is designed to operate as an "automated trading center" for the purposes of Regulation NMS. In addition, XLE is designed to operate pursuant to

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2 17 CFR 242.600(b)(47).
3 See Phlx Rule 229.
4 17 CFR 242.600(b)(4).
the requirements of Rules 610 and 611 of Regulation NMS,\(^5\) including the protection of Protected Quotations\(^6\) from both locked and crossed markets\(^7\) and from trade-throughs. Finally, XLE includes optional routing technology that XLE Participants\(^8\) may use to access the better priced quotations available in other market centers.

The Exchange recognizes that, during the period between the start of its rollout of XLE and the Trading Phase Date, other self-regulatory organizations may also be in the process of deploying new or modified systems intended to achieve full compliance with Rules 610 and 611 and other provisions of Regulation NMS by the Trading Phase Date. Consequently, the Exchange has designed XLE to operate before the Trading Phase Date, with the objectives of protecting market quality, avoiding market disruptions and protecting investors during this critical period of change.

The Exchange intends to roll out XLE, prior to the Trading Phase Date, in several phases (within each phase, the Exchange will start first with non-Nasdaq-listed securities, then Nasdaq-listed securities). XLE will begin with: (1) two-sided orders only for approximately one week; (2) then one-sided orders, all of which will be deemed “Do Not Route,” incoming linkage orders routed to the Exchange through the new NMS Linkage, and ITS commitments; and finally (3) routing functionality. In addition, the Exchange may roll out Reserve Orders later than it rolls out other one-sided orders. The Exchange anticipates that the rollout will be complete within a two month period, and it intends to publish more precise information regarding the rollout via Exchange circular.

**ITS Plan Provisions Subject to Exemptive Request**

Prior to the Trading Phase Date, Phlx rules provide that a Protected Bid, Offer or Quotation in any non-Nasdaq security is any bid, offer or quotation, as required by the ITS Plan, unless relief is granted therefrom by the Commission.\(^9\) Generally, Section 8(d)(i) and Exhibit B, Section (b)(1) of the ITS Plan, which governs trading in non-Nasdaq securities, requires the avoidance of trade throughs of any bid or offer from an ITS participating market center, unless a provision in Section (b)(3) of the ITS Plan is applicable. Consequently, Phlx requests an exemption from Section 8(d)(i) and Exhibit B, Section (b)(1) of the ITS Plan to trade through ITS Quotations in the following circumstances:


\(^6\) See 17 CFR 242.600(b)(58) and Phlx Rule 1(cc).

\(^7\) See Phlx Rules 185 and 186.

\(^8\) XLE Participants include Exchange members and member organizations, and their Sponsored Participants and their Participant Authorized Users. See Phlx Rule 1(x), (jj) and (nn).

\(^9\) See Phlx Rule 1(cc)(3). A “Protected Bid, Offer or Quotation” for trade-through purposes in XLE before the Trading Phase Date (hereinafter an “ITS Bid,” “ITS Offer” or “ITS Quotation”) will consist of each firm quotation, whether manual or automated and whether or not at the national best bid or offer (“NBBO”), that is at a better price than the next trade that would occur on XLE and that is the best bid or offer of a national securities exchange or a national securities association.
Crossed Markets. In a number of circumstances, XLE will trade through ITS Quotations when the ITS Bid is higher than an ITS Offer (a "Crossed Market"). Phlx represents that XLE’s functionality in a Crossed Market is integral to the design and operation of XLE and that Phlx needs an exemption from the ITS Plan to implement XLE in a timely manner. Phlx requests an exemption from Section 8(d)(i) and Exhibit B, Section (b)(1) of the ITS Plan to allow XLE to trade through ITS Quotations when there is a Crossed Market. Phlx notes that there is a similar exemption in Rule 611(b)(4) of Regulation NMS, which is scheduled to be operative on February 5, 2007, which allows a trade through "... when a protected bid was priced higher than a protected offer ..." This exemption is critical to Phlx’s ability to launch XLE and to the operation of its approved rules governing XLE.

Simultaneous Order Shipping and Execution. Phlx plans to use a private linkage instead of the ITS System to send and receive orders. The Exchange plans to send "away market obligations" to access ITS Quotations of away markets up to their displayed size. If an away market that trades a particular security is capable of receiving intermarket sweep orders ("ISOs") before the Trading Phase Date, then Phlx may choose to require XLE to generate and send ISOs through a private linkage to that away market. Therefore, Phlx requests an exemption from Section 8(d)(i) and Exhibit B, Section (b)(1) of the ITS Plan to allow XLE to trade through ITS Quotations when it simultaneously ships an order, using a routing broker-dealer facility of the Exchange, equaling the size and price of the ITS Quotation it is trading through either as an ISO, if available in the away market, or as an immediate or cancel order.

Intermarket Sweep Orders. Phlx plans to accept and act upon all inbound, appropriately marked ISOs received by XLE before the Trading Phase Date. Execution of ISOs received from others can violate Section 8(d)(i) of the ITS Plan because XLE will execute such orders immediately on receipt while disregarding ITS Quotations displayed by other markets. Therefore, Phlx requests an exemption from Section 8(d)(i) and Exhibit B, Section (b)(1) of the ITS Plan to allow XLE to trade through ITS Quotations when it receives an ISO or an IOC Cross Order when the XLE Participant marks "the order as meeting the requirements of an intermarket sweep order in Reg NMS Rule 600(b)(30)."

See Phlx Rule 185(b)(1)(C)(i), (b)(1)(D), (b)(2)(A) and (c)(2)(D). These sections refer to, respectively, Limit Orders and Reserve Orders with the Ship and Post Quote Management Instruction, Limit Orders and Reserve Orders marked Do Not Route, IOC Orders and IOC Cross Orders. In Crossed Markets, these orders will trade through better priced ITS Quotes without routing to those ITS Quotes. See proposed Phlx Rule 185A. If the Exchange chooses to require XLE to generate and utilize ISOs through a private linkage to an away market, XLE will simultaneously send an away market obligation to execute against the full displayed size of every other ITS Quotation. Therefore, Phlx requests an exemption from Section 8(d)(i) and Exhibit B, Section (b)(1) of the ITS Plan to allow XLE to trade through ITS Quotations when it receives an ISO or an IOC Cross Order when the XLE Participant marks "the order as meeting the requirements of an intermarket sweep order in Reg NMS Rule 600(b)(30)."
Exemption Request and Request for Relief

Phlx believes that this partial exemption from the trade through provisions of the ITS Plan and the request for relief from the corresponding Phlx rules should allow industry participants and Phlx to gain necessary experience in operating XLE in a manner that will closely approximate the manner in which it will be required to operate beginning on the Trading Phase Date. The period during which the requested exemption would be in effect is reasonably short (less than three months) given that the commencement of XLE is scheduled for mid-November 2006. Therefore, Phlx believes that the requests satisfy the requirements of Rule 608(e) of Regulation NMS, in that each is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and the perfection of the mechanisms of, a national market system.

Please feel free to contact me with any questions at (215) 496-5162.

Sincerely,

John Dayton
Director and Counsel

cc: Katherine England, Division of Market Regulation, Securities and Exchange Commission
Steve Williams, Division of Market Regulation, Securities and Exchange Commission
Nataliya Cowen, Division of Market Regulation, Securities and Exchange Commission
Richard Holley III, Division of Market Regulation, Securities and Exchange Commission