

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53870; File No. SR-Phlx-2006-27)

May 25, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change Relating to the Extension of the Exchange's Directed Order Flow Pilot Program

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 April 26, 2006, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal on an accelerated basis, for a pilot period through May 27, 2007.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Phlx proposes to extend, for an additional one year period, a pilot program concerning Exchange Rule 1080, Phlx Automated Options Market (AUTOM)³ and Automatic Execution System (AUTO-X), and Exchange Rule 1014, Obligations And Restrictions Applicable To Specialists And Registered Options Traders. Specifically the pilot program

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM's automatic execution features, AUTO-X, Book Sweep and Book Match. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to

covers: (1) Exchange Rule 1080(l), Directed Orders, under which Exchange specialists, Streaming Quote Traders (“SQTs”)⁴ and Remote Streaming Quote Traders (“RSQTs”)⁵ trading on the Exchange’s electronic options trading platform, Phlx XL,⁶ receive Directed Orders (as defined below); and (2) Exchange Rule 1014(g)(viii), which sets forth the trade allocation algorithm for electronically executed and allocated trades involving Directed Orders. This proposal is in connection with a pilot program that is currently scheduled to expire on May 27, 2006.⁷

The text of the proposed rule change is set forth below. Brackets indicate deletions; underlining indicates new text

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Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)

Rule 1080. (a) – (k) No change.

the appropriate specialist unit on the Exchange trading floor. AUTOM is today more commonly referred to as Phlx XL. See Exchange Rule 1080.

⁴ An SQT is an Exchange Registered Options Trader (“ROT”) who has received permission from the Exchange to generate and submit option quotations electronically through an electronic interface with AUTOM via an Exchange approved proprietary electronic quoting device in eligible options to which such SQT is assigned. See Exchange Rule 1014(b)(ii)(A).

⁵ An RSQT is a participant in the Exchange’s electronic trading system, Phlx XL who has received permission from the Exchange to trade in options for his own account, and to generate and submit option quotations electronically from off the floor of the Exchange through AUTOM in eligible options to which such RSQT has been assigned.

⁶ See Securities Exchange Act Release No. 50100 (July 27, 2004), 69 FR 46612 (August 3, 2004) (SR-Phlx-2003-59).

⁷ See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005) (SR-Phlx-2004-91) (“Pilot Program Approval Order”).

(l) Directed Orders. For a one-year pilot period, beginning on May 28, 2006 [the date of approval of this Rule by the Securities and Exchange Commission], respecting Streaming Quote Options traded on Phlx XL, specialists, RSQs and SQs may receive Directed Orders (as defined in this Rule) in accordance with the provisions of this Rule 1080(l).

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Obligations And Restrictions Applicable To Specialists And Registered Options Traders

Rule 1014. (a) – (f) No change.

(g)(i) – (vii) No change.

(viii) For a one year pilot period, beginning on May 28, 2006 [the date of approval of this Rule by the Securities and Exchange Commission], Directed Orders (as defined in Rule 1080(l)(i)(A)) that are executed electronically shall be automatically allocated as follows:

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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 III below. The Exchange 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 Exchange proposes to extend, for an additional one-year period, a pilot program that allows specialists, SQTs, and RSQTs assigned in options that trade on Phlx XL to receive directed orders (“Directed Orders”)⁸ from a member or member organization (“Order Flow Provider” or “OFP”)⁹ that submits, as agent, the customer order to the Exchange through AUTOM, and establishes a trade allocation algorithm for Directed Orders that are electronically executed and allocated to reward such Directed Specialists, SQTs and RSQTs with a participation guarantee for attracting such order flow to the Exchange.¹⁰ The proposed rule is subject to a pilot program scheduled to expire on May 27, 2006. The Exchange proposes that the extended pilot expire on May 27, 2007.

Pursuant to Rule 1080(l), OFPs must transmit Directed Orders to a particular specialist, SQT or RSQT through AUTOM. If the Exchange’s disseminated best bid or offer is at the National Best Bid or Offer when the Directed Order is received, the Directed Order is automatically executed on Phlx XL and allocated to the orders and quotes represented in the Exchange’s quotation. A Directed Specialist, SQT or RSQT will receive a participation allocation pursuant to Rule 1014(g)(viii) if the Directed Specialist, SQT or RSQT was quoting at the NBBO at the time that the Directed Order was received.¹¹ Otherwise, the automatic

⁸ See Exchange Rule 1080(l)(i)(A).

⁹ See Exchange Rule 1080(l)(i)(B).

¹⁰ See Exchange Rule 1080(1). The word “Directed” modifies all three; that is, it is referring to a Directed Specialist, Directed SQT and Directed RSQT.

¹¹ See Exchange Rule 1080(l)(ii).

execution will be allocated to those quotations and orders at the NBBO pursuant to Rule 1014(g)(vii).¹² When the Exchange is not quoting at the NBBO, the Directed Order will be manually handled by the specialist in accordance with the Exchange's rules.

The Exchange believes that the pilot program rewards specialists, SQTs and RSQTs for actively engaging in marketing activities and establishing relationships with OFPs that generate Directed Orders sent to the Exchange by such OFPs. The Exchange believes that the pilot program will result in additional order flow to the Exchange, thus adding depth and liquidity to the Exchange's markets, and enabling the Exchange to continue to compete effectively with other options exchanges for order flow.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act¹³ in general, and furthers the objectives of Section 6(b)(5) of the Act¹⁴ in particular, in that it 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, by permitting specialists, SQTs, and RSQTs trading options on Phlx XL to receive Directed Orders, and by encouraging the capture of order flow on the Exchange by rewarding Directed Order recipients with a participation guarantee in trades involving Directed Orders.

¹² See Exchange Rule 1080(l)(iii).

¹³ 15 U.S.C. 78f(b).

¹⁴ 15 U.S.C. 78f(b)(5).

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange believes that the proposed rule change does not 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

The Exchange has not solicited, and does not intend to solicit comments on the proposed rule change.

III. 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 and whether the pilot time frame is appropriate. 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 Number SR-Phlx-2006-27 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-Phlx-2006-27. 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 Exchange. 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-Phlx-2006-27 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of the Proposed Rule Change

The Exchange has asked the Commission to approve the proposed rule change on an accelerated basis for an additional year so that the pilot program may continue uninterrupted. After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of Section 6 of the Act¹⁵ and the rules and regulations thereunder applicable to a national securities exchange¹⁶, and, in particular, the requirements of Section 6(b)(5) of the Act.¹⁷ Section 6(b)(5) requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices,

¹⁵ 15 U.S.C. 78f.

¹⁶ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁷ 15.U.S.C. 78f(b)(5).

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. The Commission notes that the current pilot was approved on a one-year basis to give the Commission an opportunity to evaluate the impact of the pilot program on the options markets to determine whether it would be beneficial to customers and to the options markets as a whole before approving any request for permanent approval of the pilot program. The Commission believes that a one-year extension of the pilot period would provide the Commission with additional time to continue evaluate the Exchange's Directed Order program.

The Exchange has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after publication of notice thereof in the Federal Register. The Commission believes that granting accelerated approval of the proposed rule change would allow the pilot program to continue without disruption while the Commission and the Exchange continue to review the pilot program's impact on the options market. Accordingly, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,¹⁸ for approving the proposed rule change prior to the thirtieth day after publication of notice thereof in the Federal Register.

¹⁸ 15 U.S.C. 78s(b)(2).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁹ that the proposed rule change (SR-Phlx-2006-27), which institutes the pilot program through May 27, 2007, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Nancy M. Morris
Secretary

¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).