

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-54329; File No. SR-Phlx-2006-43)**

**August 17, 2006**

**Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to The Exchange's New Equity Trading System, XLE**

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup>, and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on July 13, 2006, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Phlx. On August 14, 2006, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On August 16, 2006, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Phlx, pursuant to Section 19(b)(1) of the Act<sup>5</sup> and Rule 19b-4 thereunder,<sup>6</sup> proposes to amend its rules to implement a new trading model 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, as defined below. The rules proposed herein are intended to comply with the requirements of

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 replaced and superseded the original filing in its entirety.

<sup>4</sup> See Partial Amendment No. 2.

<sup>5</sup> 15 U.S.C. 78s(b)(1).

<sup>6</sup> 17 CFR 240.19b-4.

Regulation NMS.<sup>7</sup> The Exchange will no longer operate a physical trading floor for equity securities, nor the Philadelphia Stock Exchange Automated Communication and Execution (“PACE”) system. This proposal does not affect the way options trade on the Exchange, and the Exchange will continue to have a physical trading floor for options. The text of this proposed rule change is available on the Exchange’s Web site at <http://www.phlx.com>, in the Commission’s Public Reference Room, and on the Commission’s Web site at <http://www.sec.gov/rules/sro/phlx.shtml>.

**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 Phlx 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 IV below. The Phlx 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 Phlx proposes to adopt new Phlx Rules 160-165, 170-174, and 180-189, and amend or delete other rules to accommodate the Exchange’s proposed new equity system (“XLE”). The purpose of the proposed rule change is to adopt a new market structure for the trading of equity securities on the Phlx.

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<sup>7</sup> 17 CFR 242.600 et seq.

**a. Summary of XLE**

XLE would provide Exchange members and member organizations and their Sponsored Participants and their Participant Authorized Users, described herein, (together known as “XLE Participants”) with a more efficient method for displaying, routing, and executing orders in NMS Stocks<sup>8</sup> on the Exchange. With this new system, the Exchange would no longer operate a physical equity trading floor where specialists and floor brokers execute their orders, nor would it operate its PACE system, through which member organizations currently can send orders to the Exchange electronically, which represents the Exchange’s current market structure. Instead, the Exchange proposes to adopt a new market structure in which it will operate an automated system, XLE, where XLE Participants, from any location, may submit orders for immediate execution, display, or routing, as applicable.<sup>9</sup> The Exchange believes that this new system will provide an opportunity for XLE Participants and their customers to receive efficient, low-cost executions.

The Exchange anticipates that most XLE Participants will be broker-dealers that will send orders to XLE for execution, display, or routing, as applicable. These organizations would not be required to register with the Exchange to act in any specific capacity other than as a member organization or a Sponsored Participant of a member organization. The Exchange would, however, allow member organizations to register as Market Makers on XLE.<sup>10</sup> Market Makers, once registered as such, could then choose to register in one or more securities that are

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<sup>8</sup> Currently, the Exchange trades, pursuant to unlisted trading privileges, various equity securities listed on national securities exchanges, but it does not trade Nasdaq-listed securities. On XLE, the Exchange intends to trade Nasdaq-listed securities, as well as securities listed on other national securities exchanges, pursuant to unlisted trading privileges. 15 U.S.C. 78l(f).

<sup>9</sup> See proposed Phlx Rule 160.

<sup>10</sup> See proposed Phlx Rule 1(1). See also infra Section II.A.1.c.xviii (Market Makers).

traded on XLE. Once registered in a particular security, Market Makers would be required to maintain continuous Limit Orders on both sides of the market in that security during the Core Session (normally 9:30 a.m. to 4:00 p.m.).<sup>11</sup> In addition, Market Makers could also send other types of orders to XLE in securities in which they are Market Makers.

XLE would be an order-driven system; there will be no “quotes” akin to what equity specialists submit on the Exchange today. Moreover, on XLE, there will be no specialists. Although the new rules provide for Market Makers, an NMS Stock may trade on XLE without a Market Maker.

The Exchange intends to discontinue its PACE system and the operation of its equity trading floor, and then roll-out XLE in several phases, beginning with two-sided orders only for approximately one week (with each phase, generally starting first with NYSE and Amex listed securities and then Nasdaq listed securities); then one-sided orders, all of which will be deemed “Do Not Route,” and incoming linkage orders routed to the Exchange through the new NMS Linkage and all Intermarket Trading System (“ITS”) commitments; and finally, 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 roll-out will be complete within a two month period and will publish more precise information regarding the roll-out via Exchange circular.

**b. Summary of Changes**

Because the Exchange proposes to launch XLE in lieu of trading on its physical trading floor, the Exchange is proposing to modify or delete many Phlx By-laws and Phlx Rules that relate to floor trading. The Exchange also is proposing to delete outdated Phlx Rules that relate

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<sup>11</sup> Unless otherwise noted, all time references refer to Eastern time as effective in the City of Philadelphia. See Phlx Rule 101.

to the delivery and settlement of securities,<sup>12</sup> which currently take place in registered clearing agencies. Most notably, changes to the Phlx By-laws and Phlx Rules are necessary to reflect the proposed elimination of the equity trading floor<sup>13</sup> and equity specialists,<sup>14</sup> as well as the Floor Procedure Committee and the Equity Allocation, Evaluation and Securities Committee.<sup>15</sup>

**c. The New Trading System – XLE – New Rules**

As stated above, the Exchange’s proposed new trading system is XLE. XLE would be a fully automated, electronic trading system that will accept orders in NMS Stocks traded on the Exchange from XLE Participants and display, route, and execute those orders automatically pursuant to non-discretionary algorithms codified in the proposed Phlx Rules. Orders will be ranked on XLE in price-time priority regardless of the identity of the entering XLE Participant. Executions on XLE will take place automatically and immediately upon order entry if trading interest is available. XLE will provide an optional routing service for orders for which trading interest is not present on XLE. A more detailed description of XLE is set forth below. The Exchange intends to operate XLE as an “automated trading center” for purposes of Regulation NMS<sup>16</sup> and would display automated quotations at all times except in the event that a systems malfunction renders XLE incapable of displaying automated quotations. The Exchange states that it would halt trading and therefore not display any quotations in the event of such a systems malfunction.

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<sup>12</sup> See various rules between Phlx Rules 251-423, as applicable.

<sup>13</sup> See various rules between Phlx Rules 102-124, 126-155, and 225-233, as well as certain Phlx Rules in the 600 and 700 series, certain Equity Floor Procedure Advices (“EFPAs”) from E-1 through Regulation 7, and Options Floor Procedure Advices (“OFPAs”) F-33 and Regulation 5.

<sup>14</sup> See Phlx Rules 201-220, 236, 460-461, 500-524, and EFPAs A-1 and A-2.

<sup>15</sup> See certain Phlx Rules in the 800 series.

<sup>16</sup> See proposed Phlx Rule 160.

**i. New Definitions**

A number of new definitions are used in the proposed Phlx Rules regarding XLE. The term “XLE” shall mean the electronic system which is operated by the Exchange for the entry, display, execution, and reporting of orders in “NMS Stocks.”<sup>17</sup> Various persons will be using XLE to trade NMS Stocks, which include stocks listed on national securities exchanges.<sup>18</sup> Collectively, these persons are referred to as “XLE Participants.”<sup>19</sup> Individuals authorized by a member organization or a Sponsored Participant who use XLE are “Participant Authorized Users” or “PAUs.”<sup>20</sup> Non-members may gain access to XLE by becoming “Sponsored Participants”<sup>21</sup> who are sponsored by “Sponsoring Member Organizations.”<sup>22</sup> Further, member organizations that clear transactions for XLE Participants are referred to as “clearing firms.”<sup>23</sup>

XLE Participants that are member organizations may register to become “Market Makers” in a particular security.<sup>24</sup> Because the term “Market Makers” refers to organizations and not individuals, individuals who enter orders on behalf of Market Makers are called “Market Maker Authorized Traders” or “MMATs.”<sup>25</sup> In regards to a particular security, the term “Approved Dealer” means a Market Maker on XLE in that security or a specialist or market maker registered as such with another exchange or the National Association of Securities

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<sup>17</sup> See proposed Phlx Rule 1(mm).

<sup>18</sup> See proposed Phlx Rule 1(t). Definitions of the classes of stocks traded on Nasdaq are at proposed Phlx Rule 1(r)-(s).

<sup>19</sup> See proposed Phlx Rule 1(nn). “XLE Participants” includes members and member organizations registered on XLE, Sponsored Participants, and PAUs.

<sup>20</sup> See proposed Phlx Rule 1(x).

<sup>21</sup> See proposed Phlx Rule 1(jj).

<sup>22</sup> See proposed Phlx Rule 1(kk).

<sup>23</sup> See proposed Phlx Rule 1(c).

<sup>24</sup> See proposed Phlx Rule 1(l).

<sup>25</sup> See proposed Phlx Rule 1(m).

Dealers, Inc. (“NASD”) in that security. Approved Dealers would be required to register as such with the Exchange. Approved Dealers also would be required to notify the Exchange immediately if they cease to be a specialist or market maker registered as such with another exchange or NASD in a security.<sup>26</sup> Approved Dealer status will be used to determine how certain two-sided orders will be executed.<sup>27</sup>

Certain characteristics of orders on XLE and quotations on away markets are newly defined in proposed Phlx Rule 1. The size of orders is defined by the terms “odd lot,”<sup>28</sup> “round lot,”<sup>29</sup> and “mixed lot.”<sup>30</sup> Also, XLE Participants would be required to mark all orders as “Proprietary,”<sup>31</sup> “Professional,”<sup>32</sup> or “Public Agency.”<sup>33</sup> As described below, XLE will take into account away quotations for purposes of order execution, display, and routing. The definitions include “Protected Bid, Offer or Quotation”<sup>34</sup> and “Protected NBBO.”<sup>35</sup> Because Rule 611 of Regulation NMS<sup>36</sup> changes the requirements the Exchange must meet regarding trade-throughs, the definition of Protected Bid, Offer or Quotation will reflect this. Specifically, the terms

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<sup>26</sup> See proposed Phlx Rule 1(a).

<sup>27</sup> See proposed Phlx Rule 185(c).

<sup>28</sup> See proposed Phlx Rule 1(w).

<sup>29</sup> See proposed Phlx Rule 1(gg).

<sup>30</sup> See proposed Phlx Rule 1(q).

<sup>31</sup> See proposed Phlx Rule 1(bb) (Proprietary Order is defined as an order for the account of the XLE Participant who entered the order into XLE).

<sup>32</sup> See proposed Phlx Rule 1(aa) (Professional Order is defined as an order for the account of a broker or dealer, which order is represented, as agent, by a XLE Participant).

<sup>33</sup> See proposed Phlx Rule 1(ee) (Public Agency Order is defined as an order for the account of a person other than a broker or dealer, which order is represented, as agent, by a XLE Participant).

<sup>34</sup> See proposed Phlx Rule 1(cc).

<sup>35</sup> See proposed Phlx Rule 1(dd).

<sup>36</sup> 17 CFR 242.611.

“Protected Bid, Offer or Quotation” shall: (1) have, after Rule 611 of Regulation NMS is operative on the Exchange, the same meaning as Rule 600(b)(57) and (58),<sup>37</sup> as appropriate, of Regulation NMS, provided, however that if another trading center providing a Protected Bid, Offer or Quotation repeatedly fails to respond within one second to incoming orders attempting to access its Protected Bid, Offer or Quotation, XLE may cease to consider those Protected Bids, Offers or Quotations as such by: (a) notifying the non-responding trading center immediately after (or at the same time as) electing self-help; and (b) assessing whether the cause of the problem lies with its own system and, if so, taking immediate steps to resolve the problem; (2) mean, before Rule 611 of Regulation NMS is operative on the Exchange, for Nasdaq Global Market and Nasdaq Capital Market Securities, the best bid, offer or quotation, respectively, of any national securities exchange or national securities association; and (3) mean, before Rule 611 of Regulation NMS is operative on the Exchange, for securities other than Nasdaq Global Market and Nasdaq Capital Market Securities, the bids, offers or quotations as required by the ITS Plan (as long as such Plan is in effect) and related Exchange rules or as otherwise provided in any relief granted therefrom by the Commission.<sup>38</sup>

Other terms used in the proposed Phlx Rules and defined in proposed Phlx Rule 1 are “Good Standing,<sup>39</sup>” “Quote Management Instruction” or “QMI,<sup>40</sup>” “SCCP,<sup>41</sup>” and “NSCC.”<sup>42</sup> Existing terms in current Phlx Rules 2-22 have been renumbered within proposed Phlx Rule 1.

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<sup>37</sup> 17 CFR 242.600(b)(57)-(58).

<sup>38</sup> See proposed Phlx Rule 1(cc).

<sup>39</sup> See proposed Phlx Rule 1(h).

<sup>40</sup> See proposed Phlx Rule 1(ff).

<sup>41</sup> See proposed Phlx Rule 1(hh).

<sup>42</sup> See proposed Phlx Rule 1(u).



**ii. Trading Hours**

XLE would operate three trading sessions: (1) a Pre Market Session; (2) a Core Session; and (3) a Post Market Session.<sup>43</sup> The Pre Market Session would begin at 8:00 a.m. and continue until the commencement of the Core Session. The Core Session would take place during a security's "regular trading hours" as that term is defined in Rule 600(b)(64) of Regulation NMS, which is typically from 9:30 a.m. until 4:00 p.m. The Post Market Trading Session would begin following the conclusion of the Core Session, and it would end at 6:00 p.m.

**iii. Access to XLE**

All XLE Participants would be able to access XLE through an Exchange electronic interface by means of their own communication lines or through lines established by service providers in the business of maintaining connectivity in the securities marketplace. In addition, XLE Participants may access XLE for the entry of two-sided orders through technology provided by the Exchange. Finally, to the extent that the Exchange participates in the ITS Plan or any other linkage plan for NMS Stocks, ITS commitments and other intermarket orders could be sent to XLE through these linkages.

**iv. Eligible Orders – Basic Requirements**

XLE will accept orders with either an immediate-or-cancel ("IOC") designation<sup>44</sup> or with a time designation set to cancel at the end of one of XLE's trading sessions.<sup>45</sup> The time designations include immediate-or-cancel or good until end of the end of one of XLE's three trading sessions (Pre Market, Core, or Post Market). In all cases, any open orders on XLE at the end of the Post Market Session will be cancelled. XLE would not accommodate good-til-

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<sup>43</sup> See proposed Phlx Rule 101.

<sup>44</sup> See proposed Phlx Rule 185(a), (b)(2), and (c).

<sup>45</sup> See proposed Phlx Rule 185(b)(1) and (3).

cancelled orders. XLE will accept orders, other than two-sided orders, for regular way settlement only.<sup>46</sup> Two-sided orders may be accepted with non-regular way settlement.<sup>47</sup>

XLE Participants would be required to mark all sell orders (and the sell side of a two-sided order) with the proper designation of “short” or “short-exempt” pursuant to Rule 200(g) of Regulation SHO.<sup>48</sup> This will allow XLE to treat such short sale orders properly under Rule 10a-1 of the Act.<sup>49</sup> Specifically, XLE shall not effect a sell order or sale of any security, except Nasdaq Global Market and Nasdaq Capital Market securities, unless such sell order or sale is effected in compliance with Rule 10a-1. XLE shall effect on the Exchange sell orders and sales of all Nasdaq securities without regard to any short sale price test.<sup>50</sup>

Further, all orders entered on XLE would be required to conform to the minimum increments for order entry.<sup>51</sup> Finally, in order to help prevent erroneous transactions and protect investors and the national market system, all orders would be required to meet the price limitations imposed by the Exchange.<sup>52</sup> Specifically, under proposed Phlx Rule 185(d), if an order is entered that, at the time of entry, would cross the best Protected Bid or Offer by 20% or

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<sup>46</sup> See proposed Phlx Rule 162(a).

<sup>47</sup> See proposed Phlx Rule 162(b). Under proposed Phlx Rule 162(b), a XLE Participant could mark a two-sided order not for regular way settlement with one of the following conditions: (1) cash; (2) next day; or (3) seller’s option.

<sup>48</sup> 17 CFR 242.200(g).

<sup>49</sup> 17 CFR 240.10a-1.

<sup>50</sup> See proposed Phlx Rule 455.

<sup>51</sup> See proposed Phlx Rule 125(a)-(b). In accordance with Rule 612 of Regulation NMS, 17 CFR 242.612, XLE will accept, rank and display orders priced \$1.00 or higher in increments no smaller than \$0.01 and orders below \$1.00 in increments no smaller than \$0.0001. In addition, if a security received an exemption from Rule 612, XLE will accept, rank and display orders consistent with the fullest extent of the exemption granted to the security. Finally, the Exchange will seek an exemption from Rule 612 to accept two-sided orders marked Benchmark in increments no smaller than \$0.0001.

<sup>52</sup> See proposed Phlx Rule 185(d).

more, the order would be rejected by XLE, provided, however, for orders priced under \$1.00, such orders would be rejected by XLE if they cross the best Protected Bid or Offer by \$0.20 or more.

v. **Order Types, Attributes, and Execution**

XLE will accept several order types from XLE Participants. Each order, except two-sided orders, that executes on XLE will execute against existing orders on XLE at the existing order's displayable price, in order of the existing order's ranking, unless it is routed away for execution.<sup>53</sup> An existing order's displayable price will be determined by XLE based on its limit price or pegging instructions, its routability and QMI (described below), and its short sale status.<sup>54</sup> Existing orders on XLE will be ranked according to price-time priority.<sup>55</sup>

Market Orders. XLE will accept Market Orders.<sup>56</sup> A Market Order is an order to buy or sell a stated amount of a security that is to be executed immediately and automatically against existing orders on XLE up to and including the price of the best away Protected Quotation. Any unexecuted shares of a Market Order will be cancelled. If the Protected Bid is priced higher than the Protected Offer, the Market Order shall be cancelled.

Limited Priced Orders. XLE will accept a number of limited priced orders. XLE will accept a Limit Order.<sup>57</sup> Limit Orders are one-sided orders to buy or sell a stated amount of a

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<sup>53</sup> Executions occurring as a result of orders matched on XLE shall be reported by the Exchange to an appropriate consolidated transaction reporting system. The Exchange shall promptly notify XLE Participants of all executions as soon as such executions have taken place. See proposed Phlx Rule 188.

<sup>54</sup> See proposed Phlx Rule 185(b)(1)(C)-(E), (b)(3), and (e)-(f).

<sup>55</sup> See proposed Phlx Rule 184.

<sup>56</sup> See proposed Phlx Rule 185(a).

<sup>57</sup> See proposed Phlx Rule 185(b)(1)(A).

security at a specified price or better. XLE will also accept a Reserve Order.<sup>58</sup> Reserve Orders are one-sided orders to buy or sell a stated amount of a security at a specified price or better with at least a round lot portion of the size that is displayable and with at least a round lot portion of the size that is not displayable by XLE, provided that the portion of the Reserve Order that is not displayable shall have the same price as the portion that is displayable. Limit Orders and Reserve Orders will be routable unless otherwise marked by a XLE Participant.<sup>59</sup>

Other limited priced orders include an IOC Order, a Single Sweep Order (“SSO”), and an Intermarket Sweep Order (“ISO”). IOC Orders will be executed immediately and automatically against existing orders on XLE up to and including the price of the best away Protected Quotation, unless the Protected Bid is priced higher than the Protected Offer, in which case XLE will ignore away Protected Quotations.<sup>60</sup> The shares of an IOC Order not executed on XLE shall be immediately and automatically cancelled without routing the order elsewhere. Any XLE Participant may use an IOC Order to immediately and automatically execute against the full size of the displayed quotation on XLE (including any undisplayed or reserve size available at the price of the displayed quotation). As with all executions on XLE, XLE will immediately and automatically transmit a response to the XLE Participant who sent the IOC Order indicating the action taken with respect to the IOC Order. Additionally, XLE will immediately and automatically update its bid/offer as a result of the execution.

SSOs are executed immediately and automatically against existing orders on XLE and/or away Protected Quotations, up to and including the order’s limit price.<sup>61</sup> Any shares of the SSO

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<sup>58</sup> See proposed Phlx Rule 185(b)(1)(B).

<sup>59</sup> See proposed Phlx Rule 185(b)(1)(A), (B), and (C).

<sup>60</sup> See proposed Phlx Rule 185(b)(2)(A).

<sup>61</sup> See proposed Phlx Rule 185(b)(2)(B).

not immediately executed on XLE or on an away market shall be cancelled. ISOs are executed immediately and automatically against existing orders on XLE at their displayable price, in order of their ranking, and the shares of the ISO not so executed shall be cancelled.<sup>62</sup> An ISO will be executed on XLE without regard to any away Protected Quotations.

Pegged Orders. XLE will also accept Pegged Orders. Pegged Orders are round or mixed lot limited price orders to buy or sell, only on XLE, a stated amount of a security at a display price set to track (up, down, or at) the current best Protected Bids or Offers on either side of the market by an amount specified by the XLE Participant in an increment permitted by proposed Phlx Rule 125, provided, however that the display price will not impermissibly lock or cross the market.<sup>63</sup> The tracking of the relevant Protected Bid or Offer for Pegged Orders will occur on a real-time basis, except that when the calculated price for the Pegged Order would exceed its limit price, it will no longer track and will remain displayed at its limit price. A Pegged Order must consist of at least a round lot portion that is displayable and may include at least a round lot portion that is not displayable by XLE, provided that the portion of the Pegged Order that is not displayable shall have the same price as the portion that is displayable.<sup>64</sup>

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<sup>62</sup> See proposed Phlx Rule 185(b)(2)(C). Phlx intends that the ISO Order be equivalent to the intermarket sweep order defined in Rule 600(b)(30) of Regulation NMS, 17 CFR 242.600(b)(30). XLE Participants entering an ISO must ensure that the ISO meets the requirements of Rule 600(b)(30) of Regulation NMS. This order type will not be effective until Rule 611 of Regulation NMS is operative, which is currently scheduled for February 5, 2007.

<sup>63</sup> See proposed Phlx Rule 185(b)(3).

<sup>64</sup> At the Exchange's request, the Commission has clarified the description of Pegged Orders to match the proposed rule text as specified in Exhibit 5. See Telephone call between Heather Seidel, Senior Special Counsel, Division of Market Regulation, Commission, and John Dayton, Director and Counsel, Phlx, on August 15, 2006 ("August 15 Telephone Call").

Two-Sided Orders. XLE will accept a number of two-sided orders. Two-sided orders are instructions to match immediately and automatically on XLE the identified buy-side with the identified sell-side.<sup>65</sup> For instance, XLE will accept Mid-Point Cross Orders.<sup>66</sup> Mid-Point Cross Orders are two-sided orders that execute, in their entirety, at the midpoint of the Protected National Best Bid/Offer (“NBBO”), unless the Protected Bid is higher than the Protected Offer, in which case the Mid-Point Cross Order will cancel.

XLE will also accept IOC Cross Orders.<sup>67</sup> IOC Cross Orders are two-sided orders that execute, in their entirety, at the specified price, except as described below. IOC Cross Orders will be cancelled if the specified price would trade through the price of the best order on XLE disseminated pursuant to proposed Phlx Rule 184(c). IOC Cross Orders will also be cancelled if the specified price would trade through the price of the Protected NBBO, unless the Protected Bid is priced higher than the Protected Offer or the IOC Cross Order is marked as meeting the requirements of an intermarket sweep order in Rule 600(b)(30) of Regulation NMS,<sup>68</sup> as Benchmark, or as a Qualified Contingent Trade.<sup>69</sup>

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<sup>65</sup> See proposed Phlx Rule 185(c).

<sup>66</sup> See proposed Phlx Rule 185(c)(1).

<sup>67</sup> See proposed Phlx Rule 185(c)(2).

<sup>68</sup> IOC Cross Orders so marked are intended to meet the definition of an intermarket sweep order in Rule 600(b)(30) of Regulation NMS, 17 CFR 242.600(b)(30), because the order has a limit price and the XLE Participant sending the order is responsible to send the other orders required in Rule 600(b)(30)(ii), 17 CFR 242.600(b)(30)(ii). Therefore, this order attribute will not be effective until Rule 611 of Regulation NMS is operative, which is currently scheduled for February 5, 2007.

<sup>69</sup> See proposed Phlx Rule 185(c)(3). Orders marked “Benchmark” must meet the requirements of Rule 611(b)(7) of Regulation NMS, 17 CFR 242.611(b)(7). Orders marked “Qualified Contingent Trade” must meet the requirements of an exemption to Rule 611 of Regulation NMS, 17 CFR 242.611. The Exchange intends to request the appropriate exemptive relief to accommodate these Qualified Contingent Trade orders prior to the operative date of Regulation NMS.

In addition, XLE will cancel Mid-Point Cross Orders (when the Protected NBBO is locked) and IOC Cross Orders if the order would trade: (1) if entered by an Approved Dealer, at the price of a Public Agency Order<sup>70</sup> on XLE disseminated pursuant to proposed Phlx Rule 184(c); or (2) if entered by other than an Approved Dealer, at the price of a Public Agency Order,<sup>71</sup> a Proprietary Order,<sup>72</sup> or a Professional Order<sup>73</sup> on XLE disseminated pursuant to proposed Phlx Rule 184(c).<sup>74</sup> Approved Dealers are providing liquidity in the security, either on XLE, on another exchange, or in the over-the-counter market, through their specialist or market making activities. Therefore, the Exchange believes that it is appropriate to give two-sided orders entered by Approved Dealers priority over orders for the account of broker-dealers and over proprietary orders, but not Public Agency Orders, of XLE Participants.<sup>75</sup>

Mid-Point Cross Orders and IOC Cross Orders may trade at the price of any order on XLE disseminated pursuant to proposed Phlx Rule 184(c) if neither side of the cross order is marked as Proprietary, the cross order is for at least 5,000 shares, has an aggregate value of at least \$100,000, and its size is larger than the aggregate size on XLE disseminated pursuant to

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<sup>70</sup> The term “Public Agency Order” shall mean an order for the account of a person other than a broker or dealer, which order is represented, as agent, by a XLE Participant. See proposed Phlx Rule 1(ee).

<sup>71</sup> See id.

<sup>72</sup> The term “Proprietary Order” shall mean an order for the account of the XLE Participant who entered the order into XLE. See proposed Phlx Rule 1(bb).

<sup>73</sup> The term “Professional Order” shall mean an order for the account of a broker or dealer, which order is represented, as agent, by a XLE Participant. See proposed Phlx Rule 1(aa).

<sup>74</sup> The term “Approved Dealer” means a Market Maker on XLE in that security or a specialist or market maker registered as such with another exchange or NASD in that security. See proposed Phlx Rule 1(a).

<sup>75</sup> The Exchange believes that this is similar to the provisions of current National Securities Exchange (“NSX”) Rule 11.9(l)-(m), (u).

proposed Phlx Rule 184(c) at that price.<sup>76</sup> Pursuant to proposed Rule 185(c)(iv), a non-regular way cross is a two-sided order that, if marked for non-regular way settlement, may execute at any price, without regard to the Protected NBBO or any other orders on XLE, provided that Mid-Point Cross Orders marked non-regular way will be cancelled when the Protected Bid is higher than the Protected Offer.

Finally, orders marked Benchmark cannot take priority over existing orders on XLE for less than the minimum quoting increment for that NMS stock indicated in Phlx Rule 125.<sup>77</sup>

**vi. Order Routing**

The Exchange will offer an optional routing service for XLE Participants. Any member organization that is a XLE Participant, or a Sponsored Participant's Sponsoring Member Organization, may enter into a Routing Agreement with the Exchange and the Exchange's broker-dealer routing facility to gain access to the routing features of XLE.<sup>78</sup> The Exchange intends to utilize PRO Securities LLC ("PRO")<sup>79</sup> to perform routing and processing functions necessary to clear routed orders, as described in proposed Phlx Rule 185, as a facility (as defined in Section 3(a)(2) of the Act) of the Exchange. Certain order types, including Limit Orders, Reserve Orders, and SSOs are eligible to be routed.<sup>80</sup>

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<sup>76</sup> See proposed Phlx Rule 185(c)(1)-(2).

<sup>77</sup> See August 15 Telephone Call, supra note 64.

<sup>78</sup> See proposed Phlx Rule 181.

<sup>79</sup> See infra note 183 (discussing PRO Securities).

<sup>80</sup> Regardless of whether a XLE Participant chooses to access the routing features of XLE, all XLE Participants will be able to use IOC Orders to execute against the full size of the displayed quotation on XLE (including any undisplayed or reserve size available at the price of the displayed quotation).



Limit Orders and Reserve Orders<sup>81</sup> will be executed and routed based on a XLE Participant's QMI.<sup>82</sup> XLE Participants may choose one of two QMI: (1) Ship and Quote; or (2) Post Order and Participate ("POP"). With Ship and Quote,<sup>83</sup> when the order arrives, XLE will execute it immediately and automatically against existing orders on XLE at their displayable price, up to their full size, and route orders to any away Protected Quotations up to and including the order's limit price and up to and including the full displayable size of the Protected Quotation. If the order arrives during a time when a Protected Bid is priced higher than a Protected Offer, then XLE will not route orders to any away Protected Quotations. In either case, the remaining shares of the incoming order will be displayable on XLE at the order's limit price.

With POP,<sup>84</sup> when the order arrives, XLE will execute it immediately and automatically against existing orders on XLE at their displayable price up to and including the price of the best away Protected Quotation and route orders to away Protected Quotations priced at the best away Protected Quotation. After XLE receives responses to such orders that were routed away, XLE will repeat this process by continuing to route orders to away Protected Quotations priced at the best away Protected Quotation until the incoming order is executed in its entirety or its limit price is reached. During this time, any unexecuted and unrouted shares of an incoming buy (sell) order will be displayable as the bid (offer) on XLE at \$.01 away from the best Protected Offer

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<sup>81</sup> XLE Participants may mark Limit Orders and Reserve Order with 'Do Not Route' instructions. In that case, XLE will not route those orders, but instead will only execute and display them on XLE. See proposed Phlx Rule 185(b)(1)(D).

<sup>82</sup> See proposed Phlx Rule 185(b)(1)(C).

<sup>83</sup> See proposed Phlx Rule 185(b)(1)(C)(i).

<sup>84</sup> See proposed Phlx Rule 185(b)(1)(C)(ii). The Exchange does not anticipate that this feature will be available when XLE is initially launched, but expects that it will be available soon afterwards. The Exchange will notify XLE Participants of its availability after the initial launch of XLE.

(Bid), unless: (1) the Protected Bid is priced higher than the Protected Offer, then the incoming buy (sell) order will be displayable on XLE at the same price as best Protected Offer (Bid); or (2) the Protected Bid is priced equal to the Protected Offer and XLE is displaying an order at the price of the Protected NBBO on the same side of the market as the incoming order, then the incoming order will be displayable at the Protected NBBO. The POP instruction differs from the Ship and Quote instruction, in that with the POP instruction, XLE will continue to send orders to available liquidity so long as liquidity is available up to and including the order's limit price. With the Ship and Quote instruction, XLE will only send orders once, to the liquidity that is available at the time of order entry.

The following order types are, by definition, never routed: IOC Orders, ISO, Pegged Orders, IOC Cross Orders, and Mid-Point Cross Orders. Limit Orders and Reserve Orders with "Do Not Route" instructions attached are also never routed. Pursuant to Rule 185(b)(1)(D), such Limit and Reserve Orders marked "Do Not Route" are executed immediately and automatically against existing orders on XLE at their displayable price, in order of their ranking, up to and including the price of the best away Protected Quotation, and the shares of the such Limit or Reserve Order not so executed shall be displayable as a bid (offer) on XLE, in the case of a buy (sell) order, at \$.01 away from the best Protected Offer (Bid) regardless of the XLE Participant's QMI, unless: (1) the Protected Bid is priced equal to the Protected Offer and XLE is displaying an order at the price of the Protected NBBO on the same side of the market as the incoming order, then the incoming order will be displayable at the Protected NBBO; or (2) the Protected Bid is priced higher than the Protected Offer, then a buy (sell) order will be executed immediately and automatically against existing orders on XLE at their displayable price, in order

of their ranking, without regard to away Protected Quotations, and the shares of such Limit or Reserve Order not so executed shall be displayable on XLE at the limit price.

XLE will not route orders to away quotations that are not Protected Quotations. Additionally, XLE may trade through the price of away quotations that are not Protected Quotations. XLE Participants should note that the definition of Protected Quotations is dependent on whether Rule 611 of Regulation NMS<sup>85</sup> is operative on the Exchange.<sup>86</sup> Before Rule 611 of Regulation NMS is operative on the Exchange, a Protected Quotation will be, for securities other than those listed on Nasdaq, the best bid or offer of any ITS participating market center, subject to any exemption the Exchange may receive from the Commission. For Nasdaq securities before Rule 611 of Regulation NMS is operative on the Exchange, a Protected Quotation will be the best bid, offer or quotation, respectively, of any national securities exchange or national securities association. After Rule 611 of Regulation NMS is operative on the Exchange, a Protected Quotation will have the same meaning as Rule 600(b)(57) and (58), as appropriate, of Regulation NMS.<sup>87</sup> In either case, Protected Quotations may not include every available source of liquidity in the marketplace for a security. Therefore, when deciding to route agency orders to XLE, XLE Participants should be mindful of their duty of best execution.

**vii. Order Display and Ranking**

Orders (or the portion of orders) that are not immediately executed, routed away, or cancelled become orders on XLE available to be displayed and executed against new orders sent

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<sup>85</sup> 17 CFR 242.611.

<sup>86</sup> Currently, the Commission has set the operative date for Rule 611 of Regulation NMS, 17 CFR 242.611, on among other venues, the Exchange as February 5, 2007. See Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 30038 (May 24, 2006) (File No. S7-10-04).

<sup>87</sup> 17 CFR 242.600(b)(57)-(58).

to XLE.<sup>88</sup> XLE will use two methods to display orders that are available for execution. First, pursuant to Rule 602 of Regulation NMS,<sup>89</sup> XLE will collect and make available to the appropriate market data reporting plans for dissemination the best-ranked displayed order(s) to buy and the best ranked displayed orders(s) to sell on XLE and the aggregate displayed size of such orders associated with such prices.<sup>90</sup> Second, XLE will display all orders, except the undisplayed portion of Reserve Orders, to all users of a depth of book feed on an anonymous basis.<sup>91</sup> The Exchange will make this depth of book feed available to any person, subject to any fee associated with this service.

XLE will rank orders on XLE in strict price-time priority.<sup>92</sup> Orders are ranked beginning with the highest priced orders to buy and the lowest priced orders to sell. For purposes of ranking, XLE uses the price at which the order is displayed.<sup>93</sup> Within each price, orders are ranked in time priority based on the time that: (1) an order is received; (2) the price is updated; or (3) the display portion of a Reserve Order is reduced below a round lot and the display size is refreshed with shares from the undisplayed portion of the Reserve Order, except that the undisplayed portion of Reserve Orders shall be ranked after all other orders and display portions of Reserve Orders at the same price. With regard to Reserve Orders, XLE will decrement the

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<sup>88</sup> Pegged Orders will be displayed as described, supra, in the text accompanying notes 63-64. Other than Limit, Reserve, and Pegged Orders, orders on XLE are immediate-or-cancel.

<sup>89</sup> 17 CFR 242.602.

<sup>90</sup> See proposed Phlx Rule 184(c).

<sup>91</sup> See proposed Phlx Rule 184(b).

<sup>92</sup> See proposed Phlx Rule 184(a).

<sup>93</sup> For purposes of ranking, orders are considered displayed based on the price that they would be displayed on the Exchange's depth of book feed. See proposed Phlx Rule 184(b). This price is the same price that would be disseminated to the appropriate market data reporting plans pursuant to proposed Phlx Rule 184(c) if the order was the best round lot bid or offer.

share size of the display portion of a Reserve Order upon an execution against such portion of such order. When the display portion of a Reserve Order is reduced below a round lot, the display portion of that Reserve Order will be refreshed and re-ranked in time priority based on the time of refresh, however, the undisplayed portion of that Reserve Order will retain the ranking in relation to the undisplayed portion of other Reserve Orders based on the original Reserve Order entry time. Orders for which the price is changed are ranked based on the time of the change.<sup>94</sup>

#### **viii. Anonymity**

Except as provided below, as proposed, transactions executed on XLE will be processed anonymously. This means that XLE transaction reports will indicate the details of the transaction, but will not reveal contra-party identities.<sup>95</sup> XLE will maintain this anonymity after the execution by instructing the registered clearing agencies of the anonymous nature of the transaction.<sup>96</sup> Additionally, no one having the right to trade on XLE and who has been a party to or has knowledge of an execution shall be under obligation to divulge, except to the Exchange, the name of the person buying or selling in any transaction.<sup>97</sup> The Exchange believes that post-trade anonymity should benefit investors because preserving anonymity until and after the settlement of a trade should limit the potential market impact that disclosing the XLE Participant's identity may have. Specifically, when a contra-party's identity is revealed, XLE Participants may be able to detect trading patterns and make assumptions about the potential

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<sup>94</sup> See Partial Amendment No. 2.

<sup>95</sup> See proposed Phlx Rule 189(b).

<sup>96</sup> See Securities Exchange Act Release Nos. 52651 (October 21, 2005), 70 FR 65956 (November 1, 2005) (SR-SCCP-2004-03); and 48526 (September 23, 2003), 68 FR 56367 (September 30, 2003) (SR-NSCC-2003-14).

<sup>97</sup> See proposed Phlx Rules 161 and 189(c).

direction of the market based on the XLE Participant's presumed client base. For example, if the XLE Participant handles large institutional orders and becomes an active buyer in a security, others could anticipate such demand and adjust their trading strategy accordingly. The Exchange believes that this could result in increased costs. The Exchange believes that post-trade anonymity should not compromise a XLE Participant's ability to settle an erroneous trade, because under proposed Phlx Rule 163, the clearly erroneous execution resolution process is coordinated by the Exchange, without the need for contra-parties to know each other's identities. By masking the XLE Participant's identity, the Exchange believes that it may help XLE Participants meet their best execution obligations by mitigating market impact.<sup>98</sup>

The Exchange will reveal the identity of the member organization or the member organization's clearing firm in the following circumstances: (1) for regulatory purposes or to comply with an order of a court or arbitrator; (2) when the National Securities Clearing Corporation ("NSCC") or Stock Clearing Corporation of Philadelphia ("SCCP") ceases to act for a member organization or the member organization's clearing firm and NSCC or SSCP determines not to guarantee the settlement of the member organization's trades; or (3) on risk management reports provided to the contra-party of the member organization or the member organization's clearing firm which disclose trading activity on an aggregate dollar value basis.<sup>99</sup> Also, the Exchange will reveal to a member organization, no later than the end of the day on the date an anonymous trade was executed, when that member organization submits an order that has executed against an order submitted by that same member organization.<sup>100</sup>

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<sup>98</sup> See, e.g., Securities Exchange Act Release No. 49053 (January 12, 2004), 69 FR 2642 (January 16, 2004) (SR-PCX-2003-63).

<sup>99</sup> See proposed Phlx Rule 189(c).

<sup>100</sup> See proposed Phlx Rule 189(d).

In order to satisfy the member organization's record keeping obligations under Rules 17a-3(a)(1)<sup>101</sup> and 17a-4(a) under the Act,<sup>102</sup> Phlx shall, with the exception of those circumstances described below, retain for the period specified in Rule 17a-4(a) the identity of each member organization that executes an anonymous transaction described in paragraph (b) of proposed Phlx Rule 189. In addition, member organizations shall retain the obligation to comply with Rules 17a-3(a)(1) and 17a-4(a) under the Act whenever they possess the identity of their contra-party. In either case, the information shall be retained in its original form or a form approved under Rule 17a-6 under the Act.<sup>103</sup> In connection with this proposed rule change, the Exchange intends to request, for XLE Participants, an exemption from Rule 10b-10 under the Act,<sup>104</sup> regarding the required disclosure of the contra-party on a customer's confirmation, and a no-action position on Rules 17a-3 and 17a-4 under the Act, regarding a XLE Participant's reliance on the Exchange for recordkeeping responsibilities for anonymous executions.<sup>105</sup>

**ix. Odd Lots and Mixed Lots**

XLE will rank odd lot orders<sup>106</sup> and mixed lot orders<sup>107</sup> in the same manner (in price-time

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<sup>101</sup> 17 CFR 240.17a-3(a)(1).

<sup>102</sup> 17 CFR 240.17a-4(a).

<sup>103</sup> 17 CFR 240.17a-6.

<sup>104</sup> 17 CFR 240.10b-10.

<sup>105</sup> See Letter from Brian A. Bussey, Assistant Chief Counsel, Division of Market Regulation, Commission, to Mai S. Shiver, Senior Counsel, Pacific Exchange, Inc., dated April 30, 2004.

<sup>106</sup> See proposed Phlx Rules 1(w) and 187(a) (an odd lot order shall refer to an order that is sent to XLE for less than 100 shares or a larger order that has less than 100 shares remaining unexecuted). All odd lot orders that a XLE Participant submits to XLE as an odd lot order must be a Limit Order, an IOC Order, or a two-sided order.

<sup>107</sup> See proposed Phlx Rule 1(q) (a mixed lot order shall refer to an order that is more than 100 shares, but shall not include orders in multiples of 100 shares).

priority) as round lot orders<sup>108</sup> (or multiple round lot orders).<sup>109</sup> This means that all incoming orders, except ITS commitments<sup>110</sup> and two-sided orders, will be executed against existing orders on XLE on an order-by-order basis regardless of the size of the existing orders. For example, suppose XLE receives three orders to buy in the following sequence: Order A for 50 shares priced at \$10.00, Order B for 300 shares priced for \$10.00, and Order C for 125 shares priced for \$10.00. Then, XLE receives an order to sell, Order D, for 100 shares priced at \$10.00. XLE will execute 50 shares of Order D against Order A at \$10.00 and 50 shares of Order D against 50 shares of Order B at \$10.00. This leaves 250 shares of Order B. Next, XLE receives another order to sell, Order E, for 280 shares priced at \$10.00. XLE will execute 250 shares of Order E against the remainder of Order B at \$10.00 and 30 shares of Order E against 30 shares of Order C at \$10.00. This leaves 95 shares of Order C. Finally, XLE receives an order to sell, Order F, for 100 shares at \$10.00. XLE will execute 95 shares of Order F against the remainder of Order C at \$10.00. This leaves 5 shares of Order F available to execute against future orders to sell.

The market data reporting plans that disseminate quotations pursuant to Rule 602 of Regulation NMS<sup>111</sup> only collect and report quotations in round lots and multiples of round

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<sup>108</sup> See proposed Phlx Rule 1(gg) (a round lot order shall refer to an order that is for 100 shares). Multiple round lot orders are orders for multiples of 100 shares, for example 400 shares.

<sup>109</sup> See proposed Phlx Rule 187(c).

<sup>110</sup> ITS is not configured to accept executions in share amounts other than round lots and multiples of round lots. Therefore, XLE will not execute existing odd lot or odd lot portions of mixed lot orders against an incoming ITS commitment. XLE will treat any commitment or order from any other intermarket linkage with similar restrictions in the same manner.

<sup>111</sup> 17 CFR 242.602.



lots.<sup>112</sup> For purposes of the CQ and Nasdaq UTP Plans, the Exchange will not disseminate any odd lot orders or any size connected to the odd lot portion of mixed lot orders.<sup>113</sup> For example, if XLE has two orders to buy at \$10.00, the best price to buy on XLE, one consisting of 50 shares and another consisting of 250 shares, the Exchange shall disseminate to the CQ or Nasdaq UTP Plan, as appropriate, a quotation of \$10.00 for 200 shares. XLE would ignore the 50 share odd lot order and takes into account 200 shares (the round lot multiple portion) of the 250 share order, ignoring the remaining 50 share portion (the odd lot portion of the mixed lot). XLE would not aggregate the odd lot portions. However, the Exchange's depth of book feed would display both orders at their actual size, 50 shares and 250 shares. Because the Exchange will not disseminate odd lot orders to the CQ and Nasdaq UTP Plans, the Exchange proposes the following restrictions regarding odd lot orders so that orders that would otherwise be displayable are not entered in a form that is undisplayable.<sup>114</sup> Pursuant to proposed Phlx Rule 187(d), XLE Participants shall not unbundle round lots for the purpose of entering odd lot limit orders in comparable amounts. XLE Participants shall aggregate odd lot orders into round lots when such orders are for the same account or for various accounts in which there is a common monetary interest. XLE Participants shall not enter both buy and sell odd lot limit orders in the same stock before one of the orders is executed for the purpose of capturing the spread in the stock when such orders are for the same account or for various accounts in which there is a common monetary interest.

**x. Prevention of Trade-Throughs**

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<sup>112</sup> The two market data reporting plans for quotations in NMS Stocks are the Consolidated Quotation Plan ("CQ Plan") and the Nasdaq UTP Plan.

<sup>113</sup> XLE will, however, display the actual size of odd lot and mixed lot orders over its depth of book feed. See proposed Phlx Rule 184(b).

<sup>114</sup> See proposed Phlx Rule 187(d).

XLE is designed to automatically prevent trade-throughs of Protected Quotations, both before and after Rule 611 of Regulation NMS is operative. XLE would accomplish this in two principal ways: (1) through the use of outbound routing<sup>115</sup> for those orders that will be available to route; and (2) by only displaying orders<sup>116</sup> at prices that would not impermissibly lock or cross a market. Additionally, XLE will take advantage of various exceptions to Rule 611, once operative. Phlx will allow XLE to trade-through a Protected Quotation displayed by a trading center that was experiencing a failure, material delay, or malfunction of its systems or equipment.<sup>117</sup> Specifically, if another trading center providing a Protected Bid, Offer or Quotation repeatedly fails to respond within one second to incoming orders attempting to access its Protected Bid, Offer or Quotation, XLE may cease to consider those Protected Bids, Offers or Quotations as such by: (1) notifying the non-responding trading center immediately after (or at the same time as) electing self-help; and (2) assessing whether the cause of the problem lies with its own system and, if so, taking immediate steps to resolve the problem. Further, XLE will allow two-sided orders for non-regular way settlement<sup>118</sup> to trade-through Protected Quotations.<sup>119</sup> XLE will allow Limit, Reserve, IOC, and IOC Cross Orders to execute at prices that trade-through Protected Quotations when the Protected Bid is higher than Protected Offer.<sup>120</sup> Incoming ISO orders, which may, by definition, trade-through Protected Quotations, are designed to take advantage of the Rule 611 exception for intermarket sweep orders.<sup>121</sup> XLE also

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<sup>115</sup> See supra Section II.A.1.c.vi (Order Routing).

<sup>116</sup> See supra Section II.A.1.c.vii (Order Display and Ranking).

<sup>117</sup> See 17 CFR 242.611(b)(1).

<sup>118</sup> See proposed Phlx Rule 185(c)(4).

<sup>119</sup> See 17 CFR 242.611(b)(2).

<sup>120</sup> See 17 CFR 242.611(b)(4).

<sup>121</sup> See 17 CFR 242.611(b)(5).

will allow orders<sup>122</sup> to trade-through Protected Quotations when XLE has simultaneously routed an intermarket sweep order to execute against the full displayed size of that Protected Quotation.<sup>123</sup> Rule 611(b)(7) of Regulation NMS allows orders to execute if their price was not based, directly or indirectly, on the quoted price of the NMS stock at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made.<sup>124</sup> XLE will allow IOC Cross Orders that have been marked “Benchmark”<sup>125</sup> to trade-through Protected Quotations based on Rule 611(b)(7). In addition, if the Commission grants the appropriate exemption from Rule 611 of Regulation NMS, XLE will allow certain IOC cross orders marked as “Qualified Contingent Trades” to trade through protected quotations.<sup>126</sup> XLE will identify trades executed pursuant to an exception or exemption to Rule 611 of Regulation NMS in accordance with specifications approved by the operating committee of the relevant national market system plan for an NMS Stock.<sup>127</sup>

**xi. Locked and Crossed Markets**

XLE would not, upon initial implementation, lock or cross any away Protected Quotations that it reads from an effective national market system plan, except in the following circumstances. XLE may lock or cross an away Protected Quotation when XLE reads that a Protected Bid is higher than a Protected Offer. XLE also may lock or cross an away Protected Quotation if XLE has first routed an order to that quotation and all better priced quotations for

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<sup>122</sup> Limit Orders, Reserve Orders, and SSOs. See proposed Phlx Rule 185(b)(1)(C)(i) and (b)(2)(B).

<sup>123</sup> See 17 CFR 242.600(b)(30) and 17 CFR 242.611(b)(6).

<sup>124</sup> See 17 CFR 242.611(b)(7).

<sup>125</sup> See proposed Phlx Rule 185(c)(3).

<sup>126</sup> See id. See also August 15 Telephone Call, supra note 64.

<sup>127</sup> See proposed Phlx Rule 188 and Partial Amendment No. 2.

their full displayed size. Finally, if XLE is reading the Protected Bid equal to the Protected Offer and XLE is disseminating an order pursuant to proposed Phlx Rule 184(c) equal to either the best Protected Bid or best Protected Offer, XLE may continue to display new orders at the same price of the order it is disseminating.

In addition, the Exchange proposes a rule that would require members of the Exchange to reasonably avoid displaying, and prohibit them from engaging in, a pattern or practice of displaying any quotations that lock or cross a Protected Quotation, and any manual quotations that lock or cross a quotation previously disseminated pursuant to an effective national market system plan, unless an applicable exemption applies.<sup>128</sup> Phlx requests that proposed Phlx Rule 186 not become operative until Rule 610 of Regulation NMS<sup>129</sup> is operative on the Exchange, which is currently scheduled for February 5, 2007.

## **xii. Trading Halts**

A number of current and proposed rules will govern trading halts on XLE. Proposed Phlx Rule 164(a) would allow the Chairman and Chief Executive Officer of the Exchange or his designee to suspend trading in any and all securities traded on XLE whenever in his or his designee's opinion such suspension would be in the public interest. No such action shall continue longer than a period of two days, or as soon thereafter as a quorum of Governors can be assembled, unless the Board approves the continuation of such suspension. This is the general authority to suspend trading on XLE. Additionally, current Phlx Rules 133 (Trading Halts Due to Extraordinary Market Volatility) and 136 (Trading Halts in Certain Exchange Traded Funds) would provide for trading halts in specific situations in securities to be traded on XLE.

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<sup>128</sup> See proposed Phlx Rule 186(b) and (d).

<sup>129</sup> 17 CFR 242.610.

If trading in one or more securities is halted, all orders in those securities shall be cancelled.<sup>130</sup> XLE shall not accept any orders, or any changes to orders (other than cancellations), in those securities during a trading halt. Immediately after the trading halt has ended, XLE shall begin accepting orders for processing.

**xiii. Clearly Erroneous Executions**

Pursuant to proposed Phlx Rule 163, a XLE Participant that receives an execution on an order that was submitted erroneously to XLE for its own or customer account may request that Phlx review the transaction under proposed Phlx Rule 163(b) within the time limits prescribed therein. The terms of a transaction executed on XLE would be “clearly erroneous” when there is an obvious error in any term, such as price, number of shares or other unit of trading, or identification of the security. A transaction made in clearly erroneous error and cancelled by both parties may be removed, if the parties do not object, subject to the approval of Phlx. If both parties do not agree that a transaction is clearly erroneous, then the Exchange, through an Exchange Official,<sup>131</sup> will then perform a review pursuant to proposed Phlx Rule 163(c)(1). If the Exchange Official determines that the transaction is not clearly erroneous, the Exchange Official shall decline to take any action in connection with the completed trade. In the event that the Exchange Official determines that the transaction in dispute is clearly erroneous, the Exchange Official shall declare the transaction null and void or modify one or more of the terms of the transaction to achieve an equitable rectification of the error that would place the parties in the same position, or as close as possible to the same position that they would have been in, had the error not occurred.

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<sup>130</sup> See proposed Phlx Rule 164(b).

<sup>131</sup> An Exchange Official is an officer of Phlx or such other designee of Phlx. See proposed Phlx Rule 163(b).

The party affected by the review may then appeal the decision of the Exchange Official to the Referee within the time limits set forth in Phlx Rule 124(d)(i) (currently within fifteen minutes).<sup>132</sup> The Referee shall review the decision of the Exchange Official as if it was a Floor Official Ruling.<sup>133</sup> Therefore, the decisions of the Referee are final and may not be appealed to the Board of Governors, and members or member organizations who fail to promptly comply with the decision of an Exchange Official or Referee may result in referral to the Business Conduct Committee (“BCC”).<sup>134</sup> Notwithstanding the Exchange’s dispute process, disputes continue to be eligible for arbitration pursuant to Phlx Rule 950.

Exchange Officials may, on their own motion, review transactions on XLE that arose during any disruption or malfunction in the use or operation of any electronic communications or trading facilities of the Phlx, or extraordinary market conditions or other circumstances in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest.<sup>135</sup> Each XLE Participant involved in such a transaction shall be notified as soon as practicable, and the XLE Participant aggrieved by the action may appeal such action to the Referee.<sup>136</sup>

Pursuant to Rule 12f-2 under the Act,<sup>137</sup> as amended, the Phlx may extend unlisted trading privileges to a security that is the subject of an initial public offering when at least one

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<sup>132</sup> The Referee is an Exchange employee or independent contractor who is appointed by the Phlx Board of Governors on the recommendation of the Audit Committee. See Phlx Rule 124. The Referee resolves disputes and makes certain rulings pursuant to Phlx Rule 124(d) and proposed Phlx Rule 163(c)(2).

<sup>133</sup> See proposed Phlx Rule 163(c)(2).

<sup>134</sup> See Phlx Rules 124(d)(iv) and (vi).

<sup>135</sup> See proposed Phlx Rule 163(d).

<sup>136</sup> See id.

<sup>137</sup> 17 CFR 240.12f-2.

transaction in the subject security has been effected on the national securities exchange or association upon which the security is listed and the transaction has been reported pursuant to an effective transaction reporting plan. A clearly erroneous error may be deemed to have occurred in the opening transaction of the subject security if the execution price of the opening transaction on XLE is more than the lesser of \$1.00 or 10% away from the opening price on the listing exchange or association. In such circumstances, the Exchange Official shall declare the opening transaction null and void or adjust the transaction price to the opening price on the listing exchange or association. Clearly erroneous executions of subsequent transactions of the subject security will be reviewed in the same manner as the procedure set forth in proposed Phlx Rule 163(c)(1).<sup>138</sup>

**xiv. Pre Market, Core, and Post Market Sessions**

XLE will be open to accept orders for three different trading sessions beginning at 8:00 a.m. Eastern time and continuing until 6:00 p.m., except during trading halts, every trading day unless otherwise declared by the Exchange. XLE will not have any opening or closing auctions or rotations at the beginning of, during, or at the end of any of these sessions. Therefore, XLE will not accept any orders unless it is open for trading and can immediately process those orders for execution, routing, or display, as applicable. At the end of the trading day and if trading is halted intraday, XLE will cancel all existing orders so that when trading begins again, either the next day or after the halt is lifted, there are no existing orders that would impermissibly lock or cross the market. New orders would only be accepted when they could again be executed, routed, or displayed, which would only happen when XLE is open for trading.

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<sup>138</sup> See proposed Phlx Rule 163(e).

Because XLE will operate during three distinct trading sessions, a XLE Participant may designate during which contiguous XLE trading session(s) a Limit, Reserve, or Pegged Order is eligible for execution.<sup>139</sup> For example, a XLE Participant could enter a Limit Order at 8:45:00 a.m. (during the Pre Market Session) for execution and designate it as eligible for the Pre Market and Core Sessions. That means that unless the order is fully executed, it will remain on XLE until the end of the Core Session, at which time it will be cancelled back to the XLE Participant.

Finally, no XLE Participant may accept an order from a non-XLE Participant for execution in the Pre Market or Post Market Session without disclosing to such non-XLE Participant that: (1) an order must be designated specifically for trading in the Pre Market or Post Market Session to be eligible for trading in the Pre Market or Post Market Session; and (2) trading outside of “regular” trading hours may involve material trading risks, including the possibility of lower liquidity, high volatility, changing prices, unlinked markets, an exaggerated effect from news announcements, wider spreads and any other relevant risk.<sup>140</sup> Proposed Phlx Rule 183(b) provides a form of notice XLE Participants may use to disclose the material trading risks of trading in the Pre Market or Post Market Sessions.

#### **xv. Access to XLE**

The Exchange will provide access to XLE for its members and member organizations and certain other persons who are sponsored by member organizations. Members and member organizations can register with the Exchange to become a XLE Participant, which includes entering into a XLE Participant Agreement.<sup>141</sup> The Exchange will confirm that the member or

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<sup>139</sup> See proposed Phlx Rule 185(b)(1)(A)-(B) and (b)(3).

<sup>140</sup> See proposed Phlx Rule 183(a).

<sup>141</sup> See proposed Phlx Rule 180(a).



member organization has the proper clearing relationships<sup>142</sup> and has the ability to electronically connect to XLE. Member organizations may sponsor other persons to gain access to XLE. When doing so, these member organizations become Sponsoring Member Organizations. The persons that the Sponsoring Member Organizations sponsor become Sponsored Participants.<sup>143</sup> A Sponsored Participant and its Sponsoring Member Organization would be required to enter into and maintain a XLE Participant Agreement with the Exchange. The Sponsoring Member Organization must designate the Sponsored Participant by name in its XLE Participant Agreement.<sup>144</sup> The XLE Participant Agreement is intended to highlight the responsibilities that a XLE Participant has regarding its use of XLE. In addition, it is intended to bind Sponsored Participants to their terms of use of XLE.

Sponsored Participants also would be required to enter into and maintain customer agreements with one or more Sponsoring Member Organizations so that Sponsoring Member Organizations may maintain the requisite level of control over the Sponsored Participants' trading on XLE. These customer agreements should also establish proper relationship(s) and account(s) through which the Sponsored Participant may trade on XLE.<sup>145</sup> Such customer agreement(s) must incorporate the following Sponsorship Provisions:

1. Sponsoring Member Organization acknowledges and agrees that all orders entered by the Sponsored Participants and any person acting on behalf of or in the name of such Sponsored Participant and any executions occurring as a result of such orders are binding in all respects on the Sponsoring Member Organization; and that the Sponsoring Member

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<sup>142</sup> See proposed Phlx Rule 165.

<sup>143</sup> See proposed Phlx Rule 180(b).

<sup>144</sup> See proposed Phlx Rule 180(b)(2)(A).

<sup>145</sup> See proposed Phlx Rule 180(b)(1).

Organization is responsible for any and all actions taken by such Sponsored Participant and any person acting on behalf of or in the name of such Sponsored Participant.

2. Sponsoring Member Organization shall comply with the Exchange's Certificate of Incorporation, Bylaws, Rules, and procedures with regard to XLE and Sponsored Participant shall comply with the Exchange's Certificate of Incorporation, Bylaws, Rules, and procedures with regard to XLE, as if Sponsored Participant were a member organization.
3. Sponsored Participant shall maintain, keep current and provide to the Sponsoring Member Organization a list of PAUs who may obtain access to XLE on behalf of the Sponsored Participant.
4. Sponsored Participant shall familiarize its PAUs with all of the Sponsored Participant's obligations under this Rule and will assure that they receive appropriate training prior to any use or access to XLE.
5. Sponsored Participant may not permit anyone other than PAUs to use or obtain access to XLE.
6. Sponsored Participant shall take reasonable security precautions to prevent unauthorized use or access to XLE, including unauthorized entry of information into XLE, or the information and data made available therein. Sponsored Participant understands and agrees that Sponsored Participant is responsible for any and all orders, trades and other messages and instructions entered, transmitted or received under identifiers, passwords and security codes of PAUs, and for the trading and other consequences thereof.

7. Sponsored Participant acknowledges its responsibility to establish adequate procedures and controls that permit it to effectively monitor its employees', agents', and customers' use and access to XLE for compliance with the terms of this agreement.
8. Sponsored Participant shall pay when due all amounts, if any, payable to Sponsoring Member Organization, the Exchange or any other third parties that arise from the Sponsored Participants access to and use of XLE. Such amounts include, but are not limited to, applicable exchange and regulatory fees.

**xvi. Order Entry by XLE Participants**

XLE Participants may enter any type of order available on XLE provided, however, no XLE Participant may enter a Limit Order or Reserve Order without "Do Not Route" instructions, or an SSO, unless the XLE Participant or the XLE Participant's Sponsoring Member Organization has entered into a Routing Agreement.<sup>146</sup> The Routing Agreement between the Exchange, the Exchange's routing broker-dealer and the XLE Participant or the XLE Participant's Sponsoring Member Organization allows the routing broker-dealer to act for the XLE Participant if the XLE Participant or its Sponsored Participant enters an order that is routable.

In addition, all XLE Participants may enter Proprietary Orders, Professional Orders, and Public Agency Orders.<sup>147</sup> Proprietary Orders are for the account of the XLE Participant who entered the order into XLE.<sup>148</sup> Professional Orders are for the account of a broker or dealer, which order is represented, as agent, by a XLE Participant.<sup>149</sup> Public Agency Orders are for the

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<sup>146</sup> See proposed Phlx Rule 181.

<sup>147</sup> See proposed Phlx Rule 182.

<sup>148</sup> See proposed Phlx Rule 1(bb).

<sup>149</sup> See proposed Phlx Rule 1(aa).

account of a person other than a broker or dealer, which order is represented, as agent, by a XLE Participant.<sup>150</sup> Proprietary Orders are subject to the same display and ranking processes as agency orders (Professional Orders and Public Agency Orders). XLE Participants that enter orders on XLE shall mark each order (or each side of a two-sided order) with the appropriate designator to identify the order (or the side of the order) as Proprietary, Professional, or Public Agency. In addition, all orders would need to be entered with a valid clearing account number and two-sided orders would need to be entered with valid clearing account numbers for both sides of the order.<sup>151</sup>

#### **xvii. Clearing Requirements for XLE Participants**

Each member organization that is a XLE Participant must either be a clearing firm, clear transactions on XLE through a clearing firm, or clear transaction through an entity duly authorized by the Exchange (e.g., SCCP).<sup>152</sup> Each clearing firm must be admitted to the Exchange as a member organization and to SCCP as a SCCP Participant. Clearing firms must be SCCP Participants because all transactions on XLE will be sent to SCCP to perform trade reconciliation and confirmation functions before being sent to the NSCC for clearing and settlement, which is consistent with current practice on the Exchange's equity trading floor.<sup>153</sup> Additionally, member organizations that are XLE Participants may clear transactions on XLE through SCCP without going through a clearing firm.<sup>154</sup>

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<sup>150</sup> See proposed Phlx Rule 1(ee).

<sup>151</sup> See proposed Phlx Rule 189(a)(1) and Partial Amendment No. 2.

<sup>152</sup> See proposed Phlx Rule 165(a).

<sup>153</sup> See Securities Exchange Act Release No. 41210 (March 24, 1999), 64 FR 15857 (April 1, 1999) (SR-Phlx-96-14) (text at note 26).

<sup>154</sup> SCCP is permitted to provide margin accounts for certain persons (called "Margin Members" at SCCP) that clear and settle their transactions through SCCP's Omnibus Clearance and Settlement Account at NSCC. See Securities Exchange Act Release No.

A clearing firm shall have a number of responsibilities respecting XLE executions. Clearing firms shall clear their own transactions made on XLE, if any. In addition to clearing their own transactions, a clearing firm shall be responsible for the clearance of the transactions effected by each member organization which gives up such clearing firm's name pursuant to a letter of authorization, letter of guarantee or other authorization given by such clearing firm to such member organization, which authorization shall be submitted to the Exchange.<sup>155</sup> Clearing firms may also clear transactions on XLE effected by Sponsored Participants whose Sponsoring Member Organization gives up the clearing firm or whose Sponsoring Member Organization is the clearing firm.<sup>156</sup>

**xviii. Market Makers**

XLE Participants that are member organizations may apply to register as Market Makers on XLE.<sup>157</sup> While the presence of a Market Maker in a security is not a requirement on XLE, the Exchange believes that Market Makers can provide an additional source of liquidity to XLE in the securities in which the Market Maker is making markets. Market Makers may use any of the order types available to any other XLE Participant, but there are no special order types or quotations available for Market Makers. Orders from Market Makers on XLE will be treated the same as orders from other XLE Participants. In addition, Market Makers will not have any special or enhanced access to or responsibility for the orders on XLE in any given security.

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48954 (December 18, 2003), 68 FR 75013 (December 29, 2003) (SR-SCCP-2003-04).  
SCCP Margin Members who are XLE Participants may use their SCCP margin accounts to trade on XLE without needing to use another clearing firm.

<sup>155</sup> See proposed Phlx Rule 165(c).

<sup>156</sup> See proposed Phlx Rule 189(a).

<sup>157</sup> See proposed Phlx Rule 170(a) and (b).

Market Makers shall apply to the Exchange for registration pursuant to proposed Phlx Rule 170. The Exchange will review an application to become a Market Maker considering such factors as capital, operations, personnel, technical resources, and disciplinary history.<sup>158</sup> An applicant's registration as a Market Maker shall become effective upon receipt by the member organization of notice of an approval of registration by the Exchange. In the event that an application is disapproved by the Exchange, the applicant shall have an opportunity to be heard upon the specific grounds for the denial, in accordance with the provisions of Phlx Proposed Rule 174.<sup>159</sup> Specifically, for an opportunity to be heard, persons may appeal such action to the Exchange's Board of Governors pursuant to By-Law Article XI, Section 11-1(a). The registration of a Market Maker may be suspended or terminated by the Exchange upon a determination of any substantial or continued failure by such Market Maker to engage in dealings in accordance with proposed Phlx Rule 173, which describes the obligations of Market Makers.<sup>160</sup> Any registered Market Maker may withdraw its registration by giving written notice to the Exchange. Such withdrawal of registration shall become effective on the tenth business day following the Exchange's receipt of the notice. A Market Maker who fails to give a ten-day written notice of withdrawal to the Exchange may be subject to formal disciplinary action pursuant to Phlx Rule 960.1 et seq. Subsequent to withdrawal, the member organization shall not be permitted to re-register as a Market Maker for a period of six months.<sup>161</sup>

Once registered as a Market Maker, a member organization may then register in a newly authorized security or in a security already admitted to dealings on XLE by filing a security

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<sup>158</sup> See proposed Phlx Rule 170(b).

<sup>159</sup> See proposed Phlx Rule 170(c).

<sup>160</sup> See proposed Phlx Rule 170(d).

<sup>161</sup> See proposed Phlx Rule 170(e).

registration form with the Exchange.<sup>162</sup> Registration in the security shall become effective on the first business day following the Exchange's approval of the registration. In considering a Market Maker's registration for a particular security, the Exchange may consider the fitness of Market Maker as well as attributes of the individual security and the current market for the security on XLE.<sup>163</sup> A Market Maker's registration in a security may be terminated by the Exchange if the Market Maker fails to enter quotations in the security within five business days after the Market Maker's registration in the security becomes effective.<sup>164</sup> In addition, the Exchange may suspend or terminate any registration of a Market Maker in a security or securities under this proposed Phlx Rule 172 whenever, in the Exchange's judgment, the interests of a fair and orderly market are best served by such action.<sup>165</sup> Any such suspension or withdrawal of privileges by the Exchange is subject to review pursuant to proposed Phlx Rule 174, which permits an appeal to the Board of Governors pursuant to By-Law Article XI, Section 11-1(a).

Alternatively, a Market Maker may voluntarily terminate its registration in a security by providing the Exchange with a one-day written notice of such termination.<sup>166</sup> Such termination shall be effective on the first business day immediately following the business day the Exchange received the notice. A Market Maker that fails to give advanced written notice of termination to the Exchange may be subject to formal disciplinary action pursuant to Phlx Rule 960.1 et seq.<sup>167</sup> A Market Maker may apply to the Exchange to withdraw temporarily from its Market Maker

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<sup>162</sup> See proposed Phlx Rule 172(a).

<sup>163</sup> See id.

<sup>164</sup> See proposed Phlx Rule 172(b).

<sup>165</sup> See proposed Phlx Rule 172(d).

<sup>166</sup> See proposed Phlx Rule 172(c).

<sup>167</sup> See proposed Phlx Rule 172(c).

status in the securities in which it is registered.<sup>168</sup> The Market Maker must base its request on demonstrated legal or regulatory requirements that necessitate its temporary withdrawal, or provide the Exchange an opinion of counsel certifying that such legal or regulatory basis exists. The Exchange will act promptly on such request and, if the request is granted, the Exchange may temporarily reassign the securities to another Market Maker.

Upon becoming Market Makers and registering in one or more securities on XLE, Market Makers would be required to assume a number of responsibilities.<sup>169</sup> Market Makers must engage in a course of dealings for their own account to assist in the maintenance, insofar as reasonably practicable, of fair and orderly markets on XLE. Each Market Maker must use electronic system(s) to maintain continuously two-sided markets with at least one Limit Order to buy and at least one Limit Order to sell, each for at least a round lot, in those securities in which the Market Maker is registered to trade. Market Makers must maintain adequate minimum capital in accordance with Phlx Rule 703. Market Makers must remain in Good Standing<sup>170</sup> with the Exchange. Market Makers must inform the Exchange of any adverse material change in financial or operational condition or significant change in personnel. Finally, Market Makers must clear and settle transactions through the facilities of a registered clearing agency using the means described in proposed Phlx Rule 165(a). Market Makers must meet these obligations during the Core Session in their registered securities on all days XLE is open for business.<sup>171</sup> If the Exchange finds any substantial or continued failure by a Market Maker to engage in a course of dealings required by a Market Maker, such Market Maker will be subject to suspension or

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<sup>168</sup> See proposed Phlx Rule 173(d).

<sup>169</sup> See proposed Phlx Rule 173(a).

<sup>170</sup> See proposed Phlx Rule 1(h).

<sup>171</sup> See proposed Phlx Rule 173(b).



revocation of the registration by the Exchange in one or more of the securities in which the Market Maker is registered, provided, however, this does not limit any other power of the Board of Governors under the By-laws, Rules, or procedures of the Exchange with respect to the registration of a Market Maker or in respect of any violation by a Market Maker. In accordance with proposed Phlx Rule 174, a member organization may seek review of such suspension or revocation.<sup>172</sup>

Because Market Makers are member organizations, individuals who enter orders on XLE in the course of making markets for a Market Maker are Market Maker Authorized Traders (“MMATs”). The Exchange may, upon receiving an application in writing from a Market Maker on a form prescribed by the Exchange, register a member of the Exchange as a MMAT. Each MMAT must be a member of the Exchange at all times he or she is acting as a MMAT.<sup>173</sup> All orders entered by a MMAT must contain the identification of the individual MMAT that entered the order.<sup>174</sup> MMATs may be officers, partners, employees or other associated persons of member organizations that are registered with the Exchange as Market Makers.<sup>175</sup> The Exchange may require a Market Maker to provide additional information the Exchange considers necessary to establish whether registration should be granted.<sup>176</sup> The Exchange may grant a member conditional registration as a MMAT subject to any conditions it considers appropriate in the interests of maintaining a fair and orderly market.<sup>177</sup> A Market Maker must ensure that a

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<sup>172</sup> See proposed Phlx Rule 173(c).

<sup>173</sup> See proposed Phlx Rule 171(b).

<sup>174</sup> See proposed Phlx Rule 171(a) and Partial Amendment No. 2.

<sup>175</sup> See proposed Phlx Rule 171(b)(1).

<sup>176</sup> See proposed Phlx Rule 171(b)(2).

<sup>177</sup> See proposed Phlx Rule 171(b)(3).

MMAT is properly registered to perform market making activities.<sup>178</sup> In addition, to be eligible for registration as a MMAT, a person must have served as a dealer-specialist or market maker on a registered national securities exchange or association (or be deemed to have similar experience from having functioned as a trader) for at least one year within three years of the date of application, or, in the alternative, must successfully complete the General Securities Representative Examination (Series 7).<sup>179</sup>

The Exchange may suspend or withdraw the registration previously given to a person to be a MMAT if the Exchange determines that: (1) the MMAT has caused the Market Maker to not properly perform the responsibilities of a Market Maker; (2) the MMAT has failed to meet the conditions set forth under the preceding paragraph; or (3) the Exchange believes it is in the interest of maintaining fair and orderly markets.<sup>180</sup> If the Exchange suspends the registration of a person as a MMAT, the Market Maker must not allow the person to submit orders on XLE.<sup>181</sup> Any such suspension or withdrawal of MMAT privileges by the Exchange is subject to review pursuant to proposed Phlx Rule 174. The registration of a MMAT will be withdrawn upon the written request of the member organization for which the MMAT is registered. Such written request shall be submitted on the form prescribed by the Exchange.<sup>182</sup>

**xix. Outbound Routing Facility**

In connection with the proposed changes to the trading rules described above, the Exchange intends to have PRO, a wholly owned subsidiary of Order Execution Services

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<sup>178</sup> See proposed Phlx Rule 171(b)(4).

<sup>179</sup> See proposed Phlx Rule 171(b)(5).

<sup>180</sup> See proposed Phlx Rule 171(c)(1).

<sup>181</sup> See proposed Phlx Rule 171(c)(2).

<sup>182</sup> See proposed Phlx Rule 171(c)(3).

Holdings, Inc. (“OES”),<sup>183</sup> operate as a facility (as defined in Section 3(a)(2) of the Act)<sup>184</sup> of the Exchange. PRO is a broker-dealer, a member of the NASD, and is applying to become a member organization of the Exchange. PRO plans to provide an optional routing service for the Exchange, in which PRO will route orders from the Exchange to trading centers with Protected Quotations through other brokers (“Access Brokers”) that are members or participants of those trading centers (such function of PRO is referred to as the “Outbound Router”).<sup>185</sup> As an Outbound Router, PRO will receive routing instructions from XLE, route orders to another trading center through an Access Broker, and be responsible for reporting resulting executions back to XLE.<sup>186</sup> All orders routed through PRO would be subject to the Exchange’s rules. PRO cannot change the terms of an order or the routing instructions, nor does PRO have any discretion about where to route an order.

The Outbound Router function of PRO will operate as a facility (as defined in Section 3(a)(2) of the Act).<sup>187</sup> As such, the Outbound Router function of PRO is subject to the Commission’s continuing oversight. In particular, and without limitation, under the Act, the Exchange is responsible for filing with the Commission proposed rule changes and fees relating

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<sup>183</sup> At this time, PRO Securities LLC is called Smart Execution Securities LLC. OES is in the process of changing the name of Smart Execution Securities LLC to PRO Securities LLC.

<sup>184</sup> 15 U.S.C. 78c(a)(2).

<sup>185</sup> The optional routing of orders to away markets by XLE is described above in Section II.A.1.c.vi.

<sup>186</sup> Executions occurring as a result of orders routed away from the Exchange shall be reported to an appropriate consolidated transaction reporting system by the relevant reporting market center. The Exchange shall promptly notify XLE Participants of all executions of their orders as soon as the Exchange is notified that such executions have taken place. See proposed Phlx Rule 188.

<sup>187</sup> 15 U.S.C. 78c(a)(2).

to the PRO Outbound Router function, and PRO is subject to exchange non-discrimination requirements.<sup>188</sup>

Pursuant to Rule 17d-1 under the Act,<sup>189</sup> where a member of the Securities Investor Protection Corporation is a member of more than one self-regulatory organization (“SRO”), the Commission shall designate to one of such organizations the responsibility for examining such member for compliance with the applicable financial responsibility rules.<sup>190</sup> The SRO designation by the Commission is referred to as a “Designated Examining Authority.” As noted above, PRO is applying to become a member organization of the Exchange, and is a member of the NASD. The NASD is an SRO not affiliated with the Exchange or its affiliates. Currently, the NASD is the Designated Examining Authority for PRO pursuant to Rule 17d-1 of the Act<sup>191</sup> with the responsibility for examining PRO for compliance with the applicable financial responsibility rules. The Exchange intends to enter into a 17d-2 agreement with the NASD to regulate PRO in its capacity as a member of both the Exchange and the NASD.<sup>192</sup>

XLE Participants’ use of PRO to route orders to another trading center will be optional and subject to Exchange rules, as described above. Those XLE Participants who choose to use

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<sup>188</sup> 15 U.S.C. 78f(b)(5). Neither PRO nor the Routing Agreement may unfairly discriminate among XLE Participants, pursuant to Section 6(b)(5) of the Act. See August 15 Telephone Call, supra note 64.

<sup>189</sup> 17 CFR 240.17d-1.

<sup>190</sup> Pursuant to Rule 17d-1 of the Act, in making such designation the Commission shall take into consideration the regulatory capabilities and procedures of the SROs, availability of staff, convenience of location, unnecessary regulatory duplication, and such other factors as the Commission may consider germane to the protection of investors, the cooperation and coordination among self-regulatory organizations, and the development of a national market system for the clearance and settlement of securities transactions.

<sup>191</sup> 17 CFR 240.17d-1.

<sup>192</sup> See 17 CFR 240.17d-2 and Partial Amendment No. 2.

PRO's Outbound Router function must sign a Routing Agreement.<sup>193</sup> XLE Participants that choose not to sign a Routing Agreement may still enter orders on XLE, but they may only enter orders that are not routable to other trading centers, by definition or by instruction, such as IOC Orders, Pegged Orders, ISOs, as well as Limit Orders and Reserve Orders marked "Do Not Route."<sup>194</sup>

Finally, PRO will not engage in any business other than its Outbound Router function, except as approved by the Commission. The Exchange notes that PRO's Outbound Routing function includes the clearing functions that it may perform for trades with respect to orders routed to other trading centers. Pursuant to proposed Phlx Rule 185(g), the Exchange shall establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between the Exchange and the Routing Facility, and any other entity, including any affiliate of the Routing Facility, and, if the Routing Facility or any of its affiliates engages in any other business activities other than providing routing services to the Exchange, between the segment of the Routing Facility or affiliate that provides the other business activities and the routing services. Moreover, the books, records, premises, officers, directors, agents, and employees of the Routing Facility, as a facility of the Exchange, shall be deemed to be the books, records, premises, officers, directors, agents, and employees of the Exchange for purposes of and subject to oversight pursuant to the Exchange Act. The books and records of the Routing Facility, as a facility of the Exchange, shall be subject at all times to inspection and copying by the Exchange and the Commission.

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<sup>193</sup> See proposed Phlx Rule 181.

<sup>194</sup> See id.

**d. Modifications to Current Phlx By-laws and Rules**

In addition to the proposed Phlx Rules to implement XLE, the Exchange is modifying various Phlx By-laws, Rules, EFPAs and OFPAs. Most of the changes are being made to either apply or disapply certain Phlx By-laws, Rules, EFPAs and OFPAs to XLE, to reflect the elimination of the physical trading floor for equity securities; to reflect the elimination of the Floor Procedure Committee and the Equity Allocation, Evaluation and Securities Committee; and to reflect the elimination of PACE, the Exchange's current electronic system for trading equity securities. These changes are described below beginning with the By-laws, then followed by the Rules, EFPAs and OFPAs, generally in numerical order.

**e. Modifications to Current By-laws**

Proposed Phlx By-law, Article I, Section 1-1(ii) is being added to adopt a definition of XLE, because the term is being used in a number of other By-laws. Phlx By-law, Article VIII, Section 8-1 is being amended to reflect the elimination of the Floor Procedure Committee<sup>195</sup> and to reflect that Phlx officers and employees will now handle matters that were previously referred to Floor Officials or the Committee on the equity floor.<sup>196</sup> The Floor Procedure Committee is being eliminated because Phlx believes that its function in governing conduct on the equity trading floor is no longer necessary in light of the floor's elimination. As a practical matter, the Exchange believes that the Committee's traditional role in overseeing equity trading is no longer necessary. The Exchange does not believe that the Committee is required by the federal securities laws, nor does the Exchange believe that its elimination is inconsistent with the Act. Members using XLE are represented on the Exchange's Board of Governors through the exercise

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<sup>195</sup> Currently, at least 50% of the Floor Procedure Committee must consist of permit holders or persons associated with a member organization.

<sup>196</sup> See proposed Phlx Rule 163.

of their voting rights for members of the Board of Governors.<sup>197</sup> In addition, Phlx By-law, Article X, Sections 10-1 and 10-11 are being amended and Section 10-16 is being deleted to reflect the elimination of the Floor Procedure Committee.

Phlx By-law Article X, Section 10-7 is being amended to reflect the elimination of the Equity Allocation, Evaluation and Securities Committee, which currently appoints equity specialists and handles new equity listings. With XLE, there will be no specialists, but rather Market Makers, who will be appointed by Exchange staff. Exchange staff also will manage the listing of any new equities. In addition, the composition of the Business Conduct Committee, in Section 10-11 is being amended such that the current “equity member” would be replaced by a member or a person associated with a member organization whose business is principally carried out on XLE. Accordingly, XLE Participants will be represented on the key committee involved in disciplinary matters. Additionally, Phlx By-law Article X, Section 10-15, Finance Committee, is being amended to allow for a member or person associated with a member organization that conducts business primarily on XLE, rather than on the equity trading floor, to be included on that Committee as one of the “member” Committee members. Phlx By-law Article XVI, Sections 16-1 and 16-2 are being amended to reflect the elimination of the equity floor and to include transactions on XLE as member and exchange contracts.

**f. Modifications to Current Rules**

Phlx Rule 1, Definitions, is being expanded to include the current definitions (currently contained in Phlx Rules 2-22)<sup>198</sup> and the new proposed definitions used in connection with XLE. Phlx Rule 98, Emergency Committee, is being amended to reflect the elimination of the Floor Procedure Committee and the creation of XLE. Phlx Rule 100, Committee on Floor Procedure,

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<sup>197</sup> See Phlx By-law, Article III.

<sup>198</sup> Phlx Rule 9, the definition of Bond, is proposed for deletion.

is being amended to reflect the elimination of the Floor Procedure Committee. Phlx Rules 102, Dealings on Floor - Hours; 103, Dealings on Floor - Securities; and 104, Dealings on Floor - Persons, are being amended to reflect that transactions in equity securities will no longer take place on a floor of the Exchange. Phlx Rule 105, Recognized Quotations, is being deleted because, as written, it would not apply to XLE. The Exchange is already subject to display its best quotations pursuant to Rule 602 of Regulation NMS,<sup>199</sup> and the Exchange proposes to do so as described in proposed Phlx Rule 184(c). The other provisions of Phlx Rule 105 are not applicable to XLE. Phlx Rule 106, Unit of Trading, is being deleted, but the concept is codified into the proposed definition of Round Lot in proposed Phlx Rule 1(gg). Phlx Rule 107, Bids and Offers - Other Than Unit of Trading, is being deleted, because all orders entered into XLE will specify the exact number of shares of the order. Phlx Rule 108, Bids and Offers to Be Made Within Six Feet of Post, is being amended to reflect that trading on XLE will not take place on the floor, but this rule will continue to apply to options and foreign currency options trading on the Exchange. Phlx Rule 109, Member May Bid for or Offer Round Lots in Open Market, is being deleted to reflect the elimination of the open outcry method used on the Exchange's equity trading floor. Phlx Rules 110, 119 to 121, and 123<sup>200</sup> are being amended or deleted to make them inapplicable to XLE, because the priority of orders on XLE will be governed by proposed Phlx Rule 184. Phlx Rule 111, Bids and Offers Binding, is being amended to incorporate a specific reference to orders on XLE.<sup>201</sup> Phlx Rule 112, Bids and Offers – “When Issued,” is

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<sup>199</sup> 17 CFR 242.602.

<sup>200</sup> These rules are titled, respectively: Bids and Offers – Precedence; Precedence of Highest Bid; Precedence of Offers at Same Price; Member as Principal Having Orders to Buy and Sell; and Bids and Offers to Be Made Public.

<sup>201</sup> See August 15 Telephone Call, supra note 64.



being amended to reflect that the Exchange, through its staff, as opposed to a committee of the Board, will administer the admittance of securities for trading on XLE. Phlx Rules 113, 117, and 122, relating to non-regular way settlement, are being deleted and replaced by proposed Phlx Rule 162. Phlx Rules 9, 114, 115, and 150 to 154 are being deleted because bonds will not trade on XLE.

Phlx Rule 118, Bids and Offers Outside Best Bid and Offer, is being deleted, because it is inapplicable to XLE. XLE will accept bids and offers priced below and above the best bid and offer, respectively, and rank those bids and offers on XLE pursuant to proposed Phlx Rule 184. Phlx Rule 124, Disputes, is being amended to reflect that XLE will not use Floor Officials for resolving disputes. Instead, persons using XLE may use proposed Phlx Rule 163 to address clearly erroneous executions, which provides that an Exchange official will make the determination. Further, the Phlx Rule 124 is being amended to remove a reference to the Floor Procedure Committee, which is being eliminated. Phlx Rule 126 is being deleted and replaced by proposed Phlx Rule 185(c) concerning two-sided orders. Phlx Rule 127, Substitute Principal, is being deleted, because orders on XLE shall be made and executed anonymously pursuant to proposed Phlx Rule 189. Phlx Rule 130, Offers Not Allowed on Floor, is being deleted because proposed Phlx Rule 185 lists all of the order types permitted on XLE. Phlx Rule 134, Stop Order Bans, is being deleted because stop orders will not be permitted on XLE. Phlx Rule 155, General Responsibility of Floor Brokers, is being amended to reflect that transactions in equity securities will no longer take place on a floor of the Exchange. Phlx Rules 201 to 214,<sup>202</sup> 216 to

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<sup>202</sup> These rules are titled, respectively: Specialist; Alternate Specialists - Appointment, Assignment and Termination; Registrant; Responsibilities of Alternate Specialists; Agreement of Specialists; Hours; Odd-Lot Orders Must Be Given to Specialist; Written Orders – Day Orders; Open Orders; No Commission Charged; Open Orders Ex-dividend;

220;<sup>203</sup> 236, Reports of Positions of Specialist and Alternate Specialists in Securities for Which the Exchange Is the Primary Market; 460, Procedures for Competing Specialists; and 461, PACE Remote Specialist, are being deleted. These rules describe equity specialists and how they operate currently on the equity trading floor of the Exchange. As stated above, a new type of liquidity provider, a Market Maker, will be available on XLE; the registration and functions are described in proposed Phlx Rules 170 to 173. Phlx Rules 225-228,<sup>204</sup> referring to order types available on the current equity trading floor, are being deleted. Order types available on XLE are described in proposed Phlx Rule 185. Phlx Rules 229 to 229B<sup>205</sup> are being deleted because the Exchange's current electronic order delivery and execution system, PACE, is being eliminated and replaced by XLE. Phlx Rule 230, ITS Pre-Opening Notification, and EFPA S-3, The "Three by Three" Requirement Applicable to Tape Indications and Pre-Openings, are being deleted; however, the operative date of this deletion will be no earlier than the date that the Exchange is no longer subject to the ITS pre-opening notification responsibilities in the ITS Plan. Phlx Rule 231, Inactive Securities, is being deleted, as it is not applicable to XLE, because XLE is designed to accommodate securities that trade without a specialist or market maker. Phlx Rule 232, Handling Orders When Primary Market Is Not Open for Free Trading (EXP, PPS, GTX Orders),

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Unusual Situations; Books Closed; Joint Accounts; Puts and Calls; and Violations of Rules.

<sup>203</sup> These rules are titled, respectively: Records to Be Kept; Discretionary Order; Customer's Order Receives Priority; Seller Must Be Identified; and Stopping Stock.

<sup>204</sup> These Rules are titled, respectively: Odd-Lot Orders in Securities Which the Exchange Is the Primary Market; Round Lot Orders Before the Opening in Nasdaq/NM Securities and in Securities For Which the Exchange Is the Primary Market; Odd-Lot Orders in Securities For Which Another Exchange Is the Primary Market and in Nasdaq/NM Securities; and Round Lot Orders in Securities For Which Another Exchange Is the Primary Market.

<sup>205</sup> These rules are titled, respectively: Philadelphia Stock Exchange Automated Communication and Execution System (PACE); Operation of PACE System When Competing Specialists Are Trading; and Alternative Electronic Order Entry.

is being deleted, as XLE will operate during the hours in Phlx Rule 101, Supplementary Material .02. Phlx Rule 233, Trading in Nasdaq/NM Securities, is being deleted, as the Exchange anticipates that the requirements in the Nasdaq UTP Plan for telephone access to NASD market makers will be eliminated prior to the launch of XLE. Phlx Rule 237, The eVWAP<sup>TM</sup> Morning Session, is being deleted, as it was a pilot program on the Exchange that has expired.<sup>206</sup> Therefore, the rule no longer has any application.

Phlx Rules 251 to 273, 275 to 278, and 291 to 423, including the Forms, are being deleted as obsolete, because they refer to the delivery and settlement of securities, which is not done by the Exchange, but by registered clearing agencies. The Exchange is requiring all XLE Participants to use the services of a clearing firm or SCCP to clear their securities transactions on XLE.<sup>207</sup> In turn, these entities provide for the delivery and settlement of securities pursuant to the rules of NSCC, a registered clearing agency. Phlx Rules 431, Ex-dividend, Ex-rights; 432, Ex-warrants; and 442, Communications, are being amended to reflect the elimination of the Floor Procedure Committee. Phlx Rules 441, Visitors, and 444, Wire Connections Between Exchange and Members' Offices, are being deleted because of the elimination of the equity trading floor. Phlx Rule 451 is being amended to reflect for trading on XLE by expanding its coverage to member organizations and by removing its references to bidding and offering in the open market, which are auction market concepts. Phlx Rules 500-524 are being amended to reflect the elimination of the Equity Allocation, Evaluation and Securities Committee and the elimination of equity specialists.

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<sup>206</sup> See Securities Exchange Act Release No. 45125 (December 4, 2001), 66 FR 64069 (December 11, 2001) (SR-Phlx-2001-95) (final extension of the Exchange's eVWAP pilot program).

<sup>207</sup> See proposed Phlx Rule 165(a).

Phlx Rule 604, Registration and Termination of Registered Persons, is being modified to reflect the elimination of the equity floor as well as to extend an exemption to persons whose member organization is assigned to the Exchange as their designated examining authority (“DEA”) and who is primarily engaged in business on XLE from the requirement to complete the Uniform Registered Representative Examination Series 7 (“Series 7”). Currently, persons trading on the equity floor are not required by this rule to take the Series 7 by virtue of being on the floor and therefore not an off-floor trader, because Rule 604(e)(1) applies to persons “off the floor.” The Exchange adopted the Series 7 examination requirement for off-floor traders in 1999 in order to impose a competency requirement on persons not on its floor, and not subject to its registration and testing processes for floor personnel pursuant to Phlx Rule 620 and 625.

Going forward, however, because there will no longer be an equity floor, those who trade on XLE will be, by definition, off-floor traders, unless they are trading on another Phlx trading floor. In order to address this situation, language is being added to the renumbered Phlx Rule 604(e)(iii) which would exempt those persons who are primarily engaged in either (1) submitting proprietary or agency orders for execution on XLE, or (2) making trading decisions with respect to trading on XLE from the rules requirement to take the Series 7. Modifying the exemption to reflect the elimination of the floor is intended to maintain the status quo respecting the Exchange’s requirements to take the Series 7, and is not intended to broaden the exemption beyond dealing with the elimination of the equity trading floor. The Exchange intends to interpret this exemption to permit the transition of existing floor persons to the new XLE environment. Those persons currently on the Exchange’s equity trading floor who will continue to operate their equity business in a similar fashion, now primarily on XLE, should fit within the exemption and therefore not be required to take the Series 7. The Exchange believes that absent

other changes, simply moving an existing business from the current trading floor to XLE should not result in the imposition of the Series 7 examination. Of course, XLE Participants may be required by the rules of another SRO to take the Series 7. Similarly, if a XLE Participant performs the duties reflected in revised Phlx Rule 604(a), they must take the Series 7.

Phlx Rule 625 and EFPA F-30 are being amended to specifically require new persons using XLE to successfully complete training requirements. In addition, Phlx Rule 625 will also subject persons using XLE to continuing mandatory training requirements. For these reasons, the Exchange believes that adding the Series 7 requirement to these persons is not warranted.

Rule 604 is also being amended to eliminate existing paragraph (c), Limited Registration/Floor Members, due to the elimination of the equity trading floor, and also because the Series 7A examination prescribed therein was not utilized by Exchange members and is being eliminated by the SRO administering that examination.

Phlx Rule 606, Communications and Equipment, is being amended to take into account the elimination of the equity trading floor. Phlx Rule 610, Notification of Changes in Business Operations, and related EFPA F-33 and OFPA F-33, are being amended to extend their coverage to members, foreign currency options participants, and member and foreign currency options participant organizations for which the Exchange is the DEA. This change is appropriate because, as currently written, Phlx Rule 610 would not apply to XLE Participants because the rule is currently limited to specialists and floor brokers. The change would have the effect of extending the requirements of the rule beyond those trading on XLE. However, the Exchange believes this is warranted because the purpose of the rule is to assist the Exchange's Examination Department in performing its functions as DEA. Therefore, the new language in the rule will cover all entities for which the Exchange is the DEA.

Phlx Rule 640 is being amended to extend the exemption from continuing education requirements to persons whose activities are limited solely to the transaction of business on XLE with members or registered broker-dealers. Currently, this exemption applies only to persons whose activities are limited solely to the transaction of business on the floor with members or registered broker-dealers.

Phlx Rule 701, Permission to Deal With Public, is being deleted, because it is obsolete. Today, the rules of the Commission require membership in the NASD for broker-dealers unless a narrow exception applies.<sup>208</sup> As a member of the NASD, broker-dealers' dealings with the public are regulated by NASD's rules, making permission by the Exchange superfluous. Phlx Rule 703, Financial Responsibility and Reporting, is being amended to reflect the elimination of specialists and to require certain brokers using XLE who are not self-clearing and who are assigned to Phlx as their DEA to have a sole purpose error account. Phlx Rule 715, Monthly Payment and Reporting, is being amended to reflect the elimination of the equity trading floor. Phlx Rule 722, Margin, is being amended to reflect that Market Makers may receive "good faith margin" for their market maker security positions in the same manner that equity specialists do today. Phlx Rule 755, Record of Orders - Transmitted to Floor, is being deleted to reflect the elimination of the equity trading floor. Broker-dealers continue to have responsibilities to retain certain information about their orders pursuant to the books and records rules under the Act.<sup>209</sup> Phlx Rule 774, Discretionary Transactions, is being deleted, however, the substance of subsection (c) is being moved to Phlx Rule 771, Excessive Trading by Members. The other sections of Phlx Rule 774 will not be applicable to trading on XLE, because XLE is not considered the floor of the Exchange. Phlx Rule 772, Trading for Joint Account, is being

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<sup>208</sup> See 15 U.S.C. 78o(b)(8).

<sup>209</sup> See 17 CFR 240.17a-3(a)(6).

amended to delete references to odd-lot dealers, which was a type of dealer that is being eliminated. Phlx Rule 773, Participation in Joint Accounts, is being amended to avoid overlapping regulatory burdens on members who do business on more than one exchange. Phlx Rules 800, 801, 805, 811, 813, and 864 are being modified to reflect the elimination of the Equity Allocation, Evaluation and Securities Committee, such that the listing of securities and the trading of securities on an unlisted trading privileges basis will be administered and approved by Exchange staff, rather than the Committee.

**g. Modifications to current EFPAs and OFPAs**

EFPA A-1 is being deleted, because there will be no specialists on XLE. EFPA A-2 is being deleted because there will be no stopped orders on XLE. EFPA E-1 is being deleted to reflect the elimination of the equity trading floor. EFPA E-5 is being amended to reflect the transition from the equity trading floor to XLE. EFPAs F-1, S-1, and S-2 are being deleted to reflect that XLE will open before the primary market is open and remain open after the primary market is closed, pursuant to Phlx Rule 101. EFPA F-25 is being amended to remove the word “floor,” in order to make it clear that the EFPA will apply to persons using XLE, which is not considered the floor. EFPA F-27 is being deleted to reflect the fact that XLE will not use Floor Officials for resolving disputes. Instead, persons using XLE will use proposed Phlx Rule 163 to address clearly erroneous executions. Regulations 1-7 are being deleted because they are only applicable to the equity trading floor, which is being eliminated. Regulation 5 that applies to options is being amended to reflect that the Floor Procedure Committee is being eliminated.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Sections 6(b)<sup>210</sup> and 11A<sup>211</sup> of the Act in general, and furthers the objectives of Sections 6(b)(3)<sup>212</sup> and (5),<sup>213</sup> and 11A(a)(1)<sup>214</sup> of the Act in particular, in that, in part, 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, for the reasons discussed below.

The Exchange's new automated system, XLE, will allow XLE Participants, from any location, to submit orders for immediate execution, display or routing, as applicable. The Exchange believes that XLE should provide an opportunity for XLE Participants and their customers to receive efficient, low-cost executions in an anonymous system that will execute orders according to a non-discretionary matching algorithm without the participation of a dealer. Therefore, the Exchange believes that XLE should further the goals Section 11A(a)(1)(C) of the Act,<sup>215</sup> including: (i) the economically efficient execution of securities transactions; (ii) fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets; (iii) the availability to brokers, dealers, and investors of information with respects to quotations for and transactions in securities; (iv) the practicability of brokers executing investors' orders in the best market; and (v) an opportunity,

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<sup>210</sup> 15 U.S.C. 78f(b).

<sup>211</sup> 15 U.S.C. 78k-1.

<sup>212</sup> 15 U.S.C. 78f(b)(3).

<sup>213</sup> 15 U.S.C. 78f(b)(5).

<sup>214</sup> 15 U.S.C. 78k-1(a)(1).

<sup>215</sup> 15 U.S.C. 78k-1(a)(1)(C).



consistent with the provisions with (i) and (ii) above, for investors' orders to be executed without the participant of a dealer.

The Exchange believes that the proposed rule change also furthers the objectives of Section 6(b)(3) under the Act<sup>216</sup> in that it provides a fair representation on the BCC of persons using XLE, in that Phlx By-law Article X, Section 10-11 is being amended such that the current "equity member" would be replaced by a member or a person associated with a member organization whose business is principally carried out on XLE.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition 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**

No written comments were either solicited or received by the Exchange.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

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<sup>216</sup> 15 U.S.C. 78f(b)(3).

#### **IV. 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. 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](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2006-43 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-2006-43. 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 the filing also will be available for inspection and copying at the principal office of the Phlx. 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-2006-43 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>217</sup>

Nancy M. Morris  
Secretary

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<sup>217</sup> 17 CFR 200.30-3(a)(12).