SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55729; File No. SR-Phlx-2007-26)

May 9, 2007

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change as Modified by Amendment No. 1 Thereto, Relating to Price Improved Linkage P/A Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on March 21, 2007, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the Phlx. On May 2, 2007, the Exchange filed Amendment No. 1 to the proposed rule change.[3] 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 proposes to amend Phlx Rule 1034, Minimum Increments, and to adopt proposed Phlx Rule 1080(c)(iv)(F), to permit the Exchange to execute Linkage Principal Acting as Agent ("P/A") Orders[4] that are sent to, and price-improved on, another exchange, and subsequently presented for execution on the Phlx against customer limit orders on the limit order

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

[2]   17 CFR 240.19b-4.

[3]   In Amendment No. 1, the Exchange clarified that the proposed rule change was seeking to permit manual executions of P/A Orders that had been price-improved on another exchange and submitted to Phlx for execution against the original customer limit order that gave rise to the Linkage P/A Order and made minor corrections to the rule text.

[4]   A P/A Order is an order under the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Linkage Plan"), for the principal account of a specialist (or equivalent entity on another Participant Exchange that is authorized to represent Public Customer orders), reflecting the terms of a related unexecuted Public Customer order for which the specialist is acting as agent. See Phlx Rule 1083(k)(i).

book that give rise to the initial P/A Order, at a price other than the minimum trading increment applicable to the particular series traded.

The proposed amendment to Phlx Rule 1080(c)(iv)(F) states that such orders would be ineligible for automatic execution, and would instead be handled manually by the specialist.

The text of the proposed rule change is available at Phlx, the Commission's Public Reference Room, and www.phlx.com.

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 purpose of the proposed rule change is to permit Exchange specialists to execute price-improved P/A Orders against public customer limit orders at prices other than the minimum trading increment applicable to that particular series so that the customer limit order underlying the P/A Order receives the improved price.

Currently, Phlx Rule 1034, Minimum Increments, generally provides that options quoting at $3.00 or higher have a minimum increment of $.10, and options quoting under $3.00 have a

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minimum increment of $.05. Options subject to the current "penny pilot" may be quoted and traded in increments as low as $.01.[5]

The proposed rule change concerns P/A Orders sent from the Exchange to another exchange via the Intermarket Option Linkage. When a P/A Order sent from the Exchange to another exchange is executed on that other exchange, the executed P/A Order is delivered back to the specialist electronically, where the specialist is responsible to execute the public customer limit order at the execution price of the P/A Order on the other exchange.

Recently, some P/A Orders have been executed on other exchanges at improved prices after being submitted to a price-improvement auction process on the other exchange. The result is that the executed P/A Order is delivered back to the Exchange at a price that is expressed in other than the Exchange's minimum trading increment. For example, if the Phlx disseminated market in a particular series is 2.10 bid, 2.20 ask, and another exchange is disseminating a bid price of 2.15, a P/A Order to sell an option series would be delivered by the Phlx specialist to the other exchange disseminating a limit bid price of $2.15. The specialist's P/A Order might be executed in a price-improving auction at an improved price of $2.17 on the other exchange. The P/A Order would be delivered back to the Phlx specialist for execution at $2.17. This would be prohibited under current Exchange rules, which require an execution at either $2.15 (disadvantaging the public customer), or $2.20 (disadvantaging the specialist), because the minimum trading increment applicable to the series is $.05.[6]

The proposed rule change is intended to eliminate this anomaly by providing that a P/A Order that has been sent from the Exchange to, and price-improved on, another exchange at a

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[5] See Securities Exchange Act Release No. 55153 (January 23, 2007), 72 FR 4553 (January 31, 2007) (SR-Phlx-2006-74).

[6] In this situation, Phlx specialists would execute the customer order on the book at the price most favorable to the customer.

price expressed in other than the minimum trading increment currently contained in the rule, and then submitted to the Exchange for execution against the original customer limit order that gave rise to the P/A Order, may be traded on the Exchange at such price. Therefore, in the example above, the specialist could fill the public customer order at the P/A Order execution price of $2.17.

The proposed amendment to Phlx Rule 1080(c)(iv)(F) provides that such orders would be ineligible for automatic execution and would instead be handled manually by the specialist.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,[7] in general, and furthers the objectives of Section 6(b)(5) of the Act,[8] in particular, in that the proposal is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest by establishing a rule that provides for accurate execution of customer limit orders at improved prices.

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 that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received.

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[7]   15 U.S.C. 78f(b).

[8]   15 U.S.C. 78f(b)(5).

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

Phlx 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.

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. Please include File Number SR-Phlx-2007-

26 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-2007-26. 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

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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-2007-26 and should be submitted on or before [insert date 21 days after publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[9]

Florence E. Harmon
Deputy Secretary

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[9]   17 CFR 200.30-3(a)(12).