

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-57703; File No. SR-Phlx-2008-31)

April 23, 2008

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change Relating to Changes to Phlx's Governing Documents in Connection With the Acquisition of Phlx by The Nasdaq Stock Market, Inc.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 21, 2008, 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 Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Phlx proposes to: (1) amend the Exchange's Restated Certificate of Incorporation ("Certificate of Incorporation"), By-Laws, and Rules of the Board of Governors ("Rules"), and adopt certain Rules to reflect changes in connection with the proposed acquisition of the Exchange by The Nasdaq Stock Market, Inc. now known as The NASDAQ OMX Group, Inc. ("NASDAQ OMX"); and (2) update certain language and make other minor, technical amendments to the Certificate of Incorporation, By-Laws, and Rules. The Exchange also requests Commission approval for an affiliation between the Exchange and certain broker-dealer subsidiaries of the NASDAQ OMX, as described herein. The Exchange requests that the

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

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

proposed rule change become operative upon consummation of the Nasdaq OMX Merger.<sup>3</sup>

The text of the proposed rule change is available at the Exchange, the Commission's Public Reference Room, and [http://www.Phlx.com/exchange/phlx\\_rule\\_fil.htm](http://www.Phlx.com/exchange/phlx_rule_fil.htm). The text of Exhibits 5A through 5C of the proposed rule change is also available on the Commission's Web site (<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 Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C, below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

On November 7, 2007, NASDAQ OMX announced that it had entered into an agreement with the Exchange pursuant to which NASDAQ OMX would acquire all of the outstanding capital stock of the Exchange. In connection with this acquisition, Pinnacle Merger Corp., a Delaware corporation and wholly owned subsidiary of NASDAQ OMX, would be merged with and into the Exchange, with the Exchange surviving the merger ("NASDAQ OMX Merger").<sup>4</sup>

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<sup>3</sup> Telephone conversation between Cynthia Hoekstra, Vice President, Phlx, and Richard Holley III, Senior Special Counsel, Division of Trading and Markets, Commission, on April 23, 2008.

<sup>4</sup> The NASDAQ OMX Merger is defined as the merger of a wholly owned subsidiary of NASDAQ OMX with and into the Exchange, with the Exchange as the surviving

As a result of the NASDAQ OMX Merger, all of the Exchange's common stock would be owned by NASDAQ OMX; Phlx shareholders would receive cash consideration for their shares and would not retain any ownership interest in the Exchange.

Thereafter, NASDAQ OMX would operate the Exchange as a wholly-owned subsidiary. The Exchange would continue to be registered as a national securities exchange, with separate Rules, membership rosters, and listings, distinct from the rules, membership rosters, and listings of The NASDAQ Stock Market LLC (the "NASDAQ Exchange"). Additionally, the Exchange would continue to be a separate self-regulatory organization ("SRO").

The purpose of the proposed rule change is to amend the Exchange's Certificate of Incorporation, By-Laws, and Rules to reflect NASDAQ OMX's proposed ownership of the Exchange. Most of the amendments reflect the Exchange's new ownership structure and some are designed to conform Phlx's governance provisions to those that are currently applicable to the NASDAQ Exchange. These revised governance provisions collectively regulate the Exchange and its directors, officers, and employees in light of its ownership by NASDAQ OMX, and, among other things, are designed to preserve the Exchange's independent Board of Governors ("Board").

a. Stock

Specifically, Article SECOND of the Certificate of Incorporation would be updated to reflect the address of the Exchange's registered office. Article FOURTH would be amended to: (1) reduce the amount of Common Stock that the Exchange has authority to issue to 100 shares;

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corporation, in connection with the acquisition of the Exchange by NASDAQ OMX. See proposed By-Law Article I, Section 1-1(ii).

(2) eliminate the designation of Class A and Class B Common Stock;<sup>5</sup> and (3) reduce the amount of Preferred Stock that the Exchange has authority to issue to 100 shares. Of the 100 shares of Preferred Stock that may be issued, there would continue to be one share that is designated as Series A Preferred Stock.<sup>6</sup>

All of the authorized shares of Common Stock shall be issued and outstanding, and shall initially be held by NASDAQ OMX. The Exchange would not issue additional Preferred Stock, other than the existing one share of Series A Preferred Stock, unless the resolution(s) providing for the issuance of such Preferred Stock has been filed with and approved by the Commission under Section 19 of the Act<sup>7</sup> and the rules promulgated thereunder. Additionally, Common Stock and Preferred Stock (including the Series A Preferred Stock) may not be transferred or assigned, in whole or in part, to any entity, unless such transfer shall be filed with and approved by the Commission under Section 19 of the Act<sup>8</sup> and the rules promulgated thereunder.<sup>9</sup>

Additional changes to the Certificate of Incorporation are being proposed in connection with Common Stock dividend rights,<sup>10</sup> voting rights,<sup>11</sup> required notice by stockholders to the

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<sup>5</sup> See similar changes to current Exchange By-Law Article I, Section 1-1(d).

<sup>6</sup> The one authorized share of Series A Preferred stock is currently issued and outstanding, and held by the Trust pursuant to the Trust Agreement. See By-Law Article I, Section 1-1(ee) and proposed Section 1-1(mm). At this time, there are no other outstanding shares of Preferred Stock. The single share of Series A Preferred stock is held by the Trust for the purpose of electing those “Designated Governors” voted for by Phlx Members as provided in By-Law Articles I and III. Pursuant to the Trust Agreement, the Holder of the Series A Preferred Stock is required to elect the nominees for Governor elected by the Members. The NASDAQ OMX Merger would not result in a transfer of ownership of the Series A Preferred Stock.

<sup>7</sup> 15 U.S.C. 78s.

<sup>8</sup> Id.

<sup>9</sup> See proposed Certificate of Incorporation, Article FOURTH, and proposed By-Law Article XXIX, Section 29-4.

<sup>10</sup> See proposed Article FOURTH, (c)(ii).

Exchange of Common Stock ownership in excess of certain thresholds,<sup>12</sup> ownership concentration limits,<sup>13</sup> and automatic conversion of Class A Common Stock.<sup>14</sup> These changes are being made to delete language customarily applicable to non-public companies with several stockholders, which is no longer necessary because NASDAQ OMX would become the sole holder of Common Stock.

b. Board

With respect to the composition of the board of directors, the Exchange's Board is currently composed of the Chairman of the Board, who is the individual holding the office of the Chief Executive Officer of the Exchange, and 22 other Governors, consisting of two Governors who are Member Governors, one Governor who is a Philadelphia Board of Trade<sup>®</sup> ("PBOT")<sup>15</sup> Governor, six Governors who are Stockholder Governors, 12 Governors who are Independent Governors, and one Governor who is the Vice-Chairman of the Board.<sup>16</sup> The Exchange proposes to amend the current composition of the Board so that the number and qualifications of the Governors would be fixed from time to time by the Board in accordance with the By-Laws. The Board would be composed of a majority of Independent Governors.<sup>17</sup> Specifically, the

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<sup>11</sup> See proposed Article FOURTH, (c)(iii).

<sup>12</sup> See Article FOURTH, (c)(iv).

<sup>13</sup> See Article FOURTH, (c)(v).

<sup>14</sup> See Article FOURTH, (c)(vi).

<sup>15</sup> The Philadelphia Board of Trade<sup>®</sup> is Phlx's futures exchange subsidiary, and at this time, would continue to operate as such after the NASDAQ OMX merger.

<sup>16</sup> See By-Law Article IV, Section 4-1.

<sup>17</sup> See proposed Certificate of Incorporation Article SIXTH and By-Law Article IV, Section 4-1. "Independent Governor" would continue to be defined as a Governor who is a person affirmatively determined by the Board as having no Material Relationship with the Exchange or any affiliate of the Exchange, any Member of the Exchange or any affiliate of such Member, or any issuer of securities that are listed or traded on the

Board would include one Governor who is the Chief Executive Officer of the Exchange, one Governor who is the Vice-Chair of the Board,<sup>18</sup> one PBOT Governor,<sup>19</sup> one Member Governor,<sup>20</sup> one Stockholder Governor,<sup>21</sup> and a number of Designated Independent Governors.<sup>22</sup> The Designated Governors (i.e., Designated Independent Governors, the Member Governor, and the PBOT Governor)<sup>23</sup> are intended to comply with the requirement in Section 6(b)(3) of the Act,<sup>24</sup> which requires that the rules of an exchange assure a fair representation of its members in

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Exchange or a facility of the Exchange. See By-Law, Article I, Sections 1-1(f), 1-1(o) and (p).

<sup>18</sup> The Vice-Chair would continue to be an individual who, anytime within the prior three years, has been a Member primarily engaged in business on the Exchange’s equity market or equity options market or who is a general partner, executive officer (vice-president or above) or a Member associated with a Member Organization primarily engaged in business on the Exchange’s equity market or equity options market. See By-Law Article V, Section 5-3.

<sup>19</sup> A PBOT Governor would continue to be defined as a Governor who is a member of PBOT and is duly elected to fill the one vacancy on the Board allocated to the PBOT Governor. See By-Law Article I, Section 1-1(aa).

<sup>20</sup> A Member Governor would continue to be defined as a Governor who is a Member or a general partner or an executive officer (vice-president and above) of a Member Organization and is duly elected to fill the vacancy on the Board allocated to the Member Governor. See By-Law Article I, Section 1-1(u).

<sup>21</sup> A Stockholder Governor is defined as a Governor who is an officer, director (or a person in a similar position in business entities that are not corporations), designee or an employee of a holder of Common Stock or any affiliate or subsidiary of such holder of Common Stock and is duly elected to fill the vacancy on the Board allocated to the Stockholder Governor. See By-Law Article I, Section 1-1(hh), and Article IV, Section 4-1 and proposed language in Certificate of Incorporation Article SIXTH.

<sup>22</sup> “Designated Independent Governors” would continue to be defined as those Independent Governors who are elected by the holder of the Series A Preferred Stock in accordance with Article SIXTH of the Certificate of Incorporation. See By-Law Article I, Section 1-1(f).

<sup>23</sup> The term “designated” refers to a governor who is elected by the Holder of Series A Preferred Stock to reflect the vote of the Members. See also proposed changes to Article FOURTH of the Exchange’s Certificate of Incorporation and By-Law Article I, Sections 1-1(e) and (f).

<sup>24</sup> 15 U.S.C. 78f(b)(3).

the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of an exchange, broker, or dealer (the “fair representation requirement”). The Designated Independent Governors, together with the Member Governor and the PBOT Governor, would equal at least 20% of the total number of Governors. All remaining Governors would be Independent Governors. A Governor would be permitted to fill only one position on the Board.

In terms of the election process, the Designated Governors would be elected by the vote of the holder of the Series A Preferred Stock (i.e., the “Trust”) in accordance with the results of the vote of Members conducted under By-Law Article III. All other Governors (i.e., Independent Governors, Vice-Chair, Chief Executive Officer, and Shareholder Governor) would be elected by a plurality vote of the holder of Common Stock (i.e., NASDAQ OMX). All Governors would be elected for terms of one year as recommended by NASDAQ OMX to conform with its understanding of current corporate best practices by allowing frequent review of the performance of all Governors.<sup>25</sup>

Article SIXTH would also be amended to provide that Governors, other than Designated Governors, may be removed with or without cause by vote of the holder of the Common Stock (i.e., NASDAQ OMX). This change would reflect the Exchange’s proposed status as a wholly-owned subsidiary of NASDAQ OMX. Provisions governing the removal of Designated Governors would be simplified to make it clear that such removal may be made with or without cause but requires a vote of Member Organization Representatives under By-Law Article III. A

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<sup>25</sup> Currently, Phlx Governors are divided into three classes. Each such class is constituted by election or appointment each year to serve for three years and until their successors are elected and qualify. Except for the Chairman and Vice-Chairman of the Board, Governors do not serve more than two consecutive full three year terms. See By-Law Article IV, Section 4-3.

new Article SEVENTH would provide that the stockholders (i.e., NASDAQ OMX) may act by unanimous written consent, again reflecting the Exchange's proposed status as a wholly-owned subsidiary.

c. By-Laws

The proposed amendments to the By-Laws include changes to conform to changes proposed for the Certificate of Incorporation, such as the simplification of the Exchange's capital structure and restrictions on stock transfer and the changes to the composition of the Board described above. With regard to the composition of the Board immediately following a closing of the NASDAQ OMX Merger, amended By-Law Article IV, Section 4-3 would provide that the directors of Pinnacle Merger Corporation, Inc. (the "Merger Subsidiary"), the wholly-owned subsidiary of NASDAQ OMX that would be merged with and into the Exchange through the NASDAQ OMX Merger, would become the Board of Governors of the Exchange immediately after the effective time of the NASDAQ OMX Merger. The directors of the Merger Subsidiary would satisfy the compositional requirements of the Exchange Board contained in the proposed By-Laws, as determined by NASDAQ OMX. The Designated Governors serving immediately after the effective time of the NASDAQ OMX Merger would consist of certain directors of the Merger Subsidiary who had been serving as Designated Governors of the Exchange immediately before the effective time of the NASDAQ OMX Merger, as selected by NASDAQ OMX.

Article III, Section 3-3(a), Removal of Designated Governors, currently provides that Designated Governors may be removed only for cause, unless a majority of the Board recommends that one or more Designated Governors be removed in accordance with Section 4-4 of the By-Laws, in which case such Designated Governor(s) may be removed without cause. In either case, removal of the Designated Governor requires a vote by Member Organization

Representatives at an annual or special meeting. As proposed to be amended, Section 3-3 would provide that Designated Governors may be removed, with or without cause, only by vote of Member Organization Representatives at an annual or special meeting.<sup>26</sup>

Article IV, Section 4-4, Duties and Powers, provides that in the event of the refusal or failure of any Governor to discharge his duties or for any reason deemed sufficient by the Board, the Board may, by the affirmative vote of a majority of Governors then in office, recommend to the Stockholders (and in the case of a Designated Governor, the Members) that such Governor be removed and call a special meeting of the Stockholders<sup>27</sup> (and, in the case of a Designated Governor, a special meeting of the Members and Member Organizations and subsequently a special meeting of the holder of the Series A Preferred Stock, who shall be required to vote in accordance with Article SIXTH of the Certificate of Incorporation and the Trust Agreement) for the purpose of voting on such removal. The Exchange believes that the process set forth in Article IV, Section 4-4, remains an appropriate and suitable process for the Board to address the refusal or failure of a Governor elected by the Members to discharge his duties. Thus, in all cases, authority to remove Designated Governors would rest with the Members pursuant to Section 3-3, but the Board could recommend removal and call a special meeting under Section 4-4.

Article IV, Section 4-17, Interpretation of By-Laws, would be amended to clarify that the Board shall determine whether an interpretation of the By-Laws and the Rules must be filed with the Commission as a proposed rule change, and if so, then such change would not become

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<sup>26</sup> A special meeting could be called by Members or the Board. See By-Law Article III, Section 3-2(b).

<sup>27</sup> This action may also be taken without a meeting. See proposed By-Law Article XXVIII, Section 28-13 (providing for Stockholder action without a meeting).

effective until filed with, or filed with and approved by, the Commission, as required under Section 19 of the Act<sup>28</sup> and the rules promulgated thereunder.

Article IV, Section 4-21, Annual Financial Report, would be amended to reflect that the Board of Governors would no longer send out annual financial reports as described in Section 4-21. However, annual financial reports of the Exchange would continue to be available at the Exchange and would also be reflected in the public consolidated financial statements of NASDAQ OMX.

Article V of the By-Laws would be amended to set forth in detail the powers and duties relating to the Chair, Vice-Chair, and officers of the Exchange. Specifically, the Exchange proposes to insert language in By-Law Article V, Section 5-1, Board's Appointive Powers, to state that the Board would appoint the officers of the Exchange as provided in the By-Laws and shall fix their duties, responsibilities, and terms of employment. Additionally, language would be added to Section 5-2, Chair of the Board of Governors, to set forth the powers of the Chair of the Board and to establish that the Board would select its Chair from among the members of the Board who are Independent Governors. Proposed Sections 5-4, Chief Executive Officer, and 5-5, President, set forth the duties and powers of these officers of the Exchange.<sup>29</sup>

Article VI, Equity Stock Compensation, Section 6-1, Stock Incentive and Option Plans, would be deleted as this provision is no longer applicable due to the fact that NASDAQ OMX would be the sole owner of the Exchange's Common Stock and any potential equity stock compensation is likely to consist of NASDAQ OMX stock rather than Phlx stock.

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<sup>28</sup> 15 U.S.C. 78s.

<sup>29</sup> These provisions are consistent with current NASDAQ OMX By-Law Article VII, and NASDAQ Exchange By-Law Article IV.

Additionally, By-Law Article IX, Trustees of Stock Exchange Fund, Sections 9-1 through 9-6 would be deleted, as these provisions are no longer deemed necessary after the acquisition of the Exchange by NASDAQ OMX.<sup>30</sup> The change reflects a simplification of the Exchange's financial management, under which the Exchange's assets would be subject to the oversight of the Board rather than separate trustees and also subject to public company financial controls established by NASDAQ OMX.<sup>31</sup>

d. Standing Committees

Generally, the Standing Committees of the Board would remain the same, except as discussed below. By-Law Article X, Standing Committees, would also be updated to reflect the elimination of the Automation Committee and Marketing Committee, as these committees are deemed no longer necessary at this time because automation and marketing would be guided and handled at the parent company level. Additionally, the responsibilities of the Audit Committee would be updated to conform with similar responsibilities and processes of the Audit Committees of NASDAQ OMX and the NASDAQ Exchange.<sup>32</sup> The composition of the Executive Committee and the Finance Committee would be amended to reflect the proposed changes to the composition of the Board.

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<sup>30</sup> The purpose of the Stock Exchange Fund was to appoint trustees to manage the investment of certain funds of the Exchange and collect interest, dividends and income from the funds for the Exchange.

<sup>31</sup> The applicable references to the Stock Exchange Fund in Article IV, Section 4-4, Duties and Powers, Removal of governors or trustees of gratuity fund and stock exchange for cause, would also be deleted and this section would be updated to reflect that there is no longer a gratuity fund.

<sup>32</sup> See NASDAQ OMX Audit Committee Charter approved April 18, 2007 and NASDAQ Exchange By-Law Article III.

Several Exchange committees that currently review proposed rule changes may review such proposals before the proposals are presented to either the Executive Committee<sup>33</sup> or the Board for approval for filing with the Commission.<sup>34</sup> These committees on which Exchange members serve would continue to perform this function after the NASDAQ OMX merger. For example, the Business Conduct Committee (“BCC”) may review proposed changes to the disciplinary Rules that are set forth in Exchange Rule 960 before these Rules are presented to the Executive Committee or the Board. The BCC currently consists (and will continue to consist) of nine members as follows: three Independent Governors; one Member or person associated with a Member Organization who conducts business on XLE; one Member who conducts options business at the Exchange; and four persons who are Members or persons associated with a Member Organization.<sup>35</sup>

Furthermore, the Options Committee makes or recommends for adoption such Rules as it deems necessary for the convenient and orderly transaction of business upon the equity and index options trading floor, as well as makes and enforces Rules and regulations relating to order, decorum, health, safety and welfare on the equity and index options trading floor and the

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<sup>33</sup> The Executive Committee currently consists of nine Governors; the Chairman of the Board, the Vice-Chairman of the Board; the Chairman of the Finance Committee; the Chairmen of two floor committees; two Stockholder Governors and two Independent Governors. See By-Law Article X, Section 10-14. As proposed herein, the Executive Committee would be amended so that it would consist of the Chair of the Board, the Vice-Chair of the Board, the Stockholder Governor, a number of designated Governors equal to at least 20% of the total number of Governors on the Executive Committee, and such other Governors as the Board may appoint. See proposed By-Law Article X, Section 10-14.

<sup>34</sup> Members using XLE (the Exchange’s equity trading system) are represented on the Exchange’s Board through the exercise of their voting rights for members of the Board. Currently, there is no designated committee that reviews proposed rule changes covering equity Rules. The Board or Executive Committee performs this function.

<sup>35</sup> See By-Law Article X, Section 10-11.

immediately adjacent premises of the Exchange. Fifty percent of the Members of the Options Committee are permit holders or associated with a Member Organization.<sup>36</sup> Thus, Member representation on Exchange committees would continue.

Additionally, By-Law Article X, Section 10-15, Finance Committee, would be amended such that the Chair of the Finance Committee would be the Chair of the Board and would no longer be either the Vice-Chair, Stockholder Governor or Member Governor. The Exchange also proposes to amend the description of the composition of the Finance Committee members to allow any Member or persons associated with a Member Organization, who conducts business on XLE to be a member of the Committee. Currently, the language states, in part, that the Finance Committee shall include two Members or persons associated with a Member Organization, who may be Governors, one of whom conducts business primarily on XLE or on the equity options floor. Although this proposed change is not directly related to the NASDAQ OMX Merger, the Exchange proposes to delete the word “primarily” in order to allow a greater pool of candidates to be eligible to serve on the Finance Committee.<sup>37</sup>

The purpose of deleting the supplementary material in Section 10-15 is to reflect the updated responsibilities of the Finance Committee.<sup>38</sup> The Board would establish capital

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<sup>36</sup> See By-Law Article X, Section 10-20.

<sup>37</sup> This proposed change is consistent with a recent By-Law change to Section 10-11, Business Conduct Committee, relating to the composition of the Business Conduct Committee. In that proposal, the Exchange expanded the type of business that may be conducted to qualify as a BCC member. See Securities Exchange Act Release No. 57023 (December 20, 2007), 72 FR 74398 (December 31, 2007) (SR-Phlx-2007-83).

<sup>38</sup> Currently, the supplementary material relates to directives that are applicable to the Finance Committee in the exercise of its duties, powers and authority under the By-Laws. For example, the supplementary material states that the Finance Committee may authorize certain expenditures of any budgeted line items; may delegate to the staff of the Exchange so much of its authority to make expenditures as it deems appropriate; and shall perform its functions and act with the same powers and limitations for the Exchange

expenditure policies, which may include delegation to Board committees and/or officers, but would no longer reflect these policies in the By-Laws. This reflects a more flexible approach, consistent with NASDAQ OMX's processes and the functions of a public company parent.

Also, in By-Law Article X, Section 10-19, Nominating, Elections and Governance Committee, the Exchange proposes to delete the term limit applicable to this Committee and delete the prohibition on Committee members standing for re-election to the Board. These changes are designed to increase the pool of candidates eligible to serve on the Committee and the Board. Moreover, the deletion of these restrictions is also supported by the fact that all Board members, including those serving on the Committee, would serve for one-year terms and would therefore have their qualifications for continued Board service under more frequent review.

In addition, the Nominating, Elections and Governance Committee would no longer select all Chairs of the Standing Committees in accordance with Article X. The Board would now appoint a person to fill any vacancy in a Standing Committee, including Chairs, except for the Chair of the Executive Committee, the Chair of the Nominating, Elections and Governance Committee and the Chair of the Finance Committee.<sup>39</sup> This change reflects a general philosophy that the full Board should have control over the composition of Standing Committees, including the selection of their Chairs and is consistent with how NASDAQ OMX currently operates.<sup>40</sup>

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and all subsidiaries of the Exchange. See By-Law Article X, Section 10-15, Supplementary Material.

<sup>39</sup> Pursuant to the By-Laws, the Chair of the Board is the Chair of the Executive Committee and the Finance Committee and the Chair of the Nominating, Elections and Governance Committee is selected from among the members of such Committee who are Independent Governors. See By-Law Article X, Sections 10-14(a), 10-15 and 10-19(a).

<sup>40</sup> See NASDAQ OMX By-Law Article IV, Section 4.13.

Additionally, in By-Law Article X, Section 10-21, the Exchange proposes to clarify the composition of the Quality of Markets Committee by specifically stating that the members of this Committee would include at least as many Independent members as it does the “combined number” of Stockholder-chosen members<sup>41</sup> and members who are Members of the Exchange.<sup>42</sup> The Exchange believes that adding the language “combined number” should clarify that the number of Stockholder-chosen Committee members<sup>43</sup> are added to the number of Members serving on the Committee<sup>44</sup> and that total is then compared to the number of “Independent”

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<sup>41</sup> See By-Law Article I, Section 1-1(gg).

<sup>42</sup> See By-Law Article I, Section 1-1(t).

<sup>43</sup> NASDAQ OMX, as Stockholder, would select the Stockholder member(s) of this Committee, subject to Board approval pursuant to By-Law Article X, Section 10-1(b).

<sup>44</sup> The Board would select the Member(s) serving on the Committee pursuant to By-Law Article X, Section 10-1(b).

Committee members (not to be confused with “Independent Governors,” which also rely on the definition of “Independent” in By-Law Article I, Section 1-1(o)).

In addition, the Exchange proposes to adopt for the Quality of Markets Committee a “fair representation requirement” consistent with Section 6(b)(3) of the Act,<sup>45</sup> which requires that the rules of an exchange assure a fair representation of its members in the selection of its directors and administration of its affairs. This language is intended to ensure fair Member representation on the Quality of Markets Committee.<sup>46</sup>

By-Law Article XI, Section 11-1(b) would be amended to delete references to a “special committee of the Board of Governors” that hears appeals from determinations of the Nominating, Elections and Governance Committee regarding eligibility for election to the Board. The special committee had been composed of Governors not then standing for re-election. However, because the proposed amendments to Section 4-3 eliminate the “staggering” of the Board, requiring all Governors to be elected annually, it would not be possible to form such a special committee. Now that the Exchange proposes to reduce the size of its Board, the Exchange believes that at this time, it would be more practical for the full Board to hear an appeal pursuant to Section 11-1(b) because all Governors would stand for re-election annually.

In By-Law Sections 13-5, Liability of Officers, Directors and Substantial Stockholders, 13-7, Violation of Terms of Registration, 17-4, Time for Settlement of Insolvent Member or Participant, Extension, and 18-3, Responsibility of Member or Participant for Acts of His Organization, references to receiving an affirmative vote of either 14 or 15 Governors (which used to represent a supermajority) would be changed to require an affirmative vote of a majority

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<sup>45</sup> 15 U.S.C. 78f(b)(3).

of all Governors. This change is necessary as the number of Board members may be reduced after the NASDAQ OMX Merger and therefore a vote of 14 or 15 Governors may no longer be possible.

Article XXII, Amending the By-Laws, would be amended to state affirmatively that By-Law amendments must be filed with, and/or approved by, the Commission as required under Section 19 of the Act<sup>47</sup> and that the holders of a majority of the shares of Common Stock then issued and outstanding must affirmatively vote for By-Law amendments.

Article XXVIII, Section 28-3, Nomination of Chairman and Vice-Chairman of the Board of Governors; Independent Nominations by Stockholders; Election of Nominees for Stockholder and Independent Governors, currently provides for a nomination process in connection with nominating and electing the above-referenced individuals. The Exchange proposes to amend Section 28-3 to reflect that the Holder of Common Stock would present to the Nominating, Elections and Governance Committee its candidate recommendations for Vice-Chair, Shareholder Governor and Independent Governors for placement on the ballot for election by the Holder of Common Stock at the annual meeting of Stockholders. These nominees would be placed on the ballot and elected by the Holder of Common Stock. Additionally, the Board would now appoint the Chair from among the members of the Board who are Independent Governors.<sup>48</sup> This approach is consistent with the NASDAQ Exchange's processes for nomination of non-

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<sup>46</sup> This provision is similar to the NASDAQ Exchange's Quality of Markets Committee. See NASDAQ Exchange By-Law Article III, Section 6.

<sup>47</sup> 15 U.S.C. 78s.

<sup>48</sup> See proposed By-Law Article V, Section 5-2.

Member Representative Directors by a nominating committee that may seek the input and recommendations of NASDAQ OMX as the owner of the NASDAQ Exchange.<sup>49</sup>

Article XXVIII, proposed Section 28-13, Action Without Meeting, sets forth provisions relating to action that may be taken without a meeting and the accompanying requirements relating to taking such action. This provision sets forth specifically that any action required or permitted to be taken at any annual or special meeting of Stockholders may be taken by Stockholders without a meeting as set forth in detail in Section 28-13, unless otherwise specified in the Certificate of Incorporation of the Exchange. This language should assist in providing greater flexibility in connection with taking any action required or permitted to be taken at any annual or special meeting of Stockholders and is consistent with proposed Article SEVENTH of the Exchange's Certificate of Incorporation.

Article XXIX, Capital Stock, would be updated. The proposed changes to Sections 29-1 through 29-7 are similar to NASDAQ OMX By-Law Article IX, Capital Stock, Sections 9.1 through 9.7, reflect standard provisions for a Delaware stock corporation and also reflect the contemplated ownership of all Common Stock by NASDAQ OMX. Existing provisions in Article XXIX that contemplated a possible public offering of the Exchange's stock would be deleted and replaced with restrictions on stock transfer comparable to the restrictions included in the Certificate of Incorporation and discussed above. Additionally, proposed Section 29-8, Dividends, is similar to Section 15 of the LLC Agreement of the NASDAQ Exchange, and prohibits the Exchange from using Regulatory Funds to pay dividends.<sup>50</sup>

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<sup>49</sup> See NASDAQ Exchange By-Law Article III, Section 6.

<sup>50</sup> "Regulatory Funds" are defined as fees, fines, or penalties derived from the regulatory operations of the Exchange. However, "Regulatory Funds" shall not be construed to include revenues derived from listing fees, market data revenues, transaction revenues, or

Additionally, further changes to the Certificate of Incorporation and By-Laws would be made to correct typographical errors and to update the language to more accurately reflect current practices. For example, the language relating to how the Exchange's Weekly Bulletin is distributed would be updated to not restrict its distribution to mail, but rather to permit distribution by email and posting on the Exchange's Web site.<sup>51</sup> As a second example, references to "Chairman" would be replaced with "Chair." Additionally, references to the "director" of either the Membership Services or Examinations Departments in Sections 17-1, Suspension for Insolvency on Declaration, and 17-3, Investigation of Insolvency, would be deleted in favor of more general references to the departments. Therefore, notices would still be required to be sent to these departments, but not necessarily to the director. This change should allow more flexibility in connection with sending notices to these departments.

e. Rules

The Exchange also proposes to amend the following current Exchange Rules: (1) Rule 1, Definitions; (2) Rule 98, Emergency Committee; (3) Rule 164, Trading Halts; and (4) Rule 972, Continuation of Status After the Merger. More specifically, the Exchange proposes to update Rule 1, Definitions, to include a definition of the NASDAQ OMX Merger, which will apply to Rule 972.

Rule 98, Emergency Committee, is proposed to be amended to reflect that the Board shall establish the Emergency Committee and determine its composition, which not only revises the members that comprise the Committee, but allows for greater flexibility in appointing members

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any other aspect of the commercial operations of the Exchange even if a portion of such revenues are used to pay costs associated with the regulatory operations of the Exchange. See proposed By-Law Article I, Section 1-1(kk).

<sup>51</sup> See, e.g., By-Law Article XII, Section 12-5(d).

to this Committee. Currently, the Emergency Committee consists of the following: the Chairman of the Board, the On-Floor Vice-Chairman of the Exchange, the Off-Floor Vice-Chairman of the Exchange (this position, however, no longer exists and reference to this position was inadvertently not deleted previously from Rule 98), and the Chairmen of the Options and Foreign Currency Options Committees.

Rule 164, Trading Halts, is proposed to be amended to provide that the officers of the Exchange designated by the Board shall have the power to suspend trading in any and all securities traded on XLE whenever in their opinion such suspension would be in the public interest. Currently, only the Chairman and Chief Executive Officer or his designee has the authority to suspend trading pursuant to Rule 164. Under this proposal, there would no longer be one position entitled “Chairman and Chief Executive Officer.” Accordingly, the proposed change allows for greater flexibility in designating individuals responsible for declaring any trading halts and updates the rule to reflect the proposed revisions relating to the officers of the Exchange.<sup>52</sup>

Proposed Rule 972, Continuation of Status After the NASDAQ OMX Merger, is being amended to reflect that current members,<sup>53</sup> inactive nominees, member organizations, foreign currency options participants, foreign currency options participant organizations, as well as approved lessors of foreign currency options participations holding such status prior to the NASDAQ OMX Merger would continue to hold such status following the NASDAQ OMX Merger. This provision was adopted in connection with and currently refers to the Exchange’s

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<sup>52</sup> See proposed By-Law Article V, Sections 5-1 through 5-5.

<sup>53</sup> The term “member,” defined in Rule 1(n), is not capitalized, unlike the Exchange’s By-Laws.

2004 demutualization.<sup>54</sup> It is being amended to refer specifically to the proposed NASDAQ OMX merger and to serve the same purpose as the original provision, which is to make clear that the merger does not affect membership status generally.

Additionally, the Exchange proposes to adopt two new Rules that would reflect its status as a wholly-owned subsidiary of NASDAQ OMX upon the effectiveness of the NASDAQ OMX Merger. The purpose of the Rules is to guard against any possibility that the Exchange may exercise, or forebear to exercise, regulatory authority with respect to an affiliated entity in a manner that is influenced by commercial considerations, to provide an opportunity for Commission review of certain proposed affiliations, and to ensure that certain affiliated members do not receive advantaged access to information in comparison with unaffiliated members. The Exchange believes that the proposed Rules would provide added assurance of regulatory integrity without subjecting the Exchange and its affiliates to unwarranted restrictions on their commercial activities.

First, the Exchange proposes to adopt Rule 990, which is comparable to NASDAQ Exchange Rule 4370. The rule provides that if a security issued by NASDAQ OMX or any of its affiliates is listed on the Exchange, the Exchange will apply special procedures to the regulation of that listing, including reporting to the Commission and conducting an annual independent audit of the security's compliance with Exchange listing standards.

Second, proposed Exchange Rule 985(a) would limit ownership of NASDAQ OMX's voting securities by members of the Exchange and their associated persons (i.e., their registered representatives). The Rule is comparable to Rule 2130 of the NASDAQ Exchange, and provides

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<sup>54</sup> See Securities Exchange Act Release No. 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (SR-Phlx-2003-73).

that no member or associated person of a member shall be the beneficial owner of greater than 20% of the then-outstanding voting securities of NASDAQ OMX. “Beneficial ownership” is defined with reference to NASDAQ OMX’s certificate of incorporation, which in turn provides that a person shall be deemed the “beneficial owner” of, shall be deemed to have “beneficial ownership” of and shall be deemed to “beneficially own” any securities: (i) which such person or any of such person’s affiliates is deemed to beneficially own, directly or indirectly, within the meaning of Rule 13d-3 under the Act;<sup>55</sup> (ii) subject to certain narrow exceptions described in the certificate of incorporation, which such person or any of such person’s affiliates has the right to acquire or to vote pursuant to any agreement, arrangement, or understanding or otherwise; or (iii) subject to certain narrow exceptions described in the certificate of incorporation, which are beneficially owned, directly or indirectly, by any other person and with respect to which such person or any of such person’s affiliates has any agreement, arrangement or understanding for the purpose of acquiring, holding, voting or disposing of such securities.

Third, proposed Exchange Rule 985(b) would regulate the affiliation between the Exchange and its affiliates, on the one hand, and Exchange members, on the other hand, in a manner comparable to Rule 2140 of the NASDAQ Exchange. In general, the proposed rule provides that the Exchange must file a proposed rule change with the Commission before the Exchange or an entity with which it is affiliated directly or indirectly acquires or maintains an ownership interest in, or engages in a business venture with, an Exchange member or an affiliate

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<sup>55</sup> Rule 13d-3 under the Act, 17 CFR 240.13d-3, in turn provides that a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares voting power or investment power.

of an Exchange member.<sup>56</sup> The rule defines “affiliate” with reference to Rule 12b-2 under the Act,<sup>57</sup> which provides that if one person controls, is controlled by, or is under common control of another person, the persons are affiliates.

The proposed rule would make it clear that in a case where the Exchange or an affiliate of the Exchange proposes an acquisition of, or a merger or business venture with, an Exchange member, a proposed rule change would be required. In order to make it clear that the obligation to avoid affiliations that have not been filed is imposed by the rule both on the Exchange and its members, moreover, the rule provides that an Exchange member shall not be or become an affiliate of the Exchange, or an affiliate of any entity affiliated with the Exchange, without a proposed rule change.

The term “business venture,” as used in the rule, is defined as an arrangement under which the Exchange or an entity with which it is affiliated, on the one hand, and an Exchange member or affiliate thereof, on the other hand, engage in joint activities with an expectation of shared profit and a risk of shared loss from common entrepreneurial efforts. Thus, the term does not include, and the proposed rule does not regulate, contracts with members or their affiliates to provide goods, products, or services for consideration, including, but not limited to, asset or stock purchase agreements that do not result in ongoing ties with a member or its affiliates,<sup>58</sup> credit or debt facilities, licenses of intellectual property, contracts for investment banking,

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<sup>56</sup> As used in the rule, the term “affiliate” includes natural persons, but the term “entity,” when used to describe an affiliate, excludes natural persons.

<sup>57</sup> 17 CFR 240.12b-2.

<sup>58</sup> For example, in the case of an acquisition of a non-Member subsidiary of a Member in a transaction that did not result in an ongoing affiliation with the Member, the transaction would not be regulated by the rule.

financial advisory, or consulting services,<sup>59</sup> or the provision of transaction services or data to a broker-dealer member or products or services to a listed company that is or that owns a member broker-dealer.

The rule limits possible expansive interpretations of the term “affiliate” by stipulating that one entity is not deemed to be an affiliate of another entity solely by virtue of having a common director. For example, if one of the Governors of the Exchange is also a director of an Exchange member, that member would not be deemed to be an affiliate of the Exchange solely because of the common director. In addition, the rule should not be construed to regulate in any manner the selection of Governors or standing committee members of the Exchange, NASDAQ OMX, the NASDAQ Exchange, or their affiliates, provided such selections are conducted in accordance with applicable provisions of governing corporate documents.

In circumstances where a Commission filing is required, the rule allows the Exchange to file, in appropriate cases, a proposed rule change on an immediately effective basis under Section 19(b)(3)(A) of the Act<sup>60</sup> and Rule 19b-4(f) thereunder.<sup>61</sup> For example, in cases where a proposed affiliation or business venture would not result in the establishment of a “facility” of the Exchange within the meaning of Section 3 of the Act,<sup>62</sup> a filing to establish Rules to govern the

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<sup>59</sup> In some cases, such contracts may involve sharing of confidential information with a Member in circumstances where a Member acts as a fiduciary for Phlx or one of its affiliates. The Member would be required to take measures to prevent such information from being misused, and a failure to do so may constitute a violation of Rules, including, depending on the circumstances, Exchange Rules 707, 708 and 1020.

<sup>60</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>61</sup> 17 CFR 240.19b-4(f).

<sup>62</sup> 15 U.S.C. 78c.

operation of the affiliate or business venture would not be required or appropriate. Rather, in such circumstances, the Exchange would expect to engage in informal consultation with the Commission's Division of Trading and Markets and/or members of the Commission, and would then submit a filing to amend the rule itself, to establish that the affiliation or business venture could exist as an exception to the rule. Depending on the circumstances, such a filing might be submitted on an immediately effective basis.

There are also several important exceptions to the general filing requirement of the rule. First, the rule would not require a filing for transactions that result in an Exchange member acquiring or holding an interest in NASDAQ OMX that is consistent with Rule 985(a) (discussed above). Second, no filing would be required for the Exchange or an entity affiliated with the Exchange acquiring or maintaining an ownership interest in, or engaging in a business venture with, an affiliate of an Exchange member if there are information barriers between the member and the Exchange and its facilities, such that the member: (i) would not be provided an informational advantage concerning the operation of the Exchange and its facilities, and would not be provided changes or improvements to the trading system that are not available to the industry generally or other Exchange members; (ii) would not have knowledge in advance of other members of proposed changes, modifications, or improvements to the operations or trading systems of the Exchange and its facilities, including advance knowledge of Exchange filings pursuant to Section 19(b) of the Act;<sup>63</sup> (iii) would be notified of any proposed changes, modifications, or improvements to the operations or trading systems of the Exchange and its

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<sup>63</sup> 15 U.S.C. 78s(b).

facilities in the same manner as other Exchange members are notified; and (iv) would not share employees, office space, or databases with the Exchange or its facilities, NASDAQ OMX, or any entity that is controlled by NASDAQ OMX.<sup>64</sup> The Exchange's Board must certify, on an annual basis, to the Director of the Commission's Division of Trading and Markets that the Exchange has taken all reasonable steps to implement the foregoing requirements with respect to any affiliate to which they apply and is in compliance therewith.

This exception is aimed at circumstances in which the Exchange or an affiliated entity acquires, or enters into a business venture with, an affiliate of an Exchange member, and the Exchange erects information barriers between the member and the Exchange and its facilities. Thus, the Exchange ensures that the member does not receive any advantage as a result of its affiliation.

In connection with the adoption of this rule, the Exchange hereby requests Commission approval under the rule for the affiliation that would result by virtue of the merger between the Exchange and the two broker-dealer subsidiaries of the NASDAQ Exchange: Nasdaq Execution Services, LLC ("NES") and NASDAQ Options Services, LLC ("NOS"). The acquisition of the entities that are now NES and NOS by NASDAQ OMX was approved by the Commission in 2004 and 2005.<sup>65</sup> The rules under which NES currently routes orders to other market centers

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<sup>64</sup> Phlx would not construe these limitations to bar an employee of an affiliated member from serving on a Phlx standing committee, since: (i) such committee members would be required to sign confidentiality agreements with regard to information received through committee service; and (ii) the committee member employed by the affiliate would receive information provided through committee service at the same time as other committee members.

<sup>65</sup> See Securities Exchange Act Release Nos. 50311 (September 3, 2004), 69 FR 54818 (September 10, 2004) (Order Granting Application for a Temporary Conditional Exemption Pursuant To Section 36(a) of the Exchange Act by the National Association of Securities Dealers, Inc. Relating to the Acquisition of an ECN by The Nasdaq Stock

were approved by the Commission in 2006 and subsequently amended on several occasions.<sup>66</sup> Notably, NASDAQ Exchange Rule 4758(b) establishes the parameters for operation of NES as follows: (1) all routing of equities by the NASDAQ Exchange is performed by NES, which, in turn, routes orders to other market centers as directed by the NASDAQ Exchange; (2) NES would not engage in any business other than: (a) as a outbound router for the NASDAQ Exchange, and (b) any other activities it may engage in as approved by the Commission; (3) NES would operate as a facility, as defined in Section 3(a)(2) of the Act,<sup>67</sup> of the NASDAQ Exchange; (4) for purposes of Rule 17d-1 under the Act,<sup>68</sup> the designated examining authority of NES would be a self-regulatory organization unaffiliated with the NASDAQ Exchange or any of its affiliates; (5) the NASDAQ Exchange shall be responsible for filing with the Commission rule changes related to the operation of, and fees for services provided by, NES, and NES shall be subject to exchange non-discrimination requirements; (6) the books, records, premises, officers, agents, directors and employees of NES, as a facility of the NASDAQ Exchange, shall be deemed to be the books, records, premises, officers, agents, directors and employees of the NASDAQ Exchange for purposes of, and subject to oversight pursuant to, the Act, and the books

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Market, Inc.) and 52902 (December 7, 2005), 70 FR 73810 (December 13, 2005) (SR-NASD-2005-128) (Order Approving a Proposed Rule Change To Establish Rules Governing the Operation of the INET System).

<sup>66</sup> See Securities Exchange Act Release Nos. 56867 (November 29, 2007), 72 FR 69263 (December 7, 2007) (SR-NASDAQ-2007-065); 56708 (October 26, 2007), 72 FR 61925 (November 1, 2007) (SR-NASDAQ-2007-078); 55335 (February 23, 2007), 72 FR 9369 (March 1, 2007) (SR-NASDAQ-2007-005); 54613 (October 17, 2006), 71 FR 62325 (October 24, 2006) (SR-NASDAQ-2006-043); 54271 (August 3, 2006), 71 FR 45876 (August 10, 2006) (SR-NASDAQ-2006-027); and 54155 (July 14, 2006), 71 FR 41291 (July 20, 2006) (SR-NASDAQ-2006-001).

<sup>67</sup> 15 U.S.C. 78c(a)(2).

<sup>68</sup> 17 CFR 240.17d-1.

and records of NES, as a facility of the NASDAQ Exchange, shall be subject at all times to inspection and copying by the Commission; and (7) use of NES is optional.

Currently, routing by NES on behalf of the NASDAQ Exchange takes two forms: (i) orders that access any liquidity on the NASDAQ Exchange book that has a price equal to or superior to the prices available on other “automated market centers” and thereafter route to seek the best available price; and (ii) routing of “directed orders” to automated market centers other than the NASDAQ Exchange on an “immediate-or-cancel” basis. Such directed orders may be designated as “intermarket sweep orders,” which may be executed by the receiving venue based on the representation of the market participant that it has routed to all superior protected quotations, or not so designated, in which case the orders will execute only if their execution would not result in a trade-through.

NOS serves as the outbound router for the Nasdaq Options Market (“NOM”), which commenced operations on March 31, 2008. Under Rule Chapter VI, Section 11 for NOM,<sup>69</sup> (1) NOM will route orders in options via NOS, which serves as the sole “Routing Facility” of NOM; (2) the sole function of the Routing Facility will be to route orders in options listed and open for trading on NOM to away markets pursuant to NOM rules, solely on behalf of NOM; (3) NOS is a member of an unaffiliated SRO which is the designated examining authority for the broker-dealer; (4) the Routing Facility is subject to regulation as a facility of the NASDAQ Exchange, including the requirement to file proposed rule changes under Section 19 of the Act;<sup>70</sup> (5) NOM shall establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between the NASDAQ Exchange

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<sup>69</sup> See Securities Exchange Act Release No. 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR-NASDAQ-2007-004 and -080) (the “NOM Approval Order”).

and its facilities (including the Routing Facility), and any other entity; and (6) the books, records, premises, officers, directors, agents, and employees of the Routing Facility, as a facility of the NASDAQ Exchange, shall be deemed to be the books, records, premises, officers, directors, agents, and employees of the NASDAQ Exchange for purposes of and subject to oversight pursuant to the Act, and 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 NASDAQ Exchange and the Commission.

Unlike NES, NOS does not have a “directed order” for options that are trading on NOM; rather, all routable orders for options that are trading on NOM check the NOM book prior to routing. However, NOS also routes orders in options that are not trading on NOM. When routing orders in options that are not listed and open for trading on NOM, NOS will not be regulated as a facility of the NASDAQ Exchange but rather as a broker-dealer regulated by its designated examining authority. However, as provided by Chapter IV, Section 5 of the NOM rules, all orders routed by NOS under these circumstances will be routed to away markets that are at the best price, and solely on an immediate-or-cancel basis.

Although not explicitly stated in Chapter VI, Section 11 of the NOM Rules, NOS, like NES, will be subject to exchange non-discrimination requirements, and the use of NOS will be optional.<sup>71</sup> In addition, NOS will not engage in any business other than the activities approved by the Commission in the NOM Approval Order and such other activities as may be approved by the Commission at a later date.

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<sup>70</sup> 15 U.S.C. 78s.

<sup>71</sup> Consistent with this restriction, Chapter VI, Section 11 of the NOM rules provides that routing will be based on the user’s instructions and that a participant can designate an order as not available for routing.

In order to further restrict the interaction between the Exchange and NES and NOS, the NASDAQ Exchange has agreed that it will, prior to the closing of the NASDAQ OMX Merger, amend its rules to change the routing practices of NES and NOS. With respect to NES, directed orders will not be eligible for routing to Exchange facilities. With respect to NOS, when routing orders in options that are not listed and open for trading on NOM, NOS will not route to Exchange facilities. Routing of orders that check the NASDAQ Exchange and NOM books prior to routing will continue and such orders may be routed to the Exchange as appropriate.

The Exchange notes that at a later date, the Exchange may opt to use NES and/or NOS to route on behalf of the Exchange.<sup>72</sup> Such future uses of NES or NOS would be reflected in filings to establish the terms and conditions of such routing, but would not allow for routing of directed orders to the NASDAQ Exchange, NOM, or any other affiliated exchange or trading facility thereof.<sup>73</sup>

In light of the foregoing facts and circumstances, in accordance with proposed Exchange Rule 985(b)(i)(B), the Exchange proposes that NES and NOS be permitted to become affiliates of the Exchange subject to the following:

- With respect to NES, NES remains a facility of the NASDAQ Exchange; use of NES's routing function by NASDAQ Exchange members continues to be optional; and NES does not provide routing of directed orders to the Exchange or

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<sup>72</sup> Currently, the Exchange uses PRO Securities LLC ("PRO") to route equity orders. PRO is a wholly-owned subsidiary of Order Execution Services Holdings, Inc. The Exchange routes options orders through the Intermarket Option Linkage system.

any trading facilities thereof, unless such orders first attempt to access any liquidity on the NASDAQ Exchange book.

- With respect to NOS, NOS remains a facility of the NASDAQ Exchange; use of NOS's Routing Facility function by NASDAQ Exchange members continues to be optional; and NOS does not provide routing of orders in options that are not listed and open for trading on NOM to the Exchange or any trading facilities thereof.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>74</sup> in general, and furthers the objectives of Sections 6(b)(1) and 6(b)(5) of the Act<sup>75</sup> in particular, in that it is designed to enable the Exchange to be so organized as to have the capacity to be able to carry out the purposes of the Act and to comply with and enforce compliance by members and persons associated with members with provisions of the Act, the rules and regulations thereunder, and Rules, and is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national system, and, in general, to protect investors and the public interest.

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

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<sup>73</sup> In this regard, it should be noted that both the New York Stock Exchange and the NYSE Arca use NYSE Arca's broker-dealer subsidiary to perform routing.

<sup>74</sup> 15 U.S.C. 78f(b).

<sup>75</sup> 15 U.S.C. 78f(b)(1) and (b)(5).

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 either solicited or received.

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.

The Exchange has requested accelerated approval of this proposed rule change prior to the 30<sup>th</sup> day after the date of publication of the notice of the filing thereof in the Federal Register. The Commission is considering the Exchange's request to grant accelerated approval of the proposed rule change following the conclusion of the 21-day comment period.

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-2008-

31 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-2008-31. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information

that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2008-31 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>76</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>76</sup> 17 CFR 200.30-3(a)(12).