SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54298; File No. SR-Phlx-2006-41)

August 9, 2006

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Automatic Execution of a Customer Limit Order Against an Order Entry Firm' s Proprietary Order or a Solicited Broker-Dealer Order After a Three Second Exposure Period

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 July 28, 2006, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Phlx. The Phlx filed the proposed rule change as a "non-controversial" rule change pursuant to Section 19(b)(3)(A) of the Act[3] and Rule 19b-4(f)(6) thereunder,[4] which renders the proposal effective upon filing with the Commission. 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 amend Exchange Rule 1080, Philadelphia Stock Exchange Automated Options Market (AUTOM)[5] and Automatic Execution System (AUTO-X), by: (1)

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

2 17 CFR 240.19b-4.

3 15 U.S.C. 78s(b)(3)(A).

4 17 CFR 240.19b-4(f)(6).

5 AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM's automatic execution features, AUTO-X, Book Sweep and Book Match. Equity option and index option

rescinding Exchange Rule 1080(b)(ii)(A), which requires Order Entry Firms[6] to comply with certain order marking and exposure requirements when sending a proprietary order along with a customer limit order to the limit order book; (2) adopting Exchange Rule 1080(c)(ii)(C), which would permit a customer limit order to automatically execute against an Order Entry Firm' s proprietary order or quote, or solicited orders for the accounts of member and non-member broker-dealers, after a three second exposure period; and (3) deleting Exchange Rule 1080(b)(ii)(B) and re-inserting similar language into proposed Exchange Rule 1080(c)(ii)(C)(3) providing that it shall be a violation of Exchange Rule 1080(c)(ii)(C) for any Exchange member or member organization to be a party to any arrangement designed to circumvent Exchange Rule 1080(c)(ii)(C) by providing an opportunity for a customer, member, member organization, or non-member broker-dealer to execute immediately against agency orders delivered to the Exchange, whether such orders are delivered via AUTOM or represented in the trading crowd by a member or a member organization.

Exchange Rule 1080(b)(ii) prohibits Order Entry Firms from interacting on a principal basis with a customer limit order without first marking the customer limit order with a "K" indicator and the proprietary order with an "L" indicator. The customer limit order must also be exposed to the crowd for at least 30 seconds prior to the manual execution of both orders. The Exchange proposes to permit Order Entry Firms, after exposing the customer limit order for three seconds, to automatically execute such order against a proprietary order, or a solicited order for

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specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor. See Exchange Rule 1080.

6 An Order Entry Firm is a member organization of the Exchange that is able to route orders to AUTOM. See Exchange Rule 1080(c)(ii)(A)(1).

the account of a member or non-member broker-dealer under proposed Exchange Rule 1080(c)(ii)(C). The text of the proposed rule change is set forth below. [Brackets] indicate deletions; <u>underlining</u> indicates new text.

Rule 1080. Philadelphia Stock Exchange Automated Options Market (AUTOM) and Automatic Execution System (AUTO-X)

(a) No change.

(b) Eligible Orders

(i) No change.

(ii) The Exchange' s Options Committee may determine to accept additional types of orders as well as to discontinue accepting certain types of orders.

[(A) In accordance with this sub-paragraph (ii), the Options Committee has determined to allow a customer limit order to be delivered via AUTOM onto the limit order book by an Order Entry Firm (as defined in Rule 1080(c)(ii)). If the Order Entry Firm also sends in a proprietary contraside order for the account of such Order Entry Firm, an affiliated firm, or a solicited party (as defined in Rule 1064(c)(ii)), it must label the customer order with a "K" indicator and the proprietary order (which is an immediate-or-cancel order that is not eligible for automatic execution) with an "L" indicator. The customer limit order labeled "K" may be executed by the specialist or crowd at any time. The customer limit order labeled "K" must be exposed to the trading crowd for not less than 30 seconds before it can be executed, in whole or in part, against proprietary orders with a labeled "L" indicator.

(B) It shall be a violation of Rule 1080(b)(ii)(A) for any Exchange member or member organization to be a party to any arrangement designed to circumvent Rule 1080(b)(ii)(A) by providing an opportunity for a customer, member, member organization, or non-member broker-dealer to execute immediately against agency orders delivered to the Exchange, whether such orders are delivered via AUTOM or represented in the trading crowd by a member or a member organization.]

(iii) No change.

(c) No change.

(i) No change.

(ii) Order Entry Firms and Users

(A) – (B) No change.

<u>(C) Order Entry Firms shall comply with the following requirements when interacting with orders on the limit order book which they represent as agent.</u>

<u>(1) Principal Transactions: Order Entry Firms may not execute as principal against orders on the limit order book they represent as agent unless: (a) agency orders are first exposed on the limit order book for at least three (3) seconds, (b) the Order Entry Firm has been bidding or offering on the Exchange for at least three (3) seconds prior to receiving an agency order that is executable against such order, or (c) the Order Entry Firm proceeds in accordance with the crossing rules contained in Rule 1064.</u>

(2) Solicitation Orders. Order Entry Firms must expose orders they represent as agent for at least three (3) seconds before such orders may be automatically executed, in whole or in part, against orders solicited from members and non-member broker-dealers to transact with such orders.

(3) It shall be a violation of Rule 1080(c)(ii)(C) for any Exchange member or member organization to be a party to any arrangement designed to circumvent Rule 1080(c)(ii)(C) by providing an opportunity for a customer, member, member organization, or non-member broker-dealer to execute immediately against agency orders delivered to the Exchange, whether such orders are delivered via AUTOM or represented in the trading crowd by a member or a member organization.

(iii) – (vi) No change.

(d) – (l) No change.

Commentary: No change.

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

In its filing with the Commission, the 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 modernize certain Exchange Rules in response to the automated environment of Phlx XL by deleting certain outdated requirements applicable to Order Entry Firms including those related to order marking and order exposure of customer limit orders and proprietary contraside orders under Exchange Rule 1080(b)(ii), as well as the prohibition against automatic execution of the contraside proprietary order. The proposed rule change would allow Order Entry Firms to submit orders (for the accounts of the Order Entry Firm or a solicited member or non-member broker-dealer) along with customer limit orders they represent on an agency basis to the Exchange for automatic execution following the exposure of the customer limit order for a three second period.

The Exchange proposes to establish the requirement that a customer limit order entered onto the limit order book by an Order Entry Firm must be subject to a three-second exposure period before such customer limit order may automatically execute against an Order Entry Firm's proprietary order, or solicited orders for the accounts of member and non-member broker-dealers.[7] According to the Exchange, the proposed three-second exposure period is fully consistent with the electronic nature of the Exchange's electronic options trading platform, Phlx XL.[8] Phlx XL participants have implemented systems that monitor any updates to the Phlx

[7] In addition to the "K" and "L" marking requirement, Exchange Rule 1080(b)(ii)(A) currently requires a customer limit order delivered onto the limit order book by an Order Entry Firm to be exposed to the trading crowd for not less than 30 seconds before it may be executed, in whole or in part, against proprietary orders with a labeled "L" indicator. The instant proposed rule change would both eliminate the "K" and "L" marking requirement and reduce the exposure period for the customer limit order from 30 seconds to three seconds.

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

market, including any changes resulting from orders being entered into Phlx XL, and can automatically respond based on pre-set parameters. Thus, an exposure period of three seconds would permit exposure of orders on Phlx in a manner consistent with its electronic market.

By establishing the three-second exposure period, the Phlx believes that members would be able to provide liquidity to their customers' orders on a timelier basis, thus providing investors with more speedy executions. Timely and accurate executions are consistent with the principles under which Phlx XL was developed.

The existing "K" and "L" provisions were adopted before the rollout of Phlx XL.[9] The Exchange proposes to delete the "K" and "L" marking requirement because, as a practical matter, the Exchange is able to identify the Order Entry Firm submitting the customer limit order by way of a firm mnemonic that is submitted with such an order. The firm mnemonic is a code consisting of letters and/or numbers that identify the originating broker-dealer (i.e.,the Order Entry Firm) that submits the customer limit order. The Order Entry Firm must identify the order as that of a customer, broker-dealer, or its own proprietary order. The Exchange is also able to identify a contra-side order or quote to a customer order by way of the same information included with a contra-side limit order or electronic quotation submitted through Phlx XL. If the Order Entry Firm were to submit its contra-side proprietary order or quote, or a solicited contra-side order for the account of a member or non-member broker-dealer, prior to the expiration of the three-second exposure period, the transaction would be recorded in reports prepared by the

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9 The "K" and "L" order types were adopted in September 2003 in conjunction with the Exchange's rules relating to the automatic execution of booked customer limit orders. See Securities Exchange Act Release No. 48472 (September 10, 2003), 68 FR 54513 (September 17, 2003) (SR-Phlx-2002-86).

Exchange' s Market Surveillance Department and would result in an investigation and possible disciplinary action by the Exchange.

The Phlx XL platform generally protects against trade-throughs because it will not automatically execute a transaction if the execution price is not the NBBO.[10]

The Exchange believes that this proposed rule change would permit the Exchange to competitively respond to similar functionality offered on other exchanges.[11]

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act[12] in general, and furthers the objectives of Section 6(b)(5) of the Act[13] in particular, in that it is

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10 See Exchange Rule 1080(c)(iv)(A). Orders on Phlx XL are eligible for automatic execution when the Exchange' s disseminated market is crossed or crosses another exchange' s market by just one minimum trading increment (and where the Exchange' s disseminated market is the NBBO). Exchange Rule 1085 provides an exception from trade-through liability in the event that the trade-through occurred as a result of an automatic execution when the Exchange' s disseminated market is the NBBO and is crossed by not more than one minimum trading increment, or crosses the disseminated market of another options exchange by not more than one minimum trading increment. See Securities Exchange Act Release No. 53449 (March 8, 2006), 71 FR 13441 (March 15, 2006) (SR-Phlx-2005-45).

11 See Securities Exchange Act Release Nos. 53567 (March 29, 2006), 71 FR 17529 (April 6, 2006) (SR-CBOE-2006-09) (order approving proposed rule change to decrease the exposure period for crossing orders from 10 seconds to three seconds); 53850 (May 23, 2006), 71 FR 30703 (May 30, 2006) (SR-ISE-2006-21) (notice of filing and immediate effectiveness of a proposed rule change to decrease the exposure period for crossing orders from 30 seconds to three seconds); 53854 (May 24, 2006), 71 FR 30975 (May 31, 2006) (SR-BSE-2006-23) (notice of filing and immediate effectiveness of a proposed rule change to decrease the exposure period for crossing orders from 30 seconds to three seconds); and 53609 (April 6, 2006), 71 FR 19224 (April 13, 2006) (SR-NYSEArca-2006-01) (order approving the proposed rule change to shorten the time that a broker must wait prior to executing as principal orders he or she represents as agent from 30 seconds to three seconds).

12 15 U.S.C. 78f(b).

13 15 U.S.C. 78f(b)(5).

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 promoting competition among the markets participants and between exchanges.

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 either solicited or received.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act[14] and Rule 19b-4(f)(6) thereunder.[15]

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

A proposed rule change filed under Rule 19b-4(f)(6) normally may not become operative

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[14] 15 U.S.C. 78s(b)(3)(A).

[15] 17 CFR 240.19b-4(f)(6).

prior to 30 days after the date of filing.[16] However, Rule 19b-4(f)(6)(iii)[17] permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Phlx provided the Commission with written notice of its intent to file this proposed rule change at least five business days prior to the date of filing of the proposed rule change. In addition, the Phlx has requested that the Commission waive the 30-day operative delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because the proposed rule change would allow the Exchange to implement immediately a rule proposal that corresponds to rules currently in place at other exchanges.[18] For this reason, the Commission designates the proposal to be effective and operative upon filing with the Commission.[19]

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-2006-41 on the subject line.

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[16] 17 CFR 240.19b-4(f)(6)(iii).

[17] Id.

[18] See note 11, supra.

[19] For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule' s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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-2006-41. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’ s Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission’ s Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the 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-2006-41 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.[20]

Nancy M. Morris
Secretary

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20 17 CFR 200.30-3(a)(12).