

a national securities exchange.<sup>6</sup> In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>7</sup> which requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission believes that this proposed rule change will better capture the floor-based activities of Former Floor Participants by focusing on the status of, or type of, activity performed by those persons. In addition, it should provide a clearer standard that should allow Exchange staff, as well as members and individuals, to better determine who is subject to the Series 7 requirement. This should make the administration, as well as compliance and enforcement, of the Series 7 requirement more efficient.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (SR-Phlx-2008-12), as modified by Amendment No. 1, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>9</sup>

**Florence E. Harmon,**

*Acting Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-58179; File No. SR-Phlx-2008-31]

### Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval to a Proposed Rule Change, as Modified by Amendments No. 1 and 2 Thereto, Relating to Changes to Phlx's Governing Documents in Connection With the Acquisition of Phlx by The NASDAQ OMX Group, Inc.

July 17, 2008.

#### I. Introduction

On April 21, 2008, the Philadelphia Stock Exchange, Inc. ("Phlx" or

"Exchange") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change in connection with the acquisition of the Exchange by The Nasdaq Stock Market, Inc., now known as The NASDAQ OMX Group, Inc. ("NASDAQ OMX"). On April 29, 2008, the proposed rule change was published for comment in the **Federal Register**.<sup>3</sup> The Exchange filed Amendment Nos. 1 and 2 to the proposed rule change on May 30, 2008 and July 2, 2008, respectively.<sup>4</sup> The Commission received no comments on the proposed rule change.

This order provides notice of filing of Amendment No. 2 to the proposed rule change, and grants accelerated approval to the proposed rule change, as modified by Amendments Nos. 1 and 2.

#### II. Background

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 common stock of the Exchange.<sup>5</sup> Phlx shareholders would receive cash consideration for their common stock and would not retain any ownership interest in the Exchange.

The proposed acquisition would be effected through the merger of Pinnacle Merger Corporation, Inc. ("Merger

Subsidiary"), a Delaware corporation and wholly-owned subsidiary of NASDAQ OMX, with and into the Exchange, with the Exchange surviving the merger (the "Merger").<sup>6</sup> The members of the board of directors of Merger Subsidiary would be selected by NASDAQ OMX from among the current Governors of the Exchange and would become the Board of Governors of Phlx ("Board") immediately after the effective time of the Merger.<sup>7</sup> The Exchange represents that the directors of Merger Subsidiary, and therefore the new Board, would satisfy the compositional requirements of the new Board, discussed below.<sup>8</sup>

After the Merger, the Exchange would be a wholly-owned subsidiary of NASDAQ OMX.<sup>9</sup> NASDAQ OMX would operate the Exchange as a separate self-regulatory organization ("SRO"). Accordingly, Phlx would maintain its current registration as a national securities exchange, and maintain separate rules, membership rosters, and listings that would be distinct from the rules, membership rosters, and listings of NASDAQ OMX's other national securities exchanges. Additionally, after the Merger, the Exchange would continue to operate the Stock Clearing Corporation of Philadelphia ("SCCP"),<sup>10</sup> its wholly-owned clearing agency, and The Philadelphia Board of Trade ("PBOT"), its wholly-owned futures exchange subsidiary. Separately, NASDAQ OMX also entered into an agreement with the Boston Stock Exchange, Inc. ("BSE"), pursuant to which NASDAQ OMX would acquire all of the outstanding membership interests in BSE ("BSE Acquisition").<sup>11</sup> Following the closing of the BSE Acquisition and the Merger, NASDAQ OMX will be the sole owner of five SROs: NASDAQ Exchange, BSE, the

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

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

<sup>3</sup> See Securities Exchange Act Release No. 57703 (April 23, 2008), 73 FR 23293 ("Notice").

<sup>4</sup> In Amendment No. 1, Phlx represented that, on May 6, 2008, the Exchange obtained shareholder approval of the proposed rule change, as required by Delaware General Corporation Law, and that no further action by the Exchange in connection with the proposed rule change is required. See also General Instruction E to Form 19b-4 (concerning completion of action by a self-regulatory organization on a proposed rule change). Phlx also clarified that routing by NASDAQ Execution Services, LLC ("NES") to Phlx, on behalf of The NASDAQ Stock Market LLC ("NASDAQ Exchange"), takes two forms. Amendment No. 1 is technical in nature, and therefore is not subject to notice and comment.

In Amendment No. 2, Phlx filed the complete Certificate of Incorporation and amended By-Laws of NASDAQ OMX in order to propose their adoption as rules of Phlx. The By-Laws contained minor amendments to terminology to apply to Phlx all of the same provisions that are currently specifically applicable to the NASDAQ Exchange. The amended By-Laws were published for comment in a separate NASDAQ Exchange filing. See Securities Exchange Act Release No. 57761 (May 1, 2008), 73 FR 26182 (May 8, 2008) (notice of SR-NASDAQ-2008-035) ("Nasdaq Stock Market Proposal").

<sup>5</sup> The Exchange demutualized in 2004, though it is not publicly traded. See Securities Exchange Act Release No. 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (SR-PHLX-2003-73) (approval order).

<sup>6</sup> See proposed Section 1-1(ii) of the By-Laws (defining "NASDAQ OMX Merger").

<sup>7</sup> See proposed Section 4-3(b) of the By-Laws and Notice, *supra* note 3, 73 FR at 23295.

<sup>8</sup> See *infra* notes 61-69 and accompanying text (discussing proposed compositional requirements of the Board).

<sup>9</sup> The Exchange would have a single class of common stock, all of which would be held by NASDAQ OMX.

<sup>10</sup> See Securities Exchange Act Release No. 58180 (July 17, 2008) (SR-SCCP-2008-01) (approving changes to SCCP's articles of incorporation, including language clarifying that all of the authorized shares of SCCP common stock are issued and outstanding and are held by Phlx).

<sup>11</sup> See Securities Exchange Act Release No. 57757 (May 1, 2008), 73 FR 26159 (SR-BSE-2008-23) (notice of proposed rule change related to BSE Acquisition); Securities Exchange Act Release No. 57782 (May 6, 2008), 73 FR 27583 (May 13, 2008) (SR-BSECC-2008-01) (notice of proposal to amend the articles of organization and by-laws of the BSECC to reflect its proposed acquisition by NASDAQ OMX).

<sup>6</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> 15 U.S.C. 78s(b)(2).

<sup>9</sup> 17 CFR 200.30-3(a)(12).

Boston Stock Exchange Clearing Corporation ("BSECC"), Phlx, and SCCP (collectively, "SRO Subsidiaries").

In the present filing, the Exchange has proposed to amend its certificate of incorporation ("Certificate"), by-laws ("By-Laws"), and certain rules ("Rules") to reflect NASDAQ OMX's proposed ownership of the Exchange. In general, the proposed changes are designed to address the Exchange's proposed new ownership structure and conform Phlx's governance provisions to those that are currently applicable to the NASDAQ Exchange. The Exchange is also using this opportunity to make several other changes to its governing documents to update certain language and make other minor changes that are not directly related to the proposed Merger.<sup>12</sup>

In addition, NASDAQ OMX has amended its By-Laws to make applicable to all of NASDAQ OMX's SRO subsidiaries, including Phlx and SCCP (after the Merger), certain provisions of NASDAQ OMX's Restated Certificate of Incorporation and NASDAQ OMX's By-Laws. These provisions of NASDAQ OMX's governing documents are designed to maintain the independence of each SRO subsidiary's self-regulatory function, enable each SRO subsidiary to operate in a manner that complies with the federal securities laws, and facilitate the ability of each SRO subsidiary and the Commission to fulfill their regulatory and oversight obligations under the Act.<sup>13</sup>

### III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>14</sup> In particular, the Commission finds that the proposed rule change is consistent with: (1) Section 6(b)(1) of the Act,<sup>15</sup> which requires a national securities exchange to be so organized and have the capacity to carry out the purposes of the Act and to enforce compliance by its members and persons associated with its

members with the provisions of the Act; (2) Section 6(b)(3) of the Act,<sup>16</sup> which requires that the rules of a national securities exchange assure the fair representation of its members in 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 the exchange, broker, or dealer (the "fair representation requirement"); and (3) Section 6(b)(5) of the Act,<sup>17</sup> in that it is designed, among other things, to prevent fraudulent and manipulative acts and practices; 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.

As noted above, the Merger would result in NASDAQ OMX owning two additional SROs (Phlx and SCCP). The Commission believes that the ownership of Phlx and SCCP by the same public holding company that owns the NASDAQ Exchange would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.<sup>18</sup> Further, the Commission does not believe that the ownership by one holding company of two exchanges and one clearing agency presents any adverse competitive implications in the current marketplace. The Commission notes that it has previously approved proposals in which a holding company owns multiple SROs.<sup>19</sup> The Commission continues to monitor such entities and notes that its experience to date with the issues raised by this ownership structure has not presented any concerns that have not been addressed, for example by the protections afforded at the holding company level.

In particular, as discussed below, though NASDAQ OMX is not itself an SRO, its activities with respect to the operation of Phlx and SCCP must be consistent with, and must not interfere with, the self-regulatory obligations of Phlx and SCCP.<sup>20</sup> Further, certain provisions of NASDAQ OMX's Certificate of Incorporation and By-Laws are rules of an exchange if they are stated policies, practice, or

interpretations, as defined in Rule 19b-4 under the Act, of the exchange, and must be filed with the Commission pursuant to Section 19(b) of the Act and Rule 19b-4 thereunder.<sup>21</sup> Accordingly, Phlx has filed with the Commission the Certificate and amended By-Laws of NASDAQ OMX. Notably, NASDAQ OMX's amended By-Laws would make applicable to all of NASDAQ OMX's SRO subsidiaries, including Phlx and SCCP (after the Merger), certain provisions of NASDAQ OMX's Restated Certificate of Incorporation and NASDAQ OMX's By-Laws that are designed to maintain the independence of each of its SRO subsidiaries' self-regulatory function. These provisions facilitate the ability of each SRO subsidiary and the Commission to fulfill their regulatory and oversight obligations under the Act.

Furthermore, the Commission believes that there is robust competition among market centers, as exchanges face increasing competition from non-exchange entities that trade the same or similar financial instruments, such as alternative trading systems.<sup>22</sup> In addition, despite consolidation among exchanges, other entities have recently applied for exchange registration, which evidences the continued ability of entities to enter the marketplace and further increase competition among SROs.<sup>23</sup> Accordingly, as described above, the Commission does not believe that ownership by a single holding company of multiple SROs presents any burden on competition in violation of the Act.<sup>24</sup> Nevertheless, the Commission

<sup>21</sup> 15 U.S.C. 78s(b) and 17 CFR 240.19b-4, respectively.

<sup>22</sup> See, e.g., Securities Exchange Act Release No. 58092 (July 3, 2008), 73 FR 40144, 40144 (July 11, 2008) (where the Commission recognized that "[n]ational securities exchanges registered under Section 6(a) of the Exchange Act face increased competitive pressures from entities that trade the same or similar financial instruments \* \* \*").

<sup>23</sup> See, e.g., Securities Exchange Act Release No. 57322 (February 13, 2008), 73 FR 9370 (February 20, 2008) (File No. 10-182) (notice of filing of application and Amendment No. 1 thereto by BATS Exchange, Inc. for registration as a national securities exchange).

<sup>24</sup> The Commission notes that NASDAQ OMX also entered into an agreement with the BSE, pursuant to which NASDAQ OMX would acquire all of the outstanding membership interests in BSE. See Securities Exchange Act Release Nos. 57757 (May 1, 2008), 73 FR 26159 (May 8, 2008) (SR-BSE-2008-23) (notice of proposed rule change related to BSE Acquisition); and 57782 (May 6, 2008), 73 FR 27583 (May 13, 2008) (SR-BSECC-2008-01) (notice of proposal to amend the articles of organization and by-laws of the BSECC to reflect its proposed acquisition by NASDAQ OMX). If the Commission also were to approve the BSE Acquisition, NASDAQ OMX would be the sole owner of five SROs: NASDAQ Exchange, Phlx, SCCP, BSE, and the BSECC. The Commission will consider the

<sup>12</sup> For example, as discussed in Section III.E.6, *infra*, 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 e-mail and posting on the Exchange's Web site. See Section 12-5(d) of the By-Laws.

<sup>13</sup> See Amendment No. 2, *supra* note 4 (including the amended By-Laws of NASDAQ OMX to the Phlx's proposal).

<sup>14</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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

<sup>16</sup> 15 U.S.C. 78f(b)(3).

<sup>17</sup> 15 U.S.C. 78f(b)(5).

<sup>18</sup> 15 U.S.C. 78f(b)(8) and 15 U.S.C. 78q-1(b)(3)(I).

<sup>19</sup> See, e.g., Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) (approving the combination of the New York Stock Exchange, Inc. and Archipelago Holdings, Inc.).

<sup>20</sup> See *infra* Section III.C.1 (discussing the relationship between NASDAQ OMX and Phlx).

will continue to monitor SROs, including those that are under common ownership, for compliance with the Act and the rules and regulations thereunder, as well as the SROs' own rules.

#### A. Capital Stock

The proposed Merger would result in NASDAQ OMX owning all of the issued, authorized, and outstanding common stock of the Exchange.<sup>25</sup> Accordingly, the Exchange proposes to amend the Certificate to reduce the amount of common and preferred stock, and to explicitly state that NASDAQ OMX will hold all of the common stock of the Exchange. Specifically, the Exchange proposes to: (1) Reduce the amount of common stock that the Exchange has authority to issue from one million to 100 shares;<sup>26</sup> (2) state that all authorized shares of common stock shall be issued, outstanding, and held by NASDAQ OMX;<sup>27</sup> (3) eliminate the designation of Class A and Class B common stock;<sup>28</sup> (4) reduce the amount of preferred stock that the Exchange has authority to issue from 100,000 to 100 shares;<sup>29</sup> and (5) state that only one share of preferred stock, the single share of Series A Preferred Stock,<sup>30</sup> is

implications of those proposed acquisitions when it reviews that proposal.

<sup>25</sup> See proposed Article FOURTH(c)(iv) of the Certificate and proposed Section 29-4(c) of the By-Laws.

<sup>26</sup> See proposed Article FOURTH of the Certificate.

<sup>27</sup> See proposed Article FOURTH(c)(iv) of the Certificate.

<sup>28</sup> See, e.g., proposed Article FOURTH of the Certificate and proposed Section 1-1(d) of the By-Laws. For example, Article FOURTH(b)(ii) sets forth the different dividend priority of holders of Class A common stock and Class B common stock in the event of a Liquidity Event (as defined in that subparagraph). This provision would be obsolete once only one class of common stock is authorized and outstanding. Correspondingly, the Exchange proposes to eliminate that language. Similarly, the Exchange proposes to eliminate Article FOURTH(c)(vi) of the Certificate, which governs the automatic conversion of Class A common stock, and language in Article FOURTH(c)(iii) of the Certificate that distinguishes between the voting rights of holders of Class A and Class B common stock.

On January 20, 2007, all Class A common stock converted to Class B common stock shares. See Phlx Annual Report 2006 at 42. Upon conversion to Class B, the eligibility of holders of Class A shares for a contingent dividend terminated. See *id.* The former holders of the Class A shares otherwise continued to have the same rights and privileges, including voting, as the Class B holders. See *id.*

<sup>29</sup> See proposed Article FOURTH of the Certificate.

<sup>30</sup> The share of Series A Preferred Stock, which is currently issued and outstanding, is held by the Trust pursuant to the Trust Agreement. See Section 1-1(mm) of the By-Laws (defining "Trust") and Section 1-1(ee) of the By-Laws (defining "Trust Agreement"). The Trustee of the Trust is required, under Section 4.1 of the Trust Agreement, to vote the share as directed by the vote of the Member Organization Representatives of Member

outstanding.<sup>31</sup> In addition, the Exchange proposes to delete or amend several provisions applicable to the Exchange's common stock that would become obsolete after the Merger because NASDAQ OMX would control 100% of the common stock.<sup>32</sup> These changes are necessary to reflect the change in ownership of the Exchange after the Merger, and the Commission finds them to be consistent with the Act.

#### B. Ownership Concentration Limitations and Voting Limits

Phlx proposes to amend the Certificate to replace the current ownership concentration limitations and voting limitations with new restrictions that would recognize that, following the Merger, NASDAQ OMX would own all of the common stock of the Exchange. As discussed below, the Exchange proposes to delete language in Article FOURTH of the Certificate, which limits the amount of common stock of the Exchange that any person may own or vote, directly or indirectly, without prior Commission approval. In place of this restriction, Phlx proposes to amend its Certificate and By-Laws to prohibit Phlx from transferring or assigning its common stock without prior Commission approval and from issuing, transferring, or assigning its preferred stock without prior Commission approval.<sup>33</sup>

The current Certificate imposes limits on direct and indirect changes in control of Phlx through voting and

Organizations entitled to vote. This voting arrangement is designed to give Members a voice in the management of the Exchange and is necessary because, under Delaware law, only stockholders can elect the directors of a Delaware corporation. See Securities Exchange Act Release No. 49098, *supra* note 5, 69 FR at 3979. The Merger would not result in a transfer of ownership of the Series A Preferred Stock.

<sup>31</sup> See proposed Article FOURTH(b)(iv) of the Certificate.

<sup>32</sup> For example, Phlx proposes to amend the dividend rights of common stock (see proposed Article FOURTH(c)(ii) of the Certificate) and eliminate provisions governing common stock incentive compensation. See *infra* note 146 and accompanying text (discussing the proposal to eliminate incentive compensation).

<sup>33</sup> See proposed Article FOURTH(c)(iv) of the Certificate (restriction on transferring or assigning common stock). This subparagraph also provides that all authorized shares of common stock of the Exchange (100 shares) be issued and outstanding and reflects that all of the common stock would be held by NASDAQ OMX. The Commission notes that any proposed issuance of common stock would constitute an amendment to that provision, which would be subject to the filing of a proposed rule change with the Commission. See also proposed Section 29-4(c) of the By-Laws. See proposed Article FOURTH(a) and (b)(v) of the Certificate and proposed Section 29-4(d) of the By-Laws (restriction on issuing, transferring, or assigning preferred stock). See also *infra* note 43 (restrictions on the issuance of preferred stock).

ownership limits applicable to holders of its common stock. These provisions enable the Commission, as well as the Exchange, to monitor potential changes in control of the Exchange, and thereby assist both the Commission and the Exchange in carrying out their regulatory responsibilities under the Act.<sup>34</sup> In particular, the Certificate currently provides that, unless approved by the Board and by the Commission under Section 19(b) of the Act, no Person (either alone or together with its Related Persons) may own (of record or beneficially), whether directly or indirectly, more than 40% of the then-outstanding shares of Phlx common stock. To the extent that such Person (or its Related Persons) purports to own more than 40% of the then outstanding shares of common stock of the Exchange, the Person (and its Related Persons) is not entitled to exercise any rights and privileges incident to ownership of shares in excess of the 40% limit.<sup>35</sup> The Certificate also provides that no Member (either alone or together with its Related Persons) may own, of record or beneficially, whether directly or indirectly, more than 20% of the then outstanding shares of common stock of the Exchange.<sup>36</sup> Moreover, unless approved by the Board and by the Commission under Section 19(b) of the Act, no Person, either alone or together with its Related Persons, has any right to vote, or to give any consent or proxy with respect to, more than 20% of the then outstanding shares of common stock of the Exchange.<sup>37</sup>

Currently, the Board would need to approve an amendment to the By-Laws to permit any Person, together with its Related Persons, to exercise voting rights with respect to the shares in excess of the 20% voting limit or to own more than 40% of the outstanding shares of common stock.<sup>38</sup> Such amendment would need to be filed with the Commission pursuant to Section 19(b) of the Act,<sup>39</sup> which allows the Commission an opportunity to determine, among other things, whether any additional measures may be necessary to provide sufficient regulatory jurisdiction over the proposed controlling persons.<sup>40</sup>

<sup>34</sup> See Securities Exchange Act Release No. 49098, *supra* note 5, 69 FR at 3985.

<sup>35</sup> See Article FOURTH(b)(v)(A) of the Certificate.

<sup>36</sup> See Article FOURTH(b)(v)(B) of the Certificate.

<sup>37</sup> See Article FOURTH(b)(iii)(B) of the Certificate.

<sup>38</sup> The Board cannot approve such amendment with respect to Members.

<sup>39</sup> See Article FOURTH(b)(iii)(B)(1) and FOURTH(b)(v)(A)(1) of the Certificate.

<sup>40</sup> See Securities Exchange Act Release No. 49098, *supra* note 5, 69 FR at 3985. The Commission notes

As proposed, NASDAQ OMX would acquire all of the common stock of the Exchange. To reflect such ownership by one entity, the Exchange proposes to eliminate the 40% ownership and 20% voting limits. Phlx also proposes to eliminate the prohibition on any Member, either alone or together with its Related Persons, from owning (of record or beneficially) more than 20% of its outstanding common stock of the Exchange.<sup>41</sup>

In place of these restrictions, Phlx proposes to adopt new restrictions on the transfer or assignment of common stock. Specifically, proposed Article FOURTH(c)(iv) of the Certificate would be revised to state that: (1) All 100 authorized shares of common stock of the Exchange shall be issued and outstanding, and shall be held by NASDAQ OMX; and (2) NASDAQ OMX may not transfer or assign any shares of Phlx common stock to any entity, unless such transaction is approved by the Commission.<sup>42</sup> The Exchange also proposes to adopt a restriction on the issuance of preferred stock, as well as similar restrictions on the transfer or assignment of preferred stock.<sup>43</sup>

In addition, the NASDAQ OMX Certificate of Incorporation imposes limits on direct and indirect changes in control, which are designed to prevent any shareholder from exercising undue control over the operation of its SRO subsidiaries and to ensure that its SRO subsidiaries and the Commission are able to carry out their regulatory obligations under the Act. Specifically, no person who beneficially owns shares of common stock, preferred stock, or notes of NASDAQ OMX in excess of 5% of the securities generally entitled to vote may vote the shares in excess of

5%.<sup>44</sup> This limitation would mitigate the potential for any NASDAQ OMX shareholder to exercise undue control over the operations of Phlx, and it facilitates Phlx's and the Commission's ability to carry out their regulatory obligations under the Act.

The NASDAQ OMX Board may approve exemptions from the 5% voting limitation for any person that is not a broker-dealer, an affiliate of a broker-dealer, or a person subject to a statutory disqualification under Section 3(a)(39) of the Act,<sup>45</sup> provided that the NASDAQ OMX Board also determines that granting such exemption would be consistent with the self-regulatory obligations of its SRO subsidiary.<sup>46</sup> Further, any such exemption from the 5% voting limitation would not be effective until approved by the Commission pursuant to Section 19 of the Act.<sup>47</sup> Phlx's proposed rule change reflects an amendment to the NASDAQ OMX By-Laws to require the NASDAQ OMX Board, prior to approving any exemption from the 5% voting limitation, to determine that granting such exemption would also be consistent with Phlx's self-regulatory obligations.<sup>48</sup>

The Commission approved the existing limits in Phlx's Certificate to enable the Exchange to carry out its self-regulatory responsibilities, and to enable the Commission to fulfill its responsibilities under the Act.<sup>49</sup> After the Merger, these goals would be achieved by the proposed new restrictions on the transfer or assignment of Phlx capital stock and on the issuance of preferred stock, together with the ownership and voting restrictions on NASDAQ OMX shareholders. In particular, the simplified provisions of Phlx's Certificate and By-Laws are tailored to an exchange whose common stock is

wholly-owned by one company. By explicitly stating that NASDAQ OMX would be the owner of 100% of the Exchange's issued and outstanding common stock, and that no preferred stock has been issued other than the Series A Preferred Stock held by the Trust, any purported issuance, transfer, or assignment of any capital stock would constitute an amendment to the Certificate and By-Laws and therefore be subject to a filing with the Commission under Section 19 of the Act. Moreover, the NASDAQ OMX Certificate currently includes restrictions on any person voting shares in excess of 5%. The changes to the NASDAQ OMX By-Laws would require the NASDAQ OMX Board, prior to approving an exemption from the 5% voting limitation, to determine that granting such exemption would be consistent with Phlx's self-regulatory obligations.

Accordingly, the Commission finds that the elimination of the current ownership and voting limits and the adoption of new controls on the issuance, transfer, and assignment of Phlx capital stock, together with the ownership and voting limitations in NASDAQ OMX's Certificate and By-Laws, are designed to prevent any shareholder from exercising undue control over the operation of Phlx and to ensure that Phlx and the Commission are able to carry out their regulatory obligations under the Act and thereby should minimize the potential that a person could improperly interfere with or restrict the ability of the Commission or Phlx to effectively carry out their respective regulatory oversight responsibilities under the Act.

### C. Management of the Exchange

#### 1. Relationship between NASDAQ OMX and Phlx

After the merger, Phlx would become a subsidiary of NASDAQ OMX. Although NASDAQ OMX is not an SRO and, therefore, will not itself carry out regulatory functions, its activities with respect to the operation of Phlx must be consistent with, and not interfere with, Phlx's self-regulatory obligations. Proposed changes to NASDAQ OMX's By-Laws would make applicable to all of NASDAQ OMX's SRO subsidiaries, including Phlx (after the Merger), certain provisions of NASDAQ OMX's Restated Certificate of Incorporation and NASDAQ OMX's By-Laws that are designed to maintain the independence of each of its SRO subsidiaries' self-regulatory function, enable each SRO subsidiary to operate in a manner that complies with the federal securities laws, and facilitate the ability of each

that this proposed rule change satisfies the requirements in existing Article FOURTH(b)(v)(A) and (b)(iii)(B) of the Certificate and that the Commission's approval will allow NASDAQ OMX to exceed the existing ownership and voting limits in existing Article FOURTH. The proposed rule change will become operative upon consummation of the Merger.

<sup>41</sup> See Article FOURTH(c)(v)(B) of the Certificate.  
<sup>42</sup> See also proposed Section 29-4(c) of the By-Laws.

<sup>43</sup> See proposed Section 29-4(d) of the By-Laws. The Exchange would have authority to issue 100 shares of preferred stock, of which one share would be designated Series A Preferred. See proposed Article FOURTH of the Certificate. Phlx has not issued, and does not currently intend to issue, any preferred stock other than the Series A Preferred Stock. See Notice, *supra* note 3, 73 FR at 23293. The restrictions on transfer or assignment would also apply to the Series A Preferred Stock. See proposed Article FOURTH(a) of the Certificate; see also proposed Article FOURTH(b)(v) of the Certificate. The proposed Merger would not impact the ownership of the one outstanding share of Series A Preferred Stock, which will continue to be held by the Trust pursuant to the Trust Agreement.

<sup>44</sup> See Article Fourth.C, NASDAQ OMX Certificate.

<sup>45</sup> 15 U.S.C. 78c(a)(39). See Article Fourth.C.6, NASDAQ OMX Certificate.

<sup>46</sup> Specifically, the NASDAQ OMX Board must determine that granting such exemption would (1) not reasonably be expected to diminish the quality of, or public confidence in, NASDAQ OMX or the other operations of NASDAQ OMX, on the ability to prevent fraudulent and manipulative acts and practices and on investors and the public, and (2) promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to an facilitating transactions in securities or assist in the removal of impediments to or perfection of the mechanisms for a free and open market and a national market system. See Article Fourth.C.6, NASDAQ OMX Certificate.

<sup>47</sup> See Section 12.5, NASDAQ OMX By-Laws.

<sup>48</sup> See proposed Section 12.5, NASDAQ OMX By-Laws.

<sup>49</sup> See *supra* note 34 and accompanying text.

SRO subsidiary and the Commission to fulfill their regulatory and oversight obligations under the Act.<sup>50</sup>

Although NASDAQ OMX will not itself carry out regulatory functions, its activities with respect to the operation of its SRO subsidiaries, including Phlx and SCCP, must be consistent with, and not interfere with, those subsidiaries' self-regulatory obligations. The By-Laws of NASDAQ OMX include certain provisions to address this concern. In particular, the By-Laws of NASDAQ OMX specify that NASDAQ OMX and its officers, directors, employees, and agents irrevocably submit to the jurisdiction of the United States federal courts, the Commission, and each self-regulatory subsidiary of NASDAQ OMX for the purposes of any suit, action or proceeding pursuant to the United States federal securities laws, and the rules and regulations thereunder, arising out of, or relating to, the activities of any self-regulatory subsidiary.<sup>51</sup> Further, NASDAQ OMX agreed to provide the Commission with access to its books and records.<sup>52</sup> NASDAQ OMX also agreed to keep confidential non-public information relating to the self-regulatory function<sup>53</sup> of the Exchange and not to use such information for any non-regulatory purpose. In addition, the NASDAQ OMX Board, as well as its officers, employees, and agents are required to give due regard to the preservation of the independence of Phlx's self-regulatory function.<sup>54</sup> Similarly, the NASDAQ OMX Board, when evaluating any issue, would be required to take into account the potential impact on the integrity, continuity, and stability of the its SRO

subsidiaries.<sup>55</sup> Finally, the NASDAQ OMX By-Laws require that any changes to the NASDAQ OMX Certificate and By-Laws be submitted to the Board of Directors of each of its SRO subsidiaries, including the Exchange, and, if such amendment is required to be filed with the Commission pursuant to Section 19(b) of the Act, such change shall not be effective until filed with, or filed with and approved by, the Commission.

The Commission believes that the NASDAQ OMX By-Laws, as amended to accommodate the Merger, are designed to facilitate the Phlx's ability to fulfill its self-regulatory obligations and are, therefore, consistent with the Act. In particular, the Commission believes these changes are consistent with Section 6(b)(1) of the Act,<sup>56</sup> which requires, among other things, that a national securities exchange be so organized and have the capacity to carry out the purposes of the Act, and to comply and enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange.

The Commission also believes that under Section 20(a) of the Act<sup>57</sup> any person with a controlling interest in NASDAQ OMX would be jointly and severally liable with and to the same extent that NASDAQ OMX is liable under any provision of the Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Act<sup>58</sup> creates aiding and abetting liability for any person who knowingly provides substantial assistance to another person in violation of any provision of the Act or rule thereunder. Further, Section 21C of the Act<sup>59</sup> authorizes the Commission to enter a cease-and-desist order against any person who has been "a cause of" a violation of any provision of the Act through an act or omission that the person knew or should have known would contribute to the violation.

## 2. Composition and Term of Board

The Exchange proposes to give its Board discretion to determine its size from time to time,<sup>60</sup> and after the Merger the Board would likely be reduced in

size from its current slate of 23 Governors. Specifically, the Board would include one Governor who is the CEO, one Governor who is the Vice-Chair of the Board,<sup>61</sup> one PBOT Governor,<sup>62</sup> one Member Governor,<sup>63</sup> one Stockholder Governor,<sup>64</sup> and a number of Independent Governors determined by the Board,<sup>65</sup> including the Designated Independent Governors. "Designated Independent Governors" would continue to be defined as those Independent Governors who are voted for by Members, and who are then elected to the Board by the Holder of the Series A Preferred Stock according to the vote of the Members.<sup>66</sup>

Though it may be reduced in size, the Board would be composed, as it currently is, of a majority of Independent Governors, who, by definition, would have no Material Relationship with the Exchange, any affiliate of the Exchange, any Member of the Exchange, any Member affiliate, or any issuer of securities that are listed or

<sup>61</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 Section 5-3 of the By-Laws. The term "Member Organization" is defined in Section 1-1(v) of the By-Laws.

<sup>62</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 Section 1-1(aa) of the By-Laws.

<sup>63</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 Section 1-1(u) of the By-Laws. Phlx proposes to amend its Certificate and By-Laws to reflect its proposal that the new Board consist of only one Member Governor. See proposed Article SIXTH(a)(ii) of the Certificate and proposed Sections 1-1(e), 1-1(u) and 4-1 of the By-Laws.

<sup>64</sup> See proposed Section 4-1 of the By-Laws and proposed Article SIXTH(a)(iii) of the Certificate. A Stockholder Governor would be 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 proposed Section 1-1(hh) of the By-Laws; see also proposed Article SIXTH(a)(ix) of the Certificate.

<sup>65</sup> As discussed below, Independent Governors would continue to constitute a majority of the Board, and Designated Independent Governors, would, together with the Member Governor and the PBOT Governor, equal at least 20% of the total number of Governors. See Section 4-1 of the By-Laws.

<sup>66</sup> See Section 1-1(f) of the By-Laws and Article FOURTH(a)(iii) of the Certificate, which Phlx proposes to renumber (see proposed Article FOURTH(b)(iii)).

<sup>50</sup> See Amendment No. 2, *supra* note 4 (including the amended By-Laws of NASDAQ OMX to the Phlx's proposal).

<sup>51</sup> See proposed Section 12.3, NASDAQ OMX By-Laws.

<sup>52</sup> See proposed Section 12.1(c), NASDAQ OMX By-Laws. To the extent that they relate to the activities of Phlx, all books, records, premises, officers, directors, and employees of NASDAQ OMX would be deemed to be those of the Phlx. See *id.*

<sup>53</sup> This requirement to keep confidential non-public information relating to the self-regulatory function shall not limit the Commission's ability to access and examine such information or limit the ability of directors, officers, or employees of the Nasdaq Holding Company from disclosing such information to the Commission. See proposed Section 12.1(b), NASDAQ OMX By-Laws. Holding companies with SRO subsidiaries have undertaken similar commitments. See, e.g., Securities Exchange Act Release No. 56955 (December 13, 2007), 72 FR 71979, 71983 (December 19, 2007) (SR-ISE-2007-101) (order approving the acquisition of International Securities Exchange, LLC's parent, International Securities Exchange Holdings, Inc., by Eurex Frankfurt AG).

<sup>54</sup> See Section 12.1(a), NASDAQ OMX By-Laws.

<sup>55</sup> See proposed Section 12.7, NASDAQ OMX By-Laws.

<sup>56</sup> 15 U.S.C. 78f(b)(1).

<sup>57</sup> 15 U.S.C. 78t(a).

<sup>58</sup> 15 U.S.C. 78t(e).

<sup>59</sup> 15 U.S.C. 78u-3.

<sup>60</sup> See proposed Article SIXTH(a) of the Certificate and proposed Section 4-1 of the By-Laws.

traded on the Exchange or a facility of the Exchange.<sup>67</sup> Notably, the new Board would select its Chair from among its members that are Independent Governors, instead of the current arrangement where the CEO also serves as the Chairman of the Board.<sup>68</sup>

The Commission finds that the proposed changes regarding the composition of the Board are consistent with the Act, including Section 6(b)(1) of the Act,<sup>69</sup> which requires, among other things, that a national securities exchange be organized to carry out the purposes of the Act and comply with the requirements of the Act.

Phlx proposes to set forth in detail the powers and duties of the Chair and Vice-Chair.<sup>70</sup> This provision is intended to be generally consistent with current NASDAQ Exchange By-Law Article VII, and the Commission finds it consistent with the Act.

The Exchange also proposes to change the term of office for all Governors from three years to one year<sup>71</sup> and eliminate term limits for Governors.<sup>72</sup> The Commission finds this consistent with the Act and notes that establishing one-year terms for directors is consistent with other proposals previously approved by the Commission.<sup>73</sup> Further, the Commission notes that neither Phlx's proposed parent company, NASDAQ OMX, nor NASDAQ Exchange have term limits for their respective boards.<sup>74</sup>

<sup>67</sup> See proposed Section 4-1 of the By-Laws (the Board shall be composed of a majority of Independent Governors); proposed Article SIXTH(a)(vii) of the Certificate (defining "Independent Governor"). The terms "Independent," "Material Relationship," and "Member" are defined in Sections 1-1(o), 1-1(s), and 1-1(t) of the By-Laws, respectively.

<sup>68</sup> See proposed Section 5-2 of the By-Laws. Currently, the Chairman of the Board is the CEO. See Article SIXTH(a)(v) of the Certificate and Sections 4-1 and 5-1 of the By-Laws (all providing that the Chairman of the Board shall be the individual then holding the office of CEO).

<sup>69</sup> 15 U.S.C. 78f(b)(1).

<sup>70</sup> See Article V of the By-Laws.

<sup>71</sup> See proposed Section 4-3(a) of the By-Laws. That section currently provides that the Stockholder Governors, Independent Governors (including the Designated Independent Governors), Member Governors, and the PBOT Governor serve for three-year terms, which are staggered.

<sup>72</sup> See proposed Section 4-3(a) of the By-Laws. That section currently prohibits Governors, except for the Chairman of the Board and the Vice-Chairman of the Board, from serving for more than two consecutive full terms.

<sup>73</sup> See, e.g., Securities Exchange Act Release No. 55293 (February 14, 2007), 72 FR 8033 (February 22, 2007) (SR-NYSE-2006-120) (approving one-year terms for NYSE Euronext directors). Additionally, the Restated Certificate of Incorporation of the NASDAQ Stock Market, Inc. also provides for one-year terms for directors other than Preferred Stock Directors.

<sup>74</sup> See Article IV of the NASDAQ OMX By-Laws and Article III of the NASDAQ Exchange By-Laws.

In addition, Phlx proposes that, in the event of a vacancy in the office of Vice-Chair, the Nominating, Elections and Governance Committee would select a replacement to serve the remainder of the unexpired term, subject to approval by the Board.<sup>75</sup> This provision is intended to be generally consistent with current NASDAQ Exchange By-Law Article IV. Section 4-19 of the By-Laws designates, with specificity, when a Governor's term begins, and provides that a Governor's term ends only when his or her successor is elected and qualifies, or when the Governor resigns or is removed. The Exchange proposes to modify this provision to eliminate the reference to a Governor's term beginning at a particular time and provides that a Governor's term will end when a successor is elected or upon their earlier resignation, removal, or death. The Commission finds these changes consistent with the Act and believes that they should provide additional clarity and, therefore, would facilitate orderly successions of Governors.<sup>76</sup>

### 3. Nomination, Election, and Removal of Non-Designated Governors

The Exchange proposes changes to the nomination and election process for non-Designated Governors (*i.e.*, Independent Governors, the Vice-Chair, the CEO, and the Shareholder Governor). These changes are primarily designed to simplify the process to accommodate a single Stockholder. Currently, the non-Designated Governors are nominated through different mechanisms, including: (1) The Nominating, Elections and Governance Committee nominates the individual then holding the office of CEO as Chairman of the Board for election by the Stockholders; (2) the Chairman recommends a Vice-Chairman candidate to the Nominating, Elections and Governance Committee for election by Stockholders; and (3) the Nominating, Elections and Governance Committee review the qualifications of nominees, including independent nominees, for the Stockholder Governors and Independent Governors (excluding the Designated Independent Governors).<sup>77</sup> Phlx now proposes that the holder of its common stock present for nomination to the Nominating, Elections and Governance Committee

the candidates for Vice-Chair, Stockholder Governor, and Independent Governors.<sup>78</sup> These candidates would be placed on the ballot and elected by the holder of common stock at the annual meeting of Shareholders. Thus, NASDAQ OMX, as sole holder of common stock of the Exchange, would nominate and elect all of the non-Designated Governors. This approach is consistent with the NASDAQ Exchange's processes for nomination of non-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>79</sup>

The Exchange also proposes to change the process for removing non-Designated Governors. Currently, non-Designated Governors may be removed only for cause, except that upon a recommendation by the Board to Stockholders such Governors may be removed without cause. An affirmative vote of two-thirds of the total number of Stockholders entitled to vote thereon is required to remove a non-Designated Governor. The proposed change would more explicitly permit the removal of non-Designated Governors with or without cause, and to allow removal of such Governors by the affirmative vote of a majority of the voting power entitled to vote for their election (*i.e.*, NASDAQ OMX).<sup>80</sup> This change would reflect the Exchange's proposed status as a wholly-owned subsidiary of NASDAQ OMX. The Board would continue to have the ability to recommend to the Stockholder that a Governor be removed for any reason deemed sufficient by the Board,<sup>81</sup> but such recommendation would no longer be a prerequisite for removal.

The Commission finds that the proposed changes to the nomination, election, and removal processes for non-Designated Governors are consistent with Section 6(b)(1) of the Act, which

<sup>78</sup> See proposed Section 28-3 of the By-Laws. As proposed, Section 28-3 has no provision for the nomination or election of the Chair of the Board because the Board would appoint its Chair from among the members of the Board who are Independent Governors. See proposed Section 5-2 of the By-Laws.

<sup>79</sup> See NASDAQ Exchange By-Law Article III, Section 6.

<sup>80</sup> See proposed Article SIXTH (b)(i) of the Certificate. The Exchange also proposes to allow any action required or permitted to be taken at any annual or special meeting of Stockholders to be taken by Stockholders (*i.e.*, NASDAQ OMX) without a meeting, unless otherwise specified in the Certificate. See proposed Article SEVENTH of the Certificate and proposed Section 28-13 of the By-Laws. In light NASDAQ OMX's ownership of all of the common stock of the Exchange, the Commission finds this change to be consistent with the Act.

<sup>81</sup> See proposed Section 4-4 of the By-Laws.

<sup>75</sup> See proposed Section 5-3 of the By-Laws.

<sup>76</sup> This proposed change is identical to a proposal by another national securities exchange recently approved by the Commission. See Securities Exchange Act Release No. 56955 (December 13, 2007), 72 FR 71979 (SR-ISE-2007-101) (approving proposed Section 3.2 of the by-laws of the International Securities Exchange, LLC).

<sup>77</sup> See Section 28-3 of the By-Laws.



requires an exchange to be organized in a manner that allows it to carry out the purposes of the Act. The proposed changes appropriately streamline the nomination, election, and removal processes for non-Designated Governors in light of NASDAQ OMX's ownership of all of the common stock of the Exchange.

#### Fair Representation

Section 6(b)(3) of the Act requires that the rules of an exchange assure fair representation of its members in the selection of its directors and administration of its affairs.<sup>82</sup> As discussed above, the Exchange proposes to give its Board discretion to determine its size.<sup>83</sup> Members would, nevertheless, continue to select at least 20% of the Board after the Merger, including the Member Governor, the PBOT Governor,<sup>84</sup> and the Designated Independent Governors (collectively, the "Designated Governors").<sup>85</sup> These Designated Governors would continue to be elected by the Holder of Series A Preferred Stock (*i.e.*, the Trust<sup>86</sup>), and therefore they would continue to be elected indirectly by the Members. Phlx proposes to change Section 3–7(a) of the By-Laws, which prohibits a Member Organization from endorsing more than one nominee for Governor, to clarify that Member Organizations are prohibited from endorsing more than one nominee *per vacancy*. This proposed change is designed to clarify the rights of Members in the independent nomination process by eliminating any ambiguity that each Member Organization may endorse one independent nominee per Designated Governor vacancy, not one independent nominee per election.

Designated Governors currently may be removed only for cause, unless the Board recommends that they be removed without cause. In either case, removal of a Designated Governor requires a vote by Member Organization Representatives at an annual or special meeting.<sup>87</sup> Phlx proposes to simplify the process to 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>88</sup> The Board would continue to have the ability to recommend to the Members that a Designated Governor be removed for any reason deemed sufficient by the Board,<sup>89</sup> but such recommendation would no longer be a prerequisite for removal. Importantly, the Commission notes that the Designated Governors, which are selected by a vote of the Members, may only be removed upon the affirmative vote of Members. While the Board may recommend to the Members that a Designated Governor be removed, the Board may not unilaterally remove a Designated Governor.

In addition, Members will be represented on key Standing Committees. Specifically, under the By-Laws, at least half of the Admissions Committee and the Foreign Currency Options Committee will continue to be required to be permit holders or participants or be associated with a Member Organization or participant organization,<sup>90</sup> and at least half of the Options Committee will continue to be required to be permit holders or be associated with a Member Organization.<sup>91</sup> Further, the By-Laws will continue to require that the Business Conduct Committee share jurisdiction over the revocation of permits and foreign currency options participations in connection with disciplinary matters with the Admissions Committee.<sup>92</sup>

Several Standing Committees also may review proposed rule changes before such proposals are presented to the Executive Committee or the Board for approval for filing with the Commission. These committees on which Members serve would continue to perform this function after the Merger. For example, the Business Conduct Committee may review proposed changes to the disciplinary provisions that are set forth in Rule 960 before such proposals are presented to the Executive Committee or the Board.<sup>93</sup>

Further, 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 immediately adjacent premises of the Exchange.<sup>94</sup> Additionally, the Exchange proposes to ensure Member representation on the Quality of Markets Committee.<sup>95</sup> Finally, Designated Governors, which are selected by Members, would compose at least 20% of the Executive Committee.<sup>96</sup>

The Commission finds that the selection of at least 20% of Governors of the Board,<sup>97</sup> the manner in which such Designated Governors will be nominated and elected,<sup>98</sup> the process for removing Designated Governors,<sup>99</sup> together with the representation of Members on key Standing Committees, satisfy the fair representation requirements of Section 6(b)(3) of the Act,<sup>100</sup> which requires that an exchange assure a fair representation of its members in the selection of its directors and administration of its affairs. The Commission also notes that these provisions are consistent with previous proposals approved by the Commission.<sup>101</sup>

#### 4. Special Committee of the Board

Phlx proposes to delete references to a "special committee of the Board of Governors" that hears appeals from determinations of the Nominating, Elections and Governance Committee on appeals concerning eligibility for election to the Board.<sup>102</sup> The special committee had been composed of Governors who were not then standing for re-election. However, because the

XLE; one Member who conducts options business at the Exchange; and four persons who are Members or persons associated with a Member Organization. See Section 10–11 of the By-Laws.

<sup>94</sup> See Section 10–20 of the By-Laws.

<sup>95</sup> See *infra* notes 133–134 and accompanying text (discussing Member representation on the Quality of Markets Committee).

<sup>96</sup> See *infra* text accompanying note 110 (discussing the composition of the Executive Committee).

<sup>97</sup> See proposed Article SIXTH(a)(iv) of the Certificate and proposed Section 4–1 of the By-Laws.

<sup>98</sup> See *supra* Section III.C.2 and *infra* Section III.C.4, respectively.

<sup>99</sup> See *supra* Section III.C.3.

<sup>100</sup> 15 U.S.C. 78f(b)(3).

<sup>101</sup> See, e.g., Securities Exchange Act Release Nos. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (approving the application of the NASDAQ Exchange for registration as a national securities exchange) and 49098, *supra* note 5.

<sup>102</sup> See proposed Section 11–1(b) of the By-Laws.

<sup>82</sup> 15 U.S.C. 78f(b)(3).

<sup>83</sup> See *supra* note 60 and accompanying text.

<sup>84</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 Section 1–1(aa) of the By-Laws; see also proposed Article SIXTH(a)(i) of the Certificate.

<sup>85</sup> The nominations process for Designated Governors (*i.e.*, the Designated Independent Governors, the Member Governor, and the PBOT Governor) is described in Section 3–7 of the By-Laws.

<sup>86</sup> See *supra* note 30 (discussing the purpose and operation of the Trust).

<sup>87</sup> See Article SIXTH(b)(iii) of the Certificate.

<sup>88</sup> See proposed Section 3–3 of the By-Laws. A special meeting of the Members could be called either by Members, the Board, or the Chair of the Board. See Section 3–2(b) of the By-Laws. Such Governors could be removed by the holder of the Series A Preferred Stock following a vote of the Member Organization Representatives. See proposed Article SIXTH (b)(ii) of the Certificate.

<sup>89</sup> See proposed Section 4–4 of the By-Laws.

<sup>90</sup> See Sections 10–6(a) and 10–17 of the By-Laws.

<sup>91</sup> See Section 10–20 of the By-Laws.

<sup>92</sup> See Section 10–6(b) of the By-Laws.

<sup>93</sup> The Business Conduct Committee is composed of nine members as follows: three Independent Governors; one Member or person associated with a Member Organization who conducts business on

Exchange proposes to eliminate the staggering of the Board and require all Governors to be elected annually, it would not be possible to form such a special committee. Instead, the Exchange proposes that the full Board preside over such appeals.<sup>103</sup>

The Commission finds that this proposal is consistent with Sections 6(b)(1) and 6(b)(3) of the Act.<sup>104</sup> In particular, the Commission notes that Designated Governors selected by the Members will constitute at least 20% of the Board, and therefore Members will be represented when the Board acts as an adjudicative body to hear appeals concerning eligibility for election to the Board.

#### 5. Standing Committees of the Board

The Exchange proposes several changes to its Standing Committees, which reflect incremental modifications to the structure and scope of its current committees. As discussed below, the Commission finds these changes to be consistent with the Act, including Section 6(b)(1) of the Act,<sup>105</sup> which requires that a national securities exchange be organized in such a manner as to allow the exchange to carry out the purposes of the Act, comply with the requirements of the Act, and enforce compliance with the Act by its members and persons associated with its members.

*Automation Committee and the Marketing Committee.* The Exchange proposes to eliminate two Standing Committees: the Automation Committee<sup>106</sup> and the Marketing Committee.<sup>107</sup> According to the Exchange, these committees are no longer necessary because, after the NASDAQ OMX Merger, these functions would be guided and handled at the parent company level.<sup>108</sup> The Commission believes that the elimination of these Exchange committees, combined with Phlx's reliance on NASDAQ OMX to perform the functions of those committees, is consistent with Section 6(b)(1) of the Act, which requires a national securities exchange to be so organized and have the capacity to carry out the purposes of the Act and to enforce compliance by its

members and persons associated with its members with the provisions of the Act. The Commission notes that, as the Exchange contemplates future changes to its automated trading systems, the Exchange would be required to file any changes to its rules with the Commission pursuant to Section 19(b) of the Act and Rule 19b-4 thereunder.<sup>109</sup>

*Executive Committee.* In addition, the Exchange proposes to change the composition of the Executive Committee and limit its authority. Currently, Section 10-14(a) provides that the Executive Committee be composed of the following nine members: the Chairman of the Board, who serves as Chair of the Committee; 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. Phlx proposes to amend this provision to allow the Board to determine the size of the committee, except that the Committee must include: the Chair of the Board, who would be the Chair of the Committee; the Vice-Chair of the Board; the Stockholder Governor; and a number of Designated Governors equal to at least 20% of the total number of Governors on the committee.<sup>110</sup>

The Executive Committee currently appoints, subject to approval by the Board, all members (except the Chairmen) of the Standing Committees, excluding the Nominating, Elections and Governance Committee and the Executive Committee.<sup>111</sup> The Exchange now proposes to instead provide that the Board, instead of the Executive Committee, select all members of Standing Committees,<sup>112</sup> including most Standing Committee Chairs.<sup>113</sup> This

<sup>109</sup> 15 U.S.C. 78s(b) and 17 CFR 240.19b-4, respectively.

<sup>110</sup> See *supra* text accompanying note 96 (discussing the representation of Designated Governors on the Executive Committee).

<sup>111</sup> See Sections 10-1(b), 10-4, and 10-14(c) of the By-Laws. Chairmen of the Standing Committees are selected, subject to Board approval, by the Nominating, Elections and Governance Committee. See Section 10-19(d) of the By-Laws.

<sup>112</sup> See proposed Sections 10-1(b) and 10-4 of the By-Laws. Correspondingly, the Exchange proposes to delete Sections 10-14(c) and 10-19(d) of the By-Laws which provide, respectively, that the Executive Committee shall appoint members of the Standing Committees (excluding their Chairmen), subject to Board approval, and that the Nominating, Elections and Governance Committee shall select all Standing Committee Chairmen, subject to approval by the Board.

<sup>113</sup> As amended, the By-Laws would specifically provide that: (1) The Chair of the Board is the Chair of the Executive Committee; (2) the Chair of the Board is the Chair of the Finance Committee; and (3) the Nominating, Elections and Governance Committee select its own Chair from among the

change would conform the Exchange's practice to how NASDAQ OMX currently operates.<sup>114</sup> The Commission finds that these changes are consistent with Sections 6(b)(1) and 6(b)(3) of the Act.<sup>115</sup>

*Audit Committee.* Phlx proposes to modify the responsibilities of the Audit Committee to conform to similar responsibilities and processes of the Audit Committees of NASDAQ OMX and the NASDAQ Exchange.<sup>116</sup> Specifically, Phlx proposes to replace the enumerated duties of the committee with respect to external auditors with a more general charge to select, evaluate and, where appropriate, replace the Exchange's independent auditors (or nominate the independent auditors to be proposed for ratification by the Stockholders).<sup>117</sup> Phlx would also confer to the committee more specific responsibilities with respect to the Exchange's Internal Audit Department ("IAD"), including authority to hire or terminate the head of the IAD and determine the IAD's budget. Further, Phlx proposes to eliminate the requirement that the committee review all legal matters that may materially impact the Exchange's financial statements and all regulatory examination, inspection, and other reports. The Commission finds these changes consistent with Section 6(b)(1) of the Act, and notes that such changes are based on the Audit Committees of NASDAQ OMX and the NASDAQ Exchange.

*Finance Committee.* The Exchange proposes to change the composition of the Finance Committee and update the description of the committee's responsibilities.<sup>118</sup> Currently, the committee is composed of the following nine members: the Chairman of the Board; the Vice-Chairman of the Board; one Stockholder Governor; four Independent Governors, and two Members or persons associated with a Member Organization, one of whom conducts business primarily on XLE or on the equity options floor. Phlx

members of such Committee who are Independent Governors. See proposed Sections 10-14(a), 10-15 and 10-19(a) of the By-Laws, respectively.

<sup>114</sup> See NASDAQ OMX By-Law Article IV, Section 4.13.

<sup>115</sup> 15 U.S.C. 78f(b)(1) and 15 U.S.C. 78f(b)(3).

<sup>116</sup> See NASDAQ OMX Audit Committee Charter approved April 18, 2007 and NASDAQ Exchange By-Law Article III.

<sup>117</sup> Compare Section 10-9(b) of the By-Laws with proposed Section 10-9 of the By-Laws.

<sup>118</sup> See proposed Section 10-15 of the By-Laws. The Exchange proposed to delete the Supplementary Material in Section 10-15, which sets forth a series of directives issued by the Board that were specifically applicable to the Finance Committee. These proposed changes are not directly related to the Merger.

<sup>103</sup> See *id.*

<sup>104</sup> 15 U.S.C. 78f(b)(1) and 15 U.S.C. 78f(b)(3).

<sup>105</sup> 15 U.S.C. 78f(b)(1).

<sup>106</sup> See Section 10-10 of the By-Laws. The Automation Committee currently is charged with periodically reviewing and approving automation plans affecting the trading floors, subsidiaries and the Exchange's administrative areas.

<sup>107</sup> See Section 10-18 of the By-Laws. The Marketing Committee currently acts in an advisory capacity to the officers of the Exchange in marketing the services of the Exchange.

<sup>108</sup> See Notice, *supra* note 3, 73 FR at 23295.



proposes that following the Merger, the Finance Committee would be composed of: the Chair of the Board; the Vice-Chair of the Board; a number of Designated Independent Governors equal to at least 20% of the total number of voting members on the Finance Committee; two Members or persons associated with a Member Organization who may be Governors one of whom conducts business on XLE or on the equity options floor;<sup>119</sup> and such other Governors as the Board may appoint.<sup>120</sup> Phlx states that the elimination of the requirement that one of the committee members “primarily” conduct business on XLE or the equities option floor would allow a greater pool of candidates to be eligible to serve on the Finance Committee and is consistent with a recent change to Section 10–11 of the By-Laws.<sup>121</sup>

The Exchange also would eliminate the current restriction that prohibits the Chair of the Board from creating tie votes of the Finance Committee, and would designate the Chair of the Board as the Finance Committee Chair.<sup>122</sup> Finally, the Exchange proposes to delete the Supplementary Material that sets forth a series of directives issued by the Board that are specifically applicable to the Finance Committee.<sup>123</sup> Elimination of the Supplementary Material is designed to allow the Board flexibility in establishing capital expenditure policies, which may include delegation to Board committees and/or officers. The Exchange states that this more flexible approach is consistent with NASDAQ OMX’s processes.<sup>124</sup> The Commission finds that this proposal is

consistent with Section 6(b)(1) of the Act, and notes that Phlx’s obligation to adequately fund its regulatory oversight program<sup>125</sup> is unaffected by the proposed elimination of the Supplementary Material to Section 10–15 of the By-Laws.

*Nominating, Elections and Governance Committee.* The Exchange also proposes certain changes to the composition of the Nominating, Elections and Governance Committee. Currently, the committee is composed of three Independent Governors, at least one of which is a Designated Independent Governor, one Stockholder Governor, and one Member Governor. As proposed, the committee would be composed of four Independent Governors and one Member Governor.<sup>126</sup> The Exchange also proposes to delete the term limit applicable to this committee and delete the prohibition against members of this committee standing for re-election to the Board. These proposals are designed, according to the Exchange, to increase the pool of candidates eligible to serve on the Committee and the Board.<sup>127</sup> The Commission finds that these changes are consistent with Section 6(b)(1) of the Act. The Commission notes that it recently approved a similar Phlx proposal to increase the pool of candidates eligible to serve on one of Phlx’s Standing Committees.<sup>128</sup>

*Quality of Markets Committee.* Phlx proposes to clarify the requirement that the Quality of Markets Committee include at least as many Independent members<sup>129</sup> as it does the “combined number” of Stockholder-chosen members and members who are Members of the Exchange.<sup>130</sup> The addition of the language “combined number” makes clear that the number of Stockholder-chosen committee members<sup>131</sup> are added to the number of Members serving on the committee<sup>132</sup> and that total is then compared to the number of “Independent” committee members, who do not have to be Governors.

Additionally, the Exchange proposes to adopt a new requirement that at least

20% of the total number of committee members be Members.<sup>133</sup> This is designed to provide fair representation of Phlx members on this committee and harmonize the role of the committee with that of the NASDAQ Exchange’s Quality of Markets Committee.<sup>134</sup>

#### 6. Officers of the Exchange

The Exchange proposes various changes with respect to officers of the Exchange. First, the Exchange proposes to separate the roles of Chairman of the Board and CEO. The CEO would be ineligible to serve as Chair of the Board,<sup>135</sup> and the By-Laws would be amended to describe separately the responsibilities of the Chair of the Board and the CEO.<sup>136</sup>

Second, under the proposed rule change, the Board, instead of the CEO/Chairman, would appoint all officers of the Exchange, and would fix their duties, responsibilities, and terms of appointment.<sup>137</sup>

Third, Phlx proposes to set forth in detail the powers and duties relating to the Chair, Vice-Chair, and officers of the Exchange.<sup>138</sup>

Fourth, the Exchange proposes to create an office of the President who would, in the absence of the Chair of the Board and the CEO, preside at all meetings of the Board at which the President is present. Additionally, the President would have all powers and duties usually incident to the office of the President, except as specifically limited by the Board, and would be charged with general supervision of Exchange operations.<sup>139</sup> The Exchange also proposes to delete current Section 5–5 of the By-Laws, which addresses contingencies in the event the Chairman of the Board is unable to serve. The elimination of this provision reflects the changes to the role of the Chair of the Board and the creation of a separate CEO position, as well as the new position of President.

The Commission finds that these proposed changes are consistent with the Act, including Section 6(b)(1) of the

<sup>119</sup> Under the proposal, these committee members need not be Governors, but any non-Governor would serve in a non-voting capacity. See proposed Section 10–15 of the By-Laws.

<sup>120</sup> See proposed Section 10–15 of the By-Laws.

<sup>121</sup> See Notice, *supra* note 3, 73 FR at 23296. The Commission notes that this change is similar to a recently-approved change to a different By-Law. See Securities Exchange Act Release No. 57023 (December 20, 2007), 72 FR 74398 (December 31, 2007) (SR-Phlx–2007–83) (approving a proposal to similarly expand the type of business that may be conducted to qualify as a Business Conduct Committee member).

<sup>122</sup> Under the current provision, the Chair of the Committee must be either the Vice-Chair, Stockholder Governor, or Member Governor.

<sup>123</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 and all subsidiaries of the Exchange. See Supplementary Material to Section 10–15 of the By-Laws.

<sup>124</sup> See Notice, *supra* note 3, 73 FR at 23296.

<sup>125</sup> 15 U.S.C. 78s(g).

<sup>126</sup> See proposed Section 10–19(a) of the By-Laws.

<sup>127</sup> See Notice, *supra* note 3, 73 FR at 23296.

<sup>128</sup> See Securities Exchange Act Release No. 57023, *supra* note 121.

<sup>129</sup> “Independent” committee members would be “Independent” within the meaning of Section 1–1(o) of the By-Laws.

<sup>130</sup> See proposed Section 10–21 of the By-Laws.

<sup>131</sup> NASDAQ OMX, as Stockholder, would select the Stockholder member(s) of this committee. See Notice, *supra* note 3, 73 FR 23296.

<sup>132</sup> The Board would select the Member(s) serving on the committee pursuant to Section 10–1(b) of the By-Laws.

<sup>133</sup> See proposed Section 10–21 of the By-Laws.

<sup>134</sup> See NASDAQ Exchange By-Law Article III, Section 6. See *supra* text accompanying notes 95 and 97–100.

<sup>135</sup> The Board would select its Chair from among the Independent Governors. See proposed Section 5–2 of the By-Laws.

<sup>136</sup> See proposed Sections 5–2 and 5–4 of the By-Laws. Under the current By-Laws, only the responsibilities of the Chairman of the Board are described (in Section 5–1 of the By-Laws).

<sup>137</sup> See proposed Sections 5–1, 5–4, 5–5, 5–8, 5–9 and 5–10 of the By-Laws.

<sup>138</sup> See Article V of the By-Laws. These provisions are intended to be generally consistent with current NASDAQ OMX By-Law Article VII, and NASDAQ Exchange By-Law Article IV.

<sup>139</sup> See proposed Section 5–5 of the By-Laws.

Act, which requires, among other things, that a national securities exchange be organized to carry out the purposes of the Act and comply with the requirements of the Act. Under these circumstances, the Commission believes that the creation of an independent Chair of the Board should foster a greater degree of independent decision-making by the governing body of the Exchange and mitigate the conflict between an SRO's regulatory functions on the one hand, and its business operations on the other.

#### *D. Interpretations of and Amendments to the By-Laws*

The Exchange proposes to clarify the process governing By-Law interpretations and amendments. With respect to interpretations, Section 4–17 of the By-Laws grants to the Board power to interpret the By-Laws and rules adopted pursuant thereto, and provides that any such interpretations are final, binding, and conclusive. Phlx proposes to clarify that the Board must determine affirmatively whether such interpretations must be filed with the Commission as proposed rule changes, and, if so, provides that any such interpretation not become effective until filed with, or filed with and approved by, the Commission.<sup>140</sup>

With respect to amendments, Section 22–1 currently allows the By-Laws to be amended by either: (1) An affirmative vote of a majority of the entire Board at any regular or special meeting of the Board; or (2) the affirmative vote of the holders of a majority of the shares of common stock of the Exchange then issued and outstanding at any regular or special meeting of the Stockholders. The Exchange proposes to amend this provision to state affirmatively that By-Law amendments must be filed with, or filed with and approved by, the Commission. The Exchange also proposes to require that both the Board and the holder of common stock of the Exchange approve proposed By-Law amendments.<sup>141</sup>

The Commission finds that proposed Sections 4–17 and 22–1 of the By-Laws are consistent with Section 6(b)(1) of the Act,<sup>142</sup> because they reflect the obligation of the Board to ensure compliance with the rule filing

requirements under the Act. Additionally, the Commission finds these changes to be consistent with Section 19(b)(1) of the Act and Rule 19b–4 under the Act, which require that an SRO file with the Commission all proposed rules, as well as all proposed changes in, additions to, and deletions of its existing rules. These provisions clarify that certain By-Law interpretations and all By-Law amendments constitute proposed rule changes within the meaning of Section 19(b)(2) of the Act and Rule 19b–4 under the Act,<sup>143</sup> and obligate the Exchange's Board to affirmatively make those determinations.

#### *E. Other Changes*

##### *1. Provisions Applicable to Common Stock*

Phlx proposes a number of changes that reflect the proposed ownership by NASDAQ OMX of all the common stock of the Exchange. For example, Phlx proposes to delete the following provisions: (1) Article FOURTH(b)(iv) of the Certificate, which requires written notice to the Board of intention to acquire more than 5% of the Exchange's outstanding common stock; (2) Section 29–1 of the By-Laws, which requires that sales, transfers, and other dispositions of common stock be in blocks of 100 shares; (3) Section 29–2 of the By-Laws, governing lockups; (4) Section 29–5 of the By-Laws, regarding reimbursement for expenses incurred in connection with any transfer of capital stock; (5) Section 30–1 of the By-Laws, regarding stock certificates; (6) Section 30–2 of the By-Laws, concerning closing of the transfer books and determination of record dates; and (7) Article FOURTH(c)(v)(C) of the Certificate and Sections 29–4 and 30–3 of the By-Laws, which allow the Exchange to not register any transfer of capital stock of the Exchange that violates certain provisions of the Certificate or By-Laws. Additionally, existing provisions in Article XXIX of the By-Laws that contemplate a possible public offering of the Exchange's stock would be deleted and replaced with restrictions on stock transfer discussed above.<sup>144</sup> Because these provisions are applicable to non-public companies with several stockholders, the Exchange does not believe these provisions would be applicable following the Merger. In addition, the Exchange proposes to delete provisions that govern the use of

common stock and/or common stock option incentive compensation that may be awarded to Governors and officers of the Exchange,<sup>145</sup> because such compensation would no longer be feasible if NASDAQ OMX owned 100% of the common stock of the Exchange.<sup>146</sup> The Commission finds that the elimination of these obsolete provisions are consistent with the Act and do not raise any novel regulatory issues.

##### *2. Specified Board Votes*

Sections 13–5,<sup>147</sup> 13–7,<sup>148</sup> 17–4,<sup>149</sup> and 18–3<sup>150</sup> of the By-Laws reference an affirmative vote of either 14 or 15 Governors, which used to represent a supermajority of the Board. The Exchange proposes to modify these provisions to remove the numerical reference and instead require an affirmative vote of a majority of all Governors. This change is consistent with the governing documents of Phlx's proposed parent company, NASDAQ OMX, where a supermajority vote is required only when the voting power of the then-outstanding stock entitled to vote is implicated.<sup>151</sup> The Commission finds that these changes maintain the requirement of a minimum majority Board vote and are consistent with Section 6 of the Act.

<sup>145</sup> See Section 6–1 of the By-Laws.

<sup>146</sup> The Exchange notes that, in the future, potential equity stock compensation would likely consist of NASDAQ OMX stock. See Notice, *supra* note 3, 73 FR at 23295.

<sup>147</sup> Section 13–5 of the By-Laws (Liability of Officers, Directors and Substantial Stockholders) imposes personal liability on officers, directors, and substantial stockholders of a Member Organization that is an Exchange Member when that corporation violates the By-Laws or the Rules. The Board, however, may vote to relieve the person of such personal liability.

<sup>148</sup> Section 13–7 of the By-Laws (Violation of Terms of Registration) provides the Board may vote to terminate the registration of a Member Organization for violating or failing to meet of the terms and conditions of its registration.

<sup>149</sup> Section 17–4 of the by-Laws (Time for Settlement of Insolvent Member or Participant) allows for the termination of a permit or participation when a Member or foreign currency options participant whose permit or rights and privileges have been suspended fails to settle with his creditors and apply for reinstatement within six months from the time of such suspension (or within such further time as the Board of Governors grants) or fails to obtain reinstatement. The Board, however, may vote to grant to extend the time for settlement.

<sup>150</sup> Section 18–3 of the By-Laws (Responsibility of Member or Participant for Acts of His Organization) imposes personal liability on a Member or foreign currency options participant that is a general partner in a Member Organization or participant organization for violations of the By-Laws or Rules by the partnership. The Board, however, may vote to relieve the general partner of such personal liability or reduce the amount of such liability.

<sup>151</sup> See, e.g., Section 4.6 of the NASDAQ OMX By-Laws.

<sup>140</sup> See proposed Section 4–17 of the By-Laws.

<sup>141</sup> See proposed Section 22–1 of the By-Laws. Under the current provision, By-Law amendments must be approved by either the Board or the holders of a majority of common stock of the Exchange. The Commission notes that Stockholder approval could be obtained outside of a regular or special meeting of the Stockholders by unanimous written consent pursuant to proposed Section 28–13 of the By-Laws.

<sup>142</sup> 15 U.S.C. 78f(b)(1).

<sup>143</sup> See Section 3(a)(27) of the Act (defining proposed rule change).

<sup>144</sup> See *supra* notes 33–43 and accompanying text (discussing the proposed limits on issuing, transferring, and assigning Phlx capital stock).

### 3. Capital Stock

The Exchange proposes to eliminate the current provisions of Article XXIX of the By-Laws that govern restrictions on transfers of capital stock of the Exchange. The proposed new provisions of Article XXIX include but are not limited to transfer restrictions on the capital stock of the Exchange.<sup>152</sup> In particular, proposed Sections 29-1, -2, -3, -5, -6, and -7 address stock certificates, stock ledgers, transfers of stock, and record date, respectively. The Exchange states that these are standard provisions for a Delaware stock corporation and contemplate ownership of all common stock of the Exchange by NASDAQ OMX.<sup>153</sup> The Commission notes that these new provisions are based on NASDAQ OMX By-Law Article IX, Capital Stock, Sections 9.1 through 9.7. The Commission finds that these changes are consistent with Section 6 of the Act and do not raise any novel regulatory issues.

### 4. Payment of Dividends

Proposed Section 29-8 of the By-Laws, which is similar to Section 15 of the LLC Agreement of the NASDAQ Exchange, would prohibit the Exchange from using Regulatory Funds to pay dividends.<sup>154</sup> The Commission finds that the prohibition on the use of regulatory fines, fees, or penalties to fund dividends is consistent with Section 6(b)(1) of the Act because it will further Phlx's ability to effectively comply with its statutory obligations and is designed to ensure that the regulatory authority of the Exchange is not improperly used.<sup>155</sup> This restriction on the use of regulatory funds is intended to preclude Phlx from using its authority to raise regulatory funds for the purpose of benefiting its shareholders, or for other non-regulatory

<sup>152</sup> The proposed restrictions on Phlx capital stock are discussed *supra* notes 33, 43, and accompanying text.

<sup>153</sup> See Notice, *supra* note 3, 73 FR at 23297.

<sup>154</sup> Proposed Section 1-1(kk) of the By-Laws defines "Regulatory Funds" as fees, fines, or penalties derived from the regulatory operations of the Exchange. However, Regulatory Funds do not include revenues derived from listing fees, market data revenues, transaction revenues, or 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 *id.*

<sup>155</sup> See, e.g., Securities Exchange Act Release No. 51029 (January 12, 2005), 70 FR 3233, 3241 (January 21, 2005) (SR-ISE-2004-29) (approving an International Securities Exchange, LLC rule interpretation that requires that revenues received from regulatory fees or regulatory penalties be segregated and applied to fund the legal, regulatory, and surveillance operations of the Exchange and not used to pay dividends to the holders of Class A Common Stock).

purposes, such as to fund executive compensation.

### 5. Special Meetings

Current Section 4-14 of the By-Laws empowers only the Chairman of the Board or, in certain, circumstances, the Vice-Chairman of the Board, to call special meetings of the Board. The Exchange proposes to broaden this provision to also allow the interim Chair of the Board to call special meetings of the Board, under certain circumstances. The Commission finds that this proposal is consistent with Section 6(b)(1) of the Act, which requires a national securities exchange to be organized in such a way so as to be capable of carrying out the purposes of the Act. In particular, the Commission believes that this change will provide additional flexibility where appropriate to the Board to convene special meetings to conduct the business of the Exchange.

### 6. Annual Report and Weekly Bulletin

Section 4-21 of the By-Laws requires the distribution of an annual, independently-audited financial report of the Exchange to Stockholders, Members, participants, Member Organizations, and participant organizations. Phlx proposes to delete this requirement and instead require that annual financial reports be kept on file at the Exchange and made available for inspection upon request to any Stockholder, Member, participant, Member Organization, or participant organization. The Exchange states that financial information on the Exchange also would be reflected in the public consolidated financial statements of NASDAQ OMX once the Merger is complete, and the Commission notes that this proposal does not affect the requirement that Phlx comply with Rule 6a-2 under the Act to amend its Form 1.<sup>156</sup> Further, Phlx proposes to change how its Weekly Bulletin is distributed. Section 12-5(d) of the By-Laws provides that it must be mailed, and the Exchange proposes to update this provision to permit distribution by e-mail and posting on the Exchange's Web site. The Commission finds that these changes are consistent with Section 6 of the Act and do not raise any novel regulatory issues.

### 7. Stock Exchange Fund and Gratuity Fund

The Exchange proposes to eliminate Sections 9-1 through 9-6 of the By-Laws relating to the Stock Exchange

Fund.<sup>157</sup> The purpose of the Stock Exchange Fund is 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. The Exchange believes these provisions are unnecessary because, after the Merger, the financial management of the Exchange will be overseen directly by the Board and subject to public company financial controls established by NASDAQ OMX. Similarly, the Exchange proposes to delete a provision in Section 4-4 of the By-Laws relating to the gratuity fund. This provision is obsolete, as the Exchange states that the fund no longer exists.<sup>158</sup>

### 8. Miscellaneous Changes

Additionally, the Exchange proposes to make the following changes to the Certificate and By-Laws to correct typographical errors, effect stylistic changes, move text, and/or update the language to more accurately reflect current practices. The Exchange proposes to:

- Change the title of the Certificate;
- Update the address of its registered office in Delaware;<sup>159</sup>
- Correct an error by changing the term "Board of Directors" to "Board of Governors;"<sup>160</sup>
- Update cross-references;<sup>161</sup>
- Add new definitions to its By-Laws and Rules;<sup>162</sup>
- Eliminate certain language from the Certificate that is also in the By-Laws;<sup>163</sup>
- Replace the term "Chairman" with "Chair" in referencing the head of the

<sup>157</sup> Correspondingly, the Exchange proposes to delete references to the Stock Exchange Fund in Section 4-4 of the By-Laws.

<sup>158</sup> See Notice, *supra* note 3, 73 FR at 23295, n.31.

<sup>159</sup> See proposed Article SECOND of the Certificate.

<sup>160</sup> See Article FOURTH of the Certificate.

<sup>161</sup> See proposed Article FOURTH(b)(iii) of the Certificate and proposed Sections 1-1(w) of the By-Laws.

<sup>162</sup> For example, the Exchange proposes to add a definition of the terms: "Commission;" "NASDAQ OMX Merger" (Phlx also proposes to define the term "NASDAQ OMX Merger" in its proposed Rule 1(qq)); "Regulatory Funds;" "Preferred Stock;" and "Trust," and update the definition of the term "Trust Agreement." Additionally, Phlx would eliminate the defined term "Class A Common Stock" and modify the term "Common Stock," in accordance with its proposal to issue only one class of common stock. The Exchange also proposes to modify the definitions of "Member Governor" and "Stockholder Governor" to correspond with its proposal to decrease the number of Member Governors from two to one, and the number of Stockholder Governors from six to one.

<sup>163</sup> The language in Article SIXTH(b)(i)-(ii) of the Certificate, which Phlx proposes to eliminate, is also in Section 4-4(b)(ix)-(x) of the By-Laws.

<sup>156</sup> 17 CFR 249.1.

Board<sup>164</sup> and the heads of Board committees;<sup>165</sup>

- Replace the term “Vice-Chairman” with “Vice-Chair;”<sup>166</sup>
- Replace references to the “director” of either the Membership Services or Examinations Departments in Sections 17–1 and 17–3 of the By-Laws with more general references to the departments;<sup>167</sup>
- Replace the terms “Stockholder” and “Stockholders” with stockholder and stockholders, respectively;<sup>168</sup>
- Replace “without” with “outside of” in Article TWELFTH of the Certificate;
- Use the defined term “Member” (instead of “member”) in the definition of “non-member;”<sup>169</sup>
- Use the term “Member Organization” instead of “member organization;”<sup>170</sup>
- Update the definition of “Trust Agreement;”<sup>171</sup> and
- Correct typographical errors in Section 4–4 of the By-Laws (*i.e.*, add “the” to (b)(i), add “a” to (b)(vi), and replace “also” with “and.”

The Commission finds these changes to be consistent with Section 6 of the Act generally, including Section 6(b)(1). The proposed minor changes update the Exchange’s governing documents and make them more internally consistent, and thereby facilitate Members’ understanding of their obligations and the Exchange’s ability to administer its rules.

#### F. Changes to Exchange Rules

The Exchange proposes to amend Rule 98 (Emergency Committee) to provide the Board with discretion concerning the composition of the Emergency Committee. Currently, the composition of the Emergency Committee is fixed to consist of the Chairman of the Board, the On-Floor Vice-Chairman of the Exchange, the Off-

Floor Vice-Chairman of the Exchange,<sup>172</sup> and the Chairmen of the Options and Foreign Currency Options Committees. The Commission notes that other exchanges also have an emergency committee whose composition is determined by the board of the exchange.<sup>173</sup> The Commission believes that the proposed changes to Rule 98 (Emergency Committee) should provide the Board with greater flexibility to manage the affairs of the Exchange in an emergency and are consistent with Sections 6(b)(1) of the Act,<sup>174</sup> which requires, among other things, a national securities exchange to be so organized and have the capacity to carry out the purposes of the Act.

The Exchange also proposes to amend Rule 164 (Trading Halts) to provide the Board with discretion in designating the officers of the Exchange responsible for declaring any trading halts when 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. The Commission believes that the proposed change to Rule 164 (Trading Halts) is consistent with the Act, and in particular with Sections 6(b)(1) and 6(b)(5) of the Act,<sup>175</sup> which require, among other things, that an exchange be organized and have the capacity to carry out the purposes of the Act and have rules designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, remove impediments and to perfect the mechanism of a free and open market and a national market system, and in general, to protect investors and the public interest, because it will continue to allow the Exchange to respond in a timely manner, consistent with the Exchange’s rules, to a situation where suspension of trading would be in the public interest. Currently, the Chairman and Chief Executive Officer<sup>176</sup> is authorized to suspend trading pursuant to Rule 164 or to delegate that power to another

individual.<sup>177</sup> The Commission believes that, by making the Board responsible for trading suspension decisions, or alternatively for deciding to which Exchange officers that authority should be delegated, the proposal strengthens Board oversight of decisions to halt trading and makes Rule 164 less susceptible to any potential abuse of discretion.

Finally, the Exchange proposes to add to Rule 1 (Definitions) a definition of the NASDAQ OMX Merger.<sup>178</sup> The Exchange also proposes to amend Rule 972 (Continuation of Status After the NASDAQ OMX Merger) to reflect that current members, 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 Merger would continue to hold such status following the Merger.<sup>179</sup> This change clarifies that current members and participants would continue in their current status following the Merger and would continue to have uninterrupted access to the Exchange.<sup>180</sup>

#### G. Additional Reporting Requirements for Listing Affiliated Securities

The Exchange proposes to adopt new Rule 990, which is based on NASDAQ Exchange Rule 4370.<sup>181</sup> Rule 990 would impose heightened requirements on Phlx if it lists a security of NASDAQ OMX or any of its affiliates (“Nasdaq Affiliates”). In the event that a Nasdaq Affiliate lists a security (the “Affiliate Security”) on Phlx, the proposed rule would require Phlx to file a report with the Commission on a quarterly basis detailing Phlx’s monitoring of: (1) The Nasdaq Affiliate’s compliance with the provisions of the Rule 800 Series; and (2) the trading of the Affiliate Security, including summaries of all related surveillance alerts, complaints, regulatory referrals, trades cancelled or adjusted pursuant to Rule 163, investigations, examinations, formal and informal disciplinary actions, exception reports and trading data.

<sup>164</sup> See, *e.g.*, proposed Section 4–11 of the By-Laws.

<sup>165</sup> See, *e.g.*, proposed Section 8–1 of the By-Laws.

<sup>166</sup> See, *e.g.*, proposed Section 4–14 of the By-Laws.

<sup>167</sup> Under the proposed rule, notices would still be required to be sent to these departments, but not necessarily to the director.

<sup>168</sup> See, *e.g.*, Article TENTH of the Certificate. The term “Stockholder Governor” would remain, although the term “Stockholder Governors” would be made singular (*i.e.*, “Stockholder Governor”) to reflect the Exchange’s proposal to reduce the number of such Governors from six to one.

<sup>169</sup> See proposed Sections 1–1(o), 1–1(y), 3–12(a), 10–14(d), 12–7, 13–1, 13–5, 13–8, 14–11, 16–1, and 20–3 of the By-Laws.

<sup>170</sup> See proposed Sections 4–6(b), 10–14(d), 10–17, and 17–2 (adding both Member Organization and participant organization) of the By-Laws.

<sup>171</sup> See proposed Section 1–1(ee) of the By-Laws.

<sup>172</sup> The Exchange states that the position of Off-Floor Vice-Chairman of the Exchange no longer exists and reference to this position remained in Rule 98 inadvertently. See Notice, *supra* note 3, 73 FR at 23297.

<sup>173</sup> See, *e.g.*, American Stock Exchange LLC Constitution, Article XII, Emergency Committee.

<sup>174</sup> 15 U.S.C. 78f(b)(1).

<sup>175</sup> 15 U.S.C. 78f(b)(1) and 15 U.S.C. 78f(b)(5), respectively.

<sup>176</sup> Under the proposed rule change, there would no longer be one position entitled “Chairman and Chief Executive Officer.” See *supra* Section III.C.7 and more specifically note 136 and accompanying text (explaining the proposal to separate the roles of Chairman and Chief Executive Officer).

<sup>177</sup> See Securities Exchange Act Release No. 54538 (September 28, 2006), 71 FR 59184, 59188 (October 6, 2006) (SR–Phlx–2006–43) (approving current Rule 164).

<sup>178</sup> See proposed Rule 1(qq).

<sup>179</sup> This provision was adopted in connection with, and currently refers to, the Exchange’s 2004 demutualization.

<sup>180</sup> This provision was adopted in connection with, and currently refers to, the Exchange’s 2004 demutualization.

<sup>181</sup> See NASDAQ Exchange Rule 4370. See also NYSE Rule 497, Additional Requirements for Listed Securities Issued by NYSE Euronext or its Affiliates.

The Exchange also would be required to notify the Commission at the same time it notifies the Nasdaq Affiliate if the Exchange determines that the Nasdaq Affiliate was not in compliance with any of its listing standards. Phlx would be required to notify the Commission within five business days of its receipt of a plan of compliance from the Nasdaq Affiliate and advise the Commission on whether the plan of compliance was accepted by Phlx or what other action was taken with respect to the plan, and the time period provided to regain compliance with the Rule 800 Series, if any.

In addition, the Exchange would be required to commission an annual review and report by an independent accounting firm of the compliance of the Affiliate Security with the Rule 800 Series. The Exchange would be required to furnish promptly a copy of the report to the Commission.

The listing of an Affiliate Security on Phlx could potentially create a conflict of interest between the Phlx's regulatory responsibilities to vigorously oversee the listing and trading of an Affiliate Security on Phlx, and its own commercial or economic interests. Such listing may raise questions as to the Phlx's ability to independently and effectively enforce the Commission's and the Exchange's rules against a Nasdaq Affiliate. Proposed Rule 990 is designed to address this concern.

The Commission finds that that proposed Rule 990 is consistent with Sections 6(b)(1) and 6(b)(5) of the Act<sup>182</sup> because it requires heightened reporting by Phlx to the Commission with respect to oversight of the listing and trading on Phlx of an Affiliate Security and will assist Phlx in effectively enforcing its Rules with respect to the listing and trading of these securities. In addition, the requirement that an independent accounting firm review such issuer's compliance with Phlx's listing standards adds a degree of independent oversight to Phlx's regulation of the listing of these securities, which may mitigate any potential or actual conflicts of interest and should help ensure thorough oversight of the Affiliate Security on the same basis as any other listed security.

#### *H. Restriction on Affiliation with NASDAQ OMX*

##### *1. Limitation on Phlx Members' Ownership of NASDAQ OMX*

The Exchange proposes to adopt new Rule 985(a) to prohibit Members<sup>183</sup> and persons associated with Members from beneficially owning more than 20% of the then-outstanding voting securities of NASDAQ OMX.<sup>184</sup> Members that trade on an exchange traditionally had ownership interests in such exchange. As the Commission has noted in the past, however, a member's interest in an exchange could become so large as to cast doubt on whether the exchange can fairly and objectively exercise its self-regulatory responsibilities with respect to that member.<sup>185</sup> A member that is a controlling shareholder of an exchange or an exchange's holding company might be tempted to exercise that controlling influence by pressuring or directing the exchange to refrain from, or the exchange otherwise may hesitate to, diligently monitor and surveil the member's conduct or diligently enforce its rules and the federal securities laws with respect to conduct by the member that violates such provisions.<sup>186</sup>

The Commission finds that the ownership restriction in proposed Rule 985(a), combined with the voting limitations in NASDAQ OMX's Certificate of Incorporation Article Fourth.C and By-Law 12.5,<sup>187</sup> is

<sup>183</sup> The Rules use the term "members" to refer to members of the Exchange (previously defined as "Members").

<sup>184</sup> See proposed Rule 985(a).

The Commission also notes that NASDAQ OMX's Restated Certificate of Incorporation imposes limits on direct and indirect changes in control that are designed to prevent any shareholder from exercising undue control over the operation of the exchange and to ensure that the exchange and the Commission are able to carry out their regulatory obligations under the Act. Specifically, no person, which would include any Member, who beneficially owns shares of common stock, preferred stock, or notes in excess of five percent of the securities generally entitled to vote may vote the shares in excess of five percent. See NASDAQ OMX Certificate of Incorporation Article Fourth.C.

<sup>185</sup> See Securities Exchange Act Release Nos. 57478 (March 12, 2008), 73 FR 14521, 14523 (March 18, 2008) (SR-NASDAQ-2007-004 and SR-NASDAQ-2007-080); 55389 (March 2, 2007) 72 FR 10575, 10578 (March 8, 2007) (SR-CBOE-2006-110); 55293 (February 14, 2007), 72 FR 8033, 8037 (February 22, 2007) (SR-NYSE-2006-120); 53382 (February 27, 2006), 71 FR 11251, 11257 (March 6, 2006) (SR-NYSE-2005-77); 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131); 51149 (February 8, 2005), 70 FR 7531, 7538 (February 14, 2005) (SR-CHX-2004-26); 49718 (May 17, 2004), 69 FR 29611, 29624 (May 24, 2004) (SR-PCX-2004-08); 49098, *supra* note 5 at 3986; and 49067 (January 13, 2004), 69 FR 2761, 2767 (January 20, 2004) (SR-BSE-2003-19).

<sup>186</sup> See, e.g., Securities Exchange Act Release No. 49718, *supra* note 185 at 29624.

<sup>187</sup> See *supra* Section III.B (discussing the voting limits applicable to NASDAQ OMX securities).

consistent with the Act, including Sections 6(b)(1) and 6(b)(5) of the Act. These limitations should minimize the potential that a Phlx member could improperly interfere with or restrict the ability of the Commission or the Exchange to effectively carry out their regulatory oversight responsibilities under the Act.

##### *2. Limitations on Affiliation between Phlx and Its Members*

Proposed Rule 985(b) would prohibit Phlx or an entity with which it is affiliated from acquiring or maintaining an ownership interest in, or engaging in a business venture<sup>188</sup> with, a Phlx member or an affiliate of a Phlx member in the absence of an effective filing with the Commission under Section 19(b) of the Act.<sup>189</sup> Further, the rule would prohibit a Phlx member from becoming an affiliate of Phlx or an affiliate of an entity affiliated<sup>190</sup> with Phlx in the absence of an effective filing under Section 19(b) of the Act. However, Rule 985(b) would exclude from this restriction two types of affiliations.

First, a Phlx member or an affiliate of a Phlx member could acquire or hold an equity interest in NASDAQ OMX that is permitted pursuant to proposed Rule 985(a) (*i.e.*, less than 20% of the outstanding voting securities) without the need for the Exchange to file such acquisition or holding under Section 19(b) of the Act.<sup>191</sup> Second, Phlx or an entity affiliated with Phlx could acquire or maintain an ownership interest in, or engage in a business venture with, an affiliate of a Phlx member without the need for the Exchange to file such affiliation under Section 19(b) of the Act, if there were information barriers between the member and Phlx and its facilities. These information barriers would have to prevent the member from having an "informational advantage" concerning the operation of Phlx or its facilities or "knowledge in advance of other Phlx members" of any proposed

<sup>188</sup> Phlx would define a "business venture" as an arrangement under which (A) Phlx or an entity with which it is affiliated and (B) a Member or an affiliate of a Member, engage in joint activities with the expectation of shared profit and a risk of shared loss from common entrepreneurial efforts. See proposed Rule 985(b)(i).

<sup>189</sup> 15 U.S.C. 78s(b).

<sup>190</sup> Phlx defines the term "affiliate" under proposed Rule 985(b) as having the meaning specified in Rule 12b-2 under the Act; provided, however, that for purposes of Rule 985(b), one entity shall not be deemed to be an affiliate of another entity solely by reason of having a common director.

<sup>191</sup> As discussed above, proposed Rule 985(a) provides that "[n]o member or person associated with a member shall be the beneficial owner of greater than twenty percent (20%) of the then-outstanding voting securities of The NASDAQ OMX Group Inc."

<sup>182</sup> 15 U.S.C. 78f(b)(1) and 15 U.S.C. 78f(b)(5), respectively.

changes to the operations of Phlx or its trading systems. Further, Phlx may only notify an affiliated member of any proposed changes to its operations or trading systems in the same manner as it notifies non-affiliated members. Additionally, Phlx and its affiliated member may not share employees, office space, or data bases. Finally, the Board must certify, annually, that Phlx has taken all reasonable steps to implement, and comply with, the rule.

Proposed Rule 985 is based on the rules of Nasdaq, which the Commission previously found consistent with the Act.<sup>192</sup> The Commission similarly finds that proposed Rule 985 is consistent with the requirements of Section 6(b)(5) of the Act, which requires that an exchange have rules designed, among other things, to promote just and equitable principles of trade, to remove impediments and to perfect the mechanism of a free and open market and a national market system, and in general, to protect investors and the public interest.<sup>193</sup>

The Commission is concerned about the potential for unfair competition and conflicts of interest between an exchange's self-regulatory obligations and its commercial interests that could exist if an exchange were to otherwise become affiliated with one of its members, as well as the potential for unfair competitive advantage that the affiliated member could have by virtue of informational or operational advantages, or the ability to receive preferential treatment.<sup>194</sup> The Commission believes that Phlx's proposed rule is designed to mitigate these concerns by requiring that Phlx file a proposed rule change in connection with proposed affiliations between Phlx and Members unless such affiliation is due to a Member's interest in NASDAQ OMX permitted under proposed Rule 985(a) or conforms to the specified information barrier requirements.

If Phlx entered into an affiliation with a member (or any other party) that

resulted in a change to a Rule or the need to establish new Rules, as defined under the Act, then such affiliation would be subject to the requirements of Section 19(b) of the Act and Rule 19b-4 thereunder. Proposed Rule 985(b) would not affect this statutory rule filing requirement.

### 3. Exceptions to Limitations on Affiliation Between Phlx and Its Members

NASDAQ OMX currently owns two broker-dealers: NES and NASDAQ Options Services, LLC ("NOS"). NES and NOS are members of Phlx. Absent relief, after the closing of NASDAQ OMX's acquisition of Phlx, NASDAQ OMX's ownership of NES and NOS would cause NES and NOS to violate the provision in proposed Rule 985(b) prohibiting Members from being affiliated with the Exchange.

Phlx has proposed that NES and NOS be permitted to become affiliates of the Exchange, subject to certain conditions and limitations. First, Phlx proposes that NES and NOS would only route orders to Phlx that first attempt to access liquidity on the NASDAQ Exchange.<sup>195</sup> Second, NES and NOS will remain facilities of the NASDAQ Exchange. Under NASDAQ Exchange rules, NES operates as a facility<sup>196</sup> of NASDAQ Exchange and routes orders to other market centers as directed by NASDAQ Exchange. Similarly, NOS is operated and regulated as a facility of NASDAQ Exchange with respect to its routing of System Securities ("NOS

facility function"), and, consequently, the operation of NOS in this capacity will be subject to Exchange oversight, as well as Commission oversight.<sup>197</sup> NASDAQ Exchange is responsible for ensuring that NES and NOS, each a facility of the NASDAQ Exchange, are operated consistent with Section 6 of the Act and NASDAQ Exchange's rules. In addition, NASDAQ Exchange must file with the Commission rule changes and fees relating to NES and NOS. Third, use of NES's and NOS's routing function by NASDAQ Exchange members will continue to be optional. Parties that do not desire to use NES may enter orders into the NASDAQ Exchange as immediate-or-cancel orders or any other order-type available through the NASDAQ Exchange that is ineligible for routing.<sup>198</sup> Similarly, NOM participants are not required to use NOS to route orders, and a NOM participant may route its orders through any available router it selects.<sup>199</sup> In addition, the Commission notes that NES and NOS are members of an SRO unaffiliated with the NASDAQ Exchange, which serves as their designated examining authority under Rule 17d-1.<sup>200</sup>

In the past, the Commission has expressed concern that the affiliation of an exchange with one of its members raises potential conflicts of interest, and the potential for unfair competitive advantage.<sup>201</sup> Although the Commission continues to be concerned about potential unfair competition and conflict of interest between an exchange's self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, the Commission believes that it is appropriate and consistent with the Act to permit NES and NOS to become affiliates of Phlx for the limited purpose of providing routing services for NASDAQ Exchange for orders that first attempt to access liquidity on NASDAQ Exchange's systems before routing to Phlx, and in light of the protections afforded by the other conditions described above.

<sup>192</sup> See Nasdaq Rule 2130 and Securities Exchange Act Release No. 53128, *supra* note 101. See also Nasdaq Rule 2140 and Securities Exchange Act Release No. 54170 (July 18, 2006), 71 FR 42149 (July 25, 2006) (SR-NASDAQ-2006-006) (order approving Nasdaq's proposal to adopt Nasdaq Rule 2140, restricting affiliations between Nasdaq and its members).

<sup>193</sup> 15 U.S.C. 78f(b)(5).

<sup>194</sup> See Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) (order approving the New York Stock Exchange, Inc.'s merger with Archipelago Holdings, Inc.). See also Securities Exchange Act Release No. 54170 *supra* note 192 (order approving Nasdaq's proposal to adopt a similar rule, Nasdaq Rule 2140, restricting affiliations between Nasdaq and its members).

<sup>195</sup> NES currently provides to NASDAQ Exchange members optional routing services to other market centers, including Phlx, as set forth in NASDAQ Exchange's rules. See NASDAQ Exchange Rules 4751, 4755, and 4758. NOS provides to NASDAQ Exchange members that are Nasdaq Options Market ("NOM") participants routing services to other market centers. Pursuant to NASDAQ Exchange's rules, NOS: (1) routes orders in options currently trading on NOM, referred to as "System Securities;" and (2) routes orders in options that are not currently trading on NOM ("Non-System Securities"). See NOM Rules, Chapter VI Sections 1(b) and 11. See also Securities Exchange Act Release No. 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR-NASDAQ-2007-004 and SR-NASDAQ-2007-080) ("NOM Approval Order"). With respect to System Securities, NOM participants may designate orders to be routed to another market center when trading interest is not available on NOM or to execute only on NOM. See NOM Rules, Chapter VI, Section 11. See also NOM Approval Order, 73 FR at 14532-14533.

<sup>196</sup> See NASDAQ Exchange Rule 4758(b)(3). See also Securities Exchange Act Release No. 56708 (October 26, 2007), 72 FR 61925 (November 1, 2007) (SR-NASDAQ-2007-078) ("NES Routing Release"). As a facility of NASDAQ Exchange, NASDAQ Exchange Rule 4758(b) acknowledges that NASDAQ Exchange is responsible for filing with the Commission rule changes related to the operation of, and fees for services provided by, NES and that NES is subject to exchange non-discrimination requirements.

<sup>197</sup> See NOM Rules, Chapter 11(e). See also NOM Approval Order, *supra* note 195, 73 FR at 14533.

<sup>198</sup> See NASDAQ Exchange Rule 4758(b)(7).

<sup>199</sup> See NOM Rules, Chapter VI, Section 11(a) (allowing Participants to designate orders as available for routing or not available for routing). See also NOM Approval Order, *supra* note 195, 73 FR at 14533, n.91 and accompanying text.

<sup>200</sup> See NASDAQ Exchange Rule 4758(b)(4), and NOM Rules, Chapter 11(e). See NES Routing Release, *supra* note 196; and NOM Approval Order, *supra* note 195, 73 FR at 14533, n.189 and accompanying text.

<sup>201</sup> See *supra* note 194 and accompanying text.



### III. Accelerated Approval

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>202</sup> for approving the proposal, as modified by Amendment Nos. 1 and 2, prior to the thirtieth day after the date of publication of notice of filing of Amendment No. 2 in the **Federal Register**.<sup>203</sup> In Amendment No. 2, Phlx proposed to adopt as rules of the Exchange the Certificate of Incorporation and By-Laws of NASDAQ OMX. The Certificate of Incorporation, as filed by the Exchange, was previously approved by the Commission as rules of Nasdaq.<sup>204</sup> The NASDAQ OMX By-Laws were similarly approved by the Commission.<sup>205</sup> As filed by the Exchange, the NASDAQ OMX By-Laws include certain new terminology to reflect the acquisition of Phlx by NASDAQ OMX. These changes were filed by NASDAQ Exchange as a proposed rule change, and were published for comment.<sup>206</sup> The Commission received no comments on the proposed changes to the NASDAQ OMX By-Laws.

As discussed more fully above and in the NASDAQ Stock Market Proposal, certain provisions of NASDAQ OMX's Certificate and By-Laws are designed to facilitate the ability of NASDAQ OMX's SRO Subsidiaries, including Phlx, to maintain the independence of each of the SRO Subsidiaries' self-regulatory function, enable each SRO Subsidiary to operate in a manner that complies with the federal securities laws, and facilitate the ability of each SRO subsidiary and the Commission to fulfill their regulatory and oversight obligations under the Act.<sup>207</sup> As stated above, the Commission finds that such provisions are consistent with the Act.<sup>208</sup> Notably, the NASDAQ OMX Certificate and By-Laws are rules of NASDAQ Exchange that have been approved previously by the Commission, as noted above, and the changes to the NASDAQ OMX By-Laws were published for notice and comment, as noted above, and the

Commission did not receive any comments thereon. Accordingly, the Commission finds good cause for approving the Phlx's proposal, as modified by Amendment Nos. 1 and 2, on an accelerated basis, pursuant to Section 19(b)(2) of the Act.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether Amendment No. 2 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 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 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2008-31 and should

be submitted on or before August 13, 2008.

### V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>209</sup> that the proposed rule change (SR-Phlx-2008-31), as modified by Amendment Nos. 1 and 2 thereto, be and hereby is approved on an accelerated basis.

By the Commission.

**Florence E. Harmon,**

*Acting Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-58185; File No. SR-Phlx-2008-54]

### Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Participation Guarantees for Crossing and Facilitation Orders

July 17, 2008.

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 July 14, 2008, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Phlx. The Phlx has submitted the proposed rule change as a "non-controversial" proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder.<sup>4</sup> 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 1064, "Crossing, Facilitation and Solicited Orders," to

<sup>209</sup> 15 U.S.C. 78s(b)(2).

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

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

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

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

<sup>202</sup> 15 U.S.C. 78s(b)(2).

<sup>203</sup> Pursuant to Section 19(b)(2) of the Act, 15 U.S.C. 78s(b)(2), the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of the notice thereof, unless the Commission finds good cause for so doing.

<sup>204</sup> See Securities Exchange Act Release No. 51328, *supra* note 101.

<sup>205</sup> See *id.*

<sup>206</sup> See Securities Exchange Act Release No. 57761, *supra* note 4.

<sup>207</sup> See *supra* Section III.C.1 (discussing, for example the duty of the board, officers, employees and agents NASDAQ OMX to give due regard to the preservation of the independence of the Phlx's self-regulatory function).

<sup>208</sup> See *supra* note 56 and accompanying text.