

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-55290; File No. SR-PHLX-2007-05]

**Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change as Modified by Amendment No. 1 Thereto Relating to Changing the Payment for Order Flow Fee for Options Subject to the Penny Pilot Program**

February 13, 2007.

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 January 25, 2007, the Philadelphia Stock Exchange, Inc. (“PHLX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the Exchange. On February 8, 2007, the PHLX submitted Amendment No. 1 to the proposed rule change. PHLX has designated this proposal as one establishing or changing a due, fee, or other charge imposed by PHLX under Section 19(b)(3)(A)(ii) of the Act<sup>3</sup> and Rule 19b-4(f)(2) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to

solicit comments on the proposed rule change, as amended, from interested persons.

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

The Phlx proposes to decrease its payment for order flow fee from \$0.70 per contract to \$0.25 per contract for the equity options that trade as part of the Exchange’s Penny Pilot Program to quote and trade options in penny increments (as discussed in more detail below). Listed below is each option class included in the Penny Pilot Program and the effective date of the fee change for such option class.

Symbol	Underlying security	Anticipated effective date (for trades settling on or after the dates set forth below)
IWM .....	ishares Russell 2000 Index Fund .....	February 12, 2007.
SMH .....	Semiconductor Holdrs .....	February 12, 2007.
GE .....	General Electric Company .....	February 5, 2007.
AMD .....	Advanced Micro Devices, Inc .....	February 12, 2007.
MSFT .....	Microsoft Corporation .....	February 5, 2007.
INTC .....	Intel Corporation .....	February 12, 2007.
CAT .....	Caterpillar, Inc .....	February 12, 2007.
WFM .....	Whole Foods Market, Inc .....	January 29, 2007.
TXN .....	Texas Instruments Incorporated .....	February 12, 2007.
A .....	Agilent Tech Inc .....	February 12, 2007.
SUNW .....	Flextronics International Ltd .....	February 12, 2007.
FLEX .....	Sun Microsystems, Inc .....	February 12, 2007.

For the Nasdaq-100 Index Tracking Stock<sup>SM</sup> traded under the symbol QQQQ (“QQQQ”),<sup>5</sup> the payment for order flow fee would be decreased from \$0.75 to \$0.25, anticipated to be effective for trades settling on or after February 12, 2007.

Other than the rate changes described above, no other changes to the Exchange’s current payment for order flow program are being proposed at this time.

This proposal is to become effective for trades settling on or after the rollout date for each option listed above and would remain in effect until May 27, 2007.<sup>6</sup>

The text of the proposed rule change is available at the Exchange, the

Commission’s Public Reference Room, and <http://www.phlx.com>.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change, and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. PHLX has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

**A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change****1. Purpose**

Currently, the Exchange assesses a payment for order flow fee of \$0.70 per contract for equity options other than options on QQQQ. Options on QQQQ are assessed \$0.75 per contract. Specialists,<sup>7</sup> Directed Registered Options Traders (“Directed ROTs”) and Registered Options Traders (“ROT”) are assessed a payment for order flow fee when a customer order is directed to a specialist unit or Directed ROT who participates in the Exchange’s payment for order flow program.<sup>8</sup> Trades resulting from either Directed<sup>9</sup> or non-

<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)(iii).<sup>4</sup> 17 CFR 240.19b-4(f)(2).

<sup>5</sup> The Nasdaq-100 Index, Nasdaq-100 Index, Nasdaq-100 Index, The Nasdaq Stock Market, Nasdaq-100 Shares, Nasdaq-100 Trust, Nasdaq-100 Index Tracking Stock, and QQQ are trademarks or service marks of The Nasdaq Stock Market, Inc. (“Nasdaq”) and have been licensed for use for certain purposes by the Philadelphia Stock Exchange pursuant to a License Agreement with Nasdaq. The Nasdaq-100 Index (the “Index”) is

determined, composed, and calculated by Nasdaq without regard to the Licensee, the Nasdaq-100 Trust, or the beneficial owners of Nasdaq-100 Shares. Nasdaq has complete control and sole discretion in determining, comprising, or calculating the Index or in modifying in any way its method for determining, comprising, or calculating the Index in the future.

<sup>6</sup> The Exchange’s payment for order flow program is currently in effect until May 27, 2007. See Securities Exchange Act Release No. 53841 (May 19, 2006), 71 FR 30461 (May 26, 2006) (SR-PHLX-2006-33).

<sup>7</sup> The Exchange uses the terms “specialist” and “specialist unit” interchangeably herein.

<sup>8</sup> Therefore, the payment for order flow fee is assessed, in effect, on equity option transactions between a customer and a ROT, a customer and a Directed ROT, or a customer and a specialist when a customer order is directed to a specialist or Directed ROT who participates in the Exchange’s payment for order flow program.

<sup>9</sup> The term “Directed Order” means any customer order to buy or sell, which has been directed to a

Directed Orders that are delivered electronically over AUTOM<sup>10</sup> and executed on the Exchange are assessed a payment for order flow fee, while non-electronically-delivered orders (*i.e.*, represented by a floor broker) are not assessed a payment for order flow fee.<sup>11</sup>

Separately, the Exchange intends to implement a six-month pilot period beginning on January 26, 2007 (the "pilot"), during which certain options (the options set forth in this proposal) would be quoted and traded on the Exchange in minimum increments of \$0.01 for all series in such options with a price of less than \$3.00, and in minimum increments of \$0.05 for all series in such options with a price of \$3.00 or higher, except that options overlying the QQQQ would be quoted and traded in minimum increments of \$0.01 for all series regardless of the price.<sup>12</sup>

The purpose of this proposal is to assess payment for order flow fees in a manner that the Exchange believes is more appropriate in light of the pilot. In connection with the implementation of the pilot, the Exchange proposes to decrease the amount of the payment for order flow fees in the options that are subject to the pilot because the Exchange believes that, with narrower minimum increments and therefore possibly narrower spreads, specialists, Directed ROTs, and ROTs may face tighter profit margins if coupled with the current \$0.70 (or \$0.75 for QQQQ) payment for order flow fee. By reducing the payment for order flow fees in the options that are subject to the pilot, the Exchange believes that members and member organizations should continue to display strong liquid markets, without being financially burdened with the higher payment for order flow fees that are currently in effect.

The purpose of establishing different effective dates is to implement the proposed payment for order flow fees on the date on which each specified option is rolled out in connection with the pilot. The proposed fees would remain in effect until May 27, 2007.<sup>13</sup>

particular specialist, Remote Streaming Quote Trader or Streaming Quote Trader by an Order Flow Provider.

<sup>10</sup> AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. See Exchange Rules 1014(b)(ii) and 1080.

<sup>11</sup> Electronically-delivered orders do not include orders delivered through the Floor Broker Management System pursuant to Exchange Rule 1063.

<sup>12</sup> See Securities Exchange Act Release No. 54886 (December 6, 2006), 71 FR 74979 (December 13, 2006) (SR-PHLX-2006-74).

<sup>13</sup> See *supra*, note 6.

## 2. Statutory Basis

The Exchange believes that the proposed rule change to amend its schedule of fees is consistent with Section 6(b) of the Act<sup>14</sup> in general, and Section 6(b)(4) of the Act<sup>15</sup> in particular, in that it is an equitable allocation of reasonable fees and other charges among exchange members.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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

No written comments were solicited or received with respect to the proposed rule change.

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

The foregoing proposed rule change has been designated as a fee change pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>16</sup> and Rule 19b-4(f)(2)<sup>17</sup> thereunder, because it establishes or changes a due, fee, or other charge imposed by the Exchange. Accordingly, the proposal will take effect upon filing with the Commission. At any time within 60 days of the filing of such proposed rule change the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>18</sup>

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

<sup>14</sup> 15 U.S.C. 78f(b).

<sup>15</sup> 15 U.S.C. 78f(b)(4).

<sup>16</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

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

<sup>18</sup> For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposed rule change, the Commission considers the period to commence on February 8, 2007, the date on which the Exchange filed Amendment No. 1.

## 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-2007-05 on the subject line.

## Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-PHLX-2007-05. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of PHLX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-PHLX-2007-05 and should be submitted on or before March 15, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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<sup>19</sup> 17 CFR 200.30-3(a)(12).