Proposed Rule Change by Philadelphia Stock Exchange

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

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Extension of Time Period for Commission Action

Date Expires

Description

Provide a brief description of the proposed rule change (limit 250 characters).

The Phlx proposes to amend Phlx Rule 707, Just and Equitable Principles of Trade

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name: John
Last Name: Dayton
Title: Director and Counsel
E-mail: john.dayton@phlx.com
Telephone: (215) 496-5162
Fax: (215) 496-6729

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date: 10/25/2005

By: John Dayton
Title: Director and Counsel

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

John Dayton, john.dayton@phlx.com
If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission’s permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.
1. **Text of the Proposed Rule Change**

The Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² proposes to amend Rule 707, Conduct Inconsistent with Just and Equitable Principles of Trade.

The text of the proposed rule change is set forth below.

Brackets indicate deletions; underlining indicates additions.

**Rule 707  Conduct Inconsistent with Just and Equitable Principles of Trade**

A member, member organization, or person associated with or employed by a member or member organization shall not engage in conduct inconsistent with just and equitable principles of trade.

Commentary:

.01 No Change

.02 Without limiting the generality of Rule 707, it is conduct inconsistent with just and equitable principles of trade for any member, member organization, or person associated with or employed by a member or member organization to engage in conduct that has the intent or effect of unbundling equity securities orders for execution for the primary purpose of maximizing a monetary or in-kind amount received by the member, member organization, or person associated with or employed by a member or member organization as a result of the execution of such equity securities orders. For purposes of this section, "monetary or in-kind amounts" shall be defined to include commissions, gratuities, payments for or rebate of fees resulting from the entry of such equity securities orders, or any similar payments of value to the member, member organization, or person associated with or employed by a member or member organization.

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1.

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2. **Procedures of the Self-Regulatory Organization**

The Executive Committee, pursuant to delegated authority approved the proposal for filing with the Securities and Exchange Commission ("SEC" or "Commission") on October 19, 2005.

Questions and comments on the proposed rule change may be directed to John Dayton, Director and Counsel at (215) 496-5162 or Edith Hallahan, Senior Vice President and Deputy General Counsel, at (215) 496-5179.

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

   a. **Purpose**

   The purpose of the proposed rule change is to prohibit “trade shredding” which is the practice of unbundling customer orders for equity securities into multiple smaller orders for the primary purpose of maximizing payments to the member or member organization, and thereby possibly disadvantaging the customer by, for example, charging excessive fees or commissions, or failing to obtain best execution of an equity security order. Such payments may create a conflict of interest between the customer and the member or member organization. For example, as a result of the manner in which market data revenues are calculated, market centers can derive a greater share of market data revenue by increasing the number of trades that they report to the consolidated tape. At the same time, some markets have adopted a practice of sharing these increased revenues with market participants, including non-members, who send in equity securities orders. Thus, the Commission has expressed concern that an incentive exists for market participants receiving rebates to engage in distortive behavior, such as trade shredding, as
a means to increase their share of market data revenues. Other economic arrangements between members or members organizations and their customers may create similar incentives to engage in similarly distortive behavior.

The Commission has requested that all U.S. self-regulatory organizations implement rule changes to inhibit the practice of trade shredding. The Phlx does not rebate revenues from tape reporting to members or non-members. Thus, there is no incentive in this area for Phlx order providers to engage in trade shredding on orders sent to the Exchange. However, a member or member organization may engage in conduct that has an impact similar to trade shredding, in that it unbundles a customer’s order for the primary purpose of maximizing payments to the member or member organization at the customer’s expense and to the customer’s detriment.

In response to the Commission’s request, the Exchange proposes to amend Rule 707 by adding Commentary .02 which prohibits all such practices. Specifically, the new Commentary to Rule 707 would prohibit any member, member organization, or person associated with or employed by a member or member organization from unbundling orders for execution for the primary purpose of maximizing a monetary or like payment of a type described in the rule.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act in general, and furthers the objectives of Section 6(b)(5) of the Act in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to

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and perfect the mechanism of a free and open market and a national market system, and,
in general to protect investors and the public interest, by prohibiting any member,
member organization, or person associated with or employed by a member or member
organization to engage in conduct that has the intent or effect of unbundling equity
securities orders for execution for the primary purpose of maximizing a monetary or in-
kind amount received by the member, member organization, or person associated with or
employed by a member or member organization as a result of the execution of such
equity securities orders.

4. Self-Regulatory Organization's Statement on Burden on Competition

The Phlx 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.

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

No written comments were either solicited or received.

6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period for
Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated
Effectiveness Pursuant to Section 19(b)(2)

Not applicable.
8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed rule change is based on a similar proposed rule of the New York Stock Exchange.\(^5\)

9. Exhibits

1. Notice of proposed rule for publication in the Federal Register.

Exhibit 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. ; File No. SR-Phlx-2005-63)


Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") \(^1\), and Rule 19b-4 \(^2\) thereunder, notice is hereby given that on __________, 2005, 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 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, pursuant to Section 19(b)(1) and Rule 19b-4 thereunder, \(^3\) proposes to amend Rule 707, Conduct Inconsistent with Just and Equitable Principles of Trade.

The text of the proposed rule change is set forth below.

Brackets indicate deletions; underlining indicates additions.

**Rule 707  Conduct Inconsistent with Just and Equitable Principles of Trade**

A member, member organization, or person associated with or employed by a member or member organization shall not engage in conduct inconsistent with just and equitable principles of trade.

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\(^3\) 17 CFR 240.19b-4.
Commentary:

.01 No Change

.02 Without limiting the generality of Rule 707, it is conduct inconsistent with just and equitable principles of trade for any member, member organization, or person associated with or employed by a member or member organization to engage in conduct that has the intent or effect of unbundling equity securities orders for execution for the primary purpose of maximizing a monetary or in-kind amount received by the member, member organization, or person associated with or employed by a member or member organization as a result of the execution of such equity securities orders. For purposes of this section, “monetary or in-kind amounts” shall be defined to include commissions, gratuities, payments for or rebate of fees resulting from the entry of such equity securities orders, or any similar payments of value to the member, member organization, or person associated with or employed by a member or member organization.

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

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

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

1. Purpose

The purpose of the proposed rule change is to prohibit “trade shredding” which is the practice of unbundling customer orders for equity securities into multiple smaller orders for the primary purpose of maximizing payments to the member or member organization, and thereby possibly disadvantaging the customer by, for example, charging excessive fees or commissions, or failing to obtain best execution of an equity security order. Such payments may create a conflict of interest between the customer and
the member or member organization. For example, as a result of the manner in which market data revenues are calculated, market centers can derive a greater share of market data revenue by increasing the number of trades that they report to the consolidated tape. At the same time, some markets have adopted a practice of sharing these increased revenues with market participants, including non-members, who send in equity securities orders. Thus, the Commission has expressed concern that an incentive exists for market participants receiving rebates to engage in distortive behavior, such as trade shredding, as a means to increase their share of market data revenues. Other economic arrangements between members or members organizations and their customers may create similar incentives to engage in similarly distortive behavior.

The Commission has requested that all U.S. self-regulatory organizations implement rule changes to inhibit the practice of trade shredding. The Phlx does not rebate revenues from tape reporting to members or non-members. Thus, there is no incentive in this area for Phlx order providers to engage in trade shredding on orders sent to the Exchange. However, a member or member organization may engage in conduct that has an impact similar to trade shredding, in that it unbundles a customer’s order for the primary purpose of maximizing payments to the member or member organization at the customer’s expense and to the customer’s detriment.

In response to the Commission’s request, the Exchange proposes to amend Rule 707 by adding Commentary .02 which prohibits all such practices. Specifically, the new Commentary to Rule 707 would prohibit any member, member organization, or person associated with or employed by a member or member organization from unbundling
orders for execution for the primary purpose of maximizing a monetary or like payment of a type described in the rule.

2. **Statutory Basis**

The Exchange believes that its proposal is consistent with Section 6(b) of the Act\(^4\) in general, and furthers the objectives of Section 6(b)(5) of the Act\(^5\) in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest, by prohibiting any member, member organization, or person associated with or employed by a member or member organization to engage in conduct that has the intent or effect of unbundling equity securities orders for execution for the primary purpose of maximizing a monetary or in-kind amount received by the member, member organization, or person associated with or employed by a member or member organization as a result of the execution of such equity securities orders.

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 either solicited or received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which Phlx consents, the Commission shall: (a) by order approve such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission’s Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2005-63 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-Phlx-2005-63. 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.
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 the filing also will be available for inspection and copying at the principal office of the Phlx. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2005-63 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁶

Margaret H. McFarland
Deputy Secretary

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