Proposed Rule Change by Philadelphia Stock Exchange

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

<table>
<thead>
<tr>
<th>Initial</th>
<th>Amendment</th>
<th>Withdrawal</th>
<th>Section 19(b)(2)</th>
<th>Section 19(b)(3)(A)</th>
<th>Section 19(b)(3)(B)</th>
<th>Rule</th>
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Pilot

Extension of Time Period for Commission Action

Date Expires

Description

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

Rebate excess payment for order flow funds on a quarterly basis

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 Cynthia

Last Name Hoekstra

Title Director

E-mail cynthia.hoekstra@phlx.com

Telephone (215) 496-5066

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 04/19/2006

By Cynthia Hoekstra

Director

(Note)

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.

Cynthia Hoekstra,
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") and Rule 19b-4 thereunder, proposes to amend its equity options payment for order flow program to rebate on a quarterly basis excess payment for order flow funds (funds collected but not requested by a specialist or Directed Registered Options Trader ("ROT")). After the end of each calendar quarter, any excess funds from the previous calendar quarter will be calculated and subsequently rebated on a pro-rata basis to the applicable specialists, Directed ROTs and ROTs who paid into that pool of funds. Rebated funds will be reflected as a credit on the members’ invoices.

This proposal will remain in effect as part of the Exchange’s payment for order flow pilot program that is currently scheduled to expire on May 27, 2006.

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1 and a copy of the applicable section of the Exchange’s Summary of Equity Options is attached hereto as Exhibit 5.

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 March 30, 2006.

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3. The current payment for order flow program is in effect as a pilot program that is scheduled to expire on May 27, 2006, the same date as the one-year pilot program in effect in connection with Directed Orders. See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005) (SR-Phlx-2004-91).
Questions and comments on the proposed rule change may be directed to Cynthia Hoekstra, Director, at (215) 496-5066 or Edith Hallahan, 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**

      Currently, the following payment for order flow rates are in effect at the Exchange: (1) equity options other than QQQQ\(^4\) and FXI Options are assessed $0.60 per contract; (2) options on QQQQ are assessed $0.75 per contract; and (3) no payment for order flow fees are assessed on FXI Options.\(^5\) Trades resulting from either Directed or non-Directed Orders that are delivered electronically over AUTOM, 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.\(^6\)

      Specialist units or Directed ROTs, may request that any excess funds (funds collected but not requested by a specialist unit or Directed ROT) be rebated on a pro-rata

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\(^4\) The Nasdaq-100\(^\text{®}\), Nasdaq-100 Index\(^\text{®}\), Nasdaq\(^\text{®}\), The Nasdaq Stock Market\(^\text{®}\), Nasdaq-100 Shares\(^\text{SM}\), Nasdaq-100 Trust\(^\text{SM}\), Nasdaq-100 Index Tracking Stock\(^\text{SM}\), and QQQ\(^\text{SM}\) 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\(^\text{®}\) (the Index) is determined, composed, and calculated by Nasdaq without regard to the Licensee, the Nasdaq-100 Trust\(^\text{SM}\), or the beneficial owners of Nasdaq-100 Shares\(^\text{SM}\). 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.

\(^5\) Specialists and Directed ROTs who participate in the Exchange’s payment for order flow program are assessed a payment for order flow fee, in addition to ROTs.

\(^6\) Electronically-delivered orders do not include orders delivered through the Floor Broker Management System pursuant to Exchange Rule 1063.
basis to the applicable members who paid into that pool of funds. If excess funds are rebated, they are reflected as a credit on the invoices. The amount a specialist unit or Directed ROT may request that the Exchange pay to Order Flow Providers is limited to the amount billed and collected for that month, plus any excess funds that were carried over from previous months.

The Exchange is proposing to amend its equity options payment for order flow program to rebate on a quarterly basis excess payment for order flow funds. After the end of each calendar quarter, any excess funds from the previous calendar quarter will be calculated and subsequently rebated on a pro-rata basis to the applicable specialists, Directed ROTs and ROTs who paid into that pool of funds. This should allow for sufficient time to process any rebates. Consistent with current practice, rebated funds will be reflected as a credit on the invoices.

Specialists and Directed ROTs will be able to continue to request that any excess funds be rebated to the specialists, Directed ROTs and ROTs who paid into that pool of funds. In addition, specialists and Directed ROTs may continue to request that the Exchange pay to order flow providers an amount limited to the amount billed and

7 If a specialist unit or Directed ROT leaves the Exchange mid-month, any excess funds in that specialist unit or Directed ROT pool are rebated to the applicable Exchange members on a pro rata basis.

8 For example, after the end of March (the last month of the quarter covering the period from January, February and March), any excess funds from October, November and December (the previous quarter) would be calculated.

9 At this time, the Exchange intends to rebate, in the form of a credit, any excess funds on an invoice reflecting activity in the month following the end of a calendar quarter. For example, after the end of March (the last month of a quarter) any excess funds from the October, November and December (the previous quarter) would be calculated and then reflected as a credit on the invoices that cover activity for the month of April (“April invoices”). The April invoices are typically issued in the beginning of May.
collected for that month, plus any excess funds carried over from previous months. However, under the current proposal, excess funds from the previous quarter will no longer be available to the specialists and Directed ROTs once they have directed the Exchange to make payments to Order Flow Providers for activity covering order flow received for the last month of each subsequent calendar quarter.\textsuperscript{10}

The purpose of this proposal is to reduce the economic burden on members by rebating excess payment for order flow funds. In addition, the Exchange believes that while specialists and Directed ROTs may carry forward excess amounts that were not paid to order flow providers, there should be a reasonable time frame associated with such amounts that are carried forward.

This proposal will remain in effect as part of the Exchange’s payment for order flow pilot program that is currently scheduled to expire on May 27, 2006.

No other changes to the Exchange’s payment for order flow program are being proposed at this time.

\hspace{1cm} b. \textit{Statutory Basis}

The Exchange believes that its proposal to amend its schedule of fees is consistent with Section 6(b) of the Act\textsuperscript{11} in general, and furthers the objectives of Section 6(b)(4) of the Act\textsuperscript{12} in particular, in that it is an equitable allocation of reasonable fees and other charges among Exchange members.

\hspace{1cm} \textsuperscript{10} For example, after the specialists or Directed ROTs direct the Exchange to make payments to Order Flow Providers at the end of March (last month of a quarter), any excess funds remaining from the previous quarter (October, November and December) will no longer be available to the specialists or Directed ROTs.

\hspace{1cm} \textsuperscript{11} 15 U.S.C. 78f(b).

\hspace{1cm} \textsuperscript{12} 15 U.S.C. 78f(b)(4).
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)**

The foregoing proposed rule change establishes or changes a due, fee, or other charge applicable only to a member pursuant to Section 19(b)(3)(A)(ii) of the Act and Rule 19b-4(f)(2) thereunder. Accordingly, the proposal will take effect upon filing with the Commission. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed rule change is similar to the payment for order flow refunds given by the Chicago Board Options Exchange, Incorporated.\footnote{See Securities Exchange Act Release No. 52818 (November 22, 2005), 70 FR 71568 (November 29, 2005) (SR-CBOE-2005-91) (at the end of each quarter, surplus payment for order flow funds, if any, are refunded on a pro rata basis).}

9. Exhibits

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

5. Applicable Section of the Exchange’s Summary of Equity Options Charges.
Exhibit 1

SECURITIES AND EXCHANGE COMMISSION
(Release No.  ; File No. SR-Phlx-2006-25)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to its Equity Options Payment for Order Flow Program

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")\(^1\), and Rule 19b-4 thereunder,\(^2\) notice is hereby given that on ______________________ 2006, 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) of the Act\(^3\) and Rule 19b-4 thereunder,\(^4\) proposes to amend its equity options payment for order flow program to rebate on a quarterly basis excess payment for order flow funds (funds collected but not requested by a specialist or Directed Registered Options Trader ("ROT")). After the end of each calendar quarter, any excess funds from the previous calendar quarter will be calculated and subsequently rebated on a pro-rata basis to the applicable specialists, Directed ROTs


and ROTs who paid into that pool of funds. Rebated funds will be reflected as a credit on the members’ invoices.

This proposal will remain in effect as part of the Exchange’s payment for order flow pilot program that is currently scheduled to expire on May 27, 2006.\(^5\)

A copy of the applicable section of the Exchange’s Summary of Equity Options is available on the Exchange’s Web site at 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 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

Currently, the following payment for order flow rates are in effect at the Exchange: (1) equity options other than QQQQ\(^6\) and FXI Options are assessed $0.60 per

\(^{5}\) The current payment for order flow program is in effect as a pilot program that is scheduled to expire on May 27, 2006, the same date as the one-year pilot program in effect in connection with Directed Orders. See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005) (SR-Phlx-2004-91).

\(^{6}\) The Nasdaq-100®, Nasdaq-100 Index®, Nasdaq®, 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
contract; (2) options on QQQQ are assessed $0.75 per contract; and (3) no payment for
order flow fees are assessed on FXI Options.7 Trades resulting from either Directed or
non-Directed Orders that are delivered electronically over AUTOM, 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.8

Specialist units or Directed ROTs, may request that any excess funds (funds
collected but not requested by a specialist unit or Directed ROT) be rebated on a pro-rata
basis to the applicable members who paid into that pool of funds. If excess funds are
rebated, they are reflected as a credit on the invoices.9 The amount a specialist unit or
Directed ROT may request that the Exchange pay to Order Flow Providers is limited to
the amount billed and collected for that month, plus any excess funds that were carried
over from previous months.

The Exchange is proposing to amend its equity options payment for order
flow program to rebate on a quarterly basis excess payment for order flow funds. After
the end of each calendar quarter, any excess funds from the previous calendar quarter will

Nasdaq-100 TrustSM, or the beneficial owners of Nasdaq-100 SharesSM. 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.

7 Specialists and Directed ROTs who participate in the Exchange’s payment for order
flow program are assessed a payment for order flow fee, in addition to ROTs.

8 Electronically-delivered orders do not include orders delivered through the Floor Broker
Management System pursuant to Exchange Rule 1063.

9 If a specialist unit or Directed ROT leaves the Exchange mid-month, any excess funds
in that specialist unit or Directed ROT pool are rebated to the applicable Exchange
members on a pro rata basis.
be calculated and subsequently rebated on a pro-rata basis to the applicable specialists, Directed ROTs and ROTs who paid into that pool of funds.\textsuperscript{10} This should allow for sufficient time to process any rebates. Consistent with current practice, rebated funds will be reflected as a credit on the invoices.\textsuperscript{11}

Specialists and Directed ROTs will be able to continue to request that any excess funds be rebated to the specialists, Directed ROTs and ROTs who paid into that pool of funds. In addition, specialists and Directed ROTs may continue to request that the Exchange pay to order flow providers an amount limited to the amount billed and collected for that month, plus any excess funds carried over from previous months. However, under the current proposal, excess funds from the previous quarter will no longer be available to the specialists and Directed ROTs once they have directed the Exchange to make payments to Order Flow Providers for activity covering order flow received for the last month of each subsequent calendar quarter.\textsuperscript{12}

The purpose of this proposal is to reduce the economic burden on members by rebating excess payment for order flow funds. In addition, the Exchange believes that

\textsuperscript{10} For example, after the end of March (the last month of the quarter covering the period from January, February and March), any excess funds from October, November and December (the previous quarter) would be calculated.

\textsuperscript{11} At this time, the Exchange intends to rebate, in the form of a credit, any excess funds on an invoice reflecting activity in the month following the end of a calendar quarter. For example, after the end of March (the last month of a quarter) any excess funds from the October, November and December (the previous quarter) would be calculated and then reflected as a credit on the invoices that cover activity for the month of April ("April invoices"). The April invoices are typically issued in the beginning of May.

\textsuperscript{12} For example, after the specialists or Directed ROTs direct the Exchange to make payments to Order Flow Providers at the end of March (last month of a quarter), any excess funds remaining from the previous quarter (October, November and December) will no longer be available to the specialists or Directed ROTs.
while specialists and Directed ROTs may carry forward excess amounts that were not paid to order flow providers, there should be a reasonable time frame associated with such amounts that are carried forward.

This proposal will remain in effect as part of the Exchange’s payment for order flow pilot program that is currently scheduled to expire on May 27, 2006.

No other changes to the Exchange’s payment for order flow program are being proposed at this time.

2. Statutory Basis

The Exchange believes that its proposal to amend its schedule of fees is consistent with Section 6(b) of the Act\(^{13}\) in general, and furthers the objectives of Section 6(b)(4) of the Act\(^{14}\) 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 either solicited or received.

\(^{13}\) 15 U.S.C. 78f(b).

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act\(^{15}\) and paragraph (f)(2) of Rule 19b-4\(^{16}\) thereunder. Accordingly, the proposal will take effect upon filing with the Commission. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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](http://www.sec.gov/rules/sro.shtml)); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2006-25 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.

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All submissions should refer to File Number SR-Phlx-2006-25. 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 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-2006-25 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.  

Nancy M. Morris  
Secretary  

REAL-TIME RISK MANAGEMENT FEE

$.0025 per contract for firms/members receiving information on a real-time basis

EQUITY OPTION PAYMENT FOR ORDER FLOW FEES*

(1) For trades resulting from either Directed or non-Directed Orders that are delivered electronically and executed on the Exchange: Assessed on ROTs, specialists and Directed ROTs on those trades when the specialist unit or Directed ROT elects to participate in the payment for order flow program.***

(2) No payment for order flow fees will be assessed on trades that are not delivered electronically.

QQQQ (NASDAQ-100 Index Tracking Stock℠) $0.75 per contract
Remaining Equity Options, except FXI Options $0.60 per contract

*Assessed on transactions resulting from customer orders. This proposal will be in effect for trades settling on or after October 1, 2005 and will remain in effect as a pilot program that is scheduled to expire on May 27, 2006.

***Any excess payment for order flow funds billed but not utilized by the specialist or Directed ROT will be carried forward unless the Directed ROT or specialist elects to have those funds rebated to the applicable ROT, Directed ROT or specialist on a pro rata basis, reflected as a credit on the monthly invoices. At the end of each calendar quarter, the Exchange will calculate the amount of excess funds from the previous quarter and subsequently rebate excess funds on a pro-rata basis to the applicable ROT, Directed ROT or specialist who paid into that pool of funds.

No further changes are being made to the Exchange’s fee schedule pursuant to this proposal.