Proposed Rule Change by Philadelphia Stock Exchange

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

Initial Amendment Withdrawal Section 19(b)(2) Section 19(b)(3)(A) Section 19(b)(3)(B)
✓ [ ] [ ] ✓ [ ] [ ]

Pilot Extension of Time Period Date Expires
✓ [ ] [ ]

Rule
19b-4(f)(1) 19b-4(f)(4)
19b-4(f)(2) 19b-4(f)(5)
19b-4(f)(3) 19b-4(f)(6)

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

Extend Directed Order Flow Pilot Program

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 Edith Last Name Hallahan
Title Senior Vice President & Deputy General Counsel
E-mail Edith.hallahan@phlx.com
Telephone (215) 496-5179 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 04/26/2006
By Cynthia Hoekstra Director

(Note)

Cynthia HOekstra,
**Form 19b-4 Information**
The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change**
The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3).

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**
Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**
Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**
The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**
The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**
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 extend, for an additional one year period, a pilot program concerning Exchange Rule 1080, Philadelphia Stock Exchange Automated Options Market (AUTOM)\(^3\) and Automatic Execution System (AUTO-X), and Rule 1014, Obligations And Restrictions Applicable To Specialists And Registered Options Traders. Specifically the pilot program covers: (1) Rule 1080(l), Directed Orders, under which Exchange specialists, Streaming Quote Traders ("SQTs")\(^4\) and Remote Streaming Quote Traders ("RSQTs")\(^5\) trading on the Exchange’s electronic options trading platform, Phlx XL,\(^6\) receive Directed Orders (as defined below); and (2) Rule 1014(g)(viii), which sets forth the trade allocation algorithm for electronically executed and allocated trades.

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\(^3\) AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM's automatic execution features, AUTO-X, Book Sweep and Book Match. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor. AUTOM is today more commonly referred to as Phlx XL. See Exchange Rule 1080.

\(^4\) An SQT is an Exchange Registered Options Trader ("ROT") who has received permission from the Exchange to generate and submit option quotations electronically through an electronic interface with AUTOM via an Exchange approved proprietary electronic quoting device in eligible options to which such SQT is assigned. See Exchange Rule 1014(b)(ii)(A).

\(^5\) An RSQT is a participant in the Exchange’s electronic trading system, Phlx XL who has received permission from the Exchange to trade in options for his own account, and to generate and submit option quotations electronically from off the floor of the Exchange through AUTOM in eligible options to which such RSQT has been assigned.

involving Directed Orders. This proposal is in connection with a pilot program that is currently scheduled to expire on May 27, 2006.7

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1 and the text of the proposed rule change is set forth below. Brackets indicate deletions; underlining indicates new text

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

**Rule 1080.** (a) – (k) No change.

(l) Directed Orders. For a one-year pilot period, beginning on May 28, 2006 [the date of approval of this Rule by the Securities and Exchange Commission], respecting Streaming Quote Options traded on Phlx XL, specialists, RSQTs and SQTs may receive Directed Orders (as defined in this Rule) in accordance with the provisions of this Rule 1080(l).

*     *     *     *     *

No further changes are being made to Phlx Rule 1080 pursuant to this proposal.

**Obligations And Restrictions Applicable To Specialists And Registered Options Traders**

**Rule 1014.** (a) – (f) No change.

(g)(i) – (vii) No change.

(viii) For a one year pilot period, beginning on May 28, 2006 [the date of approval of this Rule by the Securities and Exchange Commission], Directed Orders (as defined in Rule 1080(l)(i)(A)) that are executed electronically shall be automatically allocated as follows:

*     *     *     *     *

No further changes are being made to Phlx Rule 1014 pursuant to this proposal.

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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 April 20, 2006.

Questions and comments on the proposed rule change may be directed to 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 extend, for an additional one-year period, a pilot that allows specialists, SQTs, and RSQTs assigned in options that trade on Phlx XL to receive directed orders ("Direct Orders")\(^8\) from a member or member organization ("Order Flow Provider" or "OFP")\(^9\) that submits, as agent, the customer order to the Exchange through AUTOM, and establishes a trade allocation algorithm for Directed Orders that are electronically executed and allocated to reward such Directed Specialists, SQTs and RSQTs with a participation guarantee for attracting such order flow to the Exchange.\(^10\) The proposed rule is subject to a pilot program scheduled to expire on May 27, 2006. The extended pilot would expire May 27, 2007.

   Pursuant to Rule 1080(l), OFPs must transmit Directed Orders to a particular specialist, SQT or RSQT through AUTOM. If the Exchange’s disseminated best bid or

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\(^8\) See Exchange Rule 1080(l)(i)(A).


\(^10\) See Exchange Rule 1080(l). The word “Directed” modifies all three; that is, it is referring to a Directed Specialist, Directed SQT and Directed RSQT.
offer is at the National Best Bid or Offer when the Directed Order is received, the
Directed Order is automatically executed on Phlx XL and allocated to the orders and
quotes represented in the Exchange’s quotation. A Directed Specialist, SQT or RSQT
will receive a participation allocation pursuant to Rule 1014(g)(viii) if the Directed
Specialist, SQT or RSQT was quoting at the NBBO at the time that the Directed Order
was received. 11 Otherwise, the automatic execution will be allocated to those quotations
and orders at the NBBO pursuant to Rule 1014(g)(vii). 12 The specialist will manually
execute Directed Orders that are received when the Exchange is not quoting at the
NBBO. 13

The Exchange believes that the pilot program rewards specialists, SQTs and
RSQTs for actively engaging in marketing activities and establish relationships with
OFPs that generate Directed Orders sent to the Exchange by such OFPs. The Exchange
believes that the pilot program will result in additional order flow to the Exchange, thus
adding depth and liquidity to the Exchange’s markets, and enabling the Exchange to
continue to compete effectively with other options exchange for order flow.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the
Act14 in general, and furthers the objectives of Section 6(b)(5) of the Act15 in particular,
in that it is designed to promote just and equitable principles of trade, to remove

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11 See Exchange Rule 1080(l)(ii).
12 See Exchange Rule 1080(l)(iii).
13 See Exchange Rule 1080(l)(iv).
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 permitting specialists, SQTs and RSQTs trading options on Phlx XL to receive Directed Orders, and by encouraging the capture of order flow on the Exchange by rewarding Directed Order recipients with a participation guarantee in trades involving Directed 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)**

The Exchange requests accelerated effectiveness pursuant to Section 19(b)(2) of the Act\(^\text{16}\) so that the pilot program may continue uninterrupted.

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

The proposed rule change is similar to a pilot program approved by the Commission for the International Securities Exchange, Inc. (“ISE”) and outlined in ISE Rule 811.17

9. **Exhibits**

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

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SECURITIES AND EXCHANGE COMMISSION  
(Release No. ; File No. SR-Phlx-2006-27)

Self-Regulatory Organizations; Notice of Filing and Accelerated Approval of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Extension of Directed Order Flow Pilot Program

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")1, and Rule 19b-42 thereunder, 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 Act3 and Rule 19b-4 thereunder,4 proposes to extend, for an additional one year period, a pilot program concerning Exchange Rule 1080, Philadelphia Stock Exchange Automated Options Market (AUTOM)5 and Automatic Execution System (AUTO-X), and Rule 1014, Obligations

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

Specifically the pilot program covers: (1) Rule 1080(l), Directed Orders, under which Exchange specialists, Streaming Quote Traders (“SQTs”)6 and Remote Streaming Quote Traders (“RSQTs”)7 trading on the Exchange’s electronic options trading platform, Phlx XL,8 receive Directed Orders (as defined below); and (2) Rule 1014(g)(viii), which sets forth the trade allocation algorithm for electronically executed and allocated trades involving Directed Orders. This proposal is in connection with a pilot program that is currently scheduled to expire on May 27, 2006.9

Brackets indicate deletions; underlining indicates new text

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

Rule 1080. (a) – (k) No change.

(l) Directed Orders. For a one-year pilot period, beginning on May 28, 2006 [the date of approval of this Rule by the Securities and Exchange Commission], respecting Streaming Quote Options traded on Phlx XL, specialists, RSQTs and SQTs may receive Directed Orders (as defined below) in accordance with the provisions of this Rule 1080(l).

index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor. AUTOM is today more commonly referred to as Phlx XL. See Exchange Rule 1080.

6 An SQT is an Exchange Registered Options Trader (“ROT”) who has received permission from the Exchange to generate and submit option quotations electronically through an electronic interface with AUTOM via an Exchange approved proprietary electronic quoting device in eligible options to which such SQT is assigned. See Exchange Rule 1014(b)(ii)(A).

7 An RSQT is a participant in the Exchange’s electronic trading system, Phlx XL who has received permission from the Exchange to trade in options for his own account, and to generate and submit option quotations electronically from off the floor of the Exchange through AUTOM in eligible options to which such RSQT has been assigned.


No further changes are being made to Phlx Rule 1080 pursuant to this proposal.

Obligations And Restrictions Applicable To Specialists And Registered Options Traders

Rule 1014.  (a) – (f)  No change.

(g)(i) – (vii) No change.

(viii) For a one year pilot period, beginning on May 28, 2006 [the date of approval of this Rule by the Securities and Exchange Commission], Directed Orders (as defined in Rule 1080(l)(i)(A)) that are executed electronically shall be automatically allocated as follows:

No further changes are being made to Phlx Rule 1014 pursuant to this proposal.

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 extend, for an additional one-year period, a pilot that allows specialists, SQTs, and RSQTs assigned in options that trade on Phlx XL to receive directed orders (“Direct Orders”)\(^\text{10}\) from a member or member

\(^{10}\) See Exchange Rule 1080(l)(i)(A).
organization ("Order Flow Provider" or "OFP") that submits, as agent, the customer order to the Exchange through AUTOM, and establishes a trade allocation algorithm for Directed Orders that are electronically executed and allocated to reward such Directed Specialists, SQTs and RSQTs with a participation guarantee for attracting such order flow to the Exchange. The proposed rule is subject to a pilot program scheduled to expire on May 27, 2006. The extended pilot would expire May 27, 2007.

Pursuant to Rule 1080(l), OFPs must transmit Directed Orders to a particular specialist, SQT or RSQT through AUTOM. If the Exchange’s disseminated best bid or offer is at the National Best Bid or Offer when the Directed Order is received, the Directed Order is automatically executed on Phlx XL and allocated to the orders and quotes represented in the Exchange’s quotation. A Directed Specialist, SQT or RSQT will receive a participation allocation pursuant to Rule 1014(g)(viii) if the Directed Specialist, SQT or RSQT was quoting at the NBBO at the time that the Directed Order was received. Otherwise, the automatic execution will be allocated to those quotations and orders at the NBBO pursuant to Rule 1014(g)(vii). The specialist will manually execute Directed Orders that are received when the Exchange is not quoting at the NBBO.

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12 See Exchange Rule 1080(1). The word “Directed” modifies all three; that is, it is referring to a Directed Specialist, Directed SQT and Directed RSQT.
13 See Exchange Rule 1080(l)(ii).
14 See Exchange Rule 1080(l)(iii).
15 See Exchange Rule 1080(l)(iv).
The Exchange believes that the pilot program rewards specialists, SQTs and RSQTs for actively engaging in marketing activities and establish relationships with OFPs that generate Directed Orders sent to the Exchange by such OFPs. The Exchange believes that the pilot program will result in additional order flow to the Exchange, thus adding depth and liquidity to the Exchange’s markets, and enabling the Exchange to continue to compete effectively with other options exchange for order flow.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act\textsuperscript{16} in general, and furthers the objectives of Section 6(b)(5) of the Act\textsuperscript{17} 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 permitting specialists, SQTs and RSQTs trading options on Phlx XL to receive Directed Orders, and by encouraging the capture of order flow on the Exchange by rewarding Directed Order recipients with a participation guarantee in trades involving Directed 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


\textsuperscript{17} 15 U.S.C. 78ff(b)(5).
No written comments were either solicited or received

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

The Exchange requests accelerated effectiveness pursuant to Section 19(b)(2) of the Act\(^\text{18}\) so that the pilot program may continue uninterrupted.

IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission’s Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2006-27 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-2006-27. 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-2006-27 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.19

Nancy M. Morris
Secretary

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