Proposed Rule Change by Philadelphia Stock Exchange

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

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<th>Initial</th>
<th>Amendment</th>
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<th>Section 19(b)(2)</th>
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Pilot: Extension of Time Period for Commission Action [ ]

Date Expires [ ]

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

Description

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

Increase the Exchange’s Payment for Order Flow fee for equity options

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
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: 07/31/2006
By: Cynthia Hoekstra, Director

(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.)
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") and Rule 19b-4 thereunder, proposes to increase its payment for order flow fee from $.60 per contract to $0.70 per contract for equity options other than options on the Nasdaq-100 Index Tracking Stock℠ traded under the symbol QQQQ ("QQQQ"), which will continue to be assessed a payment for order flow fee of $0.75, and FXI Options, which will continue to not be assessed a payment for order flow fee. Other than the rate change 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 August 1, 2006.  

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3. 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 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.

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 Option Charges 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 July 31, 2006.

   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 Exchange assesses a payment for order flow fee of $0.60 per contract for equity options other than options on QQQQ and FXI Options. Options on QQQQ are assessed $0.75 per contract and no payment for order flow fee is assessed on FXI Options. Specialists, Directed Registered Options Traders (“Directed ROTs”) and Registered Options Traders (“ROTs”) 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. Trades resulting from either Directed or

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5 The Exchange uses the terms “specialist” and “specialist unit” interchangeably herein.

6 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.
non-Directed Orders that are delivered electronically over AUTOM\(^8\) 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.\(^9\)

The purpose of this proposal is to remain competitive with other options exchanges. The International Securities Exchange, Inc. recently increased its payment for order flow fee to $0.65 per contract and the Chicago Board Options Exchange, Incorporated also assesses a payment for order flow fee of $0.65 per contract.\(^10\)

This proposal is to become effective for trades settling on or after August 1, 2006.

b. Statutory Basis

The Exchange believes that its proposal to amend its schedule of fees is consistent with Section 6(b) of the Act\(^11\) in general, and furthers the objectives of Section 6(b)(4) of

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\(^7\) The term “Directed Order” means any customer order to buy or sell, which has been directed to a particular specialist, Remote Streaming Quote Trader or Streaming Quote Trader by an Order Flow Provider.

\(^8\) 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.

\(^9\) Electronically-delivered orders do not include orders delivered through the Floor Broker Management System pursuant to Exchange Rule 1063.


the Act\textsuperscript{12} in particular, in that it is an equitable allocation of reasonable fees and other charges among Exchange members.

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\textsuperscript{13} and Rule 19b-4(f)(2)\textsuperscript{14} 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.


\textsuperscript{14} 17 CFR 240.19b-4(f)(2).
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 fees imposed by the International Securities Exchange, Inc., the Chicago Board Options Exchange, Incorporated and the American Stock Exchange, LLC.\(^{15}\)

9. Exhibits

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

5. Applicable Section of the Exchange’s Summary of Equity Option Charges.

\(^{15}\) See supra note 10.
Exhibit 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. ; File No. SR-Phlx-2006-47)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Its 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 increase its payment for order flow fee from $.60 per contract to $0.70 per contract for equity options other than options on the Nasdaq-100 Index Tracking Stock\(^{SM}\) traded under the symbol QQQQ ("QQQQ"),\(^5\) which will continue to be assessed a

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\(^5\) The Nasdaq-100®, Nasdaq-100 Index®, Nasdaq®, The Nasdaq Stock Market®, Nasdaq-100 Shares\(^{SM}\), Nasdaq-100 Trust\(^{SM}\), Nasdaq-100 Index Tracking Stock\(^{SM}\), and QQQ\(^{SM}\) are trademarks or service marks of The Nasdaq Stock Market, Inc. (Nasdaq) and
payment for order flow fee of $0.75, and FXI Options, which will continue to not be assessed a payment for order flow fee. Other than the rate change 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 August 1, 2006.\textsuperscript{6}


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 Exchange assesses a payment for order flow fee of $0.60 per contract for equity options other than options on QQQQ and FXI Options. Options on QQQQ are assessed $0.75 per contract and no payment for order flow fee is assessed on FXI Options. Specialists,\(^7\) Directed Registered Options Traders ("Directed ROTs") and Registered Options Traders ("ROTs") 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.\(^8\) Trades resulting from either Directed\(^9\) or non-Directed Orders that are delivered electronically over AUTOM\(^10\) 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.\(^11\)

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\(^7\) The Exchange uses the terms “specialist” and “specialist unit” interchangeably herein.

\(^8\) 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.

\(^9\) The term “Directed Order” means any customer order to buy or sell, which has been directed to a particular specialist, Remote Streaming Quote Trader or Streaming Quote Trader by an Order Flow Provider.

\(^10\) 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.

\(^11\) Electronically-delivered orders do not include orders delivered through the Floor Broker Management System pursuant to Exchange Rule 1063.
The purpose of this proposal is to remain competitive with other options exchanges. The International Securities Exchange, Inc. recently increased its payment for order flow fee to $0.65 per contract and the Chicago Board Options Exchange, Incorporated also assesses a payment for order flow fee of $0.65 per contract.\(^{12}\)

This proposal is to become effective for trades settling on or after August 1, 2006.

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.

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\(^{13}\) 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\(^\text{15}\) and paragraph (f)(2) of Rule 19b-4\(^\text{16}\) thereunder. 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-2006-47 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-2006-47. 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-2006-47 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.\(^{17}\)

Nancy M. Morris
Secretary

\(^{17}\) 17 CFR 200.30-3(a)(12).
Transition Period

For any top 120 equity option listed after February 1, 2004 and for any top 120 equity option acquired by a new specialist unit** within the first 60-days of operations, the following thresholds will apply, with a cap of $10,000 for the first 4 full months of trading per month per option provided that the total monthly market share effected on the Phlx in that top 120 equity option is equal to or greater than 50% of the volume threshold in effect:

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<th>First full month of trading:</th>
<th>0% national market share</th>
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</thead>
<tbody>
<tr>
<td>Second full month of trading:</td>
<td>3% national market share</td>
</tr>
<tr>
<td>Third full month of trading:</td>
<td>6% national market share</td>
</tr>
<tr>
<td>Fourth full month of trading:</td>
<td>9% national market share</td>
</tr>
<tr>
<td>Fifth full month of trading (and thereafter):</td>
<td>12% national market share</td>
</tr>
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** A new specialist unit is one that is approved to operate as a specialist unit by the Options Allocation, Evaluation, and Securities Committee on or after February 1, 2004 and is a specialist unit that is not currently affiliated with an existing options specialist unit as reported on the member organization’s Form BD, which refers to direct and indirect owners, or as reported in connection with any other financial arrangement, such as is required by Exchange Rule 783.

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 $0.67 per contract

See Appendix A for additional fees.

*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, 2007.

***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.