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).

Changing the payment for order flow fee for options subject to the penny 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.

<table>
<thead>
<tr>
<th>First Name</th>
<th>Last Name</th>
<th>Title</th>
<th>E-mail</th>
<th>Telephone</th>
<th>Fax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cynthia</td>
<td>Hoekstra</td>
<td>Vice President</td>
<td><a href="mailto:cynthia.hoekstra@phlx.com">cynthia.hoekstra@phlx.com</a></td>
<td>(215) 496-5066</td>
<td>(215) 496-6729</td>
</tr>
</tbody>
</table>

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: 01/25/2007

By: Cynthia Hoekstra

Vice President

(line)

(Title)

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")\(^1\) and Rule 19b-4 thereunder,\(^2\) proposes to decrease its payment for order flow fee from $0.70 per contract to $0.25 per contract for the equity options listed below to be effective for trades settling on or after the rollout date for each option in connection with a pilot program to quote and trade options in penny increments (which is discussed in more detail below):

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Underlying Security</th>
<th>Anticipated Effective Date (For Trades Settling on or After the Dates Set Forth Below):</th>
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</tr>
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<td>SUNW</td>
<td>Sun Microsystems, Inc.</td>
<td>February 12, 2007</td>
</tr>
</tbody>
</table>


For the Nasdaq-100 Index Tracking Stock℠ traded under the symbol QQQQ ("QQQQ"), the payment for order flow fee will 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 will remain in effect until May 27, 2007.4

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 January 25, 2007.

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 in the future.

Questions and comments on the proposed rule change may be directed to Cynthia Hoekstra, Vice President, at (215) 496-5066 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**

   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,\(^5\) 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.\(^6\) Trades resulting from either Directed or 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-

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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.

\(^7\) 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.
delivered orders (i.e., represented by a floor broker) are not assessed a payment for order flow fee.\textsuperscript{9}

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.\textsuperscript{10}

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.

\textsuperscript{9} Electronically-delivered orders do not include orders delivered through the Floor Broker Management System pursuant to Exchange Rule 1063.

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 will remain in effect until May 27, 2007.

b. **Statutory Basis**

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

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11 The Exchange has listed the effective dates for the above-referenced payment for order flow fee changes on the applicable section of the Exchange’s Summary of Equity Option Charges. The Exchange intends to delete the references to the effective dates after all the implementation dates have occurred, pursuant to this proposed rule change, and therefore the Exchange does not intend to file a separate proposed rule change to delete the references to the effective dates.

12 See footnote 4.


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\(^{15}\) and Rule 19b-4(f)(2)\(^{16}\) 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.

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

The proposed rule change is similar to a proposed rule change filed by NYSE Arca, Inc.\(^{17}\)

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.

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\(^{17}\) See SR-NYSEArca-2007-07 (for transactions in issues which are included as part of the pilot, NYSE Arca, Inc. has proposed to no longer collect a Marketing Fee).
Exhibit 1

SECURITIES AND EXCHANGE COMMISSION
(Release No.                  ; File No. SR-Phlx-2007-05)

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Changing the Payment for Order Flow Fee for Options Subject to the Penny Pilot 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 ______________________ 2007, 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 decrease its payment for order flow fee from $0.70 per contract to $0.25 per contract for the equity options listed below to be effective for trades settling on or after the rollout date for each option in connection with a pilot program to quote and trade options in penny increments (which is discussed in more detail below):

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

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5 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.
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 will remain in effect until May 27, 2007.6


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 $0.70 per contract for equity options other than options on QQQQ. Options on QQQQ are assessed $0.75 per contract. Specialists,7 Directed Registered Options Traders (“Directed ROTs”) and Registered Options Traders (“ROTs”) are assessed a payment for order flow fee

or in modifying in any way its method for determining, comprising, or calculating the Index in the future.


7 The Exchange uses the terms “specialist” and “specialist unit” interchangeably herein.
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.\(^{11}\)

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.\(^{12}\)

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\(^8\) 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 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.\textsuperscript{13} The proposed fees will remain in effect until May 27, 2007.\textsuperscript{14}

2. Statutory Basis

The Exchange believes that its proposal to amend its schedule of fees is consistent with Section 6(b) of the Act\textsuperscript{15} in general, and furthers the objectives of Section

\textsuperscript{13} The Exchange has listed the effective dates for the above-referenced payment for order flow fee changes on the applicable section of the Exchange’s Summary of Equity Option Charges. The Exchange intends to delete the references to the effective dates after all the implementation dates have occurred, pursuant to this proposed rule change, and therefore the Exchange does not intend to file a separate proposed rule change to delete the references to the effective dates.

\textsuperscript{14} See footnote 6.

\textsuperscript{15} 15 U.S.C. 78f(b).
6(b)(4) of the Act\textsuperscript{16} 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.

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\textsuperscript{17} and paragraph (f)(2) of Rule 19b-4\textsuperscript{18} 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:


\textsuperscript{18} 17 CFR 240.19b-4(f)(2).
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-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 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-2007-05 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.\textsuperscript{19}

Nancy M. Morris
Secretary

\textsuperscript{19} 17 CFR 200.30-3(a)(12).
SUMMARY OF EQUITY OPTION CHARGES (p. 3/6)

*     *     *     *     *

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\textsuperscript{SM}]
IWM, SMH, GE, AMD, MSFT, INTC, CAT, WFMI,
TXN, A, FLEX, SUNW \textsuperscript{\#} $0.725 per contract
Remaining Equity Options $0.70 per contract

See Appendix A for additional fees.

*Assessed on transactions resulting from customer orders and are available to be disbursed by the Exchange according to the instructions of the specialist units/specialists or Directed ROTs to order flow providers who are members or member organizations, who submit, as agent, customer orders to the Exchange or non-members or non-member organizations who submit, as agent, customer orders to the Exchange through a member or member organization who is acting as agent for those 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.

\textsuperscript{\#} Payment for order flow fee effective for trades settling on or after the following dates: WFMI-January 29, 2007; GE and MSFT-February 5, 2007; and QQQQ, IWM, SMH, AMD, INTC, CAT, TXN, A, FLEX and, SUNW- February 9, 2007.

*     *     *     *     *