Proposed Rule Change by Philadelphia Stock Exchange

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

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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).

Proposed rule change relating to bid/ask differentials.

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 Richard

Last Name Rudolph

Title Vice President and Counsel

E-mail Richard.Rudolph@phlx.com

Telephone (215) 496-5074

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 officer.

Date 03/21/2007

By Richard S. Rudolph

Vice President and Counsel

(Name)

(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.

Richard Rudolph,
### 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 amend Exchange Rule 1034, Minimum Trading Increments, and to adopt Rule 1080(c)(iv)(F), to permit the Exchange to automatically execute Linkage Principal as Agent ("P/A") Orders\(^3\) that are sent to, and price-improved on, another exchange, and subsequently presented for execution on the Phlx against customer limit orders on the limit order book that give rise to the initial P/A Order, at a price other than the minimum trading increment applicable to the particular series traded.

   The proposed amendment to Rule 1080(c)(iv)(F) states that such orders would be ineligible for automatic execution and would instead be handled manually by the specialist.

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

### Minimum Increments

**Rule 1034.** (a) Except as provided in sub-paragraph (i)(B) below, all options on stocks, index options, and Exchange Traded Options quoting in decimals at $3.00 or higher shall have a minimum increment of $.10, and all options on stocks and index options quoting in decimals under $3.00 shall have a minimum increment of $.05.

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\(^3\) A P/A Order is an order for the principal account of a specialist (or equivalent entity on another Participant Exchange that is authorized to represent Public Customer orders), reflecting the terms of a related unexecuted Public Customer order for which the specialist is acting as agent. **See** Exchange Rule 1083(k)(i).
(i) (A) However, the Board of Governors may establish different minimum trading increments. The Exchange will designate any such change as a stated policy, practice or interpretation with respect to the administration of Rule 1034, within the meaning of Section 19(b)(3)(A) of the Exchange Act and will file a proposed rule change with the Securities and Exchange Commission to be effective upon filing.

(B) (1) For a six-month pilot period beginning on January 26, 2007 (the “pilot”), certain options shall 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 Nasdaq-100 Index Tracking Stock ("QQQQ")® shall be quoted and traded in minimum increments of $0.01 for all series regardless of the price. A list of such options shall be communicated to membership via Exchange circular.

([C] 2) On or before the last day of the fourth month of the pilot, the Exchange shall prepare and submit an analytical report to the Securities and Exchange Commission ("Commission") that addresses the impact of the first three months of the pilot on the quality of the Exchange's markets and option quote traffic and capacity.

(C) A Linkage P/A Order that has been sent from the Exchange to, and price-improved on, another exchange at a price expressed in other than the appropriate minimum trading increment described in this rule, and then submitted to the Exchange for execution against the original customer limit order that gave rise to the Linkage P/A Order, may be traded on the Exchange at such price.

(ii) – (iii) No change.

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

Rule 1080. (a) – (b) No change.

(c) AUTO-X. *****

(i) – (iii) No change.

(iv) Except as otherwise provided in this Rule, in the following circumstances, an order otherwise eligible for automatic execution will instead be manually handled by the specialist:

(A) [RESERVED];
(B) the AUTOM System is not open for trading when the order is received (which is known as a pre-market order);

(C) the disseminated market is produced during an opening or other rotation;

(D) When the Exchange's best bid or offer is represented by a limit order on the book (except with respect to orders eligible for "Book Sweep" as described in Rule 1080(c)(iii) above, and "Book Match" as described in Rule 1080(g)(ii) below);

(E) if the Exchange's bid or offer is not the NBBO; and

(F) when the price of a limit order is not in the appropriate minimum trading increment pursuant to Rule 1034, except in the case of a Linkage P/A Order that has been sent from the Exchange to, and price-improved on, another exchange at a price expressed in other than such appropriate minimum trading increment, and then submitted to the Exchange for execution against the original customer limit order that gave rise to the Linkage P/A Order.

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(v) – (vi) No change.

(d) – (l) No change.

Commentary: No change.

2. Procedures of the Self-Regulatory Organization

The Exchange’s Executive Committee, pursuant to delegated authority, approved the proposal for filing with the Securities and Exchange Commission (“SEC” or “Commission”) on March 19, 2007.

Questions and comments on the proposed rule change may be directed to Richard S. Rudolph, Vice President and Counsel, at (215) 496-5074, or Edith Hallahan, Senior Vice President and Deputy General Counsel, at (215) 496-5179.
3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

a. Purpose

The purpose of the proposed rule change is to permit Exchange specialists to execute price-improved P/A Orders against public customer limit orders at prices other than the minimum trading increment applicable to that particular series so that the customer limit order underlying the P/A Order receives the improved price.

Currently, Exchange Rule 1034, Minimum Trading Increments, generally provides that options quoting in at $3.00 or higher have a minimum increment of $.10, and options quoting under $3.00 have a minimum increment of $.05. Options subject to the current “penny pilot” may be quoted and traded in increments as low as $.01.

The proposed rule change concerns P/A Orders sent from the Exchange to another exchange via the Intermarket Option Linkage. When a P/A Order sent from the Exchange to another exchange is executed on that other exchange, the executed P/A Order is delivered back to the specialist electronically, where the specialist is responsible to execute the public customer limit order at the execution price of the P/A Order on the other exchange.

Recently, some P/A Orders have been executed on other exchanges at improved prices after being submitted to a price-improvement auction process on the other exchange. The result is that the executed P/A Order is delivered back to the Exchange at a price that is expressed in other than the minimum trading increment. For example, if the Phlx disseminated market in a particular series is 2.10 bid, 2.20 ask, and another exchange is disseminating a bid price of 2.15, a P/A Order to sell an option series would be delivered by the Phlx specialist to the other exchange disseminating a limit bid price
of $2.15. The specialist’s P/A Order might be executed in a price-improving auction at an improved price of $2.17 on the other exchange. The P/A Order would be delivered back to the Phlx specialist for execution at $2.17. This would be prohibited under current Exchange rules, which require an execution at either $2.15 (disadvantaging the public customer), or $2.20 (disadvantaging the specialist), because the minimum trading increment applicable to the series is $.05.

The proposed rule change is intended to eliminate this anomaly by providing that a P/A Order that has been sent from the Exchange to, and price-improved on, another exchange at a price expressed in other than the minimum trading increment currently contained in the rule, and then submitted to the Exchange for execution against the original customer limit order that gave rise to the P/A Order, may be traded on the Exchange at such price. Therefore, in the example above, the specialist could fill the public customer order at the P/A Order execution price of $2.17.

The proposed amendment to Rule 1080(c)(iv)(F) states that such orders would be ineligible for automatic execution and would instead be handled manually by the specialist.

b. **Statutory Basis**

The Exchange believes that its proposal is consistent with Section 6(b) of the Act\(^4\) in general, and furthers the objectives of Section 6(b)(5) of the Act\(^5\) in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and,


in general, to protect investors and the public interest, by establishing a rule that provides for accurate execution of customer limit orders at improved prices.

4. **Self-Regulatory Organization’s Statement on Burden on Competition**

   The Phlx does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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

   No written comments were either solicited or received.

6. **Extension of Time Period for Commission Action**

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

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

   Not applicable.

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

   The proposed rule change is not based on the rules of another self-regulatory organization or of the Commission.

9. **Exhibits**

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

SECURITIES AND EXCHANGE COMMISSION
(Release No.     ; File No. SR-Phlx-2007-26)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Price Improved Linkage P/A Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")\(^1\), and Rule 19b-4\(^2\) thereunder, notice is hereby given that on ______________________ 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 amend Exchange Rule 1034, Minimum Trading Increments, and to adopt Rule 1080(c)(iv)(F), to permit the Exchange to automatically execute Linkage Principal as Agent ("P/A") Orders\(^5\) that are sent to, and price-improved on, another exchange, and subsequently presented for execution on the Phlx against customer limit orders on the

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\(^5\) A P/A Order is an order for the principal account of a specialist (or equivalent entity on another Participant Exchange that is authorized to represent Public Customer orders), reflecting the terms of a related unexecuted Public Customer order for which the specialist is acting as agent. See Exchange Rule 1083(k)(i).
limit order book that give rise to the initial P/A Order, at a price other than the minimum trading increment applicable to the particular series traded.

The proposed amendment to Rule 1080(c)(iv)(F) states that such orders would be ineligible for automatic execution and would instead be handled manually by the specialist.


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 permit Exchange specialists to execute price-improved P/A Orders against public customer limit orders at prices other than the minimum trading increment applicable to that particular series so that the customer limit order underlying the P/A Order receives the improved price.

Currently, Exchange Rule 1034, Minimum Trading Increments, generally provides that options quoting in at $3.00 or higher have a minimum increment of $.10,
and options quoting under $3.00 have a minimum increment of $.05. Options subject to the current “penny pilot” may be quoted and traded in increments as low as $.01.

The proposed rule change concerns P/A Orders sent from the Exchange to another exchange via the Intermarket Option Linkage. When a P/A Order sent from the Exchange to another exchange is executed on that other exchange, the executed P/A Order is delivered back to the specialist electronically, where the specialist is responsible to execute the public customer limit order at the execution price of the P/A Order on the other exchange.

Recently, some P/A Orders have been executed on other exchanges at improved prices after being submitted to a price-improvement auction process on the other exchange. The result is that the executed P/A Order is delivered back to the Exchange at a price that is expressed in other than the minimum trading increment. For example, if the Phlx disseminated market in a particular series is 2.10 bid, 2.20 ask, and another exchange is disseminating a bid price of 2.15, a P/A Order to sell an option series would be delivered by the Phlx specialist to the other exchange disseminating a limit bid price of $2.15. The specialist’s P/A Order might be executed in a price-improving auction at an improved price of $2.17 on the other exchange. The P/A Order would be delivered back to the Phlx specialist for execution at $2.17. This would be prohibited under current Exchange rules, which require an execution at either $2.15 (disadvantaging the public customer), or $2.20 (disadvantaging the specialist), because the minimum trading increment applicable to the series is $.05.

The proposed rule change is intended to eliminate this anomaly by providing that a P/A Order that has been sent from the Exchange to, and price-improved on, another
exchange at a price expressed in other than the minimum trading increment currently contained in the rule, and then submitted to the Exchange for execution against the original customer limit order that gave rise to the P/A Order, may be traded on the Exchange at such price. Therefore, in the example above, the specialist could fill the public customer order at the P/A Order execution price of $2.17.

The proposed amendment to Rule 1080(c)(iv)(F) states that such orders would be ineligible for automatic execution and would instead be handled manually by the specialist.

2. **Statutory Basis**

The Exchange believes that its proposal is consistent with Section 6(b) of the Act\(^6\) in general, and furthers the objectives of Section 6(b)(5) of the Act\(^7\) 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 establishing a rule that provides for accurate execution of customer limit orders at improved prices.

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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\(^7\) 15 U.S.C. 78f(b)(5).
III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

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

IV. Solicitation of Comments

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

Electronic comments:

• Use the Commission’s Internet comment form (http://www.sec.gov/rules/sro.shtml); or

• Send an e-mail to rule-comments@sec.gov. Please include File Number SR-Phlx-2007-26 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-2007-26. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s Internet Web site.
Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission’s Public Reference Room. Copies of the filing also will be available for inspection and copying at the principal office of the Phlx. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-Phlx-2007-26 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. 8

Nancy M. Morris
Secretary