

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-57683; File No. SR-Phlx-2008-27)

April 18, 2008

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change Relating to Access to XLE on Phlx's Options Floor

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 11, 2008, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III, below, which Items have been substantially 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 Exchange proposes to delete Phlx Rule 1014(e)(iii), which limits the actions of Registered Options Traders ("ROTs") related to trading in Phlx's equity market in certain situations, and adopt Phlx Rule 175 prohibiting an XLE Market Maker from acting as an options specialist or option market maker in options overlying the securities in which the XLE Market Maker is registered.

The text of the proposed rule change is available at the Exchange, the Commission's Public Reference Room, and [www.phlx.com](http://www.phlx.com).

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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 Exchange 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 Exchange 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 clarify that members and member organizations on the Phlx options floor are permitted to have connectivity to XLE, Phlx's electronic equity trading system. XLE provides to those Phlx member organizations and their Sponsored Participants authorized to enter orders on the system ("XLE Participants") a system for the entry and execution of NMS Stock orders. XLE is the sole means on Phlx to enter and execute NMS Stock orders; the physical equity trading floor has been discontinued.<sup>3</sup> The Exchange states that, in the past, Phlx's physical equity and options floor were separated by a wall, which required a member to leave one floor and walk to the other floor in order to participate on the other floor. In addition, the wall prevented any line of site or line of hearing between the two floors. Specifically, the wall helped to prevent someone on one floor from using information gained there on the other

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<sup>3</sup> See Phlx Rule 160.

floor without first physically leaving the one floor and walking to the other, thereby mitigating the “time and place” advantage gained from being on that floor.<sup>4</sup>

When XLE started, the trading of NMS Stocks on Phlx ceased to take place on a physical floor and, instead, now takes place electronically according to the algorithms programmed in the software that operates XLE.<sup>5</sup> XLE Participants cannot alter these algorithms, nor does the identity of a XLE Participant affect the execution of the order. Access to XLE is available to XLE Participants through an Exchange electronic interface by means of their own communication lines or through lines established by service providers in the business of maintaining connectivity in the securities marketplace. In addition, XLE Participants may access XLE for the entry of two-sided orders through technology provided by the Exchange.<sup>6</sup> The Exchange states that all information about the price and size of executions on XLE is made available to both XLE Participants and non-XLE Participants at the same time and in the same manner; it may be accessed by means of the consolidated tape plans or by means of Phlx’s own depth of book feed, both of which are available to XLE Participants and non-XLE Participants in a non-discriminatory manner. Phlx further states that, with the discontinuation of the physical equity floor, there is no longer any time and place advantage to any XLE Participant using XLE. All information about the price and size of executions on XLE is made

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<sup>4</sup> Phlx Rule 606 regulates the use of electronic and telephonic means of communication on the floor.

<sup>5</sup> See Securities Exchange Act Release No. 54538 (September 28, 2006), 71 FR 59184 (October 6, 2006).

<sup>6</sup> The technology provided by the Exchange does not disseminate any information about orders or executions on XLE other than those of the XLE Participant entering the orders.

available simultaneously to anyone, including XLE Participants and to those persons who may be on the Phlx options floor.

Therefore, the Exchange submits that connectivity to trading on XLE from the Phlx options floor does not present an advantage for either trading on XLE or to trading on the Phlx options floor. In fact, options floor participants currently have access to other execution venues and order routing mechanisms for the underlying securities. Possession of XLE order entry technology does not give the possessor any special information advantage that could be used on the Phlx options floor because access to XLE information is available to all on a non-discriminatory basis. In addition, physical presence on the Phlx options floor does not provide an advantage in priority for orders entered into XLE from the Phlx options floor because XLE executes orders in price-time priority based on a pre-set algorithm that is unalterable by the XLE Participant entering the order and does not take into account the location where an order is entered. In order to further facilitate connectivity to trading on XLE in all securities, Phlx proposes to delete Phlx Rule 1014(e)(iii), which places restrictions on ROTs trading in options after trading in the underlying security.

To address concerns about Integrated Market Making,<sup>7</sup> in particular possession by options Specialists or Registered Options Traders of non-public information in the options market that could be used if they were also a Market Maker on XLE<sup>8</sup> in the

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<sup>7</sup> Integrated Market Making involves making market in both options and the securities underlying those options.

<sup>8</sup> See Phlx Rule 1(l). Market Makers must be member organizations. See Phlx Rule 170(b).

underlying equity security,<sup>9</sup> the Exchange proposes new Phlx Rule 175, which prohibits Integrated Market Making to prevent to the potential misuse non-public information. Specifically, proposed Phlx Rule 175 prohibits Market Makers on XLE, or any member, limited partner, officer, or associated person thereof, from acting as an options Specialist, Registered Options Trader or functioning in any capacity involving market making responsibilities, in any option overlying a security in which the Market Maker on XLE is registered as such. For example, an affiliate of a Market Maker on XLE registered in equity security IBM would be prohibited from becoming the options Specialist in options on IBM. In addition, proposed Phlx Rule 175 would prohibit a member organization whose member was a Registered Options Trader in options on IBM from becoming a Market Maker on XLE registered in the equity security IBM. This would be prohibited because that Market Maker on XLE would then have an associated person who is a Registered Options Trader in an option overlying a security in which the Market Maker on XLE would be registered.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>10</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>11</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove

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<sup>9</sup> The information available to options Specialist and Registered Options Traders from XLE does not raise similar concerns. XLE is electronic and does not operate as a traditional physical trading floor where physical presence could provide a participant with information that is not otherwise publicly available. All information about orders and trades on XLE is available to everyone simultaneously over the consolidated tape and over XLE's market data feed.

<sup>10</sup> 15 U.S.C. 78f(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

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 providing another venue for persons on the Phlx options floor to execute orders in NMS Stocks. Currently, persons on the Phlx options floor have access to other execution venues and order routing mechanisms for the underlying securities. This proposed rule change would permit those persons access to XLE, thereby increasing the markets available for execution of their orders. Additionally, this proposal would prohibit a Market Maker on XLE or any member, limited partner, officer, or associated person thereof from acting as an options Specialist, Registered Options Trader or function in any capacity involving market making responsibilities, in any option overlying a security in which the Market Maker on XLE is registered as such. This prohibition would prevent the use of non-public information in the options market by options Specialists or Registered Options Traders that could be used if they were also a Market Maker on XLE in the underlying security.

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 that is 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

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 the Exchange 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](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2008-27 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-2008-27. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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-2008-27 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>12</sup> 17 CFR 200.30–3(a)(12).