

Exchange's disseminated bid or offer decreases; or (3) the size associated with the Exchange's bid (offer) increases by an amount greater than or equal to a percentage (never to exceed 20%) of the size associated with the previously disseminated bid (offer). Such percentage, which would never exceed 20%, would be determined on an issue-by-issue basis by the Exchange and announced to membership via Exchange circular. The percentage size increase necessary to give rise to a refreshed quote may vary from issue to issue, depending, without limitation, on the liquidity, average volume, and average number of quotations submitted in the issue. Proposed Phlx Rule 1082(b)(ii)(C) would not be limited to options included in the pilot, and would apply to all options traded on the Exchange.

The Exchange represents that participants on its system would not be notified of any incremental increase in the size of the Exchange's quote under proposed Phlx Rule 1082(a)(ii)(C)(3) until such quote is disseminated to OPR. Therefore, no participant on the Exchange's system would have information that is unavailable to another participant.

III. Discussion

After careful review of the proposal, the Commission finds that the proposed rule change, as modified by Amendment Nos. 1 and 2, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹⁰ In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,¹¹ which requires, among other things, that the rules of an exchange be 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.

The Commission believes that the implementation of a limited six-month Penny Pilot Program by Phlx and the five other options exchanges will provide valuable information to the exchanges, the Commission and others about the impact of penny quoting in the options market. In particular, the Penny Pilot Program will allow analysis of the impact of penny quoting on: (1) Spreads; (2) transaction costs; (3) payment for order flow; and (4) quote message traffic.

¹⁰ In approving this proposed rule change the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹¹ 15 U.S.C. 78f(b)(5).

The Commission believes that the thirteen options classes to be included in the penny pilot program represent a diverse group of options classes with varied trading characteristics. This diversity should facilitate analyses by the Commission, the options exchanges and others. The Commission also believes that the Penny Pilot Program is sufficiently limited that it is unlikely to increase quote message traffic beyond the capacity of market participants' systems and disrupt the timely receipt of quote information.

Nevertheless, because the Commission expects that the Penny Pilot Program will increase quote message traffic, the Commission is simultaneously approving the Exchange's proposals to reduce the number of quotations it disseminates.¹²

In addition, the Commission believes that Phlx's proposed deletion of Phlx Rule 1080(c)(iv)(A) and proposed conforming changes to Phlx Rule 1085(b)(10) is consistent with the Act and will facilitate the prompt resolution of crossed markets by permitting automatic executions when the Exchange's disseminated market is the NBBO and is crossed, or crosses the disseminated market of another options exchange, regardless of the amount by which the market is crossed.¹³

Finally, the Commission believes that it is consistent with the Act for Phlx to update its rule governing Zero-Bid Options Series to provide that the system will convert such orders to limit

¹² In addition to the quote mitigation proposal discussed herein, Phlx also proposed other quote mitigation strategies. See *e.g.*, Securities Exchange Act Release No. 54648 (October 24, 2006), 71 FR 63375 (October 30, 2006) (SR-Phlx-2006-52); No. 54807 (November 21, 2006), 71 FR 69173 (November 29, 2006) (SR-Phlx-2006-53); 54859 (December 1, 2006), 71 FR 71605 (December 11, 2006) (SR-Phlx-2006-51); 54914 (December 11, 2006), 71 FR 75798 (December 18, 2006) (SR-Phlx-2006-81).

¹³ The exemption Phlx received from the requirement under Rule 608(c) of Regulation NMS that Phlx comply, and enforce compliance by its members, with Section 8(c) of Linkage Plan regarding trade-throughs on March 8, 2006 (see note 9, *supra*) was limited to transactions when the market was crossed by one minimum trading increment. Therefore, Phlx submitted an exemption request to expand the scope of the exemption to include trade-throughs resulting from automatic executions while the Exchange's disseminated market is crossed, or crosses the disseminated market of another options exchange, and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO, regardless of the amount by which the market is crossed. See letter from Richard S. Rudolph, Vice President and Counsel, Chairman and Chief Executive Officer, Phlx, to Nancy M. Morris, Secretary, Commission, dated January 19, 2006. The Commission granted this exemption request on January 23, 2007. See letter from Elizabeth K. King, Associate Director, Commission, to Richard S. Rudolph, Vice President and Counsel, Phlx, dated January 23, 2006.

orders to sell with a limit price of the minimum quoting increment applicable to such series, in order that options quoted and traded in minimum increments of \$0.01 pursuant to the Penny Pilot Program would convert to a limit order to sell at \$0.01, rather than \$0.05.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-Phlx-2006-74), as modified by Amendment Nos. 1 and 2, be, and hereby is, approved on a six month pilot basis, which will commence on January 26, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Florence E. Harmon,
Deputy Secretary.

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DEPARTMENT OF STATE

[Public Notice 5670]

Overseas Security Advisory Council (OSAC) Meeting Notice; Closed Meeting

The Department of State announces a meeting of the U.S. State Department—Overseas Security Advisory Council on February 22, 2007 at the Boeing Company, Arlington, Virginia. Pursuant to Section 10 (d) of the Federal Advisory Committee Act and 5 U.S.C. 552b(c)(4), it has been determined that the meeting will be closed to the public. The meeting will focus on an examination of corporate security policies and procedures and will involve extensive discussion of proprietary commercial and financial information that is considered privileged and confidential. The agenda will include updated committee reports, a global threat overview, and other matters relating to private sector security policies and protective programs and the protection of U.S. business information overseas.

For more information, contact Martha Thurman, Overseas Security Advisory Council, Department of State, Washington, DC 20522-2008, phone: 571-345-2214.

Dated: January 17, 2007.

Joe D. Morton,

*Director of the Diplomatic Security Service,
Department of State.*

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¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).