

**SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50229; File No. SR-Phlx-2004-42)**

**August 23, 2004**

**Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Its Specialist Unit Fixed Monthly Fee**

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 June 30, 2004, 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 prepared by 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**

Phlx proposes to amend its Specialist Unit Fixed Monthly Fee ("fixed monthly fee") to address situations where an equity option or index option is relinquished by a specialist unit and subsequently reallocated to a new specialist unit.

**A. Background<sup>3</sup>**

The fixed monthly fee affords specialist units<sup>4</sup> the opportunity to elect to pay a fixed monthly fee in lieu of paying fees currently in effect for equity option and index option transaction charges and for the equity option specialist deficit (shortfall) fee (collectively

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

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

<sup>3</sup> Clarifying changes in this section were made pursuant to telephone conversations on July 29, 2004, between Cynthia K. Hoekstra, Counsel, Phlx, and Steve Kuan, Attorney, Division of Market Regulation, Commission.

<sup>4</sup> The Exchange uses the terms "specialist" and "specialist unit" interchangeably herein.

“variable fees”).<sup>5</sup> The Exchange rules provide two methods for calculating the fixed monthly fee.<sup>6</sup> Pursuant to the first methodology implemented in 2003, specialist units that traded an equity option or index option on the Phlx trading floor in their capacity as a specialist unit with Phlx equity option or index option transactions in at least one equity option or index option for at least one year from September 1, 2002, and that elected to pay a fixed monthly fee, use May and June 2003 volume as the basis to calculate the fixed monthly fee. In 2004, the Exchange extended the application of the fixed monthly fee calculation from February 29, 2004 to August 31, 2004.<sup>7</sup>

Subsequently, in 2004, the Exchange implemented a fixed monthly fee for those specialist units who were not enrolled in the specialist unit fixed monthly fee program implemented in 2003.<sup>8</sup> Pursuant to the second methodology, specialist units that elect the fixed monthly fee who have been trading an equity option or index option on the Phlx trading floor in their capacity as a specialist unit with Phlx equity option or index option transactions in at least one equity option or index option for at least nine months as of March 1, 2004, use October, November and December 2003 volume as the basis for calculating their fixed monthly fee. This

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<sup>5</sup> The fixed monthly fee does not affect additional charges, such as non-transactional and membership-related charges listed on Appendix A of the Exchange’s fee schedule. In addition, a \$0.10 charge per contract side for specialist unit transactions in the QQQ equity options (“QQQ license fee”) is imposed, if applicable, if the specialist unit elects to pay the fixed monthly fee. This fee is in addition to the fixed monthly fee. The QQQ license fee is in effect through August 31, 2004.

<sup>6</sup> See Securities Exchange Act Release Nos. 48459 (September 8, 2003), 68 FR 54034 (September 15, 2003) (SR-Phlx-2003-61); 49467 (March 24, 2004), 69 FR 17017 (March 31, 2004) (SR-Phlx-2004-17); and 49770 (May 25, 2004), 69 FR 31150 (June 2, 2004) (SR-Phlx-2004-31).

<sup>7</sup> See Securities Exchange Act Release No. 49467 (March 24, 2004), 69 FR 17017 (March 31, 2004) (SR-Phlx-2004-17).

<sup>8</sup> See id.

fixed monthly fee is also in effect through August 31, 2004. Thus, there are two different time periods under which the fixed monthly fee may be calculated.<sup>9</sup>

The fixed monthly fee for both methods of calculation is currently capped at \$310,000 per specialist unit per month for transactions settling on May 1, 2004 through August 31, 2004.<sup>10</sup>

B. Proposed Modifications to the Fixed Monthly Fee

Periodically, an options specialist unit will relinquish an option for various business reasons, and in many cases the relinquished option is reallocated to another options specialist unit.<sup>11</sup> For example, Options Specialist A, who is operating under the fixed monthly fee program, relinquishes an option that is subsequently allocated to Options Specialist B, also subject to the fixed monthly fee. Using the current fixed monthly fee methodology, Options Specialist A cannot reduce its fixed monthly fee by the amount of the relinquished option. In addition, using the current fixed monthly fee methodology, Options Specialist B will have its fee increased according to the applicable fixed monthly fee calculation under which it is operating, as opposed to applying the fixed monthly fee calculation under which Options Specialist A is operating.

To address this limited situation, the fixed monthly fee for an options specialist unit that has elected the fixed monthly fee and has relinquished an equity option or index option, will be reduced, pro-rata for the month, by the amount equal to the amount used to determine the fixed

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<sup>9</sup> A specialist that elected the first methodology may not elect the second methodology. A specialist that did not elect the first methodology may only elect the second methodology.

<sup>10</sup> See Securities Exchange Act Release No. 49693 (May 12, 2004), 69 FR 28974 (May 19, 2004) (SR-Phlx-2004-30).

<sup>11</sup> Phlx represents that the procedure to reallocate a relinquished option is set forth in Phlx Rule 505 and Phlx Rule 506. Telephone conversation among Cynthia K. Hoekstra, Counsel, Phlx, and Marc McKayle and Steve Kuan, Division of Market Regulation, Commission (July 22, 2004).

monthly fee with respect to the relinquished option (e.g., a specialist that relinquishes Option A, which was factored into the fixed monthly fee using the May and June 2003 volume, will have its fixed monthly fee reduced using the same algorithm), provided the option is subsequently allocated within 30 days<sup>12</sup> to another specialist unit who has elected the fixed fee. If the specialist who has been reallocated the option elects to pay the fixed monthly fee, the new specialist will pay a pro-rata amount of the original fixed monthly fee calculation for the month in which the reallocation occurred.<sup>13</sup>

The Exchange represents that when the same option is reallocated to another specialist that has elected the fixed monthly fee, that specialist's fixed monthly fee will then increase using the same methodology and time period as the original specialist unit for that option, which should, in turn, result in a revenue neutral outcome to the Exchange.

The changes to the fixed monthly fee as set forth in this proposal are scheduled to be in effect for transactions settling on or after July 1, 2004 through August 31, 2004.

A copy of the Specialist Unit Fixed Monthly Fee Schedule of the Exchange's fee schedule is available at Phlx and at the Commission.

## **II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, 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

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<sup>12</sup> Phlx believes that the 30-day period is a reasonable time period. See id.

<sup>13</sup> If a specialist unit relinquishes an option and no other specialist units has been allocated the option within 30 days, the specialist unit relinquishing the option may not reduce the amount of its fixed monthly fee.

Item IV below. 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 more equitably assess fixed monthly fees in situations where a specialist unit relinquishes an option. By allowing the specialist unit to decrease its fixed monthly fee by the amount of the option that was relinquished, provided another specialist unit is allocated the option within 30 days and elects to pay a fixed monthly fee, the fixed monthly fee for the affected specialist units should more equitably reflect the appropriate amount of the fixed monthly fee. In addition, the Exchange represents that this proposal should maintain the same revenue stream to the Exchange.

2. Statutory Basis

The Exchange believes that its proposal to amend its schedule of dues, fees and charges is consistent with Section 6(b) of the Act<sup>14</sup> in general, and furthers the objectives of Section 6(b)(4) of the Act<sup>15</sup> in particular, in that it is an equitable allocation of reasonable dues, 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 inappropriate burden on competition.

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<sup>14</sup> 15 U.S.C. 78f(b).

<sup>15</sup> 15 U.S.C. 78f(b)(4).

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 proposed rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>16</sup> and subparagraph (f)(2) of Rule 19b-4<sup>17</sup> thereunder, because the proposed rule change establishes or changes a due, fee, or other charge imposed by the Exchange.

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such proposed 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>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Phlx-2004-42 on the subject line.

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<sup>16</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

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

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-Phlx-2004-42. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of 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-2004-42 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.<sup>18</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).