

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-49457; File No. SR-Phlx-2004-20)**

**March 23, 2004**

**Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to an Extension of Interpretation of PACE Guarantees in Securities Subject to ITS Plan Exemption**

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup>, and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on March 15, 2004, 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 and II, 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 and to grant accelerated approval.

The proposal is intended to coincide with the Commission's extension of a de minimis exemption from the trade-through provisions of the Intermarket Trading System ("ITS") Plan with respect to certain transactions in the Nasdaq-100 Index ("QQQs"), the Dow Jones Industrial Average ("DIAMONDS"), and the Standard & Poor's 500 Index ("SPDRs").<sup>3</sup> The Commission's original exemption expired on June 4, 2003.<sup>4</sup> On May 30, 2003, the Commission issued an order extending the ITS Exemption from June 4, 2003 through March 4, 2004.<sup>5</sup> On

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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> See Securities Exchange Act Release No. 46428 (August 28, 2002), 67 FR 56607 (September 4, 2002) at 56607 ("ITS Exemption Order").

<sup>4</sup> The Exchange Rule that mirrors the Commission's exemption similarly expired on June 4, 2003.

<sup>5</sup> See Securities Exchange Act Release No. 47950 (May 30, 2003), 68 FR 33748 (June 5, 2003)(order extending ITS Exemption Order).

March 3, 2004, the Commission issued another order extending the ITS Exemption for an additional nine months through December 4, 2004.<sup>6</sup> In order to avoid a lapse in the effectiveness of the corresponding Exchange Rule, this order is approving the Exchange's proposal to extend the rule from March 4, 2004 until December 4, 2004.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The Phlx proposes to extend a limited exemption in transactions in certain exchange-traded fund ("ETFs") shares from Supplementary Material Section .10(a)(iii) of Exchange Rule 229, Philadelphia Stock Exchange Automated Communication and Execution System (PACE")<sup>7</sup> beyond March 4, 2004 until December 4, 2004. The text of the proposed rule change is available at the Office of the Secretary, 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, 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 III 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**

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<sup>6</sup> See Securities Exchange Act Release No. 49356 (March 3, 2004), 69 FR 11057 (March 9, 2004) (Order Pursuant to Section 11A of the Securities Exchange Act of 1934 and Rule 11Aa3-2(f) Thereunder Extending a De Minimis Exemption for Transactions in Certain Exchange Traded Funds from the Trade-Through Provisions of the Intermarket Trading System).

<sup>7</sup> PACE is the Exchange's Automated Communication and Execution System. PACE provides a system for the automatic execution of orders on the Exchange equity floor under predetermined conditions.

1. Purpose

The purpose of the proposed rule change is to extend the time period of a current limited exemption from Phlx Rule 229.10(a)(iii). The exemption applies to the ETFs tracking the QQQs, DIAMONDS and SPDRs,<sup>8</sup> and correlates with an exemption from the ITS Plan issued by the Commission (the “ITS Exemption”).<sup>9</sup> The Commission's ITS Exemption exempted any transactions in the three ETFs that are effected at prices at or within three cents away from the best bid and offer quoted in the Consolidated Quote System from the trade-through provisions of the ITS Plan through June 4, 2003. On May 30, 2003, the Commission issued an order extending the ITS Exemption from June 4, 2003 through March 4, 2004.<sup>10</sup> On March 3, 2004, the Commission issued another order extending the ITS Exemption for an additional nine months through December 4, 2004.<sup>11</sup>

Phlx Rule 229.10(a)(iii) requires a Phlx specialist to execute certain orders that are traded-through by another market center. It provides generally that if 100 or more shares print through the limit price on any exchange(s) eligible to compose the PACE Quote<sup>12</sup> after the time

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<sup>8</sup> The Exchange does not currently trade DIAMONDS or SPDRs but may determine to do so in the future. The Exchange does trade QQQs. The Nasdaq-100<sup>®</sup>, Nasdaq-100 Index<sup>®</sup>, Nasdaq<sup>®</sup>, The Nasdaq Stock Market<sup>®</sup>, Nasdaq-100 Shares<sup>SM</sup>, Nasdaq-100 Trust<sup>SM</sup>, Nasdaq-100 Index Tracking Stock<sup>SM</sup>, and QQQ<sup>SM</sup> are trademarks or service marks of The Nasdaq Stock Market, Inc. (“Nasdaq”) and have been licensed for use for certain purposes by the Phlx pursuant to a License Agreement with Nasdaq. The Nasdaq-100 Index<sup>®</sup> (the “Index”) is determined, composed, and calculated by Nasdaq without regard to the Licensee, the Nasdaq-100 Trust<sup>SM</sup>, or the beneficial owners of Nasdaq-100 Shares<sup>SM</sup>. Nasdaq has complete control and sole discretion in determining, comprising, or calculating the Index or in modifying in any way its method for determining, comprising, or calculating the Index in the future.

<sup>9</sup> See note 3, supra.

<sup>10</sup> See note 5, supra.

<sup>11</sup> See note 6, supra.

<sup>12</sup> PACE Quote is defined in Phlx Rule 229 as the best bid/ask quote among the American Stock Exchange LLC, Boston Stock Exchange, Inc., Cincinnati Stock Exchange, Inc.,

of entry of any such order into PACE, the specialist shall execute all such orders at the limit price without waiting for an accumulation of 1000 shares to print at the limit price on the New York market.<sup>13</sup>

Prior to the Commission's issuance of the ITS Exemption, although the specialist had this obligation the specialist was, in turn, entitled to "satisfaction" of those orders pursuant to Section 8(d) of the ITS Plan. Now, where trading through is no longer prohibited by the ITS Plan, as enumerated in the ITS Exemption, the specialist does not have recourse to seek "satisfaction" for these orders and is responsible for those executions. Moreover, the Exchange believes that the provision now unduly burdens the specialist by requiring the specialist to execute orders in situations where the specialist does not have access to trading at that price. Thus, the Phlx believes that its provision guaranteeing an execution no longer makes sense.

The corresponding limited exemption contained in the last sentence of Exchange Rule 229.10(a)(iii) was initially put in effect on a pilot basis for the period September 4, 2002 to

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Chicago Stock Exchange, Inc., New York Stock Exchange, Inc., Pacific Exchange, Inc. and the Phlx, or the Intermarket Trading System/Computer Assisted Execution System ("ITS/CAES") quote, as appropriate.

<sup>13</sup> To be understood, Section .10(a)(iii) must be read in conjunction with the preceding section of the PACE Rule. Supplementary Material Section .10(a)(ii) provides as follows:

Non-Marketable Limit Orders--Unless the member organization entering orders otherwise elects, round-lot limit orders up to 500 shares and the round-lot portion of PRL limit orders up to 599 shares which are entered at a price different than the PACE Quote will be executed in sequence at the limit price when an accumulative volume of 1000 shares of the security named in the order prints at the limit price or better on the New York market after the time of entry of any such order into PACE. For each accumulation of 1000 shares which have been executed at the limit price on the New York market, the specialist shall execute a single limit order of a participant up to a maximum of 500 shares for each round-lot limit order up to 500 shares or the round-lot portion of a PRL limit order up to 599 shares.

October 4, 2002.<sup>14</sup> The pilot was subsequently extended to November 3, 2002,<sup>15</sup> and was extended again to March 4, 2004.<sup>16</sup> The Exchange is now proposing to extend the limited exemption of Phlx Rule 229, Supplementary Material .10(a)(iii) through December 4, 2004, to coincide with the most recent extension of the ITS Exemption. In order to avoid a lapse in the effectiveness of the corresponding Exchange Rule, this order is approving the Exchange's proposal to extend the rule from March 4, 2004 through December 4, 2004.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>17</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>18</sup> in particular, in that it is designed to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; 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; and is not designed to permit unfair discrimination between customers, issuers, brokers or dealers. By adopting the extension of the current exemption, the Exchange avoids

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<sup>14</sup> See Securities Exchange Act Release No. 46481 (September 10, 2002), 67 FR 58669 (September 17, 2002) (notice of immediate effectiveness of pilot for the period September 4, 2002 to October 4, 2002).

<sup>15</sup> See Securities Exchange Act Release No. 46615 (October 8, 2002), 67 FR 63723 (October 15, 2002) (notice of immediate effectiveness of extension of pilot to November 3, 2002).

<sup>16</sup> See Securities Exchange Act Release No. 48163 (July 10, 2003), 68 FR 42450 (July 17, 2003) (Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to an Extension of Interpretation of PACE Guarantees in Securities Subject to ITS Plan Exemption).

<sup>17</sup> 15 U.S.C. 78f(b).

<sup>18</sup> 15 U.S.C. 78f(b)(5).

burdening specialists with the obligation to fill an order in circumstances where an external event triggered the execution obligation and the specialist could not access trading at that price.

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.

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. 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-Phlx-2004-20. 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, comments should be sent in hardcopy or by e-mail but not by both methods. 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 such filing will also be available for inspection and copying at the principal office of the

Exchange. All submissions should be submitted by [insert date 21 days from the date of this publication].

#### **IV. Discussion**

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>19</sup> In particular, the Commission finds that the proposed rule is consistent with the requirements of Section 6(b)(5) of the Act<sup>20</sup> because it is designed to facilitate transactions in securities; 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; and is not designed to permit unfair discrimination between customers, issuers, brokers or dealers.

The Commission believes that by extending the Exchange's proposed exemption for its members, the Exchange would remove the specialist's obligation to provide trade-through protection in situations where it will not be permitted to seek satisfaction through ITS from the primary market. This obligation was one the Phlx assumed voluntarily in order to make its market more attractive to sources of order flow, not an obligation the Act imposes on a market. The Commission believes that the business decision to potentially forego order flow by no longer providing print protection is a judgment the Act allows the Phlx to make.<sup>21</sup>

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<sup>19</sup> In approving this rule proposal, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> The Commission notes that the Phlx's proposed rule change will remain in effect only until the expiration of the extension of Commission's ITS Exemption Order on December 4, 2004.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of the publication of notice thereof in the Federal Register. The Commission is granting accelerated approval in order to prevent a lapse in the effectiveness of the Exchange's rules regarding a Phlx specialist's obligation to provide trade-through protection in certain securities.

**V. Conclusion**

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>22</sup> that the proposed rule change (SR-Phlx-2004-20) is approved on an accelerated basis and is effective retroactively to March 4, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>23</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>22</sup> 15 U.S.C. 78f(b)(2).

<sup>23</sup> 17 CFR 200.30-3(a)(12).