

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50591; File No. SR-Phlx-2004-62)

October 26, 2004

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change to Waive the Options Specialist Shortfall Fee for One Specialist Unit That Did Not Have a Specialized Quote Feed In Place

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 September 23, 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 the Exchange. 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 proposes to waive the options specialist shortfall fee (“shortfall fee”) for the period May 2004 through August 2004 for one specialist unit that did not have a specialized quote feed (“SQF”) in place that could price an option accurately for any option where the primary volume in the underlying security shifted to another market.<sup>3</sup>

There is no new proposed rule language.

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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> An SQF is a specialized connection that bypasses the Exchange’s Auto-Quote, which is the Exchange’s electronic options pricing system that enables specialists to automatically monitor and instantly update quotations. Auto-Quote and SQFs (“Quoting Mechanisms”) incorporate pricing model data, which generate automatic pricing of option series based on a number of factors, including the

Background: The Exchange currently imposes a shortfall fee of \$.35 per contract for specialists trading any top 120 Option if 12% of the total national monthly contract volume (“volume threshold”) for such Top 120 Option is not effected on the Phlx.<sup>4</sup> The fee is limited to \$10,000 per month per option provided that the total monthly market share effected on the Phlx in that Top 120 Option is equal to or greater than 50% of the volume threshold in effect.<sup>5</sup> For any Top 120 Option listed after February 1, 2004 and for Any Top 120 Option acquired by a new specialist unit<sup>6</sup> within the first 60 days of operations, the following thresholds apply:<sup>7</sup>

First full month of trading:	0% national market share
Second full month of trading:	3% national market share
Third full month of trading:	6% national market share
Fourth full month of trading:	9% national market share
Fifth full month of trading (and thereafter):	12% national market share

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value of the underlying stock.

<sup>4</sup> See Securities Exchange Act Release No. 48206 (July 22, 2003), 68 FR 44555 (July 29, 2003)(SR-Phlx-2003-45).

<sup>5</sup> See Securities Exchange Act Release No. 48207 (July 22, 2003), 68 FR 44558 (July 29, 2003)(SR-Phlx-2003-47).

<sup>6</sup> A new specialist unit is one that is approved to operate as a specialist unit by the Options Allocation, Evaluation, and Securities Committee on or after February 1, 2004 and is a specialist unit that is not currently affiliated with an existing options specialist unit as reported on the member organization’s Form BD, which refers to direct and indirect owners, or as reported in connection with any other financial arrangement, such as is required by Exchange Rule 783.

<sup>7</sup> The shortfall fee is not applicable to any option traded on Phlx XL, the Exchange’s electronic trading platform, either on a variable or fixed fee basis. See Securities Exchange Act Release No. 50332 (September 9, 2004), 69 FR 55858 (September 16, 2004)(SR-Phlx-2004-49).

Proposal: The Exchange proposes to waive the shortfall fee for transactions settling on or after May 1, 2004 through August 31, 2004 for one specialist unit that did not have an SQF in place that could price an option accurately for any option where the primary volume in the underlying security shifted to another market. Generally, the most volume in an equity security occurs on the market where the security is listed, such that the listing market is known as the “primary market” and Quoting Mechanisms use that market’s process to price the overlying option, as described further below.

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. 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 Phlx filed the proposed rule change to correct an economic outcome caused when one particular specialist unit was unable to price an option accurately because of a unique situation where: (i) the key liquidity, the most volume and often the best market are other than on the market where the security is primarily listed; and (ii) the specialist unit’s Quoting Mechanism is technologically tied to the price of the underlying security on its listed market. Specifically, the specialist unit was unable to secure technology changes to price the option using the “new” primary market quickly (as both the

Exchange, respecting Auto-Quote, and outside vendors, respecting SQFs, could not make such extensive changes quickly and faced competing priorities); thus, the specialist unit has linked its failure to achieve the shortfall targets to these technology/pricing issues. Accordingly, this proposed rule change is limited in scope, and is intended to correct what the Exchange has determined is a limited, unfair outcome of its shortfall fee for this specific specialist unit.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>8</sup> and furthers the objectives of Section 6(b)(4) of the Act<sup>9</sup> in particular, in that it is an equitable allocation of reasonable dues, fees and other charges. The Exchange believes that the proposal is reasonable and equitable because it is intended to correct a situation where the operation of its shortfall fee was incompatible with the technology available to price options, which caused an unfair and unintended fee result.

### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposal 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. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

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<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(4).

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 self-regulatory organization consents, the Commission will:

- 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 No. SR-Phlx-2004-62 on the subject line.

##### 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-2004-62. 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](http://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 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 No. SR-Phlx-2004-62 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>10</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).