

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁴

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47417; File No. SR-Phlx-2002-61]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. To Amend Options Floor Procedure Advice A-13 To Include Violations for Failure To Obtain Approval To Disengage the NBBO Feature in the Exchange's Minor Rule Plan

February 27, 2003.

On October 4, 2002, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Phlx Option Floor Procedure Advice ("OFPA") A-13, Auto Execution Engagement/Disengagement Responsibility, to include in the Exchange's minor rule violation enforcement and reporting plan ("Minor Rule Plan")³ violations for failure to obtain the necessary approvals prior to disengagement of the National Best Bid/Best Offer ("NBBO") Feature of the Exchange's Automated Options Market System ("AUTOM").⁴ The Exchange's NBBO Feature automatically executes orders at the NBBO for certain options designated by the Phlx's Options Committee as eligible for the NBBO Feature ("automatic step-up options"), provided that the NBBO does not differ

from the specialist's bid or offer by more than the "step up parameter."⁵ Currently, engagement and disengagement of the NBBO Feature is governed solely by Phlx Rule 1080(c)(i), and violations are referred to the Business Conduct Committee ("BCC").

The Exchange proposed to amend OFPA A-13 to restate from Phlx Rule 1080(c)(i) the conditions for using the NBBO Feature, including the requirement to obtain approval to disengage the NBBO Feature, and to include a fine schedule for failure to obtain such approval. Specifically, the proposed fine schedule is as follows: First occurrence, \$250; second occurrence, \$500; third occurrence, \$1,000; fourth occurrence and thereafter, sanction discretionary with the BCC. The proposed fine schedule would be implemented on a one-year running basis. The BCC also would have discretion concerning sanctions for any violations should they be deemed egregious by the Exchange's Enforcement Department and referred directly to the BCC pursuant to Exchange Rule 960.2.

On November 7, 2002, the Exchange submitted Amendment No. 1 to the proposed rule change.⁶ The proposed rule change, as amended, was published in the **Federal Register** on January 22, 2003.⁷ The Commission did not receive any comment letters on the proposed rule change. This order approves the proposed rule change, as amended.

The Commission has carefully reviewed the proposal and finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange⁸ and, in particular, the requirements of section 6 of the Act⁹ and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change is consistent with section 6(b)(6) of the Act¹⁰ in that it provides a procedure whereby member

organizations can be disciplined appropriately in those instances when a rule violation is minor in nature, but a sanction more serious than an admonition letter is appropriate. Additionally, the Commission finds that the proposed rule change is consistent with the requirements of sections 6(b)(7)¹¹ and 6(d)(1)¹² of the Act. Section 6(b)(7) requires the rules of an exchange to be in accordance with the provisions of section 6(d) of the Act, and, in general, to provide a fair procedure for the disciplining of members and persons associated with members. Section 6(d)(1) requires an exchange to bring specific charges, notify such member or person of, and give him an opportunity to defend against, such charges, and keep a record, in any proceeding to determine whether a member or person associated with a member should be disciplined. Finally, the Commission finds the proposal is consistent with Rule 19d-1(c)(2) under the Act,¹³ which governs minor rule violations plans.

In approving this proposal, the Commission in no way minimizes the importance of compliance with these rules, and all other rules subject to the imposition of fines under the Exchange's Minor Rule Plan. The Commission believes that the violation of any self-regulatory organization's rules, as well as Commission rules, is a serious matter. However, in an effort to provide the Exchange with greater flexibility in addressing certain violations, the Exchange's Minor Rule Plan provides a reasonable means to address rule violations that do not rise to the level of requiring formal disciplinary proceedings. The Commission expects that the Phlx will continue to conduct surveillance with due diligence, and make a determination based on its findings whether fines of more or less than the recommended amount are appropriate for violations of rules under the Exchange's Minor Rule Plan, on a case by case basis, or if a violation requires formal disciplinary action.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-Phlx-2002-61), as amended, is approved.

²⁴ 17 CFR 200.30-3(a)(75).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Exchange's Minor Rule Plan, codified in Exchange Rule 970, includes Floor Procedure Advices with accompanying fine schedules.

⁴ AUTOM is the Exchange's electronic order delivery, routing, execution and reporting system, which provides for the automatic entry and routing of equity option and index option orders to the Exchange trading floor. Orders delivered through AUTOM may be executed manually, or certain orders are eligible for AUTOM's automatic execution feature, AUTO-X. Equity option and index option specialists are required by the Exchange to participate in AUTOM and its features and enhancements. Option orders entered by Exchange members into AUTOM are routed to the appropriate specialist unit on the Exchange trading floor.

⁵ For a complete description of the NBBO Feature, see Securities Exchange Act Release No. 43684 (December 6, 2000), 65 FR 78237 (December 14, 2000) (order partially approving SR-Phlx-00-93).

⁶ See letter from Rick Rudolph, Director and Counsel, Phlx, to Jennifer Lewis, Commission, dated November 6, 2002 ("Amendment No. 1"). In Amendment No. 1, Phlx fixed nonsubstantive typographical errors in its rule text, and added a cross-reference to Phlx Rule 960.2 in the purpose section of its proposal.

⁷ See Securities Exchange Act Release No. 47166 (January 10, 2003), 68 FR 3077.

⁸ In approving this proposed rule change, the Commission notes that it has considered its impact on efficiency, competition, and capital formation.

⁹ 15 U.S.C. 78f.

¹⁰ 15 U.S.C. 78f(b)(6).

¹¹ 15 U.S.C. 78f(b)(7).

¹² 15 U.S.C. 78f(d)(1).

¹³ 17 CFR 240.19d-1(c)(2).

¹⁴ 15 U.S.C. 78s(b)(2).

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47424; File No. SR-Phlx-2003-04]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to the Payment for Order Flow Fees for the Top 120 Options

February 28, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹, and rule 19b-4 thereunder,² notice is hereby given that on January 28, 2003, the Philadelphia Stock Exchange, Inc. ("Phlx") filed with the Securities and Exchange Commission the proposed rule change as described in items I, II, and III below, which the Phlx has prepared. 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 establish its options payment for order flow fees imposed on the transactions of Phlx Registered Options Traders ("ROTs") for the period from February through April 2003, for the top 120 options based on volume statistics from October, November, and December 2002,³ as set forth on the ROT Equity Option Payment for Order Flow Charges Schedule. The Phlx intends to implement the fees for trades settling on

February 1, 2003, through April 30, 2003. The rate levels have remained unchanged: the top-ranked option is charged a fee of \$1.00 per contract, the next 49 options are charged a fee of \$0.50 per contract, and the fee for the remaining options in the top 120 is set at \$0.00.

The Phlx's ROT Equity Option Payment for Order Flow Charges Schedule is available at the 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 had received on the proposed rule change. The text of these statements may be examined at the places specified in item IV 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

The Phlx recently filed with the Commission to reinstate its payment for order flow program.⁴ Pursuant to the Phlx's current program, Phlx ROTs are assessed a payment for order flow fee on the top 120 most actively traded equity options, on a per-contract, per-options issue basis, as set forth on Phlx's ROT Equity Option Payment for Order Flow Charges Schedule, subject to certain exceptions.⁵

1. Purpose

The purpose of the proposed rule change is to establish the payment for order flow fees for trades settling on or after February 1, 2003, through April 30, 2003, for the applicable top 120 options. The Phlx will file with the Commission a proposed rule change to address changes to the Phlx's fee schedule for subsequent time periods. No other changes to the Phlx's payment for order

⁴ See Securities Exchange Act Release No. 47090 (December 23, 2002), 68 FR 141 (January 2, 2003) (SR-Phlx-2002-75).

⁵ The payment for order flow fee does not apply to transactions between: (1) A ROT and a specialist; (2) a ROT and a ROT; (3) a ROT and a firm; and (4) a ROT and a broker-dealer. Indeed, because the primary focus of the program is to attract order flow from customers, the payment for order flow fee is not imposed on the above-specified transactions. Also, the payment for order flow fee does not apply to index or foreign currency options.

flow program are being made at this time.

2. Statutory Basis

The Phlx believes that its proposal to amend its schedule of dues, fees and charges is consistent with section 6(b) of the Act⁶ and in particular furthers the objectives of section 6(b)(4) of the Act⁷ in that it is an equitable allocation of reasonable fees among Phlx members.

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

The Phlx 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

The Phlx neither solicited or received written comments with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing proposed rule change has been designated as a fee change pursuant to section 19(b)(3)(A)(ii) of the Act⁸ and rule 19b-4(f)(2) thereunder.⁹ Accordingly, the proposal will take effect upon filing with the Commission. At any time within 60 days after the filing of the proposed rule change, the Commission may summarily abrogate the rule change if it appears to the Commission that the 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(4).

⁸ 15 U.S.C. 78(s)(b)(3)(A)(iii).

⁹ 17 CFR 240.19b-4(f)(2).

¹⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Phlx's payment for order flow fee is assessed on ROTs on the top 120 most actively traded equity options in terms of the total number of contracts that are traded nationally, based on volume statistics provided by the Options Clearing Corporation. The measuring periods for the top 120 options are calculated every three months. For example, for the period from February through April 2003, the measuring period for the top 120 options is based on volume statistics from October, November and December 2002. For the period from May through July 2003, the measuring period for the top 120 options will be based on volume statistics from January, February and March 2003. This cycle is scheduled to continue every three months, with a separate proposed rule change filed for each three-month period.