

III. Discussion and Commission Findings

After careful review, the Commission 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 exchange.¹¹ Specifically, the Commission believes the proposed rule change, as amended, is consistent with section 6(b)(5) of the Act,¹² which requires among other things, that the rules of the Exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and in general to protect investors and the public interest.

The Commission believes that the proposed rule change codifies current practices on the Exchange and existing interpretations of NYSE rules and is responsive to recommendations made by an independent consultant retained by the Exchange.¹³ The Commission also believes that the proposed rule change should clarify Exchange members' rights and obligations under certain rules such as a broker having to recross a clean agency cross when there has been price improvement, a member's ability to resolve certain disputes involving a monetary difference of \$10,000 or more by a panel or through arbitration, a member's requirement to receive all material terms of an order from the member's customer off the floor of the Exchange, a specialist's responsibility for losses incurred by other members because of an opening transaction, and the conditions for stopping stock.

Moreover, the Commission believes the proposed rule change will clarify the process by which a member can confirm or reject a transaction involving another member who has elected to take or supply for his own account the security named in an order entrusted to him.¹⁴ The Commission notes that several of the changes to NYSE Rule 91 codify the NYSE's prior interpretation of this rule. As a result, the Commission believes that codification of these interpretations will add greater transparency to the NYSE's rules. Further, the Commission notes that the proposed changes to NYSE Rule 91 aim to maintain a degree

¹¹ The Commission has considered the proposed rules' impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78f(b)(5).

¹³ See *supra* note 8.

¹⁴ The Commission notes that Exchange members should assure that any agency issues are addressed by their respective customer agreements.

of flexibility in the rule to accommodate various situations occurring during the trading day.

With respect to the changes proposed for NYSE Rule 91.50, the Commission notes that a Floor Official's review of a broker's continued pattern of rejections of a specialist's principal transactions in no way compromises the unconditional right of a broker to reject any trade where the specialist trades as principal. Furthermore, the Commission notes that the proposed rule provides that no disciplinary process would be triggered by the broker exercising his or her right to reject a trade.

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-NYSE-2002-32), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49176; File No. SR-PCX-2003-59]

Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Granting Approval to a Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. To Amend Its Rules Governing Market-Maker Obligations on the Archipelago Exchange

February 3, 2004.

On October 21, 2003, the Pacific Exchange, Inc. ("PCX" or "Exchange"), through its wholly-owned subsidiary PCX Equities, Inc. ("PCXE"), 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 its rules governing Market Maker obligations on the Archipelago Exchange ("ArcaEx"), the equities trading facility of PCXE. The PCX filed Amendment No. 1 to the proposal on December 2, 2003.³ The proposed rule change, as amended, was

¹⁵ 15 U.S.C. 78s(b)(2).

¹⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaces the originally filed Form 19b-4 in its entirety.

published for comment in the **Federal Register** on December 29, 2003.⁴ The Commission received no comment letters on the proposal. This order approves the proposed rule change, as amended.

The Commission 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 exchange⁵ and, in particular, the requirements of Section 6 of the Act⁶ and the rules and regulations thereunder. Specifically, the Commission believes that the proposed rule change is consistent with Section 6(b),⁷ which, among other things, requires that the PCX's rules be 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. The Commission notes that the PCX's restrictions on Market Makers requiring them to become odd-lot dealers and to maintain cleanup orders in the securities in which they maintain a market currently impose a competitive barrier vis-à-vis other market centers in attracting Market Maker participation on ArcaEx because competing market centers do not impose such requirements.⁸ The Commission notes that the Exchange believes that eliminating the aforementioned requirements will facilitate additional Market Maker participation on ArcaEx and will further enhance order interaction, provide greater depth in liquidity, and foster price competition. Moreover, the Exchange believes that the elimination of such requirements will place ArcaEx on a level playing field with other market centers and allow ArcaEx to fairly compete for Market Maker,⁹ and that the impact on the system from removing these requirements for Market Makers would be minimal on the ArcaEx.

⁴ See Securities Exchange Act Release No. 48928 (December 16, 2003), 68 Fr 75010 (December 29, 2003).

⁵ In approving this proposed rule change, the Commission notes that it has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁶ 15 U.S.C. 78f.

⁷ 15 U.S.C. 78f(b).

⁸ See e.g., NASD Rules 4611 and 4612.

⁹ See note 4, *supra*.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change and Amendment No. 1 thereto (File No. SR-PCX-2003-59) are approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49170; File No. SR-Phlx-2004-05]

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 2, 2004.

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 22, 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 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 equity options payment for order flow fees imposed on the transactions of Phlx Registered Options Traders ("ROTs") for the period from February 2004 through April 2004 for the top 120 equity options based on volume statistics from October, November and December 2003,³ as set forth on the ROT Equity

Option Payment for Order Flow Charges Schedule⁴ and subject to certain exceptions listed below. The Phlx intends to implement the payment for order flow fees for trades settling on or after February 1, 2004 through April 30, 2004. The rate levels would not change: the top-ranked equity option would be charged a fee of \$1.00 per contract; the next 49 equity options would be charged a fee of \$.40 per contract; and no fee would be imposed for the remaining equity options in the top 120.⁵ The Exchange'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.

measuring period for the top 120 equity options was based on volume statistics from July, August and September 2003. See Securities Exchange Act Release No. 48688 (October 24, 2003), 68 FR 61845 (October 30, 2003) (SR-Phlx-2003-70). For the payment for order flow fees imposed on trades settling on or after February 1, 2004 through April 30, 2004, as set forth in this proposal, the measuring period for the top 120 equity options is based on volume statistics from October, November, and December 2003.

⁴ To avoid confusion, the ROT Equity Option Payment for Order Flow Charges Schedule reflects only those options being charged more than \$0.00.

⁵ Under the Exchange's payment for order flow program, a 500 contract cap per individual cleared side of a transaction is imposed. Thus, the applicable payment for order flow fee would be imposed only on the first 500 contracts per individual cleared side of a transaction. For example, if a transaction consists of 750 contracts by one ROT, the applicable payment for order flow fee would be applied to, and capped at, 500 contracts for that transaction. Also, if a transaction consists of 600 contracts, but is divided equally among three ROTs, the 500 contract cap would not apply to any such ROT and each ROT would be assessed the applicable payment for order flow fee on 200 contracts, as the payment for order flow fee is assessed on a per ROT, per transaction basis. See Securities Exchange Act Release No. 47958 (May 30, 2003), 68 FR 34026 (June 6, 2003) (proposing SR-Phlx-2002-87) and Securities Exchange Act Release No. 48166 (July 11, 2003), 68 FR 42540 (July 17, 2003) (approving SR-Phlx-2002-87).

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

The Phlx has reinstated its payment for order flow program.⁶ Under the program, the Phlx charges ROTs a per-contract fee with respect to their transactions in the top 120 most actively traded equity options issues, subject to certain exceptions.⁷ The fees are set forth on the Phlx's ROT Equity Option Payment for Order Flow Charges Schedule.

1. Purpose

The purpose of the proposed rule change is to establish the payment for order flow fees for the top 120 equity options for trades settling on or after February 1, 2004 through April 30, 2004. The Phlx will file with the Commission a proposed rule change to address changes to the fee schedule for subsequent time periods. The Phlx is not making any other changes to its payment for order flow program at this time.

2. Statutory Basis

The Exchange believes that this proposal to amend its schedule of dues, fees and charges would be an equitable allocation of reasonable fees among Phlx members, and that the proposal is consistent with Section 6(b) of the Act⁸ and furthers the objectives of Section 6(b)(4) of the Act.⁹

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

The Phlx neither solicited nor received written comments on this proposal.

⁶ See Securities Exchange Act Release No. 47090 (December 23, 2002), 68 FR 141 (January 2, 2003) (SR-Phlx-2002-75).

⁷ The payment for order flow fee does not apply to specialist transactions or 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. According to the Phlx, the fee is not imposed with respect to the above-specified transactions because the primary focus of the program is to attract order flow from customers. The payment for order flow fee also does not apply to index or foreign currency options.

⁸ 15 U.S.C. 78ff(b).

⁹ 15 U.S.C. 78ff(b)(4).

¹⁰ 15 U.S.C. 78s(b)(2).

¹¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Exchange's payment for order flow fee is imposed on transactions in 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 period for the top 120 equity options encompasses three months and the Exchange files a separate proposed rule change for each three-month trading period. With respect to the payment for order flow fees imposed on trades settling on or after November 1, 2003 through January 31, 2004, for example, the