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 will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR–CBOE–2004–10 and should be submitted by March 24, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[17]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 04–4663 Filed 3–2–04; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49323; File No. SR–ISE–2003–06]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the International Securities Exchange, Inc. to Establish Rules Implementing a Price Improvement Mechanism

February 26, 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 February 25, 2003, the International Securities Exchange, Inc. (''ISE'' 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. On February 25, 2004, the ISE submitted Amendment No. 1 to the proposed rule change.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

[17] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated February 24, 2004 (''Amendment No. 1''). In Amendment No. 1, the ISE replaced the proposed rule text in its entirety.

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

The Exchange is proposing to adopt rules implementing a ''Price Improvement Mechanism'' (''PIM''). Proposed new language is *italicized;* proposed deletions are in [brackets].

* * * * *

Rule 717. Limitations on Orders.

* * * * *

(d) Principal Transactions.

Electronic Access Members may not execute as principal orders they represent as agent unless (i) agency orders are first exposed on the Exchange for at least thirty (30) seconds, (ii) the Electronic Access Member has been bidding or offering on the Exchange for at least thirty (30) seconds prior to receiving an agency order that is executable against such bid or offer, [or] (iii) the Member utilizes the Facilitation Mechanism pursuant to Rule 716(d)*, or (iv) the Member utilizes the Price Improvement Mechanism for Crossing Transactions pursuant to Rule 723.*

(e) Solicitation Orders.

Electronic Access Members must expose orders they represent as agent on the Exchange for at least thirty (30) seconds before such orders may be executed in whole or in part by orders solicited from Members and non-member broker-dealers to transact with such orders*, unless with respect to orders solicited from Members, the Member utilizes the Price Improvement Mechanism for Crossing Transactions pursuant to Rule 723.*

* * * * *

Rule 723. Price Improvement Mechanism for Crossing Transactions

(a) The Price Improvement Mechanism is a process by which an Electronic Access Member can provide price improvement opportunities for a transaction wherein the Electronic Access Member seeks to facilitate an order it represents as agent, or a transaction wherein the Electronic Access Member solicited an order from a Member to execute against an order it represents as agent (a ''Crossing Transaction'').

(b) Crossing Transaction Entry. A Crossing Transaction is comprised of the order the Electronic Access Member represents as agent (the ''Agency Order'') and a counter-side order for the full size of the Agency Order (the ''Counter-Side Order'').

(1) A Crossing Transaction must be entered only at a price that is better than the national best bid or offer (''NBBO''), and only when there are at least three (3) market makers quoting in the options series.

(2) The Crossing Transaction may be priced in one-cent increments.

(3) The Crossing Transaction may not be canceled, but the price of the Counter-Side Order may be improved during the exposure period.

(c) Exposure Period. Upon entry of a Crossing Transaction into the Price Improvement Mechanism, a broadcast message will be sent to all Members. This broadcast message will not be included in the ISE disseminated best bid or offer and will not be disseminated through OPRA.

(1) Members will be given three seconds to indicate the size and price at which they want to participate in the execution of the Agency Order (''Improvement Orders'').

(2) Improvement Orders may be entered by all Members for their own account or for the account of a Public Customer in one-cent increments at the same price as the Crossing Transaction or at an improved price for the Agency Order, and for any size up to the size of the Agency Order.

(3) During the exposure period, Improvement Orders may not be canceled, but may be modified to (1) increase the size at the same price, or (2) improve the price of the Improvement Order for any size up to the size of the Agency Order.

(4) During the exposure period, the aggregate size of the best-priced Improvement Orders will continually be updated and broadcast to all Members.

(5) The exposure period will automatically terminate (i) at the end of the three second period, (ii) upon the receipt of a market or marketable limit order on the Exchange in the same series, or (iii) upon the receipt of a non-marketable limit order in the same series on the same side of the market as the Agency Order that would cause the price of the Crossing Transaction to be outside of the best bid or offer on the Exchange.

(d) Execution. At the end of the exposure period the Agency Order will be executed in full at the best prices available, taking into consideration orders and quotes in the Exchange market, Improvement Orders and the Counter-Side Order. The Agency Order will receive executions at multiple price levels if there is insufficient size to execute the entire order at the best price.

(1) At a given price, Public Customer interest is executed in full before any Non-Customer interest.

(2) After Public Customer interest at a given price, agency orders for the account of non-Member broker-dealers

will be executed in full before any proprietary interest of Members (i.e., proprietary interest from Electronic Access Members and Exchange market makers).

(3) After Public Customer interest and agency orders for the account of non-Member broker-dealers, Member proprietary interest will participate in the execution of the Agency Order based upon the percentage of the total number of contracts available at the price that is represented by the size of the Non-Customer's interest.

(4) In the case where the Counter-Side Order is at the same price as Member interest in (d)(3), the Counter-Side order will be allocated the greater of one (1) contract or forty percent (40%) of the initial size of the Agency Order before other Member interest is executed.

(5) When a market order or marketable limit order on the opposite side of the market from the Agency Order ends the exposure period, it will participate in the execution of the Agency Order at the price that is mid-way between the best counter-side interest and the bid or offer on the Exchange, so that both the market order and the Agency Order receive price improvement. Transactions will be rounded, when necessary, to the $.01 increment that favors the Agency Order.

(6) When a market order or marketable limit order on the same side of the market as the Agency Order ends the exposure period, it will execute against any unexecuted interest in the Price Improvement Mechanism after the Agency Order is executed in full, so that the market order or marketable limit order receives an opportunity for price improvement.

Supplementary Material to Rule 723

.01 It shall be considered conduct inconsistent with just and equitable principles of trade for any Member to enter orders, quotes, Agency Orders, Counter-Side Orders or Improvement Orders for the purpose of disrupting or manipulating the Price Improvement Mechanism.

.02 The Price Improvement Mechanism may only be used to execute bona fide Crossing Transactions.

.03 Initially, and for at least a Pilot Period expiring on July 18, 2005, there will be no minimum size requirements for order to be eligible for the Price Improvement Mechanism. During the Pilot Period, the Exchange will submit certain data, periodically as required by the Commission, to provide supporting evidence that, among other things, there is meaningful competition for all size order within the Price Improvement Mechanism, that there is significant price improvement for all orders executed through the Price Improvement Mechanism, and that there is an active and liquid market functioning on the Exchange outside of the Price Improvement Mechanism. Any data which is submitted to the Commission will be provided on a confidential basis.

.04 Only one PIM may be ongoing at any given time in a series. PIMs will not queue or overlap in any manner.

* * * * *

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 Exchange 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 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 purpose of this proposed rule change is to adopt rules implementing the ISE's PIM. The PIM is a mechanism that would allow an ISE Electronic Access Member (''EAM'') to enter matched trades called ''Crossing Transactions.'' Similar to the ISE's Facilitation Mechanism,[4] a Crossing Transaction would be comprised of an order that the EAM represents as agent (''Agency Order'') and an order that is executable against the Agency Order for the full size of the Agency Order (the ''Counter-Side Order''). In the case of the PIM, the Counter-Side Order could be either the EAM's own principal interest, one or more orders the EAM solicited to trade against the Agency Order from other ISE members, or a combination of the EAM's own principal interest and such solicited order(s). A Member must enter the Crossing Transaction at a price at least one cent better than the national best bid and offer (''NBBO'').[5]

The ISE would broadcast the Crossing Transaction to all ISE members. During a three-second auction, all ISE members could enter ''Improvement Orders,'' in pennies, to improve the price of the Agency Order.[6] Improvement Orders may be for the account of a Public Customer or for the member's own account. After three seconds, the ISE would execute the Agency Order against the best prices as follows: (1) All Public Customer Improvement Orders and unrelated Public Customer orders on the book at the best price would be executed first; (2) all unrelated agency orders on the book for the account of a non-Member broker-dealer would then be executed; (3) if the entering EAM is at the best price, it would then execute against the greater of one contract or 40 percent of the Agency Order; and (4) the remainder of the order would be allocated to all other interest, which includes Improvement Orders and unrelated orders on the book for the account of an ISE member (including ISE market makers), at the best price pro-rata based on size.[7]

The three-second PIM exposure period would be ended immediately upon the receipt of certain orders in the regular Exchange market. Specifically, the PIM would end immediately when a market or marketable limit order is received in the same series or when a limit order on the same side of the market as the Agency Order is received that would cause the price of the Crossing Transaction to be outside of the best bid or offer on the Exchange. In the case where a market or marketable limit order on the opposite side of the market from the Agency Order is received, the order would execute against the Agency Order at a price that is mid-way between the best PIM price and the bid or offer on the Exchange. As a result, both orders would receive an improved price.[8] In addition, when a

[4] *See* ISE Rule 716(d).

[5] A PIM could not be initiated unless there are at least three ISE market makers quoting in the series. Moreover, there could be only one PIM ongoing in a series at any given time. Therefore, a PIM could not be initiated during an ongoing PIM in the same series.

[6] The ISE would broadcast Improvement Orders to all members. Crossing Transactions and Improvement Orders would not be displayed in the ISE BBO and would not be disseminated to the Options Price Reporting Authority.

[7] This sized-based allocation formula for the remainder of the order would be the same formula the Exchange applies in the regular market, without any special allocation rights for the Primary Market Maker. *See* ISE Rule 713, Supplementary Material .01. Improvement Orders entered by the Primary Market Maker would be treated the same as Improvement Orders entered by other broker-dealers. *See also* ISE Rule 716(d)(4)(ii) (providing for the same allocation formula in the Facilitation Mechanism).

[8] For example, assume (i) the NBBO is $5 to $5.10, (ii) a PIM has been initiated for an Agency Order to sell 100 contracts, and (iii) the best PIM price is $5.06. If a market order to buy 50 contracts is received, the PIM would terminate and the market order would execute against the Agency Order for 50 contracts at $5.08. This represents a

market order or marketable limit order on the same side of the market as the Agency Order ends the PIM, it would execute against any unexecuted Improvement Orders after the Agency Order is executed in full. The ISE believes that this would provide an opportunity for price improvement to orders in the regular Exchange market.[9]

The PIM would be available for orders of all sizes for a Pilot Period expiring on July 13, 2005. The ISE represents that during this pilot period it would provide the Commission with the following information on a monthly basis:

(1) The number of orders of fewer than 50 contracts entered into the PIM;

(2) The percentage of all orders of fewer than 50 contracts sent to the ISE that are entered into the PIM;

(3) The percentage of all ISE trades represented by orders of fewer than 50 contracts;

(4) The percentage of all ISE trades effected through the PIM represented by orders of fewer than 50 contracts;

(5) The percentage of all contracts traded on the ISE represented by orders of fewer than 50 contracts;

(6) The percentage of all contracts effected through the PIM represented by orders of fewer than 50 contracts;

(7) The spread in the option, at the time an order of fewer than 50 contracts is submitted to the PIM;

(8) Of PIM trades, the percentage done at the NBBO plus $.01, plus $.02, plus $.03, etc.; and

(9) The number of PIM orders submitted when the spread was $.05, $.10, $.15, etc. For each spread, we will specify the percentage of contracts in orders of fewer than 50 contracts submitted to the PIM that were traded by: (a) The EAM that submitted the order to the PIM; (b) ISE market makers assigned to the class; (c) Improvement Orders; and (d) unrelated orders (orders in standard increments entered during the PIM).

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act[10] in general, and furthers the objectives of section 6(b)(5)[11] in particular, in that it is designed to remove impediments to and perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest. In particular, the ISE believes that the proposal would provide an opportunity for Public Customers to receive price improvement of their orders.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

The Exchange did not solicit or receive written comments on the proposed rule change.

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

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 Exchange 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 proposal, as amended, 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*. All comment letters should refer to File No. SR–ISE–2003–06. The 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 Amex. All submissions should be submitted by March 24, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[12]

Margaret H. McFarland,

Deputy Secretary.

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$.02 improvement for the market order over the best offer price and a $.02 improvement for the Agency Order over the PIM price. The 50 contracts remaining in the Agency Order would be executed at the PIM price of $5.06, assuming that there were 50 contracts available at that price. Telephone conversation between Michael Simon, Senior Vice President and General Counsel, ISE, and Deborah Flynn, Assistant Director, Division, Commission, on February 25, 2004. All executions would be in $.01 increments, and rounding would be in favor of the Agency Order. Thus, in this example, if the best PIM price had been $5.07, the market order would have executed against the Agency Order for 50 contracts at $5.09.

[9] For example, assume (i) the NBBO is $5 to $5.10, (ii) a PIM has been initiated for an Agency Order to sell 100 contracts, and (iii) the best PIM price is $5.06 for 125 contracts. If a market order to sell 50 contracts is received, the PIM would terminate, the Agency Order would be executed at $5.06 and the market order to sell would receive 25 contracts at $5.06.

[10] 15 U.S.C. 78f(b).

[11] 15 U.S.C. 78f(b)(5).

[12] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49324; File No. SR–Phlx–2004–08]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. To Amend Its Equity Option Specialist Deficit (Shortfall) Fee

February 26, 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 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 the Exchange. On February 25, 2004, the Exchange filed Amendment No. 1 to the proposed

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b-4.