

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49801; File No. SR-Phlx-2004-38)

June 3, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. to Extend a Pilot Program under Which it Lists Options on Selected Stocks Trading Below \$20 at One-Point Intervals Until June 5, 2005

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 May 27, 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 and II below, which Items have been prepared by Phlx. 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

Phlx proposes to extend its pilot program under which it lists options on selected stocks trading below \$20 at \$1 strike price intervals (“\$1 Pilot Program”) until June 5, 2005. The text of the proposed rule change is available at the Office of the Secretary, Phlx, and 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, 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 IV

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

below. 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

1. Purpose

The purpose of the proposed rule change is to extend the term of the \$1 Pilot Program to June 5, 2005 so that Phlx can continue to list options at \$1 strike price intervals within the parameters specified in Commentary .05 to Phlx Rule 1012.

According to the Phlx, a large number of stocks have precipitously declined in price over the last three years and the number of options overlying this lowest tier of stocks has increased. On June 11, 2005, the Commission approved the \$1 Pilot Program which allows Phlx to list strike prices for options at \$1 intervals for securities trading under \$20.³ Phlx proposes to extend the \$1 Pilot Program until June 5, 2005. The Phlx does not propose any changes to the \$1 Pilot Program. Under the \$1 Pilot Program, the Phlx can establish \$1 strike price intervals on options classes overlying no more than five (5) individual stocks designated by the Phlx where the underlying stock closes below \$20 on the primary market on the trading day before selection; the \$1 strike price is from \$3 to \$20; the \$1 strike price is no more than \$5 from (i.e., \$5 above or below) the closing price of the underlying stock on the preceding day; the \$1 strike price will not be listed within \$0.50 of an existing \$2.50 strike price within the same series; and the \$1 strike price will not be applied to LEAPS. Lastly, pursuant to the \$1 Pilot Program, the Phlx can multiply list those

³ See Securities Exchange Release No. 48013 (June 11, 2003), 68 FR 35933 (June 17, 2003)(Order approving File No. SR-Phlx-2002-55).

option classes specifically designated to be listed at \$1 strike price intervals by another options exchanges that has a similar \$1 Pilot Program pursuant to its rules.

In July 2003, the Phlx chose and listed five (5) option classes at \$1 strike price intervals.⁴ Thereafter, the Phlx listed, on a multiple listed basis, options at \$1 strike price intervals on classes that were listed by the other option exchanges pursuant to their \$1 Pilot Programs. The Phlx currently lists a total of twenty-two (22) option classes at \$1 strike price intervals. The Phlx believes that its ability to list options at \$1 strike price intervals pursuant to the \$1 Pilot Program has given investors the opportunity to more closely and effectively tailor their options investments to the price of the underlying stock, has allowed the Phlx to take advantage of competitive opportunities to list options at \$1 strike prices, and, lastly, has stimulated price competition among the options exchanges in those options classes.

In its order approving the \$1 Pilot Program, the Commission stated that if the Phlx seeks to extend, expand, or permanently approve the \$1 Pilot Program, that it must include a Pilot Program Report with its filing.⁵ Phlx's \$1 Pilot Program Report ("Report") reviews Phlx's experience with the \$1 Pilot Program and supports Phlx's belief that extending the \$1 Pilot Program is proper.⁶ Among other things, the Phlx believes that the Report shows the strength and efficacy of the \$1 Pilot Program based upon the steady increase in volume and open interest

⁴ The Phlx chose the follow options classes for is \$1 Pilot Program: TYCO International, LTD (TYC), Micron Tech. (MU), Oracle Co. (ORQ), Brocade Comm. (UBF), and Juniper Networks (JUP).

⁵ See Securities Exchange Release No. 48013, supra note 3.

⁶ The Phlx attached the Pilot Program Report as an exhibit to this proposed rule change. Copies of the Pilot Program Report are available at Phlx and the Commission's Public Reference Room.

of options traded on Phlx at \$1 strike price intervals. Based upon its Report, the Phlx further believes that the \$1 Pilot Program has not and, in the future, should not create capacity problems for the Phlx or the Options Price Reporting Authority (“OPRA”) systems. Lastly, the Phlx states that most of those delisted \$1 strike price option series were delisted to ensure that the options chosen for the \$1 Pilot Program remained within the parameters of the \$1 Pilot Program.

2. Statutory Basis

Phlx believes that its proposal is consistent with Section 6(b) of the Act,⁷ in general, and furthers the objectives of Section 6(b)(5) of the Act,⁸ specifically, in that it is designed to perfect the mechanism of a free and open market and the national market system, protect investors and the public interest and promotes just and equitable principles of trade. The Phlx believes that the proposal would achieve this by allowing listing of \$1 strike price intervals, thereby stimulating customer interest in options overlying the lowest tier of stocks and creating greater trading opportunities and flexibility and providing customers with the ability to more closely tailor investment strategies to the precise movement of the underlying stocks.

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

Phlx does not believe that the proposed rule change will impose any burden on competition 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

No written comments were solicited or received.

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act⁹ and subparagraph (f)(6) of Rule 19b-4¹⁰ thereunder because it does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate; and Phlx has given the Commission written notice of its intention to file the proposed rule change at least five business days prior to filing. At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

Under Rule 19b-4(f)(6)(iii) of the Act,¹¹ the proposal does not become operative for 30 days after the date of its filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest and Phlx is required to give the Commission written notice of its intention to file the proposed rule change at least five business days prior to filing. Phlx has requested that the Commission waive the five-day pre-filing notice requirement and 30-day operative delay so that the \$1 Pilot Program may continue without interruption after it would have otherwise expired on June 5, 2004. For this reason, the Commission, consistent with the protection of investors and the public interest, has determined

⁹ 15 U.S.C. 78s(b)(3)(A).

¹⁰ 17 CFR 240.19b-4(f)(6).

¹¹ 17 CFR 240.19b-4(f)(6)(iii).

to waive the five-day pre-filing notice requirement and 30-day operative delay,¹² and, therefore, the proposal is effective and operative upon filing with the Commission.¹³

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. Please include File Number SR-Phlx-2004-38 on the subject line.

Paper comments:

¹² For purposes only of waiving the five-day pre-filing notice requirement and 30-day operative delay for this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹³ In the event that the Phlx proposes to extend the Pilot Program beyond June 5, 2005, expand the number of options eligible for inclusion in the Pilot Program, or seek permanent approval of the Pilot Program, it should submit a Pilot Program report to the Commission along with the filing of such proposal. The report must cover the entire time the Pilot Program was in effect, and must include: (1) data and written analysis on the open interest and trading volume for options (at all strike price intervals) selected for the Pilot Program; (2) delisted options series (for all strike price intervals) for all options selected for the Pilot Program; (3) an assessment of the appropriateness of \$1 strike price intervals for the options the Phlx selected for the Pilot Program; (4) an assessment of the impact of the Pilot Program on the capacity of the Phlx's, OPRA's, and vendors' automated systems; (5) any capacity problems or other problems that arose during the operation of the Pilot Program and how the Phlx addressed them; (6) any complaints that the Phlx received during the operation of the Pilot Program and how the Phlx addressed them; and (7) any additional information that would help to assess the operation of the Pilot Program. The Commission expects the Phlx to submit a proposed rule change at least 60 days before the expiration of the Pilot Program in the event the Phlx wishes to extend, expand, or seek permanent approval of the Pilot Program.

- 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-2004-38. 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>). 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, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of 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 Number SR-Phlx-2004-38 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.¹⁴

Margaret H. McFarland
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).