

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 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

1. Purpose

The purpose of the proposed rule change is to extend the Exchange's current ECN pilot program that imposes a \$2,500 monthly fee for ECNs that are member organizations and send order flow to the Exchange's equity trading floor for an additional one-year period, until January 31, 2004.⁵ According to the Exchange, the continuation of the \$2,500 fee is intended to attract equity order flow from ECNs to the Exchange by continuing to substitute a fixed monthly fee, in light of the potential for high volumes of order flow from ECNs.⁶

The monthly fee will continue to apply to ECN order flow to the Exchange's equity trading floor, including from ECNs that either became members or began sending order flow after the commencement of the program. The \$2,500 fee would continue to apply to ECN that are not acting as a Phlx specialist or floor broker.⁷

Currently, no ECN operates from the Exchange's equity trading floor as a floor broker or specialist unit. If, however, an ECN did operate from the equity trading floor, it would be subject to various floor-related fees respecting its floor operations.⁸ In addition, an

ECN's transactions as a floor broker would be subject to the equity transaction value charge, and its specialist trades would be subject to other charges.⁹ Even if the ECN were acting as a floor broker or specialist with respect to some trades, those trades for which it was not acting as a floor broker or specialist, but rather an ECN, would be subject only to the flat monthly fee and not other transaction charges.

An ECN that only operates as a specialist or floor broker would not have to pay the monthly fee, because it would, instead, be paying the normal transaction charges applicable to floor brokers and specialists.

An ECN would also continue to be subject to, if applicable, the following membership-related fees: Membership dues or Foreign Currency User Fees, Foreign Currency Option Participation Fee, Capital Funding Fee, Application Fee, Initiation Fee, Transfer Fee, Phlx CCH Guide Fee, Examinations Fee, Technology Fee, Review/Process Subordinated Loans Fee, Registered Representative Registration Fees, and Off-Floor Trader Initial Registration Fee, Annual Fee, and Remote Specialist fees.

Because the \$2,500 fee is a flat monthly fee as opposed to a per-transaction fee, it is intended to encourage ECN volume. Currently, the equity transaction value charge (that would otherwise apply to an ECN's equity trades) ranges from \$.00 to \$.0075 per share per transaction, with a \$50 maximum fee per trade side, and various other applicable discounts. Thus, many variables determine whether the proposed monthly \$2,500 fee is generally more favorable than the equity transaction value charge, depending upon the number of trades, size of the trade and type (*i.e.*, PACE). As a general matter, the Exchange believes that \$2,500 would be more favorable to the ECN because it is a fixed amount.

The Exchange believes that the monthly ECN fee provides competitive fees with appropriate incentives, thus providing a reasonable method to attract large order flow providers, such as ECNs, to the Exchange. The Phlx believes that additional order flow enhances liquidity, and improves the

Exchange's competitive position in equity trading. The Exchange believes that structuring this fee for ECNs is appropriate, as ECNs are unique in their role as order flow providers to the Exchange. Specifically, ECNs operate a unique electronic agency business, similar to a securities exchange, as opposed to directly executing orders for their own customers as principal or agent.

2. Statutory Basis

The Exchange believes that its proposal is consistent with section 6(b) of the Act,¹⁰ in general, and section 6(b)(4) of the Act,¹¹ in particular, because it provides for the equitable allocation of reasonable dues, fees and other charges among its members and other persons using its facilities. The Exchange notes the unique character of ECNs, and believes that the fixed monthly fee is a reasonable method of attracting a new form of order flow to the Exchange.

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.

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

Written comments were neither solicited nor received.

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

Because the foregoing rule change establishes or changes a due, fee, or other charge imposed by the Exchange, it has become effective pursuant to section 19(b)(3)(A) of the Act¹² and subparagraph (f)(2) of rule 19b-4¹³ thereunder. At any time within 60 days of the filing of the 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.

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.

⁵ The \$2,500 monthly fee applies regardless of the ECN's average daily Phlx equity volume.

⁶ In order to recoup costs due pays pursuant to section 31(b) of the Act, the Exchange intends to continue to apply such fee to ECNs, as the current fee schedule reflects.

⁷ An ECN would continue to incur specialist or equity floor brokerage transaction fees if it acts as a Phlx specialist or floor broker.

⁸ These include the Trading Post/Booth Fee, Trading Post w/Kiosk Fee, Kiosk Construction Fee (when requested by specialist), Controller Space Fee, Floor Facility Fee, Shelf Space on Equity Option Trading Floor Fee, Computer Equipment Services, Repairs or Replacements Fee and Computer Relocation Requests Fee. Certain communications fees could also apply, such as the Direct Wire to the Floor Fee, Telephone System Line Extensions, Wireless Telephone System,

Tether Initial Connectivity Fee, Tether Monthly Service Fee, Execution Services/Communication Charge, Stock Execution Machine Registration Fee (Equity Floor), Equity, Option, or FCO Transmission Charge, FCO Pricing Tape, Option Report Service Fee, Quotron Equipment Fee, Instinet, Reuters Equipment Pass-Through Fee and the Option Mailgram Service Fee.

⁹ The PACE Specialist Charge is a fee imposed on specialist transactions only and the Equity Floor Brokerage Assessment and Equity Floor Brokerage Transaction Fee apply to floor brokerage activity.

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(4).

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(2).