

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 III 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 time period of a current limited exemption from Phlx Rule 229.10(a)(iii). The exemption applies to the ETFs tracking the QQQs, DIAMONDS and SPDRs,⁷ and correlates with an exemption from the ITS Plan issued by the Commission (the "ITS Exemption").⁸ The Commission's ITS Exemption exempted any transactions in the three ETFs that are effected at prices at or within three cents away from the best bid and offer quoted in the Consolidated Quote System from the trade-through provisions of the ITS Plan through June 4, 2003. On May 30, 2003, the Commission issued an order extending the ITS Exemption from June 4, 2003 through March 4, 2004.⁹

Phlx Rule 229.10(a)(iii) requires a Phlx specialist to execute certain orders that are traded-through by another market center. It provides generally that if 100 or more shares print through the limit price on any exchange(s) eligible to compose the PACE Quote¹⁰ after the time of entry of any such order into PACE, the specialist shall execute all

such orders at the limit price without waiting for an accumulation of 1000 shares to print at the limit price on the New York market.¹¹

Prior to the Commission's issuance of the ITS Exemption, although the specialist had this obligation the specialist was, in turn, entitled to "satisfaction" of those orders pursuant to section 8(d) of the ITS Plan. Now, where trading through is no longer prohibited by the ITS Plan, as enumerated in the ITS Exemption, the specialist does not have recourse to seek "satisfaction" for these orders and is responsible for those executions. Moreover, the Exchange believes that the provision now unduly burdens the specialist by requiring the specialist to execute orders in situations where the specialist does not have access to trading at that price. Thus, the Phlx believes that its provision guaranteeing an execution no longer makes sense.

The corresponding limited exemption contained in the last sentence of Exchange Rule 229.10(a)(iii) was initially put in effect on a pilot basis for the period September 4, 2002 to October 4, 2002.¹² The pilot was subsequently extended to November 3, 2002.¹³ Although Exchange Rule 229.10(a)(iii) was most recently revised to provide that its limited exemption shall be in effect "for so long as the exemption granted by such Order remains in effect with respect to such exchange-traded funds," the Exchange stated in the proposed rule change adopting that language that "[t]his exemption, which went into effect on September 4, 2002 and will remain in effect until June 4, 2003, allows Participants to execute transactions, through automatic

execution or otherwise, without attempting to access the quotes of other Participants when the expected price improvement would not be significant." ¹⁴ (emphasis added)

2. Statutory Basis

The Exchange believes that its proposal is consistent with section 6(b) of the Act ¹⁵ in general, and furthers the objectives of section 6(b)(5) of the Act ¹⁶ in particular, in that it is 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; and is not designed to permit unfair discrimination between customers, issuers, brokers or dealers. By adopting the extension of the current exemption, the Exchange avoids burdening specialists with the obligation to fill an order in circumstances where an external event triggered the execution obligation and the specialist could not access trading at that price.

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

No written comments were either solicited or received.

III. 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

⁷ The Exchange does not currently trade DIAMONDS or SPDRs but may determine to do so in the future. The Exchange does trade QQQs. The Nasdaq-100®, Nasdaq-100 Index®, Nasdaq®, The Nasdaq Stock Market®, Nasdaq-100 SharesSM, Nasdaq-100 TrustSM, Nasdaq-100 Index Tracking StockSM, and QQQSM are trademarks or service marks of The Nasdaq Stock Market, Inc. ("Nasdaq") and have been licensed for use for certain purposes by the Phlx pursuant to a License Agreement with Nasdaq. The Nasdaq-100 Index® (the "Index") is determined, composed, and calculated by Nasdaq without regard to the Licensee, the Nasdaq-100 TrustSM, or the beneficial owners of Nasdaq-100 SharesSM. Nasdaq has complete control and sole discretion in determining, comprising, or calculating the Index or in modifying in any way its method for determining, comprising, or calculating the Index in the future.

⁸ See note 3, *supra*.

⁹ See note 5, *supra*.

¹⁰ PACE Quote is defined in Phlx Rule 229 as the best bid/ask quote among the American Stock Exchange LLC, Boston Stock Exchange, Inc., Cincinnati Stock Exchange, Inc., Chicago Stock Exchange, Inc., New York Stock Exchange, Inc., Pacific Exchange, Inc. and the Phlx, or the Intermarket Trading System/Computer Assisted Execution System ("ITS/CAES") quote, as appropriate.

¹¹ To be understood, Section .10(a)(iii) must be read in conjunction with the preceding section of the PACE Rule. Supplementary Material Section .10(a)(ii) provides as follows:

Non-Marketable Limit Orders—Unless the member organization entering orders otherwise elects, round-lot limit orders up to 500 shares and the round-lot portion of PRL limit orders up to 599 shares which are entered at a price different than the PACE Quote will be executed in sequence at the limit price when an accumulative volume of 1000 shares of the security named in the order prints at the limit price or better on the New York market after the time of entry of any such order into PACE. For each accumulation of 1000 shares which have been executed at the limit price on the New York market, the specialist shall execute a single limit order of a participant up to a maximum of 500 shares for each round-lot limit order up to 500 shares or the round-lot portion of a PRL limit order up to 599 shares.

¹² See Securities Exchange Act Release No. 46481 (September 10, 2002), 67 FR 58669 (September 17, 2002) (notice of immediate effectiveness of pilot for the period September 4, 2002 to October 4, 2002).

¹³ See Securities Exchange Act Release No. 46615 (October 8, 2002), 67 FR 63723 (October 15, 2002) (notice of immediate effectiveness of extension of pilot to November 3, 2002).

¹⁴ See note 4, *supra*.

¹⁵ 15 U.S.C. 78f(b).

¹⁶ 15 U.S.C. 78f(b)(5).