

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42993; File No. SR-Phlx-99-51]

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to Proposed Rule Change Assessing a \$1,500 Monthly Capital Funding Fee on a Permanent Basis

June 29, 2000.

I. Introduction

On November 26, 1999, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "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 assess seat owners a monthly capital funding fee of \$1,500 per seat owned for a period of 36 months ("permanent fee proposal"). The proposed rule change was published for comment in the **Federal Register** on February 17, 2000.³ The Commission received twenty-two comment letters from fourteen commenters regarding the proposal.⁴ On May 19, 2000, the Phlx filed Amendment No. 1 to the proposal.⁵

During the pendency of the permanent fee proposal, the Commission approved another proposed rule to implement the fee on a pilot basis. Specifically, on January 5, 2000, the Commission granted accelerated approval of the capital funding fee on a three-month pilot basis.⁶ On April 24,

2000, a proposed rule change extending the pilot program until July 6, 2000 became immediately effective under Section 19(b)(3)(A) of the Act.⁷

This order approves the permanent fee proposal, accelerates approval of Amendment No. 1, and solicits comments from interested persons on that Amendment.

II. Description of the Proposal

a. The Original Filing

The Phlx proposed to amend its schedule of dues, fees, and charges to charge a monthly capital funding fee of \$1,500 per Exchange seat to seat owners⁸ for a period of 36 months. The Phlx represents that the capital funding fee will be imposed on each of the 505 Exchange seat owners on the last business day of the calendar month. In order to be charged the fee, a seat owner must own a seat on the last business day of the month preceding the month that is being billed. Thus, at the beginning of each month, the seat owner will be billed for that entire month.⁹ The Exchange represents that it intends to segregate the funds generated from the \$1,500 fee from Phlx's general funds.

The Phlx represents that the capital funding fee is a part of its long-term financing plan.¹⁰ The fee will be charged for 36 consecutive months beginning on July 6, 2000. This monthly fee will provide funding for technological improvements and other capital needs.¹¹ Specifically, it is

⁷ See 15 U.S.C. 78s(b)(3)(A); Securities Exchange Act Release No. 42714 (April 24, 2000), 65 FR 25782 (May 3, 2000) (SR-Phlx-00-29).

⁸ The term "owner" is defined in Phlx's Certificate of Incorporation as "any person or entity who or which is a holder of equitable title to a membership in the Phlx." See Phlx's Certificate of Incorporation, Article Twentieth; Securities Exchange Act Release No. 42773 (May 11, 2000) 65 FR 31622 (May 18, 2000) (approving proposal to add definition of "owner" to Certificate of Incorporation). Although the term "seat owner" is not defined in the Phlx's By-Laws or Certificate of Incorporation, the term "seat" refers to a membership in the Phlx. Telephone conversation between Maria Chidsey, Attorney, Division of Market Regulation, Commission, and Bob Ackerman, Senior Vice President, Chief Regulatory Officer, Phlx (January 5, 2000).

⁹ For example, owners of record on September 30 will be billed \$1,500 for the month of October.

¹⁰ The other part of that financing plan is a credit to qualified members against certain member fees, dues, and other amounts owned to the Phlx. On May 15, 2000, a proposed rule change implementing that credit on a six-month pilot basis became immediately effective under Section 19(b)(3)(A) of the Act. See Securities Exchange Act Release No. 42791 (May 16, 2000), 65 FR 33606 (May 24, 2000) (SR-Phlx-00-44).

¹¹ This fee is distinguished from the Exchange's technology fee in that the technology fee was intended to cover system software modifications, Year 2000 modifications, specific system development (maintenance) costs, SIAC and OPRA communication charges, and ongoing system

intended to fund capital purchasers, including hardware for capacity upgrades, development efforts for decimalization, and trading floor expansion. The Phlx also represents that revenue raised from the fee will be utilized over a three-year period, after which time the Phlx intends to reevaluate its financing plan to determine whether to continue assessing the fee. The Phlx represents that the revenue generated from the fee will assist it in remaining competitive in the capital markets environment. The Exchange reserves the right to suspend the fee or to cease charging it altogether at any time.

b. Amendment No. 1

In Amendment No. 1, the Phlx represents that it is a Delaware non-stock corporation, and states that it believes that assessing the capital funding fee on the owners of the Exchange's 505 memberships is appropriate under Delaware law. Amendment No. 1 states that Section 102(a)(4) of the Delaware General Corporation Law ("DGCL") provides that the certificate of incorporation or by-laws of a non-stock corporation shall state the "conditions of membership of such corporations."¹² The Phlx represents that its Certificate of Incorporation authorizes its Board of Governors to impose fees on the owners of the Exchange's memberships, including owners who are lessors of memberships.¹³ The Phlx asserts that its By-Laws already impose various fees on lessors of memberships and other persons and entities that own equitable title to Exchange memberships.¹⁴

Amendment No. 1 further states that, under Section 102(a)(3) of the DGCL, the certificate of incorporation of a Delaware corporation must state the "nature of the business or purposes to be conducted or promoted" by the corporation. The Phlx represents that Article Third of its Certificate of Incorporation provides that the nature of the business and the objects and purposes of the Exchange include the authority:

maintenance charges. The technology fee became effective upon filing in March 1997. See Securities Exchange Act Release No. 38394 (March 12, 1997), 62 FR 13204 (March 19, 1997) (SR-Phlx-97-09).

¹² See Amendment No. 1, at 5.

¹³ The Phlx cites Article Twentieth of its Certificate of Incorporation, which authorizes the Board of Governors to impose fees on "owners [and] lessors and lessees of memberships." See Amendment No. 1, at fn. 9.

¹⁴ The Phlx cites Section 12-8 of its By-Laws, as authorizing the Board of Governors to assess initiation, application, and transfer-of-title fees on lessors. See Amendment No. 1, at fn. 10.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 42405 (February 8, 2000), 65 FR 8226. The capital funding fee was originally proposed on October 1, 1999, in SR-Phlx-99-43. See Securities Exchange Act Release No. 42058 (October 22 1999), 64 FR 58878 (December 15, 1999). However, on November 17, 1999, the Exchange withdrew SR-Phlx-99-43. This proposed rule change replaces SR-Phlx-99-43.

⁴ See Section III below for a discussion of the comment letters. The comments received in response to SR-Phlx-99-43 are included, to the extent relevant, in the discussion contained in Section III.

⁵ See Letter from Cindy Hoekstra, Attorney, Phlx, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated May 18, 2000 (Amendment No. 1). In Amendment No. 1, the Phlx represents that it believes that assessing the capital funding fee on the Exchange's seat owners is appropriate under Delaware law. The Phlx's arguments are more fully described below.

⁶ See Securities Exchange Act Release No. 42318 (January 5, 2000), 65 FR 2216 (January 13, 2000) (SR-Phlx-99-49).

To act as and to provide a securities exchange where the corporation's members and other persons authorized by it can buy, sell, pledge, exchange, trade and deal in any article of commerce, including, without limitation, stocks, bonds, and other securities * * * and generally to operate as and perform all of the functions of a national securities exchange.¹⁵

The Exchange also represents that Section 121(a) of the DGCL gives a corporation and its director's broad powers to conduct the operations and achieve the objects and purposes of the corporation. In addition to powers expressly granted by law or the certificate of incorporation, the corporation and its directors may exercise "any powers incidental thereto, so far as such powers and privileges are necessary or convenient to the conduct, promotion or attainment of the business or purposes set forth in its certificate of incorporation." Further, the Phlx asserts that under Section 141(a) of the DGCL, a corporation's board of directors has the legal obligation to manage the business and affairs of the corporation.

Based on these provisions of the DGCL and the nature and purpose of the Exchange, the Exchange maintains that it has the general power to assess a fee on the owners of Exchange seats and that the capital funding fee is an appropriate exercise of that power. The Phlx represents that the owners of the 505 memberships on the Exchange benefit both from the value of their seats and from doing business on the Exchange's facilities (either directly or through agents or lessees who pay fees to owners). Under these circumstances, the Exchange asserts that it believes that assessing the capital funding fee on owners is warranted.

III. Summary of Comments

The Commission received twenty-two comment letters from fourteen commenters regarding the proposed rule change. All of the commenters opposed the proposed rule change. Although the comments specifically expressed concern about the capital funding fee, they also expressed general disapproval of the Phlx financing plan, which consists of the capital funding fee and the monthly credit of up to \$1,000 for qualified members. The monthly credit is available to members who own their memberships ("member-owners") and other members who are so closely connected to the owners that the Phlx believes they should be treated as

member-owners (collectively, "qualified members").¹⁶

One commenter raised concerns that the capital funding fee in conjunction with the credit would be an inequitable allocation of fees, dues and other charges.¹⁷ Seven other commenters¹⁸ also expressed concerns that the Phlx financing plan would inequitably assess fees on seat owners. One of those seven commenters complained that his income from the seat he owned would be substantially reduced after paying the capital funding fee.¹⁹

Several commenters argued that the \$1,500 capital funding fee is excessive and lacks justification. One commenter stated that the amount of the fee is an excessive initial sum.²⁰ Another characterized the fee as an onerous financial burden on seat owners. He argued that the fee is unjustified because of the vague purpose of providing technological improvements and other capital needs.²¹ Four commenters argued that the Phlx should consider other means of raising capital and reducing expenses, such as reducing salaries, bonuses, entertainment costs, and other operating costs.²²

Four commenters expressed concern that the management of the Exchange was not serving the best interests of members, customers, seat owners, or the public.²³ One commenter requested that

he be appointed to the Board of Governors of the Phlx.²⁴ Another commenter complained specifically about the actions and management decisions of the Chairman of the Phlx.²⁵

Several commenters stated that the Phlx is attempting to reduce the value of seats on the Exchange, thus jeopardizing the future of the Exchange.²⁶ One such commenter argued that there is too much volatility in the seat prices and complained that the Phlx is deliberately attempting to dilute the value of the seats.²⁷

IV. Discussion

After careful consideration, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange. In particular, the Commission believes the proposed rule change is consistent with the requirement of Section 6(b)(4)²⁸ that the rules of an exchange provide for the equitable allocation of reasonable fees, dues, and other charges among its members and issuers and other persons using its facilities; and the requirement of Section 6(b)(5)²⁹ that the rules of the exchange are not designed to permit unfair discrimination between customers, issuers, brokers or dealers.³⁰

The Commission finds that the Phlx's capital funding fee is consistent with the Act because it is an across-the-board assessment on all seat owners intended to raise revenues to provide capital improvements to the Exchange. The capital funding fee is assessed uniformly to each seat owner per seat owned. Thus, it conforms to the requirements in the Act that the rules of the exchange provide for the equitable allocation of reasonable fees, dues, and other charges among its members and issuers and other persons using its facilities; and are not designed to permit

¹⁶ See *supra* note 10. For an explanation of the credit, see Securities Exchange Act Release No. 42791 (May 16, 2000), 65 FR 33606 (May 24, 2000).

¹⁷ See Letter from Mark Desiderio to Jonathan G. Katz, Secretary, Commission, dated October 16, 2000 ("Letter from Desiderio").

¹⁸ See Letters from: Harry Green to Jonathan G. Katz, Secretary, Commission, dated November 30, 1999, and December 21, 1999 ("Letters from Green"); Gilbert Goldstein to Jonathan G. Katz, Secretary, Commission, dated December 23, 1999 ("Letter from Goldstein"); George Nassar to Jonathan G. Katz, Secretary, Commission, dated December 17, 1999 ("Letter from Nassar"); Stanley Miller to Jonathan G. Katz, Secretary, Commission, dated January 3, 2000 ("Letter from Miller"); Michel Mesirov to Jonathan G. Katz, Secretary, Commission, dated October 15, 1999, and December 20, 1999 ("Letters from M. Mesirov"); Matthew Wayne, Vanacso, Wayne & Genelly, to Jonathan G. Katz, Secretary, Commission, dated October 15, 1999 and December 17, 1999 ("Letters from Wayne"); and William Kramer to Jonathan G. Katz, Secretary, Commission, undated ("Letter from Kramer").

¹⁹ See Letter from Miller.

²⁰ See Letter from Doris Elwell to Arthur Levitt, Chairman, Commission, dated October 4, 1999 ("Letter from Elwell").

²¹ See Letter from Desiderio.

²² See Letters from Goldstein; Elwell; Letter from Karen Janney to Arthur Levitt, Chairman, Commission, undated ("Letter from Janney"); and Letters from Richard Mesirov to Jonathan G. Katz, Secretary, Commission, dated October 15, 1999 and December 20, 1999 ("Letters from R. Mesirov").

²³ See Letters from: Green; Paul Liang to Jonathan G. Katz, Secretary, Commission, dated October 15,

1999, and to Arthur Levitt, Chairman, Commission, dated October 25, 1999 ("Letters from Liang"); Charles Hayes to Jonathan G. Katz, Secretary, Commission, dated December 16, 1999 ("Letter from Hayes"); and Steven Taylor to Jonathan G. Katz, Secretary, Commission, dated October 19, 1999 and to the Honorable Senators Mitch McConnell, Richard Durbin, and Peter Fitzgerald (forwarded to Arthur Levitt, Chairman, Commission), dated November 29, 1999, January 13, 2000, and February 13, 2000 ("Letters from Taylor").

²⁴ See Letter from Liang.

²⁵ See Letter from Taylor.

²⁶ See Letters from Miller, Green, Desiderio, M. Mesirov, Wayne, Liang, and Elwell.

²⁷ See Letter from M. Mesirov.

²⁸ 15 U.S.C. 78f(b)(4).

²⁹ 15 U.S.C. 78f(b)(5).

³⁰ In approving this proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁵ See Amendment No. 1, at 6.

unfair discrimination between customers, issuers, brokers, or dealers.³¹

We note the concern expressed by several commenters that the Phlx financing plan treats owner-lessors unfairly and thus contravenes Sections 6(b)(4) and 6(b)(5) of the Act. These concerns, however, are addressed to the credit and not to the fee. As discussed above, the credit is currently being implemented on a six-month pilot basis; the Commission will consider the commenters' concerns in determining whether to approve the credit on a permanent basis. The Commission does not believe that these concerns apply to the fee, which is an across-the-board assessment against all seat owners. Thus, the fee does not appear to raise concerns about unfair treatment of owner-lessors under the Act.

Other commenters contend that the proposed fee is unnecessary and excessive. The Exchange represents that to compete in the current capital market environment, the Exchange needs funding to make technological and capital improvements, and that the revenues raised from this fee will be used to fund those technological and capital improvements. The Exchange also represents that the owners of the 505 memberships on the Exchange benefit both from the value of their seats and from doing business on the Exchange's facilities (either directly or through agents or lessees who pay fees to owners). The Commission finds these representations to be persuasive. The rapid changes occurring in the options markets, including the trend towards greater automation of trading and increased competition among options markets—as evidenced by the move last fall to multiply trade options previously traded by only one exchange and the commencement of operations by the International Securities Exchange—have put pressure on all markets to evolve and compete. The Phlx believes that it needs this capital funding fee to make technological and capital improvements in this competitive environment, and the Commission sees no reason to second-guess the decision of the Phlx's properly constituted Board of Governors. Accordingly, the Commission finds that this proposed fee is reasonable and, as stated above, is equitably allocated.³²

The Commission is not required under Section 19(b)(2) of the Act to find that a proposed rule change by a self-regulatory organization is lawful under state corporation law; in approving this proposal, the commission is relying on the Phlx's representation that it has the general power under applicable provisions of Delaware law to assess a fee on the owners of Exchange seats, and that the capital funding fee is an appropriate exercise of that power. The Commission has not independently evaluated the accuracy of Phlx's representations about Delaware law.

In addition, the Commission finds good cause for approving Amendment No. 1 to the proposal prior to the thirtieth day after the date of publication of notice and filing thereof in the **Federal Register** pursuant to Section 19(b)(2) of the Act.³³ Amendment No. 1 does not fundamentally change the operation or scope of the capital funding fee; matters such as who will be subject to the fee, the amount of the fee, and when the fee will be charged remain unchanged by Amendment No. 1. Instead, Amendment No. 1 provides additional representations and justification concerning the Phlx's authority to assess the fee on seat owners under applicable provisions of Delaware law. Further, the capital funding fee has been operational on a pilot program basis. That pilot program expires on July 6, 2000. Absent approval of Amendment No. 1, the Phlx's ability to collect the fees would lapse because the pilot program will expire. In view of the Commission's finding that the proposed rule change is consistent with the Act, it believes that the Phlx should be able to assess this fee on an uninterrupted basis so that it may raise the revenue it needs to make technological and capital improvements.

In the Commission's view, Amendment No. 1 constitutes appropriate and necessary justification for the proposed rule change, but raises no new or novel issues under the federal

securities laws. Accordingly, the Commission finds good cause, consistent with Sections 6(b)(4),³⁴ 6(b)(5),³⁵ and 19(b)(2)³⁶ of the Act to accelerate approval of Amendment No. 1 to the proposed rule change.

V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning whether Amendment No. 1 to 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 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 will also be available for inspection and copying at the principal office of the Phlx. All submissions should refer to File No. SR-Phlx-99-51 and should be submitted by July 31, 2000.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,³⁷ that the proposed rule change (SR-Phlx-99-51) is approved and that Amendment No. 1 to the proposed rule change is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³⁸

Jonathan G. Katz,

Secretary.

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Rules of Board of Governors, Rules 3, 5, 17, and 18; and telephone conversation between Marla Chidsey, Attorney, Division of Market Regulation, Commission, and Bob Ackerman, Senior Vice President, Chief Regulatory Officer, Phlx (January 5, 2000). If seat owners are not "members" of the Exchange, they may be "other persons using [the] facilities [of the Exchange]." If so, the Commission believes Phlx's proposal equitably allocates the capital funding fee by assessing the fee against all seat owners across-the-board. If, on the other hand, seat owners are not "other persons using [the] facilities [of the Exchange]," the Commission is not required under Section 6(b)(4) of the Act to find that the capital funding fee is equitably allocated. 15 U.S.C. 78f(b)(4). Under either analysis, the capital funding fee is consistent with the Act.

³³ 15 U.S.C. 78s(b)(2).

³⁴ 15 U.S.C. 78f(b)(4).

³⁵ 15 U.S.C. 78f(b)(5).

³⁶ 15 U.S.C. 78s(b)(2).

³⁷ 15 U.S.C. 78s(b)(2).

³⁸ 17 CFR 200.30-3(a)(12).

³¹ 15 U.S.C. 78f(b)(4), (b)(5).

³² See 15 U.S.C. 78f(b)(4). The Commission has separately considered whether seat owners are "members" or "other persons using [the] facilities [of the Exchange]" under Section 6(b)(4) of the Act. 15 U.S.C. 78f(b)(4). Not all seat owners are "members" under Section 3(a)(3) of the Act or under Exchange Rules. See 15 U.S.C. 78c(a)(3); Phlx Certificate of Incorporation, Article 20 and Phlx