

November 10, 2003

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: File No. SR-Phlx-2003-66; Release No. 34-48663

Dear Mr. Katz:

The International Securities Exchange, Inc. ("ISE") appreciates the opportunity to comment on the above-referenced filing ("Filing") of the Philadelphia Stock Exchange ("Phlx"). The Phlx proposes to list and trade four options contracts based on the value of the Nasdaq Composite Index (collectively, the "Nasdaq Composite Options"). We do not object to the Phlx trading the Nasdaq Composite Options. Indeed, we have no objections to any of the specific listing or trading rules the Phlx proposes in the Filing. Our only objection concerns an issue the Filing conspicuously avoids: the fact that the Phlx's contract to license the right to trade the Nasdaq Composite Options is exclusive.¹ Thus, if the Commission approves this filing, investors will be denied the benefits of multiple trading in the Nasdaq Composite Options. We believe that the Phlx proposal does not meet the requirements of the Exchange Act, and we urge the Commission to institute proceedings to disapprove the Filing.

We believe that any exclusive license to trade index products, including the Phlx's license for the Nasdaq Composite Options, is anticompetitive and in violation of the requirements of the Securities Exchange Act of 1934, as amended ("Exchange Act"). In three previous submissions to the Commission we have addressed in great detail the burdens on competition imposed by exclusive license arrangements: a rulemaking petition asking the Commission to adopt rule outlawing exclusive licenses²; a letter supporting the petition by the Pacific Exchange to impose a moratorium on new

¹ We are troubled that neither the Filing nor the notice of the Filing published in the Federal Register even mention the exclusive nature of the licensing arrangements. We learned of this arrangement through our own discussions regarding the licensing of these products and in press reports. Because exclusive licensing arrangements raise fundamental issues of fair competition, we strongly believe that the Commission should require any future filings proposing exclusive licensing arrangements to discuss the nature of those arrangements and to provide a justification as to how such arrangements comply with the requirements of the Exchange Act.

² Letter dated November 1, 2002 from David Krell, CEO, ISE, to Jonathan Katz, Secretary, Commission (the "Petition").

exclusive licenses pending consideration of the Petition³; and a comment letter expressing concern regarding the accelerated approval of other exclusively-licensed products.⁴ Because the Submissions address the same exact issue the Phlx raises in the Filing, we incorporate the substance of those comments into this letter.

For the reasons discussed in the Submissions and outlined below, the Filing does not meet the requirements of the Exchange Act, including the requirement that the rules of a national securities exchange must not "impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]."⁵ Commission Form 19b-4 implements this requirement with the following specific instructions:

State whether the proposed rule change will have an impact on competition and, if so, (1) state whether the proposed rule change will impose any burden on competition or whether it will relieve any burden on, or otherwise promote, competition and (ii) specify the particular categories of persons and kinds of businesses on which any burden will be imposed and the ways in which the proposed rule change will affect them. If the proposed rule change amends an existing rule, state whether that existing rule, as amended by the proposed rule change, will impose any burden on competition. If any impact on competition is not believed to be a significant burden on competition, explain why. Explain why any burden on competition is necessary or appropriate in furtherance of the purposes of the [Exchange] Act. In providing these explanations, set forth and respond in detail to written comments as to any significant impact or burden on competition perceived by any person who has made comments on the proposed rule change to the self-regulatory organization. The statement concerning burden on competition should be sufficiently detailed and specific to support a Commission finding that the proposed rule change does not impose any unnecessary or inappropriate burden on competition.⁶

The Phlx addresses these detailed and specific legal requirements by including in the Filing the boilerplate statement that "[t]he Phlx does not believe that the proposed rule change will impose any inappropriate burden on competition."⁷

Our Submissions make clear that exclusive license arrangements impose both substantial barriers to competition and substantial costs on investors. In particular, the Petition details how Commission efforts – and the added competition of the ISE – led to multiple trading of options on individual stocks. This competition has resulted in reduced fees for customers, improved market quality, better market data, technological enhancements and an intermarket linkage. Competition can bring similar benefits to index options. As we noted in our Russell Index Comment Letter, in the very limited time we have been competing against the Chicago Board Options Exchange in trading index options on the S&P 600 Index, we have dramatically increased trading volume and narrowed the average quotation spread in the product by \$.10.

³ Letter dated September 13, 2003 from David Krell, CEO, ISE to Annette Nazareth, Director, Division of Market Regulation (the "PCX Petition Comment Letter").

⁴ Letter dated October 15, 2003 from Michael Simon, Secretary, ISE, to Jonathan Katz, Secretary, Commission (the "Russell Index Comment Letter," and together with the Petition and the PCX Petition Comment Letter, the "Submissions").

⁵ Exchange Act Section 6(b)(7).

⁶ Form 19-4, Section 4.

⁷ Filing, Section II.C.

The anticompetitive effects of the Phlx's proposal is self-evident: the exclusive license prohibits the ISE (or any other exchange) from offering a trading market in the product.⁸ This anticompetitive action leads directly to harm to investors, as evidenced by the Phlx's fee schedule.⁹ For equity options in which there is fierce intermarket competition, the Phlx does not charge any customer fees. In contrast, the customer fees for trading index products, including the Nasdaq Composite Options, are either \$.20 or \$.40 a contract for customer (\$.40 if the market value is \$1.00 or more). As we have shown in applying our equity options fee schedule to index options – including the waiver of all customer fees – the advent of competition in this market reduces customer costs. Indeed, the lack of competition will cost the investing public \$.20 to \$.40 for each Nasdaq Composite Option contract traded! In addition, we have adopted a temporary waiver of all fees for index option trading, providing savings even to professional traders.

The Phlx addresses these substantial competitive issues with the above-quoted boilerplate language that its proposal does not impose any unnecessary or inappropriate burden on competition. There is no discussion of the competitive issues we have raised, let alone an acknowledgment that such issues exist. Most certainly the Phlx has not complied with the requirements of the Exchange Act and Form 19b-4 in providing the detailed analysis necessary to permit the Commission to weigh the harm of the anticompetitive actions with any potential off-setting benefits there may be.

Due to the significant competitive issues the Phlx proposal raises, and the Filing's total failure to acknowledge and discuss those issues, there is no basis for the Commission to approve the Filing. We therefore respectfully request that the Commission institute proceedings to disapprove the Phlx's proposal.

If you have any questions on our comments, please do not hesitate to call.

Sincerely,

Michael J. Simon
Senior Vice President and Secretary

cc: Annette Nazareth

⁸ We recognize that no rule of the Phlx or the Commission specifically prohibits us from trading Nasdaq Composite Options. However, for us to do so would expose us to potential legal liability regarding intellectual property rights and trademarks regarding the index. Indeed, due to these legal concerns, our clearing agency, The Options Clearing Corporation, has informed us that it will not issue and clear any index options for us unless we have a license to trade the product. This effectively precludes competition for any index option subject to an exclusive license.

⁹ Phlx Fee Schedule effective September, 2003 at <http://www.phlx.com/exchange/feesched.pdf>. The Filing does not propose any changes to this fee schedule.