



September 30, 2005

**VIA OVERNIGHT MAIL**

Mr. James Brigagliano  
Assistant Director  
Division of Market Regulation, Office of Trading Practices  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-9303

**Re: Request for Clarification Regarding Rule 10a-1 under the Securities Exchange Act of 1934 and Rule 200(g) of Regulation SHO for the Pacific Exchange, Inc.'s Proposed Portfolio Crossing Service**

Dear Mr. Brigagliano:

The Pacific Exchange, Inc. ("PCX" or "Exchange"), through its wholly owned subsidiary PCX Equities, Inc. ("PCXE"), respectfully requests clarification regarding Rule 10a-1 under the Securities Exchange Act of 1934 ("Act") and Rule 200(g) of Regulation SHO (17 CFR 242.200 et seq.) in connection with trades executed through the Archipelago Exchange's ("ArcaEx") Portfolio Crossing Service ("PCS") and on behalf of Equity Trading Permit Holders ("ETP Holders") that execute trades through the proposed PCS. The Exchange submits this letter in conjunction with a proposed rule change filed by the Exchange under Section 19 of the Act, and Rule 19b-4 thereunder, to add certain PCXE rules to establish PCS.<sup>1</sup> A copy of the proposed rule change is attached to this letter. The request is limited to those trades that ETP Holders execute in the PCS process.

A. Background – Description of ArcaEx

The Archipelago Exchange ("ArcaEx") is an all-electronic stock market which trades equity securities listed with the New York Stock Exchange (NYSE), Nasdaq, American Stock Exchange (AMEX) and Pacific Exchange, as well as exchange-traded funds (ETFs) and other exchange-listed securities. Currently, ArcaEx operates as the exclusive equities trading facility of PCX Equities, Inc., a wholly-owned subsidiary of the Pacific Exchange,

---

<sup>1</sup> See SR-PCX-2005-73, SEC Release No. 34-52472 (September 20, 2005).

**Archipelago Holdings, Inc.**  
100 South Wacker Drive  
Suite 1800  
Chicago, Illinois 60606  
P 312.960.1696  
F 312.960.1369  
www.archipelago.com



September 30, 2005  
Mr. James Brigagliano  
Page 2 of 3

Inc. (PCX).<sup>2</sup> Only registered broker-dealers who have applied for and received an Equity Trading Permit are permitted to trade on ArcaEx.

The ArcaEx matching engine follows price-time priority rules for displayed orders and supports additional order types to augment traditional limit and market orders. ArcaEx maintains an electronic file of orders, called the ArcaEx Book. ArcaEx ranks and maintains limit orders on the ArcaEx Book based on a number of execution processes based on order type. At the ETP Holder's option, ArcaEx may route orders that are not matched on the ArcaEx Book to a different market center for execution.

#### B. Proposed Rule to Adopt PCS

The proposed PCS rules would provide ETP Holders an alternative method of trade execution and reporting for qualifying portfolio trade activity. Under the proposed rules, ETP Holders would be able to submit qualifying cross orders which are part of a portfolio basket trade in equity securities for execution. Qualifying baskets would be required to include matched buy and sell orders for a minimum of 15 securities having a minimum dollar value of \$1 million. ETP Holders would be able to submit eligible orders into PCS at any time trading occurs on the Exchange (currently, 4:00 a.m. Eastern Time to 8:00 p.m. Eastern Time). However, these orders would be held by the system and would not execute until at least one minute after the close of trading on the Exchange, i.e., 8:01 p.m. Eastern Time. Each side of the coupled orders entered into PCS would execute without regard to the priority of other orders entered into PCS or ArcaEx.

#### C. Short Sale Regulation

As discussed above, ETP Holders would be able to enter PCS Orders at any time during the Exchange's trading day. However, all PCS Orders would be held by the Exchange so that PCS executions occur after the close of trading. Because executions in PCS would occur after 8:00 p.m. Eastern Time but before 4:00 a.m. Eastern Time, the Exchange believes such transactions would be exempt from the tick test of SEC Rule 10a-1 under the SEC's pilot program.<sup>3</sup> To the extent the Commission determines that relief from short

---

<sup>2</sup> The SEC approved the establishment of ArcaEx as a facility of the PCX Equities, Inc. in 2001. See SEC Release No. 34-44983 (October 25, 2001); also see SEC Release No. 34-52497 (September 22, 2005), an order approving certain rule changes designed to facilitate a merger of the Exchange and Archipelago Holdings, Inc.

<sup>3</sup> See Rule 202T and Securities Exchange Act Releases No. 50103 (July 28, 2004) and No. 50104 (July 28, 2004).



September 30, 2005  
Mr. James Brigagliano  
Page 3 of 3

sale price test regulation from PCS is appropriate or required, the Exchange requests such relief.<sup>4</sup>

PCS Orders submitted by ETP Holders during any particular trading day will be subject to the order marking requirements of Regulation SHO. The Commission recently granted no-action relief to enable broker-dealers to mark exempt short sales as "short" rather than "short exempt" (the "Order Masking Letter") under certain circumstances.<sup>5</sup> The Exchange is of the view that the Order Masking Letter applies to the PCS on the same terms as it applies to normal trading on ArcaEx.<sup>6</sup> Therefore, the Exchange believes it is not necessary to seek the same no-action relief for PCS, provided that PCS as a market center meets the conditions set forth in the Order Masking Letter. To the extent the Commission determines that relief is appropriate or required under Regulation SHO for PCS, the Exchange requests such relief.

We understand the interpretations requested in this letter might be subject to change in the event the timing of the opening and closing of the consolidated tape is modified or the pilot program is suspended by the Commission.

If you have any questions or concerns, please do not hesitate to call me at 312-442-7170.

Sincerely,

Timothy Elliott  
Assistant General Counsel - Regulatory  
Archipelago Holdings, Inc.

cc: Liza Orr, Market Regulation  
Kevin O'Hara  
Janet Angstadt

---

<sup>4</sup> The Exchange notes that the Commission has granted exemptive relief from SEC Rule 10a-1 in the past for other self-regulatory organization after hours crossing facilities. See Securities Exchange Act Release No. 34-29237 (May 24, 1991).

<sup>5</sup> See April 15, 2005 no-action letter to Ira Hammerman, Senior Vice President and General Counsel of the Securities Industry Association.

<sup>6</sup> As proposed, the PCS is simply one aspect of the ArcaEx rule set.

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-52472; File No. SR-PCX-2005-73)**

**September 20, 2005**

**Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to the Establishment of a Portfolio Crossing Service**

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 7, 2005, the Pacific Exchange, Inc. (“PCX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the PCX. On September 14, 2005, the PCX filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

**I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change**

The PCX, through its wholly-owned subsidiary PCX Equities, Inc. (“PCXE”), proposes to amend its rules governing the Archipelago Exchange (“ArcaEx”), the equities trading facility of PCXE. With this filing, the Exchange proposes to establish a new transaction and trade reporting mechanism for Equity Trading Permit Holders (“ETP Holders”) to allow the execution and reporting of portfolio trades in equity securities.

The text of the proposed rule change, as amended, is available on PCX’s Web site

---

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 replaced and superseded the original filing.

(<http://www.pacificex.com>), at the PCX's principal office, and at the Commission's Public Reference Room.

**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 PCX 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 PCX 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**

As part of its continuing efforts to enhance participation on the ArcaEx facility, the PCX is proposing to implement a new Portfolio Crossing Service ("PCS") which would allow ETP Holders<sup>4</sup> to execute and report portfolio trading activity conducted as principal in equity securities. The proposed rule change would provide a new forum for trade execution and reporting within ArcaEx. In order to use PCS, ETP Holders would input a basket of individual cross orders each with a basket number identifier tying it to the other orders in the basket. These baskets of individual cross orders would not interact with orders residing in the ArcaEx facility. Further, each side of an individual coupled order in a basket entered into PCS would execute without regard to the priority of other orders entered into PCS.

---

<sup>4</sup> See PCXE Rule 1.1(n).

**A. Submitting Orders into PCS**

1. Timing of Submission.

ETP Holders would be able to submit eligible cross orders in equity securities into PCS at any time trading occurs on the Exchange (currently, 1:00 a.m. Pacific Time to 5:00 p.m. Pacific Time). However, as described more fully below, these orders would be held by ArcaEx and would not execute until at least one minute after the close of trading on the Exchange, i.e., 5:01 p.m. Pacific Time. If an ETP Holder attempted to submit orders into PCS outside of the time period described above, the submission would be rejected. ETP Holders would be able to cancel any basket of orders entered into PCS at any time before 5:00 p.m. Pacific Time.

2. Orders Eligible for Submission.

Orders would be eligible for submission to PCS only if they are part of a qualifying portfolio basket trade. To be eligible for PCS, orders must be part of a basket of individual cross orders<sup>5</sup> comprised of at least 15 securities and with a total market value of at least \$1,000,000. All symbols eligible for trading on ArcaEx would be eligible for trading on PCS. A basket of orders which meets the standards above, as described in proposed in Rule 7.65, is referred to as a "PCS Order." Each individual component of a PCS Order must be appended with a basket number identifier tying it to the other order components of the PCS Order. This identifier would be used to distinguish the individual components of any PCS Order from a Rule 7.31(s) Cross Order destined for ArcaEx.

---

<sup>5</sup> PCXE Rule 7.31(s) defines the Cross Order type with respect to trading on ArcaEx. Proposed rule 7.31(ii) establishes the new "PCS Order." Each individual component of a PCS Order would closely resemble the Cross Order type used for trading in ArcaEx with respect to the mechanics for order entry. However, the individual coupled orders which are part of a PCS Order basket would also possess a unique basket number identifying the component as part of a PCS Order.

**B. Execution of Orders in PCS**

As discussed above, ETP Holders may enter PCS Orders at any time during the Exchange's trading day.<sup>6</sup> When the Exchange receives a PCS Order, it would hold such order until the end of trading, currently 5:00 p.m. Pacific Time. All PCS Orders received during any particular trading day would be executed simultaneously in PCS at least one minute after the close of trading on the Exchange but in no event later than 8:59 p.m. Pacific Time. Each individual order component of a PCS Order would not interact with other PCS Orders or other orders residing in the Arca book<sup>7</sup> in any way. As set forth in the proposed rules, PCS would not be subject to many trading rules applicable to normal trading on ArcaEx.<sup>8</sup>

Trading halts occurring during the normal market hours in one or more individual stocks would not affect the execution of PCS Orders. However, if there is a market-wide halt in a symbol (e.g. a halt initiated pursuant to PCXE circuit breaker rules) that is still in effect at 1:00 p.m. Pacific Time, the Exchange would halt trading in such symbol through its PCS.

**C. Trade Reporting in PCS**

The Exchange would handle trade reporting for PCS executions in one of two different ways, depending on whether a particular PCS component execution involved exchange-listed or Nasdaq securities. With respect to exchange listed securities, the Exchange would not disseminate last sale reports in the individual exchange-listed stocks that comprise the

---

<sup>6</sup> The New York Stock Exchange's ("NYSE") Crossing Session II is another after hours session which allows member firms the ability to cross program trades. NYSE's Crossing Session II, however, does not accept orders until after the close of regular trading.

<sup>7</sup> See PCXE Rule 1.1(a).

<sup>8</sup> For example, because executions in PCS would occur after 8:00 p.m. ET but before 8:00 a.m. ET, PCS trades would not be subject to short sale price tests under the SEC's pilot program. See Securities Exchange Act Release Nos. 50104 (July 28, 2004), 69 FR 48032 (August 6, 2004); and 50747 (November 29, 2004), 69 FR 70480 (December 6, 2004).

component order executions in PCS. Instead, PCS executions in exchange-listed securities would be transmitted to SIAC for publication on the “tape” on an aggregate basis.<sup>9</sup> The system would calculate the total shares and total dollar amounts of all exchange-listed symbols executed in PCS in any particular trading day. The Exchange would then transmit this total as an administrative message over the high speed line to SIAC. The Exchange would not consolidate the exchange-listed volume attributable to PCS with the volume in those securities occurring in the non-PCS trading session occurring on ArcaEx. With respect to Nasdaq-listed securities, the Exchange would report symbols individually to Nasdaq as regular transactions as of the following morning.<sup>10</sup> This reporting procedure mirrors the current ArcaEx trade reporting practice for Nasdaq trades occurring after 3:30 p.m. Pacific Time.

All PCS executions, whether exchange-listed or Nasdaq securities, will be “covered sales” occurring on the Exchange for the purposes of Section 31 of the Act. The Exchange will report PCS activity to the Commission in Part II of Form R31.

**D. Commission Approval of Similar SRO Trading Sessions**

In the past, the Commission has approved the creation of crossing sessions operated by other self-regulatory organizations which provide for alternative execution and reporting services for exchange member portfolio trades.<sup>11</sup> For example, the NYSE has operated its Crossing

<sup>9</sup> The Securities Industry Automation Corporation (“SIAC”) is the information processor for exchange-listed securities. ArcaEx would coordinate with SIAC to ensure it would be able to receive messages from ArcaEx reflecting aggregate PCS executions.

<sup>10</sup> Nasdaq is the securities information processor for Nasdaq-listed securities. Section 11 of the Nasdaq Unlisted Trading Privileges Plan deals with trade reporting for Nasdaq securities after 6:30 p.m. Eastern Time.

<sup>11</sup> See Securities Exchange Act Release No. 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (order approving SR-NYSE-90-52 and SR-NYSE-90-53, the “NYSE CS II Approval Order”). See also Securities Exchange Act Release No. 38077 (December 23, 1996), 61 FR 69124 (December 31, 1996) (order approving SR-Amex-96-43, a rule

Session II, which allows for the execution and reporting of crosses of multiple-stock aggregate-price buy and sell orders, for over thirteen years.<sup>12</sup> In the Commission's NYSE CS II Approval Order, the Commission explained its rationale for approving the NYSE's proposed rules: "the Commission believes that CS II would benefit the investing public by offering members the opportunity to enter crossing portfolio orders with their customers after-hours to be executed against each other."<sup>13</sup> In the NYSE CS II Approval Order, the Commission invited other exchanges to offer similar services to compete with the Crossing Session II, stating, "if the regional exchanges or the NASD desire to compete with the OHT [Off-Hours Trading] facility, they could provide a similar service."

The Exchange, in this filing, seeks to establish a service to compete with the NYSE Crossing Session II. The Exchange believes that its proposed PCS would benefit the investing

---

proposal to establish an Amex trading session to execute, after normal trading hours, certain aggregate-price basket trade orders).

<sup>12</sup> See NYSE CS II Approval Order. SR-NYSE-90-53, which was NYSE's proposing release for its Crossing Session II, can be found at Securities Exchange Act Release No. 28640 (November 21, 1990), 55 FR 49739 (November 30, 1990) ("NYSE CS II Proposing Release").

<sup>13</sup> See NYSE CS II Approval Order at 13. In the NYSE CS II Proposing Release, the NYSE offered an additional rationale: "[T]he Exchange is trying to respond to the significant increase in overseas trading of listed stocks due to the export of orders from the United States resulting from structural and regulatory factors. In particular, the development of trading strategies involving the contemporaneous execution of multiple stocks at a single, aggregate price, often in conjunction with index options and futures, has resulted in a demand for their execution that will supplement the single-stock execution facilities traditionally offered by the NYSE." See NYSE CS II Proposing Release at 2. The Commission stated that the establishment of a portfolio trade facility "could help to recapture overseas trades of U.S. stocks by providing a mechanism by which portfolio trades arranged off the floor can be effected in an exchange trading system." See NYSE CS II Approval Order at 13. The Commission felt that such a service would help to protect the investing public and benefit the marketplace overall given that the services would bring "institutional trades that currently are being exported overseas for execution within the purview of U.S. regulatory bodies." See NYSE CS II Approval Order at 13.

public by offering ETP Holders the opportunity to enter crossing portfolio orders to be executed against each other and would therefore provide investors and ETP Holders with greater opportunities for executing large portfolio trades.

#### Request for Exemptive Relief

In connection with the Exchange's request for approval of the proposed PCS, the Exchange is also requesting exemptive relief in a separate letter from Rule 11Aa3-1 under the Act in connection with trades executed through ArcaEx's PCS. In summary, the Exchange requests exemptive relief from the requirement in Rule 11Aa3-1 that the Exchange disseminate on a consolidated basis trading volume for each of the component securities executed on the Exchange's PCS. In addition, the Exchange has requested clarification from the Commission with respect to the application of Rule 10a-1 under the Exchange Act and Regulation SHO.

### **2. Statutory Basis**

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act,<sup>14</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>15</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principals of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

#### **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 that is not necessary or appropriate in furtherance of the purposes of the Act.

---

<sup>14</sup> 15 U.S.C. 78f(b).

<sup>15</sup> 15 U.S.C. 78f(b)(5).

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

Written comments on the proposed rule change were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- (A) by order approve such proposed rule change, as amended, or
- (B) institute proceedings to determine whether the proposed rule change, as amended, should be disapproved.

IV. **Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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](mailto:rule-comments@sec.gov). Please include File Number SR-PCX-2005-73 on the subject line.

Paper comments:

- Send paper comments *in triplicate* to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-PCX-2005-73. 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 Section, Station Place, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the PCX. 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-PCX-2005-73 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.<sup>16</sup>

Jonathan G. Katz  
Secretary

---

<sup>16</sup> 17 CFR 200.30-3(a)(12).