

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52436; File No. SR-PCX-2005-53)

September 14, 2005

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the Pacific Exchange, Inc. to Create a New Order Type—Passive Liquidity Orders—for use in the ArcaEx Trading Facility of the PCX

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 15, 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 June 3, 2005, the PCX filed Amendment No. 1 to the proposed rule change.³ On August 26, 2005, the PCX filed Amendment No. 2 to the proposed rule change.⁴ 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 add one new order type, the Passive

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1, which replaced the original filing, made technical and clarifying changes to the proposed rule change.

⁴ Amendment No. 2, which replaced Amendment No. 1, clarified the execution priority of Passive Liquidity orders in PCXE Rule 7.37, as compared to other orders that are part of the Display Order Process and the Working Order Processes, and as compared to Directed Fills in the Display Order Process. In addition, Amendment No. 2 made other technical and clarifying changes to the proposed rule change.

Liquidity Order (“PL Order”). The changes described in this rule proposal would add new Rule 7.31(h)(4) and amend existing Rule 7.37(b).

The text of the proposed rule change, as amended, appears below. Additions are in italics. Deleted items are in brackets.

* * * * *

Rule 7

Equities Trading

Rule 7.31(a) – (g) – No Change

(h) Working Order. Any order with a conditional or undisplayed price and/or size designated as a "Working Order" by the Corporation, including, without limitation:

(1) – (3) – No Change

(4) Passive Liquidity Order. An order to buy or sell a stated amount of a security at a specified, undisplayed price. Passive Liquidity Orders will be executed in the Working Order Process after all other Working Orders except undisplayed discretionary order interest. Passive Liquidity Orders with a price superior to that of Directed Fills will have price priority and will execute ahead of inferior priced Directed Fills in the Directed Order Process. Passive Liquidity Orders with a price superior to that of displayed orders will have price priority and will execute ahead of inferior priced displayed orders in the Display Order Process.

* * * * *

Rule 7.37

(a) Step 1: Directed Order Process. During Core Trading Hours only, orders may be matched and executed in the Directed Order Process as follows:

(1) If a User submits a marketable Directed Order to the Archipelago Exchange and the User's designated Market Maker has a standing instruction for a Directed Fill to the Archipelago Exchange, the Directed Order shall be executed against the Directed Fill of the designated Market Maker, unless there is a Passive Liquidity Order as defined in PCXE Rule 7.31(h) with a price superior to that of the Directed Fill, in which case the Passive Liquidity Order will have price priority and will execute ahead of inferior priced Directed Fills in the Directed Order Process.

(2) – (4) –No Change

(b) If an incoming marketable order has not been executed in its entirety pursuant to paragraph (a) of this Rule, any remaining part of the order shall be routed to the Display Order Process.

(1) *Step 2: Display Order Process.*

(A) An incoming marketable order shall first attempt to be matched for execution against orders in the Display Order Process at the display price of the resident order for the total amount of stock available at that price or for the size of the incoming order, whichever is smaller. Passive Liquidity Orders as defined in PCXE Rule 7.31(h) with a price superior to that of displayed orders will have price priority and will execute ahead of inferior priced displayed orders in the Display Order Process. For the purposes of this subsection, the size of an incoming Reserve Order includes the displayed and reserve size and the size of the portion of the Reserve Order resident in the Display Order Process is equal to its displayed size. If the incoming marketable

order has not been executed in its entirety, the remaining part of the order shall be routed to the Working Order Process.

(B) – No Change

Rule 7.37(b)(2)

(2) *Step 3: Working Order Process.*

(A) An incoming marketable order shall be matched for execution against orders in the Working Order Process in the following manner:

(i) An incoming marketable order shall be matched against orders within the Working Order Process in the order of their ranking, at the price of the displayed portion (or in the case of an All-or-None Order, at the limit price or in the case of a Passive Liquidity Order, at its price), for the total amount of stock available at that price or for the size of the incoming order, whichever is smaller.

Rule 7.37 (b)(2)(A)(ii) – (d) – No Change.

* * * * *

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 Exchange proposes to add a new order type for use by Users.⁵ The new order type, the PL Order, is an order to buy or sell a stated amount of a security at a specified, undisplayed price.

PL Order Type Features

A PL Order would be an order to buy or sell a stated amount of a security at a specified, undisplayed price. PL Orders must be entered with a volume of at least 200 shares and will only be permitted in round lot denominations. ArcaEx pegging, reserve, and discretionary functionality will not be available to modify PL Orders.⁶ PL Orders will not route out of ArcaEx to other market centers and will not execute against incoming orders sent via the Intermarket Trading System.

PL Order Execution Priority in ArcaEx

ArcaEx maintains an electronic file of orders called the Arca book.⁷ The Arca book is divided into three components: the Display Order Process, the Working Order Process and the Tracking Order Process.⁸ Arca ranks and maintains limit orders in the Arca book according to price/time priority and generally affords priority to displayed orders in the Display Process and

⁵ See PCXE Rule 1.1(yy) for the definition of “User.”

⁶ More specifically, the pegging functionality will not be available for PL Orders in that the Passive Liquidity Order price will not automatically track the NBBO. See PCXE Rule 7.31(cc). Further, reserve functionality, meaning undisplayed size, and discretionary functionality, meaning undisplayed prices, will not be available for PL Orders since the Passive Liquidity Order price and size are undisplayed by definition.

⁷ See PCXE Rule 1.1(a).

⁸ The Directed Order Process, as set forth in PCXE Rule 7.37, precedes the Display, Working, and Tracking Order Processes, but is not operable at this time on ArcaEx.

prices over undisplayed orders in the Working Order Process, sizes and prices.

PL Orders would be executed in the Working Order Process after all other orders including reserve orders and the display portion of discretionary orders at a particular price level.

PL Orders would, however, take precedence over undisplayed discretionary order interest. PL Orders with a price superior to that of Directed Fills would have price priority and would execute ahead of inferior priced Directed Fills in the Directed Order Process. Also, PL Orders with a price superior to that of displayed orders would have price priority and would execute ahead of inferior priced displayed orders in the Display Order Process.

The Exchange believes that the implementation of the aforementioned rule changes relating to ArcaEx order processing would enhance order execution opportunities on ArcaEx. The Exchange believes that the proposed order type would allow for additional opportunities for liquidity providers to passively interact with interest in the Arca book.

2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act,⁹ in general, and furthers the objectives of Section 6(b)(1) of the Act,¹⁰ 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 mechanisms of a free and open market and a national market system.

B. Self-Regulatory Organization's Statement on Burden on Competition

ArcaEx intends to implement a new Directed Process in a future filing.

⁹ 15 U.S.C. 78f(b).

¹⁰ 15 U.S.C. 78f(b)(1).

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.

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

The Exchange requested that the proposed rule change be given expedited review and accelerated approval pursuant to Section 19(b)(2) of the Act. The Exchange believes that the proposed rule proposal is consistent with the requirements of Section 6(b)(5) of the Act and the rules and regulations thereunder applicable to a national securities exchange. In particular, the Exchange believes that its proposal to implement the PL Order adds significant value to investors and Users, will enhance available order interaction opportunities, and does not raise any new regulatory issues. Accordingly, the Exchange believes that its proposal will facilitate transactions in securities, remove impediments to and perfect the mechanism of a free and open market and a national system, and, in general, protect investors and the public interest.

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. Please include File Number SR-PCX-2005-53 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-2005-53. 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-2005-53 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.¹¹

Jonathan G. Katz
Secretary

¹¹ 17 CFR 200.30-3(a)(12).