

 **PACIFIC
EXCHANGE**
STOCK & OPTIONS
VIA FACSIMILE AND EXPRESS MAIL

June 29, 2005

Ms. Annette L. Nazareth, Director
Division of Market Regulation
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Subpenny Trading Increments

Dear Ms. Nazareth:

On February 10, 2005, the Division of Market Regulation ("Division") of the Securities and Exchange Commission ("Commission") issued a no-action letter to the Pacific Exchange, Inc. ("PCX" or "Exchange"), through its wholly owned subsidiary PCX Equities, Inc. ("PCXE"), granting an exemption to permit ETP Holders of the Archipelago Exchange ("ArcaEx" a facility of the PCX) to provide for order entry and trading of certain securities traded on ArcaEx (NNM securities, Small Cap Securities, and exchange-listed securities) to be entered, executed and reported in increments of less than \$0.01, while vendors that disseminate ArcaEx quotation information report and disseminate quotes for those securities in penny increments on a pilot basis until June 30, 2005.¹ The Exchange requests that the exemptive relief be extended until August 29, 2005, the effective date of Regulation NMS Rule 612.

Rules 11Ac1-1 (the "Quote Rule"), 11Ac1-2 (the "Vendor Display Rule") and 11Ac1-4 (the "Limit Order Display Rule") require exchanges, their members and quotation vendors to publicly disseminate certain bids and offers and sale information. Among other things, the Quote Rule requires exchange members to give their exchanges, and exchanges to give to quotation vendors, the best bids, best offers, quotation sizes for each security traded on that exchange. The Vendor Display Rule requires quotation vendors to display the best bids, best offers, quotation sizes and last sale information for their subject securities on their interrogation devices. The Limit Order Display Rule requires the display of certain customer limit orders when those orders are priced better than an exchange specialist's quote, or when the limit order adds to the size associated with the quote, if that quote is at the national best bid or offer. Currently on ArcaEx, its ETP Holders and quotation vendors disseminate bids, offers and last sale data, in penny increments.

¹ See letter to Mai Shiver, PCX, Director Regulatory Policy from David Shillman, Associate Director, Division of Market Regulation, Commission, dated February 10, 2005.

Pursuant to Rules 11Ac1-1(e), 11Ac1-2(g) and 11Ac1-4(d), the PCX requests that the Commission extend exemptive relief to ArcaEx and the vendors that disseminate ArcaEx quotation information, to allow the reporting and dissemination of ArcaEx quotes in penny increments even though these securities may be trading in increments smaller than a penny.² Specifically, the PCX requests that the Commission grant relief to allow any subpenny quotes in securities to be rounded up (for orders to sell) or down (for orders to buy) to the nearest penny increment for public dissemination. The Exchange understands that any subpenny limit orders must be executed, in appropriate cases, at the non-rounded prices at which they are received. Executions at non-rounded prices will be reported at the execution price and will not be rounded for trade reporting purposes.

The Exchange further understands that the relief requested would extend until August 29, 2005 in order to permit the Exchange and the Commission to study data relating to orders and executions in subpenny increments. To advance the Commission's review, the Exchange agrees to provide the Commission with monthly reports on its activity in subpenny increments.³ Such information will include reported volume of orders received and executed in subpenny increments (in terms of both trades and shares), the execution price points, and the nature of the subpenny orders received and executed (*i.e.*, agency, principal, or otherwise).

In connection with this exemption request, the Exchange intends to seek the Commission's accelerated approval of a change to PCXE Rule 7.6 to extend the pilot until August 29, 2005, the effective date of Regulation NMS Rule 612.

The PCX believes that this relief is consistent with the public interest, the protection of investors and the removal of impediments to, and perfection of, the mechanism of a national market system. ECNs, Nasdaq market makers, NSX members, and CHX specialists are permitted to trade in increments finer than a penny, but disseminate rounded quotation information. By giving ArcaEx ETP Holders the same opportunity to trade in variations smaller than a penny, the Commission will advance the interests of the investing public whose orders may receive greater price improvement.

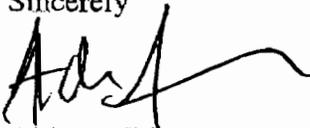
² The PCX believes that the Commission is authorized to grant the relief requested in the form of exemptive relief under Rules 11Ac1-1, 11Ac1-2 and 11Ac1-4. See Rules 11Ac1-1(c), 11Ac1-2(g) and 11Ac1-4(d) (authorizing exemptive relief when the Commission finds that it is consistent with the public interest, the protection of investors and the removal of impediments to, and perfection of, a national market system).

³ Nasdaq, CHX, and NSX have agreed to provide the Commission with similar monthly reports.

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The Exchange respectfully requests an expedited consideration and approval of this request for relief. If you have any questions concerning this letter, please contact me at (415) 393-4037.

Sincerely

A handwritten signature in black ink, appearing to read 'Alden Adkins', with a long, sweeping horizontal stroke extending to the right.

Alden Adkins
Chief Regulatory Officer
Pacific Exchange, Inc.

cc: Michael Gaw (SEC)
Ray Lombardo (SEC)
Janet Angstadt (Archipelago)
Bridget Farrell (Archipelago)