

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-45906; File No. SR-PCX-2004-22)

March 30, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. Amending PCXE Rule 7.31 to Create a New Order Type Entitled "Auto Q Order"

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 March 19, 2004 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 PCX. On March 29, 2004, the Commission received Amendment No. 1 to the proposed rule change.³ 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 the Substance of the Proposed Rule Change

PCX proposes to amend its rules governing the Archipelago Exchange, the equities trading facility of PCX Equities, Inc. ("PCXE"), by adding an automatic updating feature ("Auto Q Order") that will enable Q orders to be refreshed automatically based upon market maker determined parameters.

The text of the proposed rule change appears below. Proposed new language is in italics. Proposed deletions are in [brackets].

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Mai S. Shiver, Acting Director and Senior Counsel, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated March 26, 2004 ("Amendment No. 1"). Amendment No. 1 superseded and replaced the original rule filing in its entirety.

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Rule 7.31. Orders and Modifiers

(k) Q Order.

(1) A Q Order is a [A] limit order submitted to the Archipelago Exchange by a Market Maker. A Q Order may not be a Working Order.

(2) Auto Q Order. A Q Order may be designated as an Auto Q Order that would automatically repost a Q Order after an execution in the ArcaEx book at a designated increment inferior to the price determined by the Market Maker and for the same amount of shares. The Auto Q order would continue to repost in the ArcaEx book pursuant to Rule 7.36 upon execution at the determined increment and size until the total tradable size threshold is reached. When entering an Auto Q Order, a Market Maker would establish the following parameters: (i) price; (ii) size; (iii) buy or sell; (iv) increment update; and (v) total tradable size.

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II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, 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. 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 Archipelago Exchange (“ArcaEx”) facility, PCX is proposing to implement a new functionality type that would enable

Market Makers⁴ to automatically update their Q Orders.⁵ The Exchange proposes to add an automatic updating feature called “Auto Q” that would automatically repost a Q Order in the ArcaEx book, after an execution, at a designated increment inferior to the price determined by the Market Maker and for the same amount of shares. The Auto Q Order would continue to repost in the ArcaEx book, after an execution, at the determined increment and size until the total tradable size threshold is reached.

When entering an Auto Q Order, a Market Maker would establish the following parameters: (i) price; (ii) size; (iii) buy or sell; (iv) increment update; and (v) total tradable size.

For example,

- (1) NBBO is 30.00 x 30.10
- (2) Market Maker enters an Auto Q Order buy 500 shares at 30.05 with an increment of .02 and total tradable size 2000
- (3) NBBO becomes 30.05 x 30.10
- (4) Inbound market sell order comes into ArcaEx for 1000 shares
- (5) Market sell executes against 30.05 for 500 shares
- (6) Auto Q Order updates to buy 500 shares at 30.03
- (7) Assuming there are no other superior priced bids, ArcaEx executes the remaining portion of the market sell order at 30.03
- (8) Auto Q Order would update to 30.01 for 500 shares. Reposting would occur until maximum of 2000 shares in the aggregate had been executed against the Auto Q Order

⁴ PCXE Rule 1.1(u) defines Market Maker as an ETP Holder that acts as a Market Maker pursuant to PCXE Rule 7.

⁵ See PCXE Rule 7.31 (defining “Q Orders” as limit orders that are submitted to ArcaEx by Market Makers) and 7.34 (specifying Market Makers’ obligations to enter Q Orders).

Auto Q Orders will be governed by the price, time priority rules and order execution rules established in PCXE Rules 7.36 and 7.37. For example, superior priced displayed orders would be executed prior to Auto Q Orders and Auto Q Orders will not have precedence over same-priced displayed orders that are superior in time. Each reposted Auto Q Order would be assigned a new price, time priority as of the time of each reposting.⁶ Further, Auto Q Orders that are reposted at the same price as a non-displayed order would take precedence in accordance with PCXE Rule 7.36.

The Exchange believes that the implementation of the aforementioned order type will facilitate enhanced order interaction and foster price competition. The Exchange believes that the proposal promotes a more efficient and effective market operation, and enhances the investment choices available to investors over a broad range of trading scenarios. The Exchange also believes that the proposed rule change will permit increased execution opportunities of Market Maker orders.⁷

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)⁸ of the Act, in general, and further the objectives of Section 6(b)(5),⁹ in particular, because it is designed to promote just and equitable principles of trade, to foster cooperation and coordination

⁶ Telephone call between Tania J.C. Blanford, Staff Attorney, Regulatory Policy Department, PCX, and Leah Mesfin, Attorney, Division, Commission on March 30, 2004.

⁷ Telephone call between Tania J.C. Blanford, Staff Attorney, Regulatory Policy Department, PCX; Bridget Farrell, Regulatory Analyst, Archipelago Holdings, LLC; and Leah Mesfin, Attorney, Division, Commission on March 30, 2004.

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public interest. In addition, the Exchange believes that the proposed rule change is consistent with Section 11A(a)(1)(B) of the Act, which states that new data processing and communications techniques create the opportunity for more efficient and effective market operations.

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

The Exchange does not believe that the proposed rule change, as amended, will result in 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 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 self-regulatory organization consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-PCX-2004-22. 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, comments should be sent in hardcopy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change, as amended, that are filed with the Commission, and all written communications relating to the proposed rule change, as amended, 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. Copies of such filing will also be available for inspection and copying at the principal office of the PCX.

All submissions should refer to file number SR-PCX-2004-22 and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland
Deputy Secretary

¹⁰ 17 CFR 200.30-3(a)(12).