

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52103; File No. SR-PCX-2005-58)

July 21, 2005

Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto Relating to Market Order Auction

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 22, 2005, the Pacific Exchange, Inc. (“PCX” or “Exchange”), through its wholly owned subsidiary PCX Equities, Inc. (“PCXE” or the “Corporation”), 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 June 27, 2005, the Exchange amended the proposed rule change (“Amendment No. 1”).³ On July 8, 2005, the Exchange further amended the proposed rule change (“Amendment No. 2”).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 Exchange proposes to amend its rules governing the Archipelago Exchange (“ArcaEx”), the equities trading facility of PCXE. With this filing, the Exchange proposes to modify its Market Order Auction. The text of the proposed rule change, as amended, is available on the PCX Web site (<http://www.pacificex.com>), at the PCX’s Office of the Secretary

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, the Exchange made clarifying changes to the definition of Indicative Match Price and the purpose section and rule text describing the market auction procedure.

⁴ In Amendment No. 2, the Exchange made clarifying changes to the purpose section and the rule text describing the market auction procedure.

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 Exchange included statements concerning the purpose of, and basis for, the proposed rule change, as amended. The text of these statements may be examined at the places specified in Item IV below. The Exchange 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 is proposing to modify its Market Order Auction procedures. In conjunction with these modifications, the Exchange seeks to clarify the existing Indicative Match Price definition as defined in PCXE Rule 1.1(r) and also modify the Market Order Auction rules as described in PCXE Rule 7.35. Further, the Exchange proposes to implement price collars in order to improve the Market Order Auction pricing mechanism.

Indicative Match Price Changes

Currently, PCXE Rule 1.1(r) describes the Indicative Match Price which generally determines the price at which orders eligible for execution in the ArcaEx auctions⁵ are executed. This proposal seeks to clarify the existing Indicative Match Price functionality by indicating that the Indicative Match Price is the best price (that which is closest to the NBBO) at which the

⁵ See PCXE Rule 7.35 for a description of the Opening Auction, Market Order Auction, Closing Auction, and Trading Halt Auction.

maximum volume of shares are executable in the respective auction.

In addition, the Exchange seeks to implement a price collar proposal based on a similar standard currently in place for ArcaEx's Closing Auction which was filed on an immediately effective basis.⁶ To improve the pricing mechanism, ArcaEx proposes to implement price collars that would limit the price at which the Indicative Match Price could be established. The price collars would be determined by PCX and communicated to ETP Holders via the ArcaEx Web site. Initially, these price collar thresholds would be consistent with the PCXE Demonstrable Erroneous Execution Policy.⁷ That is, generally the Indicative Match Price would not be permitted to be greater than \$1.00 or 10% away from the consolidated last sale price. PCXE would use the pre-established price collars to limit the Market Order Auction Indicative Match Price. PCXE would not have any discretion to modify the auction process and the calculation of the Indicative Match Price other than to change the threshold parameters with prior written notice to ETP Holders.

Following is an example of how the Market Order Auction price collars would function for exchange-listed securities for which the Corporation is the primary market and all exchange-listed exchange traded funds:

Consolidated last sale price: 12.00

⁶ See Securities Exchange Act Release No. 50108 (July 28, 2004); 69 FR 47195 (August 4, 2004) (SR-PCX-2004-66). The Commission clarified this sentence to indicate that this standard was filed on an immediately effective basis. Telephone Conference among Bridget Farrell, Director, Strategy, ArcaEx and Ann Leddy, Special Counsel, Division of Market Regulation ("Division"), Commission and Mitra Mehr, Attorney, Division, Commission on July 15, 2005.

⁷ See ArcaEx Web site (<http://www.arcaex.com>), Orders and Execution policy, Erroneous Execution Policy. Any changes to the thresholds of the price collars will be communicated to ETP Holders with reasonable notice prior to the Market Order Auction.

ArcaEx Orders:

Buy 50,000 Market Order

Sell 30,000 Auction-Only Limit Order @ 12.50

Sell 20,000 Limit Order @ 13.01

Market Order Auction results: Indicative Match Price = 12.50; Matched Volume = 30,000; Total Imbalance = 20,000. The 20,000 limit sell order at 13.01 is outside of the price collar and will not be used to determine the Indicative Match Price.

Market Order Auction Changes

This proposal also seeks to modify the Market Order Auction functionality and PCXE Rule 7.35(c) such that the functionality would differ depending on the type of security. There would be three categories of securities applicable to this proposal: (1) exchange-listed securities, excluding: (i) exchange-listed securities for which the Corporation is the primary market; and (ii) all exchange-listed exchange traded funds; (2) exchange-listed securities for which the Corporation is the primary market and all exchange-listed exchange-traded funds; and (3) Nasdaq-listed securities.⁸

With respect to category (1) described above, currently the Exchange conducts a Market Order Auction of such securities which is based upon the types of orders eligible for execution where the auction price could be based on the Indicative Match Price or the midpoint of the first uncrossed NBBO after 6:30 a.m. (Pacific Time). The Exchange proposes to modify this functionality and would not conduct a Market Order Auction, but rather would route all market orders to the primary market until the first opening print on the primary market. All limit orders

and any market orders after the first primary opening print would be processed pursuant to PCXE Rule 7.37.⁹

Regarding category (2) described above, currently the Exchange conducts a Market Order Auction of such securities which is based upon the types of orders eligible for execution where the auction price could be based on the Indicative Match Price or the midpoint of the first uncrossed NBBO after 6:30 a.m. (Pacific Time). The Exchange proposes to maintain its existing Market Order Auction functionality for exchange-listed securities for which the Corporation is the primary market and all exchange-listed exchange-traded funds. In this filing, the Exchange seeks to clarify the existing rule language associated with the Market Order Auction. Such changes do not result in any functionality changes, but rather would refine the rule text to be clearer and more consistent with existing functionality. Specifically, the Exchange proposes to clarify PCXE Rule 7.35(c)(3) which describes the determination of the Market Order Auction Price. The clarifying changes would more clearly describe the pricing process as follows:

- (1) In the instance in which there are limit orders eligible for execution in the Market Order Auction, the Indicative Match Price would determine the auction price.
- (2) In the instance in which there are no limit orders eligible for execution in the Market Order Auction:
 - (i) in the case of exchange-listed exchange traded funds for which the Corporation is not the primary market, as many buy market orders and sell market orders as possible would be matched and executed at the midpoint

⁸ This category includes the QQQQ, which is a Nasdaq-listed exchange traded fund.

⁹ PCXE Rule 7.37 describes ArcaEx's execution processes including the Directed Order Process, Display Order Process, Working Order Process, and Tracking Order Process.

of the first uncrossed NBBO after 6:30 a.m. (Pacific Time), once available; or

- (ii) in the case of exchange-listed securities, including exchange-listed exchange traded funds, for which the Corporation is the primary market, market orders would be rejected.

The Market Orders that are eligible for, but not executed in the Market Order Auction, would become eligible for execution in the Core Trading Session immediately upon conclusion of the Market Order Auction.

Lastly, with respect to category (3) described above, currently the Exchange conducts a Market Order Auction of such securities which is based upon the types of orders eligible for execution where the auction price could be based on the Indicative Match Price or the midpoint of the first uncrossed NBBO after 6:30 a.m. (Pacific Time). The Exchange proposes for Nasdaq-listed securities to match and execute as many market orders as possible at the midpoint of the first uncrossed NBBO after 6:30 a.m. (Pacific Time). Limit orders and any remaining market order interest in Nasdaq-listed securities would be ranked in price/time priority as described in PCXE Rule 7.36 and processed pursuant to PCXE Rule 7.37.

The Exchange believes that clarifying the Market Order Auction pricing mechanism would help ensure that ETP Holders and investors understand how orders in the auction will be priced. In particular for those types of securities (i.e., exchange-listed securities for which the Corporation is not the primary market excluding exchange traded funds and Nasdaq-listed securities) in which the Exchange may not have sufficient liquidity on the Arca Book at the open to execute the Market Order Auction at a price that is substantially close to the opening price on the primary market, the Exchange seeks to provide its ETP Holders with the opportunity to have

those orders execute at the primary markets' prices. Further, implementing price collars would help ensure that when ArcaEx conducts a Market Order Auction, the auction would execute at prices within range of where the stock is currently trading.

2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b)¹⁰ of the Act, in general, and furthers the objectives of Section 6(b)(5),¹¹ 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. The Exchange believes that clarifying and improving the Market Order Auction pricing mechanism as described in this filing should result in a clearer understanding of how orders will be priced at the open and may provide greater assurance that orders will be priced at prices that are substantially close to where the stock is trading.

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

The Exchange does not believe that the proposed rule change, as amended, 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, as amended, were neither solicited nor received.

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(5).

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, 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-2005-58 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-PCX-2005-58. 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 Room. 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-2005-58 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.¹²

Margaret H. McFarland
Deputy Secretary

¹² 17 CFR 200.30-3(a)(12).