

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52249; File No. SR-PCX-2005-90)

August 12, 2005

Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to the Certificate of Incorporation of PCX Holdings, Inc., PCX Rules and Bylaws of Archipelago Holdings, Inc.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, as amended (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 1, 2005, the Pacific Exchange, Inc. (“PCX” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange.<sup>3</sup> On August 10, 2005, the Exchange filed Amendment No. 1 (“Amendment No. 1”) to the proposed rule change.<sup>4</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

PCX submitted to the Commission (i) a proposed amendment to the certificate of incorporation of PCX Holdings, Inc. (“PCXH”), the parent company of the Exchange and its other operating subsidiaries, (ii) proposed new PCX Rules 1.1(cc) through (gg), Rule 3.4 and

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

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

<sup>3</sup> At the request of PCX, the Commission made clarifications to the description in Item II, as noted herein. Telephone conversations between Kathryn Beck, Deputy General Counsel, PCX and Jennifer Dodd, Special Counsel, Commission, Division of Market Regulation on August 4, 2005 (“August 4, 2005 Telephone Conversation”) and August 12, 2005 (“August 12, 2005 Telephone Conversation”).

<sup>4</sup> In Amendment No. 1, the Exchange made certain corrections to the descriptions in Items I, II and III and the proposed rule text.

Rule 13.2(a)(2)(E),<sup>5</sup> which are intended to govern the ownership and voting of the stock of Archipelago Holdings, Inc. (“Archipelago”), a Delaware corporation that operates the equities trading facility of PCX and PCX Equities, Inc. (“PCXE”), by OTP Holders and OTP Firms<sup>6</sup>, and (iii) a proposed amendment to the bylaws of Archipelago ((i), (ii) and (iii) together, the “Proposed Rule Changes”). The text of the Proposed Rule Changes is available on PCX’s Web site, <http://www.pacificex.com/>, at PCX’s Office of the Secretary, at the Commission’s Public Reference Room, and on the Commission’s Web site, <http://www.sec.gov/rules/sro.shtml>.

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 self-regulatory organization 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 self-regulatory organization 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

The Exchange is submitting to the Commission the Proposed Rule Changes in connection with Archipelago’s proposed acquisition of PCXH. On January 3, 2005, PCXH, Archipelago

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<sup>5</sup> See Amendment No. 1.

<sup>6</sup> PCX rules define an “OTP Holder” to mean any natural person, in good standing, who has been issued an Options Trading Permit (“OTP”) by the Exchange for effecting approved securities transactions on the Exchange’s trading facilities, or has been named as a Nominee. PCX Rule 1.1(q). The term “Nominee” means an individual who is authorized by an “OTP Firm” (a sole proprietorship, partnership, corporation, limited liability company or other organization in good standing who holds an OTP or upon whom an individual OTP Holder has conferred trading privileges on the Exchange’s trading facilities) to conduct business on the Exchange’s trading facilities and to represent such OTP Firm in all matters relating to the Exchange. PCX Rule 1.1(n).

and New Apple Acquisitions Corporation (the “Merger Sub”), a newly formed wholly-owned subsidiary of Archipelago, entered into an Agreement and Plan of Merger (the “Original Merger Agreement”), pursuant to which Archipelago has agreed to acquire PCXH and all of its wholly owned subsidiaries, including PCX and PCXE, by way of a merger under Delaware law (the “Merger”) of the Merger Sub with and into PCXH, with PCXH as the surviving corporation. On July 22, 2005, PCXH, Archipelago and Merger Sub amended and restated the Original Merger Agreement to, among other things, provide that the consideration payable to PCXH stockholders would be made wholly in cash, and that, as contemplated by the Original Merger Agreement, the measurement dates for purposes of valuing the Archipelago stock held by PCXH would now be the ten consecutive trading days ending on the last trading day prior to the closing date of the Merger (as so amended, the “Amended Merger Agreement”).

Pursuant to the Amended Merger Agreement, subject to appraisal rights under Delaware law and other than with respect to treasury stock of PCXH and PCXH common stock beneficially owned by Archipelago for Archipelago’s own account, each share of PCXH common stock issued and outstanding immediately prior to the effective time of the Merger (the “Effective Time”) will be converted into, and become exchangeable for, an amount in cash equal to the quotient of the aggregate merger consideration divided by the sum of the number of outstanding shares of PCXH common stock and the number of shares to be issued upon the exercise of all options at the consummation of the merger. The aggregate merger consideration equals the sum of the value of the shares of Archipelago common stock owned by PCX and its subsidiaries and \$17 million, subject to market fluctuations in the Archipelago stock price and certain other adjustments pursuant to the Amended Merger Agreement. The value of Archipelago common stock shall be determined using the average of the per share closing prices

for Archipelago common stock for the ten consecutive trading days ending on the last trading day prior to the closing date of the Merger. At the Effective Time, all PCXH common stock will be cancelled or retired and cease to exist.

As a result of the Merger, PCXH, as the surviving corporation in the Merger, will become a direct, wholly-owned subsidiary of Archipelago (the post-Merger PCXH will hereinafter be referred to as the “New PCXH”). The certificate of incorporation of PCXH as in effect immediately prior to the Effective Time will, subject to approval of the Commission, be amended pursuant to the Amended Merger Agreement and as so amended, will be the certificate of incorporation of the New PCXH. The bylaws of PCXH as in effect immediately prior to the Effective Time will be the bylaws of the New PCXH, until thereafter amended as provided therein or by applicable law. The directors of the Merger Sub at the Effective Time will become directors of the New PCXH and the officers of PCXH at the Effective Time will continue to be officers of the New PCXH.

Except as described in the preceding paragraph or otherwise approved by the Commission, the Merger will not affect the internal corporate structure of PCXH or the regulatory relationship of PCX and PCXE to Archipelago Exchange, L.L.C. (“ArcaEx”), the exclusive equities trading facility of PCX and PCXE. PCX will remain a wholly-owned subsidiary of the New PCXH, will continue operating the options business of the Exchange and will retain the self-regulatory organization function for the options business as well as for PCX’s equities business subsidiary, PCXE. After the Merger, except as otherwise approved by the Commission, the board of directors of PCX will continue to comply with the compositional requirements set forth in the certificate of incorporation and bylaws of PCX. Except as otherwise approved by the Commission, PCXE’s operations, governance structure, or rules will

not be affected by the Merger. After the Merger, except as otherwise approved by the Commission, the board of directors of PCXE will continue to comply with the compositional requirements set forth in the certificate of incorporation and bylaws of PCXE. ArcaEx will remain the exclusive equities trading facility of PCX and PCXE and the Amended and Restated Facility Services Agreement among Archipelago, PCX and PCXE, dated as of March 22, 2002, which currently governs the regulatory relationship of PCX and PCXE to ArcaEx (the “Facility Services Agreement”), will remain in full force and effect in its current form.

a. Certificate of Incorporation of PCXH

(i) Proposed Amendments

In order to safeguard the independence of the self-regulatory functions of PCX and protect the Commission’s oversight responsibilities, the certificate of incorporation of PCXH, which was approved by the Commission on May 17, 2004 in connection with the demutualization of the Exchange,<sup>7</sup> imposes limitations on direct and indirect changes in control of PCXH through various ownership and voting restrictions placed on PCXH’s capital stock. Specifically, the certificate of incorporation of PCXH provides that no person,<sup>8</sup> either alone or together with its related persons,<sup>9</sup> may own, directly or indirectly, shares constituting more than

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<sup>7</sup> Securities Exchange Act Release No. 49718 (May 17, 2005), 69 FR 29611 (May 24, 2005) (order approving proposed rule change and notice of filing and order granting accelerated approval of Amendment No. 1 thereto relating to the demutualization of PCX).

<sup>8</sup> “Person” is defined to mean an individual, partnership (general or limited), joint stock company, corporation, limited liability company, trust or unincorporated organization, or any governmental entity or agency or political subdivision thereof. Restated Certificate of Incorporation of PCXH, Article Nine, Section 1(b)(iv).

<sup>9</sup> The term “related person,” as defined in the Restated Certificate of Incorporation of PCXH, means (i) with respect to any person, all “affiliates” and “associates” of such person (as such terms are defined in Rule 12b-2 under the Act); (ii) with respect to any person constituting a trading permit holder of PCX or an equities trading permit holder of PCXE, any broker dealer with which such holder is associated; and (iii) any two or more

40% of the outstanding shares of any class of PCXH capital stock,<sup>10</sup> and that no person, either alone or together with its related persons who is a trading permit holder of PCX or an equities trading permit holder of PCXE, may own, directly or indirectly, shares constituting more than 20% of any class of PCXH capital stock.<sup>11</sup> Furthermore, the certificate of incorporation of PCXH provides that, for so long as PCXH controls, directly or indirectly, PCX, no person, either alone or with its related persons, may directly or indirectly vote or cause the voting of shares of PCXH capital stock or give any proxy or consent with respect to shares representing more than 20% of the voting power of the issued and outstanding PCXH capital stock, and it also places limitations on the right of any person, either alone or with its related persons, to enter into any agreement with respect to the withholding of any vote or proxy.<sup>12</sup> In order to permit Archipelago to own 100% of the capital stock of the New PCXH upon consummation of the Merger, PCX proposes to amend the certificate of incorporation of PCXH to create an exception, with certain

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persons that have any agreement, arrangement or understanding (whether or not in writing) to act together for the purpose of acquiring, voting, holding or disposing of shares of the capital stock of PCXH. Restated Certificate of Incorporation of PCXH, Article Nine, Section 1(b)(iv).

<sup>10</sup> Restated Certificate of Incorporation of PCXH, Article Nine, Section 1(b)(i). However, such restriction may be waived by the Board of Directors of PCXH pursuant to an amendment to the Bylaws of PCXH adopted by the Board of Directors, if, in connection with the adoption of such amendment, the Board of Directors adopts a resolution stating that it is the determination of such Board that such amendment will not impair the ability of PCX to carry out its functions and responsibilities as an “exchange” under the Act and is otherwise in the best interests of PCXH and its stockholders and PCX, and will not impair the ability of the Commission to enforce said Act, and such amendment shall not be effective until approved by said Commission; provided that the Board of Directors of PCXH shall have determined that such Person and its Related Persons are not subject to any applicable “statutory disqualification” (within the meaning of Section 3(a)(39) of the Act). Restated Certificate of Incorporation of PCXH, Article Nine, Sections 1(b)(i)(B) and 1(b)(i)(C).

<sup>11</sup> Id., Article Nine, Section 1(b)(ii).

<sup>12</sup> Id., Article Nine, Section 1(c).

limitations, for Archipelago and certain related persons of Archipelago from the voting and ownership restrictions described above.

Specifically, PCX proposes to add a new paragraph at the end of Article Nine of the certificate of incorporation of PCXH, providing that for so long as Archipelago directly owns all of the outstanding capital stock of PCXH, the provisions of Article Nine, including the ownership and voting limitations with respect to shares of PCXH capital stock, shall not be applicable to the voting and ownership of shares of PCXH capital stock by (i) except for prohibited persons (as defined below), Archipelago, (ii) except for prohibited persons, any person which is a related person (as such term is defined in the certificate of incorporation of PCXH) of Archipelago, either alone or together with its related persons, and (iii) except for prohibited persons, any other person to which Archipelago is a related person, either alone or together with its related persons.<sup>13</sup>

“Prohibited persons” is defined to mean any person which is, or which has a related person which is (A) an OTP Holder or an OTP Firm (as such terms are defined in the rules of PCX, as such rules may be in effect from time to time) or (B) an ETP Holder,<sup>14</sup> except for (1) any broker or dealer approved by the Commission after June 20, 2005 to be a facility (as defined in Section 3(a)(2) of the Act) of PCX; (2) any person which has been approved by the Commission prior to it becoming subject to the provisions of Article Nine of the certificate of incorporation of PCXH with respect to the voting and ownership of shares of PCXH capital stock by such person; and (3) any person which is a related person of Archipelago solely by

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<sup>13</sup> Amended and Restated Certificate of Incorporation of PCXH, Article Nine, Section 4.

<sup>14</sup> PCXE rules define an “ETP Holder” to mean any sole proprietorship, partnership, corporation, limited liability company or other organization in good standing that has been issued an Equity Trading Permit, a permit issued by the PCXE for effecting approved securities transactions on the trading facilities of PCXE. PCXE Rule 1.1(n).

reason of beneficially owning, either alone or together with its related persons, less than 20% of the outstanding shares of Archipelago capital stock (any person covered by (1) through (3) is referred to as a “permitted person” in the proposed amendment).<sup>15</sup> The proposed Section 4 to Article Nine of the certificate of incorporation of PCXH further provides that any other prohibited person not covered by the definition of a permitted person who would be subject to and exceed the voting and ownership limitations imposed by Article Nine as of the date of the closing of the Merger shall be permitted to exceed the voting and ownership limitations imposed by Article Nine only to the extent and for the time period approved by the Commission.<sup>16</sup>

PCX believes that by creating a limited exemption from the voting and ownership restrictions in the certificate of incorporation of PCXH, the proposed amendment will permit the consummation of the Merger and the continued ownership of PCXH by Archipelago after the Merger while preserving the general applicability of such restrictions as they currently exist, so that these restrictions may continue safeguarding the independence of PCX’s self-regulatory function and the Commission’s oversight responsibilities. In addition, PCX believes that by eliminating prohibited persons from the exemption, other than those approved by the Commission, it will prevent OTP Holders, OTP Firms and ETP Holders (as such terms are defined in the rules of PCX, as such rules may be amended from time to time) from acquiring, directly or indirectly, a substantial number of outstanding shares of PCXH and exercising undue influence over the operation of PCX, including its self-regulatory functions, without proper oversight by the Commission.

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<sup>15</sup> Amended and Restated Certificate of Incorporation and PCXH, Article Nine, Section 4.

<sup>16</sup> Id.

(ii) Archipelago Securities, L.L.C.

In connection with the proposed amendment to the certificate of incorporation of PCXH described above, the Exchange requests that the Commission approve Archipelago Securities, L.L.C. (“Archipelago Securities”) to be a facility (as defined in Section 3(a)(2) of the Act) of PCX.

Archipelago Securities, a wholly-owned subsidiary of Archipelago, is a registered broker-dealer, a member of the National Association of Securities Dealers, Inc. (“NASD”) and an ETP Holder. Archipelago Securities provides an optional routing service for ArcaEx, and, as necessary, routes orders to other securities exchanges, facilities of securities exchanges, automated trading systems, electronic communications networks or other brokers or dealers (collectively, “Market Centers”) from ArcaEx (such function of Archipelago Securities is referred to as the “Outbound Router”). In its capacity as an Outbound Router, Archipelago Securities has operated as a facility (as defined in Section 3(a)(2) of the Act) of PCX. It was approved by the Commission as a facility (as defined in Section 3(a)(2) of the Act) of PCXE on October 25, 2001 in connection with the Commission’s approval of the rules of PCX establishing ArcaEx as a facility of PCXE.<sup>17</sup>

Archipelago intends to continue to own and operate Archipelago Securities following the closing of the Merger. The proposed operation of Archipelago Securities as an Outbound Router after the closing of the Merger will not change from the way it is administered and operated

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<sup>17</sup> See Self Regulatory Organizations; Order Approving Proposed Rule Change by the Pacific Exchange, Inc., as Amended, and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 4 and 5 Concerning the Establishment of Archipelago Exchange as the Equities Trading Facility of PCX Equities, Inc., Exchange Act Release No. 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (SR-PCX-00-25) (the “Original Outbound Router Release”). The name of the order routing broker-dealer was originally Wave Securities, L.L.C. as approved by the Commission in the Original Outbound Router Release.

today.<sup>18</sup> As an Outbound Router, Archipelago Securities will continue to receive instructions from ArcaEx, route orders to other Market Centers in accordance with those instructions and be responsible for reporting resulting executions back to ArcaEx.<sup>19</sup> In addition, all orders routed through Archipelago Securities would remain subject to the terms and conditions of PCXE rules.<sup>20</sup>

PCX and PCXE currently regulate the Outbound Router function of Archipelago Securities as a facility (as defined in Section 3(a)(2) of the Act) subject to Section 6 of the Act. As such, the Outbound Router function of Archipelago Securities is subject to the Commission's continuing oversight. In particular, and without limitation, under the Act, PCX is responsible for filing with the Commission rule changes and fees relating to the Archipelago Securities Outbound Router function, and Archipelago Securities is subject to exchange non-discrimination requirements.<sup>21</sup>

Pursuant to Rule 17d-1 under the Act, where a member of the Securities Investor Protection Corporation is a member of more than one self-regulatory organization ("SRO"), the Commission shall designate to one of such organizations the responsibility for examining such member for compliance with the applicable financial responsibility rules.<sup>22</sup> The SRO so

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<sup>18</sup> See, e.g., Original Outbound Router Release, at 55233-55235 (describing the operation of the order routing broker-dealer approved by the Commission).

<sup>19</sup> See Original Outbound Router Release, at 55234.

<sup>20</sup> See Archipelago Securities Routing Agreement, <http://www.tradearca.com/exchange/pdfs/ETPApplication.pdf> (last visited July 21, 2005).

<sup>21</sup> See, e.g., Section 6(b)(5) of the Act, 15 U.S.C. 78f(b)(5).

<sup>22</sup> 17 CFR 240.17d-1. Pursuant to Rule 17d-1 under the Act, in making such designation the Commission shall take into consideration the regulatory capabilities and procedures of the SROs, availability of staff, convenience of location, unnecessary regulatory duplication, and such other factors as the Commission may consider germane to the protection of investors, the cooperation and coordination among self-regulatory

designated by the Commission is referred to as a “Designated Examining Authority.”

Archipelago Securities is a member of two SROs, PCX and the NASD. The NASD is an SRO not affiliated with Archipelago or any of its affiliates (including, without limitation, PCX and PCXE) and it has been designated by the Commission as the Designated Examining Authority for Archipelago Securities pursuant to Rule 17d-1 of the Act with the responsibility for examining Archipelago Securities for compliance with the applicable financial responsibility rules. Furthermore, under an agreement between NASD and PCX originally entered into on May 27, 1977 pursuant to Rule 17d-2<sup>23</sup> under the Act (the agreement was amended on February 1, 1980, and as so amended, the “NASD PCX Agreement”), there is currently a plan in place allocating to the NASD the responsibility to receive regulatory reports from Archipelago Securities, to examine Archipelago Securities for compliance and to enforce compliance by Archipelago Securities with the Act, the rules and regulations thereunder and the rules of the NASD, and to carry out other specified regulatory functions with respect to Archipelago Securities.

ETP Holders’ use of Archipelago Securities to route orders to another Market Center is currently optional, and will remain optional after the closing of the Merger. Those ETP Holders who choose to use the Outbound Routing service of Archipelago Securities must sign an Archipelago Securities Routing Agreement. Importantly, among other things, the Archipelago

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organizations, and the development of a national market system for the clearance and settlement of securities transactions.

<sup>23</sup> Rule 17d-2 provides that any two or more SROs may file with the Commission a plan for allocating among such SROs the responsibility to receive regulatory reports from persons who are members or participants of more than one of such SROs to examine such persons for compliance, or to enforce compliance by such persons, with specified provisions of the Act, the rules and regulations thereunder, and the rules of such SROs, or to carry out other specified regulatory functions with respect to such persons. 17 CFR 240.17d-2.

Securities Routing Agreement provides that all orders routed through Archipelago Securities are subject to the terms and conditions of PCXE rules.<sup>24</sup>

PCX and Archipelago recognize that after the closing of the Merger such continued ownership and operation by Archipelago of Archipelago Securities – by virtue of Archipelago Securities being an ETP Holder and a related person of Archipelago<sup>25</sup> – would be in violation of the current and proposed limitations<sup>26</sup> to be set forth in the certificate of incorporation of PCXH described above, unless Archipelago Securities is approved by the Commission after June 20, 2005 to be a facility of PCXE<sup>27</sup> in accordance with the terms of the proposed amendment to the certificate of incorporation of PCXH described above.

PCX and Archipelago further recognize that the ownership of both PCX and Archipelago Securities by Archipelago may pose a conflict of interest between the regulatory responsibilities of PCX and PCXE and the broker or dealer activities of Archipelago Securities. This is because the financial interests of Archipelago may conflict with the responsibilities of PCX and PCXE as an SRO regarding Archipelago Securities.

PCX and Archipelago believe, however, that such conflict may be mitigated with the following proposed undertakings of Archipelago, PCX and Archipelago Securities.<sup>28</sup>

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<sup>24</sup> See Archipelago Securities Routing Agreement, <http://www.tradearca.com/exchange/pdfs/ETPApplication.pdf> (last visited July 21, 2005).

<sup>25</sup> At the request of the Exchange the Commission deleted the phrase “as an Outbound Router.” See August 4, 2005 Telephone Conversation.

<sup>26</sup> The Exchange clarified that the ownership and operation by Archipelago of Archipelago Securities would violate the current, as well as the proposed, limitations in the certificate of incorporation of PCXH, unless approved by the Commission after June 20, 2005 to be a facility of PCXE. See August 12, 2005 Telephone Conversation.

<sup>27</sup> See Amendment No. 1.

<sup>28</sup> The Exchange clarified that the undertakings of PCX should also be included. See August 12, 2005 Telephone Conversation.

(x) Proposed Undertakings

Each of Archipelago, PCX and Archipelago Securities undertakes as follows:

(1) PCX will regulate the Outbound Router function of Archipelago Securities as a facility (as defined in Section 3(a)(2) of the Act), subject to Section 6 of the Act. In particular, and without limitation, under the Act, PCX will be responsible for filing with the Commission rule changes and fees relating to the Archipelago Securities Outbound Router function and Archipelago Securities will be subject to exchange non-discrimination requirements.

(2) Currently, NASD, an SRO unaffiliated with Archipelago or any of its affiliates (including, without limitation, PCX or PCXE), carries out oversight and enforcement responsibilities as the Designated Examining Authority designated by the Commission pursuant to Rule 17d-1 of the Act with the responsibility for examining Archipelago Securities for compliance with the applicable financial responsibility rules.<sup>29</sup>

(3) The NASD PCX Agreement will stay in full force and effect and PCX will continue to abide by the terms of such agreement.<sup>30</sup> Furthermore, PCX undertakes to amend the agreement to expand the scope of NASD's regulatory functions so as to encompass all of the regulatory oversight and enforcement responsibilities with respect to Archipelago Securities pursuant to applicable laws, except for real-time market surveillance.

(4) An ETP Holder's or OTP Holder's use of Archipelago Securities to route orders to another Market Center will continue to be optional. Any ETP Holder or OTP Holder that does

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<sup>29</sup> See Amendment No. 1.

<sup>30</sup> Id.

not want to use Archipelago Securities may use other routers to route orders<sup>31</sup> to other Market Centers.<sup>32</sup>

(5) Archipelago Securities will not engage in any business other than its Outbound Router function (including, in that function, the self-clearing functions that it currently performs for trades with respect to orders routed to other Market Centers and the clearing functions that it may perform for trades with respect to orders for securities not trades on any securities exchange)<sup>33</sup> and any other activities it may engage in as approved by the Commission.

The above undertakings of Archipelago, PCX and Archipelago Securities would become effective at the effective time of the Merger.

(y) Request for Approval

In sum, PCX and Archipelago believe that the proposed undertakings of Archipelago, PCX and Archipelago Securities set forth above would address the potential conflict of interest with the regulatory responsibilities of PCX and PCXE and the continued ownership and operation of Archipelago Securities by Archipelago after the closing of the Merger.<sup>34</sup> Consequently, subject to the proposed undertakings of Archipelago, PCX and Archipelago Securities set forth above, PCX and Archipelago request that the Commission approve Archipelago Securities to be a facility (as defined in Section 3(a)(2) of the Act)<sup>35</sup> of PCX.

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<sup>31</sup> Id.

<sup>32</sup> An ETP Holder may chose to route an order to ArcaEx that, if not executable on ArcaEx, will be cancelled and returned to the ETP Holder, at which time the ETP Holder could chose to route the order to another market. See August 4, 2005 Telephone Conversation.

<sup>33</sup> See Amendment No. 1.

<sup>34</sup> Id.

<sup>35</sup> 15 U.S.C. 78c(a)(2).

b. Proposed PCX Rules

Archipelago is a public company whose common stock is listed on PCX for trading on ArcaEx. The certificate of incorporation of Archipelago, which was approved by the Commission on August 9, 2004 prior to the initial public offering of Archipelago common stock,<sup>36</sup> currently contains certain provisions intended to ensure that the ownership of Archipelago by the public will not unduly interfere with or restrict the ability of the Commission or PCX to effectively carry out their regulatory oversight responsibilities under the Act, with respect to ArcaEx, and generally to enable ArcaEx to operate in a manner that complies with the federal securities laws, including furthering the objectives of Section 6(b)(5) of the Act.<sup>37</sup> Some of these provisions impose ownership and voting limitations on Archipelago's stockholders and their related persons,<sup>38</sup> including persons who are ETP Holders and the broker-dealers with

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<sup>36</sup> Securities Exchange Act Release No. 50170 (August 9, 2004), 69 FR 50419 (August 16, 2004) (SR-PCX-2004-56) (order granting approval of proposed rule change and notice of filing and order granting accelerated approval to Amendment No. 1 to the proposed rule change by the Pacific Exchange, Inc. relating to the Certificate of Incorporation and Bylaws of Archipelago).

<sup>37</sup> Id.

<sup>38</sup> The term "related persons," as defined in the Certificate of Incorporation of Archipelago, means with respect to any person: (a) any other person(s) whose beneficial ownership of shares of stock of Archipelago with the power to vote on any matter would be aggregated with such first person's beneficial ownership of such stock or deemed to be beneficially owned by such first person pursuant to Rules 13d-3 and 13d-5 under the Act; (b) in the case of a person that is a natural person, for so long as ArcaEx remains a facility of PCX and PCXE and the Facility Services Agreement is in full force and effect, any broker or dealer that is an ETP Holder with which such natural person is associated; (c) in the case of a person that is an ETP Holder, for so long as ArcaEx remains a facility of PCX and PCXE and the Facility Services Agreement is in full force and effect, any broker or dealer with which such ETP Holder is associated; (d) any other person(s) with which such person has any agreement, arrangement or understanding (whether or not in writing) to act together for the purpose of acquiring, voting, holding or disposing of shares of the stock of Archipelago; and (e) in the case of a person that is a natural person, any relative or spouse of such person, or any relative of such spouse, who has the same home as such person or who is a director or officer of Archipelago or any of its parents or subsidiaries. Certificate of Incorporation of Archipelago, Article FOURTH, paragraph H(3).

whom such ETP Holders are associated.<sup>39</sup> In order to ensure that upon consummation of the Merger, the public company nature of Archipelago will not unduly interfere with or restrict the regulatory oversight responsibilities of the Commission or PCX with respect to the options business and the general compliance of the operations of the options business with federal securities laws, PCX proposes to impose on any OTP Holder or OTP Firm, that is not an ETP Holder, voting and ownership limitations that are analogous to those imposed on ETP Holders by the certificate of incorporation of Archipelago. In addition, PCX proposes to require such OTP Holder and OTP Firm, as well as “associated persons” (as such term is defined in Section 3(a)(18) of the Act)<sup>40</sup> of such OTP Holder or OTP Firm, to enter into an agreement with PCX and Archipelago within certain specific time periods set forth in the proposed PCX rules, pursuant to which such OTP Holder, OTP Firm and any person who is deemed an “associated person” (as such term is defined in Section 3(a)(18) of the Act) of such OTP Holder or OTP Firm (such persons are referred to in this filing as “OTP Associates”) would agree to comply with the ownership and voting limitations imposed by the proposed PCX rules, to authorize Archipelago to vote their shares of Archipelago stock in favor of amendments to the certificate of incorporation of Archipelago that incorporate such ownership and voting limitations, and to be subject to the disciplinary action in the proposed PCX rules if they violate any of the ownership or voting limitations or fail to enter into such ownership and voting agreement (such agreement, the “Ownership and Voting Agreement”). Under the proposed PCX rules, failure to comply with

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<sup>39</sup> Certificate of Incorporation of Archipelago, Article FOURTH, paragraphs (C) and (D).

<sup>40</sup> Pursuant to Section 3(a)(18) of the Act, the term “associated person of a broker or dealer” means any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by or under common control with such broker or dealer, or any employee of such broker or dealer, except that such term does not include any person associated with a broker or dealer whose functions are solely clerical or ministerial. 15 U.S.C. 78c(a)(18).

the ownership and voting limitations or failure to enter into the Ownership and Voting Agreement will subject the responsible OTP Holder or OTP Firm to the possible suspension of all trading rights and privileges. The proposed PCX Rules 1.1(cc) through (gg), Rule 3.4 and Rule 13.2(a)(2)(E) are summarized below.

(i) Ownership and Voting Limitations

The proposed PCX rules provide that for as long as Archipelago shall control, directly or indirectly, PCX, no OTP Holder or OTP Firm, either alone or with its related persons, shall own beneficially shares of Archipelago stock representing in the aggregate more than 20% of the then outstanding votes entitled to be cast on any matter (the “Ownership Limitation”).<sup>41</sup> “Related persons” is defined to mean, with respect to any OTP Holder or OTP Firm: (a) any broker or dealer with which such OTP Holder or OTP Firm is associated; (b) any natural person who is an associated person of such OTP Firm; (c) any other person(s)<sup>42</sup> whose beneficial ownership of shares of stock of Archipelago with the power to vote on any matter would be aggregated with the OTP Holder’s or OTP Firm’s beneficial ownership of such stock or deemed to be beneficially owned by such OTP Holder or OTP Firm pursuant to Rules 13d-3 and 13d-5 under the Act;<sup>43</sup> (d) any other person(s) with which such OTP Holder or OTP Firm has any agreement, arrangement or understanding (whether or not in writing) to act together for the purpose of acquiring, voting, holding or disposing of shares of the stock of Archipelago; and (e) with

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<sup>41</sup> Proposed PCX Rule 3.4(a).

<sup>42</sup> PCX Rule 1.1(v) defines “Person” to mean a natural person, corporation, partnership, limited liability company, association, joint stock company, trustee of a trust fund, or any organized group of persons whether incorporated or not. PCX Rule 1.1(v).

<sup>43</sup> PCX believes that this definition, by incorporating a “beneficial ownership” concept, will help PCX to monitor ownership of the common stock of Archipelago by monitoring filings on Schedules 13D and 13G by stockholders of Archipelago. PCX further believes that the definition of “beneficial ownership” used will cover persons which control, are controlled by or are under common control with an OTP Holder or an OTP firm.

respect to any OTP Holder and any person described in (a) to (d) above who is a natural person, any relative or spouse of such person, or any relative of such spouse, who has the same home as such person or who is a director or officer of Archipelago or any of its parents or subsidiaries.<sup>44</sup>

PCX and Archipelago believe that stockholders of Archipelago, including OTP Holders, OTP Firms and their related persons who own Archipelago stock, will be able to effectively monitor their shareholdings in Archipelago using systems they already have in place.

For purposes of the Ownership Limitation, no OTP Holder or OTP Firm shall be deemed to have any agreement, arrangement or understanding to act together with respect to voting shares of stock of Archipelago solely because such OTP Holder, OTP Firm or any of their related persons, has or shares the power to vote or direct the voting of such shares of stock pursuant to a revocable proxy given in response to a public proxy or consent solicitation conducted pursuant to, and in accordance with, Regulation 14A promulgated pursuant to the Act, except if such power (or the arrangements relating thereto) is then reportable under Item 6 of Schedule 13D under the Act (or any similar provision of a comparable or successor report).<sup>45</sup>

In addition to the Ownership Limitation, the proposed PCX rules provide that for as long as Archipelago shall control, directly or indirectly, PCX, no OTP Holder or OTP Firm, either

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<sup>44</sup> Proposed PCX Rule 1.1(gg). The proposed Rule 1.1(gg) further provides that “related persons” includes, with respect to any OTP Holder or OTP Firm: (1) any other person beneficially owning pursuant to Rules 13d-3 and 13d-5 under the Act shares of Archipelago stock with the power to vote on any matter that also are deemed to be beneficially owned by such OTP Holder or OTP Firm pursuant to Rules 13d-3 and 13d-5 under the Act; (2) any other person that would be deemed to own beneficially pursuant to Rules 13d-3 and 13d-5 under the Act shares of Archipelago stock with the power to vote on any matter that are beneficially owned directly or indirectly by such OTP Holder or OTP Firm pursuant to Rules 13d-3 and 13d-5 under the Act; and (3) any additional person through which such other person would be deemed to directly or indirectly own beneficially pursuant to Rules 13d-3 and 13d-5 under the Act shares of Archipelago stock with the power to vote on any matter.

<sup>45</sup> Proposed PCX Rule 3.4(a).

alone or together with its related persons, shall (1) have the right to vote, vote or cause the voting of shares of stock of Archipelago to the extent such shares represent in the aggregate more than 20% of the then outstanding votes entitled to be cast on any matter (the “Voting Limitation”) or (2) enter into any agreement, plan or arrangement not to vote shares, the effect of which agreement, plan or arrangement would be to enable any person, either alone or with its related persons, to vote or cause the voting of shares that would represent in the aggregate more than 20% of the then outstanding votes entitled to be cast on any matter (the “Nonvoting Agreement Prohibition”).<sup>46</sup>

The Voting Limitation and Nonvoting Agreement Prohibition shall not apply to (1) any solicitation of any revocable proxy from any stockholder of Archipelago by or on behalf of Archipelago or by an officer or director of Archipelago acting on behalf of Archipelago or (2) any solicitation of any revocable proxy from any stockholder of Archipelago by any other stockholder that is conducted pursuant to, and in accordance with, Regulation 14A promulgated pursuant to the Act.<sup>47</sup>

(ii) Ownership and Voting Agreement

The proposed PCX Rule 3.4 also requires certain OTP Holders and OTP Firms that are not ETP Holders, and certain OTP Associates,<sup>48</sup> to enter into an Ownership and Voting Agreement with PCX and Archipelago, which Ownership and Voting Agreement shall provide that for as long as Archipelago shall control, directly or indirectly, PCX: (i) no OTP Holder or

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<sup>46</sup> Proposed PCX Rule 3.4(b).

<sup>47</sup> Id.

<sup>48</sup> PCX clarified that only certain OTP Holders, OTP Firms and OTP Associates would be required to enter into the Ownership and Voting Agreement. See August 4, 2005 Telephone Conversation and text accompanying note 51, infra, for a discussion of which OTP Holders, OTP Firms, and OTP Associates would be required to enter into an Ownership and Voting Agreement.

OTP Firm, either alone or with its related persons, shall, at any time, own beneficially shares of Archipelago stock in excess of the Ownership Limitation; (ii) no OTP Holder or OTP Firm, either alone or together with its related persons, shall have the right to vote, vote or cause the voting of shares of Archipelago stock, in person or by proxy or through any voting agreement or other arrangement, in excess of the Voting Limitation; and (iii) no OTP Holder or OTP Firm, either alone or together with its related persons, shall enter into any agreement, plan or other arrangement relating to shares of Archipelago stock entitled to vote on any matter with any other person, either alone or with its related persons, in contravention of the Nonvoting Agreement Prohibition.<sup>49</sup> In addition, the Ownership and Voting Agreement provides that each OTP Holder, OTP Firm and OTP Associate who is party to such agreement shall agree to be subject to the implementation provisions imposed by the proposed PCX Rule 3.4(d), which are also going to be set forth in the Ownership and Voting Agreement;<sup>50</sup> these provisions are described in more detail below.

Finally, the Ownership and Voting Agreement provides that each OTP Holder, OTP Firm and OTP Associate who is party to such agreement shall vote, or authorize Archipelago to vote on their behalf, shares of Archipelago stock owned by such OTP Holder, OTP Firm or OTP Associate, as appropriate, in favor of amendments to the certificate of incorporation of Archipelago that incorporate ownership and voting limitations that are substantially similar to the Ownership Limitation, Voting Limitation and Nonvoting Agreement Prohibition set forth in the proposed Rules 3.4(a) and 3.4(b), as well as implementation provisions imposed by the proposed

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<sup>49</sup> Proposed PCX Rule 3.4(c).

<sup>50</sup> Id.

PCX Rule 3.4(d).<sup>51</sup> The Ownership and Voting Agreement shall be governed by Delaware law.<sup>52</sup>

Under the proposed PCX rules, the OTP Holders, OTP Firms and OTP Associates who are required to enter into the Ownership and Voting Agreement have to do so within certain specified time periods set forth in the proposed rules. Specifically, in the case of an OTP Holder, OTP Firm or OTP Associate which is not an ETP Holder and which (x) owns beneficially any shares of Archipelago stock or (y) has entered into any agreement, plan or other arrangement relating to the voting or ownership of any shares of Archipelago stock, at the time of the closing of the Merger, such person will be required to enter into the Ownership and Voting Agreement no later than 30 calendar days following the date of closing of the Merger; in the case of any OTP Holder, OTP Firm or OTP Associate which is not required to enter into an Ownership and Voting Agreement pursuant to the above clause, the Ownership and Voting Agreement has to be entered into no later than the fifth calendar day following the date on which: (x) such OTP Holder, OTP Firm or OTP Associate ceases being an ETP Holder and (A) owns or acquires beneficial ownership of any shares of Archipelago stock or (B) is a party to or enters into any agreement, plan or other arrangement relating to the voting or ownership of any shares of Archipelago stock; or (y) such OTP Holder, OTP Firm or OTP Associate which is not an ETP Holder (A) acquires beneficial ownership of any shares of Archipelago stock or (B) enters into any agreement, plan or other arrangement relating to the voting or ownership of any shares of Archipelago stock.<sup>53</sup>

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<sup>51</sup> Proposed PCX Rule 3.4(c)(3).

<sup>52</sup> Proposed PCX Rule 3.4(c)(5).

<sup>53</sup> Proposed PCX Rule 3.4(c).

The ownership and voting limitations contained in the proposed PCX Rule 3.4 and the Ownership and Voting Agreement required by the proposed PCX Rule 3.4 are designed to impose on OTP Holders, OTP Firms and their related persons restrictions that are similar to those that are currently contained in the certificate of incorporation of Archipelago with respect to ETP Holders and their related persons. The corresponding provisions in the certificate of incorporation of Archipelago are designed to prevent any ETP Holder or any ETP Holders acting together, from exercising undue control over the operation of Archipelago and, therefore, ArcaEx. PCX believes that by extending the same restrictions to OTP Holders and OTP Firms as well as their related persons, the proposed rule would accomplish the same objectives with respect to the options business of PCX. Specifically, PCX believes that the proposed rules would deter any OTP Holder or OTP Firm, either alone or together with its related persons, from accumulating a substantial number of outstanding votes entitled to be cast on any matter without Commission review. PCX believes that the imposition of such 20% ownership and voting limitations would help ensure that Archipelago, and therefore PCX, would not be subject to undue influence from an OTP Holder or OTP Firm, or a group of OTP Holders or OTP Firms that control a substantial number of outstanding votes entitled to be cast on any matter that may be adverse to PCX's or the Commission's regulatory oversight responsibilities. The proposed voting limitations, along with the related ownership limitation, would serve to protect the integrity of PCX's and the Commission's regulatory oversight responsibilities and would allow PCX to review the acquisition of substantial voting power of Archipelago, and therefore PCX and PCXE, by any OTP Holder, OTP Firm and their related persons.

(iii) Certain Matters Related to the Implementation of the Ownership and Voting Limitations

The proposed PCX Rule 3.4(d) provides that in the event that any OTP Holder or OTP Firm, either alone or with its related persons (including any related persons who are OTP Associates of such OTP Holder or OTP Firm), at any time owns beneficially shares of Archipelago stock in excess of the Ownership Limitation, Archipelago shall promptly call from such OTP Holder or OTP Firm, or an OTP Associate of such OTP Holder or OTP Firm, at a price per share equal to the par value thereof, shares of Archipelago stock owned by such OTP Holder, OTP Firm or OTP Associate that are necessary to decrease the beneficial ownership of such OTP Holder or OTP Firm, either alone or with its related persons, to 20% of the then outstanding votes entitled to be cast on any matter after giving effect to the redemption of the shares of Archipelago stock.<sup>54</sup>

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<sup>54</sup> Proposed PCX Rule 3.4(d)(1). For purposes of illustration, if there are 1,000,000 votes entitled to be cast in total and an OTP Holder acquires beneficial ownership of shares of Archipelago stock representing in the aggregate 300,000 votes, then Archipelago has to call such number of shares from such OTP Holder so that the number of votes that the OTP Holder beneficially owns after giving effect to the reduction in such OTP Holder's stake and the consequent reduction in the total number of votes entitled to be cast, is not more than 20% of the new total number of votes entitled to be cast. Thus, using the number provided in this example, Archipelago would have to call shares of Archipelago stock representing in the aggregate 125,000 votes, leaving the OTP Holder with shares of Archipelago stock representing in the aggregate 175,000 votes, or 20% of the new 875,000 votes entitled to be cast in total.

In addition, assuming there is a second OTP Holder who beneficially owns shares of Archipelago stock representing 190,000 votes, the calling of the shares of the first OTP Holder described above would result in an increase of the second OTP Holder's ownership from 19% to 21.7%. In this scenario, Archipelago would have to call shares of Archipelago stock representing 20,000 votes from the second OTP Holder and additional shares representing 5,000 votes from the first OTP Holder (for a total of 130,000 shares called from the first OTP Holder) such that upon completion of these calls, each of these two OTP Holders owns shares of Archipelago stock representing 170,000 votes, or 20% of the new 850,000 votes entitled to be cast in total.

The proposed PCX Rule 3.4(d)(1) further provides that in the event Archipelago shall call shares of Archipelago stock pursuant to the proposed PCX Rule 3.4(d)(1), notice of such

In addition, if any OTP Holder or OTP Firm, either alone or with its related persons (including any related persons who are OTP Associates of such OTP Holder or OTP Firm), acquires the right to vote more than 20% of the then outstanding votes entitled to be cast by stockholders of Archipelago on any matter, Archipelago shall have the right to vote and shall vote such shares of Archipelago stock owned by such OTP Holder, OTP Firm, or an OTP Associate of such OTP Holder or OTP Firm, in excess of the 20% voting limitation in proportion with the results of voting (excluding such excess shares) for such matter at a meeting of Archipelago stockholders.<sup>55</sup>

Furthermore, the proposed PCX rules provide that in the event of any violation by any OTP Holder or OTP Firm of the Ownership Limitation, Voting Limitation or Nonvoting Agreement Prohibition (including, without limitation, any failure of an OTP Holder, OTP Firm

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call shall be given promptly by first-class mail, postage prepaid to the holders of the shares of Archipelago stock to be so called (such holders shall include holders whose ownership of Archipelago stock exceeded the 20% ownership limitation solely as a result of the reduction in the total number of outstanding votes due to calls of shares of Archipelago stock from other stockholders), at such holders' addresses as the same appears on the stock register of Archipelago. Each such notice shall state: (a) the call date; (b) the number of shares to be called; (c) the aggregate call price; and (d) the place or places where shares are to be surrendered for payment of the call price. Failure to give notice as aforesaid, or any defect therein, shall not affect the validity of the call of the shares. From and after the call date (unless default shall be made by Archipelago in providing funds for the payment of the call price), shares which have been called as aforesaid shall be cancelled, shall no longer be deemed to be outstanding, and all rights of the holder of such shares as a stockholder of Archipelago (except the right to receive from Archipelago the call price against delivery to Archipelago of evidence of ownership of such shares) shall cease. Upon surrender in accordance with said notice of evidence of ownership of the shares of Archipelago stock so called (properly assigned for transfer, if the board of directors of Archipelago shall so require and the notice shall so state), such shares shall be called by Archipelago at par value.

<sup>55</sup> Proposed PCX Rule 3.4(d)(2). For example, if, with respect to a particular proposal submitted to stockholder vote, 60% of the vote cast by Archipelago stockholders (excluding the excess shares) was in favor of the proposal and 40% of the vote cast by Archipelago stockholders (excluding the excess shares) was against the proposal, Archipelago would vote 60% of the excess shares in favor of the proposal and 40% of the excess shares against the proposal. See Amendment No. 1.

or OTP Associate to enter into the Ownership and Voting Agreement as required by the proposed Rule 3.4(c) within the applicable time periods specified therein or any breach of the Ownership and Voting Agreement by an OTP Holder, OTP Firm or OTP Associate which is a party thereto), the Exchange shall suspend all trading rights and privileges of such OTP Holder or OTP Firm in accordance with proposed PCX Rule 13.2(a)(2)(E), subject to the procedures provided therein.<sup>56</sup>

The proposed PCX Rule 13.2(a)(2)(E) provides that in the event of any such failure to comply with Rule 3.4, the Exchange shall: (1) provide notice to the applicable OTP Holder or OTP Firm within five business days of learning of the failure to comply; (2) allow the applicable OTP Holder, OTP Firm or OTP Associate of such OTP Holder or OTP Firm fifteen calendar days to cure any such failure to comply; (3) in the event that the applicable OTP Holder, OTP Firm or OTP Associate of such OTP Holder or OTP Firm does not cure such failure to comply within such fifteen calendar day cure period, schedule a hearing to occur within thirty calendar days following the expiration of such fifteen calendar day cure period; and (4) render its decision as to the suspension of all trading rights and privileges of the applicable OTP Holder or OTP Firm no later than ten calendar days following the date of such hearing.<sup>57</sup>

Finally, the proposed PCX rules provide that in the event any OTP Holder or OTP Firm, either alone or with its related persons (including any related person that is an OTP Associate of such OTP Holder or OTP Firm), has cast votes, in person or by proxy or through any voting agreement or other arrangement, in excess of the Voting Limitation, Archipelago may bring suit

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<sup>56</sup> Proposed PCX Rule 3.4(d)(3)

<sup>57</sup> Proposed PCX Rule 13.2(a)(2)(E).

in a court of competent jurisdiction against such OTP Holder, OTP Firm or OTP Associates seeking enforcement of the Voting Limitation.<sup>58</sup>

c. Bylaws of Archipelago

(i) Duration of Certain Bylaw Provisions

With respect to the ownership and voting limitations in the certificate of incorporation of Archipelago that apply specifically to ETP Holders and their related persons (as opposed to stockholders of Archipelago in general) and certain other provisions of the certificate of incorporation of Archipelago (such provisions, collectively, the “ArcaEx Limitations”),<sup>59</sup> the certificate of incorporation of Archipelago provides that such provisions shall remain applicable for so long as ArcaEx remains a facility (as defined in Section 3(a)(2) of the Act)<sup>60</sup> of PCX and PCXE and the Facility Services Agreement remains in full force and effect.<sup>61</sup> As described previously in Item II.A.1, following completion of the Merger, ArcaEx will remain the exclusive equities trading facility of PCX and PCXE, and the Facility Services Agreement will remain in full force and effect in its current form. In order to ensure the continued force and effect of the

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<sup>58</sup> Proposed PCX Rule 3.4(d)(4).

<sup>59</sup> Certificate of Incorporation of Archipelago, paragraphs (C)(3)(y), (D)(2), (D)(2)(a) and (H)(3) of Article FOURTH, the third paragraph of Article EIGHTH, the penultimate paragraph of Article TENTH, Article THIRTEENTH, Article FOURTEENTH, Article FIFTEENTH, Article SIXTEENTH, Article SEVENTEENTH and Article NINETEENTH.

<sup>60</sup> Section 3(a)(2) defines the term “facility,” when used with respect to an exchange, to include its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service. 15 U.S.C. 78c(a)(2).

<sup>61</sup> The Exchange clarified that the provisions discussed in this section, the ArcaEx Limitations, include both the ownership and voting limitations and other provisions. See August 12, 2005 Telephone Conversation.

ArcaEx Limitations in the event of any change in the relationship of PCX and PCXE to ArcaEx or the effectiveness of the Facility Services Agreement, PCX proposes to amend the bylaws of Archipelago to provide that Archipelago will not take any action, and will not permit any of its subsidiaries, which will include PCXH, PCX, PCXE and ArcaEx, to take any action, that will cause (i) ArcaEx to cease to be a facility of PCX and PCXE, or (ii) the Facility Services Agreement to cease to be in full force and effect, unless each of the provisions in the certificate of incorporation of Archipelago relating to the ArcaEx Limitations is amended pursuant to the terms thereof, the bylaws and applicable law, to provide that such provisions shall remain in full force and effect whether or not ArcaEx remains a facility of PCX and PCXE or the Facility Services Agreement is in full force and effect.<sup>62</sup> The foregoing bylaw provisions may not be amended, modified or repealed unless such amendment, modification or repeal is (i) filed with and approved by the Commission<sup>63</sup> or (ii) approved by Archipelago stockholders voting not less than 80% of the then outstanding votes entitled to be cast in favor of any such amendment, modification or repeal.<sup>64</sup> PCX believes that, because Archipelago will own 100% of the ownership interest in PCX, these proposed Archipelago bylaw provisions, in conjunction with

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<sup>62</sup> Amended Bylaws of Archipelago, Section 6.8(c).

<sup>63</sup> The current Bylaws of Archipelago provide that before any amendment to the bylaws shall be effective, such amendment shall be submitted to the Board of Directors of PCX and if such Board shall determine that the same is required, under Section 19 of the Act and the rules promulgated thereunder, to be filed with, or filed with and approved by, the Commission before such amendment may be effective under Section 19 of the Act and the rules promulgated thereunder, then such amendment shall not be effective until filed with, or filed with and approved by, the Commission, as the case may be. Amended Bylaws of Archipelago, Section 6.8(b).

<sup>64</sup> Amended Bylaws of Archipelago Section 6.8(g). Under Section 216 of the Delaware General Corporation Law, a bylaw amendment by shareholders generally requires the affirmative vote of a majority of the shares present in person or represented by proxy at a stockholders' meeting and entitled to vote on such bylaw amendment, unless specified otherwise in the corporation's certificate of incorporation or bylaws. Del. Code Ann. tit. 8 sec. 216(2) (1998).

voting and ownership limitations currently in place, and the ownership and voting limitations that will be imposed by the Proposed Rule Changes on OTP Holders, OTP Firms and their related persons, will ensure that, regardless of whether ArcaEx remains a facility of PCX and PCXE or whether the Facility Services Agreement remains in full force and effect, the regulatory oversight responsibilities of PCX and PCXE will not be subject to any undue influences from a PCX member or a group of PCX members that control a substantial number of outstanding votes.

(ii) No Waiver by the Board of Directors of Archipelago

The certificate of incorporation of Archipelago currently contains provisions that allow the board of directors of Archipelago to, subject to certain conditions,<sup>65</sup> waive the voting and ownership limitations with respect to a specific Archipelago stockholder and its related persons, provided that neither the stockholder subject to such waiver nor any of its related persons is an ETP Holder.<sup>66</sup> These provisions reflect the heightened scrutiny with respect to ETP Holders and their related persons relative to other Archipelago stockholders due to the fact that ETP Holders are members of the Exchange and present more of a concern for undue influence than other

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<sup>65</sup> Before adopting any waiver with respect to (i) the exercise of any voting rights in excess of the voting limitation set forth in the certificate of incorporation of Archipelago, (ii) the entering into of any agreement, plan or other arrangement in violation of the non-voting agreement prohibition set forth in the certificate of incorporation of Archipelago, or (iii) the ownership of Archipelago stock in excess of the concentration limitation set forth in the certificate of incorporation of Archipelago, the board of directors of Archipelago has to determine that: (x) the undertaking of any of the actions described in (i), (ii) or (iii) above by any person, either alone or with its related persons, will not impair any of Archipelago's, PCX or PCXE's ability to discharge its responsibilities under the Act and the rules and regulations thereunder and is otherwise in the best interests of Archipelago and its stockholders; (y) the undertaking of any of the actions described in (i), (ii) or (iii) above by any person, either alone or with its related persons, will not impair the Commission's ability to enforce the Act; and (z) neither such person nor any of its related persons is subject to any statutory disqualification (as defined in Section 3(a)(39) of the Act). Certificate of Incorporation of Archipelago, Article FOURTH, paragraphs C(3) and D(1)(b).

<sup>66</sup> Certificate of Incorporation of Archipelago, Article FOURTH, paragraph C(3).

stockholders of Archipelago. In connection with the Merger and the expansion of the voting and ownership limitations to OTP Holders, OTP Firms and their related persons through the new proposed PCX rules described in Item 3.1(b), PCX proposes to amend the bylaws of Archipelago to provide that the board of directors of Archipelago will not adopt any resolution waiving the Voting Limitation, the Nonvoting Agreement Prohibition and the “Concentration Limitation” (as such term is defined in the certificate of incorporation of Archipelago)<sup>67</sup> with respect to any OTP Holder, OTP Firm or any of their related persons.<sup>68</sup> The foregoing bylaw provisions may not be amended, modified or repealed unless such amendment, modification or repeal is filed and approved by the Commission or approved by Archipelago stockholders voting not less than 80% of the then outstanding votes entitled to be cast in favor of any such amendment, modification, or repeal.<sup>69</sup> These proposed bylaw provisions, in conjunction with the ownership and voting limitations that would be imposed by the Proposed Rule Changes on OTP Holders, OTP Firms and their related persons, are designed to apply a comparable level of scrutiny that has been in place for ETP Holders and their related persons to OTP Holders, OTP Firms and their related persons after completion of the Merger. By proscribing any discretion by the board of directors of Archipelago with respect to granting waivers of the ownership and voting limitations to the OTP Holders and OTP Firms<sup>70</sup> and their related persons, the proposed bylaw provisions further

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<sup>67</sup> The “Concentration Limitation,” as defined in the certificate of incorporation of Archipelago, provides that no person, either alone or with its related persons, shall be permitted at any time to own beneficially shares of Archipelago stock representing in the aggregate more than 40% of the then outstanding votes entitled to be cast on any matter. Certificate of Incorporation of Archipelago, Article FOURTH, Paragraph D(1).

<sup>68</sup> Amended Bylaws of Archipelago, Section 6.8(d). See Amendment No. 1.

<sup>69</sup> Amended Bylaws of Archipelago, Section 6.8(g).

<sup>70</sup> See Amendment No. 1.

ensure that these limitations will be strictly enforced to fulfill their intended purpose of protecting the integrity of the regulatory oversight of PCX and the Commission.

(iii) Extension of Certain Provisions Related to ArcaEx

Among other things, the certificate of incorporation of Archipelago provides for the inspection and copying by PCX and PCXE of Archipelago's books and records, requires that Archipelago take reasonable steps necessary to cause its agents to cooperate with PCX and PCXE in connection with certain of such agents' activities and requires that Archipelago cause its officers, directors and employees to consent to the applicability to them of certain provisions of Archipelago's certificate of incorporation in connection with certain of such persons' activities.<sup>71</sup> These provisions, however, apply only to the extent that such books and records or activities, as the case may be, relate to ArcaEx. As described previously in Item II.A.1, following completion of the Merger, PCX and PCXE will become wholly-owned subsidiaries of Archipelago. In order to ensure that these provisions apply also to the operations of PCX and PCXE, PCX proposes to amend the bylaws of Archipelago to provide that, in addition to the current requirements of the certificate of incorporation of Archipelago, (i) Archipelago's books and records shall be subject at all times to inspection and copying by PCX and PCXE to the extent such books and records are related to the operation and administration of PCX or PCXE, (ii) Archipelago shall take reasonable steps necessary to cause its agents to cooperate with PCX and PCXE pursuant to their regulatory authority with respect to such agents' activities related to PCX or PCXE, (iii) Archipelago shall take reasonable steps necessary to cause its officers, directors and employees prior to accepting a position as an officer, director or employee, as

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<sup>71</sup> Certificate of Incorporation of Archipelago, Article THIRTEENTH, Article FOURTEENTH, Article SEVENTEENTH and Article EIGHTEENTH.

The Exchange clarified that Article THIRTEENTH of the Certificate of Archipelago should be included in the preceding list. See August 12, 2005 Telephone Conversation.

applicable, of the Corporation to consent in writing to the applicability to them of certain specified provisions of the certificate of incorporation of Archipelago with respect to their activities related to PCX or PCXE, and (iv) Archipelago, its directors and officers, and those of its employees whose principal place of business and residence is outside the United States shall be deemed to irrevocably submit to the exclusive jurisdiction of the United States federal courts, the Commission and PCX for the purposes of any suit, action or proceeding pursuant to the United States federal securities laws, and the rules and regulations thereunder, arising out of, or relating to, the activities of PCX or PCXE, and Archipelago and each such director, officer or employee, in the case of any such director, officer or employee by virtue of his acceptance of any such position, shall be deemed to waive, and agree not to assert by way of motion, as a defense or otherwise in any suit, action or proceeding, any claims that it or they are not personally subject to the jurisdiction of the Commission, that the suit, action or proceeding is an inconvenient forum or that the venue of the suit, action or proceeding is improper, or that the subject matter thereof may not be enforced in or by such courts or agency.<sup>72</sup> The foregoing proposed bylaw provisions may not be amended, modified or repealed unless such amendment, modification or repeal is (i) filed with and approved by the Commission or (ii) approved by Archipelago stockholders voting not less than 80% of the then outstanding votes entitled to be cast in favor of any such amendment, modification or repeal.<sup>73</sup> PCX believes that, because Archipelago will own 100% of the ownership interest in PCX (and, through PCX, in PCXE as well), these proposed Archipelago bylaw provisions will ensure that the regulatory oversight responsibilities of PCX and PCXE will also extend to such books and records, agents, officers,

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<sup>72</sup> Amended Bylaws of Archipelago, Section 6.8(e).

<sup>73</sup> Amended Bylaws of Archipelago, Section 6.8(g).

directors and employees of Archipelago as may relate to, or be involved in, the operations of PCX and PCXE (as well as ArcaEx).

(iv) Calling of Shares by Archipelago

The certificate of incorporation of Archipelago also contains provisions that govern the process that Archipelago will follow in order to call shares from certain of its stockholders in the event of breaches of certain ownership limitations.<sup>74</sup> The proposed Archipelago bylaw amendment clarifies that, in order to effect the purposes of these provisions of Archipelago's certificate of incorporation, Archipelago recognizes that the call must be undertaken and completed promptly. To that end, under the proposed bylaw amendment, the Board of Directors of Archipelago will cause Archipelago to call promptly shares of stock of Archipelago and also to give notice of such call promptly.<sup>75</sup> The foregoing proposed bylaw provisions may not be amended, modified or repealed unless such amendment, modification or repeal is (i) filed with and approved by the Commission or (ii) approved by Archipelago stockholders voting not less than 80% of the then outstanding votes entitled to be cast in favor of any such amendment, modification or repeal.<sup>76</sup>

d. Undertakings by Archipelago.

In connection with the submission of the Proposed Rule Changes, Archipelago undertakes that, prior to the earlier of (1) the 2006 annual general meeting of Archipelago stockholders and (2) the first meeting of Archipelago stockholders to occur after the closing of the Merger (other than any meeting or meetings of Archipelago stockholders convened for the purpose of considering and approving the merger of Archipelago and New York Stock

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<sup>74</sup> Certificate of Incorporation of Archipelago, Article FOURTH, paragraph F.

<sup>75</sup> Amended Bylaws of Archipelago, Section 6.8(f).

<sup>76</sup> Amended Bylaws of Archipelago, Section 6.8(g).

Exchange, Inc.), the board of directors of Archipelago shall: (a) propose amendments to the certificate of incorporation of Archipelago to (x) extend the application of voting and ownership limitations imposed on ETP Holders currently contained in the certificate of incorporation of Archipelago to OTP Holders and OTP Firms, (y) delete the phrase “[f]or so long as ArcaEx remains a Facility of PCX and PCX Equities and the FSA remains in full force and effect” from each paragraph that contains such language, which paragraphs shall include paragraphs (C)(3)(y), (D)(2), (D)(2)(a) and (H)(3) of Article FOURTH, the third paragraph of Article EIGHTH, the penultimate paragraph of Article TENTH, Article THIRTEENTH, Article FOURTEENTH, Article FIFTEENTH, Article SIXTEENTH, Article SEVENTEENTH and Article NINETEENTH, and (z) incorporate into Articles THIRTEENTH, FOURTEENTH, SEVENTEENTH AND EIGHTEENTH, as appropriate, the requirements set forth in Section 6.8(e) of the proposed Archipelago bylaw amendment; (b) declare the advisability of such amendments; and (c) direct such amendments be submitted for stockholder approval at the earlier of (1) the 2006 annual meeting of Archipelago stockholders and (2) the first meeting of Archipelago stockholders to occur after the closing of the Merger (other than any meeting or meetings of Archipelago stockholders convened for the purpose of considering and approving the merger of Archipelago and New York Stock Exchange, Inc.). The Ownership and Voting Agreement will provide that any OTP Holder, OTP Firm or OTP Associate that is subject to the Ownership and Voting Agreement shall vote, or authorize Archipelago to vote on its behalf, shares of Archipelago stock owned by such OTP Holder, OTP Firm or OTP Associate in favor of the amendments to the certificate of incorporation of Archipelago described in (x) above.<sup>77</sup>

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<sup>77</sup> Proposed PCX Rule 3.4(c)(3).

In addition, Archipelago undertakes to take reasonable steps necessary to cause Archipelago's directors and officers and those Archipelago employees whose principal place of business and residence is outside the United States prior to accepting a position as an officer, director or employee, as applicable, of Archipelago to consent in writing to the applicability to them of the proposed Section 6.8(e)(iv) of the proposed Archipelago bylaw amendment. Furthermore, Archipelago undertakes that it will take reasonable steps necessary to cause Archipelago's current directors and officers and those current Archipelago employees whose principal place of business and residence is outside the United States to consent in writing prior to the consummation of the Merger to the applicability to them of Section 6.8(e)(iv) of the proposed Archipelago bylaw amendment.

e. Certain Additional Matters<sup>78</sup>

(i) The Exchange is also requesting the Commission's approval for the following temporary exceptions for the following persons, each of whom would be subject to and exceed the voting and ownership limitations imposed by Article Nine of the certificate of incorporation of PCXH (as proposed to be amended as described in this filing) as of the date of the closing of the Merger, so that such persons be permitted to exceed such limitations imposed by Article Nine to the following extent and for the following time periods:

(x) Archipelago may, until December 31, 2005, continue to own all of its ownership interest in Wave Securities, L.L.C., a broker-dealer and wholly-owned subsidiary of Archipelago, following the closing of its acquisition of PCXH notwithstanding the terms of the certificate of incorporation of PCXH, as proposed to be amended as described in this filing.

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PCX clarified that the Ownership and Voting Agreement also would apply to OTP Associates, and that such agreement would only require a vote in favor of the amendments described in (x) above. See August 4, 2005 Telephone Conversation.

<sup>78</sup> See Amendment No. 1.

(y) Gerald D. Putnam, Chairman and Chief Executive Officer of Archipelago, may, until December 31, 2005, continue to own in excess of 5% of Terra Nova Trading, L.L.C. and continue to serve as a director of TAL Financial Services, LLC following the closing of the Archipelago's acquisition of PCXH notwithstanding the terms of the certificate of incorporation of PCXH, as proposed to be amended as described in this filing.

(ii) In order to abide by the terms of the certificate of incorporation of PCXH, as proposed to be amended as described in this filing, each of Kevin J.P. O'Hara, Chief Administrative Officer and General Counsel of Archipelago, and Paul Adcock, Managing Director, Trading, of Archipelago, shall resign from the board of directors of White Cap Trading LLC prior to the effective time of the Merger.

## 2. Basis

The Exchange believes that this filing is consistent with Section 6(b)<sup>79</sup> of the Act, in general, and furthers the objectives of Section 6(b)(1),<sup>80</sup> in particular, in that it enables the Exchange to be so organized so as to have the capacity to be able to carry out the purposes of the Act and to comply, and (subject to any rule or order of the Commission pursuant to Section 17(d) or 19(g)(2) of the Act) to enforce compliance by its exchange members and persons associated with its exchange members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the Exchange. The Exchange also believes that this filing furthers the objectives of Section 6(b)(5),<sup>81</sup> in particular, because the rules summarized herein would create a governance and regulatory structure with respect to the operation of the options business of PCX that is designed to help prevent fraudulent and manipulative acts and practices; to promote just

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<sup>79</sup> 15 U.S.C. 78f(b).

<sup>80</sup> 15 U.S.C. 78f(b)(1).

<sup>81</sup> 15 U.S.C. 78f(b)(5).

and equitable principals of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; and to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

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.

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 (1) 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 (2) as to which the Exchange 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.

The board of directors of PCXH and the board of directors of PCX approved the proposed amendment to the certificate of incorporation of PCXH at their respective meetings on June 1, 2005. The board of directors of PCX approved this filing, including the Proposed Rule Changes contained therein, at its meeting on August 2, 2005. The board of directors of Archipelago approved the proposed amendment to the bylaws of Archipelago at its meeting on July 18, 2005. In addition, PCXH will be submitting the Amended Merger Agreement to its

stockholders for approval. This vote is expected to occur at a special meeting of PCXH stockholders in September 2005. To the extent necessary, the Exchange hereby consents to an extension of the time period specified in Section 19(b)(2) of the Act until at least 35 days after the Exchange has filed an appropriate amendment to this filing setting forth the completion of all such necessary corporate actions.<sup>82</sup>

#### 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-2005-90 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-2005-90. 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

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<sup>82</sup> See Amendment No. 1.

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 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-2005-90 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>83</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>83</sup> 17 CFR 200.30-3(a)(12).