

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52769; File No. SR-PCX-2005-119)

November 10, 2005

Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto Regarding Clearly Erroneous Executions

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 24, 2005, the Pacific Exchange, Inc. (“PCX” or “Exchange”), through its wholly owned subsidiary, PCX Equities, Inc. (“PCXE”), 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 October 27, 2005, the Exchange submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> On November 9, 2005, the Exchange submitted Amendment No. 2 to the proposed rule change.<sup>4</sup> The Exchange filed the proposed rule change as a “non-controversial” rule change under Rule 19b-4(f)(6) under the Act,<sup>5</sup> which renders the proposal effective upon filing with the Commission.<sup>6</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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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> Amendment No. 1 properly identified proposed rule text that had not been indicated as new text in the original filing.

<sup>4</sup> Amendment No. 2 corrected minor typographical errors and properly indentified changes being made to existing rule text.

<sup>5</sup> 17 CFR 240.19b-4(f)(6).

<sup>6</sup> For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposal, the Commission considers the period to commence on November 9, 2005, the date on which the Exchange submitted Amendment No. 2. See 15 U.S.C. 78s(b)(3)(C).

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The PCX, through PCXE, proposes to amend its rules governing the Archipelago Exchange, the equities trading facility of PCXE. This filing proposes to amend PCXE Rule 7.10 regarding clearly erroneous executions. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in [brackets].

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**Rules of PCX Equities, Inc.**

**Rule 7**

**Equities Trading**

**Rule 7.10. Clearly Erroneous Executions**

(a) – (b) No change.

(c) Review Procedures.

(1) No change.

(2) If [a party]an ETP Holder affected by a determination made under this Rule so requests within the time permitted below, the Clearly Erroneous Execution Panel (“CEE Panel”) will review decisions made by the Officer under this Rule, including whether a clearly erroneous execution occurred and whether the correct adjustment was made; provided however that the CEE Panel will not review decisions made by an officer under subsection (d) of this Rule if such Officer also determines under subsection (d) of this Rule that the number of the affected transactions is such that immediate finality is necessary to maintain a fair and orderly market and to protect investors and the public interest.

(A) – (B) – No change.

(3) – (4) – No change.

(d) System Disruption and Malfunctions. In the event of any disruption or a malfunction in the use or operation of any electronic communications and trading facilities of the PCXE, or extraordinary market conditions or other circumstances in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest exist, the Officer, on his or her own motion, may review such transactions and declare such transactions arising out of the use or operation of such facilities during such period null and void or modify the terms of these transactions if the Officer determines that the transaction(s) is clearly erroneous, or that such actions are necessary for the maintenance of a fair and orderly market or for the protection of investors and the public interest. Absent extraordinary circumstances, any such action of the Officer pursuant to this subsection (d) shall be taken within thirty (30) minutes of detection of the erroneous transaction. Each ETP Holder involved in the transaction shall be notified as soon as practicable, and the ETP Holder aggrieved by the action may appeal such action in accordance with the provisions of subsection (c)(2)-(4).

(e) No change.

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

In its filing with the Commission, PCX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The PCX has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

Currently, PCXE Rule 7.10 sets forth procedures for PCXE when the terms of a transaction executed on PCXE are clearly erroneous. PCXE Rule 7.10 provides for PCXE review procedures, an appeal process and various procedures with respect to system disruption and malfunction and trade nullification and price adjustments for unlisted trading privileges securities that are subject to an initial public offering.

At this time, the Exchange proposes to amend PCXE Rule 7.10 with respect to the appeal procedures. Currently, PCXE Rule 7.10(c)(2) provides that if a party affected by a determination made under this Rule so requests within the time permitted, the Clearly Erroneous Execution Panel (“CEE Panel”) will review decisions made by an officer of PCXE under this rule, including whether a clearly erroneous execution occurred and whether the correct adjustment was made. The Exchange proposes to modify this provision to provide that the CEE Panel will not review decisions made by a PCXE officer under this rule in the event of any disruption or a malfunction in the use or operation of any electronic communications and trading facilities of the PCXE, or extraordinary market conditions or other circumstances, when the officer making the determination also determines on his or her own motion that it is necessary to nullify or modify clearly erroneous transactions because the number of the affected transactions is such that immediate finality is necessary to maintain a fair and orderly market and to protect investors and the public interest. PCXE also proposes to amend subsection (d) of PCXE Rule 7.10 to state that PCXE’s authority may be exercised in the event of extraordinary market conditions or other circumstances in which the PCXE officer determines that the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection

of investors and the public interest. PCXE believes that in such circumstances review(s) by the CEE Panel(s) of large numbers of trades would be impractical and could expose market participants to unacceptable levels of risk. PCXE expects that the amended rule would be used only on rare occasions and primarily in circumstances where the disruption or malfunction of a system resulted in the execution of large numbers of trades with obvious errors, such as prices substantially unrelated to the inside market.<sup>7</sup> According to the Exchange, with this rule change, it would be able to keep the markets orderly during such times when finality of trade rulings is necessary. The Exchange notes that this rule proposal is based on the National Association of Securities Dealers' ("NASD") Rule 11890(c)(1).

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>9</sup> in particular, because it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and to protect investors and the public interest.

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<sup>7</sup> For example, PCX believes that if an erroneously priced order or quote causes a large number of transactions to occur at prices far in excess of a security's true value and if a decision is made to break all of the affected trades, some sellers may appeal the decision to break the trades. If a market participant is a party to trades on both sides of the market, and some remain broken while others are appealed and reinstated, it will suffer losses that arise solely from the inconsistent treatment of its trades.

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

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

The PCX 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

The PCX neither solicited nor received written comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the proposed rule change: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of filing, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>10</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>11</sup> As required under Rule 19b-4(f)(6)(iii),<sup>12</sup> the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of the filing of the proposed rule change.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in the furtherance of the purposes of the Act.<sup>13</sup>

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<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>11</sup> 17 CFR 240.19b-4(f)(6).

<sup>12</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>13</sup> See supra note 6.

#### 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-2005-119 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 20549-9309.

All submissions should refer to File Number SR-PCX-2005-119. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section. 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-2005-119 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>14</sup>

Jonathan G. Katz  
Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).