

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53370; File No. SR-PCX-2006-11)

February 24, 2006

Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Requiring Archipelago Securities, L.L.C. to Enter Two-Sided Quotes

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on February 9, 2006, 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 and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal on an accelerated basis.

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

The Exchange, through PCXE, proposes to amend its rules governing the Archipelago Exchange (“ArcaEx”), the equities trading facility of PCXE. The Exchange proposes to amend PCXE Rule 7.58 to specify that its broker-dealer facility, Archipelago Securities, L.L.C. (“Arca Securities”), would be responsible for entering two-sided orders in all stocks eligible for trading on ArcaEx for purposes of fulfilling the two-sided quote requirement found in section 6(a)(i)(B) of the Intermarket Trading System Plan (“ITS Plan”). Further, the Exchange proposes to expand certain exceptions recently granted by the Commission to the ownership and voting restrictions in the PCX Holdings, Inc. (“PCXH”) Certificate of Incorporation to encompass the proposed new functionality.

¹ 15 U.S.C 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change appears below. Additions are in underlined.

Deleted items are in [brackets].

* * * * *

PCX Equities, Inc.

Rule 7

Rule 7.58 [Reserved.] Compliance with Two-Sided Quote Requirement in ITS Plan. Archipelago Securities, L.L.C. will enter two-sided orders in all stocks eligible for trading on the Archipelago Exchange for purposes of fulfilling the two-sided quote requirement found in section 6(a)(i)(B) of the ITS Plan. The quote parameters for these purposes will be buy orders priced at \$0.01 and sell orders priced at two times the previous day's close for the particular security, or, if required due to technology considerations, orders would be priced as near as possible to the parameters above.

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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, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change. The text of these statements may be examined at the places specified in Item III below, and is set forth in Sections A, B, and C below.

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

1. Purpose

The Exchange proposes to add new language to PCXE Rule 7.58 to specify that the broker-dealer facility of ArcaEx, Arca Securities, would be responsible for entering two-sided orders in all stocks eligible for trading on ArcaEx for purposes of fulfilling the quoting

requirements found in section 6(a)(i)(B) of the ITS Plan. Section 6(a) of the ITS Plan states that “a member in any Exchange Market may trade any System security provided that continuous two-sided quotations in such security are required to be, and are, furnished under section 6(a)(i)(B) by or on behalf of such Exchange Participant to other Participants.”

In the past, another broker-dealer affiliate of ArcaEx, Wave Securities, L.L.C. (“Wave”), performed this function.³ The Exchange has determined that transferring this responsibility to the broker-dealer Arca Securities, a facility of the Exchange, is appropriate at this time, given that Wave will no longer be owned by Archipelago Holdings, Inc. (“Archipelago”). To accommodate the two-sided quote requirement, Arca Securities would enter buy and sell orders in every listed symbol eligible for trading at the start of core trading on ArcaEx.⁴ All buy orders would be priced at \$0.01, and all sell orders would be priced at two times the previous day’s close for the particular security, or, if required due to technology considerations, orders would be priced as near as possible to the parameters above. The orders would be entered with a time in force during the core trading session on ArcaEx and, by their terms, would expire at the close of the core trading session. Should an execution result from these two-sided orders, Arca Securities, an ETP Holder on ArcaEx, would honor trades at the price of the orders entered.⁵

³ See letter from David E. Rosedahl, Pacific Exchange, Inc., to John Polise, Division of Market Regulation (“Division”), Commission, regarding ArcaEx’s compliance with the two-sided quote requirements of the ITS Plan, dated July 31, 2002.

⁴ See PCXE Rule 7.34.

⁵ Any trade occurring on the Exchange with an obvious error in terms, including price, is subject to the Clearly Erroneous Policy set forth in PCXE Rule 7.10. The Exchange represents that it would apply the procedures set forth in Rule 7.10 in an even-handed and fair manner in the event a transaction involving Arca Securities comes before it under the procedures set forth in the rule.

Arca Securities is a wholly-owned subsidiary of Archipelago, which recently acquired PCXH.⁶ In the rule filings relating to this acquisition, the Exchange requested that the Commission provide certain exceptions to the ownership and voting limitations contained in the Certificate of Incorporation of PCXH to allow any “Related Person” of Archipelago who is a prohibited person not covered by the definition of permitted person (as such terms are defined by the PCXH Certificate of Incorporation) to exceed certain voting and ownership restrictions in PCXH’s Certificate of Incorporation for certain time periods, as approved by the Commission. The Commission granted Arca Securities one such exception to the PCXH ownership and voting restrictions with respect to its Outbound Router⁷ functionality, on the condition that it would not undertake any activities other than those set forth in the Arca-PCX Approval order, unless such activity was first approved by the Commission.⁸

Because this filing requests approval for new Arca Securities functionality, i.e., permission to enter two-sided orders in all stocks eligible for trading on ArcaEx for purposes of Section 6(a)(i)(B) of the ITS Plan, the Exchange has requested that the Commission also approve an expansion of the exception to the PCXH ownership and voting restrictions to incorporate the

⁶ See Securities Exchange Act Release No. 52497 (September 22, 2005), 70 FR 56949 (September 29, 2005) (SR-PCX-2005-90) (order granting approval of proposed rule changes in relation to the acquisition of PCXH by Archipelago) (“Arca-PCX Approval Order”).

⁷ In the Arca-PCX Approval Order, the Commission defined the Outbound Router function of Arca Securities as follows: “an optional routing service for ArcaEx to route orders to other securities exchanges, facilities of securities exchanges, automated trading systems, electronic communications networks or other brokers or dealers from ArcaEx in compliance with PCXE Rules.” See Arca-PCX Approval Order at 56952.

⁸ The Commission initially granted the exception with respect to Arca Securities’ Outbound Router functionality. See Arca-PCX Approval Order, at 56952-56953 and 56958-56959.

proposed functionality and extend the exception from the PCXH ownership and voting restrictions to this new function of Arca Securities.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act⁹ in general and furthers the objectives of Section 6(b)(5),¹⁰ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transaction in securities, and to remove impediments to and perfect the mechanisms of a free and open market and a national market system.

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. Further, the Exchange believes the proposed functionality will not create a condition of unfair competition with respect to its affiliate, Arca Securities, and other equity trading permit holders because the proposed quoting parameters are designed to avoid order interaction. The orders entered by Arca Securities under the proposed functionality will not be intended to result in transactions but rather will be entered for the sole purpose of satisfying ITS Plan requirements to provide continuous two-sided quotations. The Exchange anticipates that the non-competitively priced orders placed by Arca Securities for these purposes would be filled only in exceptional circumstances and therefore the Exchange believes there would be a very remote potential for a conflict of interest between the Exchange's self-regulatory obligations and its commercial interests. For these

⁹ 15 U.S.C. 78f(b).

¹⁰ 15 U.S.C. 78f(b)(5).

reasons, the Exchange believes it is appropriate and consistent with the Act to permit Arca Securities to undertake the proposed new functionality.

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. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>);
or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-PCX-2006-11 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-PCX-2006-11. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications

relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the PCX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-PCX-2006-11 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹¹ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹² which requires that an exchange have rules designed, among other things, to promote just and equitable principles of trade, 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.

Under the proposal, Arca Securities, an affiliated broker-dealer of the Exchange, would maintain two-sided quotes in all stocks eligible for trading on ArcaEx for purposes of fulfilling the two-sided quote requirement found in section 6(a)(i)(B) of the ITS Plan. The performance of this functionality by Arca Securities, without Commission approval, would, however, cause Arca

¹¹ In approving this rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78f(b)(5).

Securities to violate ownership and voting restrictions set forth in the PCXH Certificate of Incorporation.¹³

Arca Securities, as a wholly-owned subsidiary of Archipelago, is a “Related Person”¹⁴ of Archipelago and an ETP Holder. Consequently, Archipelago’s ownership of Arca Securities would cause Arca Securities to exceed the voting and ownership limitations imposed by Article Nine of the PCXH Certificate of Incorporation, absent an exception. The Commission approved such an exception in the Arca-PCX Approval Order. The exception is, however, limited in scope to allow Arca Securities to provide an optional outbound routing service for ArcaEx and does not include the functionality contained in this proposal.¹⁵ PCX has requested that the Commission approve an expansion of the exception to the PCXH ownership and voting restrictions to allow Arca Securities to enter two-sided quotes on ArcaEx for the purpose of complying with Section 6(a)(i)(B) of the ITS Plan.

The Commission believes that extending the exception from the PCXH voting and ownership restrictions to this new function of Arca Securities is consistent with Section 6(b)(5) of the Act. Accordingly, Arca Securities may provide continuous two-sided quotes on ArcaEx for the purpose of complying with the ITS Plan. This exception is subject to the same conditions

¹³ See PCXH Certificate of Incorporation, Article Nine. See also Arca-PCX Approval Order.

¹⁴ The term “Related Person,” as defined in the PCXH Certificate of Incorporation, 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 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. PCXH Certificate of Incorporation, Article Nine, Section 1(b).

¹⁵ See Arca-PCX Order at 56958-56959. See also supra notes 7 and 8 and accompanying text.

described in the Arca-PCX Approval Order.¹⁶ Specifically, Arca Securities is, and will continue to be, operated and regulated as a facility of PCX and another self-regulatory organization (NASD) has, and will continue to have, primary regulatory responsibility for Arca Securities pursuant to Rules 17d-1 and 17d-2 under the Act.

Pursuant to Section 19(b)(2) of the Act,¹⁷ the Commission may not approve a proposed rule change prior to the thirtieth day after the date of publication of the notice thereof, unless the Commission finds good cause for so finding. The Commission hereby finds good cause for approving this proposed rule change prior to the thirtieth day after the publication of notice thereof in the Federal Register. The Commission notes that the Exchange has represented that Archipelago entered into a definitive agreement to sell its wholly-owned subsidiary, Wave, the entity which currently performs the functionality which is the subject of this proposal on behalf of the Exchange.¹⁸ Further, the Commission notes that Archipelago may, among other things, continue to own Wave until the earlier of (i) the closing date of the merger of Archipelago and the New York Stock Exchange, Inc., or (ii) March 31, 2006.¹⁹ Because of the timing of these transactions, the Commission believes there is good cause for granting accelerated approval, in order to ensure that the Exchange is able to comply with the ITS Plan, without interruption, after Wave is sold.

¹⁶ See Arca-PCX Order at 56958-56959.

¹⁷ 15 U.S.C. 78s(b)(2).

¹⁸ See Securities Exchange Act Release No. 53202 (January 31, 2006), 71 FR 6530 (February 8, 2006) (SR-PCX-2006-04), at 6535.

¹⁹ See id., at 6365.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-PCX-2006-11), is hereby approved on an accelerated basis.²⁰

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²¹

Nancy M. Morris
Secretary

²⁰ 15 U.S.C. 78s(b)(2).

²¹ 17 CFR 200.30-3(a)(12).