

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49713; File No. SR-PCX-2004-12)

May 17, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto by the Pacific Exchange, Inc. Creating an Additional Processing Capability for PNP Orders Called “PNP Plus”

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 23, 2004 the Pacific Exchange, Inc. (“PCX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by PCX. On April 23, 2004, the PCX submitted Amendment No. 1 to the proposed rule change.³ On April 28, 2004, the PCX submitted Amendment No. 2 to the proposed rule change.⁴ On May 11, 2004, the PCX submitted Amendment No. 3 to the proposed rule change.⁵ The

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Steven B. Matlin, Senior Attorney, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated April 22, 2004 (“Amendment No. 1”). Amendment No. 1 superseded and replaced the original rule filing in its entirety. In Amendment No. 1, the PCX changed the proposal to make Post No Preference (“PNP”) Plus Order election an order-by-order designation, made conforming and clarifying changes in the rule text, and provided an example of how a PNP Plus Order would be processed.

⁴ See letter from Steven B. Matlin, Senior Attorney, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated April 27, 2004 (“Amendment No. 2”). In Amendment No. 2, the PCX corrected typographical errors and made clarifying changes in the rule text.

⁵ See letter from Steven B. Matlin, Senior Attorney, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated May 10, 2004 (“Amendment No. 3”). In Amendment No. 3, the PCX made a clarifying edit to the rule text.

Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The PCX, through its wholly-owned subsidiary PCX Equities, Inc. (“PCXE”), proposes to amend its rules governing the Archipelago Exchange (“ArcaEx”), the equities trading facility of PCXE, by adding additional processing capability for PNP Orders.

The text of the proposed rule change appears below. Proposed new language is in italics.

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PCX Equities, Inc.

Rule 7

Equities Trading

Orders and Modifiers

Rule 7.31. Orders and Modifiers

(w) PNP Order (Post No Preference). A limit order to buy or sell that is to be executed in whole or in part on the Corporation, and the portion not so executed is to be ranked in the Arca Book, without routing any portion of the order to another market center; provided, however, the Corporation shall cancel a PNP Order that would lock or cross the NBBO. PNP Orders for Trade-Through Exempt Securities (as defined in Rule 7.37) will not be canceled at the time of order entry if such orders would lock or cross the NBBO. PNP Orders in ITS Trade-Through Exempt Securities may be executed at a price no more than three cents (\$0.03) away from the NBBO displayed in the Consolidated Quote. The NBBO price protection provision set forth in Rule 7.37 will not apply to PNP Orders in Nasdaq securities.

(1) PNP Plus. A PNP Order designated as PNP Plus will be automatically re-priced by the Corporation as a penny greater than the national best bid (for sell orders) or a penny lower than the national best offer (for buy orders) for any or all of the order that remains unexecuted and would otherwise lock or cross the NBBO should it be displayed in the Arca Book. The re-priced order will then be posted in the Arca Book. The PNP Plus order will continue to be re-priced at a penny greater than the national best bid (for sell orders) or penny lower than the national best offer (for buy orders) and re-posted in the Arca Book, with each change in the NBBO, until such time as the NBBO has moved to a price where the original price of the PNP Order no longer would result in a locked or crossed market, at which time the PNP Order will revert to the original price of such order. PNP Orders designated as PNP Plus shall be ranked in the Arca Book pursuant to Rule 7.36 and assigned a new price time priority as of the time of each reposting.

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

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

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

1. Purpose

As part of its continuing efforts to enhance participation on ArcaEx, PCX proposes to adopt additional processing capability for PNP Orders⁶ called “PNP Plus.” The Exchange believes that this new functionality would provide ETP Holders and Sponsored Participants with increased opportunities for executing PNP Orders while seeking to prevent locking or crossing the national best bid or offer (“NBBO”).

The Exchange’s current rules governing PNP Orders are set forth in PCXE Rule 7.31. Presently, PCXE Rule 7.31 provides that a PNP Order is a limit order that executes within the ArcaEx Book without routing to another market center. The unexecuted portion of the order is then posted in the Arca Book pursuant to PCXE Rule 7.36. In the case where posting an order in whole or in part would otherwise lock or cross the national best bid or offer, the PNP Order or portion thereof currently is rejected back to the customer.⁷

The Exchange proposes to add additional processing capability that may be selected on an order-by-order basis designated as PNP Plus. Specifically, PNP Plus provides that, when posting a PNP Order or portion thereof would otherwise result in locking or crossing the national market, the PNP Order would automatically be re-priced to be a penny greater than the national best bid (for sell orders) and a penny lower than the national best offer (for buy orders) so as to avoid locking or crossing the national market. The order would then be posted in the Arca Book pursuant to PCXE Rule 7.36 and assigned a new price time priority as of the time of each re-

⁶ See PCXE Rule 7.31(w) for the definition of “PNP Orders.”

⁷ Currently, under PCXE Rule 7.31(w), PNP Orders for Trade-Through Exempt Securities (as defined in PCXE Rule 7.37) are not cancelled if such orders would lock or cross the NBBO.

posting. The order would continue to be re-priced and re-posted, with each change in the NBBO, until such time that the national market moves such that the original price of the PNP Order would no longer lock or cross the NBBO. The PNP Order would then automatically be re-priced back to its original limit price and be re-posted in the Arca Book with a new price time priority. The PNP Plus order would not be re-priced in the instance when the order becomes locked or crossed by another market.

Following is an example of the PNP Plus functionality:

PNP Plus Example

NBBO = 20.00 to 20.03 500C (NSX) x 500T (NASDAQ) + 200P (ArcaEx)

ArcaEx Book = 15.00 to 20.03 600 x 200

Order 1 – PNP Plus Buy 1,000 @ 20.06

200 trades at 20.03 leaving 800 shares of the PNP Plus Order

PNP Plus is quoted as 800 to buy at 20.02.

New NBBO = 20.02 to 20.03 800P (ArcaEx) x 500T (NASDAQ)

NBBO changes to 20.02 to 20.05 800P (ArcaEx) x 200N (NYSE)

Order 1 PNP Plus re-quotes to 20.04 bid (to re-price at \$.01 from the NBBO)

making the NBBO 20.04 to 20.05

Order 2 – Limit Buy 9,000 @ 20.04

NBBO becomes 20.04 to 20.05 9,800P (ArcaEx) x 200N (NYSE)

NBBO changes to 20.07 to 20.10 200N (NYSE) x 200N (NYSE)

Order 1 PNP Plus re-quotes to 20.06 bid (original price)

ArcaEx Book Priority

1. Order 1 – PNP Plus Buy 800 @ 20.06
2. Order 2 – Limit Buy 9,000 @ 20.04

The Exchange believes that the implementation of this order type would facilitate enhanced order interaction and foster price competition. The Exchange also believes that the proposal would promote a more efficient and effective market operation and enhance the investment choices available to investors over a broad range of trading scenarios. Finally, the Exchange believes that the proposed rule change would permit increased execution opportunities of PNP Orders and will prevent locking or crossing the national best bid or offer.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)⁸ of the Act, in general, and furthers the objectives of Section 6(b)(5),⁹ in particular, because it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public interest. In addition, the Exchange believes that the proposed rule change is consistent with provisions of Section 11A(a)(1)(B) of the Act,¹⁰ which states that new data processing and communications techniques create the opportunity for more efficient and effective market operations.

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

¹⁰ 15 U.S.C. 78k-1(a)(1)(B).

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

The Exchange does not believe that the proposed rule change, as amended, will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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-2004-12 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-PCX-2004-12. 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, 450 Fifth Street, NW, Washington, DC 20549. 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-2004-12 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.¹¹

Margaret H. McFarland
Deputy Secretary

¹¹ 17 CFR 200.30-3(a)(12).