

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49773; File No. SR-PCX-2004-46)

May 26, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change, and Amendment No. 1 Thereto, by the Pacific Exchange, Inc. Relating to Modifying the Market Imbalance Calculation

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 May 14, 2004, the Pacific Exchange, Inc. (“PCX” or “Exchange”) submitted to 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 the PCX. On May 24, 2004, the PCX submitted Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The 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, to modify and clarify current ArcaEx practices with respect to the calculation of the Market Imbalance provided for in PCXE Rule 1.1.

The text of the proposed rule change is below. Proposed additions are in italics.

* * * * *

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter from Mai Shiver, Acting Director, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Commission, dated May 21, 2004 (“Amendment No. 1”). In Amendment No. 1, the PCX replaced and superceded the original filing in its entirety.

PCX Equities, Inc.

Rule 1

Definitions

Rule 1.1(a) – (p) – No change.

Imbalance

(q) For the purposes of the Opening Auction, the Market Order Auction, the Closing Auction and the Trading Halt Auction, as the case may be,

(1) the term "Imbalance" shall mean the number of buy or sell shares that cannot be matched with other shares at the Indicative Match Price at any given time.

(A) the term "Total Imbalance" shall mean the net Imbalance of buy (sell) orders at the Indicative Match Price for all orders that are eligible for execution during the applicable auction.

(B) the term "Market Imbalance" shall mean:

(i) as it relates to the Market Order Auction, the imbalance of any remaining buy (sell) Market Orders that are not matched for execution against Market Orders during the applicable auction.

(ii) as it relates to the Closing Auction, the imbalance of any remaining buy (sell) Market-on-Close Orders that are not matched for execution against Market-on-Close Orders during the applicable auction.

* * * * *

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 PCX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it had 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, the Proposed Rule Change

1. Purpose

The Exchange proposes to modify PCXE Rule 1.1 for the purpose of modifying the ArcaEx calculation of the Market Imbalance. Currently, the Market Imbalance, as it relates to the Market Order Auction, is defined as the imbalance of any remaining buy (sell) Market Orders that are not matched for execution during the Market Order Auction.⁴ As such, all eligible Market and Limit Orders that are eligible for execution in the auction against Market Orders are taken into consideration when calculating the Market Imbalance for the Market Order Auction. Similarly, the Market Imbalance for the Closing Auction is defined as the imbalance of any remaining buy (sell) Market-on-Close (“MOC”) Orders that are not matched for execution during the Closing Auction.⁵ As such, all eligible MOC, Limit and Limit-on-Close (“LOC”) Orders that are eligible for execution in the Closing Auction against MOC Orders are taken into consideration when calculating the Market Imbalance for the Closing Auction.

⁴ PCXE Rule 1.1(q).

⁵ Id.

The Exchange proposes to modify the Market Imbalance calculation for both the Market Order Auction and the Closing Auction such that it will only take into consideration Market Orders (for the Market Order Auction) and MOC Orders (for the Closing Auction) in determining the Market Imbalance. For example, the Market Imbalance will be calculated as the imbalance of any buy (sell) Market Orders (for the Market Order Auction) and buy (sell) MOC Orders (for the Closing Auction) that remain after executing against sell (buy) Market Orders (for the Market Order Auction) and executing against sell (buy) MOC Orders (for the Closing Auction). Accordingly, the new Market Imbalance calculation will not take Limit and LOC Orders eligible for execution in the applicable auction into consideration.

The Exchange believes that by modifying the Market Imbalance calculation, it provides better information about the nature of the imbalances in the applicable auction. In particular, currently the Market Imbalance results in zero if there are a sufficient number of Limit Orders or LOC Orders in the auction that are executable against Market Orders or MOC Orders. By limiting the Market Imbalance calculation to exclusively Market Orders and MOC Orders matched for execution, the Exchange would provide Users⁶ with more information about the number of Market Orders and MOC Orders available for execution on the side of the market with an excess number of such orders during the applicable auction.

The following example illustrates the impact of the proposed modification on the calculation of the Market Imbalance as it relates to the Closing Auction:

Current Market Imbalance calculation

Buy 100,000 MOC

Sell 50,000 LOC @ 22.00

⁶ See PCXE Rule 1.1(yy) for the definition of “User.”

Sell Limit Orders in the book = 90,000 @ 23.00

Matched Volume = 100,000

Indicative Match Price = 23.00

Total Imbalance = - 40,000

Market Imbalance = 0

Proposed Market Imbalance calculation

Buy 100,000 MOC

Sell 50,000 LOC @ 22.00

Sell Limit Orders in the book = 90,000 @ 23.00

Matched Volume = 100,000

Indicative Match Price = 23.00

Total Imbalance = - 40,000

Market Imbalance = +100,00

If a User were to enter a Sell 25,000 MOC Order, then

Market Imbalance = +75,000.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,⁷ in general, and furthers the objectives of Section 6(b)(5),⁸ 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 and perfect the mechanisms of a free and open market and to protect investors and the public interest.

⁷ 15 U.S.C. 78f(b).

⁸ 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 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

No written comments were solicited or received with respect to the proposed rule change.

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 PCX consents, the Commission will:

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

IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-PCX-2004-46 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-2004-46. 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 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-2004-46 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.⁹

Margaret H. McFarland
Deputy Secretary

⁹ 17 CFR 200.30-3(a)(12).