SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52898; File No. SR-PCX-2005-87)

December 6, 2005

Self-Regulatory Organizations; The Pacific Exchange, Inc.; Notice of Filing of Proposed
Rule Change, and Amendment No. 1 Thereto, Relating to the Tracking Order Process

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 July 26, 2005, 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 the PCX. On November 22, 2005, the

Exchange 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. With this filing, the Exchange proposes to replace the existing

PCXE rules describing the current ArcaEx Tracking Order Process[4] with new provisions

setting forth a simplified price/time execution priority for the Tracking Order Process.

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[1]   15 U.S.C. 78s(b)(1).

[2]   17 CFR 240.19b-4.

[3]   Amendment No.1, which replaced the original filing in its entirety, made
        technical and clarifying changes to the proposed rule change.

[4]   See PCXE Rule 7.37(c).

Further, the PCX proposes to modify the Tracking Order[5] for use in the revised Tracking

Order Process.

The text of the proposed rule change, as amended, appears below. Proposed new

language is underlined; deletions are [bracketed].

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Rules of PCX Equities, Inc.

Rule 7

Equities Trading

Section 3 Archipelago Exchange

Orders and Modifiers

Rule 7.31(a) – (e) – No Change.

(f) Tracking Order.

An undisplayed, priced round lot order that is eligible for execution in the Tracking Order

Process against orders equal to or less than the aggregate size of Tracking Order interest

available at that price. If a Tracking Order is executed but not exhausted, the remaining

portion of the order shall be cancelled, without routing the order to another market center

or market participant.

[(1) Any User may submit an instruction to the Archipelago Exchange for the parameters

of a Tracking Order at any time during the day. The parameters shall include:]

[(A) the maximum aggregate size, which is the aggregate size of all partial orders

generated in the Tracking Order Process for a particular security that the User is willing

to trade on that day;]

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[5]   See PCXE Rule 7.31(f).

[(B) the maximum tradeable size, which is the maximum size of any partial order generated in response to an order entering the Tracking Order Process that the User is willing to trade on that day;]

[(C) the price in relation to the NBBO; and]

[(D) the relevant security.]

[(2) Once a User has submitted an instruction for the parameters of the Tracking Order, the instruction will remain in effect until closing or until the User has traded its maximum aggregate size for that day, whichever comes first.]

[(3) The Tracking Order Process rotation is as follows: Users who have submitted an instruction for the parameters of a Tracking Order will be assigned trades on a price/time rotating basis, such that within each price level, trades shall be assigned by the time the Users' instructions are received by the Archipelago Exchange. Within each price level, the first User to send an instruction for a Tracking Order will be the first User to be assigned a trade in the rotation process. For each order that enters the Tracking Order Process, the Tracking Order Process will rotate once through the Users in the rotation pattern. In each rotation, the User will be responsible for one trade up to the User's maximum tradeable size.]

[(4) The order described in the User's Tracking Order instruction will only be generated if:]

[(A) an unfilled round or mixed lot order enters the Tracking Order Process and]

[(B) it is such User's turn as determined by the Tracking Order Process rotation pattern.]

[(5) Each partial order generated in a rotation is a limit order in which:]

[(A) the price is set at or better than the NBBO at the time the unfilled order enters the

3

Tracking Order Process, based on the User's parameters; and]

[(B) the size is (i) equal to the User's maximum tradeable size if the unfilled order is equal to or larger than the maximum tradeable size; or (ii) equal to the size of the unfilled order if the unfilled order is smaller than the maximum tradeable size.]

[(6) A User may modify the parameters of the instruction for the Tracking Order from time to time, as the Corporation permits.]

[(7) The Corporation shall suspend the Tracking Order Process for a security when a locked or crossed market exists in that security. The Tracking Order Process for that security shall resume when the locked or crossed market in that security no longer exists.]

[(8) Whenever in the judgment of the Corporation, because of an influx of orders, a system malfunction or other unusual conditions or circumstances, the interests of a fair and orderly market so require, the Corporation may suspend the Tracking Order Process. The Tracking Order Process shall resume when the Corporation determines that the conditions supporting the suspension no longer exist.]

(g) Odd Lot Tracking Order.

(1) – No Change.

(2) An Odd Lot Dealer may submit an instruction to the Archipelago Exchange for the parameters of an OLTO at any time during the day. The parameters shall include: [is a Tracking Order, as described in paragraph (f), in which:]

      (A) the maximum aggregate size [is unlimited;], which is the unlimited aggregate size of all orders generated in the Odd Lot Tracking Order Process for a particular security that the Odd Lot Dealer is willing to trade on that day;

(B) the maximum tradeable size [is] up to 99 shares, which is the maximum size of any order generated in response to an order entering the Odd Lot Tracking Order Process that the Odd Lot Dealer is willing to trade on that day;

(C) the price is set at the NBBO; and

(D) the relevant security [is one] in which the Odd Lot Dealer is registered as such; and

(E) the instruction must be in effect for the duration of Core Trading Hours; provided, however, the order described in the OLTO instruction will only be generated if

(1) an unfilled odd lot market order enters the Odd Lot Tracking Order Process pursuant to Rule 7.37(c); or

(2) an odd lot limit order causes a locked market as described in Rule 7.56.

(3) Each order generated in a rotation is a limit order in which:

(A) the price is set at the NBBO at the time the unfilled order enters the Odd Lot Tracking Order Process, based on the Odd Lot Dealer's parameters; and

(B) the size is (i) equal to the Odd Lot Dealer's maximum tradeable size; or (ii) equal to the size of the unfilled order if the unfilled order is smaller than the maximum tradeable size.

(4) An Odd Lot Dealer may modify the parameters of the instruction for the Odd Lot Tracking Order from time to time, as the Corporation permits.

(5) The Corporation shall suspend the Odd Lot Tracking Order Process for a security when a locked or crossed market exists in that security. The Odd Lot Tracking Order

Process for that security shall resume when the locked or crossed market in that security no longer exists.

(6) Whenever in the judgment of the Corporation, because of an influx of orders, a system malfunction or other unusual conditions or circumstances, the interests of a fair and orderly market so require, the Corporation may suspend the Odd Lot Tracking Order Process. The Odd Lot Tracking Order Process shall resume when the Corporation determines that the conditions supporting the suspension no longer exist.

(h) – (hh) – No Change.

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Order Execution

Rule 7.37

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(a) – (b) – No Change.

(c) Step 4: Tracking Order Process. During Core Trading Hours only, orders may be matched and executed in the Tracking Order Process as follows: If an order has not been executed in its entirety pursuant to paragraphs (a) and (b) of this Rule, the Archipelago Exchange shall match and execute any remaining part of the order in the Tracking Order Process in price/time priority [the following manner]; provided, however, any portion of an order received from another market center or market participant shall be cancelled immediately[:].

[(1) If the unfilled order is a mixed lot or round lot order, the order shall be matched against any Tracking Orders pursuant to the rotation pattern described in Rule 7.31(f)(3) for immediate execution thereafter. After the order has been matched against any

6

Tracking Orders, if the order has not been executed in its entirety and the remaining part of the order is an odd lot, the odd lot order shall be executed in the Odd Lot Tracking Order Process, as described in paragraph (2).]

Odd Lot Tracking Order Process.

[(2)](1) If the unfilled order is an odd lot, and there is an Odd Lot Dealer registered in that security, the order shall be matched in the Odd Lot Tracking Order Process against any OLTOs pursuant to the following rotation pattern:

Odd Lot Dealers who have submitted an instruction for the parameters of an Odd Lot Tracking Order will be assigned trades on a price/time rotating basis, such that within each price level, trades shall be assigned by the time the Odd Lot Dealers' instructions are received by the Archipelago Exchange. Within each price level, the first Odd Lot Dealer to send an instruction for an Odd Lot Tracking Order will be the first Odd Lot Dealer to be assigned a trade in the rotation process. For each order that enters the Odd Lot Tracking Order Process, the Odd Lot Tracking Order Process will rotate once through the Odd Lot Dealers in the rotation pattern. In each rotation, the Odd Lot Dealer will be responsible for one trade up to the Odd Lot Dealer's maximum tradeable size. [described in Rule 7.31(f)(3) for immediate execution thereafter.]

(2) If there is no Odd Lot Dealer registered in that security, the odd lot will be routed away pursuant to PCXE Rule 7.37(d).

(d) – 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, the 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 Exchange 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

To enhance participation on the ArcaEx facility, the Exchange proposes to restructure its Tracking Order Process by modifying the current rule text governing the Tracking Order Process to implement a simplified price/time priority execution process. In addition, the Exchange proposes to modify the existing Tracking Order for use in the revised and simplified Tracking Order Process.

Current ArcaEx Tracking Order Process

Current PCXE Rules 7.31(f) and 7.37(c) describe the Tracking Order Process. The purpose of the Tracking Order Process is to provide a final opportunity for execution against any remaining liquidity on the ArcaEx system before routing to an away market center. As currently written, Users[6] of the Tracking Order Process submit a Tracking Order instruction to ArcaEx based on certain parameters. ArcaEx generates orders based on these User instructions. Executions occur in a rotating manner pursuant to PCXE Rule 7.37(c). In general, the first User to send an instruction for a Tracking Order for

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[6]   See PCXE Rule 1.1(yy).

each price level is the first User to be assigned a trade in the rotation process. With each rotation, a User who has entered a Tracking Order is responsible for one trade up to the User's maximum tradable size.

Proposed Changes to the Tracking Order Process

As proposed, the rule change would modify the current Tracking Order Process described above and replace it with a new process based on the submission of orders, rather than instructions, to be executed in price/time priority. Users would no longer be required to submit and maintain Tracking Order instructions to participate in the Tracking Order Process. Instead, Users would simply submit a Tracking Order (as described below) designed specifically to reside in the modified Tracking Order Process. ArcaEx would continue to process all orders residing in the modified Tracking Order Process after it processes orders entered into the other ArcaEx execution processes.[7] Within the Tracking Order Process, the modified Tracking Order would execute based on its price and time received as opposed to the price and time the instruction was received.

This filing also proposes changes to the existing Odd Lot Tracking Order Process.[8] The Odd Lot Tracking Order Process that is currently available for incoming odd lot orders would continue to exist and would be distinct from the Tracking Order Process which would be available for incoming mixed lot and round lot orders. Accordingly, the existing Tracking Order Process and associated assignment of trades on a price/time rotating basis would continue to apply to the Odd Lot Tracking Order Process. The rule text that previously resided in PCXE Rule 7.31(f)(3) would be inserted

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[7]   See PCXE Rule 7.37 for a description of the ArcaEx execution processes that precede the Tracking Order Process. These include the Directed Process, Display Process and Working Order Process.

[8]   See PCXE Rule 7.37(c).

into PCXE Rule 7.37(c)(1) to describe the Odd Lot Tracking Order Process and revised to clarify that only Odd Lot Dealers[9] may be assigned trades under the Odd Lot Tracking Order Process.[10] Also, under the proposal, orders would only participate in the Odd Lot Tracking Order Process if there is an Odd Lot Dealer registered in that security. If no such dealer exists, the odd lot order would be routed away pursuant to PCXE Rule 7.37(d). Further, the proposal includes clarifying changes that the Odd Lot Tracking Order Process does not generate partial fills.

The Tracking Order

The rule proposal modifies an existing order type, the Tracking Order, for use in the revised Tracking Order Process. Currently, a User submits a Tracking Order instruction that includes specific parameters that must be entered including maximum aggregate size and maximum tradeable size. The revised Tracking Order is an undisplayed, priced order with a specified size that would be eligible for execution against other ArcaEx orders that have already been exposed to other ArcaEx execution processes and have not been executed in full. The Tracking Order would execute in the revised Tracking Order Process against an incoming order only if the size of the incoming order is less than or equal to the aggregate Tracking Order interest available at the price of the incoming order and the incoming order is not an odd lot order. If the size of any contra order exposed to the revised Tracking Order Process is greater than the size of the aggregate Tracking Order interest residing in the Tracking Order Process at the

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[9]   See PCXE Rule 1.1(gg).

[10]   Similarly, the rule text that describes the generation of Tracking Orders in PCXE Rule 7.31(f) and that also applies to Odd Lot Tracking Orders would be inserted in PCXE Rule 7.31(g). PCXE Rule 7.31(g) would also be further modified, as necessary, to accommodate such insertion.

executable price, such Tracking Orders would not execute against the contra order. For example, if a Tracking Order was entered for 300 shares and a contra order with a size of 301 shares was exposed to the Tracking Order Process (after being exposed to all other ArcaEx execution processes), the contra order would not execute against the Tracking Order and would route out of ArcaEx.

Tracking Orders would execute only if the price of the Tracking Order is equal to or better than prices found at away markets (and would therefore execute at the price of the NBBO at the time of execution or better).[11] If a Tracking Order is executed but not exhausted, the remaining portion of the Tracking Order shall be cancelled, without routing to another market center or market participant. Tracking Orders residing in the Tracking Order Process would be sorted and executed against in price/time priority. Tracking Orders may only be entered as round lots and are not displayed to any Users. However, mixed lot contra orders exposed to a Tracking Order would be eligible for execution against such Tracking Order (assuming the size of the contra order is equal to or less than the size of the Tracking Order).[12] An odd lot contra order would be exposed to an Odd Lot Tracking Order and eligible for execution against such Odd Lot Tracking Order as described above. In the circumstance when a Tracking Order receives a partial fill, the unexecuted portion of the Tracking Order would be cancelled. Because Tracking Orders may be cancelled and are only executed against once, the current provision in

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[11]   See PCXE Rule 7.37 which states that "for an execution to occur in any Order Process, the price must be equal to or better than the NBBO."

[12]   PCX clarified that a contra order would be eligible for execution against such Tracking Order if the size of the contra order is equal to or less than the size of the Tracking Order. Telephone conversation between Bridget M. Farrell, Director, Strategy PCX/ArcaEx and Johnna B. Dumler, Attorney, Division of Market Regulation, Commission, on December 1, 2005.

PCXE Rule 7.31(f)(8) that enables ArcaEx to suspend the Tracking Order Process because of an influx of orders, a system malfunction, or other unusual circumstances is no longer relevant and would be removed. In addition, the current provision in PCXE Rule 7.31(f)(7) is no longer relevant because the new Tracking Order Process would be integrated into existing order book processing, which is not suspended in the instance of a locked or crossed market. Accordingly, PCXE Rule 7.31(f)(7) would not be incorporated into the modified Tracking Order Process. Tracking Orders would not route to other market centers, would not be eligible for execution against other Tracking Orders, and would not execute against incoming ITS orders.

The Exchange believes that the implementation of the aforementioned rule changes relating to ArcaEx order processing would enhance order execution opportunities on ArcaEx. In particular, the Exchange believes the revisions to the Tracking Order Process and Tracking Order would simplify the Tracking Order Process and encourage order interaction on ArcaEx.

2.   Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act,[13] in general, and furthers the objectives of Section 6(b)(5) of the Act[14] in particular because 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 transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

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[13]   15 U.S.C. 78f(b).

[14]   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

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 (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 Exchange 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 at

    (http://www.sec.gov/rules/sro.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-PCX-2005-87 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 20549-9303.

All submissions should refer to File Number SR-PCX-2005-87. 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-2005-87 and should be submitted

on or before [insert date 21 days from the date of publication in the <u>Federal</u> <u>Register</u>].

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

authority.[15]

Jonathan G. Katz
Secretary

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[15]   17 CFR 200.30-3(a)(12).