

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50830; File No. SR-PCX-2004-58)

December 9, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc. Relating to the Exchange's Rules Under the Minor Rule Plan and Recommended Fine Schedule

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 December 2, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange"), through its wholly owned subsidiary PCX Equities, Inc. ("PCXE"), filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II and III 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.

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

The Exchange is proposing to amend the PCX Minor Rule Plan ("MRP") and Recommended Fine Schedule ("RFS"). The text of the proposed rule change is below.

Proposed new language is in *italics*; proposed deletions are in brackets.<sup>3</sup>

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**Rules of the Pacific Exchange, Inc.**

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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> PCX noted that there was a typographical error appearing in the proposed rule change. Note 1 should tie to PCX Rule 10.12(i) instead of Rule 10.12(k). PCX agrees to correct this error in an amendment to the rule filing to be filed prior to the expiration of the public comment period. Telephone conversation between Tania J.C. Blanford, Staff Attorney, PCX, and Jennifer C. Dodd, Attorney, Division of Market Regulation, Commission, on December 9, 2004.

**Rule 10****Disciplinary Proceedings and Appeals**

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**Minor Rule Plan**

Rule 10.12(a) – (g) – No change.

(h) Minor Rule Plan: Options Floor Decorum and Minor Trading Rule Violations

(1) – (44) – No change.

(45) Failure to maintain adequate procedures and controls to monitor and supervise the entry of electronic orders by Users to prevent the prohibited practices set forth in Rules 6.87(d) and 6.90(e). (Rules 6.87(c)(4) and 6.90(d)(3)).

(i) No change.

(j) No change.

Rule 10.12 (k) Minor Rule Plan: Recommended Fine Schedule<sup>1</sup>

(i) Options Floor Decorum and Minor Trading Rule Violations

1. – 44. – No change.

45. Failure to maintain adequate procedures and controls to monitor and supervise the entry of electronic orders by Users to prevent the prohibited practices set forth in Rules 6.87(d) and 6.90(e). (Rules 6.87(c)(4) and 6.90(d)(3)).

1<sup>st</sup> Violation

2<sup>nd</sup> Violation

3<sup>rd</sup> Violation

\$1,000.00

Full Disciplinary

Full Disciplinary

Proceeding

Proceeding

1 Fines for multiple violations of Options Floor Decorum and Minor Trading Rules are calculated on a running two-year basis.

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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 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

The Exchange proposes to amend PCX's MRP and RFS to add provisions for violations by an Order Entry Firm<sup>4</sup> of PCX Rules 6.87(c)(4) and 6.90(d)(3), which require Order Entry Firms to maintain adequate procedures and controls to monitor and supervise the entry of electronic orders.<sup>5</sup> Currently, the MRP sets forth penalties and sanctions for improperly dividing up an order to make its parts eligible for execution on Auto-Ex or PCX Plus.<sup>6</sup> The Exchange believes that the proposed amendments to its MRP and RFS are appropriate to include as part of

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<sup>4</sup> See PCX Rule 6.87(a)(3).

<sup>5</sup> PCX Rule 6.87(c)(4) requires Order Entry Firms to maintain adequate procedures and controls that will permit the Order Entry Firm to effectively monitor and supervise the entry of electronic orders by all Users. Order Entry Firms must monitor and supervise the entry of orders by Users to prevent prohibited practices set forth in PCX Rule 6.87(d). PCX Rule 6.90(d)(3) sets forth the equivalent requirement for Order Entry Firms with respect to PCX Plus.

<sup>6</sup> See PCX Rules 10.12(h)(33) and 10.12(i)(33).

the MRP and RFS since failure to monitor Users<sup>7</sup> regarding the entry of electronic orders corresponds to the violation of improperly dividing up an order to make its parts eligible for execution on Auto-Ex or PCX Plus.

The Exchange proposes a fine of \$1,000 for the first violation for failure to maintain adequate procedures and controls to monitor and supervise the entry of electronic orders pursuant to PCX Rules 6.87(c)(4) and 6.90(d)(3). In lieu of proposing fines for a second and third violation, the Exchange proposes to treat subsequent violations as a formal disciplinary matter. A formal disciplinary proceeding would be appropriate to the extent that it addresses an Order Entry Firm's repeated failure to maintain proper procedures given that the Order Entry Firm has already been charged with an MRP violation. Thus, the Exchange believes that an Order Entry Firm's repeated failure to have proper procedures in place, which are essential for the monitoring and supervising of the entry of electronic orders, warrants a formal disciplinary proceeding.

The Exchange believes that the proposed rule change will strengthen the ability of the Exchange to carry out its oversight responsibilities as a self-regulatory organization ("SRO"). The proposed rule change should also aid the Exchange in carrying out its surveillance and enforcement functions. The Exchange does not minimize the importance of compliance with these rules, and all other rules subject to the imposition of fines under the Exchange's MRP. The Exchange relies on its MRP as a tool to address enumerated violations to provide the Exchange with greater flexibility to address violations that may not require formal disciplinary proceedings. Under the proposed rules, the Enforcement Department would continue to exercise

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<sup>7</sup> See PCX Rule 6.87(a)(2).

its discretion under Rule 10.12(f) and pursue certain cases as a formal disciplinary matter, and not within the MRP process, to the extent that the facts or circumstances warrant such action.

## 2. Basis

The Exchange believes that the proposal is consistent with Section 6(b) of the Act,<sup>8</sup> in general, and Section 6(b)(5) of the Act,<sup>9</sup> in particular, in that it will promote just and equitable principles of trade; facilitate transactions in securities, remove impediments to and perfect the mechanisms of a free and open market and a national market system; and protect investors and the public interest. The proposal is also consistent with Sections 6(b)(6)<sup>10</sup> and 6(b)(7),<sup>11</sup> which require that members and persons associated with members are appropriately disciplined for violations of Exchange rules and are provided a fair procedure for disciplinary procedures.

### 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.

### 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

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

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

<sup>10</sup> 15 U.S.C. 78f(b)(6).

<sup>11</sup> 15 U.S.C. 78f(b)(7).

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 email to [rules-comments@sec.gov](mailto:rules-comments@sec.gov). Please include Filed No. SR-PCX-2004-58 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Jonathon G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609.

All submissions should refer to File No. SR-PCX-2004-58. 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, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also 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 No. SR-PCX-2004-58 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>12</sup>

J. Lynn Taylor  
Assistant Secretary

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