

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51280; File No. SR-PCX-2004-72)

March 1, 2005

Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing of a Proposed Rule Change and Amendments No. 1 and 2 thereto Relating to Clearly Erroneous Executions on the Archipelago Exchange

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 28, 2004, the Pacific Exchange, Inc. (“PCX” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. PCX filed Amendment No. 1 to the proposed rule change on December 29, 2004,³ and filed Amendment No. 2 to the proposed rule change on February 15, 2005.⁴ The Commission is publishing this notice to solicit comment 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

PCX, through its wholly owned subsidiary PCX Equities, Inc. (“PCXE”), proposes to amend its rules governing clearly erroneous executions (“CEE”) on the Archipelago Exchange (“ArcaEx”), the equities trading facility of PCXE. Specifically, the Exchange proposes to combine the provisions of PCXE Rules 7.10 (Cancellation of Revisions in Transactions) and PCXE Rule 7.11 (Clearly Erroneous Policy) into one resulting rule, PCXE Rule 7.10, “Clearly

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Amendment No. 1, submitted by Tania Blanford, Staff Attorney, PCX (“Amendment No. 1”). Amendment No. 1 replaces the original filing in its entirety.

⁴ See Amendment No. 2, submitted by James Draddy, Vice President, Equities Regulation, PCX (“Amendment No. 2”). Amendment No. 2 replaces the original filing and Amendment No 1 in their entirety.

Erroneous Executions.” The Exchange also proposes to amend the procedures that an ETP Holder would be required to follow when seeking relief for clearly erroneous executions. Finally, the Exchange has revised its guideline listing factors it may consider in making its determinations regarding CEE. A copy of the revised guideline is available at the Exchange’s Web site (http://www.pacificex.com/legal/legal_home.html).

The text of the proposed rule change is set forth below. Additions are in italics. Deletions are in [brackets].

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Rule 7: Equities Trading

Rule 7.10. Clearly Erroneous Executions [Cancellation of Revisions in Transactions]

(a) Definition. For purposes of this Rule, the terms of a transaction executed on the Corporation are “clearly erroneous” when there is an obvious error in any term, such as price, number of shares or other unit of trading, or identification of the security. A transaction [sale] made in clearly erroneous [demonstrable] error and cancelled by both parties may be removed, if the parties do not object, subject to the approval of the Corporation. [Disagreements with respect thereto shall be referred to the appropriate trading authority of the Corporation. A dispute arising on bids, offers or sales, if not settled by agreement between the parties interested, shall be settled by the Corporation.]

(b) Request for Corporation Review. An ETP Holder that receives an execution on an order that was submitted erroneously to the Corporation for its own or customer account may request that the Corporation review the transaction under this Rule. Such request for review shall be made via telephone, facsimile or e-mail and submitted within fifteen (15) minutes of the trade in question. Upon receipt, the counterparty to the trade, if any, shall be notified by the Corporation as soon as practicable. Thereafter, an Officer of the Corporation or such other designee of the

Corporation (“Officer”) shall review the transaction under dispute and determine whether it is clearly erroneous, with a view toward maintaining a fair and orderly market and the protection of investors and the public interest. Each party to the transaction shall provide, within 30 minutes of the request for review, any supporting written information as may be reasonably requested by Officer to aid resolution of the matter. Either party to the disputed trade may request the supporting written information provided by the other party on the matter.

(c) Review Procedures.

(1) Unless both parties (or party, in the case of a cross) to the disputed transaction agree to withdraw the initial request for review, the transaction under dispute shall be reviewed, and a determination shall be rendered by the Officer. If the Officer determines that the transaction is not clearly erroneous, the Officer shall decline to take any action in connection with the completed trade. In the event that the Officer determines that the transaction in dispute is clearly erroneous, the Officer shall declare the transaction null and void or modify one or more of the terms of the transaction to achieve an equitable rectification of the error that would place the parties in the same position, or as close as possible to the same position that they would have been in, had the error not occurred. The parties shall be promptly notified of the determination.

(2) If a party affected by a determination made under this Rule so requests within the time permitted below, the Clearly Erroneous Execution Panel (“CEE Panel”) will review decisions made by the Officer under this Rule, including whether a clearly erroneous execution occurred and whether the correct adjustment was made.

(A) The CEE Panel will be comprised of the PCXE Chief Regulatory Officer (“CRO”), or a designee of the CRO, and representatives from two (2) ETP Holders.

(B) The Exchange shall designate at least ten (10) ETP Holder representatives to be called upon to serve on the CEE Panel as needed. In no case shall a CEE Panel

include a person related to a party to the trade in question. To the extent reasonably possible, the Exchange shall call upon the designated representatives to participate on a CEE Panel on an equally frequent basis.

(3) A request for review on appeal must be made via facsimile or e-mail within thirty (30) minutes after the party making the appeal is given notification of the initial determination being appealed. The CEE Panel shall review the facts and render a decision within the time frame prescribed by the Corporation.

(4) The CEE Panel may overturn or modify an action taken by the Officer under this Rule. All determinations by the CEE Panel shall constitute final action by the Corporation on the matter at issue.

(d) System Disruption and Malfunctions. In the event of any disruption or a malfunction in the use or operation of any electronic communications and trading facilities of the Corporation, or extraordinary market conditions or other circumstances in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest exist, the Officer, on his or her own motion, may review such transactions and declare such transactions arising out of the use or operation of such facilities during such period null and void or modify the terms of these transactions. Absent extraordinary circumstances, any such action of the Officer pursuant to this subsection (d) shall be taken within thirty (30) minutes of detection of the erroneous transaction. Each ETP Holder involved in the transaction shall be notified as soon as practicable, and the ETP Holder aggrieved by the action may appeal such action in accordance with the provisions of subsection (c)(2)-(4).

(e) Trade Nullification and Price Adjustments for UTP Securities that are Subject of Initial Public Offerings (“IPOs”). Pursuant to SEC Rule 12f-2, as amended, the Corporation may extend unlisted trading privileges to a security that is the subject of an initial public offering

when at least one transaction in the subject security has been effected on the national securities exchange or association upon which the security is listed and the transaction has been reported pursuant to an effective transaction reporting plan. A clearly erroneous error will be deemed to have occurred in the opening transaction of the subject security if the execution price of the opening transaction on the Corporation is the lesser of \$1.00 or 10% away from the opening price on the listing exchange or association. In such circumstances, the Officer shall declare the opening transaction null and void or adjust the transaction price to the opening price on the listing exchange or association. Clearly erroneous executions of subsequent transactions of the subject security will be reviewed in the same manner as the procedure set forth in (c)(1). Absent extraordinary circumstances, any such action of the Officer pursuant to this subsection (e) shall be taken in a timely fashion, generally within thirty (30) minutes of the detection of the erroneous transaction. Each party involved in the transaction shall be notified as soon as practicable by the Corporation, and the party aggrieved by the action may appeal such action to the PCXE CRO in accordance with the provisions of subsection (c)(2)-(4) above.

Rule 7.11. Reserved [Clearly Erroneous Policy]

[(a) Definition. For the purposes of this Rule, the terms of a transaction executed on the Corporation are “clearly erroneous” when there is an obvious error in any term, such as price, number of shares or other unit of trading, or identification of the security.

(b) Request for Corporation Review. An ETP Holder that receives an execution on an order that was submitted erroneously to the Corporation for its own or customer account may request that the Corporation review the transaction under this Rule. Such request for review shall be made via telephone and in writing via facsimile or e-mail. The telephonic request should be submitted immediately and the written request should be submitted within fifteen (15) minutes of

the time the trade in question was executed. Once the request has been received, an officer of the Corporation designated by the President shall review the transaction under dispute and determine whether it is clearly erroneous, with a view toward maintaining a fair and orderly market and the protection of investors and the public interest. Each party to the transaction shall provide, on a timely basis, any supporting written information as may be reasonably requested by the designated officer to aid resolution of the matter.

(c) Review Procedures. Unless both parties (or party, in the case of a cross) to the disputed transaction agree to withdraw the initial written request for review, the transaction under dispute shall be reviewed, and a determination shall be rendered by the designated Corporation officer. If the officer determines that the transaction is not clearly erroneous, the officer shall decline to take any action in connection with the completed trade. In the event that the officer determines that the transaction in dispute is clearly erroneous, the officer shall declare the transaction null and void or modify one or more of the terms of the transaction to achieve an equitable rectification of the error that would place the parties in the same position, or as close as possible to the same position that they would have been in, had the error not occurred. The officer shall promptly notify the parties of the determination reached and shall issue a written resolution of the matter. The ETP Holder aggrieved by the officer's determination may appeal such determination in accordance with the provisions of Rule 10.13.

(d) System Disruption and Malfunctions. In the event of any disruption or a malfunction in the use or operation of any electronic communications and trading facilities of the Corporation, the Chief Executive Officer, President, or such other officer designated by the Corporation may declare a transaction arising out of the use or operation of such facilities during the period of such disruption or malfunction null and void or modify the terms of these transactions. Absent extraordinary circumstances, any such action of the Chief Executive Officer, President or

designated Corporation officer pursuant to this subsection (d) shall be taken within thirty (30) minutes of detection of the erroneous transaction. Each ETP Holder involved in the transaction shall be notified as soon as practicable, and the ETP Holder aggrieved by the action may appeal such action in accordance with the provisions of Rule 10.13.]

Rule 10: Disciplinary Proceedings, Other Hearings, and Appeals

Rule 10.13. Hearings and Review of Decisions by the Corporation

(a) No change.

(1) – (4) No change.

[(5) actions taken by the Corporation pursuant to Rule 7.11;]

(5) [(6)] Renumbered.

(6) [(7)] Renumbered.

(7) [(8)] Renumbered.

(b) – (m) No change.

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, as amended, and discussed any comments it received on the proposed rule change, as amended. 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

The Exchange currently maintains two rules regarding clearly erroneous executions: PCXE Rule 7.10 (Cancellation of Revisions in Transactions) and PCXE Rule 7.11 (Clearly Erroneous Policy). The Exchange now proposes to revise its rules in order to: (i) combine the rules for CEE into one rule, PCXE Rule 7.10, entitled “Clearly Erroneous Executions,” and (ii) amend the procedures that an ETP Holder would be required to follow when seeking relief for clearly erroneous executions.

The Exchange currently utilizes the provision set forth in PCXE Rule 7.10 in conjunction with a guideline, which describes the internal procedures used to implement PCXE Rule 7.10, as well as the prices at which transactions generally may be considered erroneous.⁵ PCXE Rule 7.11 generally provides policies that the Exchange refers to when responding to a claim that an execution resulted in an obvious error. The Exchange believes that these distinct rules and guidelines lack clarity and may result in inconsistent outcomes. Therefore, the Exchange believes that combining the pertinent elements of PCXE Rule 7.10 (and the related guideline) and PCXE Rule 7.11 is necessary to eliminate ongoing confusion regarding the Exchange’s policy. The Exchange has also revised its guideline to streamline it to a list of factors that the Exchange may consider when making its determination regarding CEEs.

The Exchange also proposes the following revisions to its rules regarding CEEs.

⁵ The current guideline is readily available on the ArcaEx Web site at <http://www.tradearca.com/traders/erroneous.asp>. The Exchange notifies the ETP Holders of any changes to the guideline via the Weekly Bulletin that is distributed to all ETP Holders and also by posting such changes on the ArcaEx Web site.

Proposed PCXE Rule 7.10(a) – the Exchange proposes to move the Definition provision from current PCXE Rule 7.11(a) to proposed new PCXE Rule 7.10(a) without substantive changes. The Exchange also proposes to delete the last two sentences of current PCXE Rule 7.10 as they are superfluous.

Proposed PCXE Rule 7.10(b) – the Exchange proposes to move the Request for Corporation Review provision from current PCXE Rule 7.11(b) to proposed new PCXE Rule 7.10(b) with four minor changes: (i) ETP Holders will be permitted to request the review by telephone, facsimile or email within 15 minutes of the trade in question instead of being required to follow up a telephone request with a facsimile or e-mail; (2) the Exchange proposes to include a provision allowing the Officer of the Corporation who ordinarily reviews such requests to appoint a designee to review the requests in certain circumstances;⁶ (iii) the Exchange proposes to change the time frame in which additional supporting information is submitted from “on a timely basis” to “within 30 minutes” as the Exchange believes it is appropriate to set forth an unambiguous timeline for such submissions; and (iv) the Exchange proposes to include a provision that would allow either party to request the written information provided by the other party on the disputed matter.

Proposed PCXE Rule 7.10(c)(1) – the Exchange proposes to move current PCXE Rule 7.11(c) to proposed new PCXE Rule 7.10(c)(1). The change to this rule is primarily stylistic with the exception of the appeals procedure, which will be deleted from this subsection and moved to proposed new PCXE Rule 7.10(c)(2)-(4).

⁶ Examples of such circumstances would include the Officer’s absence due to illness, vacation time or such other similar circumstances. The Exchange represents that the designee of the Officer will be an employee of the Corporation with similar stature as the Officer, such as a Vice President of Market Management.

Proposed PCXE Rule 7.10(c)(2)-(4) – The Exchange also proposes new PCXE Rule 7.10(c)(2)-(4) to implement a revised appeal process for determinations on clearly erroneous executions. Proposed new PCXE Rule 7.10(c)(2)-(4) allows a party affected by the determination to request an appeal to the Clearly Erroneous Execution Panel (“CEE Panel”) to review the determination made by the Officer under PCXE Rule 7.10(c)(1). The CEE Panel will be comprised of the PCXE Chief Regulatory Officer (“CRO”), or a designee of the CRO,⁷ and representatives from two (2) ETP Holders.⁸ Requests for appeal must be made via facsimile or e-mail within thirty (30) minutes after the party requesting the appeal is given notification of the initial determination. Thereafter, the CEE Panel shall review the information and may overturn or modify the action taken by the Officer within the time frame prescribed by the Corporation. Such determination by the CEE Panel will be considered a final action by the Corporation on the matter at issue. All final determinations made by the CEE Panel shall be rendered without prejudice as to the rights of the parties to the transaction to submit their dispute to arbitration. The revised process is intended to provide a timely appeal for ETP Holders in place of the lengthy general appeal process provided in PCXE Rule 10.13.

Proposed PCXE Rule 7.10(d) – the Exchange proposes to move current PCXE Rule 7.11(d) that governs the procedures for system disruption and malfunctions to proposed new

⁷ The Exchange represents that the designee of the CRO will be an employee of the Corporation with similar stature as the CRO, such as the VP of Equities Regulation. The Exchange notes that the International Securities Exchange designates an Obvious Error Panel to independently make appeals decisions and also to overturn or modify actions taken by the exchange. See ISE Rule 720.

⁸ The Exchange shall designate at least ten (10) ETP Holder representatives to be called upon to serve on the CEE Panel. In no case shall the CEE Panel include a person related to a party to the trade in question. To the extent reasonably possible, the Exchange shall call upon the designated representatives to participate on a CEE Panel on an equally frequent basis.

PCXE Rule 7.10(d). In addition, the Exchange proposes to include “extraordinary market conditions or other circumstances in which the nullification or modification of transactions may be necessary” as another condition in which an Officer may act, on its own motion, to review erroneous transactions. The Exchange believes that errors due to extraordinary market conditions warrant a review irrespective of a complaint by an ETP Holder. Such reviews are considered normal industry standard.⁹

Proposed PCXE Rule 7.10(e) – the Exchange proposes new PCXE Rule 7.10(e) in order to codify the PCXE’s current guideline with respect to trade nullification and price adjustments for securities that are the subject of initial public offerings (“IPOs”). The Exchange believes that a separate provision is appropriate because the Exchange’s intent is to always adjust the price of an opening trade on ArcaEx if it is away from the price the issue opens on the listing market. Thus, if the price of the trade is either \$1.00 or 10% away from the opening price on the listing market, the trade would be automatically adjusted to the opening price. In such circumstances, the Officer shall declare the opening transaction null or adjust the transaction price to the opening price on the listed exchange or association. Clearly erroneous executions of subsequent trades in the subject security will be reviewed in the same manner as those subject to the general guidelines. Consistent with the PCXE’s general clearly erroneous executions rule set forth in proposed new PCXE Rule 7.10, this provision also provides an immediate appeal process for determinations.

Miscellaneous – the Exchange proposes to delete paragraph (a)(5) from current PCXE Rule 10.13, which governs the hearings and review of decisions by the Corporation. Paragraph (a)(5) states that the provisions of PCXE Rule 10.13 apply to actions taken by the Corporation

⁹ See, e.g., NASD Rule 11890(b).

pursuant to current PCXE Rule 7.11. This provision would be superceded by the immediate appeal process for ETP Holders in proposed new PCXE Rule 7.10(c)(2)-(4).

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)¹⁰ of the Act, in general, and furthers the objectives of Section 6(b)(5),¹¹ in particular, because it is designed to promote just and equitable principals 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.

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 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, or

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(5).

- (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 they are 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-2004-72 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-2004-72. 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

Exchange. 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-2004-72 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.¹²

Margaret H. McFarland
Deputy Secretary

¹² 17 CFR 200.30-3(a)(12).