



RULE
ADOPTION
NOTICE

RAN-05-36
May 13, 2005

**TO: All OTP Holders and OTP Firms
ETP Holders and Sponsored Participants**

FROM: Department of Regulatory Policy

**SUBJECT: PCXE Clearly Erroneous Executions
(File No. SR-PCX-2004-72)**

On July 28, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission a proposed rule change to amend its rules governing clearly erroneous executions ("CEE") on the Archipelago Exchange ("ArcaEx"), the equities trading facility of PCXE. Specifically, the Exchange proposed 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 entitled "Clearly Erroneous Executions." The Exchange also proposed to amend the procedures that an ETP Holder would be required to follow when seeking relief for clearly erroneous executions. The Exchange filed Amendment Nos. 1 and 2 to the proposed rule change on December 29, 2004 and February 15, 2005, respectively. The Commission published the proposed rule change for notice and comment in the *Federal Register* on March 8, 2005. No comments were received. The Exchange Filed Amendment No. 3 to the proposed rule change on April 21, 2005. The Commission approved the proposed rule change on May 9, 2005 and published it in the *Federal Register* on May 13, 2005. The effective date of the proposed rule is May 16, 2005.

The following is the text of the rule change. Questions regarding this bulletin may be directed to Tania J.C. Blanford at (415) 393-4107 or Jim Draddy at (312) 442-7930.

EXHIBIT 5

Text of the Proposed Rule Change:¹

PCX Equities, Inc.

**Rule 7
Equities Trading**

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¹ New text is underscored; deleted text is in brackets.

Clearly Erroneous Executions
[Cancellation of Revisions in Transactions]

Rule 7.10(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.

[Clearly Erroneous Policy]

Rule 7.11[(a)]. Reserved. [*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.]

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Rule 10

Disciplinary Proceedings, Other Hearings, and Appeals

Hearings and Review of Decisions by the Corporation

Rule 10.13(a) – No change.

(1) – (4) – No change.

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

(5)[(6)] actions taken by the Corporation pursuant to Rule 7.22, including the denial of the application for, or the termination or suspension of, a Market Maker's registration in a security or securities;

(6)[(7)] actions taken by the Corporation pursuant to Rule 7.23;

(7)[(8)] actions taken by the Corporation pursuant to Rule 7.25, including the denial of the application for, or the termination or suspension of, an Odd Lot Dealer's registration in a security or securities.