

13.1.2 CNQ Application

BCE Place 161 Bay Street
Suite 3850 PO Box 207
Toronto Ontario M5J 2S1
T 416.572.2000
F 416.572.4160

TIMOTHY S. BAIKIE
General Counsel & Corporate Secretary
T: 416.572.2000 x2282
Timothy.Baikie@cnq.ca

VIA E-MAIL

July 29, 2005

Ms. Cindy Petlock
Manager, Market Regulation
Ontario Securities Commission
20 Queen St. W.,
Suite 1903, Box 55
Toronto, ON
M5H 3S8

Dear Ms. Petlock:

Re: Application to Amend the Recognition Order of Canadian Trading and Quotation System Inc. ("CNQ")

Pursuant to section 144 of the *Securities Act* (Ontario), Canadian Trading and Quotation System Inc. hereby applies to amend its recognition order dated May 7, 2004 in connection with its proposed Alternative Market and also applies pursuant to its recognition order for approval of rule and policy amendments in connection with the Alternative Market. Enclosed are copies of the proposed amendments to CNQ's rules and policies. Our cheque for the applicable fee will be sent under separate cover.

CNQ's Board of Directors has determined that this application and the contemplated amendments to CNQ's rules and policies are in the public interest.

CNQ was recognized as a quotation and trade reporting system by the OSC on February 28, 2003. It was the first new marketplace to be recognized since the implementation of National Instrument 21-101 — Marketplace Operation. On May 7, 2004, the OSC recognized CNQ as a stock exchange. CNQ has been exempted from recognition by the Alberta and British Columbia securities commissions and has an application for authorization to carry on business as a stock exchange pending with l'Autorité des marchés financiers in Québec.

Alternative Market

CNQ intends to trade securities of issuers listed on other Canadian exchanges, without listing them on CNQ, to provide a competitive alternative to the only Canadian exchange trading venues. Securities would be eligible to trade if they were not suspended or delisted by the exchange on which they are listed. Although the proposed rule amendments contemplate trading issuers listed on both the Toronto Stock Exchange and the TSX Venture Exchange, initially we intend to trade only securities of issuers that are currently Ontario reporting issuers.

The concept of "unlisted trading privileges" is unknown in Canada, but it is well-established in the United States. For decades, regional exchanges have traded NYSE-listed securities on an unlisted basis and competed for order flow. More recently, this has been extended to Nasdaq-listed securities. Today, even the NYSE trades some Nasdaq-listed securities and Amex-listed Exchange Traded Funds on an unlisted basis.

Given the National Instruments 21-101 Marketplace Operation and 23-101 Trading Rules (collectively, the "ATS Rules"), which create a framework for competitive trading of listed securities on Alternative Trading Systems, CNQ submits that there is no policy reason not to permit CNQ to trade these securities. What CNQ proposes to do is currently permitted an ATS; it would be inconsistent to conclude that an ATS could trade these securities but an exchange, which is subject to greater Commission oversight, cannot without fully listing them. This is particularly true given that trading on CNQ is subject to the Universal Market Integrity Rules and trading in the Alternative Market will be overseen by Market Regulation Services Inc. ("RS"). The Alternative Market furthers the goals of the ATS rules by fostering competition without compromising market integrity.

In order to alleviate possible investor confusion with the CNQ listed market, we will establish the Alternative Market as a separate and distinct trading list with a distinct name, similar to what the TSX VE did with its NEX market. In addition, we will maintain four-letter stock symbols for CNQ-listed issuers, while using the 1-3 letter symbols used by the other exchanges for the Alternative Market ones. While trading information on the Alternative Market will appear on our website, it will be properly segregated from CNQ listed market activity.

As section 14 of the Recognition Order contemplates that CNQ will have sufficient authority over issuers traded in its market, it will have to be amended to recognize that CNQ will not perform any company regulation or review of securities traded in the Alternative Market other than to remove them from trading in the event of suspension or delisting by the exchange on which they are listed.

Issuer Policy Changes

CNQ proposes to remove the restriction on listing securities that are listed on other markets contained in section 6 of Policy 2, as we do not want to preclude any issuer that meets our standards from applying to list here. We have had expressions of interest from some TSX and TSX VE-listed issuers who wish to “test the waters” in our market without having to abandon their current listing. We also propose adopting new Rule 11-102 setting out eligibility for trading in the Alternative Market. It is our intention that management will make the decision as to which securities will be eligible.

We will also remove the restriction in section 5.1 of Policy 2 from trading the same security in both Canadian and U.S. dollars. This will apply to both listed and Alternative Market securities.

Trading Rules

In order to minimize confusion, rules for the Alternative Market have been set out in a distinct Rule (new Rule 11), while trading rules for CNQ-listed securities remain in Rule 4. New Rule 11-101 lists the general trading rules that are also applicable to the Alternative Market.

The rule amendments contain several definitional changes to distinguish between CNQ-listed and Alternative Market securities. CNQ-listed and Alternative Market securities will be referred to as such.

We intend to trade Alternative Market securities according to price/time priority as we do today, but will allow crossing on the bid and offer as is the case on the other exchanges (new Rule 11-108). We do not propose to have market makers in the Alternative Market and our trading rules will continue to incorporate UMIR. The definition of “market maker” has been amended to clarify that it applies only to listed securities. We are also proposing that the requirement that 50% of an order entered on an undisclosed basis be changed for Alternative Market securities to require a minimum of one board lot or such larger amount as may be prescribed by CNQ (new rule 11-108). This is consistent with the other exchanges.

We will continue to admit to trading any dealer that meets our requirements. CNQ Dealers would be able to trade in both the listed and the Alternative Markets.

We propose to adopt a rule (new Rule 11-103) allowing CNQ dealers to provide access to the Alternative Market by qualified clients. The rule would be the same as TSX rules 2-501-3 and similar to TSX VE rules 2.51-3. We intend to engage RS to monitor compliance as part of their trade desk reviews.

The rule on foreign currency trade reporting (Rule 4-105, new Rule 11-107) has been amended to clarify that it applies anytime a trade is reported in a different currency from the currency in which the agreement to trade was made.

In addition, we propose to amend Rule 3-101(2) to provide that trading will be from 8:00 a.m. to 6:00 p.m. on each Business Day unless determined otherwise by resolution of the Board. There is currently considerable trading in ECNs in the United States outside of regular market hours, and it is unfair to deny Canadian investors the ability to trade.

Fees

We have not yet set fees for the Alternative Market. Any and all fees imposed by CNQ will be equitably allocated. They will not have the effect of creating barriers to access and will be balanced with the criteria that CNQ will have sufficient revenues to satisfy its responsibilities under the recognition order.

Capacity and Integrity of Systems

We are expanding the capacity of our current trading system to facilitate efficient trading of the anticipated volumes in the securities traded in the Alternative Market. The current software has already been benchmarked in other markets by the system owner and other exchanges to handle the volumes that are contemplated. The hardware may be upgraded readily to

accommodate much greater activity and the software can be configured to provide for any consequential rule changes.

Transparency Requirements

CNQ will comply with the pre-trade and post-trade transparency requirements set out in National Instrument 21-101 Marketplace Operation for trading in the Alternative Market.

Conclusion

We appreciate receiving your comments at your earliest convenience. If you have any questions or would like to discuss any aspects of this application, please contact Robert Cook at 416-572-2000, ext 2470 or Timothy Baikie at 416-572-2000, ext 2282.

Yours truly,



Timothy Baikie
General Counsel & Secretary

- cc: Ms. Randee Pavalow, Director, Capital Markets
Mr. Winfield Liu, Senior Legal Counsel, Market Regulation
Mr. Normand Bergeron, AMF
Mr. Blaine Young, ASC
Mr. Mark Wang, BCSC