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June 17, 2011

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: File No. SR-BATS-2011-09

Dear Ms. Murphy:

The International Securities Exchange, LLC ("ISE") appreciates the opportunity to comment on the above-referenced proposal ("Proposal") of BATS Exchange, Inc. ("BATS").[1] BATS proposes, among other things, to establish a program whereby market makers can trade against orders directed to them without first exposing the orders to other market participants. This is the second such proposal submitted by BATS.[2] ISE submitted a comment letter with respect to the first proposal[3] and a subsequent comment letter on the second proposal.[4] While BATS has submitted rebuttal letters, it has yet to address how customers would be able to achieve the best price for their orders given the lack of price competition for orders that are directed to market makers. Nor has BATS addressed the discriminatory aspects of the proposal.

As we discuss fully in our previous comment letter, the fact that directed market makers are required to publically quote at the NBBO is not relevant in determining whether the directed customer order is receiving the best available price. It is through competition that an exchange's price discovery mechanism provides customer orders with the best price. In our comment letter, we discuss in detail how directed market makers will be able to out-price all other market participants because they will be able to limit their risk of trading at the hidden price to pre-selected order flow. BATS responds to our comments as follows:

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[1] Exchange Act Release No. 64132 (March 28, 2011), 76 F.R. 18280 (April 1, 2011) (SR-BATS-2011-09).

[2] Exchange Act Release No. 63403 (December 1, 2010), 75 F.R. 76059 (December 7, 2010) (SR-BATS-2010-34).

[3] Letter from Michael Simon, Secretary, ISE, December 28, 2010.

[4] Letter from Michael Simon, Secretary, ISE, April 21, 2011.

> This is exactly the point that BATS is making in the structure of its directed order program – a structure that is lacking from the ISE's, the NYSE's and the other exchanges' directed order programs. The requirement for market makers to be on the NBBO and *at risk of trading against all incoming orders* is a competitive burden that is placed on market makers in the BATS directed order program. This competitive burden is *not* present in other, comparable programs.

This statement emphasizes our point: BATS directed market makers will be at risk of trading against *all incoming orders* only at the NBBO. At the hidden prices, directed market makers are able to limit their risk to pre-selected order flow, whereas all other market participants would be at risk of trading with all incoming orders. This gives the directed market maker an unfair advantage over all other market participants at the hidden prices, which will assure that there is no competition for directed order flow at the hidden prices.

The Commission should consider carefully the argument being made by BATS – that the burden of being at risk to all incoming orders at the NBBO is the price that directed market makers pay for the benefit of being able to execute against directed orders without having to compete with other market participants.

- ***The Commission's focus must first be on the quality of the execution received by the customer before any consideration is given to the burdens on, and benefits provided to, directed market makers under the proposal.***

BATS correctly points out that ISE and other exchanges do not require a directed market maker to quote at the NBBO. Rather, we expose each customer order so that there is competition that results in the maximum available price improvement for the customer. Execution guarantees only apply after the best price for the customer is determined through fair competition. This structure benefits the retail customer order because all market participants are on equal ground when determining the best price they can provide to the order. In contrast, BATS proposes to "burden" its directed market makers, which means they will not be able to offer as much price improvement to directed customer orders. By definition, all other market participants who are not so burdened would be able to offer more price improvement to the directed orders if given an opportunity to compete. Accordingly, the only way to assure that there are benefits for the directed market maker (i.e., executing against a high percentage of the retail customer orders directed to it) is to create a structure that limits competition at the hidden prices.

- ***The proposed trade-off for BATS directed market makers comes at the expense of retail customers because they will not receive the best possible price for their orders.***

BATS has failed to address the fundamental issues we and other commenters have raised with the Commission. In particular, we previously commented that the lack of competition at hidden prices will induce directed market makers to offer no more than the minimum amount of price improvement. BATS responded that there are no caps on price improvement in its proposal. This may be true, but the lack of competition at the hidden prices, as well as the burden of quoting at the NBBO, will depress the amount of price improvement offered by directed market makers. BATS has not addressed this point or offered any other discussion on how its proposal will incent BATS directed market makers to provide more than a minimum amount of price improvement to directed orders. Additionally, BATS acknowledges that only market makers can enter hidden penny prices in options that trade in pennies, but provides no justification for this discrimination among its market participants.

We urge the Commission to consider carefully the arguments BATS has made in support of its Proposal. BATS continues to attempt to justify its Proposal primarily on the grounds that, unlike other exchanges, it contains no execution guarantees. However, it is not necessary for BATS to explicitly provide for any execution guarantees because its proposed structure assures there will be no competition at the hidden prices. Thus, the structure provides a clear path around the maximum execution guarantees that have been established by the Commission, and does so in way that will harm customers.

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The Commission should disapprove the Proposal, as BATS has failed to provide justification under the Securities Exchange Act of 1934 for the Proposal.[5] In particular, BATS has offered no statutory justification for:

(1) Discriminating against non-market maker members by not allowing them to enter hidden penny prices in options traded in penny increments.

(2) Discriminating against all market participants (both market makers and non-market makers) to which retail orders are not directed through a structure that prevents them from competing for such orders.

(3) Allowing market makers to enter prices onto the BATS book that are not firm for all market participants.

(4) Executing customer orders without exposure to other market participants.[6]

[5] In our previous comment letter, we analyzed each sentence contained in the "Basis" section of the rule filing to emphasize that BATS has not provided a legally sufficient basis for the Commission to approve the Proposal.

Accordingly, we again urge the Commission to institute proceedings to disapprove the Proposal.

Sincerely,

Michael J. Simon
Secretary

cc: Robert Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
Heather Seidel, Associate Director, Division of Trading and Markets

[6] The ISE's qualified contingent cross (QCC) allows the execution of large-size options orders that are part of a qualified contingent transaction to be executed without exposure. The execution of these net-priced orders without exposure was narrowly designed to facilitate the execution of such large-sized transactions across multiple markets with different market structures, where the price of the options legs of the net-price qualified contingent transaction is not as material to customers as is a greater opportunity to execute the options component of the transaction. In contrast, the BATS proposal will allow retail customer orders to be executed without exposure for no reason that benefits the customer.