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March 5, 2007

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

Re: File No. SR-BSE-2006-16

Dear Ms. Norris:

The International Securities Exchange, LLC ("ISE") appreciates the opportunity to comment on the above-referenced proposal ("Proposal") of the Boston Stock Exchange, Inc. ("BSE"), on behalf of its Boston Options Exchange ("BOX") facility.[1] Under the Proposal, the BSE proposes to adopt a Universal Price Improvement Period ("UPIP"), which will expose certain incoming market and marketable limit orders to BOX participants for three seconds for potential price improvement.

While the concept of providing pricing improvement to certain incoming orders seems simple, the mechanics of the Proposal would call into question the fairness of the BOX marketplace. We believe that if such a proposal were to be approved, the BOX should be required to clearly disclose to market participants the full extent of the potential disadvantageous treatment of certain orders as a result of the UPIP. In addition, certain aspects of the Proposal are unclear, particularly with respect to how the UPIP and PIP auctions affect each other, and whether the pending proposed Automated Auction Order (AAO") type would interact with the UPIP.

We note that there are aspects of the UPIP proposal that are inconsistent with a fair marketplace. In particular, a UPIP Order will be guaranteed or "stopped" against the BOX BBO at the time the UPIP is initiated. If market participants attempt to cancel or otherwise modify any of the orders or quotes against which the UPIP Order is stopped in a way that would reduce the size of the guaranteed price, the UPIP auction will be terminated immediately and the UPIP Order will be executed before the cancel or modification is processed. This raises significant customer protection issues:

[1] Exchange Act Release No. 55253, (February 2, 2007), 72 F.R. 6626 (February 12, 2007).

As part of the UPIP, the existing interest at the top of the BOX book is essentially frozen, and market participants will be prevented from modifying their orders and quotes in relation to changing market conditions, such as a change in the price of the underlying security. In contrast, the UPIP Order may be altered or cancelled after the initiation of a UPIP auction. This means that a BOX market participant can use the UPIP to lock-in prices for up to three seconds and cancel the order if there are disadvantageous market movements. Essentially, the UPIP creates a three second option or "second look" opportunity for the participant that entered the UPIP Order to the detriment of the limit orders and quotes at the top of the BOX book.

- Market makers in particular provide liquidity through pricing models that depend on, among other things, the price of the underlying security and their ability to hedge any resulting options position in the underlying stock. When the price of the underlying stock changes, the market maker is no longer able to hedge the stock at the same price. Therefore, when the UPIP terminates an auction early upon the receipt of a quote change that would decrement the BOX BBO and potentially executes the UPIP Order against the quote that the market maker is attempting to change, it is by definition executing the market maker at an undesirable price and quantity. We believe that this could severely limit the amount of liquidity market makers will be willing to provide on the BOX.

- We believe that the UPIP can be especially troublesome when retail customers are at the BBO. The UPIP will lock-in customer orders and prevent customers from canceling or modifying their orders until after the UPIP order is executed. We believe that this is a significant disclosure issue and that customers and their brokers should be made specifically aware that orders are subject to this "second look" opportunity and that cancelling or modifying their orders may actually cause them to be executed at an undesired price.

Another problematic aspect of the UPIP related to the ability of a participant to cancel or modify a UPIP Order is that Improvement Orders received during the UPIP are disseminated during the three second auction. This means that the participant that entered the UPIP Order can monitor the amount of price improvement, if any, being offered and determine whether or not to cancel or modify the UPIP Order. This is in contrast to the rules of the BOX Price Improvement Period ("PIP"), which does not allow an order entered into the PIP for possible price improvement to be cancelled or modified during the three second auction period. The ability to cancel or modify the UPIP Order not only creates a gaming opportunity, but it compounds the "second look" problem described above.

In addition to these issues, we believe that there are several other aspects of the proposal that need to be addressed:

- Unlike the PIP, the proposed UPIP does not require that there be at least three market makers quoting in an option series before a UPIP may be initiated. This requirement was added to the PIP rules to address possible internalization. We believe that the same requirement should apply in this context as well.

- It is unclear whether the proposed AAO would interact in a UPIP auction. The text of the AAO proposed rule states that the AAO would participate in "any Improvement Auctions (e.g., PIP)." If this would include a UPIP, then we incorporate by reference our comment letter on the AAO proposal.[2] In addition, it is unclear whether an incoming AAO could itself initiate a UPIP, and if so, how this order type would be handled within the UPIP auction.

- The UPIP proposal states that there may not be a UPIP auction and a PIP auction simultaneously in the same options series. We believe there are three BOX functionalities that would potentially be affected by this limitation: UPIP, PIP and directed orders. However, there is no discussion in the filing about how this limitation will affect each of the three functionalities.[3]

We believe that the BSE needs both to address the customer protection issues the UPIP raises and to clarify the operation of this functionality before the Commission can approve this proposal. In addition, we believe that the Commission should proceed cautiously with respect to any "penny pricing" initiative while the current penny pricing pilot is in operation. That pilot is the appropriate method to approach penny pricing in the options markets since it

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[2] Letter from Michael J. Simon, Secretary, International Securities Exchange, dated March 5, 2007, commenting on SR-BSE-2006-56.

[3] For example, when a market maker receives a directed order on BOX, it must either initiate a PIP or release the order into the market within three seconds. If there is a UPIP in progress at the time a directed order is received, a directed market maker cannot initiate a PIP.

does so in a transparent and fair environment. The Commission should disfavor opaque penny proposals like the UPIP that raise significant customer protection issues.

Sincerely,

Michael J. Simon
Secretary