



Michael T. Bickford
Senior Vice President

American Stock Exchange
86 Trinity Place
New York, NY 10006
T 212 306 2500
F 212 306 2013
mike.bickford@amex.com

March 2, 2007

Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-9303

Re: American Stock Exchange LLC Comments to BSE File No. SR-BSE-2006-16 (Proposal to Adopt a Universal Price Improvement Period for Public Customer Orders)

Dear Ms. Morris:

The American Stock Exchange LLC (the "Amex" or the "Exchange") appreciates this opportunity to comment on File No. SR-BSE-2006-16 filed with the Securities and Exchange Commission (the "Commission" or the "SEC") by the Boston Stock Exchange, Inc. (the "BSE") on behalf of its Boston Options Exchange (the "BOX") facility (the "Proposal").¹ The Proposal seeks to adopt a Universal Price Improvement Period ("UPIP") for the BOX purportedly for the purpose of allowing Public Customer Orders² to be eligible for price improvement in the UPIP auction.

The Amex submits that several aspects about the Proposal are troubling, and therefore, require further attention from the Commission and market participants. First, it is unclear which orders are eligible for inclusion in the UPIP auction. Specifically, the Proposal states that an eligible order must be a limit, market or BOX-Top order that is marketable against the national best bid or offer (the "NBBO") or the BOX best bid or offer (the "BBO") if the BOX is not at the NBBO.³ If the BOX is not at the NBBO, the starting

¹ See Securities Exchange Act Release No. 55230 (February 2, 2007), 72 FR 6302 (February 9, 2007)(*Federal Register* notice of BSE File No. 2006-16).

² A "Public Customer" is defined in Section 1(a)(51) of Chapter I of the BOX Rules as a person that is not a broker or dealer in securities.

³ The *Federal Register* notice of BSE File No. 2006-16 states in footnote 6 to see proposed rule Section 29(e) of Chapter V of the BOX Rules. However, this proposed rule regarding order eligibility is not set forth in the notice nor is it available on the BOX website as is required by Commission Rules. In order to provide a meaningful comment period, we believe that the Commission should direct the BSE to provide access to its proposed rules.

price for the UPIP auction is the NBBO price on the opposite side of the market of the eligible customer order.

The Amex (as well as other market participants) would like to know how the UPIP operates in the situation where BOX is not at the NBBO and an order is submitted into the UPIP auction where subsequently no Options Participant chooses to submit quotes or orders. Does the order submitted into the UPIP get executed at the NBBO price? If the order does not get filled at the NBBO price, is it then routed out through the Options Intermarket Linkage (the "Linkage") to the better market away? If the NBBO price is no longer the same as when the Customer Order⁴ was received by BOX, at what price might the Customer Order subsequently receive an execution? The Proposal is unclear as to what happens in this situation and we believe that clarification is essential for meaningful comment.

Second, the Amex also believes that greater detail is necessary in order to identify eligible Customer Orders. When the BOX originally proposed the Price Improvement Process or "PIP", the Amex and others raised concerns over the PIP and the Directed Order process as a means to internalize orders.⁵ In order to address those concerns, BOX responded in a comment letter of its own that "The PIP is an objective and electronically transparent opportunity to compete for orders through price improvement initiatives."⁶ Further more, BOX stated, "Commentators have also suggested, in the context of the Directed Order Rules that a Market Maker could choose to opt out of a Directed Order. That is a false assumption. The Directed Order Rules were designed so that a Market Maker does not have the discretion about whether to opt out of a particular Directed Order and thus have the potential to act on material, non-public, or privileged information in relation to that Directed Order. However, any Market Maker can choose to opt out of accepting Directed Orders on a binary basis, which is to say, not receive any Directed Orders. There is no requirement that a Market Maker must receive Directed Orders, but once a Market Maker receives Directed Orders it cannot choose which Directed Orders to accept."⁷ Experience to date has shown that the Directed Order process has been operated contrary to BOX's own statements and Rules. In fact, numerous amendments have been filed with the Commission to enable them to give their market makers who receive Directed Orders the ability to discriminate on the basis of which Customer is sending them the order.⁸ The UPIP process indicates that a Directed Order recipient who releases an order directed to them to the BOX Book is placed last in time priority if the

⁴ Section 1(a)(20) of Chapter I of the BOX Rules defines Customer Order as an agency order for the account of either a Public Customer or a broker-dealer.

⁵ See letters from Michael J. Ryan, Jr, Executive Vice President and General Counsel, Amex, to Jonathan G. Katz, Secretary, SEC dated February 14, 2003 and September 12, 2003, respectively. See also, Securities Exchange Act Release No. 49068 (January 13, 2004), 69 FR 2775 (January 20, 2004).

⁶ See letter from George Mann, Executive Vice President and General Counsel, BSE, to Jonathan G. Katz, Secretary, SEC, dated January 9, 2003.

⁷ *Id.*

⁸ See Securities Exchange Act Release No. 53015 (December 22, 2005), 70 FR 77207 (December 29, 2005)(Federal Register notice of BSE File No. SR-BSE-2005-52)

order released into the BOX Book is subsequently applicable in a UPIP auction. As a result, the Amex believes it would be inappropriate to consider approving the Proposal, as submitted, without first addressing the question of whether the original PIP process used in conjunction with a Directed Order Process (without anonymity) does not unfairly discriminate against certain Customers.

As set forth above, a Directed Order recipient who releases an order directed to them to the BOX Book will be placed last in time priority if the order released into the BOX Book is entered into the UPIP auction. This process, which on the surface seems to be a disincentive for Directed Order recipients to “reject” orders directed to them is actually designed to make it easier for Directed Order recipients to avoid trading with “undesirable” customers that may have directed orders to them. For example: A Directed Order recipient is quoting an NBBO market of \$3.00 bid/\$3.10 offer. The Directed Order recipient receives a directed order from an “undesirable” customer.⁹ The Directed Order recipient in turn decides its in their best interests to release this order to the BOX Book since they don’t want to trade with that “undesirable” customer at their “firm NBBO quotes,” much less offer that “undesirable” customer a \$.01 improvement in the PIP. The order that was rejected by the Directed Order recipient is eligible for the UPIP auction and a message is broadcast. All other BOX participants except the Directed Order recipient do not know who the customer is. The Directed Order recipient has their NBBO quotes placed “last” in time priority so that even if no one responds during the UPIP auction with better quotes or orders, as long as there were other participant quotes at the NBBO when the order came in, its likely that the Directed Order recipient does not take part in the trade – which was their goal in releasing the order to the BOX Book to begin with. The ability for the Directed Order recipient to selectively be “firm” on their quotes on the basis of who is sending them orders seems to be a direct violation of the BOX’s firm quote rule.¹⁰

In addition, the ability to cancel Improvement Orders during the auction before the UPIP Auction terminates is inconsistent with the purpose and intent of the BOX’s firm quote rule. Being able to retract quotes and orders during an auction would seemingly allow an Options Participant to get a “free” look at the order during the 3-second auction. If the underlying stock ticks in an unfavorable direction during the Auction, an Options Participant can simply cancel their quotes or orders.

We also note that the Proposal states that the Options Participant who submitted the Eligible Order to BOX and subsequently submitted a Proprietary Improvement Order will be the last in time priority. Does this mean to imply that “firewalls” are not required between the order routing and the market making areas of an Options Participant? In addition, the Proposal proclaims that a Proprietary Improvement Order generated by an automated quotation system will be treated like an ordinary Improvement Order, and

⁹ The BOX has been enabling Directed Order recipients to identify on an order by order basis the identity of customer orders.

¹⁰ See Section 6(c) of Chapter VI of the BOX Rules.

therefore, would not be last in time priority. How would the BOX adequately determine whether a Proprietary Improvement Order is generated by an automated quotation system? What is the standard (if any) for making a determination that a particular quote/order system is an automated quotation system?

The Proposal provides that the duration of the UPIP will be 3-seconds or less as determined by the Board on a case-by-case basis. On what basis would the Board elect to have a UPIP duration of less than 3-seconds? How would a UPIP duration of less than 3-seconds result in any meaningful auction? How would the marketplace and the Commission know when the UPIP auction has been reduced from 3-seconds?

Finally, the Amex would like to know how the BOX Book will ascertain that an order it receives was one selectively rejected by a Directed Order recipient as opposed to a non-directed order. Additionally, what mechanism will the BOX use to ensure that the market maker who rejected a Directed Order is in fact placed last in time priority.

* * * *

We look forward to discussing the matters covered in this letter with the Commission and the Division of Market Regulation. If you have any questions or comments regarding the substance of this letter, please contact the undersigned at 212-306-2500 or Jeffrey P. Burns at 212-306-1822.

Sincerely,

