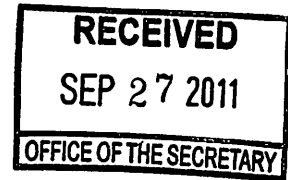


Before the
SECURITIES AND EXCHANGE COMMISSION



_____)
In the Matter of)
)
) File No. SR-BX- 2011-046
)
NASDAQ OMX BX, Inc.)
)
)
_____)

PETITION FOR REVIEW OF ACTION BY DELEGATED AUTHORITY

Pursuant to Securities and Exchange Commission (“Commission” or “SEC”) Rule of Practice 431, Boston Options Exchange Group LLC, an options trading facility of NASDAQ OMX BX, Inc. (the “Boston Options Exchange” or “BOX”) has appealed to the Commission the decision of the Division of Trading and Markets (the “Division”), by delegated authority, to institute proceedings to disapprove the above-captioned proposed rule change.¹ The Commission should find that the BOX Price Improvement Period fee proposal (the “BOX PIP fee proposal”) is consistent with the requirements of the Securities Exchange Act of 1934 (the “Act”) and, as required by Section 19(b)(2) of the Act, it should approve that proposal.

As detailed in the following pages, the inducement fee implemented by BOX on August 1, 2011 to encourage submission of orders to the BOX Price Improvement Period (“Price Improvement Period” or “PIP”):

- is an exact economic equivalent of payment for order flow schemes operated for over ten years by many of BOX’s options exchange competitors,
- is set at a level which is compatible and competitive with the payment for order flow paid by the other options exchanges,
- is not discriminatory because all participants in a PIP are charged the same fee and, accordingly, does not give any participant a pricing advantage - in contrast to the payment for order flow practices of the other options exchanges and their specialists,
- did not result in any material change in the rate of retention by PIP initiators during the weeks following its introduction, but
- did result in a substantial increase in price improvement to investors.

¹ See Exch. Act Rel. No. 65330 (Sept. 13, 2011), 76 Fed. Reg. 58065 (Sept. 19, 2011) (Order by the Division of Trading and Markets by Delegated Authority).

The BOX PIP fee proposal does, in a transparent and non-discriminatory way, what other, larger options exchanges are already doing through “marketing” or “payment for order flow” fees which they provide to their specialists to pay rebates to order flow providers who route their customer orders to the specialists’ exchange.² The BOX PIP fee proposal simply allows BOX to compete on a level playing field with the other options exchanges. Moreover, the stated objections to the BOX PIP fee proposal - primarily, that it will prevent certain BOX market participants from interacting with order flow - is directly contradicted by the data concerning the six weeks in which the BOX PIP fee proposal was in effect. During those six weeks, the amount of price improvement provided by the BOX PIP program increased dramatically, and not only did the level of order retention (that is, the percentage of each order submitted to the BOX PIP which was captured by the PIP initiator) not increase, in fact it decreased. Instituting disapproval proceedings here would be inconsistent with Congress’ intent in the Section 19(b)(3)(A) of the Act to allow self-regulatory organizations (“SROs”) better to compete on fees through immediately effective rule filings. To the extent that the Commission or the Division staff wishes to address broader market structure issues about internalization or payment for order flow, the proper forum in which to address those concerns would be a proposing release applicable to the entire industry - not a disapproval proceeding aimed at BOX, a single small options exchange. If the Commission does institute disapproval proceedings, it should not stay the effectiveness of the BOX PIP fee proposal while those proceedings are pending.

Background of the BOX PIP Fee Proposal

BOX is a small, young and innovative electronic options exchange. According to the Options Clearing Corp. (“OCC”), in the most recent reporting period, BOX was seventh of the nine U.S. options exchanges in daily trading volume. The top five options exchanges - Chicago Board Options Exchange (“CBOE”), Nasdaq OMX Phlx (“PHLX”), NYSE Arca (“ARCA”), NYSE Amex (“AMEX”) and the International Securities Exchange (“ISE”) - all had daily trading volumes more than twice as high as BOX.³ The ability of BOX to compete with its much larger, longer-established competitors is critical to BOX’s continued success.

One of the critical innovations by BOX has been its Price Improvement Period. In a PIP transaction, a market participant may either bring an investor order to BOX, along with a contra side order (known as a Primary Improvement Order) on the other side of the market. Or the market participant may use the BOX Directed Order mechanism which allows a BOX market maker to furnish the contra order and initiate the PIP. The Primary Improvement Order must be at or better than the best quoted price for that option on BOX and the national best bid or offer (“NBBO”). During the Price Improvement Period, BOX market participants compete to improve the price of the customer’s order. So long as the market participant or BOX market maker who initiates the PIP matches the eligible execution prices at the end of the Price Improvement

² In this petition we use the term “specialists” to refer to specialists, dedicated market makers, and primary market makers on the various options exchanges. Although the terms used on the various options exchanges vary, the functions of these market participants are the same.

³ See OCC, Options and Futures Volumes by Exchange - Sept. 19, 2011 (available at <http://www.theocc.com/webapps/exchange-volume?reportType=D&instrumentType=both>).

Period, that market participant or market maker gets to participate in at least 40% of the customer's order. The result of the PIP process has been that investors have saved over \$350 million by obtaining better prices since the PIP process began.

The superior customer price improvement opportunities offered by BOX have not, themselves, been sufficient to convince all broker-dealers to route their customers' options orders to BOX. As a result, BOX has long offered, and the Commission has allowed as consistent with the Act, BOX's payment of a credit to market participants who bring customer trades to the PIP at BOX. This credit is offset by a fee charged to market participants who execute against those customer orders. This fee structure is designed to encourage BOX Participants to send PIP trades to BOX. Before the current rule filing, the Commission had allowed as consistent with the Act BOX's fee schedule which provided for fees and credits of \$0.30 per contract for PIP executions.⁴

The current BOX PIP fee proposal would raise the PIP fees and credits from \$0.30 to \$0.75 for two types of trades: (1) trades in option classes not subject to the Penny Pilot for options pricing, and (2) trades in Penny Pilot classes on series where the trade price is equal to \$3.00 or more per share. Because these options classes and series have the widest spreads, these are the options contracts on which there is the greatest likelihood of customer price improvement. This fee level is in line with the ISE's payment for order flow charge of \$0.65 per contract on issues that are not in the Penny Pilot.⁵

Other options exchanges also pay market participants who bring options orders to those exchanges. However, the other options exchanges do so in a way that is less transparent than BOX's PIP fee structure. The other options exchanges charge Market Makers and professionals "marketing" or "payment for order flow" fees of \$0.70 or \$0.65 per contract for non-Penny Pilot options contracts traded with a public customer.⁶ However, the other options exchanges give those marketing and payment for order flow fees to the specialists on those exchanges, for the specialists to pay out as rebates to market participants who bring customer order flow to those specialists. These marketing payments by the specialists are not subject to filing with the Commission, and the amounts are not a matter of public record. Naturally, the other options exchanges' specialists pay more for order flow which is more profitable to them. These specialist marketing payments are inherently discriminatory. So, for example, a specialist may pay more for "uninformed" order flow in a given options class than "informed" order flow in exactly the same options class on the same day. Or a specialist may pay less to broker-dealers

⁴ See Exch. Act Rel. No. 64198 (Apr. 6, 2011), 76 Fed. Reg. 20426 (Apr. 12, 2011) (SR-BX-2011-020).

⁵ See ISE Schedule of Fees (Sept. 1, 2011).

⁶ See CBOE Fees Schedule (Sept. 1, 2011) (stating that a Marketing Fee of \$0.65 will be assessed on certain transactions); PHLX Fee Schedule (Sept. 12, 2011) (stating that Payment for Order Flow Fees are \$0.25 per contract for options trading in the Penny Pilot Program and \$0.70 per contract for the remaining equity options); ARCA Fee Schedule (July 1, 2011) (stating that a Marketing Charge of "\$0.65 per contract side [will be assessed] on transactions of Lead Market Makers and Market Makers against all public customer orders"); AMEX Options Fee Schedule (Sept. 1, 2011) (stating that a Marketing Charge of "\$0.65 per contract side [will be assessed] on transactions in non Penny Pilot issues where market makers trade against electronic customer orders [and] \$0.25 per contract side [will be assessed] on transactions in Penny Pilot issues where market makers trade against electronic customer orders").

who are less well informed about rebates available from competitor exchanges. By contrast, the BOX PIP fee proposal is transparent and non-discriminatory: it pays exactly the same amount for every contract.

The specialists at other options exchanges also pay larger rebates for order flow in options classes where the spread is wider. BOX understands that the \$0.75 per contract that it is proposing to charge for Non-Penny Pilot and \$3.00 trade price options classes is in fact the “going rate” for this order flow at the competitor options exchanges. It is impossible to provide hard data on this subject without issuing subpoenas to the other options exchanges and their specialists, because the Rule 606 of Regulation NMS only requires dealers to disclose publicly if the firm accepts payment for order flow. The rule does not require disclosure of the amount of payment received, either in the aggregate or on a per contract basis. The majority of firms simply disclose that they do or do not accept payment for order flow. A minority of firms merely provide an average (e.g., “payment for order flow averaged less than xx cents”), while a few firms opt for transparency and provide a precise figure each quarter on their websites. Furthermore, the options exchanges with specialists who administer the distribution of the marketing fee pools provide virtually no public information about to whom they pay rebates, nor any estimate of the per contract rate.

Given the paucity of publicly available hard data on the subject, BOX has discussed the rate of payment received by a number of broker-dealers concerning the classes and series covered by the BOX PIP fee proposal. Each pointed out that there was no “one size fits all rate” for payment for order flow on these classes and series; the lower end of the range from these interviews was 30 cents, the upper range, \$1.00.⁷ This was exactly the data BOX took into consideration when it proposed the \$0.75 cent fee. BOX is confident that its fee is competitive and comparable with practices at the payment for order flow exchanges.

If the Commission institutes disapproval proceedings, BOX will likely subpoena specialists at other options exchanges and prove that this is what they are paying for similar order flow. But the critical fact is this: BOX is simply changing its fees to compete with what other options exchanges (through their specialists) are already doing, at the price level they are already paying. Under Section 3(f) of the Act, the Commission must evaluate the effects of any SRO rule proposal on competition, and it must approve a rule filing that will enhance competition. The BOX PIP fee is fully transparent, unlike the other options exchanges’ specialist rebates which occur without public disclosure.

⁷ One large broker-dealer told BOX that the specialist rebates from other options exchanges for non-penny options classes and options over \$3 per contract range as high as \$1.00 per contract, well more than the \$0.75 offered in the BOX PIP fee proposal. Another large broker-dealer discloses in its Regulation NMS Rule 606 report that it receives payment for order flow payments averaging nearly \$0.50 per contract. Our estimate is that the non-penny and \$3 per contract options classes account for approximately 25% of all options volume, so that broker-dealer must be receiving almost \$0.90 per contract for these high-spread options classes. As discussed in the text, if the Commission does institute disapproval proceedings here, BOX will be able to subpoena options specialists to obtain precise data about these specialist rebate programs.

The Stated Objections to the BOX PIP Fee Proposal Have No Merit

Four parties submitted comments on the BOX PIP fee proposal. None of those comments raised any issues that justify instituting a disapproval proceeding for that proposal. First, and most significantly, TD Ameritrade supported the BOX PIP fee proposal on behalf of its large client base of individual investors.⁸ During the first month that the BOX PIP fee proposal was in effect (after it became immediately effective on filing on August 1, 2011), TD Ameritrade's customers obtained over \$600,000 in price improvement over the prevailing NBBO as a result of the PIP. TD Ameritrade found robust competition within the PIP - as TD Ameritrade recognized, if there was not robust competition within the PIP, then clients' trades would have been executed at the NBBO rather than at better prices. The Commission should not institute proceedings to disapprove a rule proposal that has already demonstrated substantial and meaningful benefits to individual investors.

Three parties opposed the BOX PIP fee proposal: Citadel, IMC and ISE.⁹ Citadel argues that the increased BOX PIP fee would make it "economically prohibitive for anyone other than the initiator to respond" in a BOX PIP auction. Based on this argument, Citadel claims that the BOX PIP fee proposal discriminates in favor of some BOX participants and against others. IMC goes further, and argues that the BOX PIP fee proposal will have the consequence of "effectively barring certain participants from competing with PIP initiators." ISE makes related arguments that the BOX PIP fee proposal discriminates among BOX participants, and thereby imposes a burden on competition.

The Citadel comment letter suggests that the credit given to the order flow side of the options participant in the PIP and the debit charged to the proprietary trading side of the participant could be netted or offset, giving the initiator an unfair competitive advantage. However, Citadel presents no evidence that this is the case, and given the nature of cost and profit centers in large firms, we find this to be unlikely. But in any case, if it is possible that BOX PIP credits and debits are offset within a market participant, then it is equally possible that the same offsetting process occurs with the payment for order flow rebates from the other options exchanges. Any offsets or rebates would take place entirely outside the exchange environment in either case; there is simply no evidence that the BOX credit is any more likely to be rebated than payment for order flow rebates at the other exchanges.

Happily, the Commission has data that allows it to evaluate the arguments in the comment letters against the BOX PIP fee proposal. The BOX PIP fee proposal was immediately effective upon

⁸ See Letter from Christopher Nagy, Managing Director Order Strategy, TD Ameritrade, to Ms. Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, re: SR-BOX-2011-046 (Sept. 12, 2011).

⁹ See Letter from John C. Nagel, Managing Director and General Counsel, Citadel Securities LLC, to Elizabeth Murphy, Secretary, Securities and Exchange Commission, re: Proposed Rule Change to Amend the BOX Fee Schedule File No. SR-BX-2011-46 (Aug. 12, 2011); Letter from Andrew Stevens, Legal Counsel, IMC Chicago, LLC, to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, re: SEC Release No. 34-64981; File No. SR-BX-2011-46 (Aug. 15, 2011); Letter from Michael J. Simon, Secretary, International Securities Exchange, to Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission, re: File Nos. SR-BX-2011-046 (Release No. 34-64981) (Aug. 22, 2011).

filing, and thus was in effect for six weeks in August and September 2011 before the Division's disapproval order. On September 8, 2011, BOX provided the Division with data about the effect of the BOX PIP fee proposal during that time. That data was unequivocal:

Description	July	August	September¹⁰
Average PIP Price Improvement - Penny Classes	\$0.0021	\$0.0036	\$0.0024
Average PIP Price Improvement – Nickel Minimum Increment	\$0.0200	\$0.0270	\$0.0236
Average Price Improvement - All PIP Transactions	\$0.0062	\$0.0087	\$0.0065
Initiating Participant Retention Rate - Penny Classes PIP Transactions	58%	57%	58%
Initiating Participant Retention Rate – Nickel Minimum Increment PIP Transactions	38%	36%	38%
Initiating Participant Retention Rate - All PIP Transactions	53%	52%	54%
Rate of PIP Transactions in Penny Classes Receiving Price Improvement	16%	21%	15%
Rate of Nickel Minimum Increment PIP Transactions Receiving Price Improvement	56%	57%	55%
Rate of All PIP Transactions Receiving Price Improvement	25%	28%	23% ¹¹

In short, the BOX PIP fee proposal worked exactly as BOX intended it, and none of the negative consequences predicted by Citadel, IMC or ISE came true. The rate and amount of price improvement at BOX increased substantially, in both the penny options classes and the nickel options classes.¹² In other words, the BOX PIP fee proposal did not simply allow initiating participants to cross trades at the NBBO; the BOX PIP process resulted in meaningful dollar-and-cents benefits to investors. BOX customers received over \$8.6 million in price improvement during the first six weeks following this fee change. The Commission should not deprive investors and the markets as a whole of this very real and tangible price improvement benefit.

Moreover, during the time the BOX PIP fee proposal was in effect, the percentage of trade volume where the initiating participant interacted with the trade did not increase; in fact that rate decreased by a slight (if statistically insignificant) amount. It was not impossible for other BOX participants to compete with PIP initiators; they did so at almost exactly the same rate (indeed, slightly more often) than they did before the BOX PIP fee proposal went into effect. The Commission has hard economic data which proves that the objections to the BOX PIP fee proposal are without merit. The Commission should not require BOX to go through a

¹⁰ The September data was for the first four trading days of the month. BOX would be happy to provide the data for the remainder of September, until the Division's Order suspended the BOX PIP fee.

¹¹ Email from Michael Burbach, Vice President, Legal Affairs, BOX to Division of Trading & Markets, Sept. 8, 2011, titled BOX PIP Information; Letter from Anthony D. McCormick, Chief Executive Officer, to Ms. Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, re: SR-BOX-2011-046 (Sept. 9, 2011). BOX's September 9 letter cited \$7.3 million in investor price improvement; that was the figure for the month of August. Through September 13, the amount of price improvement had risen to \$8.6 million.

¹² Recall that the BOX PIP fee proposal applies to penny options classes if the trade price of the option is over \$3.00 per contract.

disapproval proceeding when the outcome of that proceeding is foreordained: in the face of this clear economic evidence about the effect of the BOX PIP fee proposal, it would be arbitrary and capricious for the Commission to conclude that the Citadel/IMC/ISE objections had merit.¹³

We also suggest that the Commission should take comments from BOX's competitors with a substantial grain of salt. ISE is an options exchange which competes directly with BOX for order flow, and which currently has a market share more than double that of BOX. It has an incentive to prevent BOX from implementing innovative new fee proposals that will allow BOX better to compete for market share. ISE charges a payment for order flow fee which its specialists use, in a non-transparent way, to attract order flow - and that fee (at \$0.65 per contract for non-Penny Pilot options classes) is economically indistinguishable from the \$0.75 fee that BOX has proposed here.¹⁴

Citadel and IMC have substantial options market-making and specialist operations on other options exchanges. They have an incentive to prevent options order flow from migrating to the superior price improvement opportunities available at BOX. We suspect, and if the Commission institutes a proceeding we would be able to prove, that Citadel and IMC operate specialist rebate programs that are directly comparable with the BOX PIP fee proposal - except that they are less transparent. The same is true of specialists on the ISE. The Commission should give greater weight to the support from TD Ameritrade, which represents the interest in price improvement of its individual investor customers, than to the comments of competitors who lose money whenever order flow moves to BOX instead of other options exchanges. In any event, the hard evidence of the first six weeks of the BOX PIP fee proposal demonstrates that the stated concerns raised by those parties simply were not supported by the facts.

Instituting a Disapproval Proceeding Would Be Inconsistent with the Exchange Act's Treatment of SRO Fee Proposals.

Section 19(b)(3)(A) was intended to streamline the SRO filing process by, among other things, making immediately effective fee proposals such as the BOX PIP fee proposal. Congress adopted Section 19(b)(3)(A) because it was concerned that the ordinary SRO rule approval process, in which the SEC has to notice SRO rule proposals for public notice and comment before they could become effective, simply took too long and inhibited robust fee-based competition. In Section 916 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Congress made additional classes of SRO rule proposals immediately

¹³ Citadel's letter makes a subsidiary argument that the level of price improvement in BOX dropped in early 2011. But that argument - about the effect of the prior BOX PIP fee structure, which the Commission already has approved as consistent with the Act - is logically unrelated to the current BOX PIP fee proposal that went into effect in August 2011. The increase in price improvement after the implementation of the current BOX PIP fee proposal, and the lack of any increase in retention rates, demonstrate that the concerns raised in the comment letters about the current BOX PIP fee proposal are without merit. The decrease in price improvement in early 2011 was directly related to the market-wide decrease in options volatility during that time: when options market volatility decreases, options spreads decrease, and the opportunities for price improvement decrease as well. That decrease, which occurred at all of the options exchanges, had nothing to do with the prior BOX PIP fee structure.

¹⁴ See *supra* note 5 and accompanying text.

effective, which demonstrates that Congress believed the “immediately effective upon filing” SRO rule process was working well and could be expanded. Now that both the equities and options markets are fully competitive for order flow, Congress reasonably determined that market forces generally will be effective to constrain unreasonable or discriminatory SRO rules, including rules relating to fees.

We recognize that Section 19(b)(3)(A) (and Section 916 of the Dodd-Frank Act) retain a role for the Commission to institute disapproval proceedings in appropriate cases. However, the effect of instituting a disapproval proceeding here would be to suspend the BOX PIP fee proposal for at least 180 days until the hearing provided by Section 19(b) of the Act, and possibly longer while the administrative law judge (“ALJ”) (or other initial decision-maker) drafts an initial decision, and then during a possible appeal to the Commission. This time-frame for a decision on a major initiative for a small options exchange is not consistent with effective competition in the fast-changing and highly competitive options markets. The Commission should only take the drastic step of initiating an SRO fee disapproval proceeding where there is the most compelling reason to do so. The fact that BOX is only matching the effective level of rebates offered through the specialist marketing rebate programs of the other options exchanges, and the hard data discussed above demonstrate that the objections raised against the BOX PIP fee proposal are entirely without merit, and indicate that this is not an appropriate situation for a disapproval proceeding. Such a disapproval proceeding would be contrary to Congress’ intent to allow SROs to compete vigorously, and without delay, on fees.

The SEC Should Not Use This Proceeding To Resolve Larger Market Structure Issues

The Division’s Order instituting disapproval proceedings raises issues about internalization of orders and payment for order flow practices in the options markets more generally. As discussed above, the BOX PIP fee proposal is simply a more transparent, less discriminatory form of the specialist rebate programs, using exchange-imposed “marketing” or “payment for order flow” fees, currently in operation to attract order flow at all of the major competing options exchanges. In other words, payment for order flow practices and internalization are market-wide issues, and in no way are unique to BOX. Because these are market-wide issues, they should be addressed in a market-wide proceeding - not in a proceeding to disapprove a single exchange’s rule proposal. It is particularly inappropriate to delay (possibly for a year or longer) a fee proposal that will allow the seventh-largest options exchange to compete successfully against its larger, older and better-established competitors.

The Commission has repeatedly sought comment on the competitive landscape among the SROs. It issued a concept release on Market Fragmentation in 2000, Exch. Act Rel. No. 42,450 (Feb. 23, 2000), shortly after a related concept release on Market Data Fees, Exch. Act Rel. No. 42,208 (Dec. 9, 1999).¹⁵ In 2004, the Commission issued a concept release on Competitive Developments in the Options Markets, Exch. Act Rel. No. 49175 (Feb. 3, 2004), as well as a broader Concept Release concerning Self-Regulation, Exch. Act Rel. No. 50,700 (Nov. 18,

¹⁵ Even before these releases, the Commission Staff’s Market 2000 report, issued in 1994, also reviewed exactly the same issues.

2004). Last year, the Commission issued yet another Concept Release on Market Structure, Exch. Act Rel. No. 61,358 (Jan. 14, 2010). Every single one of these concept releases asked questions about order internalization and the effect of payment for order flow practices on competition.¹⁶ None of those concept releases have ever resulted in a concrete rule proposal.

We understand that the Division staff may have concerns about rebates over \$0.50 per contract, on the theory that rebates of this size call into question the integrity of the public quotes for those securities. If so, the Division should convince the Commission to propose such a standard in a uniform industry-wide rule. A uniform, industry-wide rule is especially necessary because, as discussed above, the BOX PIP fee proposal simply is matching (albeit in a more transparent and less discriminatory way) fee rebates offered by specialists at all of the major competing options exchanges. As discussed above (at n.5-6 and accompanying text), all of the options exchanges larger than BOX already charge marketing fees of \$0.70 or \$0.65 per contract, for non-Penny Pilot options classes, which their specialists use to pay order flow rebates. In other words, fees exceeding the \$0.50 per contract level already exist throughout the options market. There is no justification for addressing such an issue by delaying the rule proposal of a single options exchange, while allowing other options exchanges to compete for order flow through a practice which is economically indistinguishable.

With all respect, BOX firmly believes that if, as a result of its extended study, the Commission now wishes to propose some actual rules to address the issues of internalization and payment for order flow, then it should do so by means of a proposing release equally applicable to all exchanges. It would be fundamentally unfair to address these market-wide issues in an SRO rule disapproval proceeding applicable only to the seventh-largest of the nine options exchanges.

If The Commission Does Institute a Disapproval Proceeding, It Should Not Stay the Effectiveness of BOX's PIP Fee Proposal During the Course of that Proceeding

If, contrary to the arguments above, the Commission does choose to institute a disapproval proceeding here, then it should not stay the effectiveness of the BOX PIP fee proposal during that disapproval proceeding. As discussed above, the BOX PIP fee proposal simply allows BOX to compete on a level playing field with the other, larger options exchanges, which are already charging economically indistinguishable fees. If the Commission wants to address the larger market structure issues associated with internalization and payment for order flow, it should not discriminate against BOX while it undertakes that review. As discussed above, it would cause significant competitive harm to BOX, the seventh-largest of the nine options exchanges, to deny it the ability to charge the fees it proposes, while its larger competitors are allowed to charge fees that are virtually identical. As discussed above, the options market is highly competitive and rapidly changing, and it would be unfair to force BOX to wait as long as a year or more to be able to match what its competitors are already doing. If the Commission does institute a disapproval proceeding here, it should not stay the effectiveness of the BOX PIP fee proposal; it


¹⁶ The Commission has never determined that payment for order flow has a harmful effect on the markets: it has stated that these programs return money to broker-dealers which allow the broker-dealers to offer trading at lower commission rates, and to offer other beneficial programs to investors.

should allow BOX to implement the fee during the course of the proceeding. Allowing BOX to implement the BOX PIP fee proposal during the course of the proceeding would permit the Commission to consider the larger market structure policy issues without causing unfair harm to a single, small options exchange while it conducts that review.

Conclusion

The BOX PIP fee proposal benefits investors, and returned \$8.6 million in price improvement benefits to those investors in the six weeks it was in effect. The BOX PIP fee proposal, during that time, presented no obstacle to other BOX members participating in price improvement auctions. During those six weeks, the BOX PIP fee proposal did not result in any increase in internalization. The BOX PIP fee proposal is a transparent, non-discriminatory version of a practice in which the other major options exchanges (through their specialist rebate programs) already engage, and allows BOX to compete on a level playing field with those other options exchanges which already charge virtually identical fees. Section 19(b)(3)(A) was intended to permit exactly this kind of robust fee competition among exchanges. To the extent that the Commission has market structure concerns about internalization and payment for order flow, the appropriate means to address those concerns is through an industry-wide rulemaking, not a disapproval order aimed at a single, small options exchange. For all of these reasons, we urge the Commission not to institute disapproval proceedings, and to allow the BOX PIP fee proposal to remain in effect. If the Commission does institute disapproval proceedings, it should not stay the effectiveness of the BOX PIP fee proposal during the course of that proceeding.

Respectfully submitted,


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Sept. 27, 2011

PROOF OF SERVICE

I am over eighteen years of age, not a party in this action, and employed in San Francisco County, California at Three Embarcadero Center, San Francisco, California 94111-4067. I am readily familiar with the practice of this office for collection and processing of correspondence for next business day Federal Express delivery, and they are deposited that same day in the ordinary course of business.

On September 26, 2011, I served the attached:

PETITION FOR REVIEW OF ACTION BY DELEGATED AUTHORITY

- (BY FAX) on _____, at _____ m, by transmitting via facsimile the document(s) listed above to the fax number(s) set forth below on this date. The facsimile machine I used complied with California Rules of Court, Rule 2003(3) and the transmission was reported as complete and without error by the machine. Pursuant to California Rules of Court, Rule 2008(e)(4), I caused the machine to print a transmission record of the transmission, a copy of which is attached to this declaration.
- (BY MAIL) by causing a true and correct copy of the above to be placed in the United States Mail at San Francisco, California in sealed envelope(s) with postage prepaid, addressed as set forth below. I am readily familiar with this law firm's practice for collection and processing of correspondence for mailing with the United States Postal Service. Correspondence is deposited with the United States Postal Service the same day it is left for collection and processing in the ordinary course of business.
- (FEDERAL EXPRESS/OVERNIGHT DELIVERY) by causing a true and correct copy of the document(s) listed above to be delivered by Federal Express in sealed envelope(s) with all fees prepaid at the address(es) set forth below.
- (PERSONAL SERVICE) by causing a true and correct copy of the above documents to be hand delivered in sealed envelope(s) with all fees fully paid to the person(s) at the address(es) set forth below.
- (VIA EMAIL) by transmitting a true and correct copy via email the document(s) listed above on this date before 5:00 p.m. PST to the person(s) at the email address(es) set forth below.
- (VIA LEXISNEXIS) by causing a true and correct copy of the document(s) listed above to be sent via electronic transmission through LexisNexis File & Serve to the person(s) at the address(es) set forth below.

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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on September 26, 2011, at San Francisco, California.



Christine Mustin