

July 15, 2011

VIA FACSIMILE
AND FEDERAL EXPRESS

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: SR-BATS-2011-009, Securities Exchange Release No. 64781
Petition for Review

Dear Ms. Murphy:

Enclosed please find the original and three copies of Petition for Review regarding the above-caption matter. The Boston Options Exchange Group LLC (“BOX”), Chicago Board Options Exchange, Incorporated (“CBOE”), C2 Options Exchange, Incorporated (“C2”), International Securities Exchange, LLC (“ISE”), NASDAQ OMX Group, Inc., on behalf of its subsidiary options exchanges, The NASDAQ Options Market (“NASDAQ Options”) and NASDAQ OMX PHLX (“NASDAQ PHLX”), NYSE Euronext, on behalf of its subsidiary options exchanges, NYSE Arca Inc. (“NYSE Arca”) and NYSE Amex LLC (“NYSE Amex”)(together, “Parties”) submit this Petition for Review. Pursuant to Rule 154(c) of the Securities and Exchange Commission’s Rules of Practice, the Parties certify that the enclosed Petition for Review does not exceed 7,000 words. This Petition for Review was sent via facsimile to telephone number 202-772-9324 and via Federal Express on July 15, 2011. Also enclosed, please find a Certificate of Service and a facsimile confirmation sheet.

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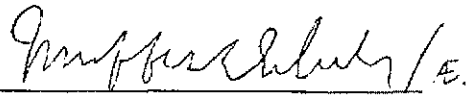
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Sincerely,



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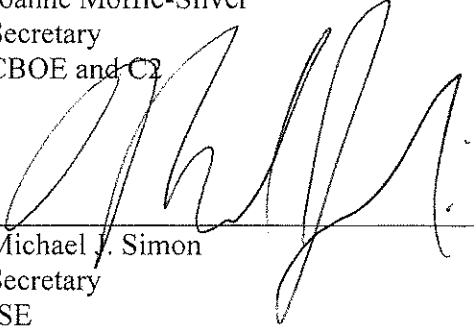
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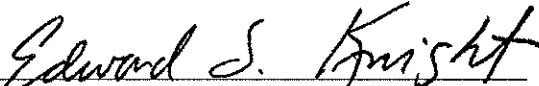
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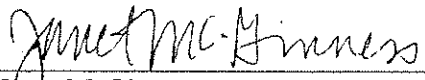

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CERTIFICATE OF SERVICE

We, Lisa J. Fall, Secretary of the Boston Options Exchange Group, LLC, Joanne Moffic-Silver, Secretary of the Chicago Board Options Exchange, Incorporated and C2 Options Exchange, Incorporated, Michael J. Simon, Secretary of the International Securities Exchange, LLC, Edward S. Knight, Executive Vice President and General Counsel of NASDAQ OMX Group, Inc., and Janet McGinness, Secretary of NYSE Euronext, hereby certify that on July 15, 2011, we served copies of the attached Petition for Review of SR-BATS-2011-009 (Securities Exchange Act Release No. 64781) by way of facsimile and that the original was sent that day by Federal Express to:

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Eric Swanson
General Counsel
Bats Exchange, Inc.
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July 15, 2011
Date



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Joanne Moffic-Silver
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July 15, 2011
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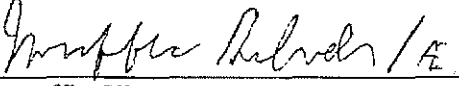
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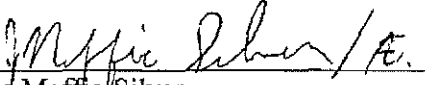
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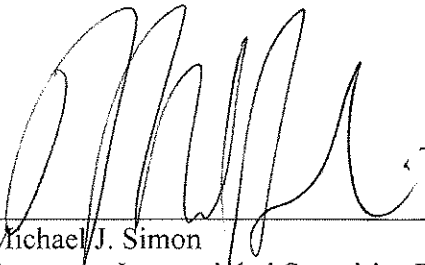
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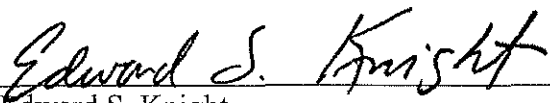
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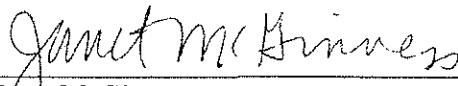

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**Before the
SECURITIES AND EXCHANGE COMMISSION**

In the Matter of the Petition of:)	
)	File No. SR-BATS-2011-009
Boston Options Exchange Group LLC;)	
Chicago Board Options Exchange,)	
Incorporated;)	
C2 Options Exchange, Incorporated;)	
International Securities Exchange, LLC;)	
NASDAQ OMX Group, Inc.; and)	
NYSE Euronext)	
)	
)	

PETITION FOR REVIEW

Every U.S. securities exchange that serves retail options investors other than the options market operated by the BATS Exchange, Inc. (“BATS”)¹ hereby petitions for further review of a precedent-setting action taken by the staff pursuant to delegated authority.² This action will harm retail investors and burden competition in violation of the Securities Exchange Act of 1934 (the “Exchange Act”). Specifically, the action under delegated authority (i) permits BATS options market makers to discriminate among order flow providers – granting access to the best prices to certain members and investors while denying it to others; and (ii) eliminates exposure

¹ The petition is filed by The Boston Options Exchange Group LLC (“BOX”), Chicago Board Options Exchange, Incorporated (“CBOE”), C2 Options Exchange, Incorporated (“C2”), International Securities Exchange, LLC (“ISE”), The NASDAQ OMX Group, Inc., on behalf of its subsidiary options exchanges, The NASDAQ Options Market (“NASDAQ Options”) and NASDAQ OMX PHLX (“NASDAQ PHLX”), NYSE Euronext, on behalf of its subsidiary options exchanges, NYSE Arca Inc. (“NYSE Arca”) and NYSE Amex LLC (“NYSE Amex”) (each, a “Party” and together, the “Parties”).

² See Securities Exchange Act Release No. 64781 (June 30, 2011), 76 FR 39953 (July 7, 2011) (“Approval Order”).

of orders, including retail customer orders, that are labeled as “directed orders”. Decreasing order exposure – in essence, reducing market transparency – in options trading contradicts long established Commission precedent, and recent Commission statements about the harms of increasing darkness in equities trading.³ If not reversed, this reduction in transparency will be replicated by competing exchanges, leading U.S. options markets into the same darkness that currently afflicts the equities markets.

The Approval Order broadly expands the type and degree of discrimination the Exchange Act permits. It contrives to distinguish between exchanges discriminating against exchange members, as opposed to exchanges facilitating discrimination by certain exchange members against other exchange members. The Approval Order’s treatment of discrimination contradicts Commission statements concerning discrimination in options pricing, and lacks a clearly articulated standard for distinguishing permissible and impermissible discrimination.⁴ Setting standards for significant policies belongs in the exclusive province of the full Commission, not in a staff-approved pilot that other exchanges will be forced to copy.

The Staff’s action is also based on erroneous conclusions of fact and law. The Approval Order contains material misstatements of fact regarding the operation of the BATS directed order program, payment for order flow, and trading in penny pilot options. There is no record evidence that the BATS directed order program is reasonably designed to or will in fact benefit retail investors. These errors are attributable to the fact that the Approval Order failed to consider

³ See Concept Release on Equity Market Structure (Release No. 34-61358; File No. S7-02-10); See Findings Regarding The Market Events Of May 6, 2010, Report Of The Staffs Of The CFTC And SEC To The Joint Advisory Committee On Emerging Regulatory Issues, September 30, 2010, at p. 56.

⁴ See, e.g., Proposed Amendments to Rule 610 of Regulation NMS (Release No. 34-61902; File No. S7-09-10), available at <http://www.sec.gov/rules/proposed/2010/34-61902.pdf>.

all of the comments submitted,⁵ and that a substantive Filing amendment was approved on an accelerated basis without the opportunity for and benefits of prior public comments.

Accordingly, the Parties hereby request, pursuant to Rule 430 of the Rule of Practice of the Securities and Exchange Commission (“Rules of Practice”), 17 CFR 201.430, that the Securities and Exchange Commission (“Commission”) review and set aside the approval by the Division of Trading and Markets (“Staff”) pursuant to delegated authority of a proposed rule change, File No. SR-BATS-2011-009 (the “Filing”), filed by BATS, pursuant to Section 19(b)(1) of the Exchange Act, 15 U.S.C. § 78s(b)(1). Under the Rules of Practice, the full Commission will review an action pursuant to delegated authority if that action involves prejudicial error, embodies a finding or conclusion of material fact or law that is clearly erroneous, and embodies an exercise of discretion or decision of law or policy that is important to investors and the options markets that should be addressed by the full Commission. As discussed in detail below,

⁵ Letters to Elizabeth M. Murphy, Secretary, Commission, from Jennifer M. Lamie, Assistant General Counsel, Legal Division, Chicago Board Options Exchange, dated June 29, 2011; Tom Wittman, The NASDAQ OMX PHLX, Inc. and The NASDAQ Options Market, dated June 24, 2011; Janet L. McGinness, SVP & Corporate Secretary, Legal & Government Affairs, NYSE Euronext, dated June 17, 2011; Michael J. Simon, Secretary, International Securities Exchange, LLC, dated June 17, 2011; Anthony D. McCormick, Chief Executive Officer, BOX Options Exchange Group, LLC, dated June 13, 2011; Angelo Evangelou, Assistant General Counsel, Legal Division, CBOE, dated April 27, 2011; John C. Nagel, Managing Director and General Counsel, Asset Management and Markets, Citadel LLC, dated April 25, 2011; Andrew Stevens, Legal Counsel, IMC Chicago, LLC d/b/a IMC Financial Markets, dated April 21, 2011; Janet L. McGinness, SVP & Corporate Secretary, Legal & Government Affairs, NYSE Euronext, dated April 21, 2011; Kurt Eckert, Principal, Wolverine Trading, LLC, dated April 21, 2011; Tom Wittman, Nasdaq, dated April 21, 2011; Michael J. Simon, Secretary, ISE, dated April 21, 2011; and Anthony D. McCormick, Chief Executive Officer, BOX, dated March 29, 2011. An additional comment letter opposing the Filing from the Securities Industry and Financial Markets Association (“SIFMA”) was received by the Commission on the day that the approval order was issued. Letter to Elizabeth M. Murphy, Secretary, Commission, from Thomas F. Price, Managing Director, SIFMA, dated June 30, 2011.

the Filing clearly represents a policy decision, in fact significant shifts in two major policies, that is important and that the Commission should review.

Description of the Filing

The Filing introduces an order type called a “Market Maker Price Improving Order” (“MMPIO”), which is an order from a BATS options market maker to buy or sell that has two components: (i) a displayed price and size, and (ii) a non-displayed price at which the market maker is willing to trade with a “Directed Order” from another BATS options member that the directed market maker has pre-selected. The non-displayed price may be entered in penny increments, and is only executable against a marketable Directed Order if the displayed price is at the national best bid (for a Directed Order to sell) or national best offer (for a Directed Order to buy).

A marketable Directed Order automatically is matched against an executable MMPIO without exposure of the order to any market participants. The only opportunity for other market participants to execute against a marketable Directed Order before it is matched against the non-displayed price of a MMPIO is to maintain pre-existing non-displayed orders on the BATS order book at prices equal to or better than the non-displayed price of the MMPIO. BATS, however, does not allow other market participants to maintain non-displayed prices in penny increments in options that trade in penny increments.⁶ Thus, for most option classes, customers will not be able to compete meaningfully with MMPIOs.

⁶ In options that trade in penny increments the ability to enter non-displayed prices in penny increments is limited to market makers that have a Directed Order arrangement with other BATS options members. Such options have accounted for 83.3 percent of all options trading volume in 2011 as of July 13th.

In an amendment to the Filing that was not published for public comment prior to approval, BATS modified the proposal to allow members to direct Directed Orders to more than one directed market maker. In such a case, if there are multiple executable MMPIOs from the selected directed market makers, the MMPIOs will be executed in price priority and in time priority at the same price.

Applicable Legal Requirements

Rules 430 and 431 of the Rules of Practice, 17 CFR 201.430 and 201.431, provide for Commission review of Staff action taken by delegated authority upon request by a person aggrieved by the Staff's action. Each Party is a national securities exchange registered with the Commission and is directly affected by the Staff's approval of the Filing because, as discussed in detail below, it fundamentally alters the structure of the options market in which the Parties conduct their business.⁷ The Parties have complied with the procedural requirements contained in Rule 430.⁸

Rule 431 contains the requirements relating to the Commission's review of the petition. Rule 431 provides that the Commission, in determining whether to grant review in response to a petition such as this one, must look to the standards set forth in Rule 411(b)(2) of the Rules of Practice, 17 CFR 201.411(b)(2). This provision instructs the Commission to consider whether the petition for review makes a reasonable showing that (i) a prejudicial error was committed in the conduct of the proceeding; or (ii) the decision embodies: (A) a finding or conclusion of material fact that is clearly erroneous; (B) a conclusion of law that is erroneous; or (C) an

⁷ BOX is an options trading facility of NASDAQ OMX BX, Inc. under Section 3(a)(2) of the Exchange Act.

⁸ The Parties had actual notice of the action on July 1, 2011, and the Parties filed an Intent Notice on July 8, 2011. See Letter from the Parties to Elizabeth M. Murphy, Secretary, SEC, dated July 8, 2011.

exercise of discretion or decision of law or policy that is important and that the Commission should review.

Background on the Options Market

In equities, broker-dealers have the ability to execute public customer order flow off-exchange, and a significant amount of trading volume, in fact, does occur “off-board.”⁹ This permits broker-dealers to trade against the most profitable order flow themselves, “internalizing” 100 percent of such order flow. In the options market, broker-dealers lack the ability to execute their retail order flow in standardized options off-exchange. Moreover, the options market generally requires that orders, regardless of origin type, be exposed to the marketplace prior to execution. Thus, orders either trade against a known national best bid or offer (“NBBO”) price where all market participants are eligible to participate at that price, or are processed through a price improvement auction that is open to all market participants. As a result of this structure, participants in the options market compete vigorously for the opportunity to execute against retail order flow, and this competition leads to better prices for all investors.

When the Commission extended the Quote Rule to cover listed options in 2000, it recognized that market makers might be willing to provide public customers better prices and sizes of quotations than those they would provide to market professionals.¹⁰ Accordingly, after carefully considering two alternative proposals, the Commission adopted a rule that allowed exchanges to establish minimum quotation sizes that could be smaller for professionals than for

⁹ In 2010, 33 percent of the volume in NYSE-listed equity securities, and 31 percent of the volume in Nasdaq-listed equity securities, was executed off-board. This was larger than the percentage executed on any one exchange. Financial Information Forum, Market Share Report (December 2010).

¹⁰ See Exchange Act Release No. 43591 (November 17, 2000), 65 FR 75439 (December 1, 2000).

public customers. However, competition among the options exchanges resulted in quotations that are firm for all orders by both market professionals and public customers for the full size of the displayed price. Consequently, the industry developed an alternative way to provide retail customers with better prices than those reflected in the public quotation through various forms of price improvement auctions that are not publicly displayed.

This market structure benefits public customers so long as the pricing process provides the best possible price to the customer. In this respect, the current structure works well because the price discovery process is open to most, if not all, of an exchange's members. This broad participation in the price discovery process is an important safeguard because it assures that retail customer orders are receiving the best prices regardless of other incentives that might exist in the marketplace (*e.g.*, fees, payment for order flow ("PFOF"), or internalization).

Significant Policy Concern that Warrants Commission Consideration

The Filing fundamentally changes the options market structure discussed above because it restricts the ability of market participants other than directed market makers to compete. Only the directed market maker has the ability to enter price improving orders with limited risk, making it impossible for other market participants to compete for Directed Orders. All other market participants, whether through publicly-displayed prices or non-displayed prices in \$0.05 and \$0.10 increment series, will be at risk of trading against all incoming orders. As discussed above, the prices at which options market participants are willing to trade with professional market participants must take into consideration the additional risk involved. Market participants will provide better prices when they know the order for which they are bidding or offering is a retail customer order. In fact, the Approval Order acknowledges and agrees with this fact:

The proposal allows market makers to differentiate between orders from traders that are relatively more informed about the short-term direction of prices (e.g., professional traders) and order from less informed traders (e.g., retail investors). In this way, it may enable BATS Options market makers to provide better prices to less informed order flow that they otherwise would not be willing or able to provide if they had to make those prices available to all incoming order flow.¹¹

However, under the BATS proposal, only the directed market maker is able to enter prices secure in the knowledge that they are only at risk of being executed by select retail order flow at the non-displayed price. In all other directed order programs, market makers are allowed to specify from whom they will accept directed orders, but only in two circumstances: (i) if the directed orders are exposed through an auction in which all members participate, or (ii) if the orders automatically execute against a transparent NBBO price that is accessible to all participants. These auctions allow other members to submit prices knowing the size of the order and that it is a customer order that was selected by another participant for price improvement, thereby giving them an equal opportunity to provide competitive pricing for the customer order. Order exposure is in the best interest of the customer, as it produces the best possible price for the order.

The Approval Order denies customer orders the opportunity to receive the best price through competitive pricing and allows directed market makers to execute against retail orders without competition by combining these three elements: (i) eliminating the auction; (ii) preventing other market participants from entering hidden prices in penny increments in over 83% of the market; and (iii) allowing market makers to post prices that are only firm for selected order flow. Contrary to the conclusions of the Staff, there is no support in the record that this will result in better prices for retail customer orders. While a greater number of retail orders may

¹¹ Approval Order, *supra* note 2, at 15.

receive executions that are better than the NBBO, there will be no net benefit to retail orders because the displayed price at the NBBO will only reflect the prices available to non-retail customers. In the Approval Order, the Staff analysis of this issue is as follows:

The Commission believes that order exposure generally is beneficial to options markets in that it provides an incentive to options market makers to provide liquidity and therefore plays an important role in ensuring competition in the options markets. The Commission also recognizes, however, the importance of providing effective opportunities for customer order flow in listed options to receive executions at prices better than the NBBO. In evaluating the proposal, the Commission has weighed the relative merits of each for the options markets.¹²

We appreciate that the review of any filing raising substantive issues requires a careful balancing of competing policy objectives, but dramatic changes to longstanding market structure policies should be approved by the full Commission. In this case, the Staff's analysis is flawed, in that it failed to recognize that competition in the options markets is important because it leads to better prices for customers. By framing order exposure as a benefit to options market makers, the Staff incorrectly weighed the benefits of order exposure for market makers versus the benefits of price improvement for customer order flow. The correct analysis, which should be completed by the full Commission, is whether customers will be benefited or negatively impacted from the Filing given that: (i) their orders will be executed at hidden prices without the safeguard provided by competitive auctions; and (ii) the NBBO from which price improvement is measured will be degraded.

The options marketplace already provides numerous opportunities for customer orders to receive executions at prices better than the NBBO. Thus, approval of the proposal was not necessary to achieve that objective. Indeed, implementation of the BATS proposal will likely siphon off public exposure and execution of retail customer order flow. This, in turn, will lead to

¹² Approval Order, *supra* note 2, at 13

the degradation of the NBBO. The careful balance the Staff sought to preserve will actually result in the general elimination of customer order exposure and customers will receive executions at prices that only improve on a degraded NBBO that reflects prices at which market makers are willing to trade with professional traders.

Additionally, the Approval Order only gives the ability to enter MMPIOs in non-displayed increments to directed market makers and only allows certain select BATS options members to trade against that non-displayed interest. All other market participants would be ineligible to participate or compete on the same terms. Under Section 6(b)(5) of the Exchange Act, among other things, exchanges are required to have rules that are not designed to permit unfair discrimination. The Approval Order does not address this issue of discrimination. The full Commission should consider whether the design of the BATS Directed Order program - the denial of access of other market participants to participate in the program (or conversely, the extension of the privilege to participate in the program to only directed market makers and their select Directed Order senders) - is "fair." By contrast, for example, in approving more traditional market maker participation entitlements (which are (i) generally limited to 40% after public customer interest is satisfied, (ii) only available after an opportunity for exposure and participation by all other market participants, and (iii) only available to market makers that satisfy certain heightened all-day quoting obligations), the SEC has made findings that based on a balancing of the interest and obligations and benefits conferred, the entitlement is fair. No finding was made here and, in addition, many of the core elements required of those traditional programs are not present in the BATS proposal.

The Approval Order shows that the primary policy concern of the Staff was the existence of PFOF in the options market. The Approval Order states:

The Commission is approving the BATS proposal in the context of the existence of PFOF arrangements in the options markets. Should such arrangements no longer be present in the options market, the Commission expects the Exchange to re-evaluate, and the Commission may re-evaluate, whether the Directed Order program is appropriate.¹³

The Commission has long debated the merits of PFOF in the securities industry, including exhaustive study of the impact of PFOF on the quality of markets and its potential effect on best execution, but has never concluded that PFOF practices are necessarily harmful to customers or inconsistent with the Exchange Act.

As discussed above, trading in listed options is conducted on exchanges through highly competitive trading mechanisms. The Commission should consider carefully that approving a mechanism which allows broker-dealers to bypass intra-market competition is a significant shift in market structure that will negatively impact the quality of the options market and result in worse prices for customer orders. Only the full Commission can decide whether the elimination of PFOF is a policy objective to be pursued even at the cost of competitive exchange markets. Moreover, as discussed below, the Parties do not believe that the Filing would achieve such a policy objective. The Commission simply cannot allow a rule change that sacrifices the quality of execution for customer order flow, and denies other market participants the fair opportunity to compete, to be approved by delegated authority based on an unsubstantiated belief that it will reduce or eliminate PFOF.

Deficiencies in Staff's Approval of the Filing

The Commission also should set aside the Approval Order because many of the Staff's findings are either erroneous or unsupported by any facts or analysis.

¹³ Approval Order, *supra* note 2, at footnote 49.

A. The Approval Order is Based on Erroneous or Unsupported Findings

The Staff based its approval of the Filing on its conclusion that it acts as an alternative mechanism to PFOF.¹⁴ The Staff states that the Filing “provides a means to benefit customers directly through price improvement, rather than the customer’s broker through PFOF.”¹⁵

However, there is no factual basis or analysis supporting this conclusion. Indeed, we believe that it is more likely that the opposite is in fact the case: Because a directed market maker will be assured of executing against all of the highly profitable customer orders directed to it without competition from other market participants, they may well pay more for directed order flow than they do on other markets. Moreover, because there will be no price competition from other BATS participants, directed market makers will offer the lowest amount of price improvement permitted, further enabling them to pay more for customer order flow. Again, even if this is an alternate form of PFOF, should an exchange be permitted to discriminate by allowing only directed market makers to participate in this form of exchange-sponsored PFOF while excluding all other market makers and market participants from participating? There is a difference between exchange-sponsored PFOF programs (which by statute and rule must be fair, non-discriminatory) and private PFOF arrangements.

The Approval Order also misconstrues how PFOF, preferencing and price improvement mechanisms work within the options market currently. The Staff states:

[PFOF] arrangements likely impact the incentives for market makers (or others) to quote aggressively to trade with order flow covered by such PFOF arrangements because market participants know that the market makers will be able to trade with some or all of the captured order flow as long as they match the

¹⁴ Approval Order, *supra* note 2, at footnote 49 and accompanying text.

¹⁵ *Id.*

NBBO (whether by displaying quotes that match the NBBO set by others or by matching better quotes elsewhere pursuant to mechanisms that provide market makers with the opportunity to step-up and trade with orders that are exposed).¹⁶

There is no empirical evidence that PFOF acts as a disincentive for market makers to quote aggressively in the options market today, and such a conclusion is inconsistent with the current options market structure. Market makers cannot execute any portion of an order unless they are quoting at the best available price, which must be at least equal to the NBBO. The NBBO represents the prices of all the options exchanges, including those that do not support PFOF programs. Moreover, while it is true that market makers on options exchanges may pay for retail order flow, it is not true that such order flow is “captured” because all such orders entered onto the exchanges are executed through competitive processes, either: (i) upon entry at the NBBO (at which preferencing is capped at 40 percent); (ii) pursuant to a price-improvement auction either initiated by a broker or a market maker to whom the order was directed; (iii) pursuant to an auction when the exchange is not at the NBBO; or (iv) at the NBBO pursuant to the intermarket linkage rules. Indeed, the Filing is significant because it allows order flow to be “captured” by two members of an exchange who can trade with each other without competition from other members.

The Approval Order contains other misstatements. For instance, the Staff also states in the Approval Order:

The Commission recognizes that other exchanges have adopted different mechanisms that include an order exposure element to provide price improvement to customer orders. The Commission questions, however, the extent to which these mechanisms are utilized.¹⁷

¹⁶ Approval Order, *supra* note 2, at 14.

¹⁷ Approval Order, *supra* note 2, at 16.

The Staff provides no support for this last statement. In fact, the exchanges that operate price improvement auctions provide the Commission with monthly data reports focused most specifically on the execution of retail-size customer orders.¹⁸ These confidential reports indicate that a significant number of retail-size customer orders are exposed via the existing price improvement mechanisms and that customers receive price improvement well above the minimum increment on average. The Commission should consider this data in evaluating whether customers are better served in the current market structure with competitive pricing and PFOF, or in a market structure that may or may not include PFOF, but allows captured customer order flow to be executed without competitive pricing.

B. The Approval Order Fails to Present a Statutory Basis

The Approval Order lacks sufficient analysis of how the Filing complies with the requirements of the Exchange Act. In particular, the Approval Order notes that the Exchange Act does not prohibit exchange members or other broker-dealers from discriminating among customers, and that broker-dealers commonly differentiate between customers based on the nature and profitability of their business. The Approval Order also notes that market makers often view less informed order flow as desirable, and that allowing market makers that participate in the Directed Order program to differentiate between customers may further

¹⁸ *E.g.*, with respect to BOX Price Improvement Period: Securities Exchange Act Release No. 62512 (July 16, 2010), 75 FR 43223 (July 23, 2010) (SR-BX-2010-046); Securities and Exchange Act Release Nos. 60337 (July 17, 2009), 74 FR 36805 (July 24, 2009) (SR-BX-2009-38); 58942 (November 13, 2008), 73 FR 70394 (November 20, 2008) (SR-BSE-2008-49); 58195 (July 18, 2008), 73 FR 43801 (July 28, 2008) (SR-BSE-2008-39); 55999 (July 2, 2007), 72 FR 37549 (July 10, 2007) (SR-BSE-2007-27); 54066 (June 29, 2006), 71 FR 38434 (July 6, 2006) (SR-BSE-2006-24); 52149 (July 28, 2005), 70 FR 44704 (August 3, 2005) (SR-BSE-2005-22); 49068 (January 13, 2004), 69 FR 2775 (January 20, 2004) (SR-BSE-2002-15) (“Original PIP Pilot Program Approval Order”); and 51821 (June 10, 2005), 70 FR 35143 (June 16, 2005) (SR-BSE-2004-51) (Order Approval Relating to the Trading of Market Orders on the Boston Options Exchange).

encourage market makers to provide price improvement to less informed customer order flow, which would benefit investors. This analysis is insufficient, however, as the Filing does not simply allow market makers to differentiate between professionals and retail customers as a group; it allows market makers to differentiate between retail customers based upon the BATS member that routes the order to the exchange.

The Approval Order appears to give broker-dealers wider discretion to discriminate among their customers than registered exchanges have to discriminate among broker-dealer members. Discrimination among exchange members as provided in the Filing and among retail customer orders based upon the firm that routed the order to the exchange are all issues of first impression that are not addressed in the Approval Order. Section 6(b)(5) states that the rules of an exchange must not be designed to permit unfair discrimination between customers, issuers, broker, or dealers. Section 6(b)(8) of the Exchange Act prohibits exchanges from imposing any burden on competition that is not necessary or appropriate.

It is inconsistent with the Exchange Act to allow a market maker on an exchange to discriminate among broker-dealers and customers as provided in the Filing. Such discrimination will be based on either an affiliation between the market maker and the order routing firm, or a business relationship (*e.g.*, PFOF arrangement) between them. This discrimination among members of an exchange as to the prices available to them on the exchange is not addressed in the order. Moreover, the discriminatory prices available to certain members on the exchange will result in discrimination among retail customers as to the prices available to them on an exchange based upon the broker-dealer that handles their orders. There is no analysis of how this discrimination is “fair” for BATS members that do not have a relationship with a directed market maker, or how it is “fair” for customer orders that are not directed to market makers, or

how it is “fair” for only market makers to submit non-displayed orders in this manner while all other BATS participants are ineligible to do so. Rather, the staff concludes that the Filing is consistent with the Exchange Act because the discrimination may benefit some investors.

The Commission and not the Staff should articulate a standard for “unfair discrimination” under the Exchange Act. Is the Commission now saying that exchanges cannot discriminate directly but that they can promulgate policies that facilitate discrimination? What is the statutorily cognizable difference between exchanges discriminating directly and facilitating the same discrimination indirectly? Are exchanges permitted to look the other way at discrimination by members or must they apply a standard of fairness to such discrimination? If so, what standard would the Commission apply or have the exchanges apply? These are important questions, and there are many others. If the Commission is prepared to answer those questions, it should do so through a concept release or adopting release rather than through piecemeal approval via delegated authority of a pilot program other exchanges will be forced to copy.

C. Accelerated Approval of the Amendment Was Inappropriate Because the Amendment Substantially Modified the BATS Proposal

As discussed above, we believe that the proposal will result in worse prices for customer orders because the Filing virtually guarantees a reduction of price competition. In the Approval Order, the Staff addresses this concern by noting in a footnote that pursuant to an amendment, BATS members will be permitted to direct their orders to more than one directed market maker.¹⁹ The Staff asserts that this may encourage competition for Directed Orders and may potentially encourage directed market makers to provide more than a minimum amount of price improvement.

¹⁹ Approval Order, *supra* note 2, at note 52.

This assertion is unsubstantiated and incorrect. Because it appears that the Staff is relying on this amendment as a basis for approving the Filing, we believe that the Commission should have sought comment on the amendment prior to approving the Filing. None of the comments received by the Commission during the comment period suggested that allowing a broker to direct orders to more than one directed market maker would address the concerns raised.²⁰ The amendment to the Filing does not require a broker to direct orders to all BATS market makers. Simply allowing a broker to direct an order to multiple market makers will have little or no impact on the Filing, as it is highly unlikely that a broker will ever direct orders to more than one BATS market maker. Rather, brokers will either direct their orders exclusively to their affiliated BATS market maker or to the BATS market maker that provides the highest level of PFOF in exchange for exclusivity. Indeed, this provision could serve to increase the amount of PFOF provided by BATS market makers, thus creating a further economic burden on them that will assure that customers receive the minimum amount of price improvement. We believe that given the previously stated incentive for undisclosed PFOF, a directed market maker may receive a higher percentage of Directed Orders despite offering a lower level of price improvement. Moreover, the amendment does not address the fact that unless an order is directed to and accepted by all BATS directed market makers, an order directed to a directed market maker whose MMPIO is at an inferior price than another directed market maker's MMPIO will not receive the best price available on the BATS exchange. Accordingly, the Filing should not have been approved without seeking comment on the amendment and should not have served as a basis for approving the Filing.

²⁰ See June 17, 2011 Letter from Janet L. McGinness, Senior Vice President –Legal and Corporate Secretary, Legal and Government Affairs, NYSE Euronext.

Conclusion

The Approval Order prompted all U.S. options markets to submit an unprecedented petition for review to the Commission. Our uniform action reflects the severe impact the Approval Order will have on the options market. This is not an issue of competition among markets; all of the Parties can (and will be forced to) copy the directed order structure of BATS if the Commission approves the Filing. Rather, the Parties believe that the Filing will remove retail order flow from the competitive exchange market structure, which will negatively impact the prices received by both retail and professional options investors. Given the importance of the Filing, we believe it is critical that the full Commission evaluate whether it is consistent with the requirements of the Exchange Act.

The Parties therefore respectfully request that the Commission grant our request for further review of SR-BATS-2011-09. At a minimum, the Staff's approval of the Filing pursuant to delegated authority was an exercise of discretion or decision of law or policy that is vitally important to the options market and the Parties, and that the Commission should review and set aside the Staff's approval order.

DATED: July 15, 2011

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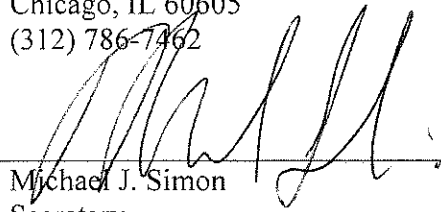
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