

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52501; File No. SR-BSE-2005-30)

September 23, 2005

Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Order Approving a Proposed Rule Change and Amendment No. 2 Thereto Relating to the Removal of Unreliable Quotes From the Exchange's Determination of the National Best Bid or Offer

I. Introduction

On July 27, 2005, the Boston Stock Exchange, Inc. ("BSE"), filed with the Securities and Exchange Commission ("Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² to adopt a rule relating to the removal of unreliable quotes from the determination of the national best bid or offer ("NBBO"). The BSE filed Amendment No. 1 to the proposed rule change on August 5, 2005 and withdrew Amendment No. 1 on August 12, 2005. The BSE filed Amendment No. 2 to the proposed rule change on August 12, 2005.³

The proposed rule change, as amended, was published for comment in the Federal Register on August 24, 2005.⁴ The Commission received one comment letter on the proposal.⁵ This order approves the proposed rule change, as amended.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 2 added clarifying language and corrected typographical and technical errors.

⁴ See Securities Exchange Act Release No. 52296 (August 18, 2005), 70 FR 49689.

⁵ See letter from Matthew Hinerfeld, Managing Director and Deputy General Counsel, Citadel Investment Group, L.L.C., on behalf of Citadel Derivatives Group LLC, to Jonathan G. Katz, Secretary, Commission, dated August 26, 2005 ("Citadel Letter").

II. Description of the Proposed Rule Change

Pursuant to obligations to avoid trade-throughs under the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (“Linkage Plan”),⁶ the Boston Options Exchange (“BOX”), in general, filters certain orders to either trade on BOX, if the best BOX price is at the NBBO or, if the best BOX price is not at the NBBO, to access the best price for such orders through the intermarket option linkage (“Linkage”).⁷

The BSE is proposing to add subsection (e) of Section 3 of Chapter XII of the BOX Rules to add provisions for declaring an away market’s quotes in a particular class of options unreliable and to thereby exclude such quotes from BOX’s NBBO determination when an away market: (i) is disconnected from Linkage; (ii) disseminates non-firm quotes; or (iii) has other confirmed quoting problems. The BSE proposes to exclude unreliable quotes from BOX’s NBBO determination, thereby including in BOX’s NBBO determination only quotes that are reliable and accessible to investors. The BSE seeks only to exclude an away market’s unreliable quotes in a particular option class from BOX’s NBBO determination for the time that such quotes remain unreliable.

⁶ On July 28, 2000, the Commission approved a national market system plan for the purpose of creating and operating an intermarket option linkage proposed by the American Stock Exchange LLC, the Chicago Board Options Exchange, Incorporated, and the International Securities Exchange, Inc. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000). Subsequently, upon separate requests by the Philadelphia Stock Exchange, Inc., the Pacific Exchange, Inc., and the BSE, the Commission issued orders to permit these exchanges to participate in the Linkage Plan. See Securities Exchange Act Release Nos. 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000); 43574 (November 16, 2000), 65 FR 70850 (November 28, 2000); and 49198 (February 5, 2004), 69 FR 7029 (February 12, 2004).

⁷ See subsection (i) of Section 1 of Chapter XII of the BOX Rules.

III. Comment Summary

As noted above, the Commission received one comment letter on the proposal.⁸ The commenter supported the proposal and recommended that the Commission approve it. However, the commenter suggested that the BSE modify its proposal to allow the BOX to determine that an away market is disconnected from Linkage without having to get confirmation from the away market that the away market is disconnected. The commenter cited “the need for immediate action” as the basis for suggesting that the BSE amend its proposal to allow the BOX to make its determination that a market is disconnected from Linkage without first obtaining confirmation from the away market.⁹

IV. Discussion

After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of Section 6 of the Act¹⁰ and the rules and regulations thereunder applicable to a national securities exchange.¹¹ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹² which requires, among other things, that the rules of an exchange be designed to promote just and equitable

⁸ See supra note 5.

⁹ The Citadel Letter also addressed File No. SR-Amex-2005-066, a proposal to allow the American Stock Exchange LLC (“Amex”) to exclude an away market’s quotes from the Amex’s determination of the NBBO when such away market is disconnected from Linkage. The commenter strongly supported Amex’s proposal. In addition, the commenter urged the Commission to address issues related to non-firm quotes that are outside the scope of these proposed rule changes.

¹⁰ 15 U.S.C. 78f.

¹¹ In approving this proposal, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78f(b)(5).

principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission believes that it is appropriate for BOX to remove an away market's disseminated quotes from BOX's determination of the NBBO when such quotes are unreliable. The Commission further believes that the proposed rule change establishes reasonable procedures to determine the unreliability of an away market's quotes and to notify promptly the affected away market, and establishes an appropriate standard for determining when to resume inclusion of the affected away market's quotes in BOX's NBBO.

The Commission has considered the comments made in the Citadel Letter. The Commission recognizes that the provision in the proposed rule change requiring BOX to contact an away market to confirm that its quotes are unreliable (except in circumstances in which the BOX Market Operations Center received a message from OPRA, the OLA Administrator, or the relevant away market) differs slightly from the rules adopted by the other options exchanges. Nonetheless, the Commission believes that the proposed provision is consistent with the Act.

V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-BSE-2005-30) as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Jonathan G. Katz
Secretary

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).