



September 29, 2004

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609

Re: File No. SR-Amex-2004-75

Dear Mr. Katz:

Susquehanna Investment Group (“SIG”) is a registered options specialist on the American Stock Exchange LLC (“Amex” or “Exchange”), and serves in a similar status and capacity on other options exchanges. SIG appreciates the opportunity to comment on the above referenced proposed rule change submitted by the Amex pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 19b-4 thereunder.

The Amex proposed rule change, if approved, would amend Amex Rule 154 to prohibit a specialist from charging a commission for handling an order (or portion thereof) that is not executed, an order that is executed on an opening or reopening, or an order (or portion thereof) that is executed against the specialist as principal. The Rule would also prohibit a specialist from charging a commission for the execution of off floor orders delivered to the specialist through the Exchange’s electronic order routing systems, subject to certain exceptions.¹ SIG believes that the Amex’s proposed rule change (the “Zero Commission Rate Proposal”) raises significant issues under the Exchange Act, including whether the proposal is consistent with Section 6(e) under the Exchange Act, which prohibits national securities exchanges such as the Amex from imposing “any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members.”²

¹ See proposed paragraph (b) to Rule 154.

² Although Exchange Act Section 6(e)(1)(B) permits “a national securities exchange, by rule, to impose a schedule or fix rates of commissions, allowances, discounts or other fees to be charged by its members for effecting transactions on such exchange” under certain circumstances, those circumstances do not exist in the instant matter and the Amex certainly has not provided the Commission or interested parties, such as SIG, information sufficient to conduct the processes and procedural safeguards required by Exchange Act Section 6(e)(3).

In its Rule filing, the Amex acknowledges that its Zero Commission Rate Proposal is in response to SIG's announcement that it intends to charge for the services it provides by handling orders as a specialist on the Amex.³ The Amex then articulates two bases for determining which orders it will allow specialists to charge a commission: namely that (1) "specialists traditionally charge a commission only for orders that they execute and do not bill for orders that they hold, but do not execute" and (2) "the Exchange has a policy . . . [that generally provides that] routine orders are not subject to specialist commissions while orders that require special handling or for which the specialist provides a service may be subject to a commission." The Exchange proceeds to list those instances where it believes the specialist provides special handling services sufficient to justify a commission. These bases are arbitrary at best. For example, proposed Rule 154(b) would prohibit a specialist from charging a commission for limit orders entrusted to it unless the order remains on the specialist's book for more than two minutes. The Amex does not provide any rationale for such a two minute distinction except to say that this has been the Exchange's policy. However, tradition and an Exchange policy that was never approved by the SEC are not persuasive or precedential authority to justify the fixing of commissions in contravention of Section 6(e) of the Exchange Act. Section 6(e) very clearly provides that exchanges cannot impose a schedule of commissions. But this is exactly what the Amex is attempting to do by telling one class of brokers, *i.e.*, specialists, that they can charge zero commissions for assuming agency obligations.⁴

A. Specialists perform agency functions

Specialists perform a dual role. Pursuant to their affirmative and negative obligations, specialists trade as a principal when liquidity is required and refrain from doing so when it is not; and they act as an agent for customers. As agent, specialists perform the key role of maintaining a book of limit orders. Through the performance of this service, specialists aid efficiency in trading by holding those limit orders and executing them when they become marketable. This accommodation permits other brokers to carry on their business elsewhere instead of remaining at the trading post, and allows upstairs brokers to enter non-marketable limit orders onto the Exchange floor in the care of a floor agent, *i.e.*, the specialist. Thus, the willingness of specialists to act as a special type of broker benefits the market. In return, specialists may make a "profit

³ Although the Amex indicates that SIG's proposed charges would "result in the specialist charging for orders that are executed automatically by the Exchange's systems," SIG has clarified its proposed charges to make clear that SIG only intends to charge for orders for which it undertakes agency responsibilities. Therefore, SIG does not intend to charge for market and marketable limit orders that are not placed on its specialist books because these orders are executed automatically by the Exchange's systems.

⁴ Although the Amex singles out SIG as a specialist attempting to charge commissions and other fees that are against its policies and traditions, the Amex omits that other specialist firms (*e.g.*, TD Options and Knight Derivatives) have also begun charging for their services provided as agent. These commissions would also be set at zero pursuant to the proposed Rule.

from *commissions* and trading as principal.” See D. Oesterle, D. Winslow and S. Anderson, *The New York Stock Exchange and its Outmoded Specialist System: Can the Exchange Innovate to Survive?*, JOURNAL OF CORPORATION LAW, Winter, 1992 (emphasis added).

Indeed, the NYSE’s website describes one of the key roles of its specialists as “Agent.” The website states that “[a] specialist is the agent for all SuperDot® (electronically routed) orders. A floor broker may also choose to leave an order with a specialist to represent it until it can be executed at a specified price. This frees brokers up to concentrate on other orders that require their immediate attention. As agent, a specialist assumes the same fiduciary responsibility as a broker.” The Commission also recognizes the dual role of specialists. The Commission stated that “[w]ith respect to the securities in which they specialize, specialists perform dual functions of brokers and dealers. In the capacity as a broker, the specialist holds and executes buy and sell order for others. Generally these orders are forwarded to the specialist by exchange members.” See SEC Staff Report, *The October 1987 Market Break*, Fed Sec L Rep (CCH) (Feb. 9, 1988). Specialists, therefore, are responsible for the best execution of their customers’ limit orders, and will be liable for breaches of their best execution obligation. If specialists miss executing customers’ limit orders, specialists will take a charge to their error accounts to make respective customers whole for missed executions. For the responsibility and risk involved in performing these essential agency order handling services, specialists are permitted to charge commissions and/or other fees for such services.

B. Specialists may charge commissions

The Commission has recognized the validity of specialists charging commissions for handling orders. For example, the firm quote rule, Securities Exchange Act Rule 11ac1-1(c)(2), explicitly recognizes the ability of a specialist, as a responsible broker-dealer, to impose charges for handling orders by excluding “any commission, commission equivalent or differential customarily charged by such [specialist] in connection with execution of any such order” from the price or “quote” upon which the [specialist] must be firm. Moreover in September 1996, when the Commission adopted the Display Rule that required the display of customer limit orders priced better than a specialist or market maker’s quote, see Rel. 34-37619A (Sept. 6, 1996) (“Order Handling Rules”), the Commission stated that “market makers [including specialists] may be able to obtain increased revenues from commissions or other fees charged directly to customers” to offset any dealer profits lost as a result of customer limit orders narrowing the dealer spread. The Commission also encouraged the charging of commissions by specialists and market makers for handling customer limit orders. The Commission stated that “[a]lthough exchange specialists and integrated firms may find it easier than wholesale firms to charge commissions initially, the Commission notes that wholesale firms *are not prohibited from attempting to compensate for handling limit orders, either*

through negotiated fee arrangements, or reducing any payment made for order flow for limit orders. (Emphasis added) *Id.*

The justifications for a specialist charging commissions for the execution of orders are equally applicable to a specialist charging for the service it provides to unexecuted orders, whether they expire automatically due to the passage of time or are cancelled. A specialist assumes the same agency responsibilities to these orders while they are still “live” as it does to orders that are executed. When discussing its rationale for permitting specialists to charge a commission for the execution of limit orders placed on its book for more than two minutes, the Amex even acknowledges that a specialist may appropriately “charge a commission in these circumstances because the specialist has assumed responsibility for the proper execution of the order.” The specialist assumes the same responsibility for orders that are ultimately cancelled or expire unexecuted. This responsibility is assumed by the specialist once the specialist is aware that the order has been placed on its order book and is not dependant upon whether the order is ultimately executed or whether the order remained on the specialist’s book for two minutes on any other specific time period.⁵

Indeed, a specialist assumes the obligation to all orders on its book to monitor such orders in the context of changing circumstances and display or execute such orders when the circumstances warrant these actions. Specialists also assume an agency obligation to yield priority to booked customer orders. Finally, with respect to cancelled orders, specialists have an agency obligation to properly discharge cancellation instructions, all the while maintaining its display and execution obligations to the rest of the book. Specialist firms must pay clerical staff to assist in the fulfillment of these agency obligations, and it is appropriate for specialists to recoup these costs and to be compensated for the services provided and regulatory and legal risks assumed pursuant to their agency responsibilities.

C. Exchange Act Section 6(e) prohibits exchanges from adopting fixed commission rate schedules, and establishes special review process and procedures

On January 23, 1975, the Commission adopted then Rule 19b-3 to prohibit any exchange from adopting or retaining any rule or practice that required its members to charge fixed commission rates for transactions executed on or by use of the facilities of the exchange.⁶ The Rule, effective on May 1, 1975 -- or “May Day” as the event

⁵ We also note that the Amex and the other floor based option exchanges have all recognized that cancellations are burdensome and have imposed and modified their own cancellation charges from time to time. See, e.g. Securities Exchange Act Release No. 34-44607; File No. SR-CBOE-2001-40 (July 27, 2001); Securities Exchange Act Release No. 34-45110; File No. SR-Amex-2001-90 (November 27, 2001); Securities Exchange Act Release No. 34-45262; File No. SR-PCX-2001-47 (January 9, 2002); Securities Exchange Act Release No. 34-46189; File No. SR-ISE-2002-16 (July 11, 2002).

⁶ The Amex cannot attempt to circumvent this prohibition by merely calling its Zero Commission Rate Proposal a prohibition on commissions as opposed to a fixing of commission rates. The effect of the

immediately became known -- was for rates charged by members with respect to transactions for persons other than members or associated persons (public rates) and for clearance charges; and on May 1, 1976, for rates charged by members to other members or associated persons. New legislation, enacted into law June 5, 1975, codified the Commission rulemaking and permitted the Commission discretion to reimpose fixed rates if warranted ("1975 Act Amendments").

The 1975 Act Amendments added Section 6(e) to the Exchange Act, which prohibits any exchange from imposing any schedule or fixing commission rates, allowances, discounts, or other fees charged by its members. The new provision did empower the Commission to permit an exchange to fix rates, but only if it observed specified due process requirements and found that the rates (i) are reasonable in relation to the costs of providing the service for which such fees are charged (and the Commission publishes the standards employed in adjudging reasonableness) and (ii) do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, taking into consideration the competitive effects of permitting such schedule or fixed rates weighed against the competitive effects of other lawful actions which the Commission is authorized to take under the Exchange Act. See Exchange Act Section 6(e)(1)(B).

Special process and procedures are required by the Exchange Act in reviewing exchange proposals such as the Amex Zero Commission Rate Schedule. Specifically,

[b]efore approving or disapproving any proposed rule change submitted by a national securities exchange which would impose a schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members for effecting transactions on such exchange, the Commission shall afford interested persons (i) an opportunity for oral presentation of data, views, and arguments and (ii) with respect to any such rule concerning transactions effected after November 1, 1976, if the Commission determines there are disputed issues of material fact, to present such rebuttal submissions and to conduct (or have conducted under subparagraph (B) of this paragraph) such cross-examination as the Commission determines to be appropriate and required for full disclosure and proper resolution of such disputed issues of material fact.

See Section 6(e)(3)(A) of the Exchange Act. The Commission also is responsible to assure that "[a] transcript shall be kept of any oral presentation and cross-examination." Section 6(e)(3)(D). Finally, special appellate court procedures are set forth in Section 6(e)(3)(E).

proposal is to fix specialists' commissions for certain services at zero, and this is precisely the activity that Exchange Act Section 6(e) was designed to prevent.

D. Amex's Zero Commission Rate Proposal raises significant issues regarding its consistency with Sections 6(b) and 6(e) of the Exchange Act

As a proposed rule change under Rule 19b-4, in order to approve the Amex Zero Commission Rate Proposal, the Commission must find that the proposal is consistent with, among other requirements, the standards of Section 6(b) of the Exchange Act. However, the proposal is inconsistent with Section 6(b)(5) in that it does not promote the “remov[al of] impediments to and perfect[ion of] the mechanism of a free open market and a national market system, and, ... [is] designed to permit unfair discrimination between customers, issuers, brokers, or dealers...” Additionally, the Amex has not provided any basis for the Commission to find that the filing does “not impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]” pursuant to Section 6(b)(7).

The Exchange summarily indicates that its proposed rule “is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable 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; and is not designed to permit unfair discrimination between customers, issuers, brokers and dealers. There is good reason why the Exchange provides no support for these statements -- they are not supportable. In most instances there is absolutely no nexus between the proposed rule and these standards (*e.g.*, there are no hints as to how the proposed Rule targets any alleged fraudulent or manipulative acts), and in other instances the proposed Rule would have an effect completely at odds to these stated goals. In this regard, Congress and the Commission have assured that the free market and competition, not SRO ratemaking, be the final arbiter of commission rates. In the options marketplace, options specialists' limit order handling fees are exposed to intense competition as there are six options exchanges, each with their competing specialists or equivalent primary market makers. Competition will govern these fees. The ETF marketplace is exposed to even greater competitive forces. If the Commission permits the Amex to regulate specialists' order handling fees, Amex specialists will be forced to raise other fees or charge new fees, which will cause economic dislocations, similar to those caused by the pre-1975 NYSE fixed commission rate schedule.

The Zero Commission Rate Proposal also unfairly discriminates between brokers. As discussed above, specialists undertake agency responsibilities for orders placed on their books, whether or not those orders are executed within a certain time or at all. Before submitting an order to a specialist for handling, the order provider has the choice to either provide that order to a floor broker for execution or to entrust that order to the specialist. In either case, the order flow provider is expecting its order to be properly handled. The specialist, in its role as agent, is no different than the floor broker that could have been entrusted with the handling of that order. However, through this proposal, the Amex is determining that a specialist cannot charge for providing this service while the floor broker can. The Amex has not provided any justification for this

discrimination against specialists, when other members, including floor brokers and off-floor members, which conduct a public business, may impose like-kind commissions on an unfettered basis.⁷

Section 6(e)(1)(B) of the Exchange Act allows the Commission to permit an exchange to fix rates if it observes specified due process requirements⁸ and finds that the rates (i) are reasonable in relation to the costs of providing the service for which such fees are charged (and the Commission publishes the standards employed in adjudging reasonableness) and (ii) do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, taking into consideration the competitive effects of permitting such schedule or fixed rates weighed against the competitive effects of other lawful actions which the Commission is authorized to take under the Exchange Act. The Amex, however, has not provided any support for the Commission to make these determinations and, as demonstrated above, could not satisfy its burden of supporting these findings. Accordingly, the Commission should disapprove the Amex's Zero Commission Rate Proposal as it violates Section 6(e) of the Exchange Act and is inconsistent with the standards of Section 6(b) of the Exchange Act.

Thank you for this opportunity to respond.

Sincerely,

Todd Silverberg

Todd Silverberg
General Counsel

⁷ In this regard, we note that Interactive Brokers, LLC, an outspoken critic of SIG's desire to assess commissions and cancellation charges, charges for both the execution of orders entrusted to it and for the cancellation of those orders.

⁸ Pursuant to these "due process requirements," the Commission must disapprove the proposal unless it can find that the Amex's proposed commission restrictions or zero commission fee schedules "(i) are reasonable in relation to the costs of providing the service for which such fees are charged . . . and (ii) do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. . ." See Exchange Act Section 6(e)(1)(B). SIG, as an Amex specialist, is an "interested person" that would be adversely effected by the Amex proposal. Therefore, if the Commission is inclined to engage in the fact-finding process required by Section 6 (e) (1)(B), SIG, pursuant to Section 6(e)(3)(A), respectfully requests an opportunity for oral presentation of data, views, and arguments to prove that the Amex Zero Commission Rate Proposal is not reasonable in relation to the costs of providing the service for which such fees are charged. In this regard, SIG is subject to significant order handling costs, including risks in handling limit orders on an agency basis for other members. Moreover, SIG will use the hearing process to present evidence and arguments that will show that the Amex proposal imposes burdens on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.