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May 12, 2006

Via Electronic Mail
and Federal Express

Nancy Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

***Re: Amendment 4 to Proposed Rule Change by the Boston Stock Exchange,
Inc. Relating to the Directed Order Process on the Boston Options Exchange,
File No. SR-BSE-2005-52-4***

Dear Ms. Morris:

The Boston Stock Exchange, Inc. (“BSE” or the “Exchange”) respectfully submits this response to the comment letters received by the Securities and Exchange Commission (“Commission”) regarding Amendment 4 of the BSE proposal (“Proposal”) to amend its rules with respect to orders sent to Market Makers¹ through the Boston Options Exchange (“BOX”) Directed Order process for voluntary price improvement consideration.² Under the Proposal, BOX Market Makers would be permitted to designate in advance those Order Flow Providers (“OFPs”) from whom they will accept Directed Orders while providing anonymity for individual Directed Orders that are

¹ Terms not otherwise defined in this letter shall have the same meaning as provided for in the currently effective rules of the BSE. We also note that currently and under the Proposal both the PIP and the BOX Book are fully anonymous.

² See Securities Exchange Act Release No. 53516 (March 20, 2006), 71 FR 15232 (March 27, 2006) (SR-BSE-2006-14).

passed on to the Market Maker for representation in BOX's Price Improvement Period ("PIP") or placement on the BOX Book. Market Makers would maintain the ability to choose, on a daily basis, whether or not to accept any Directed Orders. If a Market Maker chooses to accept Directed Orders, the decision to price improve the individual anonymous Directed Order, or not, would be on an objective and non-discriminatory basis.

The BSE believes that the reason for some of the commenters opposition to this Proposal is imbedded in their desperate attempt to eliminate price improvement so that payment for order flow can not only survive, but flourish. The Commission is aware that BOX has always been opposed to payment for order flow due to its inherent conflicts such as best execution and order routing practices and puts the rebates directly into the pockets of the broker-dealers, rather than into the customers pocket like BOX's price improvement model. Because price improvement is a direct threat to the payment for order flow programs these commenters heavily participate in and have made an integral part of their business model, these commenters are distorting and confusing the issues in an attempt to end or substantially limit price improvement to customers. One of these commenters stated their concern for potential customer harm, which on its face seems genuine and novel, but their actions suggest otherwise. This commenter is one of the biggest payment for order flow providers in the industry. Actions speak louder than words, this commenter's action show they support the payment for order flow model for broker-dealers rather than the price improvement to customers model. The BSE is taking this opportunity to present to the Commission why commenters concern for customer harm is unfounded and in some cases not genuine, that the precedence cited by opposing commenters is not on point, and to provide the Commission with ample relevant Commission precedence to support this Proposal. The BSE would also like to discuss some of the more relevant points raised by the comment letters and address any confusion that the Proposal might have created regarding the Directed Order process, the Price Improvement Period (the "PIP") auction and the Firm Quote Rule.³ Prior to this discussion, however, the BSE believes that it would be helpful to provide some background on the Directed Order process and the PIP.

I. Background

The PIP was the first price improvement auction system of its kind that today accounts for 20 percent of the total executions on BOX. It's success and importance to the market as a whole is evidenced by the number of other exchanges that have attempted to mirror its functionality.⁴ The BSE, unlike many exchanges that have rules and

³ See Rule 11A(c)1-1 under the Securities Exchange Act of 1934, as amended.

⁴ See e.g., Securities Exchange Act Release No. 53222 (Feb. 3, 2006) (approval order of the Chicago Board of Options "Automated Improvement Mechanism"). See e.g., also Securities Exchange Act Release No. 50819 (Dec. 8, 2004) (approval order for the International Stock Exchange "Price Improvement Mechanism").

programs in place to facilitate market makers to pay broker-dealers for their order flow, directs the “price improvement” offered by a Market Maker (*i.e.*, payment for order flow) in a PIP auction to the customer versus a payment to a broker-dealer. We believe this functionality embodies the very heart of Section 6(b)(5) of the Securities Exchange Act of 1934 (“Exchange Act”) in that it places the customer order at the epicenter of the system and allows any BOX Options Participant (“Participant”) to initiate a PIP auction, compete for the customer order and ultimately offer price improvement to the customer.

All Participants may access the PIP and the BOX Book through several different avenues. One such avenue is the Directed Order process. This process, however, is but *one* method to access the PIP or the BOX Book. Participants may also submit orders to the PIP directly or the BOX Book without having to send the order to another Market Maker. In fact, the PIP was originally intended to act as a simple “crossing mechanism” to provide OFPs with an opportunity to interact with their own order flow. In an attempt to widen the scope of potential participants in the PIP system, the Directed Order process was conceived as an alternate method through which other Participants could access the PIP. Conceptually, the Directed Order process permits a Market Maker, irrespective of their affiliation with an OFP, to assume the improving side of a PIP auction (*i.e.*, initiate the PIP auction) while also maintaining the integrity of the information barriers between OFPs and Market Makers. The ancillary nature of the Directed Order process is today evidenced by the small number of Directed Orders as a percentage of the total number of orders received by BOX – twenty seven percent.

Every BOX Participant has the right to initiate a PIP auction and provide the opportunity for price improvement. BOX OFPs make a choice with every order they receive to either provide price improvement independently, send a Directed Order, or submit the order to the BOX Book. It is not insignificant to note that if an OFP sends a Directed Order to a BOX Market Maker, the OFP has made the choice *not* to price improve the order itself by initiating a PIP auction but rather to send the order to a Market Maker (affiliated or not) for the Market Maker to possibly price improve the order (and assume the attendant risks and responsibilities associated with such order).⁵ The Directed Order process, therefore, is not the sole and exclusive means for OFPs to access the PIP and the BOX Book and, in particular, the opportunity for price improvement. The Directed Order process is simply one alternative available to OFPs.

⁵ A particular BOX Participant, who is affiliated with a BOX Market Maker, commented that large institutions and retail investors would be harmed by the differentiation made possible by this Proposal (*i.e.*, the choice to price improve or not to price improve). This Participant, however, fails to acknowledge that prior to the Participant’s decision to send a Directed Order to a non-affiliated Market Maker, that Participant decided twice not to provide price improvement to its own customer order: (1) by declining to have its own OFP price improve the order and (2) by refusing to have its Market Maker accept Directed Orders. The Directed Order sent to the non-affiliated Market Maker is in effect the third possible avenue for price improvement that requires this Participant to direct an order to a competing Market Maker only after this Participant has refused to price improve its own customer order in the first *and* second instance.

II. The Comment Letters

The Commission received a number of comment letters regarding the Proposal. The comment letters discuss five general areas raised by the Proposal: (i) the Directed Order process as a “discretionary service”, (ii) the Firm Quote Rule, (iii) the fair access requirement under Regulation ATS,⁶ (iv) the potential for customer harm, and (v) Section 6(b)(5) of the Exchange Act. In the following sections of this letter the BSE will attempt to address each of these areas.

A. Directed Order - A Discretionary Service

A few of the comment letters asserted that the Directed Order process is not a “discretionary service.” On the contrary, the BSE believes that the Directed Order process is very similar to other well-established “discretionary services”, such as offering payment for order flow, preferencing, stopping stock, soft dollar arrangements, charging varying commission rates and execution fees, and research services. Market Makers and other broker-dealers that choose to offer these discretionary services -- including price improvement to customers through the Directed Order process -- do so above and beyond satisfying their core regulatory obligations.⁷ The Commission recognizes that offering discretionary services on a voluntary basis is a valuable component of the securities markets and generally complies with the requirements of Section 6(b)(5) of the Exchange Act. In particular, the Commission has approved self-regulatory organization rules that recognize the ability of market participants to offer discretionary services on a voluntary basis.

i. The Rules of the Philadelphia Stock Exchange

The Commission has approved several Philadelphia Stock Exchange (“PHLX”) rules that permit specialists/market makers to choose for whom or how they will offer a voluntary, discretionary service.⁸ The PHLX’s directed order rule, for example, requires a member firm to enter into an agreement with a specialist prior to sending directed

⁶ See Regulation ATS, Rule 301(b)(5).

⁷ The BSE notes that in all events, whether a Market Maker elects to accept Directed Orders or to systematically refuse all Directed Orders, a Market Maker’s displayed best bid and offer are firm and accessible for automatic executions by any and all order submitters.

⁸ See generally PHLX Rule 229.02 (stating “[n]on-agency orders are not permitted on PACE except where the Exchange has been provided with a Specialist Agreement, signed by the respective specialist, acknowledging the acceptance of such non-agency orders from the specific firm(s), and any minimum execution parameters (order size guarantees) agreed to be provided to such orders by the respective specialist”) and PHLX Rule 229.03 (stating “floor brokerage or service charges on orders executed under PACE are subject to negotiation by the specialist and the participating member organization. [A]n automated execution program, by nature, involves set parameters. The Exchange permits such a program, but does not require its members to participate in it. Thus, fees are ultimately subjected to competitive determination. Members may choose to deal on the program, not on the program, or on other markets.”).

orders to the specialist.⁹ By definition, therefore, member firms are not permitted to send directed orders to any and all specialists. The BSE's Directed Order Proposal, similarly, permits Market Makers and OFPs to mutually agree to enter into an arrangement whereby the OFP will send Directed Orders to the Market Maker.¹⁰

ii. The Rules of the Pacific Stock Exchange

Likewise, the Commission recently approved amendments to the directed order process on the Pacific Stock Exchange ("PCX"), now known as NYSE Arca, to "add a provision that requires Users to be given permission by DMMs [Designated Market Makers] in order to send a Directed Order to that DMM."¹¹ Without such permission a firm cannot send a Directed Order to the DMM on the PCX. Likewise, the BSE Proposal permits a Market Maker on BOX to designate the OFPs from whom the Market Maker will accept Directed Orders.¹²

iii. The Rules of Multiple Equity Exchanges - Stop Orders

The Commission also has approved other exchange rules that permit market makers or specialists to pick and choose the beneficiaries of a discretionary service, such

⁹ The definition section of the rule states, "'Directed order' shall mean an order that a member organization directs to a particular specialist *pursuant to an agreement* with that specialist in which the member organization agrees to place orders in the security with that specialist." (emphasis added) See Rule 229A(b)(1) of the Philadelphia Stock Exchange.

¹⁰ See Securities Exchange Act Release No. 53357 (Feb. 23, 2006), 71 FR 10730 (March 2, 2006) (SR-BSE-2005-52).

¹¹ See Securities Exchange Act Release No. 52827 (Nov. 23, 2005), 70 FR 72139 (Dec. 1, 2005) (SR-PCX-2005-56). See also NYSE Arca Rule 1.1 (2006) (generally defining the term "User" to mean any ETP Holder or Sponsored Participant who is authorized to obtain access to the NYSE Arca Marketplace pursuant to Rule 7.29.)

¹² It is important to note that unlike the BOX Directed Order Rule, the PHLX and PCX Directed Order rules, as well as various other exchanges' "directed order" rules, are mechanisms designed to allow specifically identified market makers to provide automatic executions at the NBBO, while maintaining certain trade allocation guarantees for themselves. Price improvement is merely an available option. Some of these mechanism do not even offer price improvement (See e.g., Securities Exchange Act Release No. 51759 (May 27, 2005) (SR-Phlx-2004-91). See also PHLX Options Rule 1080(l) which defines directed order and Rule 1014(g)(viii) which generally discusses the obligations and restrictions applicable to Specialists and Registered Options Traders on PHLX). BOX does not have this type of NBBO "preferencing" rule. If a BOX Market Maker does not submit the Directed Order to the PIP but rather releases it to the BOX Book, he is unlikely to execute against the Directed Order at the NBBO, given the customer protections built into the Directed Order process. The Market Maker is forced to forgo whatever time priority he may have had over his competitors at the top of the BOX Book for that option series in the Directed Order. Moreover, the Market Maker also is obligated to freeze his quote for three seconds and trade with any unexecuted Directed Order quantity (but only if no other Market Maker wants to trade with the Directed Order). Essentially, this means the Market Maker will trade with the declined Directed Order only when no one else wishes to interact with the order.

as stopping stock¹³ or providing payment for order flow.¹⁴ For example, pursuant to Chapter II, Section 38 of the BSE Rules of the Board of Governors, a BSE equity specialist is permitted to stop stock upon the unsolicited request of another member.¹⁵ “The stop permits a BSE specialist to guarantee to its customers that their orders will be filled at the stop price, with an opportunity for price improvement.”¹⁶ Like the New York Stock Exchange (“NYSE”), American Stock Exchange (“Amex”), PHLX and Chicago Stock Exchange (“CHX”), the BSE’s equity trading floor is not anonymous, yet the specialists on each exchange are free to choose whether or not to grant a stop request, on an order-by-order basis. We note further that “[t]he Commission...has approved the [aforementioned] practice in limited circumstances where the potential harm is offset by the improvement in marketplace liquidity and the possibility of price improvement for the customer.”¹⁷

iv. The Rules of Multiple Option Exchanges - Payment for Order Flow

The Commission has also approved the payment for order flow programs of various options exchanges. These programs allow market makers to direct discretionary payments to an exclusive group of firms.¹⁸ For example, on PHLX, specialists and Registered Options Traders (“ROTs”) in the Top 120 Options on the PHLX apply a fee to each option transaction. The specialists and the ROTs may use the fees collected with

¹³ See New York Stock Exchange (“NYSE”) Rule 116.30; American Stock Exchange (“Amex”) Rule 109; and Article XX, Rule 12 of the Chicago Stock Exchange (“CHX”) Rules. See also Securities Exchange Act Release No. 34614 (Aug. 30, 1994), 59 FR 46280 (Sept. 7, 1994) (SR-PHLX-93-41) (PHLX Proposal to codify its procedures for stopping stock into Equity Floor Procedure Advice A-2, Stopping Orders).

¹⁴ See generally Securities Exchange Act Release No. 47948 (May 30, 2003), 68 FR 33749 (June 5, 2003) (SR-CBOE-2003-19); Securities Exchange Act Release No. 44830 (Sept. 21, 2001), 66 FR 49728 (Sept. 28, 2001) (SR-PCX-2001-37); Securities Exchange Act Release No. 43833 (Jan. 10, 2001), 66 FR 7822 (Jan. 25, 2001) (SR-ISE-00-10); Securities Exchange Act Release No. 43177 (Aug. 18, 2000), 65 FR 51889 (Aug. 25, 2000) (SR-PHLX-00-77).

¹⁵ See Securities Exchange Act Release No. 35068 (Dec. 8, 1994), 59 FR 64717 (Dec. 15, 1994) (SR-BSE-94-09) (approving the BSE’s Proposal to codify its procedures for stopping stock.).

¹⁶ See Securities Exchange Act Release No. 34569 (Aug. 15, 1994), 59 FR 44437 (Aug. 22, 1994) (SR-BSE-94-09) (proposing to codify the BSE’s procedures for stopping stock).

¹⁷ See Securities Exchange Act Release No. 35068 (Dec. 8, 1994), 59 FR 64717 (Dec. 15, 1994) (SR-BSE-94-09) (approving the BSE’s Proposal to codify its procedures for stopping stock), citing Securities Exchange Act Release No. 28999 (March 21, 1991), 56 FR 12964 (March 28, 1991) (SR-NYSE-90-48) (approving proposed rule change to permit NYSE specialists to stop stock in minimum variation markets when an imbalance is of sufficient size to suggest the likelihood of price improvement) (“1991 NYSE approval order”).

¹⁸ See generally Securities Exchange Act Release No. 47948 (May 30, 2003), 68 FR 33749 (June 5, 2003) (SR-CBOE-2003-19); Securities Exchange Act Release No. 44830 (Sept. 21, 2001), 66 FR 49728 (Sept. 28, 2001) (SR-PCX-2001-37); Securities Exchange Act Release No. 43833 (Jan. 10, 2001), 66 FR 7822 (Jan. 25, 2001) (SR-ISE-00-10); Securities Exchange Act Release No. 43177 (Aug. 18, 2000), 65 FR 51889 (Aug. 25, 2000) (SR-PHLX-00-77).

respect to a particular option to make payments to broker-dealers for order flow in that option. The rules permit each option specialist to have discretion in determining to whom an order flow payment will be made and the amounts of those payments.¹⁹ As stated above, BOX's PIP process is similar to this discretionary service in that both payment for order flow and price improvement are rebates of the market maker's/specialist's profit from the transaction (*i.e.*, bid/ask spread). A primary distinction between these services, however, is that PIP transfers the rebate *directly to the customer* in the form of price improvement where a payment for order flow program transfers the benefit to broker-dealers. Moreover, unlike the Commission-approved practice of selectively offering payment for order flow, the PIP process is open to all market participants' orders.

B Price Improvement and Firm Quote

One commenter has attempted to analogize Firm Quote obligations under the Exchange Act (the "Firm Quote Rule")²⁰ with the Directed Order and price improvement processes. As fodder for their smoke and mirrors, the commenter cites two former rule Proposals considered by the Commission regarding executions at the Firm Quote price and size.²¹ The BSE believes these cited rule Proposals are irrelevant. Price improvement is not subject to the same requirements as a specialist's or market maker's obligations under the Firm Quote Rule. Additionally, executions on the BOX Book are handled with strict price and time priority and BOX Market Maker quotes are firm and available to all market participants for their full displayed size. Indeed, BOX was the first options exchange to propose to remove limitations on access to displayed prices to professional accounts, a policy that has subsequently been copied by all options exchanges.

A market maker's obligations under the Firm Quote Rule are mandatory while the decision to receive Directed Orders and to ultimately price improve an order are both voluntary. BOX Market Makers are required to execute trades at their publicly displayed price up to the full amount of their displayed size on the BOX Book in a fair and equal manner to all market participants that present them with a marketable order (assuming of course that the Market Maker is at NBBO and at the top of the BOX Book). The Proposal does not alter this obligation in any way.²² The Firm Quote Rule does not

¹⁹ Securities Exchange Act Release No. 34-43177 (Aug. 18, 2000), 65 FR 51889 (Aug. 25, 2000) (SR-PHLX-00-77).

²⁰ See Rule 11A(c)1-1 under the Securities Exchange Act of 1934, as amended ("Act").

²¹ See Letter to Nancy Morris, Secretary, Securities and Exchange Commission, from Adam C. Cooper, Senior Managing Director & General Counsel, Citadel (March 17, 2006). The letter discusses, in part, the Nasdaq's application to become an exchange which lacked price and time priority access to Firm Quotes and an unpublished PHLX rule Proposal regarding Firm Quote execution size.

²² We note that under the Proposal, the Directed Order process retains the Guaranteed Directed Order ("GDO") which guarantees the Directed Order will receive the Market Makers displayed quote if the Market Maker submits the Directed Order to the BOX Book instead of the PIP.

extend to specialists or market makers that provide price improvement. Price improvement occurs when a specialist or market maker decides to execute an order at a price *better* than its displayed quote price.²³ There is neither a requirement under the Exchange Act nor any interpretive guidance by the Commission that requires a market maker to price improve an order or even consider an order for price improvement, which by definition is a voluntary execution beyond what is required by the Firm Quote Rule. As long as Market Makers are providing *all* market participants with the ability to access their displayed price and size on an equal and non-discriminatory basis, the Market Makers should be allowed to choose whether and to whom they will offer price improvement.

The real question underlying all of this is whether a BOX Market Maker must offer price improvement to an order presented by another Participant who has already refused to price improve the order. If a Participant truly wants to offer its customers price improvement the Participant has the option to improve the order itself or send a Directed Order to an affiliated or non-affiliated Market Maker. These options for handling a customer's order fly in the face of one commenter's assertion that "[t]he amended Proposal would allow BOX market makers to entirely block competitors and their customers from sending directed orders."²⁴ A truly confounding mischaracterization that presupposes that the commenter is somehow being prevented from playing the same game. Clearly, that commenter has the option of directly price improving its customer orders or sending such orders to affiliated or non-affiliated Market Maker.

C. Price Improvement and Fair Access

Two commenters cited Regulation ATS, specifically Rule 301(b)(5), in which the Commission requires the most active ATS' to provide fair access to all of their services.²⁵ The commenters suggest that access to the BOX Book and the PIP is somehow limited and that fair access is not being provided. This is a flawed comparison in that the Proposal does not preclude anyone from having access to the BOX Book or the PIP. Although Market Makers are permitted to choose the OFPs from whom they will accept Directed Orders, the OFPs' access to the BOX Book, the PIP and even the ability of a Participant to send Directed Orders to alternative Market Makers for submission into the PIP or the BOX Book remain unobstructed. *Any* Participant is eligible to send a Directed Order and *any* Market Maker may choose to accept Directed Orders. Moreover, the

²³ A Directed Order receives price improvement in the BOX PIP auction over the NBBO which will also be at a better price than the Market Maker's displayed quote.

²⁴ See Letter to Nancy Morris, Secretary, Securities and Exchange Commission, from Adam C. Cooper, Senior Managing Director & General Counsel, Citadel (March 17, 2006).

²⁵ See Letter to Nancy Morris, Secretary, Securities and Exchange Commission, from Michael J. Simon, Secretary, International Securities Exchange ("ISE") (March 23, 2006); see also Letter to Nancy Morris, Secretary, Securities and Exchange Commission, from Adam C. Cooper, Senior Managing Director & General Counsel, Citadel (March 17, 2006).

Proposal does not limit the number of Market Makers that may accept Directed Orders for each option class.

D. Directed Order Process - Customer Harm?

One commenter claims that the Proposal would facilitate harm to innocent investors because when an OFP is excluded from a Market Maker's list of OFPs permitted to send Directed Orders, Market Maker's would be disadvantaging all of the competitors' customers, not just competitors proprietary trades.²⁶ This is a nonsensical result since this commenter has the choice of directly price improving its customer orders or simply sending the orders to another market maker. We assume that this commenter is not truly concerned with price improving customer orders, but, rather, has an ulterior motive to disparage price improvement systems since this commenter distributes some of the largest payments in payment-for-order flow rebates to broker-dealers. This commenter's true intentions, to continue the practice of rebating to broker-dealers versus customers and is, therefore, not genuinely concerned about their customers not receiving price improvement on BOX.

Aside from the commenters' motivations we believe that eliminating receipt of Directed Orders from hostile competitors will likely increase the amount of Directed Orders sent to the PIP and thereby provide greater opportunity for price improvement. Alternatively, if Market Makers are not allowed to make this choice, they may choose to reduce or simply stop initiating a PIP on behalf of another Participant. The BSE, therefore, believes the Proposal will continue to increase price improvement on BOX and continue to benefit customers.

E. Directed Order - Section 6(b)(5)

Several commenters contend that the Proposal violates the requirements set forth under Section 6(b)(5). The BSE, however, believes that its Proposal to maintain complete anonymity for Directed Orders that are submitted to the PIP or the BOX Book, while also permitting Market Makers to choose the OFPs from whom they will accept Directed Orders, is appropriate and consistent with applicable legal standards.²⁷ In particular, the BSE believes based on the reasons stated above that its Proposal is consistent with each of the requirements set forth under Section 6(b)(5), which provides, in part, that the rules of a national securities exchange must not permit unfair discrimination between customers, brokers or dealers and should be 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.²⁸ In particular, we note that the parameters of the Proposal, coupled with the

²⁶ See Letter to Nancy Morris, Secretary, Securities and Exchange Commission, from Adam C. Cooper, Senior Managing Director & General Counsel, Citadel (March 17, 2006).

²⁷ See Securities Exchange Act Release No. 53357 (February 23, 2006), 71 FR 10730 (March 2, 2006) (SR-BSE-2005-52).

²⁸ See 15 U.S.C. § 78f(b)(6).

BOX rules that guarantee equal access to the PIP and the BOX Book, satisfy the statutory mandates of Section 6(b)(5) of the Exchange Act. Moreover, the BSE believes that the Commission has clearly recognized the principles of Section 6(b)(5) in other recent rule-filings and has permitted other self-regulatory organizations to implement rules in analogous situations that permit market participants to select the persons to whom they will offer a voluntary and discretionary service.²⁹

III. Conclusion

BOX has been the leader in providing a service that provides price improvement to customers. Despite BOX's relatively small size in the industry, over \$200,000 per day is returned to options investors in the form of price improvement that would not have been available otherwise. Other exchanges have since followed BOX by establishing price improvement mechanisms on their exchanges. The BSE believes it would be enormously detrimental to the interests of customers to significantly decrease or stop the amount of price improvement provided to customers which has been such a success story since BOX's inception. If a Market Maker can not choose from whom it may receive Directed Orders, the receiving Market Makers will be significantly burdened. The Proposal addresses this issue by allowing Market Makers to designate from whom they will accept Directed Orders, while at the same time providing anonymity for individual Directed Orders. The BSE believes the Directed Order process is a voluntary and discretionary service that is bolstered by substantial Commission precedent to allow Market Makers to choose the recipients of a discretionary service. Moreover, this Proposal does not relieve Market Makers from any Exchange Act requirements, such as the Firm Quote Rule. The BSE also believes that this Proposal will benefit investors in the form of continued price improvement in the BOX tradition. The BSE thanks the Commission for the opportunity to respond to comments on the Proposal.

Please contact me if you have any questions regarding this response or if you would like to discuss these matters further.

Sincerely,



Alden Adkins
Executive Vice President

²⁹ See Securities Exchange Act Release No. 45183 (Dec. 21, 2001), 67 FR 118 (Jan. 2, 2002) (SR-PHLX-2001-97) (approving PHLX Rule 229A). See also Securities Exchange Act Release No. 52827 (Nov. 23, 2005), 70 FR 72139 (Dec. 1, 2005) (SR-PCX-2005-56).

cc: Chairman Christopher Cox
Commissioner Cynthia A. Glassman
Commissioner Paul S. Atkins
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