



INTERNATIONAL SECURITIES EXCHANGE

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March 23, 2006

Ms. Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-0609

**Re: File No. SR-BSE-2005-52; Amendment No. 4 (Release No. 34-53357)**

Dear Ms. Morris:

The International Securities Exchange, Inc. ("ISE") appreciates the opportunity to comment on recent amendments to a proposal (the "Proposal") by the Boston Stock Exchange, Inc. ("BSE"), on behalf of its Boston Options Exchange ("BOX") facility (the "Amended Proposal").

The Proposal sought to eliminate the anonymity feature of the BOX's "directed order" process so that directed market makers would know which firms entered directed orders routed to them. That Proposal would have allowed directed market makers to discriminate among firms to which they would provide price improvement. The Amended Proposal no longer seeks to disclose the identity of the directing firm. Rather, BOX now seeks to allow directed market makers to limit which firms may direct orders to them. Thus, the Amended Proposal merely contains a different means to the same end: providing market makers the authority to deny order flow providers access to an exchange facility at the market maker's discretion.

As we stated in our January 19, 2006, comment letter on the Proposal,<sup>1</sup> we believe that allowing market makers to choose which orders to price improve based upon the firm that represents the orders will foster unfair discrimination in violation of the Securities Exchange Act of 1934 (the "Act"), which requires that the rules of a national securities exchange, among other things, not be "designed to permit unfair discrimination between customers, issuers, brokers, or dealers...."<sup>2</sup>

While there is no requirement under the Act for a market maker to provide price improvement for any particular customer, once an exchange offers a facility through which it makes price improvement generally available to customers it must do so in a manner that is consistent with the Act. Because the Amended Proposal continues to provide a means by which a market maker can discriminate among customer orders

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<sup>1</sup> Letter to Nancy M. Morris, Secretary, Commission, from Michael J. Simon, General Counsel, ISE, dated January 19, 2006.

<sup>2</sup> Exchange Act Section 6(b)(5).

based solely upon the identity of the entering firm, it continues to be inconsistent with the Act for all of the same reasons we stated in our prior comment letter. We thus incorporate that letter by reference into this comment letter.

While the Amended Proposal continues to be inconsistent with the Act based upon unfair discrimination among customers, it exacerbates the issue by delegating to certain exchange members the discretion to deny other exchange members access to the directed orders facility. BOX argues that the Amended Proposal is necessary to give market makers the ability to discriminate against firms to protect themselves against "hostile competitors" and because there otherwise will be "an opportunity for Options Participants to engage in abusive practices that jeopardize the ability of all Market Makers to price improve customer orders." The BOX further states: "Some Options Participants, including Market makers, could send large numbers of proprietary Directed Orders to competitors using strategies that effectively amount to arbitraging the PIP auction against previous executions obtained on exchanges that do not provide price improvement opportunities."

These statements support our concern that BOX market makers should not be given the discretion to apply their own standards to determine who can utilize the BOX's directed order facility. What makes a competitor "hostile" or practices "abusive?" How would they determine whether a customer is arbitraging previous executions? BOX does not cite any of its rules or any of the Federal Securities Laws that such actions would violate. We certainly are not aware of any such rules. Thus, BOX seeks to grant its market makers discretion to deny price improvement to order-entry firms based on arbitrary, subjective standards that have no legal basis.

If the BOX's directed orders and PIP facilities are prone to abusive practices that degrade the value of the services, then BOX, as a facility of a registered securities exchange, needs to address the abusive practices on behalf of its members in a manner that is consistent with the Act. As discussed in depth by the Commission in its adoption of Regulation ATS,<sup>3</sup> registered exchanges are subject to substantial regulation under the Act that is not applicable to broker-dealers. While broker-dealers have certain discretion to discriminate among customers with whom they conduct business off of an exchange, the Act requires that registered exchanges provide fair access to its facilities. Thus, exchanges have no legal basis to provide its broker-dealer members unfettered discretion to discriminate among customers with respect to access to exchange facilities.

The Amended Proposal denies certain broker-dealers and all of their customers access to an exchange facility arbitrarily, without due process, and without any right to appeal. Surely, the Commission would reject a rule proposal by BSE to summarily deny access to certain of its members without due process based on undefined behavior that BSE, in its discretion, arbitrarily determined to be "abusive." The Commission must also then reject the Amended Proposal, which simply adopts a structure that delegates to market makers the discretion to deny certain broker-dealers access to the BOX's directed order facility based upon each individual market makers' assessment of what is abusive. To approve the Amended Proposal would make a mockery of the "fair access" requirement of the Act.

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<sup>3</sup> Release No. 34-40760 (December 8, 1998).

Accordingly, we urge the Commission to commence proceedings to disapprove the Amended Proposal. We thank the Commission for the opportunity to comment on the Amended Proposal, and we are available to discuss this issue with either the Commission or its staff if you would find that useful.

Sincerely,

A handwritten signature in black ink, appearing to read "M. J. Simon". The signature is fluid and cursive, with a prominent initial "M" and "S".

Michael J. Simon  
Secretary

cc: Robert Colby  
Elizabeth King