July 8, 2005

Dear Sir:

You are being asked to sanction a rule change by the ISE which alters the method in which cancel fees are calculated.

The SEC has in the past sanctioned cancel fees for various option exchanges.

The stated goal for this type of fee has usually been to pay for the cost of the scarce network resources used by those customers entering and canceling large numbers of orders. The true goal, in my opinion, is to discourage "smart" orders from being entered. The ability to cancel or adjust an order in response to changes in price of the underlying security, is fundamental to options trading. Market makers change their quotes very frequently. If they were forced to pay similar cancel fees they would all be losing money. By imposing them on customers only, exchanges have found an SEC sanctioned method of deterring competing providers of liquidity. "Smart" order flow is impeded and "Dumb" order flow (willing to let their orders sit on the book without canceling if underlying price changes materially or those who enter market orders) is unaffected.

If exchanges are serious about spreading the systems costs among users, much lower cancel fees could be applied to all users including market makers thereby raising an equal amount of revenue. Many of the same exchanges are involved in payment for order flow schemes which establish flexible payments to hand picked firms. They also encourage "dumb" order flow to the exchange and discourage "smart" order flow. (No scarce resource arguments heard here!)

It is time for the SEC to say enough is enough. Prohibit all selective payment for order flow and fees which are not applied equally to all market participants. Doing anything less violates the basic principals which are the reason for the SEC's existence.

Sincerely yours,
Stephen H. Kaelber