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Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, NE
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Re: SEC File No. SR-OCC-2006-01

To the Members of the Commission:

Our firm, Allagash Trading LLC, has several issues with the proposal to modify the 10% rule as outlined in the SEC File No. SR-OCC-2006-01. Specifically, we take exception to the section of the rule as summarized as follows:

> "(2) provide for the adjustment of outstanding options for special dividends (*i.e.,* cash distributions not declared pursuant to a policy or practice of paying such distributions on a quarterly or other regular basis). The proposed rule change would also add a $12.50 per contract threshold amount for cash dividends and distributions to trigger application of OCC's adjustment rules."

We believe that the proposed regulation will add significant confusion to the marketplace and prevent the market participants from making narrow and deep markets. This letter outlines numerous areas where the proposed dividend adjustment policy is going to take away from market clarity and inhibit liquid markets until the OCC Securities Committee convenes.

Clarity and Certainty of Current Rule

The 10% rule as currently applied actually provides tremendous certainty and clarity in the market place. With the advent of modern market models, traders are able to effectively price and maintain narrow markets even in situations where a large irregular dividend has been declared. It is the current regulations' certainty that allows it.

By way of example, when a company currently trading for $20 announces its intention to pay out a special dividend of $3.00, traders are able to quickly recognize that the proposed special dividend exceeds the 10% threshold and therefore will trigger an adjustment to the contract by the OCC. In these cases traders do not price the special dividend into their models.

Similarly, when a company trading for $20 announces a special dividend of $0.80, market participants are able to quickly recognize that the newly announced dividend needs to be priced into their models immediately so as to prevent other participants from taking advantage of an arbitrage opportunity.

It is only in the extremely rare situation where a company announces their intention to pay a special dividend equivalent to approximately 10% of their current share price that uncertainty enters the marketplace vis-à-vis whether the share price of the stock will be greater than or less than the 10% threshold rule on close of trading on the actual dividend declaration date and thus trigger the contract adjustment process. As referenced in the proposed changes by the OCC,

> "The date the dividend is announced (by press release or by some other means) is not normally the "declaration date" when the dividend is officially declared by an issuer's board of directors. Until the actual declaration date, investors and traders may not know whether or not an announced dividend will trigger an adjustment based on the company's share price. In the interim it is difficult for traders and investors to price their options because they do not know if an adjustment will be made."

The OCC is very much on point in these very rare circumstances, and traders typically price their options very wide with a smaller quantity until such time as resolution is provided vis-à-vis an official declaration date and the close of trading on that day. As such, the marketplace handles these rare situations as efficiently as possible, largely due to the clarity and certainty encapsulated by the current rules.

While the OCC is attempting to address this seeming inefficiency in very rare circumstances, their proposed changes would exacerbate the problem in two ways.

(1) Rather than waiting for the actual dividend declaration date for resolution of whether the special dividend will trigger a contract adjustment, traders and investors will now have to wait until an announcement is made by the OCC concerning the dividend. This would necessarily have to be after the actual dividend declaration date, meaning that markets will have to stay wide and illiquid for an even longer period of time than under the current regulations.

(2) By lowering the threshold amount for possible contract adjustments, the OCC will be required to render decisions on contract adjustments much more frequently, thus creating a much higher incidence of wide and illiquid markets as marketplace participants await OCC decisions on contract adjustments for many more dividend announcements.

Lack of Clarity in the Definition of "Special Dividend"

As written in the proposed rule change,

> "Under the revision proposed by the OCC, a cash dividend or distribution would be considered ordinary (regardless of size) if the OCC Securities Committee determines that such dividend or distribution was declared pursuant to a policy or practice of paying such dividends or distributions on a quarterly or other regular basis. In addition, as a general rule, a cash dividend or distribution that is less than $12.50 per contract would not trigger the adjustment provisions of Article VI, Section 11A."

While the above referenced text seems straightforward, application of the proposed rule change would be very complex. Take as a case in point Nucor (a listed company on the NYSE). The following is a list of its recent dividend payouts, as retrieved from a Bloomberg terminal:

Company	**Announce Date**	**Ex-Date**	**Type**	**Amount**
Nucor (NYSE:NUE)	2/24/2005	3/29/2005	Regular Cash	Gross Amount: 0.15
Nucor (NYSE:NUE)	2/24/2005	3/29/2005	Special Cash	Gross Amount: 0.25
Nucor (NYSE:NUE)	6/ 1/2005	6/28/2005	Regular Cash	Gross Amount: 0.15
Nucor (NYSE:NUE)	6/ 1/2005	6/28/2005	Special Cash	Gross Amount: 0.25
Nucor (NYSE:NUE)	9/ 7/2005	9/28/2005	Regular Cash	Gross Amount: 0.15
Nucor (NYSE:NUE)	9/ 7/2005	9/28/2005	Special Cash	Gross Amount: 0.25
Nucor (NYSE:NUE)	12/ 6/2005	12/28/2005	Regular Cash	Gross Amount: 0.15
Nucor (NYSE:NUE)	12/ 6/2005	12/28/2005	Special Cash	Gross Amount: 0.50
Nucor (NYSE:NUE)	2/22/2006	3/29/2006	Regular Cash	Gross Amount: 0.20
Nucor (NYSE:NUE)	2/22/2006	3/29/2006	Special Cash	Gross Amount: 0.50

As can be seen in the table, Nucor pays a Regular Cash dividend on a quarterly basis. In this case one would assume that the Regular Cash dividend of $0.15 would not trigger an adjustment by the OCC. But would the OCC be required to render a decision on the Regular Dividend announced on 2/22/06? In this example, Nucor has raised its Regular Cash dividend from $0.15 to $0.20, a 33.3% increase. Will market participants have to wait for a decision by the OCC Securities Committee before they can know whether a contract adjustment will be made? If so, markets will remain wide and illiquid until such determination is made by the OCC.

Furthermore, Nucor routinely pays out a Special Cash dividend on a quarterly basis. The determination of Regular vs. Special cash dividend is made by the company itself. Additionally, the amount and timing of the Special Cash dividend in this example is both routine and predictable. The company even went so far as to announce in its own press released dated 2/22/06:

> *The supplemental dividend of fifty cents ($0.50) per share represents a portion of a total supplemental dividend estimated to be two dollars ($2.00) per share that Nucor's Board expects to declare and pay over this and the next three quarterly dividend payments.*

-- Press Release Issued by Nucor on 2/22/2006

The OCC's proposed rule changes do not provide any guidance on whether situations like Nucor's would fall under the guidelines mandating a contract adjustment for the special dividend. Presumably the OCC would have to wait for actual dividend announcements before the OCC Securities Committee could render a decision. (It does not seem likely that the OCC Securities Committee would render a decision on contract adjustments based on a company's stated intentions to declare special dividends in the future.) In this example, no prudent trader or investor would provide deep, narrow markets in any of the Nucor options given the uncertainty of whether the dividends would trigger a contract adjustment.

This would represent a significant step backwards, as currently the market for options in Nucor (and other stocks with frequent special dividends) is highly liquid.

Lack of Clarity in the Definition of "Policy"

The OCC's proposed rule changes state that the determination of a special dividend which requires a contract adjustment will be dependent on whether the "dividend or distribution was declared **pursuant to a policy** or practice of paying such dividends or distributions on a quarterly or other regular basis." (emphasis added)

The OCC has provided no language to clarify its definition of what constitutes a policy on the part of a company to pay dividends.

With the prevalence in today's markets of structured products that are required to pay dividends, the OCC is offering no guidance on what constitutes a "policy" to pay dividends. If for example a REIT is required to pay out profits in the form of a quarterly dividend, and the REIT pays $0.10 one quarter and $1.25 the next, is that a regular dividend not subject to contract adjustment?

If an ADR pays out $0.20 each March and then pays out its profits every August, is the dividend going to be "special" in the eyes of the OCC if it pays out $1.20 August '06 and only paid $0.50 in August '05? In this case the company has a policy of paying out dividends on a regular basis. But if market participants don't know whether the OCC will deem such payments as "special", they will have no way of making liquid markets.

As in the case where lack of clarity in the definition of "special dividend" creates more market uncertainty, so to the lack of clarity in the definition of "policy" creates more market uncertainty, not less.

Significant Market Impact on Options currently traded

The OCC states in its proposed rule change:

> "By definition, however, special dividends cannot be anticipated in advance and thus cannot be integrated into option pricing models."

As has been shown in the previously mentioned example of Nucor, special dividends can in fact be predicted and are accurately reflected in pricing models. In this case the dividend is so predictable the company has gone so far as to announce the frequency and amount of the dividends.

If the OCC rule changes are adopted as written, they will create uncertainty where currently none exists.

Furthermore, the OCC correctly states that option positions today are much larger than they were when the original rule was adopted, and that option positions are often much further out in expiration than when the rules were first written.

> "If adjustments are not made in response to special dividends (*i.e.,* by calling for delivery of the dividend) call holders can capture the dividends only by exercising their options. Often in these cases, especially with LEAPS options or FLEX options which can exist for 5 to 10 years, early exercise would sacrifice substantial option time value."

Once again the OCC is on point, but does not state the unintended effects of its proposed rule change. By changing the rules regarding contract adjustment, the OCC will be effecting massive windfall profits/losses on these very same-referenced larger, further-out positions.

Going back to our Nucor example, the VUB Jan '07 100 Put is currently priced mid market at $16.35 with the stock trading around $90.25 (VUB is the wrap symbol for NUE in the LEAPS.) The corresponding call is priced at $7.84. (These prices were retrieved from a Bloomberg terminal on 3/20/06.)

If the proposed rule changes are adopted, option pricing models (using a Bloomberg terminal for pricing) place the theoretical price of the above mentioned options at $15.58 for the puts and $8.63 for the calls.

	Calls	Puts
Current Rule	7.84	16.35
Proposed Rule	8.63	15.58
Difference	+0.79	-0.77

This would cause a $1.56 change in the put/call parity, resulting in the very same windfall profits/losses that the OCC is attempting to avoid. As one looks further out beyond January '07 expiration the immediate economic impact on current option prices becomes even greater as more dividends are subject to the possibility of a reclassification by the OCC Securities Committee.

Ironically, the OCC's attempt to eliminate perceived economic disadvantage in the future will in fact cause actual economic disadvantage today. For this reason, if the SEC chooses to adopt the OCC's proposed changes, implementation of the change at the very least should be scheduled to happen after the furthest out expiration of currently existing listed options (e.g. after January 2008 expiration).

False Claim of Elimination of Market Risk

In discussing the desire to avoid sudden prices changes in equity options, the OCC states that:

> "To the extent that equity options can be priced accurately and consistently without dislocations due to unforeseen special dividends, these economic disadvantages can be avoided."

However rather than eliminating the risk associated with the announcement of unforeseen dividends, the OCC's proposed rule changes simply transforms the risk from one of an unforeseen dividend announcement to one of an unforeseen decision on the part of the OCC Securities Committee.

The main problem lies in that the proposed regulations place more decision-making policy in the readjustment of the option by the OCC Securities Committee, than in the regulations themselves. In the current market, participants react to company announcements in a timely fashion, applying the existing regulation to the nature of the announcement. Conversely, under the proposed rule changes market participants will have to wait until a determination is made by the OCC Securities Committee before being able to accurately price options.

Furthermore, by significantly lowering the price threshold under which a determination is required by the OCC Security Committee, the new rule would greatly increase the frequency in which the market would be disrupted by the need to wait for a determination by the OCC. Rather than reducing risk, this proposed change would greatly increase risk to market participants.

Symbol Proliferation

> "Adjusting for dividends can cause a proliferation of outstanding option symbols and series. In the interest of providing some limit on option symbol proliferation, the proposed rule change includes a de minimis threshold of $12.50 per contract."

Symbol proliferation is a major headache for both the professional and non-professional trader, as it introduces the potential for errors in risk management, settlements, etc. The proposed rule changes will have the opposite impact of its stated goal of limiting symbol proliferation. Under the proposed rule change, any non-standard dividend greater than $0.125 per share (assuming 100 share contracts) will trigger a contract adjustment. The frequency of such adjustments will be very high, causing a sharp spike in symbol proliferation – the exact opposite of the intended effort to limit symbol proliferation.

Referencing our original example of Nucor, if the company continues its pattern of declaring a special cash dividend every quarter, by the time the existing January ’08 options expire there would be 7-8 different, non-standard wraps for the January ’08 options alone. Clearly this is not an instance of limiting symbol proliferation.

Adding further confusion, there could frequently be situations in which the declaration of a special dividend would cause a contract readjustment for some of the wraps of a given option expiry, and not others. For example, a company declares a special cash dividend in the amount of $0.13. In the January ’07 options there are two wraps – one representing a 100 share contract, and another January ’07 option wrap representing 91 shares plus cash in lieu which was created due to a previous contract adjustment necessitated by a previous special cash dividend. The first 100 share contract would be adjusted based on the total dividend amount of $13.00 per contract, but the second contract would not be adjusted since the $0.13 on 91 shares represents $11.83 in per contract dividend. The resulting confusion in the marketplace would be immense.

Conclusions

Our objections to the proposal for modification to the 10% rule as outlined in the SEC File No. SR-OCC-2006-01 are summarized as follows:

- The OCC has failed to show that the current rule introduces substantial economic disadvantages to market participants, to the extent that participants are unable to provide deep, liquid markets.
- The proposed rule change creates a great deal of uncertainty surrounding the definition of what constitutes a “special dividend” which would require contract adjustment.
- The only factual risk to market participants which the OCC highlights is the period between a dividend announcement and the actual declaration date on which the 10% rule is applied to determine whether a contract adjustment is warranted, and only then when the dividend amount is very close to the 10% threshold. The OCC proposes to increase the amount of time required to determine a “special dividend” by requiring market participants to wait until the OCC makes a determination **after** the declaration date, and to increase the frequency of such determinations by lowering the threshold to $0.125 dividends.
- The proposed rule change would have an immediate, large economic impact on market participants in all option classes with a non-standard dividend greater than 12.5 cents – a much larger population of products than the number of products currently subject to price dislocations under the 10% rule.

- The proposed rule change will result in rampant symbol proliferation, increasing the risk of errors from non-standard contracts and confusion for the investing public.

Based on the above comments, we strongly oppose the adoption of the changes outlined in SR-OCC-2006-01 with respect to the 10% dividend rule. We therefore respectfully request that the Commission institute proceeding to determine whether the rule change should be disapproved as written.

Thank you for your consideration of this matter.

Kind Regards,

(Submitted Electronically)

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