

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54328; File No. SR-BSE-2006-10]

### Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 2 Thereto, To Establish a Fee Per Contract Traded for Improvement Orders Submitted Into a Price Improvement Period by a Public Customer That Are Not Submitted as Customer PIP Orders

August 16, 2006.

On March 6, 2006, the Boston Stock Exchange, Inc. ("BSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend the Fee Schedule of the Boston Options Exchange ("BOX") in the manner described below. The proposed rule change was published for comment in the **Federal Register** on May 15, 2006.<sup>3</sup> The Commission received one comment letter concerning the proposal.<sup>4</sup> On June 29, 2006, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>5</sup> On August 14, 2006, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>6</sup> This order publishes notice of and grants accelerated approval of the proposed rule change, as modified by Amendment No. 2, on an accelerated basis.

#### I. Description of the Proposal

Currently, there are two ways Public Customer Orders<sup>7</sup> can be submitted into a Price Improvement Period ("PIP")

auction as an Improvement Order.<sup>8</sup> The first method is the Customer PIP Order ("CPO"), which is an order provided by a Public Customer to her/his BOX Order Flow Provider ("OFP") that contains a standard limit order price in the standard minimum trading increment—the Book Reference Price<sup>9</sup>—and a limit order placed in a penny increment, the CPO PIP Reference Price.<sup>10</sup> Through a CPO, a Public Customer may participate passively in a PIP auction (should one occur while her/his limit order is at the top of the BOX book) by virtue of the previously submitted instructions given to the OFP, *i.e.*, the CPO PIP Reference Price.

Alternatively, a Public Customer may submit an Improvement Order into a PIP auction through an OFP with any instructions that the OFP is willing to accept.<sup>11</sup> These non-CPO Improvement Orders do not have a Book Reference Price and are not exposed on the BOX Book; OFPs submit them on behalf of Public Customers in response to a PIP Broadcast<sup>12</sup> and PIP auction updates.

Originally, the Exchange proposed to amend the BOX Fee Schedule to establish a fee of \$.20 per contract traded for Improvement Orders submitted into a PIP by a Public Customer that are not submitted as CPOs.

In its letter, which was submitted in response to the original proposed rule change, Citadel urges the Commission to disapprove the proposed rule change because the proposed \$.20 per contract traded fee is inconsistent with three provisions of the Act. Citadel argues that the original proposed rule change was inconsistent with Section 6(b)(4) of the Act<sup>13</sup> because it would effect an inequitable allocation of reasonable fees among members and persons using the BOX facilities. Specifically, Citadel stated that the proposed \$.20 per contract fee was inequitable because Public Customers would not be afforded a volume discount similar to the one offered to BOX Market Makers<sup>14</sup> who,

according to Citadel, enjoy other benefits and privileges that are unavailable to Public Customers.

Citadel also argues that the proposed rule change is inconsistent with Section 6(b)(5) of the Act<sup>15</sup> in that it would discriminate unfairly between Public Customers with access to sophisticated technology and trading techniques ("Options Professionals") and all other Public Customers ("Investors") by imposing a fee upon Options Professionals and not Investors.

Further, Citadel argues that the fee, as originally proposed, would be inconsistent with Section 6(b)(8) of the Act<sup>16</sup> in that it would harm competition. Specifically, Citadel asserts that the proposed rule change would discourage Public Customers from sending non-CPO Improvement Orders to the BOX, which would result in fewer Improvement Orders competing to improve orders submitted to the PIP. Additionally, Citadel predicts that this diminished competition would make it easier for Market Makers to step ahead of Public Customer limit orders posted on the book, which would encourage BOX Participants to internalize more of their order flow, and thereby diminish price discovery and transparency and increase the costs of options investors.

In response to the Citadel Letter, the Exchange proposes to modify its proposal in Amendment No. 2. In Amendment No. 2, the Exchange proposes to reduce the trading fee applicable to each Improvement Order for a Public Customer not submitted as CPOs from \$.20 to \$.15. Further, the Exchange proposes to clarify that, under the proposed Fee Schedule as amended, no trading fee would be charged for Public Customer Improvement Orders submitted as CPOs or for Public Customer Orders traded on BOX including marketable orders, which interact with a PIP already underway.

#### II. Discussion

After careful consideration of the Citadel Letter and the proposed rule change, as amended in response to the Citadel Letter, the Commission finds that the proposal, as amended, is consistent with the requirements of Section 6(b) of the Act<sup>17</sup> in general and Section 6(b)(4) of the Act<sup>18</sup> in particular, in that it is designed to provide for the equitable allocation of

volume traded across all assigned classes. See Section 3.c. of the Fee Schedule.

<sup>15</sup> 15 U.S.C. 78f(b)(5).

<sup>16</sup> 15 U.S.C. 78f(b)(8).

<sup>17</sup> 15 U.S.C. 78f(b).

<sup>18</sup> 15 U.S.C. 78f(b)(4).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 53774 (May 9, 2006), 71 FR 28058 ("Notice").

<sup>4</sup> Letter to Nancy Morris, Secretary, Commission, from Adam C. Cooper, Senior Managing Director & General Counsel, Citadel Investment Group, LLC ("Citadel"), dated June 9, 2006 ("Citadel Letter").

<sup>5</sup> In Amendment No. 1, which superseded and replaced the original filing, the Exchange modified its proposal by lowering the proposed BOX fee from \$.20 per contract traded to \$.15 per contract traded. The Exchange also clarified its reasons for imposing the new fee.

<sup>6</sup> In Amendment No. 2, which supersedes and replaces Amendment No. 1 (and the original filing), the Exchange proposes to modify the proposed rule text and clarifies its reasons for imposing the new fee.

<sup>7</sup> The term "Public Customer Order" is defined as "an order for the account of a Public Customer. See BOX Rules, Chapter I, Section 1(a)(51). "Public Customer" is defined as "a person that is not a broker or dealer in securities." See BOX Rules Chapter I, Section 1(a)(50).

<sup>8</sup> The term "Improvement Orders" is defined in the BOX Rules Chapter V, Section 18(e)(i).

<sup>9</sup> The term "Book Reference Price" is defined in BOX Rules Chapter V, Section 18(g)(i).

<sup>10</sup> The term "CPO PIP Reference Price" is defined in BOX Rules Chapter V, Section 18(g)(i).

<sup>11</sup> See BOX Rules Chapter V, Section 18(e)(i).

<sup>12</sup> The PIP broadcast is disseminated once a PIP is initiated and is distributed solely to BOX Options Participants. The broadcasting of this message advises the Options Participants: (1) That a Primary Improvement Order, as that term is defined in the BOX Rules Chapter V, Section 18(e), has been processed; (2) of information concerning series, size, price and side of market; and (3) when the PIP will conclude ("PIP Broadcast").

<sup>13</sup> 15 U.S.C. 78(b)(4).

<sup>14</sup> BOX Market Makers may receive a volume discount of up to \$.05 per contract based upon total

reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

To justify this new trading fee on non-CPO Improvement Orders by Public Customers, the Exchange states that these types of orders, like the Improvement Orders of Market Makers and OFPs, are closely monitored for manipulative activity because they are submitted by sophisticated parties, with advanced technology, directly in response to PIP data updates. In contrast, the Exchange characterizes CPOs as more "passive" orders, because they contain preset PIP auction instructions, which pose less of a manipulation risk and therefore draw less regulatory scrutiny. The Exchange states, therefore, that CPOs are less costly to surveil than non-CPO Improvement Orders.

In addition, the Exchange states that the high volume of non-CPO Improvement Orders justifies the imposition of the proposed fee. The Exchange states that CPOs, as a result of their passive nature, generate fewer new Improvement Orders than non-CPO Improvement Orders, which are generated by sophisticated trading systems capable of generating many new Improvement Orders during a PIP. Increased Improvement Order traffic requires additional capacity on the BOX trading host, and investment in this additional capacity taxes the Exchange's resources. In light of the increased costs associated with non-CPO Improvement Orders,<sup>19</sup> the proposed fee provides for an equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

As mentioned above, in Amendment No. 2, the Exchange proposes to decrease the amount of the proposed fee. Currently, Market Maker and broker-dealer accounts are charged \$0.20 per executed contract for Improvement Orders traded in a PIP. As Citadel points out, however, some Market Makers receive volume discounts of up to \$0.05 per contract. In response to the Citadel Letter, the Exchange modified its proposal to reduce the proposed trading fee applicable to non-CPO Improvement Orders for Public Customer accounts from \$.20 to \$.15 per executed contract.<sup>20</sup> As a result, under the amended proposal, the BOX will impose upon Public Customers participating in the PIP through the use of non-CPO

Improvement Orders the same transaction fee as a Market Maker receiving the highest volume discount.

The Commission also finds that the proposed rule change is consistent with Section 6(b)(5) of the Act.<sup>21</sup> Section 6(b)(5) of the Act prohibits only "unfair discrimination," not discrimination *simpliciter*.<sup>22</sup> On its face, the proposed fee discriminates between different means of participating in the PIP auction.<sup>23</sup> However, a CPO and non-CPO Improvement Order impact the BOX differently. A non-CPO Improvement Order, which interacts in the PIP on a dynamic basis, taxes the Exchange's systems capacity and regulatory personnel to a greater degree than do passive CPO participants. In addition, the Book Reference Price associated with a CPO adds liquidity to the displayed BOX Book, which provides value to the BOX because it attracts additional orders. A non-CPO Improvement Order does not provide such liquidity. The Commission believes these differences are a reasonable basis for the Exchange to charge different fees. Discrimination on the basis of the disparate costs to the Exchange of administering the PIP auction is not unfair, particularly given the benefit (*i.e.*, liquidity) provided to the Exchange by CPOs.

Finally, the Commission finds that the proposed rule change is consistent with Section 6(b)(8) of the Act,<sup>24</sup> which requires that the rules of the Exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. A \$0.15 fee per executed contract, or \$0.0015 for each share underlying an option contract, will increase costs to Public Customers submitting non-CPO Improvement Orders by only a *de minimus* amount. Market Makers are charged comparable fees for participating in PIPs. Accordingly, the Commission does not believe this fee will discourage the submission of non-CPO Improvement Orders or impose a burden on competition.

The Commission finds good cause for approving Amendment No. 2 to the proposed rule change prior to the 30th day after the amendment is published for comment in the **Federal Register** pursuant to Section 19(b)(2) of the Act.<sup>25</sup> The proposed rule change, in its original form, was published for

comment<sup>26</sup> and, as mentioned above, the Commission received only one comment letter. Amendment No. 2 modifies the substance of the original proposal only by decreasing the amount of the proposed transaction fee from \$.20 per contract traded to \$.15 per executed contract.<sup>27</sup> This reduction to the proposed fee, which the Exchange offered in response to the Citadel Letter, does not raise any additional regulatory issues.

### III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning whether Amendment No. 2 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-BSE-2006-10 on the subject line.

#### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-BSE-2006-10. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commissions Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be

<sup>26</sup> See Notice, *supra* at note 3.

<sup>27</sup> In Amendment No. 2, the Exchange also revised the proposed rule text to make explicit that "[t]here are no trading fees for any other Public Customer Orders which may be executed including CPOs and Public Customer orders on the Book." This new language is consistent with the Exchange's description of the proposed rule change in the original filing: "All other Public Customer Orders traded on BOX, including marketable orders, which interact with a PIP already underway, will continue to be free."

<sup>21</sup> 15 U.S.C. 78s(b)(5).

<sup>22</sup> See *Timpinaro v. SEC*, 2 F.3d 453, 456 (DC Cir. 1993).

<sup>23</sup> The proposed fee would not apply to CPOs submitted by sophisticated Public Customers.

<sup>24</sup> 15 U.S.C. 78s(b)(8).

<sup>25</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> As discussed below, broker-dealers and Market Makers pay comparable trading fees. See Sections 2 and 3 of the Fee Schedule.

<sup>20</sup> See Amendment No. 2.

available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-BSE-2006-10 and should be submitted on or before September 13, 2006.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>28</sup> that the proposed rule change (SR-BSE-2006-10), as amended, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>29</sup>

Nancy M. Morris,  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54323; File No. SR-CHX-2006-27]

### Self-Regulatory Organization; Chicago Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change Relating to Retroactive Application of Participant Fees and Credits

August 16, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 10, 2006, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CHX. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The CHX proposes to make effective, retroactive to February 9, 2005, the trading permit fee due to the Exchange

if a CHX participant's trading permit is cancelled intra-year.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the CHX included statements concerning the purpose of, and basis for, the proposed rule changes and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in Item IV below. The CHX has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Changes

###### 1. Purpose

The Exchange proposes to make effective, retroactive to February 9, 2005, a change to the Fee Schedule relating to the trading permit fee due to the Exchange if a CHX participant's trading permit is cancelled intra-year. This change to the Fee Schedule originally became effective on October 24, 2005,<sup>3</sup> and provided that for trading permits cancelled intra-year, the CHX participant shall pay the Exchange the lesser of \$2,000 or the remaining balance of the annual trading permit fee. The Exchange believed that it was appropriate to amend the Fee Schedule to provide for some fee relief for CHX participants whose trading permits are cancelled intra-year. However, the Exchange also believed that it was necessary for the Exchange to have an adequate basis on which to budget and project annual revenues. Accordingly, the Exchange instituted the Fee Schedule change that it now seeks to make retroactive.

The Exchange believed that it had requested retroactive application of the Fee Schedule change at the same time that the change was originally filed with the Commission.<sup>4</sup> It now appears that retroactive application was not requested at that juncture. The Exchange has, however, been reserving funds to be refunded to CHX participants once retroactive application of the Fee Schedule change is approved. The Exchange believes that its participants are entitled to such refunds on account of intra-year trading permit termination. Accordingly, the Exchange

proposes retroactive application of the Fee Schedule change, dating back to February 9, 2005.<sup>5</sup>

###### 2. Statutory Basis

The CHX believes the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange and with the requirements of Section 6(b) of the Act.<sup>6</sup> The CHX believes the proposal is consistent with Section 6(b)(4) of the Act<sup>7</sup> in particular in that it provides for an equitable allocation of reasonable fees and other charges among the Exchange's participants.

##### B. Self-Regulatory Organization's Statement of Burden on Competition

The Exchange does not believe that the proposed rule changes will impose any burden on competition.

##### C. Self-Regulatory Organization's Statement on Comments Regarding the Proposed Rule Changes Received From Members, Participants or Others

No written comments were either solicited or received.

#### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

<sup>5</sup> February 9, 2005 was the date of the Exchange's demutualization, and, correspondingly, the date upon which the Fee Schedule provision relating to trading permit fees first became effective.

<sup>6</sup> 15 U.S.C. 78f(b).

<sup>7</sup> 15 U.S.C. 78f(b)(4).

<sup>28</sup> *Id.*

<sup>29</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 52815 (November 21, 2005), 70 FR 71572 (November 29, 2005) (SR-CHX-2005-31).

<sup>4</sup> *Id.*