VIA EMAIL AND FEDERAL EXPRESS

December 28, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: SEC Release No. 34-63403 – File No. SR-BATS-2010-034

Dear Ms. Murphy:

NYSE Euronext, on behalf of its subsidiary options exchanges, NYSE Arca Inc. ("NYSE Arca") and NYSE Amex LLC ("NYSE Amex"), appreciates the opportunity to comment on the BATS Exchange, Inc. ("BATS") proposal ("Proposal")[1] with the Securities and Exchange Commission ("SEC" or "Commission") to establish a directed order program ("Directed Order Program") on the BATS Exchange Options Market ("BATS Options"). While characterized by BATS as a program to provide price improvement, we believe that the Proposal would effectively create a mechanism to allow BATS Options Market Makers to internalize 100% of their customer order flow. Furthermore, we believe that the Proposal is inconsistent with established principles within the options industry regarding participation guarantees. For these reasons, we believe that the Proposal is inconsistent with the Securities Exchange Act of 1934 ("Exchange Act"), and strongly urge the Commission to disapprove the Proposal.

The Proposal

BATS is proposing to establish a Directed Order Program through which its Options Members can direct an order to a particular BATS Options Market Maker for potential execution.[2]

As part of the Directed Order Program, BATS is proposing to define two new order types. The first would be Market Maker Price Improving Orders, which are orders from a BATS Options Market Maker to buy or sell an option that has a displayed price and size and a non-displayed price at which the BATS Options Market Maker is willing to trade with a Directed

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1 *See* Securities Exchange Act Release No. 63403 (December 1, 2010), 75 FR 76059 (December 7, 2010) (SR-BATS-2010-034).

2 Capitalized terms not defined in this letter have the meaning in SR-BATS-2010- 034.

Order. As proposed, a Market Maker Price Improving Order would be ranked on the BATS Options Book at its displayed price; the non-displayed price of the Market Maker Price Improving Order would not be available to trade unless certain conditions were met (i.e., the order would trade at its non-displayed price solely in response to a Directed Order sent to the BATS Options Market Maker).

The second proposed order type is a Directed Order, which is an order from a BATS Options Member that would be directed for execution to a particular BATS Options Market Maker. For a BATS Options Market Maker to participate in an execution against a Directed Order (1) the Directed Order must be from a BATS Options Member that is on a list of eligible Options Members specifically provided by the BATS Options Market Maker, (2) the BATS Options Market Maker must be publicly quoting on BATS at the National Best Bid ("NBB") (for sell Directed Orders) or National Best Offer ("NBO") (for buy Directed Orders) (together "NBBO") with a Market Maker Price Improving Order that contains a non-displayed amount of price improvement over the NBB or NBO at the time the Directed Order arrives to BATS, and (3) the Directed Order must be marketable against the non-displayed price of the Market Maker Price Improving Order.

<u>The BATS Proposal Allows for Immediate 100% Internalization</u>

Despites claims by BATS about the merits of the Proposal, we believe that it is nothing more than a mechanism to allow BATS Options Market Makers to internalize customer order flow. In particular, the Directed Order Program would permit a BATS Options Market Maker to selectively choose the BATS Options Members from which it will accept Directed Orders. For competitive reasons, it is likely that a BATS Options Market Maker will only accept Directed Orders from BATS Options Members with which it has an established business relationship (e.g., a broker dealer affiliate of the Market Maker). In essence, the Proposal would create a private, two-tiered market in which BATS Options Market Maker could internalize customer order flow, denying such customers and other market participants the benefits of order exposure. Allowing such discriminatory trading arrangements only serves to degrade the transparency, high level of competition and deep liquidity that are the cornerstones of the options markets.

We also take issue with BATS' claims that the Directed Order Program is specifically designed to enhance opportunities for it Options Members to obtain price improvement for customer orders. More specifically, BATS insists that by requiring Options Market Makers to include a non-displayed price that is better than the Options Market Maker's displayed limit price, the Directed Order Program would increase the opportunities for customer orders to receive price improvement over the NBBO. In support, BATS cites to the Nasdaq Options Market ("NOM") Price Improving Order.

However, the NOM Price Improvement Order is fundamentally different from the proposed BATS Market Maker Price Improving Order. Whereas the NOM Price Improvement is available for execution against any marketable inbound order, the BATS Market Maker Price Improving Order, as proposed, would only execute against the Directed Orders of those specific Options Members that the Market Maker has personally selected. If BATS believes that its Directed Order Program will lead to meaningful price improvement, then these benefits should be made equally available to all BATS Options Members in a non-discriminatory manner, not just to those approved by BATS Options Market Makers for acceptance of Directed Orders.

BATS also claims that the Commission has previously approved rules that permit a specialist or market maker to determine the firms from which it will accept directed or preferenced orders, and has implicitly approved such practices in the options markets by allowing certain price improvement auctions to exist pursuant to pilot programs. While we are aware that the selective directed order concept has been used in the stock markets, it is *not* one that has been approved by the Commission for use in the options markets, despite similar proposals from other options exchanges.[3] Moreover, the industry practice for directed orders is that the order sending firms select the market makers to which they will send orders, rather than the market makers selecting the order sending firms from which they will receive orders. In this regard, the BATS Directed Order proposal turns the industry practice on its head. In addition, we fail to see how the various price improvement auctions in the options markets provide support for BATS' Directed Order proposal, particularly in light of the fact that such auctions afford all respondents the opportunity to participate. In sum, BATS' Proposal is not like existing directed order mechanisms or even auctions that reveal the counterparty because it would allow for immediate 100% internalization for only those counterparties selected by a BATS Options Market Maker.

In addition, BATS claims that by permitting all Options Members to enter orders in the same increments as Market Maker Price Improving Orders, including as proposed at the midpoint of the NBBO, and affording those orders in all cases priority at their non-displayed prices over Market Maker Price Improving Orders, the proposal avoids creating participation guarantees in place at other markets.[4] This argument is disingenuous, especially in light of the lack of transparency that the Proposal creates. To the contrary, we believe that if the Proposal is approved there is a significant probability it will lead to a 100% *de facto* participation guarantee, which is inconsistent with established precedent across the industry.

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3 *See, e.g.*, Securities Exchange Act Release No. 63539 (December 14, 2010), 75 FR 79429 (December 20, 2010) (SR-BX-2010-079) (Proposal to Allow Executing Participants to Provide BOX a List of the Order Flow Providers for which the Executing Participants will provide Directed Order Services). *See also* proposed Chapter VI, Section 5 of the Boston Options Exchange ("BOX") Directed Order Rule ("Prior to accepting any Directed Order through the Trading Host, an [Executing Participant] must inform BOX of the [Order Flow Providers] from whom it has agreed to accept Directed Orders through the Trading Host ("Listed OFPs" or "LOFPs"). The Trading Host will then only send to the EP Directed Orders from LOFPs.").

4 *See* Proposal at 6, 8.

BATS' NBBO Quoting Requirement is Misleading

BATS further claims that by requiring BATS Options Market Makers quote at the NBBO to participate in an execution against a Directed Order directed to it, BATS' Directed Order Program will incentivize its Options Market Makers to competitively quote and thereby further the public price discovery process.[5] While it may be true that a BATS Options Market Maker would be required to quote at the NBBO, we understand that it would only require a posted size of 1 contract at the NBBO.[6] As set forth below, this leaves a Market Maker with order routing affiliates free to post a token displayed size at the NBBO while becoming eligible to accept the Directed Orders of the affiliates it has chosen as counterparties. Moreover, the Proposal would create a powerful disincentive to quote on the NBBO for all market makers without order routing affiliates, since by doing so they take on substantial risk but would be deprived of the opportunity to interact with order flow from the order-routing affiliates of BATS Options Market Makers.

For example, assume the market for a particular series is as follows:

Exchange	Bid Size	Bid Price	Ask Price	Ask Size
Amex	100	$1.00	$1.05	100
Arca	50	$1.01	$1.05	250
CBOE	75	$1.00	$1.05	150
NBBO	50	$1.01	$1.05	500

Given these markets a BATS Options Market Maker could submit a Reserve Order $1.01 bid at $1.05 display 1 hide 19 along with a Market Maker Price Improving Order with the following parameters:

	Bid Size	Bid Price	Ask Price	Ask Size
Displayed Reserve Order	1	$1.01	$1.05	1
Non-Displayed Price Improving Order	20	$1.02	$1.04	20

The market for the series would then be as follows:

Exchange	Bid Size	Bid Price	Ask Price	Ask Size
Amex	100	$1.00	$1.05	100

5 *See* Proposal at 6.

6 *See* BATS Options Rule 22.6(a) (Size Associate with Quotes). The best bid and best offer entered by a Market Maker must have a size of at least one (1) contract.

Arca	50	$1.01	$1.05	250
BATS	1	$1.01	$1.05	1
CBOE	75	$1.00	$1.05	150
NBBO	50	$1.01	$1.05	500

Under this scenario, a BATS Options Member that the BATS Options Market Maker has chosen could send a Directed Order to the BATS Market Maker to buy 10 contracts for $1.05. If there is no other non-displayed interest priced at or better than $1.04, the BATS Market Maker would trade 100% of the Directed Order.

In reality, we believe that the Proposal would actually *disincentivize* BATS Options Market Makers from posting significant displayed size that the NBBO. The larger the displayed size, the greater the likelihood that the Market Maker's quote will be hit by a non-Directed Order, thereby rendering the non-displayed size of the Market Maker Price Improving Order unavailable to trade against a Directed Order. This disincentive is bad for the marketplace, and will likely contribute to thinner market depth at the NBBO. This is likely to be seen on BATS Options and across the entire U.S. market for listed options, as other markets are sure to adopt similar provisions for competitive purposes.[7]

The BATS Proposal Should be Disapproved

When taken as a whole, we do not see how the Proposal benefits the marketplace or the investing public. Moreover, we believe that the Proposal is inconsistent with Section 6(b) of the Exchange Act, which requires, in part, that "the rules of a national securities exchange promote just and equitable principles of trade" and not be "designed to permit unfair discrimination between customers, issuers, brokers, or dealers."[8] In our view, the proposed Directed Order Program on BATS discriminates against some BATS Members in favor of others, and accordingly should be disapproved.

Conclusion

NYSE Euronext recognizes and supports the Commission's ongoing leadership in reviewing and addressing trading practices that cause harm to the national market system as a whole and

7 We note that the controversial aspect of the BOX pilot referenced above was immediately adopted and implemented by the International Securities Exchange ("ISE") once it became aware of the practice on BOX, despite ISE's public comments regarding the negative impact that it would have on the marketplace. *See* Securities Exchange Act Release No. 53104 (January 11, 2006), 71 FR 3144 (January 19, 2006) (SR-ISE-2006-02).

8 15 U.S.C. 78f(5).

the listed options markets specifically. We believe that mechanisms like the proposed BATS Directed Order Program have no place in the options markets.

We therefore respectfully urge the Commission to disapprove the Proposal.

Very truly yours,