



September 3, 2008

Florence E. Harmon, Esq.
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Petition for Rulemaking dated July 15, 2008 filed by Citadel Investment Group L.L.C. (Docket number 4-562)

Dear Ms. Harmon:

NYSE Euronext submits this letter in opposition to the Petition for Rulemaking to Address Access Fees in the Options Market filed by Citadel Investment Group, L.L.C. ("Citadel") on July 15, 2008 (the "Petition"). NYSE Euronext is the parent company of NYSE Arca, Inc. ("NYSE Arca") and is in the process of acquiring the American Stock Exchange, Inc. ("Amex"), each of which is a registered securities exchange that disseminates quotes and provides facilities for the trading of listed options contracts.

As stated more fully below, we urge the Commission to reject the Petition because it fails to take into consideration the fee structures in all options exchanges. The Petition is too narrow in scope and as such – capping certain "non-member" access fees – does not foster a fair and orderly market or further the goal of transparency. Instead, we recommend that the Commission direct the Division of Trading and Markets to conduct a comprehensive study not only of the fee structures of options exchanges but also of the financial inducements offered by such exchanges to attract order flow. Such a study should focus on the extent to which particular models are consistent with the exchange's obligation under the Securities Exchange Act of 1934, as amended and further (or impede) the development of a fair and orderly market for the trading of listed options contracts.

Citadel's Petition requests the Commission to adopt a rule that would limit the amount of non-member exchange fees that could be imposed on a non-member for the execution of a transaction against a quotation for a listed options contract disseminated by such exchange to \$.20 per contract. The Petition describes such fees as "taker fees" in the context of a "maker-taker" fees structure adopted by certain options exchanges, including NYSE Arca. In a "maker-taker" structure, an exchange provides an economic benefit to reward members that provide a service by adding liquidity through quoting trading interest on the exchange and charges members a fee for trading against the quoted interest. Taker fees can be used to subsidize the rebates paid to members providing liquidity by posting quotations.

The Petition focuses on the taker fees charged when an order received by another options exchange must be sent to a maker-taker exchange that is quoting a better price that cannot be matched by the competing exchange. Citadel characterizes this result as a charge to a non-member, even though the technical means for routing such orders is through a broker-dealer affiliate of the competing exchange which is a member of the exchange with the better quote. Thus, the charge is not a direct charge to non-members, but to the broker-dealer that handles a customer order. The broker dealer is not required to pass this charge on to the customer.

As the Petition notes, three options exchanges (including NYSE Arca) currently operate a maker-taker model. What the Petition fails to point out is that the three exchanges using the maker-taker model have adopted trading rules that generally provide price-time priority to quotations on their exchange. The result is that these exchanges' quotations often provide better prices (tighter spreads) that require orders entered in competing exchanges to be routed to the better-priced quotes (if not matched by market-makers on the competing exchange).

The remaining four options exchanges (including Amex) have adopted a different mechanism for attracting order flow which we call a payment for order flow or PFOF model. In the PFOF model, the exchange charges trading fees to market makers when trading against customer orders. The fees are deposited into an account which is controlled by the market maker assigned to the option. This monetary pool must be distributed by the designated market maker to compensate broker-dealer members whose orders generate liquidity, but the allocation is at the sole discretion of the market maker.

Both models recognize that order flow has value. The maker-taker model coupled with its price/time priority market structure, and the PFOF model coupled with its directed order flow market structure, are simply two methods to determine who pays for and who receives this value.

In both models customers may benefit. In the maker-taker model all liquidity takers are charged the same amount and all liquidity providers benefit equally. The maker-taker exchanges would also argue that their model benefits all customers (particularly liquidity takers) by encouraging quotes at fair value (resulting in tighter spreads and better prices). In the PFOF model, broker-dealers who route order flow and receive compensation may use that cash flow to add services or reduce commissions. PFOF exchanges would argue that their model encourages quoting larger sizes at their best bid/offer.

The two models described have evolved as a result of structural transition in the options markets as a result of several factors that include penny pricing, electronic trading, and technological improvements that have augmented the customer trading experience. The options market has grown substantially and continues to outpace other U.S. securities markets as a result of these factors.

The Commission is to be applauded for allowing these competing models to flourish to meet the differing needs of customers. The competing models have brought independent

costs and benefits to the different constituents, and transfer the economic benefit of order flow in different ways, but share a common trait: there is a party who pays a cost (and must incorporate that cost in their trading and routing decision) and a party who receives an economic benefit for providing liquidity.

Because we have an economic interest in exchanges that use competing models, our position is based on the principle that the framework of both models should be centered on the hallmark of transparency and better opportunities for price discovery, taking into account broker-dealer obligations to seek best execution for customer orders that they control. We also appreciate that the differences in these models may distort the business model of order flow providers. For example, the value of payment for order flow is diluted when the order is re-routed to a maker-taker exchange that assesses a charge for that service, even though the customer actually benefits from the better price.

We believe that any changes to the cost/benefit paradigm of one model should be applied to the other model. Access fees should be addressed not as one model versus the other but as a fee to access the market independent of the market structure that marketplace employs.¹

Although we oppose the Petition, we are in favor of rules that ensure the reasonableness of fees, similar to rate caps that were enacted in the equities markets in Regulation NMS. We recommend that the Commission direct the staff of the Division of Trading and Markets to undertake a study of pricing and order-flow compensation practices in the options markets that would result in recommendations to the Commission regarding the objective level at which to establish any such caps – to be applied to both market models. In the interim, we recommend that the maker/taker exchanges continue to be permitted to experiment with fee structures, because we believe that market forces will ultimately lead to pricing which determines the optimal level in the marketplace, and thereby establish a level at which a cap, if finally determined to be in the best interests of the options market, can be fixed. We believe this is consistent with the market level from which the equities fee cap of \$.003 per share, established in Regulation NMS, was ultimately determined.

As the Commission begins its review we would like to briefly address two points asserted in the Petition, namely (i) that “excessive” taker fees cause locked and crossed markets; and (ii) that taker fees are “frequently imposed on retail customers because retail customers are generally taking and not providing liquidity.”

With respect to locked and crossed markets, the Petition’s assertion is made on anecdotal observations rather than on hard data. The Commission staff is in a better position to study whether locked and crossed markets have increased and whether taker fees have been a factor in this increase. Our own observation is that the majority of locked and crossed

¹ Citadel focuses strictly on access fees charged to non-members in the maker-taker model. As described more fully herein, in order to foster a fair and orderly marketplace, the scope of the Commission’s review must be the entire options landscape. As such, it is important to note that access fees in the maker-taker model range to a high of \$.55 per contract, while exchange PFOF collection rates range as high as \$.75 per contract with PFOF distribution rates in some instances exceeding \$1.00 per contract.

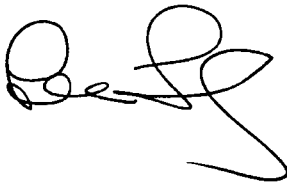
markets result not from disparate market fee structures but due to technology performance gaps or the coincidence of market prices bumping up against one another. In any case, we agree that locked and crossed markets are not in the interest of investors and measures should be implemented to prevent them.

Second, the Petition's claim regarding the impact of taker fees on customers does not take into account the benefit customers often receive from obtaining a better price in the tighter markets that are often available in the price/time priority model that is employed by the "maker/taker" exchanges. The real issue is the extent to which payment for order flow affects the routing decisions of firms handling customer orders. The question of how customers are charged (or not) for the taker fee is a decision made by the broker-dealer handling the customer order. This issue, as well, is worthy of further study.

In summary, NYSE Euronext requests that the Commission (i) deny Citadel's Petition and (ii) direct the Division of Trading and Markets to undertake a comprehensive study of pricing and compensation levels of options exchanges and to make recommendations as to whether any restrictions should be imposed on such practices. We further request that, in the interim, exchanges be permitted to experiment with fee structures to allow market forces to affect these decisions.

As the owner of a price/time options exchange and the prospective owner of an exchange operating a PFOF model, our interest is to assure that the exchanges are able to compete fairly where the costs and benefits of trading on an exchange are transparent and non-distortive. If fee caps are to be imposed, they should be imposed regardless of the manner in which the costs and benefits of participation are allocated. Ultimately, the approach the Commission takes must be one that bears the hallmark of fairness, transparency, and enhanced opportunity for price discovery.

Sincerely yours,



Lawrence Leibowitz
Group Executive Vice President and
Head of Global Execution and Technology

cc: Hon. Christopher Cox, Chairman
Hon. Louis A Aguilar, Commissioner
Hon. Kathleen L. Casey, Commissioner
Hon. Troy A. Paredes, Commissioner
Hon. Elisse B. Walter, Commissioner
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