September 21, 2009

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

RE: Amendments to Regulation SHO Release No. 34-60509; File No. S7-08-09

Ms. Murphy:

BATS Exchange, Inc. ("BATS") appreciates the opportunity to comment on the above referenced alternative proposal to amend Regulation SHO ("Alternative Proposal"). In our prior comments on the Securities and Exchange Commission's ("SEC" or "Commission") proposal to amend Regulation SHO by implementing an uptick rule or a modified uptick rule with or without a circuit breaker, BATS supported the SEC's efforts to restore investor confidence.[1] However, we also argued that the SEC's efforts to that end were best spent through enforcement of existing anti-manipulation laws rather than through implementation of artificial regulatory restraints on short selling, the effect of which would be to reach far beyond reducing manipulation opportunities and serve instead to the detriment of market efficiency.

BATS continues to believe that there is no compelling empirical evidence to support reintroduction of a short sale price test restriction. To the contrary, we call attention to the volumes of empirical data that supported eliminating price test restrictions on short selling in the first instance. To date neither the SEC nor the thousands of commenters favoring reintroduction of such a price test have produced empirical evidence to support doing so.

That said, and consistent with our prior comments, should the SEC determine it is appropriate to implement some form of short sale price test restriction, BATS supports many aspects of the Commission's current Alternative Proposal, if it is combined with a circuit breaker. Pursuant to the Commission's Alternative Proposal, the Commission is seeking comment on the imposition of what it refers to as the "alternative uptick rule." The alternative uptick rule would allow short selling only at a price above the current national best bid ("NBB"). Stated another way, absent an exemption, a short sale could not execute at a price at or worse than the NBB.

As we noted in our prior comments, and as the SEC acknowledges in its Alternative Proposal, the alternative uptick rule, while comparatively easy to implement, is more restrictive

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1 *See* Letter to Elizabeth M. Murphy, Secretary, SEC, regarding Amendments to Regulation SHO Release No. 34-59748, File No. S7-08-09 from BATS Exchange, Inc. (May 14, 2009).

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than the uptick rule or modified uptick rule. The alternative uptick rule is easier to implement because it does not require industry participants or exchange surveillance systems to track successive bids or last sale prices and to calculate whether those successive bids or last sales are plus, minus, zero, or zero-plus ticks. Accordingly, BATS believes actual implementation costs in terms of time and capital expenditure would be negligible when compared to those involved in implementing either the uptick rule or modified uptick rule.

The alternative uptick rule is more restrictive, however, because unlike the uptick rule or the modified uptick rule, it would prevent an incoming short sale order from automatically executing at a price at or worse than the NBB, regardless of whether that NBB reflects a plus or minus tick.[2] This restriction would have the effect of dramatically decreasing downward price pressure on a security, including pressure that could be resulting from manipulative short selling. In other words, in a falling market, the inability for a manipulative short seller to execute against a resting displayed bid would effectively prevent the use of short sales to push the market down further. Similarly, in a rising market the inability for a manipulative short seller to execute against a resting displayed bid would prevent the use of short sales to slow or stop the price rise. For the same reasons, however, the tradeoff for <u>preventing</u> manipulative short selling rather than identifying and enforcing existing anti-manipulation rules after the fact would be the decrease in available and legitimate sell liquidity at any given NBB.

Because the alternative uptick rule is more restrictive than the other potential price tests proposed by the Commission, BATS believes that it would likely have a more dramatic detrimental impact on the provision of liquidity. While this detrimental impact could be justified to combat abusive short selling during times of market stress, BATS believes it would not be justifiable to impose such a draconian restriction on short selling in the absence of such market stress. Thus, BATS believes that the alternative uptick rule should only be applied in conjunction with a circuit breaker. As we stated in our prior comments, by implementing the alternative uptick rule only after a circuit breaker threshold has been reached, BATS believes the Commission would strike the appropriate balance between the desirable goals of maximizing efficiency when the market is operating within normal trading ranges and prohibiting potentially abusive short selling when it is not, while refraining from imposing excessive implementation costs on the industry.

The Commission also requested comment on whether the Alternative Proposal should be implemented via a policies and procedures approach, a strict prohibition approach, or some combination of the two. BATS believes that trading centers should be required to have

[2] In the Alternative Proposal, the Commission stated that "[b]ecause it would only permit short selling at an increment above the national best bid, the alternative uptick rule would not allow short sales to get an immediate execution . . ." *See* Alternative Proposal at p. 6. BATS understands the Commission to mean that a short sale could not get an immediate execution at a price equal to or worse than the NBB. BATS, as well as other equity exchanges, often have non-displayed liquidity on their books at prices between the NBBO. As such, an incoming short sale order could execute immediately against a non-displayed bid priced higher than the NBB. BATS believes that such outcome is consistent with the policy goals sought to be achieved by the Commission's proposal.

reasonable policies and procedures designed to prevent a short sale from executing at a price equal to or worse than the NBB. As part of these reasonable policies and procedures, trading centers should be permitted to rely on a broker-dealer's marking of an order as "short exempt" to execute at a price equal to or worse than the NBB (if the order would execute at a price that is worse than a protected quote under Regulation NMS it would, of course, also need to be marked with the intermarket sweep order ("ISO") flag).

With respect to specific exemptions, BATS supports those proposed by the Commission. BATS also supports the addition of both an equity and options market maker exemption, consistent with our prior comments.

BATS also requests that the Commission implement an additional exemption under the alternative uptick rule similar to the ISO exception to trade through and locked and crossed market prohibitions under Regulation NMS. In particular, BATS believes that broker-dealers should be able to mark an order "short exempt" when sending an order to a market center at a time when the broker-dealer's market data feeds, subject to reasonable policies and procedures to ensure accuracy, demonstrate that such order is priced higher than the existing NBB. In the absence of such an exemption, race conditions will exist in which an incoming bid could arrive to the market center first and prevent the short sale from executing.

BATS submits that in such a case, prohibiting the short sale order from executing would not further the Commission's efforts to combat abusive short selling, but would unnecessarily interfere with the efficient functioning of the markets. The Commission's policy goals of preventing abusive short selling would not be furthered because at the time the broker-dealer submitted the order to the market center it was priced higher than the NBB; as such, the order could not be considered to be intended to drive down the price of the security. Similar to the use of ISOs under Regulation NMS, by permitting a broker-dealer to mark an order "short exempt" in this scenario, the Commission's goals underlying the Alternative Proposal would not be undermined and at the same time the markets would be free to maximize available efficiencies given the constraints imposed under the Alternative Proposal. As with any available exemptions, broker-dealers would be required to maintain reasonable policies and procedures related to their use of the exemption and, would be required to maintain documentation sufficient to evidence their compliance with the exemption.

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BATS appreciates the opportunity to comment on the Commission's Alternative Proposal. Please feel free to contact me if you have any questions in connection with matter.

Sincerely,

SVP & General Counsel

cc: The Hon. Mary L. Schapiro, Chairman
The Hon. Kathleen L. Casey, Commissioner
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
James Brigagliano, Co-Acting Director, Division of Trading and Markets
Daniel M. Gallagher, Co-Acting Director, Division of Trading and Markets