(This letter relates primarily to SR-NYSE-2006-36, but has relevance here)

June 22, 2006

Dear SEC:

As with other aspects of the NYSE's artificially contrived, floor-constituency self-serving "hybrid"
market, the proposal under discussion herein is conceptually muddled, incoherently presented, and inconsistent with clearly applicable law.

The proposal has been described in some quarters, entirely inaccurately, as somehow creating a "discretionary order" that "replicates" the way a floor broker "works" an order in the physical auction.
In reality, of course, an "automated discretionary order" is an oxymoronic concept, and the proposal in no way "replicates" the way floor brokers exercise discretion in the physical auction.

Rather, using misleading terminology focusing on the word "quote", the NYSE is simply proposing to give floor brokers the exclusive franchise to be able to enter conditional hidden, in-between-the-published-quotation go along limit orders, which receive non-discretionary automated executions pursuant to their terms as contra interest enters the market.

The NYSE proposal is seriously objectionable for the following reasons:

(1) This proposal, as with other aspects of the "hybrid" market, raises significant, fundamental market structure issues, and serious legal issues under Section 11A of the Securities Exchange Act, which should not be resolved through ad hoc approvals of self-serving proposals. At the end of the day, the Commission will find that it has, in fact, blundered into permitting the evolution of a non-transparent "national market system" that is inconsistent with the Commission's philosophy in Regulation NMS, and in direct conflict with the Congressional mandate expressed in Section 11A.

(2) The terminology used is misleading to investors because it does not conform to common English language understandings of the word "quote", and thereby suggests that a process which is entirely hidden is in fact transparent.

(3) The proposal in no way "replicates" the physical auction, but rather introduces a radical new way of trading that is fundamentally unfair to those who enter public limit orders. The proposal exploits a highly "unlevel" informational playing field to the entire advantage of floor brokers.

(4) Even if the Commission is inclined to permit hidden, in-between-the-published-quotation limit order trading in some form, it is anti-competitive, and in clear violation of Sections 6(b) and 11A of the Securities Exchange Act, to give floor brokers the exclusive ability to enter orders that will in fact be executed systemically, with no human intervention.

(5) The proposal in no significant way mitigates the anti-competitive advantage enjoyed by specialist algorithmic trading, and would permit specialist trading in absolute contravention of Section 11A of the Securities Exchange Act.

A Note on the SEC's Rule Approval Process

Before addressing the substantive deficiencies of the NYSE's proposal, I would like to note several disturbing developments that have crept into the Commission's rule approval process. Section 19(b) of the Securities Exchange Act and the SEC's Rule 19b-4 contemplate that an SRO's rule submission will indicate the "basis" under the Act justifying the Commission's approval of the submission. The Commission itself states its reasons for finding an SRO's rule submission consistent with the Act when it issues an approval order.

In recent years, the Commission's rule approval process has been allowed to become a meaningless, largely pro forma exercise in this regard. SROs (the NYSE is hardly the only offender) simply refer to a provision of the Act (typically, one of the platitudinous concepts in Section 6(b)(5)), and make a conclusory assertion that this is the "basis" under the Act for the proposal. The entire exercise smacks of a meaningless checking off of a box on a checklist, and clearly communicates no useful information whatsoever. Conclusory assertions are entirely devoid of intellectual or legal content, and are essentially without real meaning. This can hardly be what was intended when the requirement for demonstrating a "basis" under the Act was first adopted. An SRO must be made to demonstrate why a particular proposal promotes fair and orderly markets, etc., and not be allowed to get away with merely asserting that this is so. The Commission has allowed its standards to seriously deteriorate in this regard.

Sadly, the Commission's standards in its approval orders have similarly deteriorated in too many cases, with empty conclusory assertions (often simply regurgitating those made by the SRO) substituting for legal reasoning. In my March 27, 2006 comment letter on SR-NYSE-2004-05, I expressed my dismay at the absence of legal analysis in the SEC's "hybrid" market approval order. In that order, the SEC merely noted (with material omissions) serious, substantive public commentator criticisms, noted the NYSE's positions, and then uncritically accepted the NYSE's positions, making conclusory assertions about "basis" under the Act. This cannot be how the public comment process is supposed to work, unless the SEC staff's role has been reduced to the merely clerical function of producing summaries of positions.

The SEC staff are expected to exercise and reflect independent critical judgment, particularly when serious, substantive criticisms raise significant questions about an SRO's self-serving assertions. This is not simply a disagreement about ultimate conclusions, which are the Commission's prerogative.
Rather, it is a statement that, regardless of the conclusions it comes to, the Commission must deal fairly with the public comments it solicits, must fully analyse them, must reflect that analysis in its conclusions, and must exercise independent, critical judgment in so doing.

The NYSE Proposal Raises Serious Market Structure Issues

The NYSE's proposal brings to the fore a broad and deeply disturbing issue. It is obvious that, regardless of the obfuscatory euphemisms used (broker agency interest files, specialist algorithms, e/d-quotes, reserve interest), the NYSE is really talking about hidden orders that compete directly, and under more favorable conditions, with fully transparent market interest.

Hidden order trading, of course, is a routine aspect of any number of trading strategies. (Indeed, many traders, in all seriousness, want to hide their own orders, while demanding that everyone else show theirs). But the overall market structure implications are insufficiently appreciated, as there are two different trading philosophies on a direct collision course with each other, with many public investors, particularly the least sophisticated, being trapped in the middle.

The fundamental difficulty with hidden order trading is obvious: it makes the markets less transparent to those who seek to access liquidity, and it often denies executions to those who post liquidity to be accessed. The potential for a classic vicious cycle is clear: the disincentives to posting liquidity mean that less liquidity will be displayed, which in turn means that those seeking to access liquidity will have a harder time finding it (hidden orders by definition cannot attract liquidity) and discovering prices they can trust. This, in turn, further disincents the posting of liquidity, etc. This is hardly a rational objective for a true national market system, but the NYSE's proposal clearly makes the NYSE, the world's premier price discovery venue for its listed stocks, a far less transparent, and therefore a far less trusted, place to do business.

Should the Commission "institutionalise" hidden order trading between the quote on the NYSE, other markets are sure to follow suit, and the Commission, having set a precedent with the NYSE, will be required to approve those initiatives. The result, of course, will make a mockery of Regulation NMS, as there will be a great deal of pre-programmed, immediately executable market interest overhanging the market in between the published quotation that is entirely hidden from those seeking to access liquidity. This renders meaningless the notion of "published quotations" or "national best bid/offer" as barometers of liquidity/best prices, and creates price and execution uncertainty.

I am not suggesting there are easy answers in any of this, as hidden order trading, in some form, is a fact of life. But the signposts for an intelligent regulatory approach are clear. The U.S. Congress, in Section 11A of the Securities Exchange Act, clearly came down on the side of market transparency as a fundamental objective of the national market system.
The Commission clearly sought to effectuate this objective in Regulation NMS, with its emphasis on protecting displayed limit orders. The reasons for such protection are obvious: a fully transparent market is the fairest for all investors (both for those who display liquidity and those who seek to access it), and such a market provides an environment in which public investors may discover the fairest prices.

The Commission needs to pay attention to the law of unintended consequences here, and assess the issue truly raised by the NYSE's proposal: to what extent should hidden limit order trading be permitted at the expense of fully displayed liquidity, and at hidden prices that are better than published quotations that purport to establish the national best bid/offer? The potential for de facto trade-throughs is, of course, enormous. For example, assume that the national best bid (non-NYSE) is .20, but an NYSE floor broker has entered an automated hidden limit order that can trade at .21. A seller will direct an order to the best published bid of .20, not knowing that there is a hard-wired, pre-programmed order that will provide an immediate execution on the NYSE at .21.

This is hardly in keeping with the philosophy of Regulation NMS, and as this sort of trading proliferates on other markets, as it inevitably will, Regulation NMS will be essentially gutted, as the "published" national best bid/offer will become a meaningless concept.

And no, the NYSE's proposal is not simply a "replication" of the physical auction in this regard.
While floor brokers and specialists could always provide an in-between-the-published-quotation
execution on a case-by-case basis as orders were exposed to the NYSE market, this was a result of ad hoc, spontaneous trading decisions made after contra side orders arrived. There is a quantum disticntion between this sort of physical auction order interaction (where a better price may or may not be
available) and an automated execution system in which better prices are absolutely available and overhang the market, as they have been pre-programmed for immediate, non-discretionary execution as contra side interest enters NYSE systems.

The Commission clearly needs to take a step back and carefully consider all the implications here as to automated hidden order trading by NYSE specialists and floor brokers (and in short order by other markets), particularly the implications for market transparency, meaningfulness of the published national best bid/offer, protection of displayed public limit orders, and integrity of the price discovery process. These are hugely significant issues, and they cannot be adequately addressed, much less resolved, by the Commission's ad hoc, seriatim approvals of the NYSE's self-serving proposals.

The Commission needs to issue a concept release and seek public comment on how to balance fully displayed versus hidden order trading. Pending the SEC's resolution of this matter, neither the NYSE nor any other market should be permitted to implement new automated hidden order trading mechanisms.

There is no prejudice to the NYSE in such an approach because the automated hidden order trading it is proposing (whether by specialists or floor brokers) is certainly not required for the NYSE to be able to comply with the implementation of Regulation NMS.

The NYSE Proposal Uses Highly Misleading Terminology That Suggests an Entirely Hidden Trading Process is Somehow Transparent

The presentation of the NYSE's proposal is, and I'm being charitable, an incoherent mess. In critical instances, where explanatory paragraphs and detailed examples are called for, the NYSE merely provides jargon-laced "bullet points." Overall, the rule submission reads like a summary prepared for one of its trader committees rather than a document seriously and thoughtfully prepared for intelligent public review and comment.

At the heart of the proposal, the NYSE presents, without embarrassment, a linguistic absurdity: the notion that something can be called a "quote" when it remains entirely hidden from public view and is never "quoted" as that term is commonly understood by those of us who speak English.

The NYSE's penchant for inflated, self-invented jargon reaches new heights (or is it depths?) with the term "e-quote", which we are told is synonymous with "broker agency interest files", itself a flight of fancy that simply means orders, or to be more precise, in context, hidden go along orders. (Occasionally, part of an order may be displayed, but these are essentially hidden orders). The "e-quote" has a first cousin, the "d-quote", which is simply a conditional hidden go along order that trades with incoming contra side interest priced in between the NYSE's published quotation. For all intents and purposes, only the broker's hidden go along order and the specialist's algorithm (hidden order) can trade in this fashion.

The "d-quote" has been characterised, falsely, as a discretionary order. It is plainly no such thing.
Rather, the "d-quote" is simply a conditional limit order, as to which no discretion whatsoever can be exercised as to its executability once it is entered into an NYSE system. The price range (a floating limit, depending on contra side pricing) and size associated with the order are simply conditions appended to it. When the NYSE system sees that an incoming order can be matched against a condition on the hidden order, the hidden order will be automatically executed.

It is obvious that "automated discretionary order" is an oxymoron. Regardless of how "creative" the order's conditions may be, the computer, reading the conditions, can only do what it has been programmed to do, i.e., execute the order once it sees that the applicable conditions have been met. Computers (to date) cannot, of course, be programmed to exercise "discretion" as that concept is commonly understood.
(The NYSE, in footnote 3 of its proposal, clearly understands that "discretion" means exercising discretion as to both the price and time of execution.
The NYSE computer, which is the actual "executing broker", cannot exercise either price or time discretion, much less both.

The hidden, conditional limit order being proposed by the NYSE is not different (except, obviously, for the conditions) from other types of conditional orders.
For example, consider a buy minus limit order in the "hybrid" market. An "upstairs" trader may enter such an order into the NYSE's Superdot system where it will lie inert until an NYSE system reads that the

condition (minus tick within limit price) is executable against an incoming sell order. The system will then automatically execute the buy minus order.
One could (but one wouldn't) say that the upstairs trader exercised "discretion" in imposing the buy minus condition, and in setting the limit price, and that the trader retained "discretion" in the sense of being able to modify or cancel the order prior to execution. But no upstairs trader would say this, as this sort of "discretion" is a meaningless truism, and hardly constitutes what the trading community understands to be a "discretionary order."

In reality, the floor broker is simply doing, conceptually, what the upstairs trader did. The broker predetermines the conditions (price range and size) and enters the order into an NYSE system. The order lies inert in the system in the same way the buy minus order does, and is automatically executed when the conditions are met, as is the buy minus order. In neither case is there any exercise of discretion once the order is entered into the NYSE system. The floor broker is no more creating a "discretionary order" by placing conditions on the hidden limit order than the upstairs trader is creating a "discretionary order" by placing the buy minus condition on his order.

I can understand that the Commission is inclined to give an SRO a fair amount of leeway in devising terminology for its proposals. In the "hybrid" market proposal, the NYSE's confusing, convoluted new terminology was, for the most part, benignly laughable. But the NYSE has stepped way too far over the line here. Calling a conditional hidden limit order a "quote" is unfathomable, and cannot possibly be deemed acceptable. Nothing is in fact quoted, nothing is transparent. The notion that an order which is buried in an NYSE computer can be called a "quote"
is absurd on its face. Worse, it is misleading to investors, as the Commission's (and Congress') use of words such as "quote" and "quotation" have always connoted transparency and accessibility. (See, in particular, Section 11A(1)(C)(iii), which emphasises that information about "quotations" must be made available to investors).

For the protection of investors, the Commission must insist that the NYSE recharacterise its proposal and inform users of its markets, in plain, simple English, what it is really proposing here: the NYSE is simply proposing to allow floor brokers (and only floor brokers) to enter conditional hidden limit orders for automated execution between the fully transparent public quotation. The terms "e/d quote" and "discretionary order" should be banished from further public discussion.

The NYSE Has Not "Replicated" Its Physical Auction Market, But Rather Has Created A Radical New Way of Trading

The NYSE proposal can fairly be charactised as little more than the "Floor Broker Relief Act of 2006." The NYSE's hidden order trading methodology creates a highly "unlevel" informational playing field, and represents a radical new way of trading that in no way replicates the physical auction. By giving the floor trading constituency (floor brokers in this proposal and specialists in SR-NYSE-2004-05)the

exclusive right to enter hidden orders, the NYSE has succeeded in "replicating" only the least desirable aspect of the physical auction, the time/place advantage accruing to floor traders by virtue of their presence on the trading floor. This has long been perceived as a necessary evil, the inevitable consequence of human beings interacting with each other in a physical trading environment.

But the time/place advantage has historically been made tolerable to outsiders by a number of significant ameliorating factors, such as "fishbowl" trading, the absolute transparency of all bids and offers, and the requirement that no orders can participate in a trade unless they have been first exposed to the market.

The NYSE's hidden order trading methodology dispenses entirely with these ameliorating factors, while giving the floor trading constituency an even greater time/place advantage by reserving an entire range of automated executions as to which only they may participate because of their exclusive ability to enter hidden orders. Not even Samuel Beckett, at the height of his creative powers, could have conjured up the theater of the absurd that is the NYSE "hybrid" floor: a place where floor traders function as order entry clerks inputting orders for automated, no human intervention, cyberspace execution. Or is this really Albert Camus and existential alienation, modern man/floor broker searching for meaning in a "world" that no longer makes sense? Does the trading community really need a physical trading floor for this, with broker/clerks being given the exclusive clerical "input" franchise? (More on this below).

In the event, in addition to its disastrous national market system implications as noted above, the NYSE proposal significantly transforms the order pricing dynamics of the physical auction. In the physical auction, floor brokers can only trade in between the quote through a public bidding and offering process.
Brokers make a decision to trade only after an order has entered the market. Brokers compete for executions, and those whose orders would interact with this floor broker competition often re-price those orders as they become aware of floor broker interest.
For example, a seller who becomes aware of significant floor broker buying interest in trading in betweeen the quote will typically re-price an order to seek a higher price in the face of this buying interest. This is the way a supply-and-demand, transparent (at the point of sale) market should operate.

All of this is lost in the NYSE proposal. The floor broker in-between-the-quote interest is entirely hidden, which gives two huge advantages to floor brokers. First, (I'll use sell-side contra interest), a seller has no opportunity to more appropriately price its interest, given what may be a large amount of hidden, pre-programmed buying interest overhanging the market. In the physical auction, where potential interest is ascertainable at the point of sale, sellers would routinely re-price their interest in this situation. Thus, in the NYSE proposal, true price discovery is compromised, to the entire benefit of floor brokers.

The notion that the seller in this situation should not complain because it is getting a better-than-displayed-bid execution is absurd. The "real" market is the hidden, overhanging market. This sort of

hidden order trading renders obsolete the concept of a national best bid/offer as a fair means to discover prices and price orders. Simply put, the seller might make an entirely different trading decision if pre-programmed, overhanging buying interest were fully transparent.

The other huge advantage floor brokers have is that their hidden orders, pre-programmed to trade, are entered with full knowledge of public orders on the public limit order book. Public customers entering such orders might well change their limits in response to this floor broker competition, if they knew about it. But they don't, and so they can't. This is unfair, per se, and entirely detrimental to public investors.

In its "hybrid" market approval order, the Commission, notwithstanding significant public comments that many aspects of the NYSE's hidden order proposals were blatantly unfair to the public limit order book, simply ducked the issue. Rather than deal with it head-on, the Commission made the astonishing, throw-away observation (with no explanation or analysis whatsoever) that the NYSE proposal somehow retained incentives for the placement of public limit orders. This simply will not do, and the SEC staff need to understand that their credibility in the professional trading community has suffered with this superficial brush-off of a major issue, fairly and substantively presented.

Consistent with its clearly articulated philosophy in Regulation NMS, the Commission must review these issues not simply from the standpoint of trying to grasp the NYSE's convoluted, self-serving proposal, but from the standpoint of public investors with orders on the public limit order book, which the Commission itself has identified as the critical component of the national market system's price discovery process.

Independent, critical judgment is obviously required here. The Commission must see through the sham about "replicating" the physical auction market and assert the public interest in this situation.

The NYSE Proposal Is Blatantly Anti-Competitive

If the Commission determines to permit hidden order trading in some form, it cannot possibly permit it as contemplated by the NYSE. It is utterly nonsensical to require public investors to retain the services of an intermediary whose principal "function" going forward will simply be to input orders into a computer. But even more fundamental, it is illegal to give floor brokers this exclusive clerical franchise.

Section 6(b)(5) of the Securities Exchange Act makes clear that an exchange's rules cannot permit "unfair discrimination between customers, issuers, brokers, or dealers...." Section 6(b)(8) of the Act states, "The rules of the exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act...." Section
11A(1)(C)(i) of the Act speaks of the need for "economically efficient execution of securities transactions....", while subparagraph (ii) speaks of "fair competition among brokers and dealers, among exchange

markets, and between exchange markets and markets other than exchange markets...."

The law is abundantly clear: securities transactions are to be effected in as economically efficient a manner as possible, and in an environment that does not give undue competitive advantage to any market participant.

The NYSE proposal clearly inhibits economically efficient execution of securities transactions, and the reservation of hidden order trading privileges exclusively to floor brokers and specialists is blatantly anti-competitive, with no purposes of the Act being furthered by this discrimination.

As to economic efficiency, the NYSE proposal requires an institution with its own trading strategy to first transmit an order to a floor broker, who must then go to the physical location on the trading floor where the security is traded, and only after arriving there may the floor broker then perform the clerical function of inputting the order into an NYSE computer, which will then do the actual "work" of representing the order and executing it.

I defy anyone, anywhere, to tell me that this makes sense in the modern world. Clearly, the NYSE proposal is a direct impediment to the economically efficient execution of securities transactions that do not require human intervention.

Giving floor brokers this exclusive clerical franchise is discriminatory per se, and far from furthering any purpose of the Act, it directly frustrates the Act.

Institutions and broker-dealers are permitted to enter other types of orders into NYSE systems for automated executions. These market participants should not be discriminated against with respect to entry of whatever types of hidden orders the Commission determines to permit. If an institution wants to retain the services of a floor broker, it is free to do so, and floor brokers who can demonstrate true "value added" will flourish. But an institution that wishes to exercise its own professional judgment (no, floor brokers do not necessarily know better!) should be free to do so, without having to incur the significant additional expense, and the sheer waste of time, required by the useless "forced intermediation"
being mandated by the NYSE.

This is a very significant expense issue for public institutions, and I am hardly the only one raising it.
(See, e.g., the July 20, 2005 letter from The Vanguard Group commenting on SR-NYSE-2004-05).

The NYSE not only ignores the issue (to the ire of the institutional constituency it purports to serve, and which has clearly called this to the NYSE's attention) but has the gall to make the pro forma claim that its proposal will not impose any unnecessary burden on competition.

This issue was fairly and squarely presented to the Commission in its review of SR-NYSE-2004-05, and the Commission quite simply refused to deal with it. But the day of reckoning is again at hand, as this

proposal absolutely calls the question, and the Commission must respond.

If the Commission determines to permit hidden order trading in some form, it must insist that all market participants have a fair opportunity to trade, and that such trading not be conducted on discriminatory terms that mandate human intervention where none is required.

In the unlikely event the Commission is inclined to approve the NYSE proposal as is, the Commission is going to have to square its decision with the statutory provisions I noted above, a clearly impossible task.

The NYSE Proposal Does Not Mitigate the Anti-Competitive, Illegal Advantages Enjoyed by Specialist Hidden Order Trading

The NYSE inaccurately represents that its proposal addresses concerns about the anti-competitive and illegal advantages enjoyed by specialists in conducting "algorithmic trading." This mumbo jumbo is simply hidden order trading by specialists with incoming limit orders priced in between the NYSE's published quotation, and with incoming marketable orders. In reality, the NYSE proposal does not address this issue in a meaningful way, and to the limited extent it does address the issue, its proposal is clearly illegal.

The NYSE rule submission is particularly muddled on the interaction of floor broker and specialist hidden order trading. The body of the rule submission contains several references to floor broker competition with specialists in this regard, but the text of proposed Rule 70.25(c)(iii) states that "only displayed interest will be used by exchange systems to determine whether the size of contra side volume is within the d-quote's discretionary size range." As discussed below, this language, buried in the text of one of the densest, least readable rules ever conceived by the legal "imagination", is a huge limitation on the extent to which floor broker public orders can actually compete with specialist hidden orders.

The NYSE is proposing to permit specialist hidden order trading in two ways. Specialists would be permitted to trade with incoming limit orders priced in between the NYSE's published quotation. The NYSE provided in SR-NYSE-2004-05 that the specialist's hidden order would be delayed by the "transit time" between entry of the incoming limit order into an NYSE system and its arrival at the display book (and "publication" as the new best quote). The NYSE contended that this "delay" ensured a level informational playing field as to all market participants. I pointed out that this "delay time" was a matter of nanoseconds, and that the specialist's hidden order, pre-programmed and embedded in NYSE systems, had a clear-cut advantage on what is assuredly the most "unlevel" informational playing field imaginable. For some inexplicable reason, the Commission simply did not deal with this.

In the instant proposal, the floor broker's hidden order could also trade with the incoming limit order.

Presumably (the NYSE's proposal does not appear to address this), the floor broker's hidden limit order is also subject to the same (essentially fictitious) "delay time." In reality, as a practical matter, the NYSE is simply proposing that only floor brokers and specialists get the first crack at incoming in-between-the-quote limit orders, as their hidden orders get to pounce on them the instant they are "published."

The NYSE is proposing that if both a floor broker's and a specialist's hidden order can trade with an incoming limit order, the floor broker and specialist will trade on "parity", meaning that they split the execution. This aspect of the NYSE proposal is clearly illegal, as it violates both the negative obligation and Section 11A of the Securities Exchange Act.

I discuss the negative obligation below, but at this point I would like to focus on Section 11A. Even if it were possible to rationalise specialist hidden order trading under the negative obligation (highly doubtful), Section 11A is a separate, absolute bar in parity situations.

It is worth presenting the text of Section 11A(1)(C)(i)-(v):

"It is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure

(i) economically efficient execution of securities transactions;

(ii) fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets;

(iii) the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities;

(iv) the practicability of brokers executing investors' orders in the best market; and

(v) an opportunity, consistent with the provisions of clauses (i) and (iv) of this subsection, for investors' orders to be executed without the participation of a dealer."

As subparagraph (v) makes clear, it is a fundamental objective of the national market system that public orders be given the maximum opportunity to interact directly with each other, without dealer intervention.
Congress' wisdom here is readily apparent:
public-to-public trading at a particular price will ensure that the fairest prices are discovered.

Subparagraph (v) is conditioned only by the references to subparagraphs (i) and (iv). Absent one of these two subparagraphs being applicable,

subparagraph (v) must be strictly enforced, as there are no other statutorily permitted exceptions or qualifications.
Thus, dealer participation might be permissible if needed to promote either economically efficient execution of securities transactions (subparagraph (i)), or the practicability of brokers executing investors' orders in the best market (subparagraph (iv)). But absent either subparagraphs (i) or (iv) being applicable, subparagraph (v) clearly mandates that public orders be allowed to trade directly with one another without dealer participation.

The NYSE's proposal to permit the specialist's hidden order to trade on parity with the floor broker's hidden public order is clearly illegal under Section 11A(1)(C)(v). The floor broker's public order is fully capable of trading directly with the incoming contra side order without the specialist's dealer participation. There is no issue concerning economically efficient execution, as the floor broker's hidden order will provide an immediate, automated execution in the same manner as the specialist's hidden order would.

There is another huge problem for the NYSE here:
permitting specialist parity participation is not only unnecessary from the standpoint of efficient execution, but, in fact, it makes the order execution process less economically efficient. Such specialist parity participation forces the contra party to have to settle the trade with an additional, and unnecessary, party, the specialist, when the contra party could more efficiently settle with just one party, the floor broker. It is axiomatic that the fewer parties to trade settlement, the more efficient the overall trading process.

There is clearly no issue under subparagraph (iv), because this is an entirely intra-NYSE matter.

The Section 11A issue is extremely important to public investors, as "forced" dealer participation means less of a "fill" for public orders, and ultimately degrades the quality of public order execution. In its "hybrid"
market approval order, the Commission made several pro forma conclusory assertions about Section 11A, but did not confront the issues with any explanation, analysis, or judgment.

The instant proposal absolutely calls the question, and the Commission must assert the public interest here, affirm that Section 11A means exactly what it says, and enforce the statute as written.

Simply put, Section 11A absolutely prohibits specialist hidden order parity trading as proposed by the NYSE. Regardless of the positions it thought it was taking in the "hybrid" market approval order, if the Commission has the view that the NYSE proposal is somehow legal, it owes public investors a detailed explanation, because the statute is crystal-clear on its face.

The second, and far more prominent, way that specialists may engage in hidden order trading with incoming orders is their exclusive ability to trade with incoming marketable orders. It would appear from the NYSE proposal that floor broker hidden orders do not have the opportunity to compete with the specialist in this regard at all. I say "would appear" because the NYSE proposal is particularly opaque on this point.

The examples in the NYSE rule submission all involve the floor broker's hidden orders trading with incoming limit orders, not marketable orders. As noted above, the NYSE's proposed rule states that the floor broker's hidden order will trade only against "published" contra side interest. ("Published" in this context is clearly a term of art, as the order disappears virtually the instant it is "published").
But in SR-NYSE-2004-05, the NYSE made clear that when the specialist's hidden order trades with an incoming marketable order (as opposed to an incoming limit order between the quote), the marketable order is never published. A report of execution simply appears on the tape. Thus, the floor broker's hidden order never gets to compete with the specialist in what will almost certainly be the greatest number of instances of hidden in-between-the-quote trading.

If I am wrong in my analysis as to what the NYSE is up to here, then the NYSE needs to clean up its rule submission. But the NYSE still faces the impenetrable bar of Section 11A, which mandates that the floor broker's hidden order be permitted to trade without the specialist's "parity" participation.

If I am correct in my analysis, and the NYSE has reserved the entire universe of incoming marketable orders as the specialist's exclusive preserve, then the NYSE has acted disingenuously, if not duplicitously, in suggesting that it has provided meaningful public competition with the specialist in this regard.

The Commission clearly must demand that the public be given the opportunity to trade in this situation.

In my comment letters on SR-NYSE-2004-05, I have repeatedly expressed dismay as to how the radical expansion of specialist dealer activity in the "hybrid" market can be squared with historic limitations on dealer trading in the negative obligation, absent a substantial overhaul of the specialist regulatory framework. In the infamous footnote 382 of the "hybrid" market approval order, the Commission appeared to be expressing its own unease in this regard, as the NYSE is being required to provide "guidance" to specialists as to how expanded dealer trading is expected to comply with the negative obligation.

The NYSE has suggested that this is a matter of routine, non-substantive interpretation, but the NYSE's position in this regard is simply not credible or sufficient to assure public investors that they have enough information as to when specialists may compete with, or supersede, their orders. The NYSE's "routine interpretations" are not broadly disseminated to the public, and typically consist of platitudinous reiterations of broad principles, noble enough in themselves, but clearly no substitute for hard-edged standards fairly known to all market participants.
This is what the "guidance" should consist of if it is to be meaningful and of value to public investors.

Specialist trading under the NYSE's "interpretations"
of the negative obligation clearly impacts the quality of public order executions, and thus the public clearly has the right to know exactly what the standards are, and how the NYSE enforces them (particularly in light of recent NYSE trading scandals, which have lessened public

confidence in the NYSE market). Any "guidance" proffered by the NYSE must be submitted to the Commission under Rule 19b-4 for prior public review and comment, so that public investors may fairly assess (i) the adequacy of that "guidance"; (ii) the degree to which specialist trading may affect or interfere with their orders, and (iii) whether the NYSE is really the most appropriate market for their orders.

One would think the NYSE would understand the need to serve public investors in this regard. In the event, the Commission, which rightly prides itself on "government in the sunshine", needs to assure that the public interest is properly served here by a prior review and comment process.

Conclusion

The NYSE proposal is clearly unacceptable in its present form. In concept, it raises serious market structure issues. In its details, the proposal:

(i) uses misleading terminology;

(ii) falsely claims to "replicate" the physical auction market;

(iii) creates an "unlevel" informational playing field to the advantage of privileged floor intermediaries;

(iv) provides a method of trading that exploits and disadvantages the public limit order book;

(v) requires expensive, unnecessary "forced intermediation;"

(vi) violates federal law by permitting specialist dealer participation where it is clearly prohibited by statute; and

(vii) gives specialists exclusive trading privileges in contravention of the negative obligation.

I am submitting this letter before this matter has been officially published for comment because of the Commission's dismaying practice of giving immediate or accelerated effectiveness (no prior public comment) to "hybrid" market matters that clearly raise serious, substantive issues.

This proposal is deeply flawed, and requires extended public comment.

Sincerely yours,

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