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June 18, 2009

By e-mail

Securities and Exchange Commission

100 F Street, NE

Washington, D.C. 20549-1090

rule-comments@sec.gov

Re: File Number S7-08-09; Proposed Amendments to Regulation SHO

Ladies and Gentlemen,

Liquidnet, Inc. appreciates the opportunity to comment on the proposed amendments to Regulation SHO recently published by the Securities and Exchange Commission (the Commission)[1]. We appreciate that the Commission has solicited feedback on a number of issues related to this proposal.

Our three main points, discussed in more detail below, are:

- We do not believe a price test is needed because the Commission's September 2008 Emergency Order imposing enhanced delivery requirements has addressed fails to deliver.[2] We believe a circuit breaker proposal that would restrict short sales after the circuit breaker is triggered would be a preferable approach.
- If a price test were imposed, we agree with the Commission that a bid test would be more suitable to today's markets than a last sale test.
- If a bid test were imposed, any increment established for short selling on a down-bid should allow for mid-point executions. In particular, where the spread is one cent, short sale executions at ½ cent above the best bid should be permitted. These executions provide price improvement to both buyer and seller and, because they are executed at the mid-point between the national best bid and best offer, should not impact the current market price.

Bid vs. last sale test

We agree with the Commission's preliminary determination in the release "that a short sale price test based on the national best bid would be more suitable to today's markets than a short

[1] Securities Exchange Act Release No. 34-59748 (April 10, 2009) (the Release).
[2] Securities Exchange Act Release No. 58572 (September 17, 2008). Subsequently extended by Securities Exchange Act Release No. 58773 (October 14, 2008).

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sale price test based on the last sale price"[3]. In particular, we agree with the Commission's comment that the last sale price might not accurately reflect up-ticks and down-ticks in the market because trades are not necessarily sent to and posted on the tape in the order in which they are executed.[4]

We further agree with the Commission that a bid test is preferable to a last sale test because a bid test would not impede mid-point and similar derived price trading, while a last sale test would make mid-point trading more difficult.[5] Mid-point trading is beneficial for market participants because it provides price improvement to both sides to the trade, including institutional and retail customers that historically had no choice but to pay the spread to market intermediaries as part of the cost of trading. Mid-point trading also should not impact the current market price, as a general rule, because a mid-point trade is executed at the mid-point between the best bid and best offer posted in the market at the time of execution. Since mid-point trading is beneficial for market participants and does not raise concerns that a short sale price test is intended to address, a price test like a bid test that accommodates mid-point trading should be preferred over a price test like a last sale test that impedes mid-point trading.

We also believe that the NBBO can provide a more accurate depiction of current market conditions than the last sale price because of changes in market conditions that occur after a last sale that are reflected in subsequent quote updates. Finally, we believe there would be more technical hurdles in re-introducing a last sale test relative to a best bid test.

Bid test increment on a down-bid

If a bid test were adopted, we would not favor a specified minimum increment by which a trade must be executed above the bid on a down-bid. If the NBBO spread is one cent on a down bid, it is beneficial for market participants if they can execute a trade at the mid-point. This should be permitted, even though the trade is executed at a price that is less than one cent above the best bid. As a mid-point execution, it is beneficial for market participants and should not impact the market price, and thus should be permitted.[6]

Responding to recent market changes

In the release the Commission asks "to what extent, if any, would a short sale price test ... be necessary or appropriate in light of recent changes in market conditions". [7] Because market

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[3] Release at page 41.
[4] See Release at pages 42 and 73-74.
[5] Release at pages 42-43.
[6] We note that Rule 612 of Regulation NMS generally prohibits the acceptance of orders priced in an increment of less than one cent, subject to certain exceptions. Rule 612 should protect against attempts to evade any down-bid requirement that is adopted. The Commission could prohibit trading at sub-penny increments where the intent of the trading center is to evade the requirements of the down-bid test, but we do not favor a fixed mandated minimum increment. To the extent a mandated minimum increment is adopted, it should, at a minimum, allow for mid-point trading when the NBBO spread is one cent.
[7] Release at page 105.

conditions change over time, and because rule changes often require industry participants to expend considerable resources, it is important to consider the advisability of a rule change over the long-term and not based on circumstances existing during a specific period of time.

Exemption for sales of restricted stock

An exemption for sales of restricted stock should apply. From an economic standpoint, sales of restricted stock are not short sales because the seller owns the stock being sold. Because these are long sales from an economic standpoint, the policies implicated by the short sale rule do not apply.

Circuit breaker vs. price test

Liquidnet's first preference would be that the Commission not adopt any of the proposed rule changes at this time. We agree with the Commission's statement in the Release that the Commission's September 2008 Emergency Order imposing enhanced delivery requirements on sales of equity securities "appears to be having a positive effect toward achieving our goal of reducing fails to deliver".[8]

Of the proposals put forth in the Release, our first preference would be a circuit breaker rule that prohibits short selling in a security after a circuit breaker has been triggered in the security. Our second preference would be a circuit breaker rule that triggers a bid test restriction for short selling in a security after the circuit breaker has been triggered in the security. While a prohibition on short selling after a circuit breaker halt is triggered would be more restrictive than the imposition of a bid test after a circuit breaker halt is triggered, we believe the former proposal would be less costly for the industry to implement. Our third preference would be a bid test that applies for all securities.

We have two primary concerns regarding the implementation of a price test. Our first concern is the resources that the industry would have to expend to comply with the rule. We believe it would be preferable to allocate these resources towards providing improved products and services for customers. Our second concern is the complexity of arbitrage and other exceptions to the rule that would have to be considered and that could result in different rules applying for different industry participants.

Implementation of circuit breakers

Ideally, the primary market where a security is listed would notify the Securities Information Processor (SIP) electronically when a circuit breaker has been triggered. The SIP, in turn, would provide a circuit breaker notification to the trading centers. Alternatively, the trading center could arrange to receive this information directly from the primary market. Each trading center should be responsible for compliance with the circuit breaker requirements upon receipt of the notification.

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[8] Release at p. 22.

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Implementation

There are a number of proposals set forth in the release, each with its own series of permutations, and it is difficult to predict the specific proposal or combination of proposals, if any, that will be adopted. This makes it difficult to predict the implementation time frame. We believe it would be advisable to determine first the specific proposal or proposals to be adopted and then to solicit feedback from market participants on the appropriate time frame for implementation.

As a general matter, we believe that implementation of a price test would be more difficult than implementation of a circuit breaker requirement. We note that even for circuit breakers, trading centers would be dependent on the exchanges, SIPs and market data providers for communication of circuit breaker notifications.

Since there are a number of proposals set forth in the release, it is difficult for parties to comment in detail on each proposal. Once the commission has decided on a specific proposal, it might be advisable to issue a subsequent proposing release to solicit more detailed comments relating to implementation of the specific proposal to be adopted.

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We would like to thank the Commission for the opportunity to comment on this proposal.

Very truly yours,

Howard Meyerson, General Counsel