December 1, 2006

Dear SEC:

I am writing to supplement my prior correspondence on the above-referenced matter, and in particular to discuss the egregious footnote 49 in the SEC staff's approval order for 2006-65 as it bears on the instant matter.

Let me state preliminarily that the approval order for 2006-65 simply reflects the SEC staff's a priori determination to approve almost anything the NYSE submits, with an "analysis" of comments that suggests, at best, that the SEC staff are simply over their heads in trying to deal with this highly arcane subject matter. (I could give many examples here, but my personal favourite is the SEC staff's confusing discussion of elected stop orders, and their absolute inability/disinclination to deal head on with the fact that the NYSE is giving the specialist's algorithm the exclusive ability, if it so chooses, to trade with these orders before any other market participant becomes aware of them). And while the SEC staff repeat the NYSE's canard that I am opposed to the hybrid market and am simply making repetitive objections, any fair reading of my correspondence makes clear that I am a firm advocate of electronic trading, and am making objections only to those aspects of the NYSE proposal that confer unfair, anti-competitive per se trading advantages on the NYSE's floor trading constituency.

To the extent my objections appear "repetitive", it is only because the SEC staff have consistently failed in approval order after approval order to discharge their statutory duty to explain the "basis under the Act" for their approvals of various aspects of the NYSE proposal that in fact raise highly troubling legal issues, and which in several particulars are flatly inconsistent with, in particular, Section 11A of the Securities Exchange Act.

Which brings us to the profound intellectual dishonesty of footnote 49. This footnote provides, "The Commission notes that the commenter [yours truly] also argued that specialist interest should not be able to trade on parity with floor broker agency interest. The commenter continues to argue that this is inconsistent with Section 11A of the [1934] Act and the specialist's negative obligation. The Commission approved this aspect of the Hybrid Market and NYSE has not proposed to change the approved parity rule in the instant proposed rule change. See Hybrid Market Order...."

The problem here, as any fair reading of the hybrid market approval order makes abundantly clear, is that the Commission did not discuss therein the basis under the Act for such specialist trading. The hybrid market approval order is widely regarded as a mess, as the SEC staff are well aware. Commentators raised dozens of significant issues, many of which (but by no means all) were "summarised" in the order. Rather than work through these issues, and discuss them in terms of "burden on competition" and "basis under the Act", as statutorily required, the Commission proceeded by meaningless conclusory assertion, thereby effectively ducking the issues. So while the SEC staff are correct in a narrow technical sense

that the Commission "approved" such specialist trading, they are incorrect as a matter of law that any such approval was effected in lawful discharge of statutory duty. We all know the dynamics of what happened: the SEC staff, swamped by a host of thorny issues and the time pressure (then) of Regulation NMS, simply took the path of least resistance and proceeded by way of conclusory assertion to move the approval process along. As their "work product" makes abundantly clear, the SEC staff lacked either the time, the inclination, or the ability to work through the practical effects of the NYSE's self-serving specialist trading proposals under applicable legal standards. Quite frankly, the SEC staff were "snookered" by the NYSE, and failed to appreciate, in particular, the Section 11A implications of what they thought they were approving.
And rather than deal with these issues honestly now, the SEC staff are simply hiding behind an approval order that manifestly failed to provide any rationale whatsoever for specialist trading that is clearly illegal, and which degrades the quality of public order execution. As the SEC staff are well aware, should this matter wind up in court, the Commission's failure to discuss these issues (rather than make meaningless conclusory assertions) makes this an obvious, and embarrassing, loser for the Commission on this ground alone.

If for no other reason than for the sake of their professional reputations, the SEC staff must do better here.

I will not fully repeat the points I have made in prior correspondence, but some degree of reiteration is appropriate. Under the negative obligation, a specialist may trade only when reasonably necessary to off set a short-term disparity in supply and demand.
In specialist go along trading ("parity"), there is no such disparity. The specialist is simply displacing public orders fully capable of trading with contra side interest. There is no way that specialist "parity" trading can be reconciled with the negative obligation.

Section 11A, as I have pointed out in specific detail, is intended to maximise direct public order interaction without dealer intervention. As with my point above, in "parity" situations, public orders are fully capable of trading with one another without dealer intervention. The specialist's trading in these situations simply displaces public orders or results in less of a "fill" for them, and thereby degrades the overall quality of public order execution.

In absolutely none of its many "hybrid" market submissions has the NYSE provided so much as a single sentence attempting to justify specialist "parity"
trading under the negative obligation and Section 11A.
I assume this is because the NYSE knows full well it can make no such case. And it is absolutely shocking that the SEC staff have required nothing from the NYSE in this regard.

The task for the SEC staff is simple here, and the performance of that task is long overdue: they must explain "why" specialist "parity" trading is consistent with the negative obligation and Section 11A. This is their bare-minimum statutory duty, not the making of meaningless conclusory assertions. And the continued pointing to a grossly deficient "approval order" that entirely evades the "why" question is abject dereliction of that statutory duty.

The Commission and the SEC staff are bound by clear, black letter law as to specialist trading that interferes with direct public order execution. These continued attempts by the SEC staff to simply default to a prior "approval order" are widely perceived as the intellectual equivalent of a street hustler's shell game. No matter what shell one looks under, there is no pea. And so it is with the "hybrid" market "approval order." No matter where one looks, there is no independent legal analysis or justification. All one finds are in-passing, substantively meaningless conclusory assertions, the functional equivalent of turning over an empty shell.

The Commission must insist that the clear-cut law of the land means what it says and will be enforced, and that the interests of public investors take precedence over NYSE dealer interests.

It really is that simple.

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