



November 18, 2003

Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609

Re: File No. SR-NASD-2003-143

Dear Mr. Katz,

### **Introduction and Summary**

The Inet ATS, Inc. (“Inet”)<sup>1</sup> appreciates the opportunity to provide the U.S. Securities and Exchange Commission (“Commission”) its comments regarding the above-referenced proposal by the NASD, Inc., on behalf of its subsidiary The NASDAQ Stock Market, Inc. (“NASDAQ”), to establish a new “Auto-Ex” order in NASDAQ’s SuperMontage system.<sup>2</sup> The practical effect of the rule would be to establish an order type that would ignore the quotes/orders of ECNs that participate in SuperMontage on an order delivery basis.

Inet believes that the proposal is an unnecessarily broad and discriminatory means of addressing NASDAQ’s purported concerns with the order response times of ECNs participating in SuperMontage on an order delivery basis (“order delivery ECNs”). Prior to adopting an order type that bypasses the orders of all order delivery ECNs, regardless of their individual order response times, NASDAQ first should establish criteria as to what would be acceptable order response times for order delivery ECNs and provide them with the opportunity to demonstrate their ability to meet such criteria. For its part, Inet is confident that it can meet whatever order response criteria NASDAQ establishes. Therefore, Inet strongly recommends that the Commission not approve the proposal in its current form.

### **Description of Proposal**

NASDAQ’s proposed Auto-Ex order type would execute solely against the contra-sided quotes/orders of market participants that accept automatic execution from

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<sup>1</sup> Information regarding The Inet ATS, Inc. is available on our website at <http://www.inetats.com>.

<sup>2</sup> Securities Exchange Act Rel. No. 48675 (Oct. 21, 2003), 68 FR 61528 (Oct. 28, 2003) (File No. SR-NASD-2003-143).

SuperMontage and do not charge access fees. The Auto-Ex order type would ignore quotes/orders of other SuperMontage participants at the same price level, specifically order delivery ECNs and any ECNs that accept automatic execution but charge an access fee.

NASDAQ's primary rationale for the proposal is that while SuperMontage was designed to offer market participants rapid execution speed, SuperMontage may not be able to deliver the benefits of its efficiency to market participants valuing such speed if "all or a portion of an order is delivered to a [SuperMontage order delivery ECN], which has up to 30 seconds to respond to the order (and which may respond by declining to fill the order)."<sup>3</sup> However, NASDAQ acknowledges in a footnote that it had previously noted that the average response time of an order delivery ECN is less than one second, but adds that "the response time to particular orders may be far longer."<sup>4</sup> NASDAQ does not provide any data to substantiate these statements. Finally, NASDAQ states that the Auto-Ex order type is "closely aligned in function and purpose" with the fill-or-return order type currently offered by the Archipelago Exchange ("ArcaEx").<sup>5</sup>

### **Discussion**

Inet believes that NASDAQ's proposal to adopt the Auto-Ex order is an unnecessarily overbroad and discriminatory response to NASDAQ's purported concern with the real or perceived adverse impact of the order response times of certain ECNs on the speed of execution available through SuperMontage.

The proposal is overbroad in that it makes no distinction between those order delivery ECNs that consistently have rapid order response times and those that would have comparatively slow order response times (either on a regular or intermittent basis).

The proposal is discriminatory in that it would result in NASDAQ allowing ECN orders with time priority at a particular price level to be systematically bypassed in SuperMontage in favor of quotes/orders of automatic execution participants.<sup>6</sup> Apart from its direct discriminatory impact, the proposal undercuts the price/time priority principles that NASDAQ recently has sought to reinforce in SuperMontage with its proposed elimination of the two order execution algorithms available through the system that did not operate on a price/time priority basis.<sup>7</sup>

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<sup>3</sup> Id. at 68 FR 61529.

<sup>4</sup> Id. at n.5.

<sup>5</sup> Id. at 68 FR 61530.

<sup>6</sup> The fact that the Auto-Ex order type also bypasses quotes/orders of ECNs that accept automatic execution from SuperMontage but charge access fees puts into question what NASDAQ's true motivations are in seeking to adopt this order type – enhancing speed of execution or providing for systemic discrimination against SuperMontage ECN market participants.

<sup>7</sup> Securities Exchange Act Rel. No. 48501 (Sept. 17, 2003), 68 FR 56358 (Sept. 30, 2003) (File No. SR-NASD-2003-128).

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Inet believes that the proposal is *unnecessarily* overbroad and discriminatory in that NASDAQ has not attempted to first establish criteria as to what would be acceptable order response times for order delivery ECNs and providing ECNs with the opportunity to demonstrate their ability to meet such order response times. Doing so would enable NASDAQ to calibrate more finely any future actions seeking to address what it would deem unacceptable order response times on the part of order delivery ECNs, thus avoiding the adoption of an order type that would discriminate against ECNs as a class.

In this regard, Inet previously announced its intention to participate in SuperMontage in the near future as an order delivery ECN. For its part, Inet believes that it will be able to meet any criteria that NASDAQ may seek to adopt to address any legitimate concerns regarding the order response times of order delivery ECNs.

Finally, Inet believes that NASDAQ's comparison of the Auto-Ex order type with ArcaEx's fill-or-return order type is inapposite. The ArcaEx fill-or-return order does not distinguish among ArcaEx market participants, but is eligible to execute in price/time priority against all contra-side orders then available on ArcaEx. By entering a fill-or-return order, the ArcaEx market participant simply is indicating that ArcaEx should not route any unfilled portion of its order to external markets. In comparison, the Auto-Ex order would ignore orders represented in the SuperMontage market itself.

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In conclusion, Inet strongly recommends that the Commission not approve NASDAQ's proposal in its current form and that NASDAQ first should take the more limited step of establishing criteria as to what would be acceptable order response times for order delivery ECNs and providing them with the opportunity to demonstrate their ability to meet such order response times.

If you have any questions regarding the foregoing, please do not hesitate to call either myself at 212.310.4511 or Paul Merolla, EVP and General Counsel, Instinet Group Incorporated, at 212.310.4427.

Sincerely yours,

Alex Goor  
President  
Inet ATS, Inc.

cc: Katherine A. England, Assistant Director, Division of Market Regulation