November 1, 2005

Dear SEC:

(I am submitting this material under SR-NYSE-2004-05 as it discusses a matter mentioned in detail in this rule submission, the NYSE's treatment of its Rule 108. The bulk of this letter discusses specifically SR-NYSE-2005-74, the NYSE's attempt to gain SEC approval of an "interpretation" of Rule 108 first mentioned in the NYSE's September 21, 2005 comment letter on SR-NYSE-2004-05. The analysis in this letter is equally applicable to the NYSE's attempts to amend Rule 108 in SR-NYSE-2004-05).

In several recent comment letters (see, e.g., recent correspondence on SR-NYSE-2005-57), I have noted that heavy staff turnover at th NYSE has resulted in a current staff who are simply intellectually overmatched by the demands of the rule submission process. In submission after submission, the NYSE staff misrepresents its own rules, fails to acknowledge and discuss obviously relevant rules, demonstrates ignorance as to how the NYSE market actually operates, and is incapable of the legal reasoning/justification clearly contemplated by the SEC's rules and the Securities Exchange Act. (See, e.g., the pitiful embarrassment of SR-NYSE-2005-69, which the NYSE had the decency to withdraw several days after it was submitted, and which is summarised/analysed in my October 11, 2005 comment letter on SR-NYSE-2005-57).

I have stopped short of suggesting that the NYSE staff is engaging in intentional misconduct, but the rule submission under discussion herein clearly raises that issue. It is impossible to view SR-NYSE-2005-74 as anything other than a back-and-fill, make-it-up-as-they-go-along, backside-covering rationalisation of a clear-cut failure to surveil and enforce Rule 108 for God only knows how many years. The NYSE is presenting a newly-invented, "longstanding interpretation" of Rule 108 that not only flatly contradicts the plain, unambiguous language of the rule, but even more incredibly, flatly contradicts the NYSE's own clearly stated positions of as recently as June 17 and September 21, 2005. By characterising this total dismantling of a decades-old regulatory prohibition as an "interpretation" eligible for immediate effectiveness, the NYSE has completely abused the SEC's rule approval process, and denied the public an opportunity for prior public comment on a highly significant issue. Very troubling, indeed, is the fact that the NYSE is again attempting an "end run" (as it did in SR-NYSE-2005-57) around the controversial "hybrid market" proposal (SR-NYSE-2004-05), the context in which the Rule 108 issues first surfaced. The NYSE appears intent on "spinning off" "hybrid market" matters and misrepresenting them as eligible for immediate effectiveness, thereby obtaining SEC approval when no aspect of the "hybrid market" proposal has otherwise been approved under the Commission's normal prior public comment process.

Equally, if not more, troubling is the representation in Item 2 of Form 19b-4 that the NYSE staff is acting on its own here, with no oversight or approval from the NYSE Board of Directors. Obviously, the NYSE staff has to be permitted to act under "delegated authority" to issue routine rule interpretations. But this is hardly such a case. Even if one accepted at face value everything in the NYSE's rule submission (in reality,

as I demonstrate below, one can accept virtually nothing), the NYSE is, in essence, admitting that it has violated the law. If this really is a "longstanding interpretation", how has the NYSE been able to act under it all these years without obtaining prior SEC approval? By making this rule submission, the NYSE is clearly acknowledging that it needs SEC approval in order to proceed lawfully under the "interpretation."

The plain English translation of all this is readily apparent: in the absence of prior SEC approval, the NYSE has been failing to enforce Rule 108 properly, and has been permitting clearly illegal behavior to occur.

If this is not a matter that the NYSE's Board of Directors should have been involved in, I cannot imagine what would be. On a human level, I can understand the NYSE staff's reluctance to surface yet another instance of the somnolent NYSE surveillance staff's being "asleep at the switch." But the pattern is obvious: a credulous NYSE staff accepts the "reasonableness" (I demonstrate below the absolute unreasonableness) of self-serving positions advocated by its trading floor constituency, and "interprets" rules to give its floor traders "carte blanche", regardless of what the rules state by their simple, express terms. And notwithstanding two recent SEC enforcement actions against the NYSE for failing to enforce its rules by adopting such dubious "interpretations", the NYSE staff still hasn't gotten the message.

The failure of the NYSE staff to review with the NYSE Board of Directors a matter in which the NYSE has not followed the law suggests a significant lapse in moral judgment and raises serious questions of legal ethics. I am growing increasingly frustrated at the offensive drivel being put forward by the NYSE staff. Do I need to ask a friend of mine at the Wall Street Journal to start writing about this? Do I need to contact several acquaintances who are staff to congressional oversight committees? My purpose is not really to embarrass the NYSE, only to urge that it act fairly and with respect for the Commission, its processes, and the public.

In the event, it seems clear that the NYSE needs to seriously consider transferring any NYSE staff associated with this travesty to positions that do not involve the public trust. As the NYSE obviously does not have the staff that can actually do the rule submission work to the requisite professional standard, it needs to retain competent outside counsel.

What Rule 108 Provides

One aspect of the NYSE's rule submission that is immediately striking is the total absence of any discussion whatsoever of Rule 108's background, history, and purpose. Fundamental legal analysis should dictate that the NYSE review and discuss this material to justify a dismantling of a decades-old regulatory prohibition intended to put the interests of the investing public ahead of the interests of privileged intermediaries on the NYSE floor. But there is total silence here. The "legal" justification put forward by the NYSE is little more than "We want what we want because we want it." To the limited extent the NYSE does attempt to justify the proposal, its positions are entirely spurious

(as I demonsrate below) because the purported "benefits" are readily realisable under current rules, which fully accommodate legitimate institutional "go along"trading, but prevent specialist overreaching at the public's expense. This proposal is not at all about serving institutional customers; it is all about providing additional proprietary trading opportunities for specialists.

The NYSE's attempt to dismantle Rule 108 can only be understood as a craven accommodation of specialist self-interest. The NYSE staff's failure to deal with Rule 108's background, history, and purpose is a reflection of either the staff's total ignorance, or a de facto acknowledgement that the rule's background, history, and purpose make a complete mockery of the positions set forth in the rule submission. Ultimately, whether the NYSE staff is duplicitous or merely ignorant is not the heart of the matter. Either way, they have submitted a proposal that is truly offensive.

My research indicates that Rule 108 predates the major amendments to the Securities Exchange Act enacted in 1975, and is a decades-old regulatory prohibition intended (in the situations covered by the rule) to put public orders ahead of the orders of NYSE members who are permitted to "originate an order" on the NYSE floor for their own accounts (i.e., to engage in on-floor trading). The rule provides, in pertinent part, the following:

"No bid or offer made by a member or made on an order for stock originated by a member while on the floor to establish or increase a position in such stock for an account in which such member has an interest shall be entitled to parity...."

Rule 108 dates to a time when the NYSE had dozens of "registered traders" permitted to engage in on-floor trading, as well as specialists. Today, with very limited exceptions, the rule applies for all intents and purposes only to specialists.

The prohibition in Rule 108 is simple and direct and can be paraphrased as follows: "No specialist is entitled to trade on parity when establishing or increasing a position." There is no ambiguity whatsoever in the rule's language, nor any suggestion whatsoever that an absolute bar against being entitled to trade on parity can in any way be modified to provide a "conditional entitlement" (e.g., specialist parity trading permitted with floor broker permission or in the absence of floor broker objection). (As discussed below, the NYSE attempts an absurd linguistic sleight-of-hand on this point).

Rule 108 has always been construed as operating in tandem with the specialist's negative obligation (Rule 104), which prohibits the specialist from effecting proprietary trades "unless such dealings are reasonable necessary to permit such specialist to maintain a fair and orderly market."

Rule 108 does not prohibit specialist parity liquidations because such dealings have historically been considered to be consistent with the negative obligation. The "tick" restrictions in Rule 104 that "concretise" the negative obligation essentially make the specialist a "passive" trader in most market situations. The specialist is significantly

constrained, in NYSE jargon, from "hitting bids" or "taking offers" (instances in which the specialist would be "reaching across the market", but acting alone, not in competition with floor brokers) because of Rule 104's "tick" restrictions against initiating price changes. Therefore, a good deal of specialist proprietary trading involves their bids or offers being "hit" or "taken."

Trading in this type of situation often involves direct competition with floor brokers representing public orders, who are also making bids or offers that may be "hit" or "taken." In the liquidation context, a restraint on specialist parity trading would mean that the specialist would face serious difficulty in recapitalising (selling off a long position or buying to cover a short position to obtain capital to re-enter the market as required to maintain a fair and orderly market). Therefore, specialist parity liquidations have historically been considered to be consistent with the negative obligation because the specialist cannot maintain a fair and orderly market without the ability to recapitalise. (In its September 21, 2005 comment letter on SR-NYSE-2004-05, the NYSE states that a specialist's ability to trade on parity should not be dependent on the specialist's position. The NYSE expresses no comprehension of the historic rationale here, namely that liquidations are consistent with the negative obligation, whereas aquisitions are not).

No such justification under the negative obligation for parity acquisitions has ever been deemed appropriate. Historically, such trading has been deemed to constitute an unfair and unnecessary interference with public order execution, and inconsistent with the maintenance of a fair and orderly market. Specialist acquisition trading is conducted under the affirmative obligation, whereby they are required to trade when necessary to maintain a fair and orderly market (i.e., no public orders at prices that reflect appropriate market depth and trade-to-trade price continuity).

In a meaningless, insulting, and disingenuous representation in the rule submission, the NYSE states that specialists should be mindful of the negative obligation when effecting parity acquisitions. The NYSE staff is being either ignorant or duplicitous here. Under the NYSE's regulatory framework, and the SEC's rules, specialist parity acquisitions can NEVER be reconciled with the negative obligation, and have always been prohibited, because there is NEVER any market "necessity" whatsoever for the specialist to effect proprietary trades at a price at which public orders can otherwise fully satisfy contra side interest (see below for further discussion of this point).

It really is that simple.

The NYSE's Teatment of Rule 108 Since the Beginning of 2004

The NYSE's recent attempts at dealing with Rule 108 suggest that the NYSE staff have been completely unfamiliar with the rule, and have not surveilled or enforced it, but are caught up in a situation in which they have become aware of trading activity inconsistent with the rule which they are now trying to "sanitise" after the fact.

In SR-NYSE-2004-06, submitted to the Commission on February 6, 2004, the NYSE proposed to adopt new Rule 104.10(6)(i)(C) to apply to situations in which the specialist is liquidating or decreasing a position. (At the time the proposal was submitted, I had not yet been retained by my institutional clients to comment on NYSE rule submissions. After having been retained, I commented on the serious inadequacies of the NYSE's approach here in my February 18, 2005 comment letter on SR-NYSE-2004-70. As SR-NYSE-2004-06 had (unfortunately) been approved by that time, the NYSE offered no rebuttal).

Rule 104.10(6)(i)(C) provides that when a specialist is liquidating or decreasing a position, a floor broker, on behalf of a customer, may object to the specialist's being on parity with the customer's order. Such a customer objection must be a condition of the order and appropriately documented. As I noted above, Rule 108 has for decades been the rule specifically addressed to specialist parity trading, and for decades had not prohibited specialist parity liquidations or imposed any restraint thereon in order to facilitate essential recapitalisation. Strangely, the NYSE made no mention whatsoever in its rule submission of the Rule 108 regulatory framework, thereby avoiding any discussion/justification as to why it was imposing a never-before-deemed appropriate restraint on specialist recapitalisation. However belatedly, the NYSE finally acknowledged that Rule 104.10(6)(i)(C) is indeed, for all intents and purposes, an aspect of the overall Rule 108 regulatory framework. In its September 21, 2005 comment letter on SR-NYSE-2004-05, the NYSE mentions Rule 104.10(6)(i)(C) entirely in the context of its discussion of Rule 108.

In SR-NYSE-2004-05 (the "hybrid market" proposal) and amendments 1, 2, and 3, submitted to the Commission throughout 2004, the NYSE discussed almost as an after-thought the ability of specialists to trade electronically on parity with public investor orders represented by floor brokers. The NYSE made no distinction between parity acquisitions and liquidations, except to say that Rule 104.10(6)(i)(C) would not apply in the hybrid market (notwithstanding the effort the NYSE put into having Rule 104.10(6)(i)(C) approved in the first place). Surprisingly, the NYSE made no mention whatsoever of Rule 108 in any of these rule submissions, even though the rule, by its plain, express terms, prohibits the parity acquisitions the NYSE was positing as a routine feature of its proposed new market.

In a March 10, 2005 comment letter on its then-current hybrid market proposal, I noted that the NYSE had ignored the prohibitions in Rule 108 and that the prohibitions were of long duration and had served the public interest very effectively.

In SR-NYSE-2004-05, amendment numner 5, submitted to the Commission on June 17, 2005, the NYSE, for the first time in approximately a year and a half (dating from the original hybrid market submission and SR-NYSE-2004-06), acknowledged that Rule 108 did indeed apply to specialist parity acquisitions, and proposed to amend the rule to permit such trading without restriction, condition, or qualification whatsoever in the hybrid market.

In amendment number 5, the NYSE made the following, straight-forward statement: "Currently, NYSE Rule 108 prohibits the specialist from trading for its proprietary account on parity with the crowd in situations where the specialist is establishing or increasing a position." The NYSE did not qualify this statement in any way (nor could it have, as it accurately reflects the rule's terms). The NYSE made no mention whatsoever of any "interpretation" that would have permitted such trading in the face of the clear-cut regulatory prohibition that the NYSE had fairly noted. The NYSE did, however, state (without apparent embarrassment, much less intelligent thought) that its proposed amendment to Rule 108 "comports with existing practice on the floor where brokers may voluntarily allow specialists to be on parity with them."

In my July 20, 2005 comment letter on amendment number 5, I noted with absolute dismay what the NYSE was really saying: there is a rule (clearly acknowledged by the NYSE) that prohibits specialist parity acquisitions, but the practice is occurring anyway. I pointed out the obvious: a proposal to amend rules to "comport with existing practice" means that the "existing practice" is illegal unless and until the SEC approves the proposed amendment to Rule 108. And even an SEC approval order cannot cure the past (and, as I write this, on-going) illegality.

Up to this point, it seems clear what had been happening at the NYSE. The NYSE staff (I'm giving them the benefit of the doubt here) presumably unfamiliar with Rule 108, simply ignored it, and the underlying public policy concerns underlying it. Nothing else (short of intentional misconduct) can explain why they did not deal with Rule 108 when submitting SR-NYSE-2004-06 and SR-NYSE-2004-05 and its first three amendments. Once I submitted my March 10, 2005 comment letter, the NYSE staff began their "back-and-fill", belatedly proposing to amend Rule 108. The NYSE staff still did not grasp the background, history, and purpose of the rule, which is obvious from their cavalier mention of "existing practice" that violates the express terms of the rule.

Following submission of my July 20, 2005 comment letter, the NYSE staff must have understood that they were between the proverbial rock and a hard place, as they had (presumably unwittingly) admitted that the NYSE was permitting trading to occur that was not allowed by the NYSE-acknowledged express terms of Rule 108.

Rather than immediately inform its members to cease engaging in the "existing practice" until and unless approved by the SEC, as required, the NYSE submitted to the Commission on September 21, 2005 a comment letter discussing, among other matters, Rule 108. In this letter, the NYSE clearly stated (similar to its statement in amendment number 5) that "When establishing or increasing a position, Rule 108(a) provides that specialists are not entitled to trade on parity with the crowd." After noting accurately the clear-cut regulatory prohibition, the NYSE made the following (incredible) statement: "However, under current practice, based on the Exchange's interpretation of Rule 108, brokers in the crowd may trade on parity with their orders."

In a feat of fancy footwork worthy of the great Bojangles himself, the NYSE had gone from forgetting entirely about Rule 108 (no mention for a year and a half in rule

submissions raising Rule 108 issues), to a belated recognition forced upon them that the rule needed to be amended, but which made no mention whatsoever of any "interpretation", to a comment letter mentioning (with no details) a hitherto unknown "interpretation" (it does not appear to have been published or made known to the Commission in any public document, much less to have obtained the requisite SEC approval).

One can hear the wheels turning at the NYSE: "We've stumbled into admitting that illegal trading is occurring, but let's see if we can't find retroactive cover by hiding behind a previously unmentioned "interpretation" that somehow makes all of this okay."

Needless to say, the NYSE provided no documentation whatsoever for any of this. Pardon me for being more than a tad cynical here, but the SEC needs to demand to know when and how this purported "interpretation" was first adopted, how, what form, and to whom it was communicated, and how the NYSE could have proceeded under the "interpretation" without prior SEC approval since it contradicts the simple, unambiguous language of the rule.

The Septemeber 21, 2005 comment letter makes two points in support of the "interpretation", both of which are bogus. The NYSE contends that allowing specialist parity acquisitions is an "incentive for participating in the price discovery process at the point of sale" and "has the beneficial effects of dampening volatility and lowering execution costs at the point of sale." The NYSE also contends that specialist parity acquisitions further the objective of broker customers who want to see additional volume accompanying executions of their orders.

The NYSE's contention with regard to "incenting" specialists and dampening volatility is embarrassing, make-weight nonsense and reflects the NYSE staff's incomprehension of its own rules and of what parity trading really means. Since when do specialists have to be "incented" to do their job by permitting them to elbow aside the public in situations never before permitted? Is this a new gloss on the affirmative obligation? Specialists are required to trade as necessary (no incentives!) to maintain a fair and orderly market, and the NYSE is required as a regulator to take strict action when they fail to do so. Period. Specialists occupy a unique and privileged position, and it is absolutely sickening for the NYSE to contend it needs to dismantle a long-standing public protection rule in order to give them "incentives" to do their highly profitable jobs.

And parity trading has absolutely nothing whatsoever to do with price volatility; it is, in fact, the least volatile trading scenario imaginable, as it simply involves market participants splitting an execution at the same price, with no price change. To the extent the specialist needs to trade when there are imbalances, all well and good (his job!). But that is not parity trading.

The NYSE is correct that there are market participants who like to see "trade along" volume associated with their order executions (my institutional clients are often in this category). And the NYSE is also correct, all things being equal, that it not of the essence

as to who provides the trade along volume. But (and I have reviewed this extensivelywith my institutional clients, as well as other institutional traders) existing rules and procedures easily accommodate their preferences with no need for specialist parity trading that competes with public institutional orders and degrades the quality of institutional public order execution (I discuss this in detail below). And institutional traders are virtually unanimous that, all things being equal, there is greater price validation when the "trade along" volume consists entirely of other public orders rather than the specialist's dealer account.

Mr. Bojangles learned a few new steps when the NYSE submitted SR-NYSE-2005-74 on October 25, 2005. The "interpretation" referred to in the September 21, 2005 comment letter had now somehow morphed into a "longstanding interpretation" (time periods unspecified, of course). This rule submission, which appears to have been written by a committee of rogue specialists rather than experienced compliance professionals dedicated to the public interest, would essentially give specialists carte blanche to elbow aside the public in parity situations, unless floor brokers have the temerity to object, which, given the retributive powers of specialists, is likely to happen once every millenium or so (more on this point below). The rule submission contains the same spurious "rationale" as in the September 21, 2005 comment letter.

It's obvious what happened here. The NYSE had largely forgotten about Rule 108. In none of the documents I have discussed has the NYSE made any representation that it even surveils or enforces Rule 108, much less how it does so. Yet, its "existing practice" clearly involves specialists' disadvantaging public orders by trading in contravention of both Rule 108 and the negative obligation.

When my comment letters forced the NYSE to acknowledge Rule 108, the NYSE staff probably discovered that the NYSE's infamous wink-and-a-nod surveillance department had been permitting specialist parity trading, doubtless seduced by the same specialist "reasonableness" arguments in the face of clear-cut regulatory prohibitions that have resulted in two recent SEC enforcement actions against the NYSE for failing to enforce rules as written. Rather than simply acknowledge what has gone on and enforce the rule unless and until it obtains SEC approval of an amendment, the NYSE is choosing to dignify this mess by references to an unknown (certainly beyond the trading floor) "interpretation" that meets no known legal standard, condones trading in contravention of a simple, unambiguous rule, is legally unenforceable absent prior SEC approval, and is completely unnecessary to meet the needs of the very institutional customers it is purporting to accommodate.

SR-NYSE-2005-74 is simply shameful. Rule 108 puts the public's interest ahead of the specialist. At one time, that regulatory philosophy was indeed the very hallmark of the NYSE. By proposing to effectively rescind Rule 108, the NYSE staff have revealed themselves to be handmaidens of a self-serving specialist community eager to expand proprietary trading opportunites, rather than true protectors of the investing public.

Why the "Interpretation" Requires Prior SEC Approval

The definition of a rule of an SRO in the Securities Exchange Act extends not only to conventionally-denominated rules, but also to "stated policies, practices, and interpretations" of an SRO. Under SEC Rule 19b-4, however, not every "interpretation" is a "proposed rule change" requiring prior SEC approval before it can be implemented. The determinant is whether the "interpretation" can be "reasonably and fairly implied" by the plain language of the rule proposed to be interpreted. If the answer is yes, the SRO need not submit the "interpretation" for SEC approval, but can proceed to act under it. If the answer is no, the SRO must submit the "interpretation" as a "proposed rule change" for prior SEC approval before the SRO can act under it.

It is obvious that, at a minimum, the NYSE's "intepretation" of Rule 108 cannot be "reasonably and fairly implied" by the plain text of Rule 108. The rule's simple, direct language expresses a clear-cut prohibition which the NYSE acknowledged without any qualification whatsoever in its June 17, 2005 amendment number 5 to SR-NYSE-2004-05 and in its September 21, 2005 comment letter on that rule submission. In the face of the NYSE-acknowledged clear-cut prohibition, the NYSE is now proposing to "interpret" the prohibition as conditional, a position that is absolutely at odds with the rule's plain language.

By submitting the proposed rule change for SEC approval, the NYSE is acknowledging the obvious: the "interpretation" is not reasonably and fairly implied by the plain text of Rule 108.

Since the NYSE has been permitting a trading practice to occur that in fact requires prior SEC approval before it can lawfully occur, the NYSE has clearly been in violation of the law here.

The SEC staff must demand that the NYSE cease and desist permitting this trading practice to occur unless and until the Commission approves a properly submitted rule change.

The "Interpretation" Is Not Eligible for Immediate Effectiveness

SEC Rule 19b-4(f) provides that an SRO rule intepretation requiring prior SEC approval can be given immediate effectiveness (no prior public comment), provided the SRO has "properly designated" the matter as an interpretation. In discussions with the SEC staff over the years, I have been informed that the "properly designated" language is an important safeguard to prevent SROs from circumventing the normal rule approval process by submitting as "interpretations" material that clearly requires amendment of existing rule text or the adoption of a new rule.

The NYSE's "interpretation" of Rule 108 is clearly an instance of material requiring formal amendment of the rule, with full prior public comment. It is obvious the "interpretation" cannot be reasonably and fairly implied by the rule text. But the problem here goes well beyond that: the "interpretation" cannot conceivably be derived from the

rule's language. The SEC staff have consistently informed me that, even though material not reasonably and fairly implied by rule text may qualify as an interpretation, material that is inconsistent with rule text, or which contradicts rule text, will not be considered as having been "properly designated" as an "interpretation." This is clearly the case with the NYSE's proposed "interpretation" of Rule 108.

As discussed above, the NYSE itself, in both amendment number 5 and the September 21, 2005 comment letter acknowledged the clear-cut regulatory prohibition without suggesting in any way that the prohibition was qualified and conditional. Now, however, in SR-NYSE-2005-74, submitted to the Commission on October 25, 2005, the NYSE has attempted a bizarre, intellectually dishonest circumlocution that is almost comical (if it were not so pathetic) in its reflection of the absolute desperation of the NYSE staff to rationalise the awful mess they have created for themselves.

Despite having previously acknowledged on two recent occasions (in June and September 2005) an unqualified prohibition, the NYSE stated (page 5 of SR-NYSE 2005-74): "But, because the rule only speaks to specialists not being "entitled" (i.e., not having an unconditional right) to be on parity rather than flatly prohibiting them from being on parity, the rule, by its terms, does not preclude specialists from trading on parity when establishing or increasing their positions if brokers in the crowd raise no objections."

This is breathtaking in its sheer audacity. Piecing together the June and September statements and this moronic drivel, it appears that the NYSE is saying that while Rule 108 "prohibits" specialist parity acquisitions (no can do), the rule does not "flatly prohibit" (really, really no can do, this time we mean it) such trading. Are we back to the good old days of wondering what the meaning of "is" is?

The background, history, and purpose of Rule 108 (studiously avoided by the NYSE staff for the obvious reason that it hurts them) make clear what "entitled" means: consistent with standard dictionary definitions and the common sense understanding over the years, it simply means "allowed to act." All Rule 108 is saying is that the specialist is not "allowed to act" to trade on parity when establishing or increasing a position. The NYSE itself understood this in June and September, and the industry has understood this for decades. The notions of "unconditional right" are bizarre in this context, and to the extent they have any bearing at all on "entitlement" they derive from tertiary definitions related to the law of property that are completely irrelevant to this discussion.

But even accepting the NYSE's ludicrous terms at face value, the NYSE staff is still running around in circles here. The rule states clearly that specialists shall not be entitled. There is no conceivable way that a bar on entitlement can be read to mean that a conditional entitlement can be established, absent formal amendment of rule text.

There is something morally and intellectually bankrupt at the heart of the NYSE's rule submission process when the NYSE staff attempts such ridiculous word games on a matter that deeply affects the quality of public order executions. There has been no

formal, "longstanding interpretation", but rather a thoughtless, asleep-at-the-switch "winking" at trading practices not permitted by the plain text of a simple, direct rule. The "longstanding interpretation" is of extremely recent vintage, and the "word game" of SR-NYSE-2005-74 was obviously invented over the last several weeks, as the NYSE itself made no reference to it whatsoever as recently as September 21, 2005, its immediately prior public statement on Rule 108.

The SEC staff should demand that the NYSE demonstrate its bona fides in this matter by producing documentation that the bizarre rationalisation contained in SR-NYSE-2005-74 is reflected in formal, publicly disseminated NYSE material dating far enough back in time so as to justify the NYSE's use of the term "longstanding interpretation." I would not hold my breath waiting for the NYSE to produce such documentation.

I have admired the NYSE over the years, and am deeply saddened to make these sorts of comments. The NYSE and the quality of its staff are just not what they used to be. The SEC staff should seriously consider applying the term "fraudulent and deceptive practice" to the NYSE's treatment of Rule 108 and its misrepresentations to the Commission and to the public. As recent events demonstrate, the "cover-up is always worse than the crime."

The NYSE "Interpretation" Is Really About Providing Increased Dealer Trading Opportunites for Specialists, Not Serving Institutional Customers

As my two teenage sons would say, let's get real here. NYSE specialists make most of their money by engaging in in-and-out proprietary trading for the dealer account. They resent restraints on trading, because they limit specialist financial return. A rule such as Rule 108, if properly enforced to put the public ahead of the specialist, as required, will have an adverse impact on the specialists' bottom line. It is no secret that specialists aggressively lobby the NYSE staff to be given more and more proprietary trading opportunities, particularly since decimalisation has negatively impacted specialist profitability. Doubtless, they have made self-serving arguments to the credulous NYSE staff about their need to "service" institutional customers by providing "trade along" volume, which is just a smoke-screen for their wanting to compete directly with those institutional customers so as to maximise their proprietary trading opportunites.

I have reviewed this matter with my institutional clients. They are surprised to learn that the NYSE has been permitting specialists to compete directly with their orders, and they are satisfied that NYSE rules and procedures, strictly enforced, both satisfactorily address their need for "trade along" volume, and maintain confidence that specialists are not abusing their privileged positions.

The two simple examples below demonstrate how institutional need for "trade along" volume can be accommodated under current rules without specialist parity acquisition trading.

Example 1: One Floor Broker

Assume a trading crowd consists of one broker (Broker A) working a large not held order for an institutional trader who would prefer not to be 100% of the trading volume. The bid in the market is for 2000 shares, 1000 of which is for Broker A, with the other 1000 being the specialist's dealer account. Another floor broker (Broker B) enters the crowd to sell 1000 shares to the bid. Rule 108 precludes the specialist from trading on parity (i.e., the specialist and Broker A each buying 500 shares in a single trade) but this by no means precludes the specialist from providing "trade along" volume. What the rules, strictly enforced, provide in this situation is that Broker A can buy 500 shares in one trade. In a second trade, printed immediately after the first, the specialist would buy the other 500 shares. The institutional trader is happy because there is immediate "covering" volume on the tape, and the specialist is acting properly under the negative obligation because he/she is trading with the unfilled balance of Broker B's order in the absence of any other public order willing to buy the 500 shares at that price.

It is irrelevant to the institutional trader that there are two immediately contemporaneous trades, rather than a single trade. The principal consideration is simply that the institution's trade has been immediately "covered" by the second trade. It is absolute nonsense that institutions want to trade "on parity" with the specialist in a single trade. Most institutional traders have no understanding of the NYSE's parity rules and how they operate on the NYSE floor. Institutional traders are, however, quite comfortable with "follow" trades (such trades are standard at the opening and close, as well as intra day in stop and CAP order election situations, etc.) as the appropriate means for "covering" their trades, and ensuring that specialist participation is limited only to those situations in which the specialist's participation does not diminish the size of an execution the institution would otherwise receive. (E.g., in this example, if Broker A wanted to trade the entire 1000 shares, and was not concerned with "covering" volume, the NYSE's proposal would permit the specialist to "elbow aside" Broker A to the extent of 500 shares that should otherwise go to the public institutional customer).

Example 2: Several Floor Brokers and the Specialist

Assume a trading crowd consists of four floor brokers (on parity) each bidding 2000 shares, with the specialist bidding 2000 shares for the dealer account as well. A seller enters the market to sell 8000 shares to the bid. Under Rule 108 as it should be enforced, each broker would buy 2000 shares (the specialist could not interfere with the public orders here) and each individual institutional customer would be satisfied with the "covering" volume.

Under the NYSE's proposal, however, there would be a 5-way split, with each institution receiving 1600 shares instead of 2000, because the specialist is participating, even though there is absolutely no need under the negative obligation for him/her to do so. The quality of public institutional order execution is degraded by 400 shares, and repetitions of this type of specialist behavior will clearly have a negative impact on whether the institutional orders may ultimately receive a complete fill. Specialist trading activity in situations such as this (which are quite typical, particularly in active stocks) can never be justified under

the negative obligation because there is sufficient public order liquidity to exhaust the contra side interest. There is never any "necessity" for the specialist to participate.

If, in this situation, under Rule 108 as it should be enforced, each broker did not take an "equal split", the specialist would be free to trade immediately with the unfilled balance of the contra side order in a follow trade. But this would not be trading on parity.

The specialist community will, of course, present the self-serving argument that requiring a follow trade (perfectly acceptable to institutions) is "form over substance", and that everything can be handled in a single trade. But any self-respecting regulator would obviously see through this argument. In Rule 108, as with many NYSE and SEC rules, strict adherence to form is the only substantive, meaningful safeguard against specialist overreaching. The only reason why specialists want a single trade is because it is the only way they can assure themselves of a proprietary trading opportunity in situations in which they would otherwise be shut out.

The notion that the ability of floor brokers to "object" to specialist parity trading somehow sanitises this proposal is absurd. Floor brokers joke openly about adverse consequences to them and their customers if they do not allow the specialist to trade along with their orders. Floor brokers are made to "get along by going along", and are subject to all sorts of subtle and not so subtle pressures to accommodate the all-powerful specialist (just ask them, they'll tell you). Let me pose a simple question: would the public have more confidence in enforcement of a strict prohibition, or in the notion that floor brokers could meaningfully protect the public interest by "objecting" in the current environment that prevails on the NYSE trading floor? To ask the question is to answer it.

Conclusion

As this proposal will almost certainly have to be reproposed, I will defer comment on the numerous technical errors in the proposed Information Memo, as well as the NYSE's bogus claim that the proposal is somehow consistent with CAP and best execution rules.

It is clear that this entire matter is a woeful mess. The SEC staff must take the following actions:

1. Order the NYSE to cease and desist acting under its illegal "interpretation" of Rule 108.

2. Inform the NYSE that SR-NYSE-2005-74 has not been "properly designated" for immediate effectiveness.

3. Urge the NYSE to put the interest of the public ahead of the interest of the specialist and commit to strict enforcement of the plain text of Rule 108.

Sincerely yours,

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