November 17, 2005

Dear SEC:

(This letter supplements my November 1, 2005 letter. The thrust of the comment is addressed to SR-NYSE-2005-74, but is also being submitted under SR-NYSE-2004-05 because the substantive issues have arisen in the context of that rule submission).

I am writing to supplement my November 1, 2005 letter on the above-referenced matter (which should be incorporated by reference herein) and to express my dismay at the NYSE's "re-dating" of the proposal (from October 25, 2005 to November 14, 2005) and failing to acknowledge the critical comments that have been made.

Sr-NYSE-2005-74 originally appeared on the NYSE website with a submission date of October 25, 2005. On November 1, 2005, I noted the serious defi ciencies in the proposal, pointing out that it had not been "properly designated" as a rule interpretation as required by SEC Rule 19b-4(f). My November 1, 2005 comment letter was also submitted under SR-NYSE-2004-05, the context in which the Rule 108 issues first surfaced. This letter, with its clear cross-reference to SR-NYSE-2005-74, was published on the SEC website shortly thereafter.

Presumably, the NYSE monitors comments on its rule submissions. The NYSE clearly was in "constructive receipt" of my November 1, 2005 comments prior to its November 14, 2005 re-dating (with no indication of such on the NYSE website) of SR-NYSE-2005-74. Yet, in Item 5 of SR-NYSE-2005-74, the NYSE represents that it has received no written comments on its proposal. This is clearly false, and deceives the public into thinking that no one has raised issues here. On this ground alone, the NYSE must be made to revise SR-NYSE-2005-74.

But, as my November 1, 2005 comment letter demonstrated, there are even more serious issues here. At best, the NYSE has operated for (apparently) years without required SEC approval for its purported "longstanding interpretation." At worst (as appears the case), the NYSE had not properly considered the strictures of Rule 108, had permitted practices to occur that were prohibited by the rule's plain language, and is now trying to claim that this is somehow all covered by a hitherto unknown (to the public, whose order executions are affected, as well as to the Commission) "longstanding interpretation" that flies in the face of the Rule 108's plain language, and contradicts the NYSE's own prior statements on this point.

And I expressed particular dismay that the NYSE staff had not reviewed this matter with the NYSE Board of Directors, as even under the best case scenario here the NYSE has been operating for years without required SEC approval (which means th at the NYSE has been violating the law).

What the NYSE has is a longstanding "practice." It does not necessarily follow at all that this practice has been permitted under a formal, "longstanding interpretation", or that

even if one suspended disbelief and accepted that the interpretation existed, that the interpretation was in any way legal. (See the two recent, major SEC enforcement actions against the NYSE for failing to interpret its rules correctly and thereby permitting longstanding, illegal trading practices to occur. And, inasmuch as many of the NYSE staff are new, any "longstanding interpretation" would have had to occur on the watch of the NYSE's discredited regulatory officials. But, of course, there really is no formal, "longstanding interpretation").

Rule 108 unambiguously prohibits, without any expressed qualification or any qualification that can conceivably be implied by the rule's plain language, specialist parity acquisition trading. As I have previously demonstrated, this prohibition has been historically rooted in the negative obligation, which can never be reconciled with such trading. The regulatory framework in this regard is of long duration, and is simple, consistent, logical, and coherent.

Any "interpretation" by the NYSE must be rooted in Rule 108's plain language. And this is where SR-NYSE-2005-74 is simply outrageous. The heart and soul of the "longstanding interpretation" is the following: "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 objection."

As I noted in my November 1, 2005 commen t letter, this is absurd (see prior discussion), and (as discussed below, as well as in my November 1, 2005 letter) isn't even what the NYSE itself believed until the last few weeks. This linguistic flim-flam is obviously a recent fabrication, and reeks of the stench of desperate, ex post facto rationalisation.

If the NYSE is acting in good faith here (doubtful, but even if they are, they still have been violating the law for years), then the NYSE should submit documentation, in a public document upon which the public may comment prior to any SEC approval, showing that the NYSE had in fact adopted the language I quoted above far enough back in time to justify the NYSE's use of the term "longstanding interpretation."

It really is this simple: the NYSE needs to "put up" or "shut up" about the "longstanding interpretation." And, while the NYSE is at it, they need to explain why, if this really is a "longstand ing interpretation", it has never been previously communicated to the general public or to the Commission.

I would like to take this opportunity to comment on two particularly egregious misstatements/misrepresentations in SR-NYSE-2005-74. On pages 3-4, the NYSE references its amendment number 5 to SR-NYSE-2004-05 and makes the following statement: "As noted in that filing, the proposed rule change comports with and would incorporate into the rule text, the Exchange's longstanding interpretation of NYSE Rule 108(a) as permitting a specialist to be on parity with orders in the Crowd when the specialist is establishing or increasing his or her position, provided that the brokers

representing orders in the Crowd permit to the specialist trading along with them by not objecting to such participation."

This is a truly audacious and palpably false statement, as demonstrated by what it was that the NYSE ac tually said in amendment number 5 to SR-NYSE-2004-05. The NYSE acknowledged the "practice" of specialist parity acquisitions, but, notwithstanding the "as noted in that filing" language quoted above, in fact made no mention whatsoever of any "longstanding interpretation." Rather, the NYSE made the following statement (page 14 of amendment number 5): "Currently, NYSE Rule 108 prohibits the specialist from trading for its proprietary account on parity with the Crowd in situtations where the specialist is establishing or increasing a position. The Exchange proposes to amend NYSE Rule 108 to eliminate that restriction and provide that specialists would be entitled to parity with orders represented by brokers in the Crowd...when establishing or increasing a position."

In other words, as recently as June 17, 2005 when amendment number 5 was submitted, the NYSE not only clearly acknowledged that Rule 108 "prohibits" specialist pari ty acquisition trading, but further acknowledged that in order to "eliminate that restriction" it had to propose a formal amendment to the text of Rule 108. There was no linguisitc flim-flam here about a "longstanding interpretation", and no ludicrous distinctions about "prohibit" versus "flatly prohibit", much less an attempt at a legal sleight of hand to obviate the rule amendment process by submitting material for immediate effectiveness with no prior public comment. The NYSE made similar reference to the unqualified prohibition in Rule 108 in its September 21, 2005 comment letter on SR-NYSE-2004-05.

Only one conclusion reasonably presents itself here: the "longstanding interpretation" was invented sometime between September 21, 2005 and October 25, 2005 as the NYSE sought to wrestle with how to deal with the problem of having permitted trading practices to occur without prior SEC approval.

On page 6 of SR-NYSE-20 05-74, the NYSE states: "Notably, however, the interpretation does not give specialists the unfettered ability to trade for their proprietary accounts, since in effecting such transactions, they remain bound by the reasonable necessity considerations contained in Rule 104 and since their ability to trade on parity in any event always remains subject to consent by the Crowd."

In my November 8, 2005 comment letter on SR-NYSE-2004-05 (in the context of the NYSE's discussion of Rule 108), I demonstrated that the current NYSE staff cannot even distinguish between the specialist's affirmative and negative obligations, and have no credibility in their references to the negative obligation. The interplay between Rule 108 and the negative obligation is too well established to require much further discussion here. Suffice it to say that the NYSE staff have offered no plausible explanation whatsover as to how specialist parity acquisitions can ever be squar ed with the negative obligation.

But the real howler in the language I quoted above is the NYSE's reference to specialist parity acqusition trading as requiring floor broker "consent." The "longstanding interpretation" is obviously of such recent vintage that the NYSE staff cannot even get their story straight. The NYSE proposal, in essence, presumes that the specialist can engage in parity acquisition trading unless a floor broker objects. The NYSE's proposal is not, as the NYSE's misrepresentation would have it, that the specialist cannot engage in parity acquisition trading unless a broker consents. This is not simply a semantic distinction. There is a world of substantive difference between "right unless objection" versus "prohibition unless consent." The former greatly strengthens the specialist's hand, as it gives his trading the presumption of right; the latter suggests a misleading degree of floor broker power and public protection, a laug hable concept in the real world culture (e.g., specialists raping the Superdot order flow, per the recent SEC enforcement action) of the NYSE trading floor.

The NYSE's misrepresentation here is unconscionable, but par for the course in the whole sorry mess that is SR-NYSE-20005-74.

Rule 108 protects the public interest by putting the public ahead of the specialist's dealer account. Rule 108 does not prohibit in any way legitimate specialist trading (see discussion in my November 1, 2005 comment letter), but is a significant, substantive safeguard against specialists' forcing their way into trades in which their participation is not required, but will in fact degrade public order execution.

Adherence to the strictures of Rule 108 is a far more effective and substantive deterrent to unnnecessary dealer activity at the public's expense than the meaningless, cosmetic "fluff" o f a floor broker objection mechanism. And certainly, from the standpoint of public perception, the public will have far more confidence in the fairness of the NSE market if Rule 108 is strictly enforced.

Conclusion

The NYSE should obviously be made to put the public ahead of the dealer account. But if the NYSE is adamant about accommodating specialists here, the NYSE must be made to submit formal amendments to Rule 108 and the negative obligation for prior public comment before SEC approval is obtained. And the NYSE must be told to cease and desist specialist parity acquisition trading unless and until formal SEC approval is obtained.

Clearly, SR-NYSE-2005-74 is not a matter that can be processed for immediate effectiveness. But even if it were (inconceivable to me), the SEC staff could not, in light of the serious objections raised, simply issue the NYSE's proposed approval order, which would put the Commission's imprimatur on the NYSE's misrepresentations. The SEC staff would have to issue its own approval order, analysing all of the objections in such a way as to favor the NYSE, a clearly impossible task.

Sincerely yours,

George Rutherfurd
Consultant (to two institutional trading organisations)
Chicago, IL