

January 10, 2005

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

Re: File No. SR-NYSE-2004-67, Extension of Pilot Program Permitting a Floor Broker to Use an Exchange Authorized and Provided Portable Phone on the Floor.

Dear Mr. Katz:

Introduction

Inet ATS, Inc. (“INET”) respectfully submits this comment letter to the U.S. Securities and Exchange Commission (“SEC” or “Commission”) in response to the above-referenced proposed rule change by the New York Stock Exchange (“NYSE” or “Exchange”) (“Proposal”).¹ With respect to this Proposal, INET requests the NYSE to further explain the following passage in the Proposing Release and directly address the important policy questions below that INET believes are raised by the Proposal.

By enabling customers to speak directly to a Floor broker in the trading crowd on an Exchange authorized and issued portable telephone, the Exchange believes that the proposed rule change would expedite and make more direct the free flow of information which, prior to the Pilot, had to be transmitted somewhat more circuitously via the broker’s booth. (emphasis added)

INET believes that the NYSE should further explain what information is being communicated in the thousands of incoming and outgoing calls from the floor of the Exchange where floor brokers have access to information not available to the general public, who are the likely recipients of the information, and how the information is being used.

Further, INET believes the issue of using cell phones on the floor is really a sub-issue to a very important policy question concerning the fairness of the NYSE’s floor based system, and in particular the role of floor brokers. For example, in the Proposal, the NYSE indicates that one purpose of the cell phones is to facilitate “market look” observations.² It is INET’s understanding that a “market look” is something that a floor

¹ Securities Exchange Act Rel. No. 50777 (Dec. 1, 2004), 69 FR 71090 (Dec. 8, 2004) (File No. SR-NYSE-2004-67) (Proposing Release).

² Id. at 69 FR 71091.

broker provides a client that is off the floor.³ Market looks are useful because investors cannot get the entire picture of what is occurring on the Exchange by simply looking at the quotations disseminated by the NYSE. To really find out what the true market is on the NYSE, investors must use a floor broker and pay them \$0.02 or \$0.03 cents a share to walk up to the specialist and ask, “what’s the market?” This information is then transmitted back to clients in many ways, including, by virtue of the Proposal, by cell phone. Thus, it is clear from the Proposal that NYSE floor brokers and their clients acquire valuable market information before the general public.

Historically, the SEC has taken the policy position that integrity and fairness are critical components of our securities markets. This philosophy has manifested itself in numerous places including the Commission’s regulation of alternative trading systems, insider trading prohibitions, and corporate information disclosure policies.

Regulation ATS

In adopting Regulation ATS, the SEC took the position that if an alternative trading system (“ATS”) disseminated information to more than one participant in its system then the same information must be disseminated to all system participants.⁴ Therefore, for example, INET would appear to not be in compliance with the requirements of Regulation ATS if INET offered a data feed to its ten highest paying subscribers that would allow them to exclusively see reserve and non-displayed orders on the INET system. The plain language of Regulation ATS prohibits such a data feed, even if INET could show it would reduce market volatility.

In contrast, NYSE floor brokers are able to probe the market and obtain information that is not available to other investors trading NYSE-listed securities. INET believes that the NYSE should explain why it is fair for floor brokers and their customers to have exclusive access to this information, especially when ATSS are precluded from favoring certain segments of their customers over others.

Insider Trading Prohibitions

Another example of the SEC’s commitment to fairness is rules prohibiting insider trading.⁵ At the heart of the insider trading laws is the notion that no investor should have an unfair advantage over other investors. For example, it would be illegal for a corporate insider to tip a third party (“tippee”) about material non-public information.⁶ The basic policy notion underlying this prohibition is that insiders have better access to information and would unfairly benefit at the expense of the general public.

³ NYSE Rule 115.

⁴ Rule 301(b)(3) of Regulation ATS, 17 CFR 240.301(b)(3).

⁵ Exchange Act Rule 10(b)(5), 17 CFR 240.10(b)(5).

⁶ See, e.g., *Dirks v. SEC*, 463 U.S. 646 (1983).

In contrast, it appears on the NYSE, a floor broker can effectively “tip” a client about material non-public trading information and still be in compliance with the NYSE Rules. The information on the floor is non-public since it is only available to floor brokers and their customers (i.e., their “tippees”). The NYSE could claim that though they have what amounts to an informational advantage over other market participants, floor brokers are a net benefit to the marketplace. But, that is the same argument that free marketers have unsuccessfully advanced in pushing for the elimination of insider trading prohibitions. The NYSE also could claim that under its rules the specialist who provided the “market look” to the floor broker is required to make this information available in a fair and impartial manner to any member while on the floor.⁷ However, the NYSE’s rules only require the specialist to disclose such information upon each member’s request, not to make it known generally to members or the market as a whole at the same time, leaving investors and other market participants at a distinct informational disadvantage to floor brokers and their clients.

Regulation Fair Disclosure

In adopting Regulation Fair Disclosure (“Regulation FD”) the SEC again took the position that it is unfair for certain people to learn information before the general public.⁸ The SEC was particularly uncomfortable with the practice of corporations briefing analysts who then, in turn notified favored clients at their firms, providing clients of that firm a trading advantage over every other market participant. To eliminate this perceived unfairness, the SEC adopted Regulation FD, which generally requires corporations to release material news to the general public at the same time it releases the information to analysts. In other words, everyone receives everything at the same time or nobody receives it.

In contrast, NYSE rules allow floor brokers and their clients to obtain material trading information before the general public. This non-public information is then transmitted to favored clients of floor brokers so that they can act on information.

Floor Trading Prohibitions – Section 11(a)

In addition to the policy questions regarding fairness, the Proposal also raises questions about its conformity with the goals of Section 11(a) of the Securities and Exchange Act of 1934 (“Act”).⁹ Section 11(a) of the Act was specifically adopted to, among other things, prevent members on the floor of an exchange from unfairly benefiting from their time and place advantages on the floor. To reduce the likelihood of abuse, Section 11(a) of the Act prohibits floor brokers from trading for their own account absent an exception. But the Proposal makes clear that floor brokers are now doing indirectly what they cannot do directly by the terms of Section 11(a) of the Act.

⁷ NYSE Rule 115(iii).

⁸ Rule 100 of Regulation FD, 17 CFR 243.100.

⁹ Section 11(a) of the Act, 15 U.S.C. 78k(a).

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Specifically, rather than trading for their own account, floor brokers are passing on information gained from their inherent time and place advantages to third parties. In return for passing on such information, floor brokers are paid above market rates for their services, benefiting in much the same way as they would if they traded directly. Therefore, INET believes that one of the main purposes behind Section 11(a) of the Act, protecting the integrity of the market by eliminating the use of exchange members' time and place advantages to make a trading profit, is frustrated by this Proposal.

Summary

In light of the SEC's basic policy positions on information dissemination discussed above, INET believes that the Commission should not allow the pilot program under the Proposal to continue. Further, the SEC should require the NYSE to justify the ability of floor brokers to provide information to their clients via cell-phone or any other means when the same information is not simultaneously disseminated to the general public. INET believes this practice is inconsistent with the position the SEC has taken on other analogous issues.

Again, we appreciate the opportunity to comment on the Proposal. If you have questions regarding any of the issues raised in this letter, please do not hesitate to call me directly at 212.231.5101, or Cameron D. Smith, Chief Strategy Officer, Inet ATS, Inc., at 202.231.5018.

Sincerely yours,

Alex Goor
President
Inet ATS, Inc.

cc: The Honorable William H. Donaldson, Chairman
The Honorable Cynthia Glassman, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Harvey J. Goldschmid, Commissioner
The Honorable Paul S. Atkins, Commissioner

Annette Nazareth, Director, Division of Market Regulation
Robert L.D. Colby, Deputy Director, Division of Market Regulation