February 13, 2006

Dear SEC:

This is a truly baffling and disturbing matter. The Federal Register notice announcing the immediate effectiveness of the NYSE's proposal, which is the functional equivalent of an SEC approval order, was prepared (as is typically the case) by the NYSE, and gives little hint of what has actually transpired here.

This matter was first submitted to the Commission on October 25, 2005, and withdrawn and resubmitted (with the exact same same content) several times prior to December 13, 2005, what the Commission in footnote 29 refers to as the effective date of the original proposed rule change. In its December 13, 2005 resubmission, the NYSE, acting at the Commission's behest, purported to respond to criticisms I had made. On December 11, 2005 (this letter responds to the December 13, 2005 resubmission, notwithstanding the dates; the December 13 material had been re-dated from several days earlier), I submitted a letter demonstrating that the NYSE, far from answering my criticisms, had in fact further undermined its own position. On December 17, 2005, I submitted an additional letter pointing out that two major NYSE fiduciary constituencies, floor broker and mutual fund trade associations, had never heard of the "longstanding interpretation", and were in fact strongly opposed to the underlying concept.

It is deeply disturbing that the NYSE did not even acknowledge the points made in these letters in its January 31, 2006 submission of Amendment 1, which simply restated its earlier "responses", and added new, non-responsive material (as I discuss below) about a 1979 NYSE rule submission. While these letters were addressed to the Commission, and not the NYSE, they were published on the SEC's website under SR-NYSE-2004-05 (the "hybrid market" proposal) and it is impossible to believe the NYSE was not aware of them, and thus, at a minimum, in "constructive receipt" of them. The NYSE should have, in light of the serious issues raised, responded to my December letters of its own volition. Clearly, when the NYSE failed to do so, the SEC staff should have insisted that the NYSE respond, as they had insisted with respect to my earlier comments. (More on this point below).

While the NYSE takes the position that its "longstanding interpretation" of Rule 108 is "reasonably and fairly implied" by the text of Rule 108, the tortured procedural history of this submission (to say nothing of the substantive issues) leads to the exact opposite conclusion. A matter that is "reasonably and fairly implied" by the text of an existing rule does not even have to be submitted to the Commission in the first place. The Commission staff obviously had doubts about this proposal or they would not have held it up for more than three months, giving the "green light" only aft er the NYSE finally produced a document that, on its face, discussed Rule 108. As I discuss below, however, this is another instance in which the NYSE's purported "support" for its "longstanding interpretation" in fact fully supports my position.

The Commission's rule approval processes are easily the finest in the world, fairer to all than those of any other regulatory agency. But the procedures for "immediate effectiveness" are occasionally fraught with a high degree of uncertainty and awkwardness for the public. While Section 19(b)(3)(A) of the Securities Exchange Act provides that an SRO's rule interpretations "may take effect immediately upon filing with the Commission", in reality the matter is far more complicated. SEC Rule 19b-4 requires that a purported "rule interpretation" be "properly designated" as such. It is well-known that the SEC staff engage in a vetting process, as happened here. SROs understand that until the Commission gives the " green light", a matter does not become effective, notwithstanding the statutory language about "take effect upon filing."

The problem for the public is that there is no "sunlight" regarding the SEC staff's vetting process, as the public has no formal notice that an SRO is seeking immediate effectiveness of a purported interpretation. (I only became aware of this matter by seeing it on the NYSE website when I was looking for something else. I had to scramble to make hurried comments, as there is no notice period).

Most of the time, the process, intended for routine or administrative matters, works fine. But the NYSE over the past year or so has had trouble with it, as it has sought immediate effectiveness of clearly ineligible, substantive trading-related matters. This creates extraordinary difficulty for the SEC staff, who cannot be expected to be experts on SRO rules, and who need to assume that the SRO knows what it is talking about.

In December 2004, the NYSE sought immediate effectiveness of SR-NYSE-2004-70. The SEC staff refused to permit this, insisting that the NYSE resubmit this matter under the Commission's normal, prior public comment process. To date, almost 14 months later, SEC approval is still pending with respect to a matter for which the NYSE had originally sought immediate effectiveness.

In August 2005, in SR-NYSE-2005-57, the NYSE sought immediate effectiveness of a proposal to "systematize" the execution of certain orders, including elected stop orders.Critical to the NYSE's claim that immediate effectiveness was appropriate was an assertion that it was not changing the rules by which elected stop orders were actually executed. After seeing the notice of immediate effectiveness on the SEC's website, I wrote a comment pointing out that the NYSE was most certainly changing the rules by which elected stop orders are executed, and that the matter clearly had not been eligible for immediate effectiveness. Apparently acting at the SEC staff's behest, the NYSE then submitted a purported "clarification" in SR-NYSE-2005-69. After I pointed out the serious inadequacies and errors in this material, the NYSE hastily withdrew it.

In its rule submission to implement the "hybrid market" pilot program, the NYSE obtained approval of a temporary rule change to permit elected stop orders to be executed systemically, the very change the NYSE had maintained was unnecessary in SR-NYSE-2005-57. The NYSE's action constitutes a de facto admission that it had acted in error in seeking immediate effectiveness of SR-NYSE-2005-57. There are other, recent, significant NYSE "rule approval" problems. The "market scenarios" in SR-NYSE-2004-

70, and the NYSE's inability to distinguish between the specialist's affirmative and negative obligations in its Septembe r 21, 2005 comment letter on SR-NYSE-2004-05, are two particularly troubling examples.

The NYSE is similarly proceeding inappropriately under the immediate effectiveness process in SR-NYSE-2005-74. This again places the SEC staff in the extremely difficult position of having to assess the bona fides of an SRO's representations as to what should be a simple, routine, administrative matter. There is no formal public comment period, and the SEC does not even publish its own approval order, with the Commission's independent assessment of comments received. The Commission simply publishes whatever the NYSE has prepared, with the NYSE's own, unrebutted "slant" on negative comments received by the Commission. The end result, essentially, is publication of a self-serving NYSE statement, with the imprimatur of an SEC Release number, filled with errors, that can only be challenged by a public faced with a complete reversal of the burden of proof, a limite d comment period, and a 60-day clock that starts ticking (as of January 31, 2006) well before the public has any formal notice of any of this.

Regardless, the Commission may abrogate the effectiveness of SR-NYSE-2005-74 if such action "is necessary or appropriate in the public interest, for the protection of investors...." While abrogation of immediate effectiveness is uncommon (given what is supposed to be the routine, non-controversial nature of such matters), this is clearly a compelling case in which the public interest and the protection of investors demand such a result.

It is an absolutely compelling public interest that the SEC maintain the integrity of its rule approval processes. An SRO must not be permitted to effect a major, substantive rule change by resorting to the Commission's immediate effectiveness process, a process intended for routine technical matters.

There is a compelling public interest, one that is absolutely addressed to protecting public investors, in ensuring that any SRO rulemaking action that may adversely affect the quality of public order executions (as is certainly the case in SR-NYSE-2005-74) is approved by the Commission only after the public has had a full and fair opportunity for comment, and only after the Commission has weighed in with its own assessment of the public's comments.

The NYSE's Proposal Has Not Been "Properly Designated" As a Rule Interpretation

On page 8 of the Federal Notice, the NYSE observed that my criticisms of its proposal "rely on sweeping generalizations or incorrect assumptions, are unsupported by any verifiable legal or other authority, and consist largely of meritless accusations."

This is a curious statement for the NYSE to make. Far from presenting "sweeping generalizations or incorrect assumptions", I have in fact presented a very detailed,

focused, logical, in-depth rebuttal to every point raised by the NYSE, and I have met every issue fully, fairly, and head-on (unlike the NYSE). Indeed, my extensive analysis is far lengthier than the NYSE's own presentation. The NYSE's point about my not relying on authority is particularly strange, since, in fact, the NYSE submitted historical documentation only after my November comment letters pointed out the complete absence of legal authority in the NYSE's original iteration of SR-NYSE-2005-74 in October.

This is, first and foremost, a matter of understanding the text of Rule 108. I have consistently relied on the primary authority in a case such as this, the plain language of the rule itself. In addition, I have noted SEC Rule 19b-4's requirements (the NYSE seems confused on this), and I have noted the negative obligation (NYSE Rule 104), which precludes specialist dealer trading unless "reasonably necessary to maintain a fair and orderly market", the so-called "necessity test" which specialist parity trading, virtually be definition, fails. I am happy to adopt several authorities cited by the NYSE (the dictionary definitions, the canon of statutory construction, and the NASD precedent), as they fully support my position and undermine the NYSE's. (See my December 11, 2005 letter on this point).

Clearly, I cannot be expected to present authority to "prove a negative", namely the non-existence of the purported "longstanding interpretation." The NYSE has the burden of proving the existence of the "longstanding interpretation", and has yet (even after three months of back and forth with the SEC staff) to produce any authority whatsoever that refers to this "longstanding interpretation" in any way, shape, or form.

As I demonstrate in detail below, the SE C must abrogate the immediate effectiveness of SR-NYSE-2005-74, and find that the NYSE has not "properly designated" this matter as a rule interpretation, for the following six reasons:

1. The "longstanding interpretation" is flatly contradicted by the plain language of the rule it purports to interpret.

2. The "longstanding interpretation" is contradicted by the NYSE's own, recent statements on this matter.

3. The "longstanding interpretation" is not supported by any historical documentation whatsoever.

4. The "longstanding interpretation" has never been communicated to anyone.

5. The activity addressed in the "longstanding interpretation" is in fact strongly opposed by the very public whose interests the NYSE is purporting to protect.

6. The "longstanding interpretation" is inconsistent with the specialist's negative obligation.

1. The "Longstanding Interpretation" Is Flatly Contradicted by the Plain Language of the Rule It Purports to Interpret

Rule 108 provides in pertinent part: "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...." The language as applied to specialists today can be paraphrased as "No specialist shall be entitled to parity when establishing or increasing a position."

I don't know what could be clearer. The plain meaning is obvious: the specialist cannot engage in parity acquisition trading. And lets be clear as to what "parity acquisition trading" means: direct dealer competition with public orders represented by floor brokers. I n my other correspondence, I have given examples of how such direct dealer competition degrades the quality of executions received by public customers. The issue in this matter may seem obscure and technical, but it is hugely significant.

There is no ambiguity whatsoever in the rule's simple language, no hint that this bar to being entitled to trade on parity is in any way conditional, and there is no reference whatsoever to floor brokers, much less to a floor broker's ability to "entitle" the specialist to engage in parity acquisition trading by not objecting.

The NYSE premises its position here on a curious type of circular reasoning, inserting into its argument conditional terms that do not appear in the rule, and then arguing that this conditional terminology demonstrates that the phrase "No [specialist] shall be entitled [to engage in parity acquisition trading]" actually means the opposite of what it appears to m ean, namely that every specialist is in fact entitled to engage in parity acquisition trading unless a floor broker objects. This is a most unusual approach to rule interpretation, to say the least.

Central to the NYSE's argument is its assertion that "no specialist shall be entitled" to engage in parity acquisition simply means that specialists do not have an "unconditional" right to engage in such trading. Thus, in the NYSE's view, specialists have a "conditional" right to engage in such trading, the condition being the absence of floor broker objection.

In my November comment letters, I strongly objected to the NYSE's attempt to condition a word ("entitle") that is presented in the rule in a simple, absolute sense, with no hint in the actual rule next that the bar to entitlement can be conditioned. The NYSE appeared to be simply plucking the term "unconditional right" out of thin air. In its December 13, 2 005 resubmission, the NYSE attempted to address my criticism by presenting two dictionary definitions of the word "entitle." Neither of the NYSE's definitions contained any conditional terminology whatsoever. Nevertheless, the NYSE engaged in the same type of circular reasoning, asserting that the definitions demonstrated that "entitle" was a conditional term, and therefore specialists were permitted to trade on parity if floor

brokers did not object, etc. The definitions provided by the NYSE simply define entitle as being given a "right." In its discussion, however, the NYSE speaks of the definitions as referring to an "automatic or unfettered right", terminology that simply does not appear in the definitions as actually quoted by the NYSE. The NYSE is simply substituting its own terminology for the terminology it actually quoted, and then it is using the substituted terminology to justify its position. This is classic circular reasoning.

It is as though the NYSE quoted a definition as stating "up means up" and then turned around and maintained that the definition said "up means down." This is remarkable stuff. The NYSE cannot be permitted to misstate what its authorities actually provide to suit its own purposes.

The NYSE's position here is simply untenable. The NYSE cannot read "conditions" into a rule whose plain language is a simple bar to entitlement, and then use these "conditions" as the basis for "interpreting" the rule as providing the opposite of what it plainly says. (See my December 11, 2005 comment letter on this point, and on the NYSE's point about the canon of statutory construction).

The NYSE, in fact, uses the word "entitle" in other of its rules to express simple prohibitory concepts.

For example, NYSE Rule 117.10 provides that a member is not "entitled" to have his/her bid/offer represented in a tradi ng crowd if the member leaves the crowd. Rather, the member is required (as spelled out in the rule, not a matter of "interpretation") to leave the order with another member if he/she wants to be represented. Surely, the NYSE will not now contend that "entitled" in Rule 117.10 means the opposite of what it plainly says, namely that a member's bid/offer will continue to be represented in the crowd unless another member objects.

The NYSE takes the position that words such as "shall not", "must not", or "prohibit" must appear in NYSE rules for the NYSE to have intended to proscribe specified conduct. Thus, the NYSE argues that because Rule 108 does not contain the word "prohibit", specialist parity acquisition trading was not intended to be barred. The NYSE is demonstrating a shocking and serious ignorance here as to how many of its rules, including most of its key trading rules, are in fact drafted. Most of the NYSE's rules numbered 90 th rough 120 (its key trading rules) express what are clearly prohibitory concepts, but do not use "shall not", "must not", or "prohibit" terminology. These rules employ a "No [member] shall [take a described action]" drafting convention. In context, the "No [member] shall" drafting convention means exactly the same thing as "A member shall not" or "A member is prohibited." Rule 108 follows this exact same drafting convention. Since the NYSE interprets every other rule using this drafting convention as imposing a prohibition, the NYSE must obviously be made to take the same position with respect to Rule 108.

Many SEC and SRO rules proscribe behavior by using terms that are, in context, synonymous with "prohibit." We all know that rules written in different periods of time

express the different drafting conventions of the era in which they were written. The NYSE rule book, in particular, reflects the absence of any singl e, uniform, "cookie cutter" approach to expressing prohibitions. But the context makes perfectly clear when a prohibition is intended, as this the case with the "No [member] shall" drafting convention.

I suggest, for example, that the SEC staff take a look at NYSE Rule 105(a), which employs the same drafting convention as Rule 108 (and most other NYSE rules in the 90-120 series), starting with "No [specialist]" (exactly as in Rule 108) and then using the "shall be" formulation (as in Rule 108), and then indicating the proscribed behavior (In Rule 108, parity trading, in Rule 105(a), having an interest in pool dealings). Clearly, as in Rule 108, the drafting convention expresses a simple prohibition, even though the terms "prohibit", "shall not", or "must not" do not appear in the rule. Would the NYSE argue that Rule 105(a) really meant that specialists could engage in pool dealings so long as no one objected? Of course not. As I noted above, this same "No [member] shall" drafting convention appears in most of the NYSE's key trading rules to express prohibitory concepts.

In context, as most of the NYSE's key trading rules demonstrate, the NYSE's "No [member] shall" drafting convention means exactly the same thing as "A member shall not". The NYSE needs to seriously reconsider its point about how its rules are drafted, as its rulebook contains numerous examples of various formulations that, in context, clearly express prohibitions even though they do not use the word "not" or "prohibit."

I would pose the following to the SEC staff: if someone said to you, "No SEC staff member shall be entitled to take a specific action", would you interpret it to mean that every SEC staff member could in fact take that action unless someone objected? Of course not. You would interpret the statement as meaning that you could not take the action.

It really is that simple with respect to Rule 108.

The Commission must abrogate the immediate effectiveness of SR-NYSE-2005-74 and assert the public interest in the integrity of the Commission's rule approval process by denying the NYSE the ability to use the immediate effectiveness process to effect what is clearly a major, substantive rule change completely at odds with what the rule actually states, and which would effectively rescind a prohibition intended to protect public investors.

2. The "Longstanding Interpretation" Is Contradicted by the NYSE's Own, Recent Statements on This Matter

It is not surprising that the NYSE cannot support its "textual analysis" of the plain language of Rule 108. The NYSE itself did not believe any of this as recently as June 2005. In amendment 5 to SR-NYSE-2004-05, the NYSE stated clearly and

unambiguously , "Currently, 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." (Page 14 of Form 19b-4).

At that time, the NYSE unambiguously understood that this clear prohibition could not be lifted by an "interpretation." The NYSE stated, "The Exchange proposes to amend Rule 108 to eliminate that restriction...." (Page 14 of Form 19b-4). The Exchange went on to refer to the "proposed change to Rule 108."

I have repeatedly pointed out the contradictions in the NYSE's position, and the NYSE has simply "stonewalled" by refusing to even acknowledge this most obvious of points. The inference to be drawn appears clear: the NYSE has no answer.

The public record on this critical point is singularly ugly. How is the public supposed to believe the NYSE's position about a "longstandi ng interpretation" when the NYSE itself did not believe it as recently as eight months ago?

It is clearly in the public interest for the Commission to abrogate the immediate effectiveness of SR-NYSE-2005-74, and insist that the NYSE proceed, as it told the Commission and the public it would, by formal amendment to the text of Rule 108. Anything less seriously compromises the integrity of the Commission's rule approval processes.

3. The "Longstanding Interpretation" Is Not Supported by Any Historical Documentation Whatsoever

This should be a simple, straight-forward matter. When an SRO asserts a "longstanding interpretation", typically it would simply present documentation that clearly and unambiguously refers to the subject at hand. But the NYSE has singularly failed in this most obvious matter of process.

In its origi nal October 25, 2005 submission, the NYSE provided no historical documentation whatsoever. In response to my criticisms, the NYSE, in its December 13, 2005 resubmission, referred to two early SEC studies of floor trading on U.S. exchanges dating from the late 1930s-early 1940s. The NYSE also presented a statement made by the NYSE's president in 1945. This material simply makes broad reference to the regulation of floor trading, and does not refer at all to the specific issue herein, much less to any interpretation of Rule 108 premised on a floor broker objection mechanism. There simply is no linkage whatsoever between this general "historical documentation", the specific "longstanding interpretation" at issue, and the plain language of Rule 108. The NYSE needs to present, but apparently cannot, relevant historical documentation bearing on the precise issue in this matter.

The absence of historical documentation referring specifica lly to specialist parity acquisition trading is not surprising. The only "rationale" offered by the NYSE in support of the "longstanding interpretation" is that "customers" (unspecified) want the specialist to trade on parity with their orders so that there is accompanying volume on the tape. Below, I discuss the problems with the NYSE's position in the current market. But in historical terms, the NYSE's "rationale" is an absolute non-starter.

"Go along"/accompanying volume trading is a phenomenon of the last 20 to 25 years or so, as index-related and derivatives-related trading strategies have come to dominate the equities markets. The NYSE is positing the "interpretation" as "longstanding" and presenting (although to no relevant effect) historical documentation that ends in the mid-1940s, an era when go along/accompanying volume trading was unknown. Clearly, the NYSE's "rationale" is out of sync with its assertion that the "interpretation" is "longstanding."

To justify its assertion of "longstanding", the NYSE would need to show a rationale as to why specialist parity acquisition trading was appropriate to the markets as they existed in the 1930s and 1940s. I submit that there is no such rationale.

In its Amendment 1 to SR-NYSE-2005-74, submitted on January 31, 2006, the NYSE finally submitted a document that referred specifically to Rule 108. The document in question is a 1979 NYSE rule submission in which the NYSE, reacting to the 1975 amendments to Section 11(a) of the Securities Exchange Act, amended Rule 108 to provide, in essence, that a specialist shall be entitled to engage in parity acquisition trading in direct competition with so-called G orders (orders for members/member organisations, not public orders). This "documentation" apparently had some effect on the SEC staff, as the immediate effectiveness of SR-NYSE-2005-74 dates from the offic ial submission date of this material.

Obviously, this "documentation" must have been the subject of prior discussion between the SEC and NYSE staffs. It is most unfortunate that there was no public "sunlight" on this process, particularly in.light of the serious issues that had already been raised, as the NYSE has entirely mischaracterised this material. As I discuss below, the NYSE's treatment of the 1979 rule submission not only does not substantiate a "longstanding interpretation", but is another demonstration of the NYSE's circular reasoning.

The 1979 amendment, by its clear terms, simply provides that a specialist "shall be entitled" (the language provides an exception to the "No specialist" formulation) to engage in parity acquisition trading along with G orders. The amendment made no change whatsoever to the broad "No [specialist] shall be entitled" language with respect to all other orders.

Notwithstanding the simple, and limited, language of the rule amendment, the NYSE proceeds, in the circular reasoning manner it employed in its attempts to define "entitle", to read into the amendment terms that do not appear there, and then use these self-created terms as the basis for its position.

The NYSE states, "In essence, the amendment permitted a specialist to trade on parity with G orders even if the entering member would have objected to parity." The problem with this statement is obvious: it asserts, as a given, that a floor broker objection mechanism already exists in the rule, and that the amendment simply deleted it with respect to G orders. But there is no floor broker objection mechanism in the rule, and the NYSE has produced no pre-1979 historical documentation whatsoever that Rule 108 had been "interpreted" as providing one at that time. This is the NYSE's critical failing here.

The NYSE's presentation in the 1979 rule submission was simple and straight-forward: specialists could compete with G orders, but the restriction on specialist parity acquisition trading with respect to all other order types remained. The rule submission is clear and to the point, and contains no discussion whatsoever that the only purpose of the rule amendment was to delete a floor broker objection mechanism for G orders. How could the rule submission have been otherwise when there is no such concept in the rule?

If the effect of the 1979 rule submission was as the NYSE now claims, surely the NYSE, and the Commission in its approval order, would have said so, if only in passing. But there isn't even the slightest hint of this in any material anywhere. I have reviewed the NYSE's G order Information Memos and can find no reference whatsoever to anything that even remotely supports the NYSE's position. The NYSE is clearly seeking to sup erimpose a year 2006 "creation" on material written more than 25 years ago that clearly was intended to reflect exactly the opposite position.

The NYSE also attempts to quote language in the 1979 rule submission indicating that Rule 108 does not "prohibit" specialist parity acquisition trading. The NYSE notes the following language in the rule submission: "In varying degrees, Exchange Rules 108 and 112 restrict bids and offers of specialists...from having priority, parity, or precedence based on size over orders initiated off the floor....The restriction primarily applies when a member is establishing or increasing a position as opposed to liquidating a position."

In the NYSE's view, "The use of the terms 'restrict' and 'restriction' is significant, as it reinforces the interpretation that NYSE Rule 108 does not, and was not intended to, 'prohibit' specialist parity, but merely 'restrict' it to certain situations - namely where a broker objects to the specialist trading on parity."

The problems with the NYSE's position here are manifold. The most immediately obvious is the familiar circular reasoning issue: reading into the rule a floor broker objection mechanism that doesn't exist there, and then using this as the basis for concluding that specialist parity acquisition trading is not proscribed. This just doesn't work, as discussed above.

The NYSE's point that "restrict" in this context does not mean "prohibit" is untenable. I have discussed above how the NYSE uses various formulations and drafting conventions to express prohibitory concepts, and pointed out that many NYSE rules express such concepts without using the word "prohibit." In particular, I noted how Rule 108's drafting

convention is exactly the same one used in most of the NYSE's trading rules to express a prohibition. "Restriction" and "prohibition", in c ontext, are commonly understood to be synonymous terms. Indeed, and specifically in the context of Rule 108 and the issue of specialist parity acquisition trading, the NYSE itself has used the terms interchangeably. In Amendment 5 to SR-NYSE-2004-05, the NYSE stated: "Currently, 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 Exchange proposes to amend Rule 108 to eliminate that restriction...." (Page 14 of Form 19b-4).

How is that the NYSE could equate "prohibit" and "restrict" eight months ago, specifically in the context of Rule 108, and now expect the Commission and the public to believe that the terms cannot be equated? And, again, I would say to the SEC staff, if someone told you, "The SEC staff are restricted from taking a certain action", would you interpret it to mean that the SEC staff can in fact take that acti on unless someone objects? The answer is obvious. The NYSE clearly needs to rethink its argument.

It is clearly in the public interest for the SEC to abrogate the immediate effectiveness of SR-NYSE-2005-74, and uphold the integrity of its rule approval processes, in a situation where an SRO can provide no historical documentation whatsoever relating specifically to its claim of a "longstanding interpretation" of a significant public investor rule.

4. The "Longstanding Interpretation" Has Never Been Communicated to Anyone

Typically, an SRO propounding a "longstanding interpretation" can point to a record of that interpretation's having been appropriately communicated to its affected constituents. In fact, the "longer-standing" the interpretation, the greater one would expect the record of communication to be. But the NYSE cannot produce even one single document demonstrating that this "longstanding interpretation" has, in fact, been communicated to anyone, ever.

This is deeply troubling, and the public record on this issue severely undermines the NYSE's position. Two major NYSE fiduciary constituencies are on record with the Commission as having no knowledge of the "longstanding interpretation." In its July 20, 2005 comment letter on SR-NYSE-2004-05, the Investment Company Institute expressed its clear understanding that Rule 108 prohibits specialist parity acquisition trading. (Page 3 of letter).

In its December 7, 2005 comment letter, the NYSE's Independent Broker Action Committee (representing more than 100 NYSE floor brokers) expressed a similar understanding that Rule 108 prohibited specialist parity acquisition trading. (Page 4 of letter).

If the NYSE's own floor brokers and its major customers have not heard of the "longstanding interpretation", who has? I should add here that my clients, two large

institutions with active trading portfolios, had never heard of the "longstanding interpretation" either.

By characterising its "interpretation" as "longstanding", the NYSE is implicitly stating that the interpretation is, in fact, a well-known aspect of the way in which the NYSE conducts its business. But, in fact, the exact opposite is the case.

It is manifestly in the public interest for the SEC to abrogate the immediate effectiveness of an SRO-characterised "longstanding interpretation", and essential for maintaining the integrity of the Commission's rule approval processes, where it appears that a "longstanding interpretation" affecting the quality of public order execution is in fact unknown to that public.

5. The Activity Addressed by the "Longstanding Interpretation" Is in Fac t Opposed by the Very Public Whose Interests the NYSE Is Purporting to Address

The only rationale offered by the NYSE to support the "longstanding interpretation" is its assertion that there are (unspecified) "customers" who want the specialist to trade along with their orders because they want to see accompanying volume on the tape. I discussed above how this "rationale" does not work in any historical sense in terms of this being a "longstanding" interpretation.

But, in today's markets, there is a huge difference between having accompanying volume on the tape, and permitting the specialist to compete directly with public orders. As I have demonstrated in earlier correspondence, the NYSE's "follow trade" methodology (standard on openings, CAP and stop order elections, etc.) easily allows for immediately contemporaneous trading that provides accompanying volume against an unfilled contra side imbalance, while precluding direct specialist competition with public orders. This is not "form over substance." Only by strictly adhering to form can the NYSE assure the public that specialist dealer trading is limited only to appropriate circumstances, and does not constitute inappropriate competition with their orders. This is a classic instance in which the form, in effect, becomes the substantive safeguard against the reality, and the perception, of specialist overreaching. I have raised this point in prior correspondence, and the NYSE has not responded, presumably because it cannot.

But even more to the point, two major NYSE constituencies, well familiar with go along trading, are on record with the Commission as being strongly opposed to specialist parity acquisition trading. Both constituencies strongly reject the claim that specialist parity acquisition trading meets the needs of customers.

In its July 20, 2005 comme nt letter on SR-NYSE-2004-05, the Investment Company Institute stated (page 3), "The Institute opposes eliminating the restriction [against specialist parity acquisition trading]. Placing specialists trading for their proprietary account on parity with investor orders misaligns the interests of participants on the Exchange...."

The NYSE's Independent Broker Action Committee, representing more than 100 NYSE floor brokers who typically represent the orders of large institutions, observed, "Entitling the specialists to parity when opening or increasing positions would...have the added negative consequence of increased volatility in the market....Indeed, the specialist's role would be largely shifted from its traditional one of auction facilitator to being much more of a market competitor. The specialist's 'negative obligation' would thus be turned on its head, as specialists would be permitted to use their information and speed advantages to particip ate in proprietary trading to a much greater extent than they are today." (Page 7 of December 7, 2005 comment letter on SR-NYSE-2004-05).

The fact that two major NYSE constituencies, who directly or indirectly act as fiduciaries for millions of individual investors, are strongly opposed to specialist parity acquisition trading should be a huge red flag for the Commission, even irrespective of the issue of understanding the plain language of Rule 108.

It is manifestly in the public interest, and necessary for the protection of public investors, for the Commission to abrogate the immediate effectiveness of SR-NYSE-2005-74, because the underlying matter involves significant and substantial public investor protection issues, as raised, for example, by two major NYSE fiduciary constituent groups. These issues are clearly too important to be dealt with through the "back door" by an immediately effective "longstanding interpret ation" that appears to have been previously unknown and which had never been exposed for prior public comment. Rather, these issues must be dealt with in a properly submitted and justified amendment to the text of Rule 108, with full and fair opportunity for prior public comment.

6. The "Longstanding Interpretation" Is Inconsistent with the Negative Obligation

The specialist's negative obligation prohibits the specialist from effecting dealer trades unless "reasonably necessary to maintain a fair and orderly market." As the NYSE itself has emphasised over the years, the negative obligation imposes a "necessity test" on specialist dealer trading: the specialist should trade only when necessary to promote reasonable trade-to-trade price continuity with reasonable depth. Typically, the specialist is expected to trade to minimise short term disparities between supply and demand. Absent a ny market "necessity" for the specialist's trade, the specialist must refrain from trading.

Specialist parity acquisition trading is the clearest example possible of trading for which there is no market necessity. "Parity" trading means competing with other orders that are fully capable of providing the requisite depth and liquidity at the trade price. The specialist adds no depth and liquidity here and provides no "value added" to the market. The specialist's participation simply means less participation in the trade for the public orders with which the specialist is competing, with the result that the quality of public order executions is frequently degraded. The specialist is not engaging in "market

making" here, because the "market" is already being fully made by the orders against which the specialist is competing. The specialist is simply seizing a proprietary trading opportunity in direct conpetition with public orders, a practice which is precluded by the negative obligation.

Under the negative obligation, a specialist should trade only against an unfilled contra side imbalance, which is an aspect of the market making function. After floor brokers have traded their public orders as they deem appropriate, the specialist would then trade with any unfilled imbalance. This is the process clearly contemplated by the negative obligation, as it ensures that public orders are executed without unwarranted dealer interference, while also ensuring that the specialist will then trade as appropriate against remaining contra side market interest, providing depth and liquidity in the absence of other market interest. This is clearly the process that the NYSE's major fiduciary constituents, such as the Investment Company Institute and the Independent Broker Action Committee, expect to be followed.

I will not repeat here my critici sms of the floor broker objection mechanism, except to say that the NYSE itself thinks so little of it as a meaningful protection for the public that it has eliminated it entirely, as a practical matter, for any broker who wants (as they must) to have their public orders represented in the "hybrid market."

The only reference the NYSE makes in its rule submission to the negative obligation is a statement that specialists are "reminded" of their responsibilities thereunder. This is meaningless, cosmetic fluff, as it references no objective standards as to how direct competition with public orders can be reconciled with the prohibition against trading except when necessary to maintain a fair and orderly market. In reality, such trading can never be reconciled with the negative obligation, and it benefits only the specialist, not the public. How does the NYSE intend to enforce the "reminder" to assure the public that specialists will not unduly interfere with their orders? In reality, it cannot enforce the "reminder", as it has given specialists "open sesame" here.

The NYSE is clearly attempting in this proposal and in its "hybrid market" proposal to significantly "dealerise" the NYSE. This may or may not be appropriate, but what is disturbing is that the NYSE is not forthrightly acknowledging this and proposing appropriate changes to the overall regulatory framework governing specialist trading activity. The NYSE is indulging in the fiction that increased dealerisation can be reconciled with a regulatory framework intended to minimise dealer activity. The NYSE is on a collision course with logic and common sense here. The end result is that the NYSE is stretching rules to the point of meaninglessness, as typified by the "reminder" about the negative obligation at the same time that specialists are being given carte blanche to compete with the public at will. This is a very strange position for a regulator to be putting itself in.

I have repeatedly made these comments about the negative obligation, which are major, fundamental objections, and again the NYSE has simply "stonewalled."

It is manifestly in the public interest, and necessary for the protection of public investors, for the Commission to abrogate the immediate effectiveness of SR-NYSE-2005-74, because the NYSE's proposal obviously conflicts with a regulatory framework clearly intended to put the public's interest ahead of that of the dealer.

A Note on Fairness and Process

This is obviously an awkward matter procedurally, as the SEC's processes (intended for routine, non-substantive matters) do not appear to contemplate receipt of public comments on submissions for immediate effectiveness that are received before the "immediat e effectiveness" in fact becomes effective. But once those comments are received, it is essential, for reasons of fundamental fairness, that those comments be accurately reflected.

The NYSE's self-serving Federal Register notice makes a caricature of my extensive comments, and does not respond at all to my November comments that its position cannot be reconciled at all with its prior statements or with the negative obligation. The NYSE should have been made to respond to my December comments that major fiduciary constituents had never heard of the "longstanding interpretation" and were in fact strongly opposed to the underlying concept. While the SEC staff cannot be the arbiter here, and cannot be expected to permit an endless back-and-forth, they nonetheless have a responsibility to assure the fairness of material that will be publicly disseminated under an SEC Release number.

The NYSE's slanted, one-sided Federal Register notice hardly gives fair notice of all the issues involved here, and is a most inadequate vehicle for soliciting public comment. Most observers view an "immediate effectiveness" notice simply as a non-substantive "done deal", and pay it no mind. That factor, coupled with the abbreviated comment period and 60-day clock, make it unlikely that the Commission will receive comments on what is a highly significant public investor protection issue.

However, the Commission should consider the Investment Company Institute and Independent Broker Action Committee letters I have noted as fully bearing on this proposal, as they clearly address the underlying concept.

Conclusion

If the Commission determines not to abrogate the immediate effectiveness of this proposal, it cannot simply let the matter rest, given the significance of the underlying issue. The NYSE should be made to respond, point-by-point and in a manner which fairly joins issue, with the specific criticisms made. The Commission should "stop" the 60-day clock to give the public a full and fair opportunity to respond. If the Commission

determines again not to abrogate the immediate effectiveness of the proposal, the Commission needs to weigh in with its own assessment of the comments received, and its own views as to the appropriateness of direct dealer competition with public orders.

But the preferable, indeed compelling, course of action is for the Commission to abrogate the immediate effectiveness of the proposal. The NYSE's rule submission is riddled with errors of fact, law, and logic. The NYSE's "textual analysis" of Rule 108 obviously does not withstand scrutiny on any level, and the NYSE cannot find any authority anywhere that supports either the existence of the "interpretation" , or that it is "longstanding."

I have some sympathy for the NYSE. It has obviously permitted this trading practice to occur, and now finds itself in the position of having to "rationalise" it. But the strained circular reasoning process it has to resort to is clearly inappropriate as a matter of rule interpretation. If the Commission's rule approval processes are to work as intended, the "immediate effectiveness" must be abrogated, with the NYSE then submitting an amendment to the text of Rule 108 under the Commission's normal rule approval process.

A separate, and compelling, ground for abrogating immediate effectiveness is the significance of the underlying issue and the impact of the proposal on public order execution. Although the issue appears clouded in the technicalities of an obscure rule, it is in fact of major importance. Public orders will clearly be impacted by the proposal, as direct dealer competition w ill result in lesser "fills", and, as market prices move away from customer limits, will result in remaining order balances that will not be filled, but which could have been filled but for the dealer competition.

The importance of the issue is underscored by the fact that two major NYSE fiduciary constituents are strongly opposed to specialist parity acquisition trading. It is the customers they represent who will be harmed.

Clearly, this issue is too significant to be disposed of as a back-door "immediate effectiveness" rule interpretation where the public had no opportunity for prior public comment.

This issue must be fully and fairly "aired out" in a proposal submitted under the Commission's normal prior public comment process.

Very truly yours,

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