BAKER
&
HOSTETLER LLP
COUNSELLORS AT LAW

666 FIFTH AVENUE • NEW YORK, NEW YORK 10103 • (212) 589-4200 • FAX (212) 589-4201

MARC D. POWERS
WRITER'S DIRECT DIAL NUMBER (212) 589-4216
E-MAIL: MPOWERS@BAKERLAW.COM

February 2, 2006

VIA EMAIL

Nancy M. Morris, Esq.
Secretary
United States Securities and Exchange Commission
Station Place
100 F Street, NE
Washington, DC 20549-9303

Re: Proposed Rule Changes by the New York Stock Exchange Relating to the NYSE/Archipelago Merger (File No. SR-NYSE-2005-77) and the Hybrid Market Proposal (File No. SR-NYSE-2004-05)

Dear Ms. Morris:

This firm is co-counsel with Andrew J. Goodman, Esq. of Kurzman Eisenberg Corbin Lever & Goodman, LLP, in representing Independent Broker Action Committee ("IBAC") in connection with rule filing 2005-77 (the "Merger Proposal") by the New York Stock Exchange ("NYSE"), as well as the NYSE's earlier rule filing (SR-NYSE-2004-05) (the "Hybrid Market Proposal").

Enclosed herewith is IBAC's comment letter relating to this matter. As stated in the letter, analysis of the Merger Proposal reveals that, if it were approved, the NYSE's market and regulatory functions would be under the effective control of NYSE Group, Inc., a public company obligated to maximize profits for its shareholders. The Merger Proposal leaves open many troubling questions as to, among other things, funding of the regulatory function, the operation of the trading floor and potential undue influence of regulated entities which are also major Group shareholders. As further stated in the letter, the Merger Proposal, in conjunction with the Hybrid Market Proposal, would negatively impact trading at the NYSE, in that public investors would face unfair discrimination and be disadvantaged. Competition would be undermined at both the point of sale and in the process for obtaining access to trading rights. Additionally, the floor brokers' business interests would be impaired.

As set forth in the letter, IBAC respectfully requests that the Commission not approve either the Merger Proposal or the Hybrid Market Proposal. Instead, IBAC respectfully requests that, before considering approval of either proposal, the Commission (i) conduct formal public hearings on the issues addressed in IBAC's letter; (ii) require the NYSE to provide statutorily required information regarding the proposals' effects on competition; and (iii) consider the modifications and alternatives to the proposals suggested by IBAC. Finally, IBAC respectfully requests that, unless the NYSE substantially modifies the proposals to address IBAC's concerns, the Commission reject the proposals.

Very truly yours,

Marc D. Powers

cc (with enclosure):

Warren P. Meyers, President
Independent Broker Action Committee

Andrew J. Goodman, Esq.
Kurzman Eisenberg Corbin Lever & Goodman, LLP

Independent Broker Action Committee

Website: www.IBAC.us

February 2, 2006

VIA EMAIL

Nancy M. Morris, Esq.
Secretary
United States Securities and Exchange Commission
Station Place
100 F Street, NE
Washington, DC 20549-9303

Re: Proposed Rule Changes by the New York Stock Exchange
Relating to the NYSE/Archipelago Merger (File No. SR-NYSE-2005-77)
and the Hybrid Market Proposal (File No. SR-NYSE-2004-05)

Dear Ms. Morris:

Independent Broker Action Committee, Inc. ("IBAC") is a not-for-profit corporation whose membership consists of independent brokers on the floor of the New York Stock Exchange ("NYSE"). In the short time of its existence, IBAC's membership has grown to over 100 dues-paying members, reflecting the commitment and concern of the NYSE floor brokerage community with respect to the NYSE's proposals.

Perhaps more than any other constituency that operates on the NYSE floor, independent floor brokers – who act as agents in executing orders to buy or sell stocks on behalf of clients – represent the interests of the investing public. It is with these interests in mind that IBAC has raised issues with regard to the NYSE's proposals to revamp its business and operations. First, we submitted a comment letter, dated December 7, 2005, in connection with NYSE rule filing 2004-05 (the "Hybrid Market Proposal"). We next submitted a letter to the Commission (dated December 16, 2005), concerning the NYSE's plans to auction trading licenses. We write now to comment on NYSE rule filing 2005-77 (the "Merger Proposal"), involving the NYSE's proposals as to its structure, operation and rules in the event it is permitted to merge with Archipelago Holdings Inc. ("Archipelago"). In this letter, we refer to the Hybrid Market Proposal and Merger Proposal collectively as "the Proposals."

As set forth below, analysis of the proposed corporate architecture reveals that the NYSE's market and regulatory functions would be under the effective control of NYSE Group, Inc. ("Group"), which will operate as a public company seeking to maximize profit for its shareholders. Moreover, the NYSE proposal leaves open many troubling questions as to, among other things, funding of the regulatory function, the operation of the trading floor and potential undue influence of regulated entities which are also major Group shareholders. These issues are addressed below under the heading "The NYSE's Proposed Corporate Structure."

As also set forth below, the Proposals, rather than fostering an efficient and competitive marketplace for the benefit of the investing public, would actually negatively impact trading at the NYSE. Public investors would face unfair discrimination and be disadvantaged; competition would be undermined at both the point of sale and in the process for obtaining access to trading rights; and floor brokers' business interests would be impaired.

For the reasons set forth below, we respectfully request that the Commission not approve the Proposals. We respectfully request that, before considering approval of either proposal, the Commission (i) conduct formal public hearings on the issues addressed herein; (ii) require the NYSE to provide statutorily required information, which it has thus far failed to provide, regarding the Proposals' effects on competition; and (iii) consider the modifications and alternatives to the Proposals suggested herein. Finally, we respectfully request that, unless the NYSE substantially modifies the Proposals to correct the deficiencies cited herein, the Commission reject the Proposals.

THE NYSE'S PROPOSED CORPORATE STRUCTURE

There is an inherent tension between for-profit demutualized ownership on the one hand and self-regulatory obligations on the other. An exchange must regulate itself and provide a fair and orderly market under the Securities Exchange Act of 1934 ("Exchange Act"). Conversely, a board of directors' legal obligation to its shareholders is to maximize profit. This is true under the law of both Delaware (which is the proposed NYSE Group's state of incorporation) and New York (the NYSE's principal place of business).

It is well settled that corporate officers and directors stand in a fiduciary relation to a corporation and its stockholders. Specifically, the law requires a corporate director or officer to adhere to "the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would . . . deprive it of profit . . . ."[1]

[1] Guth v. Loft, Inc., 23 Del.Ch. 255, 270; 5 A.2d 503, 510 (1939). See also Foley v. D'Agostino, 21 A.D.2d 60, 66-67, 248 N.Y.S.2d 121, 128 (1st Dep't 1964) ("Officers and directors of a corporation owe to it their undivided and unqualified loyalty.").

This duty to singularly pursue the maximization of corporate profits is inconsistent with the quasi-governmental function of a self-regulatory organization. "One of their principal goals [self-regulatory organizations] is the prevention of inequitable and unfair practices and the advancement of the public interest." S. Rep. 94-75, 1975 U.S.C.C.A.N. 179. A public corporation, managed by directors who are bound to pursue corporate profits, cannot also be entrusted to simultaneously advance the public interest with equal dedication and rigor.

> The impact of demutualization is the creation of another SRO [self-regulatory organization] constituency – a dispersed group of public shareholders – with a natural tendency to promote business interests. To the extent that a well-regulated market is considered by an SRO's owners to be in their commercial interest, demutualization could better align the goals of SRO owners with their statutory obligations. On the other hand, it could also exacerbate the concern . . . that SROs may put their commercial interests ahead of their responsibilities as regulators.[2]

The Commission's November 18, 2004, Concept Release Concerning Self-Regulation[3] (hereinafter "the Concept Release") notes the inherent conflict between these regulatory obligations and demutualized shareholders:

> Another significant conflict of interest for SRO responsibilities is with SRO shareholders. SRO demutualization raises the concern that the profit motive of a shareholder-owned SRO could detract from proper self-regulation. For instance, shareholder owned SROs may commit insufficient funds to regulatory operations or use their disciplinary function as a revenue generator with respect to member firms that operate competing trading systems or whose trading activity is otherwise perceived as undesirable.

Unrelated to profit, the regulatory function must be "strong, vigorous, and sufficiently independent and insulated from improper influence from management or any regulated entity."[4]

> The Exchange Act requires [the Exchanges], as registered exchanges, to conduct oversight of their members and their markets. In conducting such

[2] Fair Administration and Governance of Self-Regulatory Organizations, Exchange Act Release No. 50699 (Nov. 18, 2004), 69 FR 71126 at 71132 (Dec. 8, 2004) (emphasis added).
[3] Concept Release, Exchange Act Release No. 50700 (Nov. 18, 2004), 69 FR 71256 at 71263 (Dec. 8, 2004).
[4] Exchange Act Release No. 48946 (Dec. 17, 2003), 68 FR 74678 at 74687 (Dec. 24, 2003) (order approving proposed NYSE rule change relating to governance and management architecture) (hereinafter, "Order Approving NYSE Governance").

> oversight, the [Exchanges] must comply with, and vigorously enforce, in an evenhanded and impartial manner, the provisions of the Exchange Act, the rules and regulations thereunder and their own rules.[5]

Further, "[T]here must be sufficient independence in the regulatory process to prevail against undue interference or influence from the persons or entities being regulated."[6] The Commission has noted the risk of discriminatory regulatory practices attendant to for-profit ownership:

> Today, a member who trades on an exchange can have an ownership interest in the exchange. However, a member's interest could become so large as to cast doubt on whether the exchange can fairly and objectively exercise its self-regulatory responsibilities with respect to that member. A member that also is a controlling shareholder of an exchange might be tempted to exercise that controlling influence by directing the exchange to refrain from diligently surveiling the member's conduct or from punishing any conduct that violates the rules of the exchange or the federal securities laws. An exchange also might be reluctant to surveil and enforce its rules zealously against a member that the exchange relies on as its largest source of capital.[7]

More subtle, perhaps, but (as noted by the Commission in the Concept Release) no less dangerous, is affording certain constituencies or affiliates trading time and place preferences:

> These advantages, such as greater access to information, improved speed of execution, or enhanced operational capabilities in dealing with the exchange, might constitute unfair discrimination under the Exchange Act . . . .[8]

The NYSE's proposed post-demutualization structure is rife with each and every one of these risks – compromising Exchange operations in favor of short term profits; potential undue influence by major NYSE members; and favoring principal trading over a fair and open agency auction market are all very real problems.

The NYSE proposes to operate both the market and regulation functions as direct second tier wholly-owned subsidiaries of Group. New York Stock Exchange LLC (hereinafter "LLC") is to be wholly-owned by Group. In turn, LLC is to wholly own NYSE Market,

---

[5] In re Certain Activities of Options Exchanges, Exchange Act Release No. 43268 (Sept. 11, 2000).
[6] Order Approving NYSE Governance, supra, 68 FR 74678 at 74687 (Dec. 24, 2003).
[7] Exchange Act Release No. 49098 (Jan. 16, 2004), 69 FR 3974 at 3986 (Jan. 27, 2004) (order approving proposed rule relating to the demutualization of the Philadelphia Stock Exchange).
[8] Concept Release, supra, 69 FR 71256 at 71260 (Dec. 8, 2004).

Inc. ("Market") and be the sole member of NYSE Regulation, Inc. ("Regulation"), a not-for-profit company. However, and of great significance, Group appoints all of LLC's directors. LLC in turn appoints a substantial majority of Regulation's board. LLC will appoint (i) a majority of Regulation's board who are not also Group directors, plus (ii) three Group directors to also serve as Regulation directors.

To avoid legal liability to Group's shareholders, the Group directors on the Regulation board will be required to maximize shareholder profit. Thus, as a practical matter, Group's control over a majority of Regulation's board will also result in the profit motive dominating Regulation. Accordingly, so long as Group controls the appointment of a majority of Regulation's directors, the profit motive will reign supreme, to the potential detriment of regulatory and public interest concerns.

While it is true that Regulation is a separate not-for-profit entity, this does not solve the dilemma. Regulation will not be able to upstream money. Will it have to generate sufficient sanctions and penalties to fund its own operation? Alternatively, will Group and LLC be willing to fund Regulations' expenses in whole or in part regardless of the impact on Group's bottom line? As the Concept Release notes:

> The Commission's supervision of the adequacy of SRO regulatory funding presents considerable challenges. Given the inherent tension between an SRO's role as a business and as a regulator, there undoubtedly is a temptation for an SRO to fund the business side of its operations at the expense of regulation. [9]

This is no chimera: In its November 3, 2005, S-4 Amended Registration Statement ("Registration Statement"), the NYSE stated plans to trim \$200 million of expenses in three years, and it has already started by firing right before Christmas a number of NYSE employees, including squads[10] and coatroom staff. Some of these employees had worked at the NYSE for over 25 years. Similarly, by a January 3, 2006, Memorandum to all its members, the NYSE advised that it would no longer provide support services to timestamps at floor post and booth locations. Nor will the NYSE any longer provide brokers with free handheld electronic units for floor use, instead now charging \$5,000 per unit.[11] A disturbing pattern is developing even at this early stage.

This stands in stark contrast to the NYSE's generosity to itself: reserving (according to the Registration Statement) \$50 million worth of Group stock for its own employees. The NYSE seatholders have gotten their payday by approving the merger; now the NYSE

[9] Concept Release, supra, 69 FR 71256 at 71268 (Dec. 8, 2004).
[10] Squads are messengers who distribute paperwork throughout the floor. Given the recent history of electronic failures on the trading floor, eliminating squads appears "penny wise and pound foolish."
[11] Exchange Act Release No. 53071 (Jan. 6, 2006), 71 FR 2281 at 2282 (Jan. 13, 2006) (notice of filing and immediate effectiveness of proposed NYSE rule change to revise certain fees).

management and employees apparently want their share of the wealth – perhaps blinding them to the problems of their own Proposals.

The NYSE attempts to address the funding issues by Amendment 6 to File No. SR-NYSE-2005-77, Release No. 53073, proposing (at p. 6) to add that:

> There will be an explicit agreement among NYSE Group, New York Stock Exchange LLC, NYSE Market and NYSE Regulation to provide adequate funding for NYSE Regulation.

This vague statement hardly resolves the problem. What is "adequate" funding? Since Group controls the appointment of a majority of Regulation's directors, "adequacy" will be determined by the same conflicted directors who have the responsibility to maximize Group's profitability. This new rhetorical subterfuge thus changes the substance not one iota. A central unresolved structural problem as to appropriate funding remains.

Further, at the very least the possibility of undue influence is a real and practical concern. Various NYSE members will own substantial equity interests in Group by virtue of the large number of member seats they own and the NYSE and Archipelago proposed merger. Thus, these members will be regulated by Regulation and have an influence upon its board composition.

Nor are these concerns fanciful. Charges of regulatory favoritism are not new, and have been leveled at other SROs. Thus, a March 8, 2005, comment letter from the Financial Services Institute responding to the Concept Release noted that group's belief that:

> [T]he SEC is correct when it suggests that SROs (including the NASD) have traditionally failed to enforce rules as aggressively against larger, more influential firms. This is blatantly evident even through a cursory review of NASD's press releases for 2003 and 2004 regarding settled enforcement actions.[12]

Similarly, the former head of equity trading compliance at the Archipelago subsidiary Pacific Exchange claims that, during his time at the Pacific, he "was constantly pressured by senior management to lighten up on the members in a disciplinary way because of the constant threat that the members would take their business elsewhere."[13]

---

[12] Mar. 8, 2005, letter from Dale E. Brown to Jonathan G. Katz, at p. 2. The Financial Service Institute represents independent NASD regulated broker-dealers. Its March 8 letter then went on to provide examples of what it perceives to be unequal enforcement.

[13] Dec. 14, 2004, letter from Kenneth J. Marcus (commenting on Concept Release).

We concur with the Financial Services Institute that fair representation in the governance process is crucial to prevent preferential treatment.[14] Yet, while asking for approval of a structure laden with potential for abuse, the NYSE (although concededly complying with minimum fair representation requirements) actually proposes to decrease the management involvement of its independent constituencies, specifically by eliminating the NYSE Board of Executives (the "BOE"). The BOE was created as part of the overall 2003 NYSE management reorganization. At the time, the Commission noted, "The Board of Executives provides a useful mechanism designed to assure that various Exchange stakeholders continue to have a voice in the decisions of the Exchange . . . ."[15] Yet the present proposed corporate architecture does not include the BOE.

Simultaneously, the NYSE is creating a trading architecture potentially disadvantaging the trading public in favor of large member firms. Presently pending before the Commission is the Hybrid Market Proposal. As our December 7, 2005, comment letter explains, the NYSE's present proposal is incomplete because, while it provides for systematic electronic algorithmic interface for the specialists acting as principal at price parity with order flow, there is as yet no proposal that affords the trading crowd the same opportunity. As described below and in our prior letter, this precludes agency price improvement, in favor of principal trading by broker-dealers.

The NYSE claims to ameliorate these numerous problems by purporting to separate its commercial and regulatory functions into distinct corporations. Upon even a cursory examination, however, the NYSE proposal is wholly ineffective. So long as Group's wholly-owned subsidiary controls the Regulation board – as the NYSE proposes – in reality the regulatory function will be entirely under the thumb of Group's commercial interests.

The NYSE's proposed management structure consequently runs afoul of the Commission's proposed SRO corporate governance rule:

> [T]he Commission is proposing to require exchanges and associations among other things to effectively separate their regulatory function from their market operations and other commercial interests . . .
>
> * * *
>
> Specifically, the proposals would require that the exchange's or association's regulatory program be either: (1) structurally separated from the exchange's or association's market operations and other commercial interests, by means of separate legal entities; or (2) functionally separated

[14] See the March 8, 2005, comment letter from Dale E. Brown to Jonathan G. Katz, supra, at p. 3.
[15] Order Approving NYSE Governance, supra, 68 FR 74678 at 74686 (Dec. 24, 2003).

> within the same legal entity from the exchange's or association's market operations and other commercial interests. In the Commission's view, such separation must be designed to permit the regulatory program to function independently from the market operations and other commercial interests of the exchange or association.[16]

That Group actually intends nevertheless to control the operation of Regulation cannot be doubted.

Initially, and indeed until the January 20, 2006, filing of Amendment 6, the Merger Proposal explicitly provided that Group directors would constitute a majority of Regulation's board. Amendment 6 proffers a modification that the majority of Regulation's board will not also be Group directors. However, LLC – whose own board is entirely appointed by Group – will appoint these "non-Group" Regulation directors. Additionally, three Group directors will also serve as Regulation directors. Thus, Regulation's board will consist of a majority of directors appointed by Group plus three Group directors.

At best, this change is cosmetic; in truth it tightens Group's control over Regulation's board. Before Amendment 6, a majority of Regulation's directors were also Group directors. Now, Group through its appointment power controls a majority of Regulation's board, plus Group has an additional three of its own directors on the Regulation board.

The Concept Release commented on the Commission's proposed SRO Corporate Governance Rules and proffered this observation on models adopting the separate corporate subsidiary approach the NYSE here proposes:

> While the SRO Governance and Transparency Proposal relies on corporate reporting lines to insulate the regulator function, this model would house the regulator and market in distinct corporate subsidiaries that would be governed by separate boards.[17]

Giving in effect "super-majority" control of Regulation's board to Group, Regulation's board cannot be viewed as truly separate.

Further, judicial guidance dictates that an exchange must be controlled by its participants. Judge Posner, writing for the United States Court of Appeals for the Seventh Circuit, explicitly stated that:

---

[16] Fair Administration and Governance of Self-Regulatory Organizations, supra, 69 FR 71126 at 71141-42 (Dec. 8, 2004) (emphasis added).
[17] Concept Release, supra, 69 FR 71256 at 71277 (Dec. 8, 2004) (emphasis added).

> [T]he statute requires that an exchange be controlled by its participants, who must in turn be registered brokers or individuals associated with such brokers. Securities and Exchange Act of 1934, §§ 6(b)(3), (c)(1), 15 U.S.C. §§ 78f(b)(3), (c)(1); Securities Exchange Act Release No. 21439, 49 Fed. Reg. 44577, 44578 (Oct. 31, 1984).[18]

In short, while the NYSE proposal might technically comply with the proposed SRO Governance Rules, certainly it violates at least its spirit by placing Market and Regulation under the effective control of Group's board. Before any approval, then, the NYSE must redo its corporate structure to remedy this defect and effectively divest Group of control over Market and Regulation.

There are other alternative structures. For example, NASD has approached this structural problem by spinning off Nasdaq into a for-profit company accepting outside investors, while preserving the independent regulatory function within the not-for-profit parent framework. Even then, the Commission expressed continuing reservations about granting the Nasdaq exchange status, having solicited comments for more than four years, as to whether, for example, "Nasdaq's proposed structure insulate[s] its regulatory function from its market and other commercial operations so that it may carry out its regulatory obligations under the Exchange Act."[19]

IBAC submits that these complicated and highly significant issues affecting the integrity of the largest securities exchange in the world cannot be resolved in haste, and require appropriate public hearings. As Congress noted in enacting the legislation requiring the opportunity for public input before Commission approval of proposed SRO regulations, "[i]n cases in which fundamental policy issues are involved, however, oral hearings or publicly announced conferences might be most appropriate."[20] Thus, for example, the Commission held public hearings on NSCC's application for registration as a clearing agent, an application much less far reaching than the present one.[21]

The NYSE itself, in commenting with regard to its proposed rule relating to governance and management architecture, acknowledged the complexity of the issues: "Whether self-regulation should continue to be a lynchpin of the securities industry, and if so, how it should be structured, are complex issues on which there are divergent views requiring careful analysis."[22] The Securities Industry Association likewise submitted "that it is time to determine whether our current self-regulatory system offers sufficient checks and

---

[18] Board of Trade of the City of Chicago v. SEC, 923 F.2d 1270, 1272 (7th Cir. 1994).
[19] Exchange Act Release No. 52559 (Oct. 4, 2005), 70 FR 59097 at 59098 (Oct. 11, 2005) (notice of Nasdaq's filing of amendment nos. 4 and 5 to application for registration as a National Securities Exchange).
[20] S.Rep. 94-75, 1975 U.S.C.C.A.N. 179, 1975 WL 12347 (Leg. Hist.) at p. 22.
[21] See Bradford National Clearing Corp. v. SEC, 590 F.2d 1085 (D.C. Cir. 1978).
[22] Dec. 12, 2003, letter from John S. Reed to Jonathan G. Katz, at p. 3.

balances, or whether a different or improved model would provide a greater level of investor protection and regulatory efficiency."[23] By letter dated March 8, 2005, in response to the Concept Release, the Council of Institutional Investors called for "public roundtables and other open forums" to discuss the appropriate SRO regulatory structure.[24]

We now join in that call. We can think of no more significant SRO restructuring in the recent history of our securities markets than that proposed by the NYSE. The largest securities exchange in the world, home to 80% of all securities trades for the world's largest companies, not only seeks to demutualize, but to simultaneously place its regulatory function under the control of directors legally beholden to public shareholders. And it seeks to do so in a context laden with key, unresolved questions already placed front and center by the NYSE's management conduct to date. How will the market and regulatory functions be funded, especially in light of management's stated fiscal objectives and an already evident pattern of service cuts? How can regulation function on a level playing field when it is controlled by a public company whose major shareholders include significant regulated entities? How will the NYSE develop the technology to put systematic electronic price improvement in the hands of IBAC's constituency, especially in a cost-cutting environment controlled by major institutions who can (and frequently do) trade as principals?

IBAC submits that unless and until all these questions are satisfactorily answered, the Commission should not approve the merger between the NYSE and Archipelago and the demutualization of the NYSE. IBAC submits that the present proposal should be rejected for its failure to provide a truly independent regulatory structure. IBAC further submits that any subsequent proposal regarding the post-merger corporate and trading architecture should then be subjected to full and open public hearings before the Commission.

THE AUCTION MARKET AND THE TRADITIONAL ROLE OF THE FLOOR BROKER AT THE NYSE

Throughout its history, the NYSE has operated predominantly as an auction market. The face-to-face auction market has long been recognized as the hallmark of the NYSE's success. As the NYSE itself has stated:

> Independent research shows that auction representation dampens volatility and lowers trading costs, particularly in periods of market stress or order imbalances. The auction model differentiates the NYSE from other

---

[23] Dec. 5, 2003, letter from Marc E. Lackritz to Jonathan G. Katz, at pp. 2-3.
[24] Mar. 8, 2005, letter from Ann Yerger to Jonathan G. Katz, at p. 3.

> markets and provides more stability and significant savings in trading costs.[25]

Consequently, "Nasdaq trades face higher liquidity costs than similar NYSE trades."[26]

Floor brokers play a vital role in the NYSE auction process. Summarizing relevant studies in their 2004 article, The Economic Value of a Trading Floor: Evidence from the American Stock Exchange, Professors Puneet Handa and Ashish Tiwari (of the University of Iowa) and Robert A. Schwartz (of Baruch College of the City University of New York) noted:

> [A 1997] analysis of floor broker participation on the NYSE, find[s] that floor brokers do contribute additional liquidity. [A 1992 study] point[s] out a further advantage of a floor-based trading system: it gives participants the opportunity to observe who trades with whom, how urgently they seem to want to trade, etc. There are a number of other ways in which a floor trader may add value: (a) the trader might obtain knowledge of the presence of a contra party, mitigating price impact; (b) the trader could "round up" multiple counter parties, again cushioning the impact by trading in what may be viewed as a spontaneous call auction; (c) the trader could anticipate periods when liquidity is high and trade more often in larger sizes during such periods; (d) the trader could avoid trading periods when trading is low; and (e) the trader may possess superior ability to read momentum in the market and to time trades accordingly.[27]

Floor brokers are perhaps even more critical when electronic systems malfunction, as they inevitably do on occasion, and as they recently did on June 1, 2005, and November 30, 2005.[28] Indeed, the Japanese market meltdown over the past two weeks should, itself, give the Commission pause in allowing the wholesale electronic conversion of the NYSE trading floor over the next several years.[29]

---

[25] "Hybrid Market – Key Attributes," at www.nyse.com.

[26] Robert Battalio, Brian Hatch and Robert Jennings, Dimensions of Best Execution for Market Orders: Assessing Differences between the NYSE and the Nasdaq Third Market, March 2000 (paper delivered at NYSE conference), at 4.

[27] University of Chicago Journal of Business, Vol. 77, No. 2 (April 2004).

[28] See "Malfunction Briefly Halts Trading on Big Board," New York Times, June 2, 2005 ("Yesterday's breakdown puts the exchange's recent shift to more electronic trading in something less than its best light.")

[29] The Japanese stock market was, until 1999, an auction market like the NYSE. It is now deemed antiquated and lacks liquidity in stressful, volume intense markets. See "Tokyo Exchange to Retool Trading System," Wall Street Journal, p. B1 (Jan. 21, 2006).

Specialists, too, serve critical functions in the auction market: as trade facilitator, managing the auction process and acting as catalyst to bring together buyers and sellers; as agent for customer orders; and as liquidity provider by providing stabilizing capital.[30]

THE NYSE'S HYBRID MARKET AND MERGER PROPOSALS

Since July 2004, when the NYSE first proposed the creation of a "hybrid market" that would purportedly combine the benefits of the NYSE's traditional face-to-face auction market with the opportunity for automatic execution of orders,[31] the NYSE has stressed the importance of preserving a viable and robust auction market. On August 2, 2004, John Thain, the NYSE's Chief Executive Officer, stated that, while adopting the hybrid market, the NYSE wanted "to preserve the unique advantages of the auction system."[32] He explained that the active participation of floor brokers, and their interaction with specialists, has proven vital in maintaining a marketplace that protects the public interest:

> Floor brokers and specialists create these advantages by adding human judgment, the opportunity for price improvement, and lower volatility on the Exchange. The human factor is particularly important at opens and closes, and during times of uncertainty, when earnings surprises or outside events disrupt the market. . . . Fully electronic markets cannot respond well to these types of events, and so prices whipsaw and investors get hurt.[33]

In April 2005, when the NYSE announced its plans to merge with Archipelago, the owner and operator of the all-electronic Archipelago Exchange, the NYSE again acknowledged what market experts recognized, namely, the vital role that the auction market would continue to have at the NYSE: "Many trading experts and market observers contend that, for most NYSE-listed stocks, floor-based trading remains at the core of the NYSE's value proposition, despite the rapid advances of electronic trading."[34] Indeed, the NYSE stated that maintaining a strong auction market is fundamental to investor protection: "Fully electronic markets, [Mr. Thain] contends, don't respond well under market stress and exhibit much higher price volatility."[35]

---

[30] See NYSE Hybrid Training Program e-mail from NYSE, Vol. 12 (Nov. 4, 2005), at www.nyse.com.
[31] See Exchange Act Release No. 50173 (Aug. 10, 2004), 69 FR 50407 (Aug. 16, 2004).
[32] "John Thain's Opening Remarks on the SEC Filing for Approval of Direct+," Public Statements (Aug. 2, 2004), at www.nyse.com.
[33] Id.
[34] "Building Global Competitiveness: NYSE and Archipelago Agree to Merge," NYSE Newsletter (May 2005), at www.nyse.com.
[35] Id.

Throughout this period, the NYSE has also claimed that the hybrid market would allow investors to choose how their orders are executed. As described in the Commission's August 2004 release, the NYSE claimed that "[i]nvestors seeking the speed and certainty of an automatic execution, as well as investors who prefer the opportunity for price improvement provided by an auction market, would both be able to obtain executions in accordance with their preferences on the NYSE."[36]

As the details of the Hybrid Market Proposal have been developed, however, it has become clear that the so-called "hybrid" will, in fact, not allow the auction market to continue to function as it has. The customers of IBAC's members have come to rely on a physical auction at the point of sale for price improvement. In practice, much of the functionality of that physical auction would be lost under the Hybrid Market Proposal. Floor brokers will not be able to react instantaneously to changing market conditions, but rather, in order to interact with incoming orders, will have to place their bids and offers in advance into the electronic NYSE Display Book. As a result, investors who currently rely on the face-to-face auction market will lose, not gain.

Moreover, notwithstanding the public assurances by NYSE management that it would ensure a continued, vital role for the auction market at the NYSE, we have been concerned – particularly since the announcement of the proposed merger with Archipelago – that the NYSE's ultimate plans are to move past any true "hybrid" and phase out the auction market entirely. Recent developments have heightened these concerns. On January 6, 2006, the Philadelphia Stock Exchange ("PHLX") announced that it intends to evolve from a floor-based equity exchange to a fully electronic exchange.[37] Notably, less than a year earlier, the PHLX was touting its transition from a floor-based model to a hybrid market that combined floor-based and automatic executions:

> PHLX XL [the Phlx's electronic trading platform] . . . enhances PHLX's position as the most versatile, cost-efficient marketplace combining the best attributes of electronic and floor-based trading. PHLX XL now enables market makers to electronically deliver streaming quotes on or off the floor, producing even tighter and deeper markets. It enables the PHLX to improve electronic access for customers, broker dealers and market makers while leveraging the advantages of a floor-based environment.[38]

The PHLX, to be sure, is not the NYSE, and any parallels to be drawn from one to the other are necessarily inexact. One might argue that it would be unjustified to be

---

[36] Exchange Act Release No. 50173 (Aug. 10, 2004), 69 FR 50407 at 50407 (Aug. 16, 2004).
[37] "Philadelphia Exchange Confirms CNBC Report," PHLX Press Release (Jan. 6, 2006), at www.phlx.com.
[38] "Philadelphia Stock Exchange Is First Floor-Based Exchange to Complete Rollout of Its Electronic Options Trading System – PHLX XL," PHLX XL Update (Feb. 16, 2005), at www.phlx.com.

concerned that the PHLX's announcement might be a portent that the NYSE, if the Proposals are approved. To the contrary.

Just four days after the PHLX's announcement, the NYSE's Chief Regulatory Officer, Richard Ketchum, was quoted in the press as stating that he expects that the NYSE's hybrid market will move the NYSE from an environment where about 12 percent of the volume occurs through automatic execution to one where a "vast majority" occurs that way.[39] As far as we know, Mr. Ketchum's comment is the first public statement by an NYSE executive acknowledging that the "hybrid" market will actually give automatic execution a strongly dominant role in NYSE trading. And, we fear, once a "vast majority" of NYSE trades are handled via automatic execution, an all-electronic NYSE may be but a slippery slope away.

Any substantial lessening of the role of the auction market at the NYSE would, as explained in our December 7 comment letter, severely impact and disadvantage the investing public, which relies on the face-to-face interaction on the floor of the NYSE to achieve the best prices while minimizing volatility. A complete phase-out of the auction market would destroy what the NYSE itself has cited, as indicated above, as "the core of the NYSE's value proposition."

These ominous developments for the auction market have coincided with developments in the NYSE's plans to merge with Archipelago. On November 3, 2005, over six months after the April 2005 announcement of the intent to merge, the NYSE submitted the Merger Proposal to the Commission. The NYSE has since made a number of amendments to this filing, with the most recent, concerning the NYSE's proposed corporate structure as described above, on January 20, 2006.

Meanwhile, on December 6, 2005, both NYSE members and Archipelago shareholders voted to approve the merger. Over 90% of NYSE members eligible to vote voted in favor. If the merger is completed, each member entitled to receive proceeds from the sale of their interests in the NYSE will receive 80,177 shares in the combined entity, plus $300,000 in cash. As of December 6, 2005, the total value of the deal was approximately $5.11 million for each selling member.[40]

[39] "Reuters Summit – Arca Deal Seen Completed in Feb. – Ketchum," Reuters news article (Jan. 10, 2006), at today.reuters.com.

[40] "NYSE Members Approve Archipelago Merger, Transforming Exchange," Bloomberg news article (Dec. 6, 2005), at www.bloomberg.com. In voting in favor of the merger, NYSE "regular members" were no doubt influenced by the shimmering pot of gold each would receive upon the merger's completion. Floor broker "lessee members," on the other hand, are not burdened by such distraction and, we submit, have a greater focus on ensuring the continued viability of the NYSE marketplace and protecting the interests of public investors.

THE NYSE'S PROPOSAL REGARDING AUCTIONING TRADING LICENSES

One very significant aspect of the Proposals is the NYSE's plans for demutualization; that is, the separation of equity ownership in the NYSE from trading privileges on the NYSE. Under the proposal, after the merger is completed, trading privileges on the NYSE would be available exclusively through annual trading licenses. Each trading license would entitle its holder to physical and electronic access to the trading facilities of Market.

In brief, the quantity and price of trading licenses issued would be determined annually via a "Dutch auction," with each acquirer of a license paying the same purchase price. For each auction, NYSE would set a minimum bid price, which would be no greater than 80% of the clearing price at the last annual auction. At the end of each annual auction, Market would select, as the clearing price, the highest bid price that would allow it to sell the number of trading licenses that would maximize auction revenue to Market, provided that NYSE would sell in the auction between 1,000 and 1,366 trading licenses. Market, however, would have the discretion to select a purchase price below the clearing price but not lower than the minimum bid price. In each auction, the maximum number of licenses for which any single member organization could bid would be limited to the greater of (i) 35 and (ii) 125% of the number of trading licenses utilized by the member organization in its business immediately prior to the auction. With limited exceptions, trading licenses would not be permitted to be leased or transferred.

Despite the fact that the rules regarding these auctions were (and still are) pending before the Commission, the NYSE has already conducted the auction for trading licenses for 2006. On December 8, 2005, the NYSE issued a Special Membership Bulletin announcing that it was moving forward with the first annual auction for trading licenses, with the auction to take place December 20.[41] The NYSE took this action despite acknowledging that the Commission had not yet approved the NYSE's proposal, or indeed the merger itself.

Reaction among NYSE members was swift. The NYSE held an emergency meeting with members at which a number of questions and objections were raised concerning the auction process. On December 14, IBAC delivered a letter to NYSE management, objecting to the holding of the auction prior to Commission approval. When the NYSE did not respond, we delivered a letter to the Commission on the morning of December 16, asking it to act immediately to cause the NYSE to delay the auction.

---

[41] "NYSE Trading Licenses," Memorandum from John A. Thain to NYSE Members and Member Organizations (Dec. 8, 2005), at www.nyse.com.

In the late afternoon of December 16, the NYSE issued a new Special Membership Bulletin, announcing that the auction would be delayed until the first week in January and establishing a maximum bid price of $73,935 for each trading license.[42] But the Bulletin made clear that only the 2006 trading licenses auction would have a maximum bid price. Auctions in subsequent years would proceed without any established maximum bid price.

On January 4, 2006, a NYSE press release announced the results of the trading licenses auction: 1,274 trading licenses were acquired, at the minimum bid price previously established by the NYSE: $49,290 for each license.[43] The NYSE noted that the number of successful bids exceeded the current number of seats being actively used for trading, indicating that some firms have determined to increase their presence at the NYSE. The NYSE did not reveal the identities of the firms or individuals who had acquired the licenses.

THE HYBRID MARKET AND MERGER PROPOSALS, AS PROPOSED, WOULD THWART COMPETITION AND HARM PUBLIC INVESTORS

A. Both the Hybrid Market Proposal and the Merger Proposal Should Be Rejected Because They Both Lack Statutorily Required Information on Possible Impacts on Competition

Under Section 6(b)(8) of the Exchange Act, the Commission has the duty to consider whether any proposed NYSE rules would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. In order to enable the Commission to make this determination, SEC Form 19b-4 requires any SRO filing a proposed rule change to include a specific "Statement of Burden on Competition" (emphasis added):

> State whether the proposed rule change will have an impact on competition and, if so, (i) state whether the proposed rule change will impose any burden on competition or whether it will relieve any burden on, or otherwise promote, competition and (ii) specify the particular categories of persons and kinds of businesses on which any burden will be imposed and the ways in which the proposed rule change will affect them. If the proposed rule change amends an existing rule, state whether that existing rule, as amended by proposed rule change, will impose any burden on competition. If any impact on competition is not believed to be significant burden on competition, explain why. Explain why any burden

[42] "NYSE Trading Licenses," Memorandum from John A. Thain to All NYSE Members and Member Organizations (Dec. 16, 2005), at www.nyse.com.

[43] See "NYSE Inaugural 'SEATS' Auction Produces 1,274 Trading Licenses at Annual Price of $49,290 Each," NYSE press release (Jan. 4, 2006), at www.nyse.com.

> on competition is necessary or appropriate in furtherance of the purposes of the Act. In providing those explanations, set forth and respond in detail to written comments as to any significant impact or burden on competition perceived by any person who has made comments on the proposed rule change to the self-regulatory organization. The statement concerning burdens on competition should be sufficiently detailed and specific to support a Commission finding that the proposed rule change does not impose any unnecessary or inappropriate burden on competition.

SEC Form 19b-4, moreover, stresses the importance for any SRO that proposes a rule change to provide all information required by the form (emphasis added):

> This form . . . is intended to elicit information necessary for the public to provide meaningful comment on the proposed rule change for the Commission to determine whether the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the self-regulatory organization. The self-regulatory organization must provide all the information called for by the form . . . .

Section 19(b)(1) of the Exchange Act provides that no rule changes that an SRO may propose may take effect unless filed with the Commission in accordance with such rules as the Commission may prescribe. In sum, then, the Commission is statutorily prohibited from approving any rule change proposed by the NYSE that does not specifically address the issues identified in SEC Form 19b-4.

In its filings for both Proposals, the NYSE has failed to provide the information required by Form 19b-4. In the Hybrid Market Proposal, the NYSE stated merely, "The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act."[44] Likewise, in the Merger Proposal, the NYSE stated similar language.[45] The NYSE thus did not fulfill its statutory obligations. The NYSE did not state in either proposal that the proposed changes would not have an impact on competition, or conversely that they would burden competition, but that such burden is necessary or appropriate in furtherance of the purposes of the Exchange Act. Rather, the NYSE melded those separate issues into a single issue, and thus failed to abide by the requirements imposed by the Exchange Act and Form 19b-4. For this reason, the Commission should reject both Proposals, at

---

[44] See Form 19b-4, Proposed Rule Change by NYSE, Amendment No. 1 to SR-NYSE-2004-05 (cover letter dated July 30, 2004; Form 19b-4 dated Aug. 2, 2004); Form 19b-4, Proposed Rule Change by NYSE, Amendment No. 7 to SR-NYSE-2004-05 (Oct. 10, 2005), both at www.nyse.com.
[45] See Form 19b-4, Proposed Rule Change by NYSE, SR-NYSE-2005-77 (Nov. 3, 2005); Form 19b-4, Proposed Rule Change by NYSE, Amendment No. 3 to SR-NYSE-2005-77 (Dec. 12, 2005), both at www.nyse.com.

least until such time as the NYSE provides the required information, and the public has been given an appropriate opportunity to comment on it.[46]

B. The Proposals Would Impair Competition and Unfairly Discriminate Against Floor Brokers and Investors

The NYSE's failure to address the competition issue is not merely technical. The Proposals would in fact, if approved, impose significant burdens on competition. And because alternatives, such as those proposed below, could substantially alleviate these burdens, the burdens are not necessary or appropriate in furtherance of the purposes of the Exchange Act. Accordingly, under Section 6(b)(8) of the Exchange Act, the Commission should not approve the Proposals.

Moreover, under Section 6(b)(5) of the Exchange Act, the Commission is to consider whether proposed NYSE rules are "designed to permit unfair discrimination between customers, issuers, brokers, or dealers." The Proposals, however, not only "permit" unfair discrimination, they themselves discriminate against floor brokers and their customers, the investing public. The Commission should therefore reject the Proposals on this ground as well.

As described more fully in our December 7 comment letter, the auction market as it has long existed at the NYSE has produced a fair and competitive marketplace that has worked for the benefit of public investors. In particular, the inherent information and speed advantages that specialists possess have been offset by denying specialists parity when opening or increasing their positions.

The Hybrid Market Proposal would tilt that balance to the detriment of floor brokers and, more importantly, their customers. Specifically, by permitting specialists to trade for their own account with incoming orders using proprietary algorithms, and entitling them to trade on parity with the crowd when opening or increasing a proprietary position, the Hybrid Market Proposal gives unfair discriminatory trading advantages to the specialists.

The proposed rules in the Merger Proposal for future auctions of trading licenses raise additional concerns, particularly in the way those rules would dovetail with the effects of the hybrid market. Because the parity and algorithmic trading provisions of the hybrid market proposal would allow specialists to exploit their inherent advantages, floor brokers would be disadvantaged and could find it increasingly difficult to sustain the profitability of their businesses.

[46] We recognize that prior rule proposals, by the NYSE and other SROs, have been approved even though they included a Statement of Burden on Competition that used a formulation similar to those in the Proposals. Nonetheless, the extent to which any other rule proposals have been approved or rejected does not affect the clear statutory requirements that the NYSE has failed in these Proposals to satisfy.

Another consequence is that, in future auctions, specialists and large institutional broker-dealers may seek to bid for an increasingly higher number of licenses (up to 125% of their prior year's allotment), and may also bid at higher prices than the prior clearing price. As noted above, while the NYSE has not revealed which member organizations did so, some firms apparently began with the January 2006 auction to seek to increase their share of NYSE trading privileges. In such a scenario, floor brokers may find themselves unable to compete, and perhaps wind up with fewer licenses, either because they will not be able to afford to maintain the same number of licenses as before or because the bid price(s) they will be able to afford will be too low to acquire the same number of licenses. This scenario can become a vicious circle, as diminished floor broker profitability decreases the number of floor broker licenses, which further reduces profitability, etc. We recommend a bid cap.

The NYSE's proposed system for auctioning trading licenses may itself lead to a diminished role for floor brokers on the NYSE floor, and a consequently weakened auction market. As discussed above, public investors require a robust auction market. If the auction market falters, the public investor will suffer as a result.

Thus, the Proposals would burden competition in two ways. First, by discriminating against floor brokers and their customers, the Proposals directly restrict competition at the point of sale. Second, by hampering the ability of floor brokers to participate in future auctions for trading licenses, the Proposals burden competition in the market for access to trading rights. The resulting anticompetitive effects, and harm to the public, would include increased share price volatility, wider spreads, consolidation of market power in fewer hands, and the opportunity for collusion, and perhaps collusion itself, among the smaller numbers of competitors.[47]

THE PROPOSALS WOULD UNDULY IMPAIR FLOOR BROKER LESSEES' BUSINESS INTERESTS

Historically, only brokers and dealers who have been approved as NYSE members have been permitted to conduct transactions at the NYSE. Most members, and most floor brokers, are "lessee members" who have obtained the right to conduct transactions on the floor of the exchange by virtue of leases in which they have leased membership rights

[47] We note that the competitive issues discussed here are not the same ones that the U.S. Department of Justice (DOJ) considered in its evaluation of the NYSE's proposed merger with Archipelago. As made clear in the DOJ's press release, the DOJ examined competition among exchanges, and concluded that the imminent entry of regional stock exchanges and other entities would ensure continued competition among markets. "Department of Justice Antitrust Division Statement on the Closing of Its Two Stock Exchange Investigations," press release (Nov. 16, 2005). That analysis has nothing to do with the important issue of competition within the NYSE itself.

from "regular members."[48] Under the NYSE Constitution, during the term of a lease, these floor brokers have the rights of members. With exceptions not applicable here, the Constitution states that "for the purposes of this Constitution and the rules hereunder, the lessee shall be considered to be, and the lessor shall not be considered to be, a member of the Exchange."[49]

Many of the individuals, and many of the firms, operating on the NYSE floor as floor broker lessees have been in this business for years and decades. Individual and firm floor brokers have invested hundreds of thousands of dollars in training and equipment, with the reasonable expectations that they would be permitted to continue to lease memberships. The leases afforded trading rights which, once access to trading on the floor was obtained, permitted brokers to compete fairly for business at the point of sale. These expectations, however, would be overturned if the Proposals are approved and implemented.

One consequence of the Hybrid Market Proposal, as discussed above, is that it puts floor brokers at a trading disadvantage, with the likely result of a significant impairment in their businesses. In addition, one consequence of the Merger Proposal, and more specifically of its system of auctioning trading licenses, is the termination of all seat leases in existence at the time the merger is completed.[50] When done by a governmental body, these consequences would amount to an improper "taking" within the meaning of the Fifth Amendment of the U.S. Constitution.

The Fifth Amendment provides, in pertinent part, that no person shall be deprived of property without due process of law, nor shall private property be taken for public use, without just compensation. The Fifth Amendment generally applies to the federal government, not (in general) to private entities. However, a private entity may be deemed to be a governmental actor, and thus subject to the Fifth Amendment, if its actions are "fairly attributable" to the government.[51] This standard appears to be satisfied here, where the Commission (an instrumentality of the federal government) closely oversees the NYSE's conduct of its business; the Proposals cannot become effective unless approved by the Commission; and the Commission's Regulation NMS is part of the driving force behind the NYSE's move toward the hybrid market.[52] While we are

---

[48] See "New York Stock Exchange Announces Certified Results of Dec. 6 Member Vote on Merger with Archipelago Holdings, Inc.," NYSE press release (Dec. 7, 2005), at www.nyse.com (938 of 1,366 NYSE memberships are leased).
[49] NYSE Constitution, Article II, Section 2.
[50] See "NYSE Trading Licenses and SEATS SYSTEM: Frequently Asked Questions" (Dec. 21, 2005), at www.nyse.com.
[51] Lugar v. Edmondson Oil Co., 457 U.S. 922, 937, 102 S. Ct. 2744, 2753 (1982).
[52] See "Reuters Summit – SEC May Overhaul Stock Trading in Stages," Reuters news article (Jan. 12, 2006), at http://today.reuters.com ("Reg NMS is pressuring the NYSE to shift trading onto automated systems."); see also "Philadelphia Exchange Confirms CNBC Report," PHLX Press Release (Jan. 6, 2006),

cognizant that courts have in certain circumstances found that self-regulatory organizations are not "state actors," here the NYSE proposals are for pecuniary business purposes as opposed to regulatory purposes. Thus, a different view should result.

For there to be a taking of property within the meaning of the Fifth Amendment, two elements must be satisfied: There must be property and there must be a "taking." As for the property element, it is well established that intangible property (such as NYSE membership and access to trading rights) is protected by the Fifth Amendment.[53] As for the taking element, it is also well established that a taking need not involve an act akin to a physical occupation of land or a seizure of portable property. Courts have found that, "if regulation goes too far it will be recognized as a taking."[54] Moreover, even a "non-categorical" (that is, not complete) taking can be the basis of a Fifth Amendment claim.[55] Hence, it appears that the Proposals would effect a taking of the floor brokers' property interests, by significantly damaging their businesses and upsetting their distinct, investment-backed expectations in being permitted access to trade at the NYSE without unfair discrimination or improper burdens on competition. Accordingly, the Commission should consider ways to avoid these unjust and imprudent results to our membership and the investing public.

SUGGESTED MODIFICATIONS AND ALTERNATIVES

As a preliminary matter, we suggest that neither the Hybrid Market Proposal nor the Merger Proposal should be approved until, at a minimum, (i) the NYSE provides the statutorily mandated information relating to burdens on competition, and the public is provided an appropriate period for comment; and (ii) formal public hearings are held regarding the NYSE's proposed corporate restructuring.

Throughout this comment letter and the comment letter we submitted in reference to the Hybrid Market Proposal, we have pointed out numerous deficiencies and weaknesses in the NYSE's proposals. In the event the Commission is considering approving any aspect of the Proposals, we respectfully request that the Commission consider the following modifications or alternatives:

---

at www.phlx.com (stating that Phlx intends to evolve from a floor-based equity exchange to a fully electronic exchange "so we will conform with the SEC requirements under Reg. NMS.")

[53] See Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1003-04, 104 S. Ct. 2862, 2873 (1984).

[54] Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 415, 43 S. Ct. 158, 160 (1922).

[55] See Penn Central Transportation Co. v. New York City, 438 U.S. 104, 124, 98 S. Ct. 2646, 2659 (1978); Cooley v. US, 324 F.3d 1297,1304-05 (2003).

Corporate Structure

- Regulation should be spun off as a completely separate not-for-profit entity totally independent of NYSE Group.

- To help ensure that the views of floor brokers will be heard and their interests protected, the By-Laws of Group, Market and Regulation should provide that the Board of Directors of each of those entities shall at all times include at least one director who is currently affiliated with an active independent floor brokerage business on the NYSE floor.

Hybrid Market

- As we suggested in our December 7 letter, we request that the Commission direct that the NYSE retain its present parity rules and put effective electronic price improvement in the hands of the floor brokers.

- Particularly in light of the NYSE's representations concerning the importance of the auction market, the Commission should decline to approve any proposal that is not reasonably designed to maintain the viability of the auction market.

- The implementation of Reg NMS should be pushed back until the NYSE provides proven technology that will allow agent brokers to compete adequately with the specialists and add value at the point of sale for their customers.

Auction for Trading Licenses

- Each auction in perpetuity should have both a minimum and a maximum bid price set at 20% below and above the prior year's license purchase price.

- To help protect current lease (or license) holders from being squeezed out – i.e., unable to maintain their positions as lease (or license) holders – the rules should provide that an existing lease (or license) holder will be permitted to acquire a license in the following year, at a price no greater than the prior year's clearing price, plus a specified percentage (not to exceed 20%).

- The proposed limitation on the number of licenses for which any single member organization could bid at auction – the greater of (i) 35 and (ii) 125% of the number of trading licenses utilized by the member organization in its business immediately prior to the auction – does not provide adequate protection, because it leaves open the possibility that, over time, large institutional firms may (singly or together) acquire an excessive concentration of licenses. A stricter limitation should be developed, such as limiting the number of licenses a firm acquires or controls to a certain percentage of the total number of licenses available and/or limiting the number of licenses the top five firms acquire or control to a certain percentage of the total number of licenses available.

CONCLUSION

In short, the NYSE's proposed corporate structure is seriously flawed. The Proposals would burden competition and unfairly discriminate against floor brokers and public investors. The Proposals would impair our membership's business interests which they have built on the floor of the NYSE.

We respectfully request that the Commission not approve the Proposals. We respectfully request that, at a minimum, neither Proposal be approved until (i) the NYSE provides the statutorily mandated information relating to burdens on competition, and the public is provided an appropriate period for comment; and (ii) formal public hearings are held regarding the NYSE's proposed corporate restructuring. We further respectfully request that, in the event the Commission is considering approving any aspect of the Proposals, it consider the modifications and alternatives described above.

Respectfully submitted,

INDEPENDENT BROKER ACTION COMMITTEE, INC.

By: Wa My
Warren P. Meyers, President