

**INTERACTIVE BROKERS  
THE TIMBER HILL GROUP**

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**David M. Battan**  
Vice President and General Counsel

December 29, 1999

**VIA HAND DELIVERY**

Jonathan G. Katz, Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

**Re: Short Sales, File No. S7-24-99**

Dear Mr. Katz:

Interactive Brokers, on behalf of itself and its parent company, The Timber Hill Group<sup>1</sup>, respectfully submits these comments on the concept release issued by the Commission regarding the short sale rule. For the reasons described below, we believe that the short sale rule has outlived its original purpose and that its costs outweigh the benefits – if any – it provides. We therefore recommend that the Commission eliminate the rule.<sup>2</sup>

We commend the Commission for enumerating a number of other potential solutions to the problems created by the rule, short of repeal (e.g., focusing short sale restrictions on certain market events and trading strategies). However, we think that these other approaches will be complex and difficult to administer and will create potential

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<sup>1</sup> The Timber Hill Group includes Timber Hill LLC, Interactive Brokers LLC and other affiliates which, through the use of proprietary communications technology, trade standardized derivative investment products on organized securities and futures exchanges worldwide. Timber Hill LLC is registered with the Commission as a broker-dealer and is a member in good standing of the Chicago Board Options Exchange, American Stock Exchange, National Association of Securities Dealers, Philadelphia Stock Exchange and Pacific Exchange. Interactive Brokers LLC, also a registered broker-dealer, engages exclusively in agency trading. It is a member in good standing of the Chicago Board Options Exchange, American Stock Exchange and Philadelphia Stock Exchange, where it offers execution of customer orders in all option classes.

ambiguities that will make enforcement of any new rule very difficult. Rather than trying to patch-up the existing rule, we think the better and simpler approach is to eliminate it.<sup>3</sup>

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The Rule Artificially Constrains Market Movement. Markets function best when they are accessible, transparent and competitive. Any rule that artificially constrains the market should be scrutinized carefully by the Commission and should not be maintained in the absence of a compelling justification. By limiting the circumstances under which short sales may be effected, Rule 10a-1 reduces liquidity, impairs the free flow of capital and reduces the efficiency of the price discovery mechanism. Moreover, as the Commission has noted there is little evidence that the short sale rule provides any meaningful brake – nor probably could it – on downward market movements, yet there is some evidence that it hampers ordinary market activity in normal or upward markets.

Market Changes Since Rule’s Enactment. When the short sale rule was enacted in 1938, its negative side effects may have been warranted given the recent abuses the rule was meant to address. Sixty years later, however, the market has changed profoundly, and the benefits of the rule are much more abstract. As the Commission noted in its concept release, markets are far more transparent and liquid than in the late 1930s. “Bear raids” and other market manipulations are therefore many times more difficult and risky for the potential manipulator than six decades ago. Likewise, with advances in technology and expanded Commission and SRO regulatory presence, market surveillance and enforcement efforts are a far more serious deterrent to market manipulation than before.

There is also no reason to believe that downside market manipulation is any easier or more likely than upside manipulation. Indeed, in today’s momentum-driven bull market, the opposite may be true. Yet it is difficult to imagine anyone suggesting implementation of a “downtick” rule that would prevent purchase of stock except on a downtick in order to slow fast upward market moves. This highlights that the short sale rule is something of a historical anomaly and is too blunt and antiquated an instrument to remain on the Commission’s books.

Costly and Difficult to Administer. In addition to its negative impact on market efficiency, the rule is costly and difficult to administer and is a potential trap for the unwary for broker-dealers and their customers. With the proliferation of trading systems and trading sessions, the administrative burden of the short sale rule has increased dramatically, and careful broker-dealers have had to spend an extraordinary amount of time, effort and expense attempting to comply with various trading venues’ implementation of it.<sup>4</sup> The systems and procedures of ECNs, Nasdaq and the New York Stock Exchange all vary with respect to the short sale rule. In after-hours trading, the situation is even

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<sup>3</sup> If the Commission is wary of permanently eliminating the rule from the outset, it could suspend the rule for a trial period of one-year or some other time period, in order to evaluate the result.

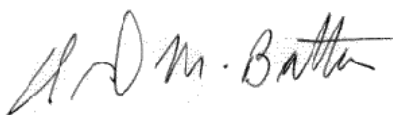
<sup>4</sup> For example, specialists on the New York Stock Exchange generally will enforce the strictures of the rule and will not execute orders in violation of the uptick provision. The Nasdaq system places the burden on the broker-dealer, however, and will execute an order in violation of the rule.

worse, as treatment of the short sale rule is inconsistent and perpetually in flux.<sup>5</sup> This not only results in hefty compliance costs, but it creates tremendous confusion among customers, who have difficulty understanding the policy or operation of the rule to begin with.<sup>6</sup>

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In short, because of the substantial changes in the markets since it was implemented, and because of its administrative burden and its interference with the free operation of the markets, we respectfully recommend that the Commission repeal Rule 10a-1.

Sincerely,

A handwritten signature in black ink that reads "David M. Battan". The signature is written in a cursive, slightly slanted style.

David M. Battan  
Vice President and General Counsel

cc: James Brigagliano, Esq.  
Alan Reed, Esq.  
Michael Trocchio, Esq.

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<sup>5</sup> For example, listed stocks cannot be sold short after-hours at any price lower than the closing price on the consolidated tape, acting as a significant and seemingly unjustified limitation on after-hours short sales. On Nasdaq, on the other hand, the short sale rule does not apply at all after-hours. This is a good example of the arbitrariness of the rule's operation.

<sup>6</sup> Likewise, SROs devote significant financial and personnel resources to enforce the short sale rule, which could better be spent on other matters.