



November 13, 2009

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File Nos. 10-193 & 10-194 – Response to Comment

Dear Ms. Murphy:

Direct Edge Holdings, LLC¹ (“Direct Edge”) appreciates the opportunity to respond to comments² submitted by The NASDAQ OMX Group, Inc. (“NASDAQ OMX”) with respect to the Notice of Filing of Applications, as Amended, by EDGX Exchange, Inc. (“EDGX”) and EDGA Exchange, Inc. (“EDGA”, and collectively with EDGX, the “Applicants”) for Registration as National Securities Exchanges under Section 6 of the Securities Exchange Act of 1934, Securities Exchange Act Release No. 60651 (September 11, 2009), 74 FR 47827 (September 17, 2009) (File Nos. 10-193 and 10-194) (the “Applications”). In general, NASDAQ OMX’s comments fail to raise any legal issues regarding the Applications under the Securities Exchange Act of 1934 (“Exchange Act”) as currently in effect and interpreted by the Commission. Accordingly, we urge the Commission to approve the Applications.

NASDAQ OMX’s concerns are based on a combination of factual inaccuracies, legal inaccuracies, and its advocacy for future Commission regulatory action, and are inconsistent with current practices of NASDAQ OMX itself and other licensed exchange operators.

NASDAQ OMX makes a variety of arguments and in its attempt raise concerns regarding the Applications. Direct Edge offers its summary responses to each of the principal arguments, in the approximate order put forth in the NASDAQ OMX Letter:

NASDAQ OMX claims that “because [Exhibit K of the Applications] fails to provide meaningful information about the persons that actually will control the Applicants..... the Applications are not in technical compliance with the requirements of Form 1”.³

This comment reflects a misunderstanding of the requirements Exhibit K of Form 1, which solely require non-member owned, corporate-form exchanges to provide a list and related information regarding “each shareholder that directly owns more than 5% of a class of a voting security of the applicant.”⁴ Regarding the Applicants, the only entity meeting such definition is Direct Edge Holdings, LLC, and the requisite information has been provided in Exhibit K to the Applications.

¹ Direct Edge currently operates the third-largest stock market for the trading of U.S. equity securities, behind only NYSE Euronext and NASDAQ OMX. More information about Direct Edge is available at <http://www.directedge.com>.

² Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX, to Elizabeth M. Murphy, Secretary, Commission, dated November 11, 2009 (“NASDAQ OMX Letter”).

³ *Id.*, at 2.

⁴ See Application for, and Amendments to Application for, Registration as a National Securities Exchange or Exemption From Registration Pursuant to Section 5 of the Exchange Act, available at <http://www.sec.gov/about/forms/form1.pdf>, at 6 (“Form 1”).

NASDAQ OMX also appears to mistakenly construe the requirements of Form 1 to either mandate some broader disclosures with respect to some undefined group of “actual control persons” beyond what Exhibit K (or any other part) of Form 1 requires. While Exhibit C does require certain disclosures regarding “affiliates”, defined as “any person that, directly or indirectly, controls or is under common control with, or is controlled by” an exchange applicant,⁵ and Exhibit K requires a determination as to whether or not any entity described therein has “control” as defined in the Form 1 instructions, no further information is required. In publishing the applications, the Commission has already made the determination that the Applications “provide detailed information on how [the Applicants] propose to satisfy the requirements of the Exchange Act.”⁶

NASDAQ OMX claims that “insofar as the Applicants fail to provide any discussion or analysis about how they and their actual owners will manage conflicts of interest that may exist in the proposed ownership structure... the Commission will need to evaluate whether the Applicants have met their burden of demonstrating that they are organized in a manner that will allow them to comply with the requirements of Section 6 of the Act.”⁷

This claim, and the related request of NASDAQ OMX to “the Commission to reject the Applications as incomplete,”⁸ appear to misunderstand the requirements of a Form 1 application. A Form 1 applicant that is a corporation is required to provide certain information regarding its subsidiaries, affiliates and 5% shareholders, and make a determination as to whether such shareholders have “control”, as those terms are defined therein.⁹ Aside from these requirements, no further “discussion” or “analysis” is required, with respect to these parties or any other. The absence of such discussion or analysis in the Applications does not affect their completeness, nor does it in any way heighten or otherwise alter the Commission’s responsibilities with respect to the scope or timing of their review and approval.

These claims are also conflated with NASDAQ OMX’s argument that the ownership structure of Direct Edge, as discussed below, means “that the Applicants must take special measures to manage conflicts of interests and bias..... and must thoroughly describe those measures in advance of registration to allow the Commission and the public to evaluate them.”¹⁰ As discussed in further detail below, NASDAQ OMX’s advocacy for future, more stringent restrictions on market infrastructure ownership do not affect the current obligations of the Applicants. To the extent that new “special measures” for self-regulatory organizations are adopted by the Commission, and more “thorough” descriptions of such measures are required in the related Form 1, the Applicants would comply at such time. Until such time, the only obligation of the Commission is to grant the registrations if it finds that the current requirements of the Exchange Act and the rules and regulations thereunder with respect to the Applicants are satisfied.¹¹

⁵ *Id.*, at 3.

⁶ Securities Exchange Act Release No. 60651, at 1.

⁷ NASDAQ OMX Letter, *supra* n.2, at 2.

⁸ *Id.*, at 6.

⁹ See Form 1, *supra* n.4, at Exhibits C, D and K, and at Instructions.

¹⁰ NASDAQ OMX Letter, *supra* n.2, at 8.

¹¹ 15 U.S.C. 78(s)a.

NASDAQ OMX insinuates that the ownership structure of Direct Edge would allow for “concentrated dealer control [with] the potential to affect numerous aspects of the operations of both the exchange and its member/owners” and “believes the time is ripe for the Commission to evaluate the trend of remutualization of exchanges subject to control of a small subset of brokers.”¹²

This argument, made in several forms throughout the NASDAQ OMX Letter, is predicated on the assertion by NASDAQ OMX belief “that the Commission should consider not only the risk of inadequate surveillance and enforcement, but also the risk that exchanges will be operated for the benefit of a small number of member/owners with consolidated ownership well in excess applicable to a single member” and “the possibility that multiple owners, each owning 20%, could have a commonality of interest that causes them to act in concert on a consistent basis.”¹³ NASDAQ OMX cites what it believes to be Congressional focus on these issues,¹⁴ lectures the Commission as to what NASDAQ OMX believes to be the Commission’s responsibility to “provide active oversight” in such circumstances,¹⁵ and makes myriad permutations of the same underlying argument: NASDAQ OMX objects to the “trend towards remutualization”¹⁶ and believes that regulation should be enacted to further standardize and restrict broker-dealer ownership of exchanges, alternative trading systems and other market infrastructure. The seminal inference of these arguments is that the approval of the Applications should be delayed until these regulations are adopted or the issues otherwise resolved.

By their very nature, this line of argument conflates NASDAQ OMX’s advocacy for future regulation with current requirements. The ownership and governance structure of Direct Edge and the Applicants comport with all the requirements of the Exchange Act and regulations thereunder, and are substantially similar with respect to both broker-dealer ownership and participation of representatives of said owners on both holding company and exchange governance bodies. The clearest of examples of these similarities are with respect to the National Stock Exchange, the Chicago Stock Exchange and BATS Exchange, Inc.¹⁷ NASDAQ OMX’s call for new regulation does not in any way change the fact that the Applications are in compliance with respect to requirements for the operator of a national securities exchange, and as such that they should be approved by the Commission.

All of the issues raised in this vein by NASDAQ OMX are within the scope of the Commission’s “ongoing review of SRO structure, governance and transparency.”¹⁸ Direct Edge acknowledges the importance of this review, but also agrees with Commission’s rejection of the argument that said review should result in a Commission-imposed moratorium on all rule filings and other matters that may be impacted by the issues

¹²NASDAQ OMX Letter, *supra* n.2, at 4, 8.

¹³*Id.*, at 3-4.

¹⁴*Id.* at 4. Direct Edge notes that several market structure issues have received similar levels of Congressional attention recently, including short-selling, sponsored access, high-frequency trading, co-location and payment for order flow through exchange rebates and other means. See Testimony of the Hon. Senator Edward D. Kaufman before the Senate Banking Committee, October 28, 2009, available at http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=a26871a3-7049-48b3-86c4-157af1be89da. Direct Edge believes it would set a disturbing precedent were such attention to be interpreted to immediately alter the responsibilities and requirements of the Commission, self-regulatory organizations or other industry participants.

¹⁵*Id.* at 6.

¹⁶*Id.*

¹⁷See, e.g., Exchange Act Release No. 57322 and related forms and exhibits (February 13, 2008) (regarding the Notice and Filing of Application and Amendment No. 1 of BATS Exchange, Inc. for Registration as a national securities exchange).

¹⁸Securities Exchange Act Release No. 59039 (December 2, 2008), at 6-7, referencing Securities Exchange Act Release Nos. 50699 & 50700 (December 8, 2004).

contained therein. In December of 2008, the Commission approved a proposed rule change related to the sale by NYSE Arca of certain proprietary market data products.¹⁹ Several commentators called for a moratorium on all proposed rule changes related to market data products and fees due to SRO structural and governance issues inherently intertwined with market data policy issues.²⁰ In response, the Commission stated that it “does not, however, believe that imposing a moratorium on the review of proposed rule changes... would be appropriate or consistent with the Exchange Act. A primary Exchange Act objective for the national market system is to promote fair competition. Failing to act on the proposed rule changes of particular exchanges would be inconsistent with this Exchange Act objective, as well as with the requirements pertaining to SRO rule filings more generally.”²¹ During the debate, NASDAQ OMX strongly supported the Commission’s approach, stating that such a “moratorium is contrary to the agency’s obligation under the Securities Exchange Act of 1934, and has damaged the competitiveness of the U.S. capital markets both domestically and internationally.”²²

Direct Edge believes the highly similar nature of both the issues raised and the implied approach advocated by NASDAQ OMX warrants a similar Commission conclusion: that while the arguments raised by NASDAQ OMX reflect on important issues regarding SRO structure, governance and transparency, the ongoing review of said issues by the Commission is the appropriate vehicle to address them. Commission action with respect to its approval of the Applications should not be affected in the interim.

NASDAQ OMX claims that there are “inadequacies” and “deficiencies” in the rulebooks of the Applicants by virtue of their inclusion of order types that would use flash technology, and by failing to clearly require the registration of all associated persons and the registration of one or more principals at each member firm.²³

The rulebooks of the Applicants do in fact reference usage of flash technology, at times also known as “step up” functionality, as currently in use by Direct Edge ECN LLC, a predecessor entity of the Applicants. In connection with and as reflected in the Applications, the Applicants note that their use of flash functionality as described is the same as that used currently by Direct Edge ECN, LLC, and Applicants agreed to amend the Applications to comply with any Commission rulemaking in this area.²⁴ Accordingly, no further action regarding this matter is warranted by the Commission on this topic pending the outcome of such rulemaking.

With respect to rule revisions governing registration of associated persons of members, and requiring at least one or more associated persons of a member to be registered as a principal, Direct Edge is aware of the Commission dialogue with various self-regulatory organizations on this topic. As with similar topics such as sponsored access, consolidated market surveillance and other issues that affect multiple SROs, Direct Edge would anticipate amendment of the Applications upon final determination by the Commission of the appropriate course of action, or amendments to the rules of the Applicants should such resolution occur after the approval of the Applications.

¹⁹ See generally *Id.*

²⁰ See *Id.*

²¹ *Id.*, at 7.

²² Letter of Jeffrey S. Davis, Vice President and Deputy General Counsel, NASDAQ OMX, to Florence Harmon, Acting Secretary, Commission, August 1, 2008, at 1.

²³ NASDAQ OMX Letter, *supra* n.2, at 6-7.

²⁴ See Letter from William O’Brien, Chief Executive Officer, Direct Edge Holdings LLC, DECN, EDGX, and EDGA, to James Brigagliano, Co-Acting Director, Division of Trading and Markets, Commission, dated August 10, 2009.

NASDAQ OMX asserts that because a schedule of fees, dues and other charges are not included with the Applications, “this omission makes the Applications deficient, since the Applicants have not actually filed all of the rules under which they propose to operate.”²⁵

This argument ignores current Commission requirements of all self-regulatory organizations regarding the approval process for their execution facilities, which merely require the requisite fee filings prior to the operational effectiveness of the relevant facility. NASDAQ OMX itself followed this long-established precedent regarding the creation of its NASDAQ BX facility²⁶ and the NASDAQ Options Market. Other self-regulatory organizations follow the same protocol. The Applicants fully expect to file the appropriate fee filings after approval of the Applications, but prior to operational effectiveness of the Applicants’ facilities, consistent with this practice.

NASDAQ OMX also attempts to draw the Applicants into its own attempts to eliminate Commission proscriptions on cross-subsidization of pricing across facilities of distinct self-regulatory organizations.²⁷ While Direct Edge is somewhat sympathetic to NASDAQ OMX’s efforts where the relevant SRO memberships are overwhelmingly similar, the Applicants fully expect to comply with current Exchange Act requirements in this area when the requisite fee filings are made.

Conclusion

Direct Edge would summarize its response as follows – the NASDAQ OMX Letter fails to raise any legal issues regarding the Applications under the Exchange Act as currently in effect and interpreted by the Commission. To the extent NASDAQ OMX has touched upon issues of broader application with respect to SRO structure, governance and transparency, these issues should continued to be addressed in the context of the Commission’s ongoing review of these areas without, formally or informally, delaying Commission action with respect to the Applications. Accordingly, we urge the Commission to approve the Applications notwithstanding the comments of NASDAQ OMX.

Sincerely,



William O’Brien
Chief Executive Officer

²⁵ NASDAQ OMX Letter, *supra* n.2, at 7.

²⁶ See Securities Exchange Act Release No. 58927 (November 10, 2008) at 18 n.20, (noting that, in proposing NASDAQ BX facility rules that “the Exchange’s fees other than listing fees, which will be included in a separate filing.”). These fees were filed on January 14, 2009 several weeks subsequent to the Commission’s approval of NASDAQ BX, and two days prior to the operational effectiveness of the facility. See Securities Exchange Act Release No. 59337 (February 2, 2009).

²⁷ See generally SR-NASDAQ-2009-54 (June 24, 2009).

Ms. Elizabeth Murphy, Secretary

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cc: Hon. Mary Schapiro, Chairman
Hon. Luis A. Aguilar, Commissioner
Hon. Kathleen L. Casey, Commissioner
Hon. Troy A. Paredes, Commissioner
Hon. Elisse B. Walter, Commissioner
Robert W. Cook, Director, Division of Trading and Markets
James A. Brigagliano, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets
David Hsu, Senior Special Counsel, Division of Trading and Markets
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