NetCoalition.com

July 10, 2008

VIA Electronic Submission

U.S. Securities and Exchange Commission
100 F Street, N.W.
Washington, DC 20549

Attention: Ms. Florence E. Harmon, Acting Secretary

Re: Proposed Order Approving Proposal by NYSEArca, Inc. to Establish Fees for Market Data and Request for Comment (SEC Release No. 34-57917)

Dear Chairman Cox and Commissioners:

On behalf of NetCoalition,[1] I write to respond to the Commission's invitation for comments regarding the above captioned release. The proposed order ("Proposed Order") flows from the Commission's December 27, 2006 order granting NetCoalition's petition for review of the Division of Market Regulation's action in approving by delegated authority file No. SR-NYSEArca-2006-21. We are appreciative of the Commission's decision to grant the NetCoalition Petition and appreciative of the enthusiastic and thoughtful support the Petition received from commenters.[2] It is our understanding that the Commission has rarely, if ever, approved such a petition for review. We believe this step underscored the critical importance to the investing public of addressing the issues raised in the NetCoalition Petition. Unfortunately we believe the Proposed Order — which would establish fees for certain market data that NYSEArca had previously made available without charge — does not correctly analyze the legal, economic and policy issues raised by the NYSEArca proposal and the NetCoalition Petition. If the Commission were to issue the Proposed Order as a final order, that action would be reversible as a matter of law by the United States Court of Appeals.

The Internet is one of the most dynamic forces in our economy, creating new ways of doing business and providing unprecedented convenience, choice and access to information for hundreds of millions of users worldwide. As the collective public policy voice of many of the world's leading

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1 NetCoalition represents some of the Internet's most innovative companies, including Bloomberg LP, CNET Networks, Google, IAC/Interactive Corp., Yahoo! and various local and State ISPs.

2 Commenters in Support of the NetCoalition Petition include the Securities Industry and Financial Markets Association; Financial Services Roundtable; United States Chamber of Commerce; American Bar Association Committee on Federal Regulation of Securities; Chairman Kanjorski of the House Financial Services Committee's Subcommittee on Capital Markets, Insurance & Government Sponsored Enterprises; the National Stock Exchange; Citigroup; Bloomberg L.P. and Charles Schwab & Co.

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Internet companies, NetCoalition is committed to building user confidence in the Internet through responsible market-driven policies; preserving the open and competitive environment that has allowed the Internet to flourish; and ensuring the continued vitality of the Internet through active dialogue with policymakers. As will be discussed below, we believe the Proposed Order runs contrary to these objectives and will increase consumer costs, create an inferior consumer market, potentially reduce significant consumer protections and rob the public of the benefits that would flow from a truly competitive regulatory framework.

If the Proposed Order is implemented, the Commission will miss an important opportunity to take advantage of the Internet and technological realities that, if permitted to be fully utilized, can provide consumers with more transparency, lower costs, and better information upon which to make financial decisions. The Proposed Order supports a framework that would perpetuate artificial and nonsensical barriers to the flow of market information that only promotes the interests and profit-motives of the Self-Regulatory Organizations (SROs).

We respectfully request that the Commission set aside the Proposed Order until such time as the Commission is able to consider and implement a statutorily-supported transparent process for evaluating market data fees, which we believe will result in the making available of more and better market information for the investing public.

A. Outline of Proposed Order

On May 23, 2006, NYSEArca filed its proposed fees with the Commission, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 19b-4, 17 C.F.R. §240.19b-4.[3] On October 12, 2006, the Division of Market Regulation[4] approved the Proposed Rule pursuant to delegated authority (the "Staff Approval").[5] On November 6, 2006, NetCoalition filed its petition with the Commission pursuant to Rule 430 of the Commission's Rules of Practice, 17 C.F.R. § 201.430, requesting that the Commission set aside the Staff Approval. On December 27, 2006, the Commission granted the Petition and sought additional comment.[6] On June 4, 2008, the Commission published the Proposed Order, inviting further comment.[7]

The goal of the Proposed Order is to introduce a "market-based" approach to assessing market data proposals. To do so the Commission draws a distinction between what the Proposed Order describes as "core data" and "non-core data." Under the Proposed Order, "core data" consists of best-price quotations and comprehensive last sale reports of all markets that are consolidated and

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3 SEC Release No. 34-53952 (Jun. 7, 2006).

4 Now, the Division of Trading and Markets.

5 SEC Release No. 34-54597 (Oct. 12, 2006).

6 SEC Release No. 34-55011 (Dec. 27, 2006).

7 SEC Release No. 34-57917 (Jun. 4, 2008).

distributed by a central processor. By contrast, "non-core" data is defined as information voluntarily distributed by exchanges and other market participants. "Non-core" data thus includes NYSEArca depth-of-market data.

According to the Proposed Order the analysis for assessing fees charged for "non-core" data would be as follows. The Commission looks to whether the exchange was subject to "significant competitive forces" with respect to the terms it set, including any level of fees. If the Commission believes such "significant competitive forces" exist, then the terms would be presumptively valid unless the Commission determined that there is a "substantial countervailing basis" to find that the terms still failed to meet an applicable requirement of the Exchange Act or its rules. If no "substantial competitive forces" are identified, the exchange then would be required to provide a "substantial basis" in its proposed rule change demonstrating that the proposed terms are nonetheless equitable, fair, reasonable and not unreasonably discriminatory.

B. "Core" versus "Non-Core" Data"

The terms "core" and "non-core" data are found nowhere in the Exchange Act. In setting out the legal standards applicable to exchange rule proposals, the Exchange Act references quotation and transaction data. Not only do the terms "core" and "non-core" data not appear in the Act, but it appears that the first time these terms appear is more than 25 years *after* passage of the 1975 Amendments, appearing in the "Seligman Commission Report."[8] While no conclusions seemed to have been reached regarding "core" and "non-core" data by the Seligman Commission, we would note that the reflections of an advisory panel cannot override a statute passed by the Congress and signed by the President. We also note that the Seligman Commission—unlike the Congress—did not include representation from outside of Wall Street.

The Commission has specified in its rules the data that must be consolidated pursuant to national market systems plans approved by the Commission, and the contexts in which consolidated data must be displayed. *See* Rule 603(b) and (c) of Regulation NMS. "Core data" is just a term that the Commission uses to describe data that *must* be consolidated.[9] "Non-core" data describes that data which is not consolidated. These terms are important in some contexts — *i.e.*, the Commission's trade-through rule (Rule 611 of Regulation NMS) — but these terms cannot override the statutory terms governing market data.

It is worth recollecting the circumstances that so troubled the Commission and the Congress in 1975, resulting in the passage of what up to then stood as the most significant overhaul of the Exchange Act since 1934. Beginning in the early 1970s, the largest exchange in the country, the New York Stock Exchange (the "NYSE"), claimed an ownership right in market data. This data,

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8 *Report of the Advisory Committee on Market Information: A Blueprint for Responsible Change* (Sep. 14, 2001) (the "Seligman Report").

9 SEC Release No. 34-57917 (Jun. 4, 2008) ("Core data is the best-priced quotations and comprehensive last sale reports of all markets that the Commission requires a central processor to consolidate and distribute to the public pursuant to joint-SRO plans.")

particularly quotation data, was not widely available to the public. Transparency and efficiency suffered. Investors were in the dark. Capital markets were fragmented.

With the ardent support of the Commission, the Congress acted decisively. The 1975 Amendments crafted a bargain. The first half of the bargain was that broker-dealers were required to provide their customers' market data to the exchanges immediately and without compensation. The second half was that exchanges were required to consolidate that data and make it available to the public according to the statutory protections that have been described at length during this proceeding. The objective of the 1975 Amendments was the creation of a national market system with maximum transparency to benefit investors. In short, the 1975 Amendments were animated largely by a recognition that dominant exchanges are not subject to "market forces" and that, in the absence of regulation, information vital to investors will be withheld.

The Exchange Act seeks to make quote and trade data broadly available to the public. Interestingly, just as the terms "core" and "non-core" data, do not appear in the Act, the term "consolidated" does not appear in the Exchange Act in connection with market data either. As the Commission recognized:

> When Congress mandated the creation of a national market system, it stated that 'communication systems, particularly those designed to provide automated dissemination of last sale and quotation information with respect to securities, will form the heart of the national market system.'... Congress did not specifically mandate the creation of a consolidated market data processor system.[10]

In short, "consolidation" is simply one potential means to an end, the end of widely distributing quotations and transactions to the public. To argue that the end was instead to encourage the distribution of only "consolidated data," and that the Commission is at liberty to define that data set so narrowly as to carry only a tiny fraction of quotations is legally unsound. Such a misreading would re-create in substantial part the world that the Congress was trying to reform in 1975 — a world in which NYSE, and now Nasdaq, will be able to abuse by virtue of their monopoly positions. Indeed, by effectively repealing the second half of the 1975 bargain — the protections against monopoly abuse — while retaining the first half of the bargain — the mandate that consumers' market data be provided by broker dealers immediately and for free to the exchanges — the natural monopoly the exchanges enjoyed in 1975 is further bolstered by now unjustified government powers and protections.

In discussing Commission activity during consideration of Reg NMS, it is noted that "the Commission ultimately decided that the consolidation model should be retained for core data because of the benefit it afforded to investors ...."[11] The fact that the Commission believes it could dispense

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10 Concept Release Concerning Self-Regulation, SEC Release No. 34-50700 (Nov. 18, 2004), n.229 (citation omitted).

11 Order at 39.

all together with the consolidation model would seem to underscore that the mandate of the Act was not to ensure the availability of consolidated data — but rather to ensure the availability of the quotations and transactions specified in the Act.

The impact of Commission action in recent years has been to radically diminish the displayed liquidity and utility of "core data." The Commission mandate that the markets move to decimalized pricing, in which there are 100 price points to the dollar instead of the previous eight or sixteen has meant that the volume displayed at each market's best bid or offer is exceedingly small. Other steps, including the revision of consolidated display requirements have likewise reduced the informational content and utility of "core" data.[12]

C. What do Investors "Need"?

According to Charles Schwab & Co., the average retail order often exceeds the liquidity displayed by "core" data.[13] If an average investor wants to actually know what his or her average trade will cost, that average investor needs to obtain depth of book data. Whereas ten years ago, before decimalization and the extraordinary consolidation in the market, a consumer could see six cents of liquidity — more than enough for retail trading — for $36 per year. Seeing that same liquidity today would cost a consumer $1,176 per year.[14] What is effectively a 30 fold increase in prices should not occur under a statute which grants exchanges quasi-governmental powers ostensibly to promote the broad public availability of data.

The Proposed Order has side-stepped this issue by simply asserting that retail investors do not need access to quotation data. Certainly, under the Proposed Order, quotation data will be priced to ensure retail investors do not see this data. Chairman Cox notes that he wants to make sure retail investors have "access to market data that meets their needs ...", namely, last sale data, referred to as "reference data products."[15]

If the Proposed Order is implemented, the Commission will be saying that retail investors do not actually need quotations — they do not need tradable data. The Commission notes, "Moreover, outside of trading contexts, the ArcaBook data will be far broader than individual investors typically

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12 Proposed Order at 34. *See* SEC Release No. 34-49325 (Feb. 26, 2004) (describing the evolution of required data display in the "national market system"). Prior to the adoption of Regulation NMS in 2005, consolidated data included a montage of the best quotes from all reporting market centers trading a security. Rule 600(b)(13) of Regulation NMS "substantially revised the consolidated display requirement … to simply require a consolidated display that is limited to the prices, sizes, and market center identifications of the NBBO, along with the most recent last sale information." Id.

13 Letter from Jeffrey T. Brown, Senior Vice President, Schwab, on Release No. 34-54597 (Jan.17, 2007).

14 SIFMA Letter, Jan. 17, 2007. Appendix A.

15 Letter from SEC Chairman Cox to Capital Markets Subcommittee Chairman Kanjorski, January 18, 2008. Order at 74.

need...for retail investors that are not trading...data regarding trading interest outside the best price is not needed."[16]

But retail investors *do trade* — that is why industries have grown up to service them, and why the Act requires the broad dissemination of quotations and transactions. The Congress could have restricted access to quotations and transactions to professional investors, but it did not. Financial web sites received 48,802,000 "unique visitors" in May of 2006.[17] As each unique visitor is tied to the IP address[18] of the user, this is essentially a fingerprint that suggests that, indeed, approximately 50 million Americans visit a major Internet financial web site every month. These web sites offer a variety of financial information, but our members' experience suggests that the overwhelming majority of these visitors are looking for the market data that is essential to trading. Given the phenomenon of the "Investor Class" — in which unprecedented numbers of Americans are actively managing their own portfolios to plan for retirement, education, major purchases and more — the need for quotations in sizes at least large enough for normal retail trading is real.

The point and purpose of the 1975 Act was to spur public access to the "oxygen" of the market. Providing the public with "reference" data while empowering for-profit exchanges to withhold quotation data would disadvantage the consumers served by NetCoalition's members while undermining both the statute and the promise of the Internet. Indeed, as NetCoalition has indicated in previous communications, the Commission should use recent advances in technology to work toward eliminating the dichotomy between information available to investors on Wall Street and information available to investors on Main Street. While the Commission finds the last sale proposals an example of "market forces" at work, there are no "market forces" at play here.[19] The Congress could have provided for the broad public dissemination of "transactions," or "reference data" or "some fraction of quotations." Congress instead provided for the broad dissemination of "quotations and transactions."

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16 Order at 77

17 ComScore Media Matrix Releases May Top 50 Web Rankings at http://www.comscore.com/press/release.asp?press=906.

18 Wikipedia defines IP address as follows:

> An IP address (Internet Protocol address) can . . . be thought of as the equivalent of a street address or a phone number . . .for a computer or other network device on the internet. Just as each street address and phone number uniquely identifies a building or telephone, an IP address can uniquely identify a specific computer or other network device on a network.

Wikipedia, available on the Internet at: http://en.wikipedia.org/wiki/IP_address.

19 "We suppose market forces, like beauty, are in the eye of the beholder. Prior to filing the Petition, NetCoalition's members were being given an ultimatum by a government-sponsored monopoly. After filing the petition — and demonstrating the potential of exercising our legal rights to hold the exchanges to the standards in the statute — we have seen modest progress. A fair conclusion to draw from this experience is that monopolies need rigorous oversight and supervision. We see no evidence of market forces." NetCoalition letter of March 6, 2007.

D. Will Reducing Best Execution Duties Reduce Consumer Protection?

Among the reasons the broker dealer community has complained that permitting NYSE and Nasdaq to charge monopoly rents is unfair is the fact that, not only are NYSE and Nasdaq the unique sources of data in their respective markets, but also because the broker dealer obligation of "best execution" has been interpreted as requiring the purchase of depth-of-book data. The SEC order attempts to partially address this concern with the announcement that there is now no "best execution" obligation requiring the purchase of depth-of-book data — despite the fact that ascertaining the total price of an average retail trade *requires* depth of book data.

For years, the Commission has pointed to a robust best execution obligation as a significant consumer protection. Yet, without anyone seeking repeal in this proceeding, or any discussion during this proceeding, this heretofore essential consumer protection is being jettisoned. That raises a number of questions. Does the Commission believe that other state and federal laws impose comparable requirements, hence the Commission's requirements are unnecessary? (Of course, if there are comparable requirements, then broker dealers still may feel compelled to buy, underscoring the absence of "market forces" in the purchase of market data.) Has the Commission engaged in some analysis that the cost of this regulation exceeds the benefit? If so, will that analysis be shared with the public? What are the effects on consumers of eliminating this protection?

We believe the best way to help broker dealers who may be constrained to purchase depth-of-book data is the way visualized in the statute — namely, by requiring that fees be reasonably related to cost. In the absence of any supporting data, eliminating fiduciary obligations that are intended to protect consumers is ill-advised.

E. The Issue of Competition

Exchange Act Section 19(b)(2) permits the Commission to approve a proposed rule change of an SRO only if it finds the rule change to be consistent with the Exchange Act provisions applicable to the SRO.[20] If it cannot make that affirmative finding it *must* initiate proceedings looking toward disapproval of the rule change. In a doubtful case, therefore, the statute defaults to disapproval. Relevant Exchange Act provisions pertaining to market data include:

a. Exchange Act Section 6(b)(4), which requires an SRO's rules to provide for "equitable allocation of reasonable fees, dues, and other charges among its members and issuers and other persons using its facilities;"

b. Exchange Act Section 6(b)(5), which requires that SRO rules be designed to "remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers;"

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20 *See Timpinaro v. SEC*, 2 F.3d 453, 456 (D.C. Cir. 1993).

c. Exchange Act Section 6(b)(8), which prohibits SROs rules from imposing "any burden on competition not necessary or appropriate" in furtherance of the purposes of the Exchange Act;

d. Exchange Act Section 11A(c)(1), which empowers the Commission to adopt rules applicable to SROs, securities information processors, brokers, and dealers, "as necessary in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act" to, among other things:

i. assure the prompt, accurate, reliable, and fair collection, processing, distribution, and publication of quotation and transaction information, and the fairness and promptness of the form and content of such information (Exchange Act Section 11A(c)(1)(B));

ii. require an SRO that is an exclusive securities information processor [such as NYSEArca with respect to NYSEArca data] [21] to distribute on a "fair and reasonable basis" the quotation and transaction data that it collects, processes or distributes. (Exchange Act Section 11A(c)(1)(C) and Exchange Act Rule 603(a)(1) of Regulation NMS);

iii. require an SRO that distributes information with respect to quotations and transactions to a securities information processor, broker, dealer, or other persons to do so on terms that are "not unreasonably discriminatory" (Exchange Act Section 11A(c)(1)(D) and Exchange Act Rule 603(a)(2) of Regulation NMS); and

e. Exchange Act Section 3(f), which provides that, whenever the Commission is engaged in the review of a rule of an SRO and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission "shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."

The Commission's "competitive forces/market forces" approach does not comport with these statutory standards. The Commission's statement that this approach "follows the clear intent of Congress in adopting Section 11A that, whenever possible, competitive forces should *dictate* the services and practices that constitute the U.S. national market system for trading equity securities"[22] is not an accurate rendition of the weight Congress indicated should be given to competition factors. The Exchange Act states the Commission "shall also consider" competition, as well as investor protection, efficiency, and capital formation. It does not say that the Commission's interpretation of "competitive forces" should "dictate" outcomes. There is nothing to suggest that "competition" takes

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21 *See* Exchange Act Section 3(a)(22)(B). NYSEArca is an exclusive securities information processor of its data. Proposed Order, at n.156.

22 SEC Release 34-57917 (Jun. 4, 2008) (emphasis added).

precedence over the other general considerations enumerated — investor protection, efficiency and capital formation. There is, of course, nothing to suggest that these general considerations should take priority over specific requirements of the statute.

The preamble to Section 11A underscores that competition considerations do not control other objectives of the national market system:

> It is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure:
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> . . .
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> (ii) fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets; [and]
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> (iii) the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities.

These are separate objectives. It is worth stressing that, even as to the competition objective, Section 11A's standard is not met if the Commission merely believes that competition, or "significant competitive forces,"[23] are present. It is met only if the competition is *fair*. The statutory mandate of making quotation and transaction information available to brokers, dealers, and investors cannot be satisfied simply by a belief that competitive forces exist in relation to market data.

The Commission cites the following passage from the legislative history of the 1975 amendments which shows how the Congress expected the national market system to evolve:

> It is the intent of the conferees that the national market system evolve through the interplay of competitive forces as *unnecessary regulatory restrictions* are removed.[24]

As the National Market System evolved, the Congress was expecting the Commission to adjust its regulatory scheme. The Congress did not expect the Commission to override statutory requirements. The Commission is not empowered to override the standards that the Exchange Act mandates for the review of SRO rule filings.

The Congress determined that competition could not be relied on to regulate commercial conduct of exchanges as exclusive processors, regardless of whether or not there was also a consolidator of data from several exchanges. That determination applies to NYSEArca, which the Commission has already determined is an exclusive processor.[25] Exchange Act Section 11A(c)(1)(C)

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23 SEC Release No. 34-57917 (Jun. 4,2008).

24 Id.

25 Proposed Order at n.145.

speaks of exclusive processors, not consolidators or consolidated data, which the Congress did not mandate and which Congress believed might not be necessary.[26] The Congress warned the Commission not to rely on "competitive forces" in dealing with exclusive processors and that the antitrust laws might have to provide the necessary protections if the Commission did not:

> Although the SEC's basic role would be to remove burdens on competition which would unjustifiably hinder the market's natural economic evolution and to assure that there is a fair field of competition consistent with investor protection, in situations in which natural competitive forces cannot, for whatever reason, be relied upon, the SEC must assume a special oversight and regulatory role. *An exclusive processor for a national market system would create such a situation and so would self-regulatory projects which are not economically self-sufficient, which enjoy an effective monopoly, or which are merchandised to members on a basis other than cost and quality of services.* The bill would give the SEC broad authority over and significant responsibility for the development and operation of such facilities, subject of course to any ultimate judicial reconciliation of the policies of the Exchange Act with those of the antitrust laws.[27]

F. Assessing Competition Requires More Than Conclusive Statements

We are submitting under separate cover an economic analysis to address the Commission's competition arguments. In addition to that, we'd like to explore a broad policy question, namely — in instances where regulators have reversed settled decisions and found a previously uncompetitive market to be competitive, what process was engaged in to ensure that competition existed and hence that the public was protected?

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[26] The Congress was leery of having an exclusive consolidator and warned about the anticompetitive dangers of such an arrangement:

> The Committee believes that if economics and sound regulation dictate the establishment of an exclusive central processor for the composite tape or any other element of the national market system, provision must be made to insure that this central processor is not under the control or domination of any particular market center. Any exclusive processor is, in effect, a public utility, and thus it must function in a manner which is absolutely neutral with respect to all market centers, all market makers, and all private firms. Although the existence of a monopolistic processing facility does not necessarily raise antitrust problems, serious antitrust questions would be posed in access to this facility and its services were not available on reasonable and nondiscriminatory terms to all in the trade or if its charges were not reasonable.

Senate Report on S.249 at 11.

[27] Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing, and Urban Affairs to Accompany S.249 (the "Senate Report on S.249"), S. Rep. No. 94-75, 9th Cong., 1st Sess. 12 (1975) (emphasis added).

The Federal Communications Commission's determination that the interexchange (long distance) telephone service market was competitive occurred at the end of a process that took approximately sixteen years.[28] In 1979, the FCC proposed differing levels of regulation for dominant and non-dominant carriers, the latter being largely deregulated.[29] AT&T was the only long distance carrier placed in the dominant category. In the years following the Bell System divestiture in 1984, the FCC had occasion to consider whether increasing competition enabled it to reclassify AT&T as non-dominant. The assessments of AT&T's market power occurred over eleven years, with determinations that it faced sufficient competition to be regarded as non-dominant occurring market segment-by-segment. In 1991, most of AT&T's services to business customers were designated as non-dominant.[30] In 1995, in separate examinations, the remainders of AT&T's services were categorized as non-dominant.[31] In the process of an assessment covering more than 100 pages in the FCC Record, he FCC indicated that it considered six "primary factors" in gauging whether the level of long distance competition was sufficient to relax regulation:

> (1) demand elasticity; (2) supply elasticity (and in particular the supply capacity of existing competitors); (3) the relationship of AT&T's prices to its price cap; (4) AT&T's market share; (5) relative cost structures of AT&T and its competitors; and (6) AT&T's size and resources.[32]

Putting aside the statutory prohibition on allowing the invocation of the words "market forces" to result in the nullification of the express protections in the Act, as an economic matter has any analysis of sufficient rigor been offered in support of the Commission's analysis? We think not.

G. Did the Public Miss the Debate?

The Proposed Order asserts: "In 2005, however, the Commission stated its intention to apply a market-based approach that relies primarily on competitive forces to determine the *terms* on which non-core data is made available to investors." This is inaccurate. The Reg NMS Release states that competitive forces would determine the terms on which other data would be made available *to a Network processor*[33] and that "the adopted consolidated display requirement will allow market forces, rather than regulatory requirements, to determine *what, if any, additional quotations outside the*

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28 *See* Motion of AT&T Corp. to Be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271, 3273-3285 (1995).

29 Competitive Carrier Rulemaking, Notice of Proposed Rulemaking, 77 FCC 2d 308 (1979), First Report & Order, 85 FCC 2d 1 (1980). The deregulation of non-dominant firms occurred gradually, principally in terms of diminishing FCC review of their proposed rates, terms, and conditions.

30 1991 Report on Interexchange Competition, 6 FCC Rcd 5880 (1991).

31 Motion of AT&T Corp. to Be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271 (1995).

32 Id., at 3278.

33 Id. in text accompanying 649.

NBBO are displayed to investors."[34] This has been conflated into the inaccurate assertion that "market forces will determine terms on which non-core data is available *to investors*."[35]

Although the Commission has chosen to allow SROs to decide *what* additional market data they wish to display it has not and cannot alter the statutory standards that apply to *how* that data may be distributed, including the fees that may be charged for the data. With regard to fees for market data, the Commission has stated that the core/non-core distinction is irrelevant in applying the statutory requirements.

All exchange rules governing fees are subject to the standards in Section 6(b). Once an exchange elects to publish its depth-of-book market data, regardless of whether it is obliged to do so, it brings upon itself the full panoply of Exchange Act duties with respect to that data.

Exchange rules must meet the standard for use of their facilities set out in Exchange Act Section 6(b)(4):

> the rules of the exchange [must] provide for the equitable allocation of reasonable dues, fees, and other charges among the members and issuers and other persons using its facilities.

Exchange Act Section 3(a)(2) defines "facility" to clearly cover, *inter alia*, all market quotation data:

> the term 'facility' when used with respect to an exchange includes its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service.

Thus, if exchanges are going to make depth-of-book data available, Section 6 does not permit a different standard to be used for accessing the consolidated book, as opposed to depth-of-book.

Currently, the Commission typically reviews market data fees in the context of proposed fee changes filed by the three networks that disseminate market data [namely, core data] in NMS stocks. These fee filings are published for notice and comment before Commission action. After those filings are published, the Commission determines whether the fees are fair and reasonable, not unreasonably discriminatory, and otherwise consistent with the requirements of the Exchange Act. Although most

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34 SEC Release Nos. 34-49325 (Feb. 26, 2004); 34-51808 (Jun. 9, 2005).

35 Proposed Order in text accompanying n.17.

market data fee filings currently involve Network fees, *the same standard applies and the same questions arise with regard to the market data fees of an individual SRO.*[36]

The suggestion that these issues were "resolved" during the Reg NMS debate is baffling. The Commission observed during Reg NMS that

> Many commentators recommended that the level of market data fees should be reviewed and that, in particular, greater transparency concerning the costs of market data and the fee setting process is needed. The Commission agrees .... [W]e believe that the level of market data fees is most appropriately addressed in a context that looks at SRO funding as a whole. The Commission's review of SRO structure, governance, and transparency provides a useful context in which these competing policy concerns can be evaluated and balanced appropriately.[37]

This SEC committed that a comprehensive review of market data fees would take place in Regulation SRO. We have not seen any evidence of that over the past four years. While we are appreciative that the NetCoaltion Petition was granted, we suspect a broader and more public deliberative process — as promised by the Commission — rather than the current 30 day public comment being offered would have provided a better chance of getting this right.

H. The *Feist* Case

The freedom the Proposed Order grants exchanges to control depth-of-book data is constitutionally invalid. As we pointed out in our Petition, the Supreme Court decided unanimously in the *Feist* case[38] to reaffirm our nation's historic position that facts, the building blocks of information, cannot be owned. As Justice O'Connor stressed, this is a constitutional requirement.[39] For years, the exchanges have fought a rearguard action to overturn the *Feist* holding through the so-called database legislative proposals. The Congress has turned that away repeatedly.[40] The extraordinarily diverse group that successfully urging the Congress to reject the NYSE- and Nasdaq-backed approach included NetCoalition, the Securities Industry Association, the U.S. Chamber of Commerce, the National Academy of Sciences, the American Conservative Union, the American Civil Liberties Union, Consumers Union and numerous other prominent organizations.

It is easy to see why the exchanges want to overturn *Feist,* as it is impossible for the exchanges to assert an ownership right in factual market data as long as *Feist* is the law of the land.

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36 Concept Release Concerning Self-Regulation, *supra,* in text accompanying nn.231-2.

37 SEC Release No. 34-51808 (Jun. 9, 2005) (adoption of Regulation NMS).

38 *Feist v. Rural Telephone Service Co, Inc.*, 499 U.S. 340 (1991).

39 *Id.* at 347.

40 *See* NetCoalition Petition, pp. 17-20, and authorities cited therein.

Indeed, this reality was underscored a year ago in the decision by the United States Court of Appeals for the Second Circuit in *New York Mercantile Exchange, Inc. v Intercontinental Exchange.*[41] In reliance on *Feist* — and reflecting the settled policy that prices cannot be owned — the Second Circuit upheld the judgment of the United States District Court for the Southern District of New York that the New York Mercantile Exchange settlement prices can not be copyrighted. The nature of the equity markets would clearly make the argument of "ownership" even less likely to withstand judicial scrutiny than the failed argument in the commodity context. The importance and breadth of this holding is illustrated by the *Amicus Curiae* brief of the United States in support of the Register of Copyright's position that this market data could not be copyrighted:

> The United States has a substantial interest in the resolution of this appeal. It has numerous responsibilities related to the proper administration of the intellectual property laws, as well as primary responsibility for enforcing the antitrust laws, which establish a national policy favoring economic competition. Accordingly, the United States has an interest in properly maintaining the 'delicate equilibrium', Computer Assocs. Int'l v. Altai, Inc., 982 F.2[d] 693, 696 (2[nd] Cir. 1992), Congress established with the copyright law, between protecting private ownership of expression to encourage creativity and enabling the free use of information for future creativity. See Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975). The claims in this case seeking copyright protection for a commodity exchange's individual determinations of futures contract settlement prices threaten that equilibrium.[42]

Without a rigorous review of how market data fees relate to the cost of consolidating the data, the Commission implicitly allows the NYSE and Nasdaq to proceed as if they "own" this factual data and can charge users whatever the market will bear for access to the this "property." In fact, although NYSE and Nasdaq have tried mightily to create an ownership right in this factual data, NYSE and Nasdaq do not "own" this data — which is, of course, information that broker-dealers are legally required to provide to them at no cost.

The concerns of NetCoalition during the database debate were straightforward. It was clear to us that an ownership right in facts would fundamentally change the nature of the Internet. By sanctioning monopolies in facts, the database proposals would have resulted in skyrocketing prices for the data itself and would have severely limited users' access to information on the World Wide Web. Sanctioning the monopoly control of facts would also have allowed sole source providers to leverage their monopolies in the raw data market downstream into currently competitive markets for value-

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41 *New York Mercantile Exch., Inc., v Intercontinental Exch., Inc.*, U.S. Court of Appeals for the Second Circuit, Docket No. 05-5585-ev (August 1, 2007).

42 *New York Mercantile Exch., Inc. v Intercontinental Exch., Inc.*, U.S. Court of Appeals for the Second Circuit, Docket No. 05-5585-cv Brief *Amicus Curiae* of the United States of America in Support of Defendant-Appellee Intercontinental Exchange, Inc.

added products. This is a formula for higher prices, reduced transparency and less innovation in both the primary and downstream markets.

Apparently wanting both a "belt and suspenders," the NYSE and Nasdaq backed this legislation while simultaneously claiming that they already owned the quotes. Indeed those who took issue with the exchanges' property claims were derided by the NYSE's General Counsel:

> Those trying to shift the debate and focusing on this question are obfuscating the real issue: the apportionment of costs of generating market data among broker-dealers and investors. Those focusing on 'property rights' conveniently ignore the fact that those who approve the Exchange's budget and market data (and other) fees are the ones who pay.[43]

The NYSE was certainly correct in saying the real issue is the "apportionment of costs of generating market data among broker-dealers and investors."[44] The relevant sections of the securities laws have not changed since that statement. Indeed, the fact that we now have for-profit exchanges should increase, not diminish, the scrutiny necessary to control conflicts of interest. The assertion that the public is protected because "those who approve the Exchange's budget and market data (and other) fees are the ones who pay"[45] has certainly never been true for Internet companies and is not true now of the broker-dealer community. The only effective restraint on abusive monopoly behavior is the SEC's enforcing the securities laws.

I. Do the Same Statutory Terms Mean Different Things Depending Upon Whether an Exchange is Collecting or Paying a Fee?

As the record of this proceeding reflects, most commenters believe, as the SEC observed in 1999, that the statute's standard that fees be "fair and reasonable" was fairly interpreted as meaning that fees must be "reasonably related to cost."[46] There is at least one group, however, that believes fees should be strictly cost based. That group is the exchanges, with the approval of the Commission. In 2004, the Division of Market Regulation, provided the following guidance to the Consolidated Tape Association with respect to the fees to be charged to Nasdaq and other new exchange entrants pursuant to its Plan under the same terms of the Act:

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43 *Market Data: Implications to Investors and Market Transparency of Granting Ownership Rights over Stock Quotes: Hearing before the H. Subcomm. on Capital Market and Government Sponsored Enterprises of the H. Comm. on Financial Services*, 107th Cong. (2001) (statement of Richard P. Bernard, Vice President and General Counsel, NYSE).

44 *Id.*

45 *Id.*

46 1999 Concept Release, IV.C.

> The Division believes that the process for determining a proper entrance fee should be transparent to ensure fairness to potential new participants and to address potential anti-competitive concerns. New entrant fees should not pose an unnecessary competitive burden or barrier to entry on new entrants. We therefore believe that the Plan should be amended to include solely objective standards for determining new entrant fees. In particular, the Plan should delineate the method for determining (1) the specific costs current Plan participants have incurred in the development, expansion, and maintenance of CTA-related facilities and/or systems, (2) the portion of those costs participants can legitimately recoup from a new entrant, and (3) the costs incurred or to be incurred for modifying systems to accommodate the new participant (which are not otherwise required to be paid or reimbursed by the new participant). The Plan should not otherwise include any subjective criteria, or objective factors designed to compensate for the costs of operating the systems prior to the time the new participant joins the Plan, or for 'goodwill' or any future benefits to the new entrant.[47]

In short, the Commission concluded that the entry fees should be "fair and reasonable" and that a rigorous cost-based analysis was therefore required. On March 17, 2005, the Commission, by delegated authority, approved the Entry Fee Amendments, which were incorporated into the CTA Plan as Section III(c). In its adopting release, the Commission stated that "the main purpose of a participation fee is to require each new party to the [CTA and CQ] Plans to pay a fair share of the costs previously paid by the CTA for the development, expansion, and maintenance of CTA's facilities." It stated further that the CTA and CQ Plan participants "should only consider the costs of tangible assets that could have been treated as capital expenditures under GAAP in the fee calculation, and if so treated, would have been amortized for a five-year period preceding the new party's admission to the Plans."

The Commission cautioned, however, that participants "must not consider any historical costs of operating the systems prior to the time a new party joins the Plans, or any subjective or intangible costs such as 'good will' or any future benefits to the new party." The Commission concluded that "the proposed new standards, if appropriately employed by the [p]articipants, should foster a fair and reasonable method for determining the amount of a new [p]articipant's entrance fee to be paid to the Plans."[48]

In that regard, the Commission noted with apparent disapproval that the CTA had not presented work papers to support its calculations of cost.[49] The Commission concluded that it had

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47 Letter dated August 3, 2004 from Annette Nazareth to Thomas E. Haley, Chairman, CTA.

48 SEC Release No. 34-55909 (Jun. 14, 2007) in text at nn. 17-20 [emphasis in original deleted; footnotes omitted].

49 *Id.* in text following n. 22.

insufficient cost data to properly assess whether CTA's fees were "fair" and "reasonable" and it referred the matter to an administrative law judge to preside over the proceeding.[50]

After days of depositions and hundreds of pages of testimony and supporting documents, the state-of-play can be summarized as follows. Using a very strict cost-based accounting calculation, Nasdaq claims it owes the CTA $233,132. Using a slightly less strict cost-based accounting calculation, the CTA claims Nasdaq owes CTA $833,000. Nasdaq concedes that it owes the CTA at least $233,132, but asserts that it will pay nothing. Why? Because — although the CTA used a cost-based accounting calculation — Nasdaq believes the CTA's failure to adhere to a stricter cost-based accounting means *the CTA has failed to carry its statutory burden of establishing a fair and reasonable fee.*[51]

Under the law, "fair" and "reasonable" can not mean one thing when Nasdaq proposes a fee and something all together different when Nasdaq (or NYSE) charges a fee. The Commission argues that a cost-based analysis is necessary in the Nasdaq/CTA instance because of the absence of competitive forces.[52] Let us put aside the fact that this "competition rationale" is being articulated years after the proceeding commenced. Let us also put aside the fact that there is overwhelming evidence that "non-core" data is also not subject to competitive forces. Why does the Commission's assertion not mean that "core" data — which is monopoly data and which broker-dealers trading for clients are obligated to buy — is subject to a strict cost-based accounting?

The proposed one-time fee of $833,000 that the CTA seeks to impose on Nasdaq has been the subject of far more empirical analysis than the billions in fees that investors and intermediaries have paid the exchanges over the past decade. How can these cost factors be unquantifiable, unknowable, and unnecessary when Nasdaq proposes a fee, but be quantifiable, knowable, necessary and required when Nasdaq is paying a fee?

The SEC specifically criticizes the failure to present work papers in support of its calculations in the *CTA* case.[53] NYSEArca has not only failed to provide work papers in support of its calculations, but also has failed to provide any calculations or any cost data on which calculations might be made.

The term "fair" and "reasonable" cannot mean in one fee context that costs are highly relevant, but mean something quite different in another fee context. As the Court of Appeals in *Goldstein v. Securities and Exchange Commission* stated:

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50 *Id.* in text at n. 35.

51 *In the Matter of the Application of The Nasdaq Stock Market, LLC,* File No. 3-12384, Post-Hearing Brief of The Nasdaq Stock Market LLC, December 21, 2007.

52 Proposed Order at n.219.

53 Nasdaq/CTA Dispute Release at 6.

> We ordinarily presume that the same words used in different parts of a statute have the same meaning. *See Sullivan v. Stroop*, 496 U.S. 478, 484 (1990). The Commission cannot explain why 'client' should mean one thing when determining to whom fiduciary duties are owed, 15 U.S.C. § 80b-6(1)-(3), and something else entirely when determining whether an investment adviser must register under the Act, *id.* § 80b-3(b)(3). *Cf. Mobil Oil Corp. v. EPA*, 871 F.2d 149, 153 (D.C. Cir. 1989).
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> . . .
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> That the Commission wanted a hook on which to hang more comprehensive regulation of hedge funds may be understandable. But the Commission may not accomplish its objective by a manipulation of meaning.[54]

In short, the Commission cannot have the same terms mean one thing when an exchange is paying a fee and something all together different when the fee is being charged by an exchange.

J. Reducing Public Input

The proposed adoption of this new "market based approach" to review SRO rule filings is in fact Commission rulemaking that must be published for public notice and comment.[55] In effect, the Commission is attempting to amend Rule 19b-4 without following required agency rulemaking procedures under the Administrative Procedure Act.[56]

The Commission has noted:

> As Congress has stated on a number of occasions, SROs are 'quasi-public agencies, not private clubs, and . . . their goal is the prevention of inequitable and unfair practices and the advancement of the public interest. An important way for the Commission to help ensure that the SROs are serving those goals is through the review of SRO rule filings.'[57]

Rule 19b-4 requires all SRO proposed rule changes to be filed with the Commission on Form 19b-4.[58] The form "is intended to elicit information necessary for the public to provide meaningful

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54 451 F.3d 873, 882 (D.C. Cir. 2006).

55 SEC Rule of Practice 192(b), 17 CFR § 201.192(b).

56 5 U.S.C. § 553 (2008). The publication for comment of the Commission's proposed approval order for one SRO proposed rule change does not satisfy the requirement to expose for public comment a *Commission* rule that will apply to an entire class of rule filings.

57 SEC Release No. 34-43860 (Jan. 19, 2001) (footnote omitted).

58 The exception is proposed rule changes submitted pursuant to Exchange Act Section 19(b)(7), which must be filed on Form 19b-7.

comment on the proposed rule change and for the Commission to determine whether the proposed rule change is consistent with the requirements of the [Exchange] Act and the rules and regulations thereunder applicable to the [SRO]."[59]

Form 19b-4 requires statements concerning the purpose of and statutory basis for the proposed rule change, and the impact on competition. Those representations must include why the proposed rule change is consistent with the statute and rules that apply to the SRO, including the provisions that prohibit unfair discrimination between customers, issuers, brokers, or dealers.[60] In addition, the discussion of the burdens that the proposed rule change may have on competition must, among other things: (1) specify the particular categories or persons and kinds of businesses on which any burden will be imposed and the ways in which the proposed rule will affect them; (2) explain why any burden on competition is necessary or appropriate in furtherance of the purposes of the Exchange Act; and (3) 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.[61]

The Commission review required by Rule 19b-4, and the finding required by Section 19(b)(2) that a proposed rule is or is not consistent with the provisions of the Exchange Act, would be replaced with a presumption of compliance with the Exchange Act and the rule if the Commission believes "significant competitive forces" are present. This promises to make even more opaque an already non-transparent process.

K. Conclusion

The Internet is one of the most dynamic forces in our economy, creating new ways of doing business and providing unprecedented convenience, choice and access to information for hundreds of millions of users worldwide. The ready availability of market data coupled with the technology of the Internet could revolutionize the financial services sector.

The broader distribution of critical market data on the Internet could generate significant trading revenues for for-profit exchanges. The broader distribution of critical market data on the Internet could generate significant new liquidity for our capital markets, and expand the universe of participants who amortize the costs of producing market data, thus reducing the fees of all market participants. The broader distribution of market data on a non-discriminatory basis would likely catalyze innovation with the entire market having an equal opportunity to develop value-added products.

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59 Form 19b-4, General Instruction B.

60 Form 19b-4, Item 3.

61 *Id.*, Item 4.

In testimony before the House of Representatives in 2005, then-SEC Chairman William Donaldson observed:

> In sum there is an inherent tension between price transparency for investors, which is a fundamental objective of the Exchange Act, and expanding the extent to which market forces determine market data fees and SRO revenue."[62]

We believe the Proposed Order resolves this tension in a fashion contrary to the Exchange Act's fundamental objective of transparency. The Proposed Order fails to exploit the opportunities provided by the Internet and instead imposes increased consumer costs, the creation of an inferior consumer market, the potential of significantly reduced consumer protections, and a regulatory structure hostile to competition. Beyond our policy concerns, we respectfully believe the Proposed Order violates the Act and, if the Commission were to issue the Proposed Order as a final order, that action would be reversible as a matter of law by the United States Court of Appeals

Respectfully submitted,

Mark Ek

Markham C. Erickson
Executive Director and General Counsel

cc: The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Kathleen L. Casey, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
The Hon. Elisse B. Walter, Commissioner
Dr. Erik R. Sirri, Director, Division of Trading and Markets
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62 *Concerning Proposed Regulation NMS: Hearing before the U.S. House of Representatives Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the Committee on Financial Services*, 109th Cong. (2005) (statement of William Donaldson, Chairman, Securities Exchange Commission).