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May 5, 2006

Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NW
Washington, D.C. 20549

Re: File No. SR-NASDAQ-2006-001
File No. SR-NASD-2006-048

Dear Ms. Morris:

Knight Capital Group, Inc. (Knight)[1] welcomes the opportunity to offer our comments to the Securities and Exchange Commission (Commission) on the above referenced rule filings submitted by the National Association of Securities Dealers, Inc (NASD) and its subsidiary, The Nasdaq Stock Market, Inc. (Nasdaq). We have commented previously, through our Direct Edge ECN subsidiary, on these issues in a joint letter written to the Division of Market Regulation (a copy is attached below).

Knight respectfully opposes both proposals and requests that the Commission reject both rule filings. Additionally, we support the recent submission of Bloomberg Tradebook LLC (dated May 5, 2006) and incorporate herein the arguments advanced in their letter.

As we have noted previously, the market impact of the Nasdaq proposals is severe as they hinder competition by targeting unfairly one group of its competitors – the last of the remaining independent Electronic Communication Networks (ECN). The independent ECNs play a critical role in the marketplace and contribute a significant percentage of the daily liquidity provided to investor trades. As noted in our prior submission and the Bloomberg letter, these proposals effectively strip these remaining ECNs of any economic and operational viability within the Nasdaq system. As such, it is clear by these filings that ECNs are being forced from the Nasdaq system. To put the issue squarely in perspective, one need only ask a

[1] Knight is the parent company of Direct Edge ECN LLC, Knight Equity Markets, L.P., Knight Capital Markets LLC, Knight Equity Markets International Ltd., Direct Trading Institutional, L.P., and Hotspot FX, Inc. all of whom are registered with SEC or CFTC. Knight and its affiliates, make markets in equity securities listed on Nasdaq, the OTC Bulletin Board, and the New York Stock Exchange, American Stock Exchange, both in the United States and Europe. Knight also owns an asset management business for institutional investors and high net worth individuals through its Deephaven subsidiary. Knight is a major liquidity center for the Nasdaq and listed markets. We trade nearly all equity securities. On active days, Knight executes in excess of one million trades, with volume exceeding one billion shares. Knight's clients include approximately 600 broker-dealers and 800 institutional clients. Currently, Knight employs more than 700 people.

few simple questions. Are investors and the marketplace better off without the liquidity and services provided by the remaining five independent ECNs? Should competition be permitted to be simply snuffed-out through rule filings which obliterate legitimate business models?

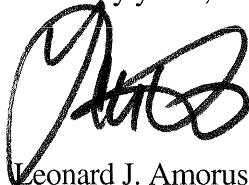
Fair competition and investor choice should continue to dictate and shape the national market system. These principles have formed the bedrock of the U.S. capital market system and have made it envy of the entire world.

Conclusion

We reiterate that proper measures must be taken to insure a level playing field for all market participants and investors. Accordingly, we respectfully submit those aspects of the subject rule filings which unfairly impede competition (i.e., at Nasdaq's proposed order delivery fee and the proposal to eliminate order-delivery functionality) should be rejected completely.

Thank you again for providing us with the opportunity to comment on these rule proposals. Knight would welcome the opportunity to discuss our comments with the Commission.

Sincerely yours,



Leonard J. Amoruso

cc: Chairman Christopher Cox
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A. Glassman
Commissioner Annette L. Nazareth
Robert L. D. Colby, Deputy Director, Division of Market Regulation
Robert R. Glauber, NASD, Chairman and CEO
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March 21, 2006

Robert L .D. Colby, Esq.
Acting Director, Division of Market Regulation
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100 F Street, N.E.
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Dear Mr. Colby:

The undersigned firms, which operate electronic communications networks ("ECNs") that contribute their liquidity to Nasdaq, are writing this letter to express concerns about a proposal by the Nasdaq Stock Market Inc. to shift onto the ECNs the fees it currently charges order-entry firms for delivery of orders to the ECNs via the Nasdaq Stock Market, as well as concerns about a proposal to require ECNs to accept auto executions rather than orders. Nasdaq's fee proposal, which Nasdaq has announced and which apparently is scheduled to go into effect April 1, 2006, would discriminate unfairly, and we believe illegally, against ECNs, as we explain below. The proposal to require ECNs to accept auto executions reverses a carefully negotiated solution to problems Nasdaq's SuperMontage presented. As you know, the decision to permit ECNs to elect order delivery rather than auto execution was designed to promote competition in the markets and investor choice. Nasdaq's market has long allowed for order delivery and Nasdaq has not demonstrated that terminating this feature would be in the public interest. Regardless of whether other exchanges do or do not allow for order delivery, Nasdaq should not be allowed to delete it without public comment.[1]

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[1] Indeed, the order delivery function on Nasdaq has helped ensure that ECNs can compete by providing liquidity and enhancing investor choice. Those same benefits should be available to investors on the listed markets as well. Rather than eliminating order delivery or confining it to one stock exchange, it is a function exchanges in general should make available to enhance both the efficiency and competitiveness of the national market system.

We appreciate your attention to our concerns. Time is of the essence. We understand that Nasdaq intends to file its fee proposal for immediate effectiveness. The fee filing is integrally related to Nasdaq's proposal to eliminate the order-delivery function. Together, Nasdaq's proposals, if allowed to become effective, would cripple the ability of independent ECNs to compete in the Nasdaq Stock Market and to continue to offer the choices and opportunities they today offer to investors and other market participants. In light of the significant impact that both proposals will have, we believe the issues we raise in this letter must be considered in the full notice and comment process for both rules. In particular, given the harmful effects of the Nasdaq fee proposal, we ask the Commission to advise Nasdaq that it is not appropriate to file its proposed fee change for immediate effectiveness. That would provide us, as well as other market participants, the opportunity to comment on all the issues these filings may raise. The Commission also should require Nasdaq to comply fully with the requirement in Item 4 of Form 19b-4 to discuss and justify the competitive impact of its proposals. As you are aware, formulaic recitals to the effect that Nasdaq does not believe, or has concluded, that its proposed rule change would not impose any burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Securities Exchange Act of 1934 (the "Exchange Act") do not comply with Form 19b-4 and do not give the Commission a legally sufficient basis on which to conclude that a Nasdaq rule change is consistent with the Exchange Act.

Changes to Nasdaq's Order-delivery Fee

Currently, as you know, all ECNs that participate in the Nasdaq Stock Market elect order delivery. In posting quotations on Nasdaq, they can charge liquidity takers an access fee up to a maximum of 30 cents per 100 shares ($0.003 per share). In addition, Nasdaq directly charges liquidity takers a fee of 10 cents per 100 shares ($0.001 per share) to deliver orders to such ECNs. Nasdaq currently caps its order-delivery fee at $10,000 per month for each order-entry firm.

Under the rule proposal, which Nasdaq announced in Head Trader Alert 2006-029, available at http://www.nasdaqtrader.com/Trader/News/2006/headtraderalerts/hta2006-029.stm, but apparently has not yet filed with the Commission, Nasdaq would no longer charge liquidity takers an order-delivery fee. Instead, it would shift that charge to the independent ECNs that provide liquidity, that is, ECNs other than BRUT and INET. Under Nasdaq's proposal, there would not be any cap on the order-delivery fee. Head Trader Alert 2006-029 states that the new regime will be effective April 1, 2006, pending SEC approval.

As you know, ECNs that participate in the Nasdaq Stock Market provide valuable liquidity to the Nasdaq Market Center by revealing their trading interest and making it available to the central matching engine. This is native liquidity available for immediate execution through the order-delivery mechanism. It is therefore unclear why independent ECN participants should pay a service charge for receiving order deliveries, which are central to the design of the system.

Under this new proposal, Nasdaq would effectively set a cap that is 10 cents per 100 shares lower than the 30-cent cap in Rule 610(c) of Regulation NMS. Under the Nasdaq proposal, if Nasdaq is allowed to charge ECNs a 10-cent fee, the maximum amount an independent ECN could collect would be 20 cents per 100 shares, not enough to provide a competitive rebate. By imposing that cap on ECN fees, Nasdaq would make it impossible for ECNs to collect a 10-cent spread (standard industry practice is to charge 30 cents and rebate 20 cents) for providing liquidity (BRUT and INET can collect the 10 cents as well, since Nasdaq can collect the 30 cents for them and not suffer the 10-cent reduction).

Elimination of Nasdaq's Order-Delivery Function

In addition to the proposed change to its order-delivery-fee structure, Nasdaq is proposing to eliminate its order-delivery function. Currently, as noted above, ECNs may participate on Nasdaq by electing order-delivery. All the ECNs on Nasdaq have elected to receive order delivery rather than auto executions. When an order is presented to an ECN through Nasdaq, the ECN may either accept the order, fill it in part or decline it, depending on whether the contra order in the ECN has previously been filled. The major advantage of Nasdaq's order-delivery function for ECNs is that it protects them from the risk of double executions in a race condition, a risk that would arise if they accepted auto execution and nevertheless remained subject to having their still-published quotations "hit" by other broker-dealers. Unlike market makers, ECNs are agency brokers and do not carry an inventory or act as principal. If they were forced to take executions, they would have to abandon their current business models and begin to act, involuntarily, as dealers. Unlike market makers, ECNs do not earn a market makers' bid/asked spread. Being forced to "eat" an execution could never be profitable for them on balance and instead would involve costs and risk of adverse market movement.

Nasdaq proposes to eliminate its order-delivery function and to require participating ECNs to accept only auto executions, that is, orders via Nasdaq that directly take ECN liquidity. Nasdaq has announced that it intends to go fully effective under the revised rule in July 2006. The filing relating to this rule proposal has not yet been published in the Federal Register and has not yet been the subject of public comment. It clearly is too early to contemplate an effective date for this proposal, particularly given the legal infirmities discussed below.

Commercial Effects and Legal Infirmities

If put into effect, Nasdaq's proposed changes would put the independent ECNs out of business on the Nasdaq platform. It would make them unable to compete effectively as liquidity providers. The proposed rule changes would diminish investor choice, harm the markets and raise fundamental public policy issues.

- <u>Nasdaq's order-delivery fee proposal unfairly discriminates against ECNs</u>. — The references in Nasdaq's Head Trader Alert 2006-029 to "order delivery participants" are misleading and opaque. The only "order delivery participants" on the Nasdaq system are

the ECNs. Nasdaq's order-delivery-fee proposal would apply solely to that subset of its members that are ECNs. The proposed fee change imposes considerable burdens on those ECNs in that, as noted above, it eliminates the ECNs' profitability and effectively prices them out of the business.

- The Nasdaq fee proposal discriminates against even non-fee-charging ECNs by giving them worse treatment than is given to market makers. The proposed fee would apply to ECNs but would not be applied to market makers. As a result, a non-fee-charging ECN receives a net rebate (i.e., net of the fee) of 10 cents per 100 shares for providing liquidity, but a Nasdaq market maker would receive 20 cents per 100 shares.

- Nasdaq's order-delivery fee proposal is anti-competitive. — One consequence of Nasdaq's revised fee structure would be to compromise the ability of ECNs to compete with Nasdaq in attracting liquidity. As you know, Nasdaq participants can use Nasdaq's BRUT and INET — two ECN-like facilities which Nasdaq purchased — just as they would use an independent ECN. If Nasdaq's fee proposal becomes effective, BRUT and INET would be able to charge liquidity takers 30 cents per 100 shares and provide a rebate to liquidity providers of between 20 cents and 25 cents. In the case of the independent ECNs, on the other hand, after paying Nasdaq's order-delivery fee under the new rule, the maximum amount available for rebates and other expenses would be only 20 cents per 100 shares (30 cents charged less the new 10-cent fee). That surely would put them at a significant competitive disadvantage to BRUT and INET, Nasdaq's own embedded ECN facilities since BRUT and INET would each have a full 30 cents to fund rebates and other operational expenses. In that way, Nasdaq's proposal not only unfairly discriminates against independent ECNs but also inappropriately impairs competition.

- Nasdaq's proposal is an exercise in monopoly pricing power. — Nasdaq's fee proposal does not merely shift its order-delivery fee from one participant in its marketplace to another. It would impose a tax on the independent ECNs by removing the cap on those fees thus increasing the revenue it currently derives from the fees and using that increased revenue to subsidize the liquidity rebate BRUT and INET can provide. Nasdaq also could use the money it would collect on delivering orders to its independent ECN members to draw order flow to BRUT and INET. In that way, the proposed Nasdaq fee structure would first weaken and then eliminate independent ECN members, opening the path for Nasdaq to charge monopoly rents in future.

- Nasdaq is attempting to do indirectly what it is prohibited from doing directly. — The Exchange Act expressly prohibits an exchange from imposing any schedule or fixing rates of commission or other fees charged by its members. Requiring independent ECNs to pay Nasdaq's order-delivery fee and removing the cap on those fees deprives them of a substantial portion of the 30 cents per 100 shares they are permitted to charge in access fees. Nasdaq's fee proposal not only slashes the profitability of independent ECNs, but it effectively imposes a maximum fee they can charge. The proposal thus contravenes the statutory prohibition against fixing fees and, in effect, accomplishes indirectly much of what an outright ban on charging access fees would accomplish directly. Exchange Act

Section 20(b) prohibits Nasdaq from doing indirectly anything it is prohibited from doing directly.

- Nasdaq's intent is clear from the timing of its fee proposal. Nasdaq has twice filed with the SEC within the past year seeking to prohibit its ECN members from charging access fees. (*See* Release No. 34-51609 (April 26, 2005) and File No. SR-NASDAQ-2006-001 (Feb. 7, 2006).) Nasdaq's two prior attempts to adopt rules imposing an outright ban on ECNs' charging access fees ran into legal problems,[2] which forced Nasdaq to try a subterfuge in an effort to get around the statute. The current fee proposal, in tandem with Nasdaq's proposal to eliminate the order-delivery function from its system, is designed to destroy independent ECNs and eliminate the choices they traditionally have provided to investors.

Nasdaq's order-delivery-fee proposal is not simply a change in dues or fees. The change is both economic and structural. It effectively prices independent ECNs out of the Nasdaq marketplace. That prospect raises a fundamental public policy question: how are investors and the national market system served by eliminating the competitive liquidity and investor choices provided by ECNs?[3]

Just as Nasdaq's earlier, failed attempts to eliminate ECN access fees contravened the Exchange Act, these additional proposals do so as well, in three respects:

- They discriminate against ECNs among all other members, violating the prohibition in Exchange Act Section 6(b)(5) against exchange rules that are "designed to permit unfair discrimination between . . . brokers, or dealers . . . ."

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[2] *See*, letter from Bloomberg Tradebook LLC to Brian G. Cartwright, General Counsel, SEC (March 6, 2006) and authorities referred to therein. As noted above, Nasdaq's efforts several years ago to impose execution delivery on ECNs in its SuperMontage proposal, and then through its order-priority algorithm to penalize ECNs for electing order delivery, failed because of the anticompetitive and illegal purposes and effects of these regulatory abuses. *See*, e.g., *Order Approving Proposed Rule Changes by the National Association of Securities Dealers, Inc. and Amendment Nos. 1, 2, 3, 4, 5, 6, 7 and 8 Thereto and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 9 Relating to the Establishment of the Nasdaq Order Display Facility and Order Collector Facility and Modifications of the Nasdaq Trading Platform*, Securities Exchange Act Release No. 43863 (January 19, 2001), available at http://www.sec.gov/rules/sro/nd9953o.htm.

[3] The Alternative Display Facility is hardly an alternative to Nasdaq participation. As reported on Bloomberg, daily volume on the ADF averages around fifteen million shares out of a total daily volume in Nasdaq-quoted securities of approximately 1.7 billion shares. The ADF does not provide an execution facility. The ADF offers only very limited quote attribution. It does not provide the ability to quote in listed securities other than Nasdaq securities. As a result, the ADF does not offer any meaningful competition to Nasdaq. The regional exchanges currently offer little more, individually or in the aggregate.

- Since the purpose and effect of the discriminatory fee structure is to cap the fees ECNs can charge, the Nasdaq proposals violate the prohibition in Exchange Act Section 6(e)(1) against exchange rules that fix fees.

- The proposals would violate the prohibition in Exchange Act Section 6(b)(8) by imposing burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Conclusion

Nasdaq should not be allowed to use its regulatory power, including its monopoly power as the entity running the Nasdaq Stock Market, to achieve illegal and anticompetitive ends. These proposals demonstrate graphically the evils of allowing self-regulatory organizations to de-mutualize and become for-profit entities unless they are subject to pervasive, exacting and continuous scrutiny. Given the problems discussed above, the Commission at a minimum should abrogate the Nasdaq filing summarily[4] if it is filed for immediate effectiveness and, if it is filed for public comment, the Commission should require that it be revised to cure these problems.

In light of the potential impact of the Nasdaq proposals and the prospect of an April 1 effective date for Nasdaq's fee proposal, it is important that we meet with you and the Staff to discuss the Nasdaq proposals as soon as possible.

Respectfully submitted,

BLOOMBERG TRADEBOOK LLC

By: *Kim Bang* by RDB
Chief Executive Officer

BATS TRADING, INC.

By: *David Cummings* by RDB
Chief Executive Officer

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[4] *See*, e.g., *Order of Summary Abrogation*, Securities Exchange Act Release No. 46159 (July 2, 2002).

DIRECT EDGE ECN LLC

By: *Ronald Pasternak* by RDB
President

TRACK ECN

By: *Martin Kaye* by RDB
Chief Executive Officer

cc: The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Cynthia A. Glassman, Commissioner
The Hon. Roel C. Campos, Commissioner
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