

March 6, 2006

**Via Electronic Mail (cartwrightb@sec.gov)**

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General Counsel  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549

**Re: Commission File No. SR-NASDAQ-2006-001**

Dear Mr. Cartwright:

We are writing to raise a substantial issue of legal authority with respect to the above captioned filing, which is the same issue we raised with respect to a filing by the NASD on behalf of Nasdaq, SR-NASD-2005-013, in our comment letters dated May 20, August 26 and December 19, 2005.<sup>1</sup> In its current filing, Nasdaq asks the Commission to approve a proposed rule change that would prohibit its members from “assessing fees triggered by the execution of a quote order to other broker-dealers that access their quotes and orders via the Nasdaq Market Center.”<sup>2</sup>

The issue this presents relates to Nasdaq’s ability as a national securities exchange to impose any schedule or fixing rates of commission or other fees charged by its members — as opposed to Nasdaq’s setting rates it will itself charge members and other market participants. We demonstrated in our August 26 letter that Section 15A(b)(6) of the Securities Exchange Act of 1934 (the “Exchange Act”) prohibited Nasdaq, as a facility of a national securities association,

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<sup>1</sup> Letters from Bloomberg L.P. in SEC File No. SR-NASD-225-013, available at <http://www.sec.gov/rules/sro/nasd/nasd2005013.shtml>.

<sup>2</sup> SR-NASDAQ-2006-001 in text following n. 13 (page 61 of 158). To the best of our knowledge, the Commission has not yet published this filing for public comment. We may have additional comments on other aspects of the rule filing if it is published for comment.

from imposing schedules or fixing rates of commissions or fees its members may charge. The analysis and conclusion are the same under Exchange Act Section 6(e)(1). The language in Section 6(e)(1) is based on and is indeed identical, *mutatis mutandis*, to the language in Section 15A(b)(6):

no national securities exchange may impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members . . . .

That statutory prohibition is absolute and is not susceptible of being overridden by a Nasdaq rule. It does not apply only to schedules or fixed rates applied generally across all market venues. The prohibition applies to any Nasdaq rule fixing, even at zero, any fees charged by Nasdaq members. Bloomberg Tradebook and the other electronic communications networks (“ECNs”) are Nasdaq members and the prohibition Nasdaq would apply to them flies directly into the Section 6(e)(1) prohibition, which as noted above is identical to the Section 15A(b)(6) prohibition.. As we demonstrated in our August 26 letter, the legislative history of the Maloney Act, which added Section 15A to the Exchange Act, makes it clear that, in Senator Maloney’s words:

[T]o provide safeguards against unreasonable profits, it is contemplated that associations may adopt rules designed to prevent each member thereof from exacting in any particular transaction a profit which reasonable men would agree was unconscionable in the light of all of the concrete facts and circumstances of that transaction; but an association, whether in a bona fide attempt to prevent or under the pretext of preventing unreasonable profits, may not impose any schedule of prices or commissions.<sup>3</sup>

### **Deficiency in Nasdaq’s Form 19b-4 Filing**

The deficiencies in the Nasdaq filing are not limited to contravening express statutory prohibitions. Once again, as in the earlier filing, Nasdaq has flouted the requirement in Form 19b-4 to discuss and justify burdens on competition. It has simply parroted the language of Section 6(b)(8) by asserting that Nasdaq “does not believe that its proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the Exchange Act.”<sup>4</sup> That rote incantation of the Section 6(b)(8) standard, unsupported by any

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<sup>3</sup> See Regulation of Over-the-Counter Markets, Report of the Senate Comm. on Banking and Currency to Accompany S. 3255, S. Rep. No. 1455, 75<sup>th</sup> Cong., 3d Sess. 7 (1938). See also, Regulation of Over-the-Counter Markets, Report of the House Comm. on Interstate and Foreign Commerce to Accompany S. 3255, H.R. Rep. No. 2307, 75<sup>th</sup> Cong., 3d Sess. 8 (1938).

<sup>4</sup> SR-NASDAQ-2006-001 at page 156 of 158.

discussion or any demonstration at all, does not satisfy the requirements of the Commission's Form 19b-4 that such burdens be explained and justified in detail.<sup>5</sup> As the Commission is aware, moreover, the courts have applied strict scrutiny to rule filings that do not meet statutory standards.

If the competitive impact of the Nasdaq rule proposal were trivial, an elaborate discussion would not be warranted. That is not the case here, however. Destroying the pricing power of a subset of members, that is, ECNs, distinguished solely by their business model is not trivial. Given the inadequacy of the record, the public would be effectively deprived of a meaningful opportunity for comment on the proposed rule.<sup>6</sup> The Commission, in turn, would be

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<sup>5</sup> The General Instructions to Form 19b-4, 5 Fed. Sec. L. Rep. (CCH) ¶ 32,356, are explicit on the point. They provide, with respect to "Information to be Included in the Completed Form", as follows:

4. *Self-Regulatory Organization's Statement on Burden on Competition*

State whether the proposed rule change will have an impact on competition and, if so, (i) state whether the proposed rule change will impose any burden on competition or whether it will relieve any burden on, or otherwise promote, competition and (ii) specify the particular categories of persons and kinds of businesses on which any burden will be imposed and the ways in which the proposed rule change will affect them. If the proposed rule change amends an existing rule, state whether that existing rule, as amended by the proposed rule change, will impose any burden on competition. If any impact on competition is not believed to be a significant burden on competition, explain why. Explain why any burden on competition is necessary or appropriate in furtherance of the purposes of the [Exchange] Act. In providing those explanations, set forth and respond in detail to written comments as to any significant impact or burden on competition perceived by any person who has made comments on the proposed rule change to the self-regulatory organization. *The statement concerning burdens on competition should be sufficiently detailed and specific to support a Commission finding that the proposed rule change does not impose any unnecessary or inappropriate burden on competition* [emphasis added].

*Id.* at p. 22,318.

<sup>6</sup> To assist the Commission in its adjudicatory proceedings under the Exchange Act, such as the approval by order of a self-regulatory organization's proposed rule change under Exchange Act Section 19(b), Nasdaq must provide an adequate basis for comment on its rule proposals and, where significant competitive issues are involved, must provide an opportunity for the public to comment meaningfully on the issues involved. Perfunctory recitals do not provide that basis. *See Connecticut Light and Power Co. v. NCR*, 673 F.2d 525, 530-31 (DC Cir. 1982):

The purpose of the comment period is to allow interested members of the public to communicate information, concerns, and criticisms to the agency during the rule-making process. If the notice of proposed rule-making fails to provide an accurate picture of the reasoning that has led the agency to the proposed rule, interested parties will not be able to comment meaningfully upon the agency's proposals. As a result, the agency may operate with

*(Footnote continued)*

denied the benefit of the comments that could arise from the fully informed dialogue and genuine interchange of data, views and arguments the Congress called for in the rule-approval process embodied in Exchange Act Section 19(b).<sup>7</sup>

We point these matters out to underscore the deficiency in the Nasdaq filing from the point of view of public disclosure, which presents an independent, *per se* basis on which the Commission cannot lawfully approve the filing — Nasdaq's failure to observe the disclosure requirements set forth in the Commission's own Form 19b-4. In this instance, though, given the even more serious and incurable statutory infirmities in Nasdaq's filing, to require Nasdaq to upgrade its filing before seeking public comment would not be useful. Instead, we recommend that the Nasdaq be told to withdraw that portion of the instant rule proposal that would fix at zero

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(Continued footnote)

a one-sided or mistaken picture of the issues at stake in a rule-making. . . . To allow an agency to play hunt the peanut with technical information, hiding or disguising the information that it employs, is to condone a practice in which the agency treats what should be a genuine interchange as mere bureaucratic sport.

<sup>7</sup> The rigorous approach built into the Commission's Rule 19b-4 and Form 19b-4 responds to a direct, specific and unequivocal congressional mandate. *See* Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S.249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 29-30 (1975):

In order to facilitate expeditious Commission review and evaluation of [proposed rule changes] and to assure informed public comment on them, Section 19(b)(1) would require all self-regulatory organizations to file with the SEC in connection with any proposed rule change a "concise general statement of the basis and purpose" of the proposed rule change. *It is the Committee's intention in adopting this standard to hold the self-regulatory organizations to the same standards of policy justification that the Administrative Procedure Act imposes on the SEC.*

. . . [T]he Committee believes interested persons should have a meaningful opportunity to obtain accurate information about proposed changes in self-regulatory rules and to comment on the need or justification for these changes. Section 19(b)(1) would require the SEC to give notice and provide an opportunity for interested persons to participate in the process of reviewing a proposed change in a self-regulatory organization's rules. In addition, this section would require that all comment and all correspondence between the SEC and the self-regulatory agency concerning the proposal be available for public inspection. . . .

. . . The Committee believes the Commission has a responsibility to see that self-regulatory rules are fully responsive to regulatory needs. By explicitly providing that the Commission's oversight authority encompasses major self-regulatory policies, the bill would make this responsibility clear and substantially decrease the possibility of slippage between regulatory need and self-regulatory performance [emphasis added]. . . .

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the fees ECNs can charge for access to the Nasdaq Market Center and, if Nasdaq is unwilling to do so, that the Commission commence proceedings to consider disapproval of the proposal.

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Again, we appreciate the time you and your colleagues have given to considering these issues in the past in connection with the earlier filing. We believe the issues bear on fundamental questions of the scope of SRO and Commission rulemaking authority. We would be pleased to discuss them further, respond to any questions you may have or provide any additional comments or information you may request.

Respectfully submitted,

*Kim Bang* by R.D.B.

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