

May 17, 2006

Via e-mail: rule-comments@sec.gov

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

Attention: Ms. Nancy M. Morris, Secretary

Re: Commission File Nos. SR-NASDAQ-2006-006

Ladies and Gentlemen:

We appreciate the opportunity to comment in response to the request by the Securities and Exchange Commission (the "Commission") in Securities Exchange Act Release No. 53697 (April 21, 2006) (the "Release") for comment on a proposed rule change filed by The NASDAQ Stock market LLC ("Nasdaq") that would (i) govern acquisitions, mergers or business ventures between Nasdaq and an affiliate of Nasdaq, on the one hand, and a Nasdaq member or affiliate of a Nasdaq member, on the other hand, ("Business Ventures")¹ and (ii) make changes to its disciplinary proceedings rules (the "Proposed Rule Change"). Our comments are limited to those parts of the Proposed Rule Change that relate to Business Ventures.

This Proposed Rule Change is not clear on its face. Properly understood, however, it would appear to curtail the Commission's power to review Nasdaq rulemaking under Section 19(b) of the Securities Exchange Act of 1934 (the "Exchange Act"). Its effect, if approved by the Commission, apparently would be to exempt a broad category of core Nasdaq facilities from the Commission's powers to review Nasdaq rules.

The matters that would no longer be subject to Commission review would include, among other things, contracts between Nasdaq and its affiliates and Nasdaq members or their affiliates to provide goods, products or services, including, e.g., licenses of intellectual property and the provision of transaction services or data to a broker-dealer member or a listed company that owns a broker-dealer member.² As the Commission knows, Nasdaq contracts that prescribe extensive and specific limitations on particular types of transactions or conduct that are not apparent from an existing Nasdaq rule must themselves be filed as proposed rule

¹ See, proposed Nasdaq Rule 2140(a)(2) in Release in text after n. 3.

² See, Release in text accompanying nn. 9 & 10.

changes under Section 19(b) and Rule 19b-4.³ The Proposed Rule Change apparently is designed, *sub silentio*, to reverse that result and thereby to nullify the Commission's policy conclusions reflected in, among other things, its decisions concerning the New York Stock Exchange's Liquidity Quote agreement.⁴

In addition, under the Proposed Rule Change, Nasdaq would not have to file rules governing the operation of Business Venture that has met certain enumerated conditions. Those enumerated conditions are a truncated version of conditions in an exemptive order the Commission granted to the NASD and Nasdaq in 2000 (the "FSI Order").⁵ The FSI Order permitted the NASD and Nasdaq to develop trade analytics through a separate subsidiary without filing proposed rule changes under Section 19(b) and Rule 19b-4 on behalf of the subsidiary. The Commission granted that relief on several conditions that were designed to ensure that (a) the activities of FSI would not involve core functions of Nasdaq and (b) FSI would not obtain any informational benefit from Nasdaq that would give it a commercial advantage over its competitors.

Nasdaq avoids citing the FSI Order, probably for good reason. Nasdaq apparently intends the Proposed Rule Change to trump Exchange Act Section 19(b) and Rule 19b-4 thereunder for a much broader universe of potential business activities than the FSI Order contemplated. Most importantly, the conditions recited in the Proposed Rule Change under which a Business Venture would be freed of having to file rule changes omit a key condition in the FSI Order, that:

the products of FSI will not be necessary for broker-dealers to access the NASD's fundamentally important or core services, including quotation collection and dissemination, order routing and execution, and trade reporting. The NASD and Nasdaq have agreed to maintain an independent functionality for the NASD's market-related facilities — that is, neither FSI's products nor enhanced software products of any kind will be necessary for a broker-dealer to obtain access to the NASD's fundamentally important or core services. The basic software products necessary to obtain such access (currently provided through the NWII service) will be provided separately from FSI.⁶

³ See, *Filings by Self-Regulatory Organizations of Proposed Rule Changes*, Securities Exchange Act Release No. 17258 (October 30, 1980), 21 SEC Docket 347, 359-60. See also, *William J. Higgins*, 48 S.E.C. 713, 724 (1987) ("stated policy imposing a broad prohibition on [NYSE] members access" to Exchange services would "have to be apparent from the face of the existing NYSE rules to fall within the reasonably and fairly implied category").

⁴ See, *Matter of Bloomberg*, Securities Exchange Act Release No. 49076 (January 14, 2004).

⁵ Securities Exchange Act Release No. 42713 (April 24, 2000) (2000 SEC LEXIS 807).

⁶ *Id.* in text following n.22 [footnote omitted].

By omitting that fundamental part of the FSI Order, the Proposed Rule Change would go far beyond *FSI's* limited context and would, it appears, exempt core business activities of Nasdaq, such as licensing intellectual property and granting access to transactional services and Nasdaq data.

Secondly, in the FSI Order, the Commission was mindful of the delays implicit in Rule 19b-4 rule filings and concluded that the delays would “put FSI at such a competitive disadvantage as to render the acquisition of FSI or the rights to the software impracticable.”⁷ Unlike *FSI*, however, the Proposed Rule Change would not be limited to cases in which a Business Venture is competing with other business entities not affiliated with Nasdaq.

The Business Ventures thus could both involve a core Nasdaq function and be in competition with other entities. Indeed, the Business Venture could benefit from Nasdaq’s monopoly powers since it could offer the only way for a broker-dealer to obtain access to Nasdaq’s “fundamentally important or core services.” As a result, the Proposed Rule Change would subvert the Commission’s policy judgments reflected in the FSI Order:

Given the rapid advances in technology, the increasing reliance of the financial industry on automation and the degree of competition in the supply of technological solutions, we believe that in certain circumstances, including those presented in this request, a policy distinction can be made between essential or core SRO services and ancillary non-essential or optional services such as those offered by FSI to permit the latter category of services to be offered by an SRO on a fully competitive basis without compliance with the notice and comment process while at the same time ensuring that those services are offered in a way that is consistent with the goals and requirements of the Exchange Act.

As noted above, OTC Tools offers a variety of features to assist NASD broker-dealers in efficiently managing their quotes, monitoring and executing incoming orders, continually checking for closed, locked or crossed markets, and monitoring the depth of the market. *These functions to be performed by OTC Tools are not central to the core functionality of Nasdaq’s marketplace. Rather the functions involved are supplemental to, and independent of, the primary functions of Nasdaq.*

Moreover, the NASD and Nasdaq believe that the exemption requested is consistent with the purposes of the Exchange Act, particularly the protection of investors, the maintenance of fair and orderly markets, and the fostering of competition. This segment of the financial software market is highly competitive. As discussed above, there are a number of other firms that offer competing

⁷ FSI Order in text following n.7.

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products to OTC Tools. The NASD and Nasdaq propose that Nasdaq will operate FSI as a stand-alone business, capitalized separately and not subsidized by NASD members or other revenues of the NASD or Nasdaq.⁸

In view of these serious deficiencies, we respectfully suggest that the Commission request that Nasdaq withdraw the Proposed Rule Change since it would violate Exchange Act Section 19(b) and Rule 19b-4 and the Commission could not lawfully approve it.

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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⁸ FSI Order, in text preceding n.8 [emphasis added; footnote omitted].