

October 8, 2010

Via Electronic Mail (rule-comments@sec.gov)

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Attention: Florence E. Harmon, Deputy Secretary

COMMENT LETTER AND PETITION FOR DISAPPROVAL

Re: Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NASDAQ OMX PHLX, Inc. Relating to Market Data Feeds, File No. SR-Phlx-2010-121, Exchange Act Release No. 62887 (Sept. 10, 2010) (“PHLX Notice”)

Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Establish an Optional Depth Data Enterprise License Fee, File No. SR-NASDAQ-2010-111, Exchange Act Release No. 62908 (Sept. 14, 2010) (“Nasdaq Notice”)

Dear Ms. Harmon:

We appreciate the opportunity to comment on the above-captioned notices (together the “Notices”), under which NASDAQ OMX PHLX, Inc. (“PHLX”) proposed a rule change to amend its fee schedule to establish fees for a direct data product, PHLX Options Trade Outline (“PHOTO”),¹ and The NASDAQ Stock Market LLC (“Nasdaq”) proposed a rule change to establish an optional Depth Data Enterprise License Fee for TotalView depth-of-book data to non-professional users.² The proposed rule changes became effective upon filing with the U.S. Securities and Exchange Commission (the “Commission”) under Section 19(b)(3)(A) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).³ The Commission published the Notices for comment on September

¹ *Self Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NASDAQ OMX PHLX, Inc. Relating to Market Data Feeds*, Exchange Act Release No. 62887; File No. SR-Phlx-2010-121; 75 Fed. Reg. 57092 (Sept. 17, 2010).

² *Self Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by The NASDAQ Stock Market to Establish an Optional Depth Data Enterprise License Fee*, Exchange Act Release No. 62908; File No. SR-NASDAQ-2010-111; 75 Fed. Reg. 57321 (Sept. 14, 2010).

³ 15 U.S.C. § 78s(b)(3)(A) (2010).

10, 2010 and September 14, 2010, respectively. For the reasons set out below, and because the exchanges' actions are inconsistent with the recent decision of the United States Court of Appeals for the District of Columbia Circuit in *NetCoalition v. Securities and Exchange Commission*,⁴ we respectfully petition the Commission to temporarily suspend both rule changes under recently-amended Section 19(b)(3)(C) of the Exchange Act⁵ and institute proceedings to disapprove (or properly approve) those changes under Section 19(b)(2)(B) of the Exchange Act.⁶ As we have previously conveyed to the Commission, time is of the essence in the need for the Commission to suspend the effect of these and other similar market data fee rule changes proposed by self-regulatory organizations based on invalid grounds omitting cost data. We therefore urge the Commission to act immediately to suspend these and other similar fee rule changes until the Commission and the public have had ample time to determine whether they should be disapproved.

A. Description of Market Data Fees

1. PHOTO

PHOTO provides specified proprietary information to data subscribers, who may be both members and non-members of PHLX, about the activity in a particular options series during a trading session.⁷ Subscribers will receive the following data about an options series:

- Aggregate number of buy and sell transactions;
- Aggregate volume traded electronically on the Exchange;
- Aggregate number of trades effected on the Exchange to open a position;
- Aggregate number of trades effected on the Exchange to close a position; and
- Origin of the orders involved in trades on the Exchange in the series during a particular trading session, specifically aggregated in the following categories of participants: customers, broker-dealers, market makers, and professionals.⁸

PHLX offers two PHOTO products: an end-of-day product and an intra-day product. The end-of-day product provides aggregate data on the relevant options series

⁴ 2010 U.S. App. LEXIS 16303 (D.C. Cir. Aug. 6, 2010).

⁵ 15 U.S.C. § 78s(b)(3)(C) (2010).

⁶ 15 U.S.C. § 78s(b)(2)(B) (2010).

⁷ PHLX Notice at 2.

⁸ *Id.* at 2-3.

for the entire trading session, *i.e.*, an entire trading day. The monthly subscriber fee for the end-of-day product is \$500.⁹

The intra-day product provides cumulative data on 10-minute trading sessions. Data is captured in “snapshots” taken every 10 minutes throughout the session and is available to subscribers within five minutes of the end of each 10-minute period. Each snapshot includes data captured in all previous snapshots. The monthly subscriber fee for this product is \$1,500.¹⁰

2. TotalView

Nasdaq has changed its fees for specified depth-of-book data and direct data access. TotalView is a subscription service under which the subscriber receives depth-of-book data feeds. TotalView subscribers pay distributor fees for data on both Nasdaq and non-Nasdaq listed stocks. Subscribers to Nasdaq’s Level 2 and OpenView services, however, pay distributor fees only for data on non-Nasdaq-listed securities (even though Level 2 is a subset of TotalView data). Nasdaq has amended Rule 7019 so that Level 2 and OpenView subscribers now pay for data on Nasdaq-listed, as well as non-Nasdaq-listed securities.⁹

Nasdaq also is imposing a direct access fee to people who access data under a Level 2 subscription directly from Nasdaq. Before the imposition of the fee, TotalView and OpenView subscribers paid a fee to access data directly from Nasdaq, but the Level 2 subscribers did not. Subscribers to all three services are now charged one direct access fee for Nasdaq-listed securities and one direct access fee for non-Nasdaq-listed securities.¹⁰

The rule change proposed by Nasdaq adds an enterprise pricing option for the internal use by and redistribution to non-professional users of, in the aggregate, NQDS, TotalView and OpenView. The price of the enterprise license for these services is \$300,000. The license is available only to broker-dealers registered under the Exchange Act. Despite Nasdaq’s assertion that the pricing “provides broker-dealers with an additional approach to providing more NASDAQ data at a lower cost,” the option is priced at such a high and uncompetitive level that it is unlikely to be of any benefit for all but the largest broker-dealers, if any. The pricing for this service will be attractive to few if any broker-dealers because redistribution of the services to huge numbers of non-professional users is required for the pricing to be economical.

⁹ *Id.* at 4.

¹⁰ *Id.*

⁹ Nasdaq Notice at 3.

¹⁰ *Id.* at 4.

B. Market Data Fees Must be “Fair and Reasonable.”

Under the Exchange Act, the SEC has a duty to ensure that the proposed fees are, among other things, “fair and reasonable.”¹¹ Both Notices assert, incorrectly, that the recent amendment to Section 19(b)(3)(A) of the Exchange Act in Section 916 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”)¹² reflects a presumption that all fees are constrained by competition and that the Commission is therefore relieved of its obligation to ensure that the data fees are “fair and reasonable” within the meaning of Sections 11A(c)(1)(C) of the Exchange Act.¹³ Neither the plain language of the recent amendment to Section 19(b)(3)(A) of the Exchange Act, nor the available legislative history of that amendment, supports PHLX’s and Nasdaq’s contention that the amendment reflects any such presumption. It is true, as the Commission knows, that Section 916 of the Dodd-Frank Act amended paragraph (A) of Section 19(b)(3) of the Exchange Act by inserting the phrase “on any person, whether or not the person is a member of the self-regulatory organization” after “due, fee or other charge imposed by the self-regulatory organization.”¹⁴ As a result, all SRO rule proposals establishing or changing dues, fees, or other charges are effective immediately upon filing regardless of whether such dues, fees, or other charges are imposed on members of the SRO, non-members, or both and also regardless of whether such dues, fees or other charges are or are not consistent with the provisions of the Exchange Act applicable to the Exchange. To protect against the evident risk of abuse, Section 916 also amended paragraph (C) of Section 19(b)(3) of the Exchange Act to read, in relevant part, as follows:

At any time within the 60-day period beginning on the date of filing of such a proposed rule change in accordance with the provisions of paragraph (1) [of Section 19(b)], the Commission summarily may temporarily suspend the change in the rules of the self-regulatory organization made thereby, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title. If the Commission takes such action, the Commission shall institute proceedings under paragraph (2)(B) [of Section 19(b)] to determine whether the proposed rule should be approved or disapproved.¹⁵

¹¹ Exchange Act, Sections 11A(c)(1)(C) (fees must be “fair and reasonable” and not “unreasonably discriminatory”) & 6(b)(4) (exchange must also “provide for the equitable allocation of reasonable dues, fees, and other charges among . . . persons using its facilities”).

¹² Pub. L. No. 111-203, H.R. 4173 (June 29, 2010).

¹³ 15 U.S.C. § 78k-1(c)(1)(C) (2010).

¹⁴ 15 U.S.C. § 78s(b)(3)(A) (2010).

¹⁵ As discussed below, Section 19(b)(C) also provides that a proposed rule change that has become effective immediately may be enforced by the self-regulatory organization “to the extent it is not inconsistent with any provision of [the Exchange Act], the rules and regulations thereunder and applicable

There is no basis at all for PHLX's and Nasdaq's unwarranted statements in the Notices that the Congress amended Section 19(b)(3)(A) of the Exchange Act to confirm that fees that an exchange imposes are *per se* fair and reasonable because those fees are subject to competitive forces. The plain language of Section 19(b)(3)(A)(ii) does not refer to competitive forces in permitting rules imposing exchange fees to become effective upon filing with the Commission. PHLX and Nasdaq do not cite to, and we are not aware of, any legislative history under the Dodd-Frank Act that suggests that proposed exchange rules establishing or changing fees may become effective immediately because such fees are deemed to be subject to competitive forces. The Dodd-Frank Act, moreover, did not amend Section 11A(c)(1)(C), which imposes on the Commission a duty to ensure that fees imposed by an SRO, such as PHLX's PHOTO data fees and Nasdaq's Depth Enterprise License Fee, among other things, are "fair and reasonable."¹⁶

C. The Exchanges Have Not Shown that These Market Data Fees are Constrained by Competitive Forces.

The Commission has not required either PHLX or Nasdaq to show, and neither PHLX nor Nasdaq has shown, that it is subject to significant competitive forces that would limit charging reasonable fees in pricing PHOTO and TotalView market data. The *NetCoalition* case made it clear that costs incurred in providing data are relevant in assessing the reasonableness of the fees an exchange charges to provide the data because "in a competitive market, the price of a product is supposed to approach its marginal cost, i.e., the seller's cost of producing one additional unit."¹⁷ On the other hand, "[s]upracompetitive pricing may be evidence of 'monopoly,' or market power . . . Thus the costs of collecting and distributing market data can indicate whether an exchange is taking excessive profits' or subsidizing its service with another source of revenue"¹⁸ The cost of producing market data would be direct evidence of whether competition constrains the ability to impose supracompetitive fees.¹⁹ The Notices, however, do not contain any information about PHLX's costs of collecting and distributing the PHOTO market data and, therefore, do not give the Commission the information the *NetCoalition* court found to be necessary to sustain the Commission's approval of the exchange rule there at issue.

We rather suspect that the reason none of the exchanges have been willing to provide data to the Commission, at least for publication in their market data rule filings, is that the costs are minimal.

federal and state law." Accordingly, if such a rule could not be enforced, and fees could not lawfully be collected, if the rule did not meet those standards, including, for example, applicable federal and state antitrust law.

¹⁶ 15 U.S.C. § 78k-1(c)(1)(C) (2010); *see also NetCoalition v. Sec. Exch. Comm'n*, 2010 U.S. App. LEXIS 16303, *21 (D.C. Cir. Aug. 6, 2010).

¹⁷ *NetCoalition*, 2010 U.S. App. LEXIS 16303 at *32.

¹⁸ *Id.* at *32 - *33.

¹⁹ *Id.*

Rather than provide information on the costs of collecting and distributing the market data that comprise these products, PHLX and Nasdaq rehash in the Notices a theory, relied upon by NYSE ARCA, Inc. in *NetCoalition*, that market behavior constrains the prices they may charge for this data because (1) increases in market data prices will drive order flow to other trading venues, and (2) there are alternatives to purchasing these market data products. PHLX and Nasdaq, however, do not provide any support for this theory other than precisely the type of conclusory statements that were rejected by the Court in *NetCoalition*.

PHLX and Nasdaq do not support their contention that order flow competition constrains these market data fees.

PHLX and Nasdaq do not provide any evidence or create a record in the Notices that supports its theory that order flow competition creates a competitive market for the PHOTO and TotalView market data that constrains the price of that data. Their competitive markets argument, therefore, must be rejected. Without providing any evidence for their position, the exchanges assert that the “market for market data products is competitive and inherently contestable because there is fierce competition for the inputs necessary to the creation of proprietary data [*i.e.*, order flow] and strict pricing discipline for the proprietary products themselves.”²⁰ That is, neither PHLX nor Nasdaq provide any evidence that these data fees themselves are subject to competitive forces, but each concludes that that must be the case because order flow data is a component of their market data, and the market for order flow is subject to competitive forces. Moreover, each note that market data fee competition must exist because broker-dealers have numerous venues available to which they may route order flow and those venues produce market data of various types.²¹ The Court in *NetCoalition* rejected the order flow argument, however, because, like here, there was no support for the assertion that order flow competition constrained the ability of the exchange to charge supracompetitive prices for data. In rejecting the argument, the Court discounted the statements made by various exchanges to the effect that the exchanges consider the impact on attracting order flow in setting data prices. “The self-serving views of the regulated entities ... provide little support to establish that significant competitive forces affect their pricing decisions.”²²

The exchanges do not support its contention that there are reasonable substitutes for the market data.

The exchanges additionally assert that several alternatives to the data products at issue are available, but do not provide any evidence that the alternatives are reasonable substitutes for, and therefore competitors to, the PHOTO and TotalView market data such that pricing of the data was constrained by competitive forces. PHLX contends that the proprietary market data from other exchanges provides competition for PHOTO market

²⁰ PHLX Notice at 12; Nasdaq Notice at 12.

²¹ *Id.*

²² *NetCoalition*, 2010 U.S. App. LEXIS 16303 at *42 - *43.

data, noting “that at least two other U.S. options exchanges offer a market data product that is substantially similar to PHOTO, which the PHLX must consider in its pricing discipline in order to compete for listings, trades, and the market data itself.”²³ According to PHLX, non-exchange entities, such as alternative trading systems (“ATs” and each, an “ATS”) and broker-dealers, produce proprietary data and publish it on the Internet and, thus, provide competition for, and pricing discipline on, market data providers.²⁴ PHLX also states that market vendors, “because they control the primary means of access to users,” provide pricing discipline. PHLX argues that data vendors would not offer market data products from providers such as PHLX if end users would not use the data products because of price.²⁵

Neither PHLX nor Nasdaq provide evidence that the availability of other proprietary options market data constrains its pricing of PHOTO and TotalView data products; they offer no support for their contention that other data products are substitutes for this market data. Under the Court’s holding in *NetCoalition*, a market data provider must evaluate the number of potential users of its data and assess how those users might react to changes in the price of that data.²⁶ “[D]ata from other exchanges could be an alternative for individual securities but that determination cannot be made without knowing how actively the security is trade[d] on those exchanges.”²⁷ The exchanges provide no evidence, only theories, as to how broker-dealers might react to changes in the prices of its data products. Just as in *NetCoalition*, in which the Court observed “[t]here is no dispute that NYSE Arca is the “exclusive” provider of this data [and] [w]hile many exchanges sell Google stock, only NYSE Arca offers access to the Google limit orders included in its depth-of-book product,”²⁸ here the PHLX and Nasdaq have the exclusive ability to offer the products they propose to sell. Other exchanges and/or venues may offer similar products, but only PHLX and Nasdaq are able to offer the data in the proposed products at the same speed.

The “platform competition” approach does not support the exchanges’ contention that PHOTO and TotalView data prices are constrained by competition.

PHLX and Nasdaq’s “platform competition” approach to pricing the PHOTO and TotalView data products is inherently flawed because that approach (1) is simply a rehash of the argument rejected by the Court in *NetCoalition* that the competitive need to attract order flow acts as a significant competitive force in regulating the price of market data, (2) does not support the contention that the market data prices are constrained by competitive forces, and (3) is inconsistent with the Exchange Act. Under a platform competition approach to pricing, market data and trade executions are viewed as “joint”

²³ PHLX Notice at 12.

²⁴ PHLX Notice at 13.

²⁵ *Id.*

²⁶ *NetCoalition*, 2010 U.S. App. LEXIS 16303 at *48.

²⁷ *Id.* at *50 - *51.

²⁸ *NetCoalition*, 2010 U.S. App. LEXIS 16303 at *34.

products and are priced in the aggregate.²⁹ Under such a theory, an exchange could price its data fees higher and execution fees lower, or vice versa, but would be constrained by competitive forces from pricing those fees in the aggregate above the price of joint products on other exchanges or trading venues. This is simply a thinly veiled rehash of the rejected argument in *NetCoalition* that competition for order flow acts as a significant competitive force to constrain the pricing of market data. The platform competition approach is inconsistent with the “fair and reasonable” requirement of Section 11A(c)(1)(C) of the Exchange Act because, as here and as the Court in *NetCoalition* found, there is no substantial evidence to support the contention that competition for order flow constrains market data fees. PHLX and PHOTO have presented no evidence to support their recast theory, only the same type of conclusory statements dismissed by the Court in *NetCoalition*. As here, the Court in *NetCoalition* found, “More problematic is the lack of support in the record for the SEC’s conclusion that order flow competition constrains market data prices.”³⁰

In addition, the platform theory is flawed because under the platform approach pricing, PHLX may set PHOTO data prices, and Nasdaq may set TotalView data prices, at supracompetitive levels, notwithstanding the exchanges’ contention that market data prices are constrained by competitive forces, as long as they charge less for other services, even though some users of the data may consume only the PHOTO data services, and not PHLX’s other services, such as trade execution. This approach to pricing would therefore immunize data fees from review by wrapping them together with fees for other services and would thus nullify the “fair and reasonable” standard.³¹ If two products are bought and sold separately, the price of each should be the result of the distinct competitive conditions confronting each product.³²

Finally, PHLX theorizes that:

if a platform increases its market data fees, the change will affect the overall cost of doing business with the platform, and affected broker-dealers will assess whether they can lower their trading costs by directing orders elsewhere and thereby lessening the need for the more expensive data.³³

This theory assumes that the broker-dealer (1) stops consuming a platform’s market data if it directs trade execution to another platform, and (2) consumes both market data and other services that a platform sells. Directing trade execution to a different platform from the one from which the broker-dealer purchases market data does not save the broker-dealer the costs of purchasing market data if the broker-dealer needs to obtain the market data from that platform irrespective of where the broker-dealer

²⁹ See *Id.* at *45 - *46 n. 16.

³⁰ *NetCoalition*, 2010 U.S. App. LEXIS 16303 at *42.

³¹ PHOTO market data products are offered on a monthly subscription basis. Notice at 4.

³² See *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 929 (2d Cir. 1982).

³³ PHLX Notice at 10.

executes trades. Moreover, if a broker-dealer purchases only market data from a platform and no other services, its only choice would be to pay the increased data prices imposed by the platform or stop buying the data entirely. PHLX's theory, therefore, does not demonstrate that PHOTO data fees are constrained by competitive forces.

The Commission must determine whether it must consider cost data as an essential element of the Commission's "competitive forces" test, as we believe *NetCoalition* requires, or whether other data would support a finding of competitive forces, before approving these or any other future market data fee filings. Neither the Commission nor the exchanges should circumvent the court's findings in *NetCoalition* through the procedural mechanism of Section 19(b)(3)(A). The failure to address the court's concerns that the Commission's application of the market forces test – relied upon again here by PHLX and Nasdaq – is not supported by substantial evidence and renders the subject market data rule filings unenforceable under Section 19(b)(3)(C).³⁴

Conclusion

For the reasons set out above, and given the absence of cost data or any other evidence supporting the exchanges' contention that these data fees are constrained by competitive forces, we respectfully request that the Commission temporarily suspend the proposed rules establishing PHLX's PHOTO market data fees and Nasdaq's TotalView enterprise license fee under Section 19(b)(3)(C) of the Exchange Act, and institute proceedings to disapprove the proposed rule under Section 19(b)(2)(B) of the Exchange Act. We respectfully point out in that regard that it likely would be better to evaluate this rule filing in the context of a normal notice-and-comment proceeding under Section 19(b) than to let the 60-day period pass without action which would prompt consideration of further action by SIFMA, NetCoalition, and our members.

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³⁴ As noted above, Section 19(b)(3)(C) provides: "Any proposed rule change of a self-regulatory organization which has taken effect pursuant to subparagraph (A) or (B) of this subparagraph may be enforced by such organization to the extent it is not inconsistent with the provisions of this title, the rules and regulations thereunder, and applicable federal and state law."

If you have any questions or you would like to discuss these matters further, please call either of the undersigned or Melissa MacGregor, Managing Director and Associate General Counsel, SIFMA, at 202-962-7385.

Respectfully submitted,

Ira D. Hammerman
Senior Managing Director
and General Counsel
SIFMA

Markham Erickson
Executive Director
and General Counsel
NetCoalition

1101 New York Ave., NW, 8th Floor
Washington, DC 20005
202-962-7300

400 North Capitol Street, N.W.
Suite 585
Washington, D.C. 20001
202-624-1460