



**JOAN C. CONLEY**  
SENIOR VICE PRESIDENT & CORPORATE SECRETARY  
805 KING FARM BLVD.  
ROCKVILLE, MD 20850

**P:** (301) 978-8735  
**F:** (301) 978-5055  
**E:** joan.conley@nasdaqomx.com

June 4, 2012

***Via Electronic Delivery and Overnight Mail***

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

**Re:** Order Granting Petition for Review and Scheduling Filing of Statements Concerning NASDAQ's "Platform Pricing" Proposal, Release No. 66667, File No. SR-NASDAQ-2011-10 (Mar. 28, 2012)

Dear Ms. Murphy:

On April 18, 2012, the Securities Industry and Financial Markets Association ("SIFMA") and NetCoalition submitted a comment letter in response to the Commission's order granting the petition for review of The NASDAQ Stock Market LLC ("NASDAQ") in the above-titled matter. NASDAQ respectfully submits this letter in response to the submission by SIFMA and NetCoalition.

**I. The D.C. Circuit Has Rejected The Argument That Exchanges Must Submit Cost Data In Support Of Market Data Fees, And In Any Event, The Commission Has Already Deemed NASDAQ's Non-Discounted Fees Fair And Reasonable.**

SIFMA and NetCoalition are the only third parties to submit a comment in response to the Commission's order granting NASDAQ's petition for review. In arguing that the Commission should affirm the decision made by the Division of Trading and Markets ("Division") acting pursuant to delegated authority, SIFMA and NetCoalition principally contend that NASDAQ has failed to justify its market data fees by reference to the costs of collecting and distributing that data. *See* NetCoalition Letter at 3-4. This argument is misplaced, for at least two reasons.

*First*, according to SIFMA and NetCoalition, cost data is important because in a competitive market, the price of a product is expected to approach its marginal cost. *See id.* at 4. But the Commission has *already approved* the baseline prices that NASDAQ charges for its market

data products and execution services; the current proposal merely provides an optional *discount* to certain customers that purchase both items in large quantities. There is no reason to require NASDAQ to submit cost data to justify *lowering* prices that the Commission has already deemed fair and reasonable. Indeed, reducing an item's concededly reasonable price could only narrow the gap between that price and the item's marginal cost.

*Second*, SIFMA and NetCoalition base their demand for cost data on a misreading of the D.C. Circuit's decision in *NetCoalition v. Securities & Exchange Commission*, 615 F.3d 525 (D.C. Cir. 2010). In that decision, the D.C. Circuit *rejected* the argument advanced by SIFMA and NetCoalition that exchanges are required to submit cost information in support of proposed prices for market data products. The text of the Exchange Act, the court reasoned, did not speak to "whether the SEC is required to evaluate non-core [depth-of-book] data under a cost-based approach." *Id.* at 534. The court concluded that the Commission's "market-based approach to evaluating whether . . . non-core data fees are 'fair and reasonable' . . . is a permissible one," and is consistent with the Commission's past regulatory practice (including Regulation NMS). *Id.* at 535-37. In reaching that conclusion, the D.C. Circuit explained that, while the Commission *may* rely on cost data to show the existence of a competitive market, it can also rely on "alternative indicator[s] of competitiveness" if supported by adequate evidence. *Id.* at 539.

A requirement to submit cost data would be particularly inappropriate here because, as NASDAQ explained in an economic study submitted with its rule proposal, "market data and trade executions are 'joint products' with 'joint costs' at each trading 'platform,' or exchange." *Id.* at 541 & n.16; *see also* Statement of Janusz Ordover and Gustavo Bamberger ¶¶ 19-29 (Dec. 29, 2010) ("Ordover/Bamberger Statement"). Therefore, "[a]lthough an exchange may price its trade execution fees higher and its market data fees lower (or vice versa), because of 'platform' competition the exchange nonetheless receives the same return from the two 'joint products' in the aggregate." *NetCoalition*, 615 F.3d at 541 & n.16. The Commission relied on this very same "'platform' competition" theory before the D.C. Circuit in *NetCoalition* to justify its reliance on market forces, rather than cost data, to evaluate the prices of market data products. *Id.* The D.C. Circuit expressly reserved the question whether this theory could provide a basis for the Commission to deem fees fair and reasonable. *Id.*

SIFMA and NetCoalition mischaracterize NASDAQ's argument when they claim that, under the "platform competition" theory, exchanges could charge supracompetitive prices for one product (such as market data) as long as they charge significantly lower prices for a separate product (such as execution services). *See* NetCoalition Letter at 4-5. NASDAQ has invoked the "platform competition" theory not to justify supracompetitive pricing but to demonstrate why it is impossible to set the prices of market-data products at or near the marginal cost of compiling and distributing data. Specifically, the costs of creating market data products consist primarily in the "fixed" costs of establishing a trading platform and facilitating trades between buyers and sellers, *i.e.*, offering the execution services that provide the raw input for

NASDAQ's depth-of-book data. Once those costs are incurred and the data is collected, the incremental (or "marginal") costs of providing that data to each additional customer are relatively low, if not zero. *See* Ordover/Bamberger Statement ¶ 45. But it does not follow that NASDAQ's depth-of-book data products should be priced at or near zero; to the contrary, "insofar as there is demand for that product at a positive price, the price for that product should be positive." *Id.* ¶ 49; *see also* NetCoalition Letter at 4 (conceding that NASDAQ should not be expected to set prices at marginal cost). The price of market data, in conjunction with the price of execution services, must be sufficiently high to permit the exchange to "cover all the joint and common costs" of running a trading platform. Ordover/Bamberger Statement ¶ 50.

Moreover, because there are shared costs associated with providing execution services and creating and distributing market data, "'cost-based' regulation of pricing of market data requires inherently arbitrary cost allocations," as "there is no meaningful way to allocate 'common' or 'joint' costs across different joint products." *Id.* ¶ 19 & n.8. Because there is no way "that 'costs' for market data and trade execution fees can be unambiguously measured separately," there is no basis for the Commission to accept, or even evaluate, NetCoalition's claim that "the price of market data is 'high' relative to costs while the price of execution services is 'low' relative to costs and 'subsidized' by market data revenue." Reply Statement of Janusz Ordover and Gustavo Bamberger ¶¶ 21-22 (Apr. 4, 2011) ("Ordover/Bamberger Reply Statement").<sup>1</sup> In short, the cost-based approach advocated by SIFMA and NetCoalition is flawed in theory and unworkable in practice. For these reasons, contrary to what SIFMA and NetCoalition propose, the Commission's emphasis should not be on the marginal cost of producing market data, but rather on whether there are sufficient competitive forces in play to constrain the price of that data. *NetCoalition*, 615 F.3d at 535-37.

NASDAQ submitted ample evidence of such competitive constraints here. One "alternative indicator of competitiveness" identified in *NetCoalition* is evidence that competition for order flow—which all parties agree is "fierce"—constrains the price of market data. *Id.* at 539. In accordance with the D.C. Circuit's guidance, NASDAQ submitted evidence (which SIFMA and NetCoalition ignore) that consumers of NASDAQ's depth-of-book data contribute, at a minimum, 22% of the exchange's order flow. *See* Petition for Review at 5. By any measure, that is a sufficiently large segment of the market to prevent NASDAQ from charging supracompetitive prices for market data products; if NASDAQ nevertheless did so, it would risk driving away a significant portion of its order flow. *See NetCoalition*, 615 F.3d

---

<sup>1</sup> The rebuttal report submitted by Drs. Ordover and Bamberger on April 4, 2011, and attached to NASDAQ's April 18, 2012 comment letter as **Exhibit B**, provides a full response to the expert report by Dr. Davis S. Evans attached by SIFMA and NetCoalition to their comment letter. The Evans expert report, which is dated March 21, 2011, was previously submitted during the comment period prior to the Division's order disapproving NASDAQ's proposed rule, and contains no new analysis.

at 541 n.14 (noting that effective competitive constraints could include evidence that depth-of-book consumers “execute an outsized share of the total trading volume so that unreasonable fees would cause them to place their orders elsewhere and ultimately affect order flow”).

Nor do SIFMA and NetCoalition offer effective responses to NASDAQ’s other evidence of competitive constraints on the price of market data. For example, SIFMA and NetCoalition acknowledge NASDAQ’s evidence that there has been substantial turnover in its customer base for depth-of-book products, but object that NASDAQ has not specifically identified “who these customers are” or “why they may have stopped (or started) using [NASDAQ’s] depth-of-book data.” NetCoalition Letter at 6-7. But, with or without that level of evidentiary detail, the fact remains that customers—who enjoy substantial choice in the market for depth-of-book products—can and do exercise the choice to cease purchasing NASDAQ’s data.

SIFMA and NetCoalition further acknowledge that there may be “higher demand” for certain depth-of-book data feeds, and that some such products may merely be “optional” for investors. *Id.* at 7. That concession is flatly inconsistent with their central argument that NASDAQ has monopoly power and therefore must be subject to cost-based ratemaking by the Commission because investors have *no choice* but to purchase *all* of an exchange’s depth-of-book data to get a full picture of the market. *Cf.* NetCoalition Letter, Exhibit 1, Report of Dr. David S. Evans, at 4 (Mar. 21, 2011) (“each exchange’s depth-of-book data are unique to that exchange and traders must purchase such data from all exchanges with significant depth-of-book liquidity to know how much liquidity is available at what prices and where”). The fact that NASDAQ’s different depth-of-book data feeds have different levels of demand directly refutes that premise.

SIFMA and NetCoalition claim that this evidence “does not speak to whether competition constrains the price of depth-of-book data that [NASDAQ] makes available.” NetCoalition Letter at 7. But NASDAQ also presented evidence that customers were sensitive to changes in the price of its TotalView depth-of-book product; for example, when NASDAQ lowered the price of TotalView from \$150 per month to \$70 per month, its subscribers increased by more than a factor of five. Ordovery/Bamberger Reply Statement ¶ 14. Moving the target yet again, SIFMA and NetCoalition discount this evidence because, they claim, the “preferred test” for determining market power is to show customer sensitivity to a “small but significant non-transitory increase in price.” NetCoalition Letter at 7 (quoting *NetCoalition*, 615 F.3d at 542). The D.C. Circuit, however, merely cited this as one possible piece of evidence that could show a customer’s “price sensitivity,” or “elasticity of demand.” *NetCoalition*, 615 F.3d at 542. The court defined elasticity of demand as “the rate at which customers will turn away from the firm’s product in response to a price increase *or toward it in response to a price decrease.*” *Id.* (quoting 2B Phillip E. Areeda, Herbert Hovenkamp & John L. Solow, *Antitrust Law* § 503 (3d ed. 2007) (emphasis added)). Thus, NASDAQ’s experience with an increase in subscription rates to TotalView in response to a price decrease speaks directly to

“the number of potential users of the data [and] how they might react to a change in price.” *NetCoalition*, 615 F.3d at 542.

Because NASDAQ has submitted extensive evidence that competitive forces constrain the price of its market data products, it has established that its “market-data fees by themselves are ‘fair and reasonable.’” *NetCoalition* Letter at 5. There is no risk that approving NASDAQ’s proposal will result in an “abdication of [the Commission’s] supervisory role in assessing the fairness and reasonableness of an exchange’s facility charges.” *Id.* at 3. Rather, because (a) NASDAQ’s execution services and market data are “joint” products that share common costs, (b) reliance on marginal cost data to price “joint” products would be both unwise and impractical, and (c) competitive forces constrain the price of its market data products, NASDAQ has satisfied any burden it might have to show that its prices are fair and reasonable under the Exchange Act.

Moreover, that the Commission received only one submission opposing NASDAQ’s proposed rule is itself strong evidence that there is no widespread objection to the practice of offering customers a discount when they purchase two related products in sufficiently large quantities. To the contrary, NASDAQ cited numerous expert authorities in its petition that showed that discounts (including the “bundled” discounts at issue in this proposal) are pro-competitive and benefit consumers. *See* Petition for Review at 19-25. The Division ignored the “[b]asic economic logic” that discounts benefit consumers when it disapproved the proposed rule. *Mobil Pipe Line Co. v. FERC*, \_\_ F.3d \_\_, 2012 U.S. App. LEXIS 7625, at \*13 (D.C. Cir. Apr. 17, 2012); *see also id.* at \*17 (finding agency acted in arbitrary and capricious manner when it ignored “basic economic and competition principles” that it had previously adopted to guide its discretion). Similarly, SIFMA and *NetCoalition* summarily dismiss NASDAQ’s authorities in their comment letter (*NetCoalition* Letter at 8 & n.42), preferring instead to refight the battle over cost data that they lost in the D.C. Circuit.<sup>2</sup>

NASDAQ’s “platform pricing” proposal—which would result in lower prices for consumers and is supported by extensive, un rebutted evidence showing the existence of a competitive market for data products—is not the appropriate vehicle for the Commission to reinstate cost-based review of data fees. The Commission has already wisely rejected that approach on the ground that it leads to costly inefficiencies and arbitrary judgments. *See, e.g.*, Petition for Review at 21 & n.11. There is no reason for the Commission to reconsider that decision here. Rather, if the Commission reaches the merits of NASDAQ’s proposal, it should

---

<sup>2</sup> SIFMA and *NetCoalition* have adopted a similar approach in other recent filings. *See, e.g.*, SIFMA & *NetCoalition*, Comment Letter and Petition for Suspension and Disapproval, File No. SR-Nasdaq-2012-005, Exchange Act Release No. 66165, at 2-3 (Feb. 6, 2012); SIFMA & *NetCoalition*, Comment Letter and Petition for Disapproval, File No. SR-NASDAQ-2011-21, Exchange Act Release No. 63892, at 2-4 (Mar. 8, 2011).

conclude that the Division erred in ignoring NASDAQ's evidence of competitive forces in the markets for data and execution services, and approve the proposed rule.

## **II. NASDAQ's Proposed Rule Should Be Deemed Approved Because The Commission Failed To Act In The Time Allotted By The Dodd-Frank Amendments To The Exchange Act.**

While NASDAQ's proposal to lower prices already deemed fair and reasonable by the Commission plainly meets the Exchange Act's requirements, the Commission can and should resolve this matter without even reaching that issue. As NASDAQ explained at length in its petition (Petition for Review at 7-11), its "platform pricing" proposal is "deemed . . . approved" as a matter of law because the Commission did not make a final determination approving or disapproving the proposed rule change within the 240-day period established by the Dodd-Frank amendments to the Exchange Act. 15 U.S.C. § 78s(b)(2)(D). SIFMA and NetCoalition do not meaningfully engage NASDAQ's statutory argument on this point, but instead find it "rather remarkable" that a self-regulatory organization would advance the argument at all. NetCoalition Letter at 3.

NASDAQ is of course aware that, "[f]or decades, the Commission's staff has taken action in the name and on behalf of the Commission." *Id.* But the Commission had never before operated under a congressional mandate that it approve or disapprove a proposed rule within 240 days. Under the Dodd-Frank amendments—which were designed to streamline the review process for fees submitted by the exchanges—the full Commission must "issue an order approving or disapproving the proposed rule change" within the statutorily mandated timeframe. 15 U.S.C. § 78s(b)(2)(D). Full Commission review includes the disposition of any timely petitions for review of action taken by delegated authority. *Id.* § 78d-1(c). If the Commission does not take final action within that time, a "proposed rule change shall be deemed to have been approved" by operation of law. *Id.* § 78s(b)(2)(D).

It would be an absurd construction of the Act to conclude that a thinly-reasoned staff order is sufficient to satisfy the statutory deadline and Congress's interest in prompt decision-making, and that a proposed rule change may thereafter be delayed indefinitely while the Commission considers a petition for review. Because the Commission has failed to act within the applicable timeframe here—which expired on September 23, 2011—NASDAQ's proposed rule should be deemed to be in effect.

## **III. The Dodd-Frank Amendments Support The Commission's Reliance On Competitive Forces To Determine The Reasonableness Of Data Fees.**

SIFMA and NetCoalition also object to NASDAQ's position that the Dodd-Frank amendments evidence Congress's intent to rely to a greater extent on market forces to determine the prices of market data fees. NetCoalition Letter at 2-3. SIFMA and NetCoalition argue that "[n]either the plain language of the recent amendment to Section

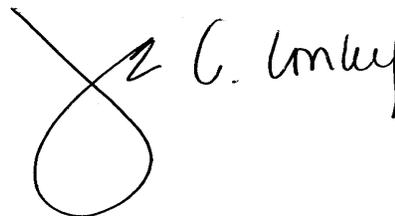
19(b)(3)(A), nor the available legislative history of that amendment, supports the contention that the amendment reflects any . . . presumption” that market fees are adequately constrained by competitive forces. *Id.* at 2.

But as the commenters concede, the operation of the statute itself reflects that policy choice: “[A]s a result of the amendments, all SRO rule proposals establishing or changing dues, fees, or other charges are effective immediately upon filing,” if so designated by the SRO, “*regardless* of whether such rule change is consistent with the provisions of the Exchange Act applicable to the Exchange.” *Id.* (emphasis added). Rules designated immediately effective by an exchange are subject only to retrospective review by the Commission where, to prevent “evident risk of abuse,” the Commission institutes review proceedings and disapproves the proposed rule. *Id.* (citing 15 U.S.C. § 78s(b)(3)). Even then, as noted above, an exchange’s proposed rule is “deemed . . . approved” unless the Commission approves or disapproves it within 240 days (including any extensions). 15 U.S.C. § 78s(b)(2)(D). Congress thus plainly anticipated a system in which exchanges, guided by market forces, would be the primary determinants of the fees they charge for proprietary data products subject to efficient and focused oversight by the Commission.

There is no basis for the Commission to exercise that regulatory oversight here to disapprove NASDAQ’s “platform pricing” proposal, which would provide an optional, pro-competitive discount off prices that the Commission has already found to be fair and reasonable. Even if that proposal were not already “deemed . . . approved,” NASDAQ has submitted extensive evidence to show that the fees for its market-data products are subject to significant competitive constraints. By submitting that evidence, NASDAQ has responded to the D.C. Circuit’s invitation in *NetCoalition* to submit data in support of fee submissions demonstrating a robust marketplace for depth-of-book products.

For all of these reasons, and for the reasons stated in its previous submissions in this matter, NASDAQ respectfully requests that the Commission deem its “platform pricing” proposal approved by operation of law, or in the alternative, set aside the Division’s order and approve the proposal on the merits.

Respectfully submitted,

A handwritten signature in black ink, consisting of a large, stylized loop followed by the name "C. Conley" written in a cursive script.