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July 19, 2012

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

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Attention: Elizabeth M. Murphy, Secretary

COMMENT LETTER AND PETITION FOR DISAPPROVAL

Re: Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Modify an Optional Depth Data Enterprise License Fee for Broker-Dealer Distribution of Depth-of-Book Data, File No. SR-NASDAQ-2012-069, Exchange Act Release No. 67253, 77 Fed. Reg. 38871 (June 29, 2012).

Dear Ms. Murphy:

SIFMA[1] and NetCoalition[2] appreciate the opportunity to comment on the above-captioned Notice, under which The NASDAQ Stock Market LLC ("Exchange") proposed a rule change to modify the optional Enterprise License fee for Non-Professional Subscribers of certain NASDAQ Depth-of-Book market data as of July 1, 2012.

This change results in a 35% increase in the cost of depth of book market data for retail, non-professional users - without any justification. Firms under the current enterprise license fee have been able to expand the range of retail investors who can take advantage of the faster and more informative depth-of-book data. With this substantial fee increase, which is anything but incremental, firms may be forced to curtail retain investor access to this data, a

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1 The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to develop policies and practices which strengthen financial markets and which encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

2 NetCoalition is the public policy voice for some of the world's most innovative companies on the Internet. NetCoalition represents the interests of Internet and technology companies, including Amazon.com, eBay, Google, Bloomberg L.P., IAC/Interactive, and Yahoo!.

major step backwards and contrary to the Commission's policy of improving fair access to our national market system.

This is the type of behavior and result that the *NetCoalition* decision (citation below) was intended to prevent. Firms are now forced to determine whether the additional cost (estimated at over $2 million a year) is affordable for the firms and their clients. If a firm determines that it cannot afford to buy this data, then the firm will have to devote significant resources to explain this industry decision to its retail investors and disentangle this data from current information displays online and otherwise. These significant impacts were not considered in NASDAQ's filing.

The proposed rule change is purported to become 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] For the reasons set out below, and because the Exchange's 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 this rule change under recently amended Section 19(b)(3)(C) of the Exchange Act[5] and institute proceedings to disapprove (or properly approve) those changes under Section 19(b)(2)(B) of the Exchange Act.[6]

As a result, the Commission should immediately suspend the effect of this and other similar unlawful market data fee rule changes proposed by self-regulatory organizations. The Commission staff should not be accepting such rule change filings as complete, and those rule changes cannot become effective upon filing, if on their face they are unlawful. The rule change at issue here is unlawful because it was based on invalid grounds omitting cost data and otherwise failed to comport with the Exchange Act as interpreted by the Court in *NetCoalition*. We therefore urge the Commission to act immediately to suspend this and other similar fee rule changes until the Commission and the public have had ample time to determine whether they should be disapproved.

A. Market Data Fees Must be "Fair and Reasonable."

There is no explanation in NASDAQ's filing as to why an immediate 35% increase in the fee for a market data product intended for retail investors is fair or reasonable. Under the Exchange Act, the SEC has a duty to ensure that the proposed fees are, among other things, "fair and reasonable."[7] SIFMA disagrees with any notion that the amendment to Section 19(b)(3)(A) of the Exchange Act in Section 916 of the Dodd-Frank Wall Street Reform and

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3 15 U.S.C. § 78s(b)(3)(A) (2010).

4 *NetCoalition v. SEC*, 615 F.3d 525 (D.C. Cir. 2010).

5 15 U.S.C. § 78s(b)(3)(C) (2010).

6 15 U.S.C. § 78s(b)(2)(B) (2010).

7 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").

Consumer Protection Act of 2010 (the "Dodd-Frank Act")[8] 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.[9] 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 the Exchange's contention that the amendment reflects such a presumption.[10]

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

The arbitrary 35% increase in the enterprise license fee is a prime example as to why the exchange's setting of market data fees is unconstrained by any competitive forces. The Commission has not required the Exchange to show, and the Exchange has not shown, that it is subject to significant competitive forces that would limit it to charging reasonable fees in pricing this market data. *NetCoalition* 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."[11] 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 . . . ."[12] The cost of producing market data would be direct evidence of whether competition constrains the ability to impose supracompetitive fees.[13] The Notice, however, does not contain any evidence of the Exchange's costs of collecting and distributing the market data and does not provide the Commission with the type of substantial evidence the NetCoalition court found to be necessary to sustain the Commission's approval of an exchange rule seeking to impose a market data fee.

The Exchanges does not support its argument that order flow competition constrains market data fees.

The Exchange does not provide any evidence that this data fee is subject to competitive forces, but concludes there must be competition because order flow data is a component of its market data, and the market for order flow is subject to competitive forces. Moreover, the Exchange notes 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. The Court in *NetCoalition* rejected the order flow argument

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

9 15 U.S.C. § 78k-1(c)(1)(C) (2010).

10 For a fulsome discussion of these arguments, please see Letter from Ira D. Hammerman to Florence Harmon (SEC) re: Exchange Act Release No. 62887 and Exchange Act Release No. 62908 (Oct. 8, 2010).

11 *Id.* at 537.

12 *NetCoalition*, 615 F.3d at 537.

13 *Id.*

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."[14]

The Exchange does not support its contention that there are reasonable substitutes for the market data.

The Exchange also asserts that several alternatives to the data products at issue are available, but does not provide any evidence that the alternatives are reasonable substitutes for, and therefore competitors to, this market data product such that pricing of the data is constrained by competitive forces. 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.[15] The Exchange provides no evidence, only theories, as to how broker-dealers might react to changes in the prices of its data products. Just as in *NetCoalition*, here the Exchange has the exclusive ability to offer the products they propose to sell. Other exchanges and/or venues may offer similar products, but only the Exchange is able to offer the data in the proposed products at the same speed.

The "platform competition" approach does not support the exchanges' contention that the proposed data prices are constrained by competition.

The Exchange's "platform competition" approach to pricing these data products is inherently flawed because that approach (1) simply rehashes 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" products and are priced in the aggregate.[16] 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. The platform competition approach is inconsistent with the "fair and reasonable" requirement of Section 11A(c)(1)(C) of the Exchange Act because, just as the Court in *NetCoalition* found, there is no substantial evidence here to support the contention that competition for order flow constrains market data fees. The Exchange has presented no evidence to support its recast theory, only the same type of conclusory statements dismissed by the Court in *NetCoalition*.

In addition, the platform theory is flawed because under the platform approach to pricing, the Exchange may set market data prices at supracompetitive levels, notwithstanding the

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14 *Id.* at 541.

15 *Id.* at 542.

16 *See Id.* at 541-42 n. 16.

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 these data services, and not the Exchange'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. If two products are bought and sold separately, the price of each should be the result of the distinct competitive conditions confronting each product.[17] In fact, market data is bought and sold separately from execution services, as evidenced by the fact that SIFMA member firms' customers often buy market data on their own, and NetCoalition members are not broker-dealers who purchase the exchanges' execution services.

Conclusion

We believe *NetCoalition* requires the Commission to review cost data as an essential element of considering whether there is substantial evidence of any kind to meet the Commission's "competitive forces" test, before approving this 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 regarding the market forces test renders this market data rule filing unenforceable under Section 19(b)(3)(C).[18]

For the reasons set out above, and given the absence of cost data or any other evidence supporting the Exchange's contention that these data fees are constrained by competitive forces, we respectfully request that the Commission temporarily suspend the proposed rules establishing these market data fees 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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17 *See Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 929 (2d Cir. 1982).

18 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 Melissa MacGregor, Managing Director and Associate General Counsel at SIFMA at 202-962-7385.

Respectfully submitted,

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