International Securities Exchange

May 20, 2014

Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: File No. SR-PHLX-2013-113

Dear Ms. Murphy:

The International Securities Exchange, LLC ("ISE") appreciates the opportunity to submit an additional comment letter regarding the above-referenced fee filing ("Filing") of NASDAQ OMX PHLX LLC ("Phlx").[1] The Filing proposes to increase the rebate Phlx pays for certain customer orders, doing so in an unprecedented manner (the "Proposal"). Rather than basing its tiered fee structure solely on the level of member trading in its own market, Phlx seeks to base the rebate on its member options trading on three affiliated exchanges: the Phlx, the NASDAQ Options Market LLC ("NOM") and NASDAQ OMX BX ("BX").

ISE has submitted two previous letters on the Filing, once upon initial submission of the Filing and the second in response to the Order.[2] Phlx has responded both to our comment letter and various other comment letters, with Phlx arguing that the Filing meets the requisite statutory standards and should be approved.[3] The Commission has extended the period for its review of the Filing and has requested comment on a number of additional issues regarding the proposal.[4] Phlx has submitted certain information in response to questions the Commission asked in a letter to Phlx dated April 7, 2014.[5] This letter responds to mischaracterizations and inaccuracies in the Phlx Letter and the Phlx April Letter, and provides comments on the issues the Commission raises in the Extension Order. We believe the Commission should disapprove the Filing.

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[1] Securities Exchange Act Release No. 70940, November 25, 2013 (78 *F.R.* 71700, November 29, 2013) (the "Order"). The Commission previously published the Filing for comment in Securities Exchange Act Release No. 70866, November 13, 2013 (78 *F.R.* 69472, November 19, 2013) (the "Proposing Release").

[2] Letters dated November 11, 2013 and December 20, 2013 ("Initial Letter"), from Michael Simon, Secretary, ISE, to Elizabeth Murphy, Secretary, Commission.

[3] Letter dated January 24, 2014, from Joan C. Conley, Senior Vice President and Corporate Secretary, Nasdaq OMX, to Elizabeth Murphy, Secretary, Commission ("Phlx Letter").

[4] Securities Exchange Act Release No. 71883, April 7, 2014 (79 F.R. 20288, April 11, 2014) (the "Extension Order").

[5] Letter dated April 18, 2014, from Jeffrey S. Davis, Vice President and Deputy General Counsel, Nasdaq OMX, to Elizabeth Murphy, Secretary, Commission ("Phlx April Letter"). The Commission letter to the Phlx is not available in the public file.

With respect to the Phlx Letter, it mainly consists of economic analysis commissioned by the Phlx. That analysis concludes that: the Phlx is subject to significant competitive forces in the market; the Proposal does not raise antitrust concerns; and the comment letters opposing the Filing do not provide an economic basis to oppose the Proposal. However, Phlx's economic analysis is irrelevant to the Commission's consideration of the Filing since it provides no analysis of, or support for, the Phlx's position that the Filing complies with the legal standards under which the Commission must judge exchange rule filings under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Rather, it contains a discussion of antitrust law, which is not directly applicable to the Filing.

This letter focuses on the Phlx's legal arguments that the Proposal is consistent with the Exchange Act. We then address the issues the Commission raises in the Extension Order, discussing the inherent conflict between competition and fragmentation in the securities markets. We conclude that approval of the Filing would foster inappropriate market fragmentation that outweighs any possible benefits of competition.

The Proposal Results in Unfair Discrimination

Phlx argues that the Filing provides all its members with an opportunity for an additional rebate, and thus is not unfairly discriminatory. Specifically, Phlx states that the Proposal is not unfairly discriminatory because

> *any* Phlx market participant can qualify for the [rebate]. ... Given the ease with which market participants can become members of Phlx and its affiliated exchanges, there are no significant barriers to anyone taking advantage of the enhanced rebate.[6]

Phlx then argues that the Proposal is not unfairly discriminatory because it is similar to other types of fee structures, such as volume tiers and fee caps. Further, Phlx argues that the fee is allowable because other exchanges can replicate the rebate by registering additional options exchanges, a claim we discuss below under "burden on competition."

First, Phlx incorrectly states that any market participant can qualify for the rebate. A Phlx member can take advantage of the rebate only if that member joins one or both of the affiliated exchanges, NOM and BX. There are significant one-time and continuing costs to such multiple memberships. These costs include not only membership and regulatory fees, but also connectivity and line charges. Requiring members to absorb these additional costs to qualify for the rebate is not reasonable. Therefore, the claim that the fee is non-discriminatory is inaccurate because it very much discriminates against those members who do not have at least one additional membership to a Phlx affiliate, a requirement which adds significant costs to the member but benefits Phlx and its affiliates. All of the other fees the Phlx cites as precedent are inapposite in that they are single-exchange fees and do not require members to incur any of these multi-exchange costs.

[6] *Id.* at 5. Emphasis in original.

Furthermore, the filing is unfairly discriminatory because Phlx's rebate is based on trading volume on only three of the 12 options exchanges. Thus, Phlx's "non-discrimination" argument hinges on its position that affiliated exchanges can eschew competition and operate cooperatively in the marketplace. That is not the case. The Commission's "ArcaBook Order"[7] states the obvious: a registered exchange must comply with the requirements of the Exchange Act to compete at the individual level, and not with respect to a "group" of exchanges. We discuss below how Phlx's letter fails in its attempt to explain away the ArcaBook Order.

The Proposal is a Burden on Competition Prohibited Under the Exchange Act

Phlx argues that the rebate is not a burden on competition because as "a matter of economics and antitrust law, there is nothing inherently suspicious or unlawful about a rebate or discount that is bundled across multiple products or services."[8] Regardless of whether that statement is correct, it is irrelevant. The required analysis is whether, under the Exchange Act, the proposed fee imposes an inappropriate burden on competition. Indeed, the specific standard is that an exchange's rules must "not impose any burden on competition not necessary or appropriate *in furtherance of the purposes of [the Exchange Act].*"[9] Thus, the Commission must analyze the competitive impact in connection with the purposes of the Exchange Act, and not in the theoretical economic vacuum that the Phlx Letter discusses.

The stated purposes of the Exchange Act include the goals: "to remove impediments to and perfect the mechanisms of a national market system for securities"[10]; and to assure "fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets."[11] Analyzing the effects of the Proposal in light of these over-arching market goals shows that the Filing would impose inappropriate burdens on competition.

First, by limiting its proposed rebate to executions on affiliated exchanges, Phlx eliminates the possibility of fair competition between exchanges since any such competition requires an exchange operator to register multiple exchanges in order to compete. Indeed, Phlx states that "there are no significant barriers to self-regulatory organizations ("SROs") creating additional options exchanges." However, Phlx provides no support for that assertion. In contrast, having just registered ISE Gemini, LLC, as a new exchange we have real-world experience in the matter.

As opposed to filing a simply "effective-on-filing" rule change to establish a new fee, creating a new exchange takes a considerable amount of time. In addition to the costs of preparing and filing the necessary papers with the Commission, an applicant incurs seven-figure costs to join The Options Clearing Corporation and to participate in multiple national market system plans. There are also the costs of hiring additional staff,

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[7] Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770 (December 9, 2008).
[8] Phlx Letter at 9.
[9] Exchange Act Section 6(b)(8). Emphasis added.
[10] Exchange Act Section 1.
[11] Exchange Act Section 11A(a)(1)(B)(ii).

particularly in technical and surveillance areas. These are "significant barriers" to competition. Moreover, it is unfair discrimination to treat its affiliates differently than exchanges that have not undertaken these steps to compete with the Phlx/NOM/BX complex.

Moreover, the Filing imposes – not eliminates – impediments to the development of a national market system for securities. To date, the national market system for options transactions has been built on a foundation of competition between exchange markets. Each exchange competes for order flow through a variety of means, including execution quality, speed of execution, customer service, and fees. As the Commission has held in the ArcaBook Order, this competition has always been at the individual exchange level, not the "group" level. Indeed, the Exchange Act specifies that the Commission should be fostering competition between "exchange markets," not "groups of exchange markets." To hold otherwise would require a major change to the underlying assumptions regarding a national market system, a change that could have significant unintended consequences. If the Commission ever were to contemplate such a change, it would be best addressed either through Commission rulemaking or Congressional action, not through the review of an individual exchange's rule filing.

The Proposal is Inconsistent with the Commission's "ArcaBook" Order

The ArcaBook Order requires Phlx to justify its proposed rebate by applying the Exchange Act to the Phlx as a single exchange, not as a part of a group of exchanges. The Phlx Letter fails to meet that burden. The Phlx addresses the ArcaBook Order in two lines of argument: (i) by citing as precedent a 1985 Commission opinion issued under the Public Utility Holding Act of 1935 ("PUHCA")[12]; and (ii) by arguing that the analysis in the ArcaBook Order actually supports its Proposal. Both arguments fail.

With respect to the Phlx's "precedent," it is quite telling that the closest ruling Phlx can find involves a decision the Commission: issued under a law far removed from the relevant Exchange Act; citing facts irrelevant to the Proposal; and establishing a principle that has nothing to do with the Phlx's proposed rebate. *Central* involved the operation of a number of affiliates of a power company and how those companies interacted with one another. The Commission found that the company interactions in *Central* did not "violate the antitrust laws or result in undue concentration of control under [PUHCA]."[13] In support, the Commission cited *Copperweld*, paraphrasing the Supreme Court as saying "a corporation and its wholly owned subsidiary companies constitute but one economic enterprise for the purpose of conspiracy claims under Section 1 of the Sherman Antitrust Act."[14]

Central and *Copperweld* are irrelevant in an analysis of the Phlx Filing. As discussed above, the Commission must analyze the competitive effects of the proposed rebate against the standards and purposes of the Exchange Act, not PUHCA or the

[12] *In re: Central and Sw. Fuels, Inc.*, 49 S.E.C. 404, 412 (1985) ("*Central*"), citing the United States Supreme Court in *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984) ("*Copperweld*").
[13] *Copperweld* at 7.
[14] *Id.* At note 12.

Sherman Antitrust Act. Indeed, the principle the Commission applied in *Central* was the concept of a company acting jointly with its subsidiaries with respect to "conspiracy claims under the Sherman Act." It is irrelevant whether Phlx and its affiliates are "conspiring" to restrain competition under the antitrust laws. What is relevant is that the proposed policy of combining fee structures of ostensibly competing entities violates the specific provisions of the Exchange Act regarding burdens on competition, unfair discrimination, and the equitable allocation of fees.

As compared to the Phlx's cited precedent of different facts analyzed under inapplicable laws, in the ArcaBook Order case the Commission addressed the very issue the Proposal raises: the possibility of exchange groups acting together with respect to the fees they charge. Contrary to Phlx's assertions, its proposed rebate runs directly contrary to the Commission's holding in ArcaBook. In our Initial Letter, we quoted the following from the ArcaBook Order:

> Exchanges under common control clearly have incentives to avoid competing with each other. Each national securities exchange, however, is subject to a comprehensive regulatory structure that is designed to address anti-competitive practices. This regulatory structure limits the potential for related exchanges to act jointly in ways that would inappropriately inhibit competition by other exchanges and trading centers with each related exchange. Section 6 of the Exchange Act requires that the rules of a national securities exchange be designed to promote a free and open market. Moreover, it prohibits a national securities exchange from adopting rules that are designed to permit unfair discrimination among its customers or that would impose an unnecessary or inappropriate burden on competition. All of these requirements are applied at the level of the individual registered securities exchange, not at the group level of exchanges that are under common control. In particular, a proposed exchange rule must stand or fall based, among other things, on the interests of customers, issuers, broker-dealers, and other persons using the facilities of that exchange.[15]

The ArcaBook facts closely parallel the Proposal. NYSE Arca, Inc. ("NYSE Arca") proposed fees for its proprietary market data. Commentators raised a number of concerns with the Proposal, arguing, among other things, that there were no market or regulatory checks regarding what one exchange could charge for its own market data. In reviewing the proposed fees, the Commission raised for comment the concept that one check on potential overreaching by an exchange could be the effect of competition on the fees that the exchange could charge for its proprietary data. The Commission stated its intention to approve these market data fees only if the exchange was subject to "significant competitive forces" in setting such fees.[16]

A number of commentators took exception to the Commission's proposed analysis of competition, arguing that Arca was a member of an exchange group that included the New York Stock Exchange, Inc. ("NYSE"). The Commission summarized the commentators as saying that "because NYSE and NYSE Arca are under common control, they will have an incentive to coordinate their pricing and not compete with one

[15] ArcaBook Order at 74793.
[16] *Id.* at 74771.

another."[17] The Commission then dismissed this concern with the analysis we quoted in the Initial Letter and above.

Thus, in ArcaBook, the Commission determined that it must apply the Exchange Act's provision regarding rule and fee changes to individual exchanges, and not to exchanges as a "group." Moreover, the Commission explicitly endorsed the position that affiliated exchanges would compete against other, not cooperate with respect to the fees they charge.

While not directly challenging the ArcaBook conclusion, Phlx attempts to deflect the application of ArcaBook to its Proposal by claiming that ISE contends that the Exchange Act "contains a blanket prohibition against exchanges cooperating with respect to fees in any circumstances."[18] However, we make no such contention. We simply are restating what the Commission concluded in its ArcaBook Order: that the correct analysis of an exchange's fee requires the application of the Exchange Act's provisions to that exchange's fees on a stand-alone basis. When so viewed, by treating its affiliated exchanges differently than other competing exchanges, the Phlx rebates result in unfair discrimination and an inappropriate burden on competition.

When cutting through all of the clutter of the Phlx's argument, the core of what Phlx proposes is that the Commission should allow it to discriminate in favor of affiliated exchanges, an argument that fails to comply with the standards of the Exchange Act and the ArcaBook Order. Indeed, in the actual filing Phlx attempts to justify its discriminatory treatment of non-affiliated exchanges by stating that it can favor NOM and BX because volume on those exchanges "benefits Phlx by contributing to the overall financial well-being of the exchange group of which Phlx is a part."[19] That is exactly the reasoning the Commission rejected in the ArcaBook Order when stating that any analysis of the NYSE Arca market data fees must take care not to include any effect those fees may have in the context of the NYSE complex.

Rather than backing off from this statement, the Phlx Letter doubles down by stating that "Phlx obviously has a legitimate commercial reason to limit its rebate to market participants who trade on *it* or *its affiliated* exchanges."[20] Somehow Phlx sees this not as unfair discrimination but as "the essence of competition."[21] As in the Filing, Phlx is attempting to condone its discrimination by citing commercial reasons for favoring its affiliates. While there may be valid commercial reasons for an exchange to want to favor its affiliated exchanges, that does not mean that such proposals pass legal muster. Indeed, an exchange making such a discriminatory proposal must justify such action on

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[17] *Id.* At 17793.

[18] Phlx Letter at 13. Similarly, the Phlx Letter goes so far as to say that the ArcaBook Order "presupposes that affiliated exchanges will at times act jointly and that they will not violate the requirements of the Exchange Act by doing so." Id. At 12. While we find no support whatsoever for that statement in the actual ArcaBook Order, it is also irrelevant. The question is whether this particular fee proposal violates the Exchange Act, not whether there are theoretical situations in which such actions would not be violative.

[19] Proposing Release at note 52.

[20] Phlx Letter at 7. Emphasis in original.

[21] *Id.*

a stand-alone basis regarding the effects of such proposal, not on the well-being of the group as a whole. The Phlx has failed to do so.

The Commission Has Not Approved Similar Pricing Arrangements in the Past

Phlx attempts to support its Proposal by arguing that the proposed rebate is similar to: (i) listing fee discounts when a company moves its listing from one exchange to an affiliated exchange; (ii) trading fees a single exchange charges for trading various products on the same exchange; and (iii) the options regulatory fee or "ORF."[22] In reiterating these precedents, Phlx opines that we have failed to explain why there is a meaningful distinction between the Proposal and these operative fees. We are pleased to provide the Commission with more specifics as to why the Phlx's supposed precedents are irrelevant.

With respect to listing fees, those fees do not raise any of the market structure issues raised by the proposed Phlx rebate. The listing fee that Phlx cites – the fee the New York Stock Exchange charges for the transfer of listings from an affiliated exchange – is the fee of a single exchange and does not combine activity on multiple exchanges. As a single exchange fee, any other listing exchange can mimic that fee by providing the same fee waiver to a company that seeks to move its listings to such exchange from an NYSE-affiliated exchange. In contrast to listing fees, no exchange operator with only a single exchange can offer similar rebates. Thus, the Exchange Act issues we have raised with respect to the Proposal do not apply to exchange listing fees, and the Commission's sanctioning of such fees provides no useful precedent for the Phlx.

With respect to a single exchange charging fees based on the trading of multiple products on the same exchange, the Phlx cites an exchange combining fees for equity and index products and an options exchange trading index and equity options. This obviously differs from the Proposal because the products trade on the same exchange and the fee structure does not involve competition for order flow in a single product. In contrast, Phlx, NOM and BX trade – and compete for order flow in – exactly the same products. Thus, an order flow provider can choose between any of the three exchanges when deciding where to send, for example, an order for options in Apple, Inc. All three exchanges have competing markets and, to date, competing fee structures. This direct competition in the same product differentiates the proposed rebate from a single exchange providing overall pricing in multiple non-competing products.

Finally, with respect to ORF, Phlx takes issue with the statement in our Initial Letter that the ORF is almost the exact opposite of the proposed Phlx rebate. As we stated in that letter, the rebate is intended to attract order flow to the Phlx-affiliated options exchanges while the ORF, imposed on the trading on all exchanges, is structured to avoid competitive effects by removing any incentive by a member to avoid the fee by trading elsewhere. Phlx attempts to rebut our argument by stating that if "exchanges are allowed to engage in certain activity in order to *prevent* members from

[22] A number of options exchanges charge the ORF to off-set a portion of their regulatory costs. These exchanges impose the fee on customer volume a member executes on all options exchanges.

trading *off* that exchange, they should be allowed to engage in the same activity in order to *entice* members to trade *on* that exchange."[23]

We are not sure what Phlx means by that statement. In any event, the purpose of ORF is not to "prevent" members from trading "off" the exchange charging the ORF. The purpose of the cross-exchange aspect of ORF is to remove any competitive effect of the fee. All exchanges charging an ORF base the fee on trading activity on all the options exchanges. It is not limited to trading on affiliated exchanges, unaffiliated exchanges, or other exchanges that impose an ORF. The ORF thus does not raise any of the competitive or market structure issues as the Phlx rebates. As compared to the Phlx rebate, it is not a fee based on an affiliated group of exchanges, it is not a variable fee based on the volume of transactions across exchanges, and most importantly, the choice of exchange or exchanges to which a broker-dealer sends its order flow has absolutely no effect on the level of fee the broker-dealer pays. As with the other fees the Phlx cites, the ORF is irrelevant in an analysis of the proposed rebate.

The Proposal Would Result In Unwarranted Fragmentation of the Options Market

In the Extension Order the Commission asks a number of questions regarding the impact of the Proposal on options market structure. The specific questions cover such areas as liquidity, competition, and best execution. The Commission further asks what effect, if any, approval of the Filing would have on the number of options exchanges and also inquires as to the related costs of connecting to, and routing between, such exchanges. We believe that the options market currently operates efficiently and that Commission approval of the Filing would have adverse market structure consequences that would greatly outweigh any possible benefits.

There is an inherent tension between competition and fragmentation. The greater the number of options exchanges that trade the same products, at least in theory there should be increased price and service competition between those exchanges for order flow. On the other hand, as the number of exchanges increase there is greater fragmentation of the market, which can disperse liquidity and create pricing inefficiencies. Fragmented markets present challenges as broker-dealers seek to provide best execution for their customer orders and liquidity providers seek to maximize their use of capital across markets. The goal is to fashion a market structure that enhances competition while minimizing the adverse effects of fragmentation.

In our view, the options market structure currently reflects an appropriate balance between competition and fragmentation. As opposed to equity trading, all trading in standardized options must occur on an exchange registered with the SEC. Requiring that all trading occur on-exchange provides unrivaled transparency, where all quotations and trades occur in full public view. While the number of exchanges has grown over the last few years, this increase has resulted in lower spreads, improved technical efficiency, innovation, and experimentation with various fee structures.

[23] Phlx letter at 16. Emphasis in original.

To date, an exchange operator will bring to market a new exchange only when the operator sees an opportunity to offer something of value to market participants. That value could be new order types, a new fee structure, enhanced technology, or services complementary to the exchange operator's other offerings. Indeed, we registered ISE Gemini as a way to offer market participants a competing fee structure for an exchange offering pro-rata allocation of orders. Under the current market structure we were unable to offer such fee structures under a single exchange registration.

In contrast, Commission approval of the Filing unavoidably will lead to a proliferation of exchange registrations that offer little value to market participants, leading to unnecessary market fragmentation. Indeed, rather than register exchanges to offer value to the market, operators will view exchange registration as a defensive measure against exchange operators with multiple markets. Entities with multiple exchanges will be able to operate their exchange complex with a single, integrated, fee structure, cross-subsidizing various offerings in a way that exchanges with only one market will not be able to match. Thus, operators will need to register multiple exchanges simply to match competitive offerings, rather than providing any real benefit to the market, which will tip the balance against the benefits that competing exchanges can provide. This will lead to increased fragmentation without any corresponding benefits. The Commission should not permit this to happen.

The Phlx April Letter Underscores the Lack of Legal Support for the Proposal

In its April Letter, Phlx provides certain information regarding the fees of Phlx and its affiliated exchanges. That letter also includes a number of statements and conclusions that are either incorrect or misleading. We have the following specific comments on the Phlx April Letter:

- ISE's "Competitive Response" to the Proposal: Phlx states that "within one month of Phlx's initial announcement of the Proposal [the Miami International Securities Exchange ("MIAX")] and ISE countered with enhanced rebates of their own."[24] The implication that we amended our fees in response to the Phlx Proposal is not correct. We continuously adjust fees to address the current competitive landscape. These fee changes respond to our view of overall competition in the market and, in fact, it would be difficult to find a month in recent years in which we did *not* adjust our fees. Unless we were to offer a multi-exchange fee rebate between ISE and ISE Gemini (which we did not), no specific ISE fee change could possibly be a direct competitive response to the Proposal.

- "Bundled Pricing": Phlx states the Proposal "could allow Phlx and its affiliated exchanges to increase their share as some firms shift volume from competing exchanges to Phlx, NOM, or BX."[25] Phlx refers to this as "bundled pricing" permitted under antitrust law.[26] This again misses the point. As discussed, the Exchange Act requires Phlx to justify the competitive implications of its fees with respect to the Phlx itself. By defending its Proposal as "bundled pricing" intended to improve the

[24] Phlx April Letter at 1.
[25] *Id.* at 7.
[26] *Id.* at note 11.

competitive posture of the three affiliated exchanges, Phlx once more attempts to present a justification that has no basis under the Exchange Act.

- Effect of the Proposal on "All Other Market Participants": The Commission asked Phlx to explain what it meant when it stated that "'all other market participants' are expected to benefit from the additional rebate."[27] The exchange responded that the Proposal "will benefit all Phlx market participants, including those who obtain the enhanced rebates and those who do not."[28] Thus, Phlx admits the obvious: the Proposal will not benefit "all" market participants, but only Phlx members, particularly those who also trade on NOM and BX.[29] There are no benefits to other options market participants. Indeed, we do not believe that there even will be benefits for all Phlx members. Firms that do not also trade on NOM or BX, or have insufficient order flow on those exchanges to qualify for enhanced rebates, will reap no benefits from the Proposal. In fact, they may lose order flow to larger firms that consolidate order flow in order to meet the rebate thresholds.

- Competitive Posture of "Single Exchanges": The Commission asked Phlx to explain its comment that "an exchange could offer the same rebate to customers who execute the designated volume on a single exchange."[30] Phlx had a number of responses to that question, none of which was on point:

    - Single exchanges can offer their own volume-based rebate: Phlx again states that ISE increased its rebates after Phlx filed the Proposal, concluding that this fee change was in response to the Phlx Proposal. Again, our rebate filing was in response to the general competitive environment and our single-exchange rebate could not compete against the Phlx multi-exchange rebate.

    - No exchange has claimed that it cannot match Phlx's price cut: Perhaps Phlx did not carefully read our Initial Letter. We stated there, and restate here, that no single exchange can match the Phlx Proposal. To state the obvious, without having multiple exchanges an exchange operator cannot provide a multi-exchange rebate.

    - The Proposal addresses an inefficiency not faced by single exchange operators: Turning the analysis on its head, Phlx argues that the Proposal addresses an inefficiency that single exchanges do not face. Specifically, Phlx argues that only complexes with multiple exchanges have concerns regarding members shifting order flow from affiliated exchanges. Stated in the inverse, Phlx appears to argue that single exchanges do not have concerns about members shifting volume away from affiliated exchanges

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[27] *Id.* at 5.
[28] *Id.*
[29] It is speculative whether the Proposal will benefit Phlx members other than those who also trade on NOM and BX. Phlx postulates that the Proposal will increase trading volume on Phlx, thus providing more liquidity in the market even for those members who do not also trade on NOM and BX. While that may be the case, the general goal of all fee reductions or rebates is to attract additional order flow and increase liquidity.
[30] Phlx April Letter at 9.

because they do not have affiliated exchanges. If Phlx views this as an inefficiency, it can address this inefficiency of its own creation by having its parent cease to trade options on its affiliated exchanges. However, we assume that Phlx believes that there are benefits to the three-exchange complex that outweigh this perceived "inefficiency." Moreover, this argument once more attempts to confuse the issue. Phlx's concern about shifting order flow away from affiliated exchanges again asks the Commission to apply the Exchange Act to exchange complexes, rather than individual exchanges, a reading of the Exchange Act that has no basis in the law.

- Single exchanges can open new exchanges: Phlx ends its April Letter much where its arguments begin, stating that exchange operators always can register more exchanges if they believe that such additional registrations are necessary for competitive purposes. As discussed: the cost and timing of such registrations impose unacceptable competitive impediments; and registering additional exchanges as defensive moves to match competing fee structures will unnecessarily fragment the market and increase industry costs without any significant off-setting gains.

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The Phlx is proposing an unprecedented fee structure that violates numerous requirements of the Exchange Act. The Phlx has not provided any legal support for this Proposal, nor has it provided any precedent for such a fee. We thus respectfully ask the Commission to disapprove the Filing.

We again thank the Commission for the opportunity to comment on the Filing. If you have any questions on our comments, please do not hesitate to contact us.

Sincerely,

Michael J. Simon
Secretary

cc: Stephen Luparello, Director, Division of Trading and Markets
James Burns, Deputy Director, Division of Trading and Markets
Heather Seidel, Associate Director, Division of Trading and Markets