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

Re: File No. SR-Phlx-2013-113—Comment Letter from the International Securities Exchange, LLC

Dear Ms. Murphy:

NASDAQ OMX PHLX LLC (“Phlx” or the “Exchange”) respectfully submits the following response to the comment letter of the International Securities Exchange, LLC (“ISE”), dated May 20, 2014.¹ ISE’s letter asks the Commission to disapprove Phlx’s proposal to amend the Customer Rebate Program in Section B of its Pricing Schedule to increase rebates available to certain market participants who transact customer orders on Phlx (the “Proposed Rule”).² ISE’s letter mischaracterizes the Proposed Rule in key respects and makes unsupported legal and factual claims. This response focuses on those specific points in ISE’s letter. Phlx’s prior submissions to the Commission more fully explain why the Proposed Rule is consistent with the Exchange Act and should be approved.

I. ISE Mischaracterizes The Operation Of The Proposed Rule

First, in arguing that the Proposed Rule is unfairly discriminatory, ISE mischaracterizes the structure of the rebate program. According to ISE, “[a] Phlx member can take advantage of the rebate only if that member joins one or both of the affiliated exchanges, NOM and BX.”³ Consequently, ISE argues, “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

¹ Letter from Michael J. Simon, Secretary, ISE, to Elizabeth Murphy, Secretary, Commission (May 20, 2014) (“ISE Letter”).

² See Exchange Act Release No. 34-70866 (Nov. 13, 2013) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Offer a Customer Rebate).

³ ISE Letter at 2.

membership to a Phlx affiliate, a requirement which adds significant costs to the member but benefits Phlx and its affiliates.”⁴

In fact, as Phlx explained in its January 24, 2014 comment letter, “any market participant can qualify for the rebate by executing the required volume *on Phlx alone*.”⁵ Because any customer who executes the required 2.5% or more of national customer volume exclusively on Phlx is entitled to the rebate, the Proposed Rule does not discriminate between customers who trade exclusively on Phlx and those who trade on multiple Nasdaq-affiliated exchanges.⁶ ISE is therefore wrong in stating that the Proposed Rule requires members to incur multi-exchange costs. In any event, any Phlx member could readily apply for and obtain membership in another Nasdaq-affiliated exchange at minimal cost. Indeed, most current Phlx members are already members of other Nasdaq-affiliated exchanges. Of the Phlx members that directed electronic customer orders to Phlx for execution in May 2014, 100% are members of the NASDAQ Options Market (“NOM”), and 88.6% are members of all three NASDAQ options exchanges. For these reasons, the proposed rebate does not impose any costs or limitations that would unfairly discriminate against a particular class of customers.

II. Antitrust Precedent Informs The Analysis Of Whether The Proposed Rule Places An Unnecessary Burden On Competition Under The Exchange Act

ISE also errs in arguing that Phlx cannot rely on antitrust principles to show that the Proposed Rule does not burden competition under the Exchange Act. Unwilling to engage Phlx’s economic arguments on the merits, ISE instead asserts that Phlx’s “discussion of antitrust law . . . is not directly applicable to the Filing” because “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.”⁷ But the Commission routinely cites and discusses antitrust authorities in support of its orders approving exchanges’ rule changes.⁸ In

⁴ *Id.*

⁵ Letter from Joan C. Conley, Senior Vice President and Corporate Secretary, Phlx, to Elizabeth Murphy, Secretary, Commission (Jan. 24, 2014), at 3 (emphasis added); *see also id.* at 5 (“If, on the other hand, a market participant directed sufficient liquidity to Phlx alone, it could qualify for the rebate on that basis as well.”); *id.* (“[A]ny Phlx market participant can qualify for the Customer Rebate Program.”).

⁶ *Id.* at 6.

⁷ ISE Letter at 2, 3.

⁸ *See, e.g.*, Order Approving Proposed Rule Change To Establish New Fee for TotalView Service Available to Non-Professionals and To Establish an Optional Non-Display Usage Cap for Internal Distributors of TotalView, Exchange Act Release No. 34-62258, File No. SR-BX-2010-027 (June 10, 2010), at 6 n.16; Order Approving Proposed Rule Change To Establish NYSE Amex Trades and NYSE Amex BBO Services and Related Fees, Exchange Act Release No. 34-62187, File No. SR-NYSEAmex-2010-35 (May 27, 2010), at 18 n.23; Order Approving Proposed Rule Change To Modify the Fees for NYSE Arca Trades, To Establish the NYSE Arca BBO Service and Related Fees, and To Provide an Alternative

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the ArcaBook Order itself, for example, the Commission cited an economic analysis of monopolies and pricing.⁹ Indeed, the Commission concluded in the ArcaBook Order that, when competitive forces are operative, there must be a “substantial countervailing basis for determining that a proposal is inconsistent with the Exchange Act.”¹⁰ The D.C. Circuit has likewise relied on antitrust principles in evaluating whether fees comport with the Exchange Act.¹¹ The principles of economic theory embedded in antitrust case law are thus highly relevant to the question whether the Proposed Rule imposes a burden on competition not necessary or appropriate in furtherance of the Exchange Act. ISE’s submission makes no effort to argue that the proposed rebate is *not* pro-competitive, or to supply a “substantial countervailing basis” for disapproving the Proposed Rule. Instead, ISE merely relies on the legally unsupported assertion that antitrust principles are irrelevant to the analysis. As the Commission’s prior orders make plain, that is not so.

III. The Proposed Rule Does Not Unfairly Discriminate Against Non-Affiliated Exchanges

ISE also contends that “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.”¹² But as Phlx has already explained, its competitors can compete with the proposed rebate in any number of ways without establishing new exchanges.¹³ Competitors are free to establish customer rebates at the same level (or even lower levels) than those proposed by Phlx, or to offer lower prices or enhanced services as competing incentives.¹⁴

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Unit-of-Count Methodology for Those Services, Exchange Act Release No. 34-62188, File No. SR-NYSEArca-2010-23 (May 27, 2010), at 17 n.22.

⁹ ArcaBook Order, 73 FR 74770, 74781 n.200 (Dec. 9, 2008) (citing Richard Posner, *Economic Analysis of Law* § 9.1 (5th ed. 1998)).

¹⁰ *See id.* at 74782.

¹¹ *See, e.g., NetCoalition v. SEC*, 615 F.3d 525, 542 (D.C. Cir. 2010) (citing antitrust treatise and other authorities).

¹² ISE Letter at 3.

¹³ Letter from Joan C. Conley, Senior Vice President and Corporate Secretary, Phlx, to Elizabeth Murphy, Secretary, Commission (Jan. 24, 2014), at 7.

¹⁴ *Id.* In fact, just this week, the Miami International Securities Exchange, LLC (“MIAX”) filed an amendment to its pricing schedule that expanded the number of option classes that qualify for a \$0.20 per contract credit for transactions in MIAX Select Symbols, provided the member meets certain volume thresholds. *See* Notice of Filing and Immediate Effectiveness of a Proposed Rule Change by Miami International Securities Exchange, LLC To Amend Its Fee Schedule, Exchange Act Release No. 34-_____, File No. SR-MIAX-2014-26 (May 27, 2014), at 13. MIAX noted that its rebate program “is based on the substantially similar fees

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A competitor is also free to create new exchanges if it believes that it would be attractive to customers to have a choice between multiple, affiliated exchanges.¹⁵ Remarkably, ISE attempts to use its recent creation of a new exchange as evidence that there are significant barriers to doing just that.¹⁶ Of course, any effort to create a new corporate entity requires some amount of time and money, but the fact that ISE recently registered a new exchange demonstrates that the barriers to entry are not prohibitively high and that, presumably, ISE determined there were sound, pro-competitive reasons for establishing a second exchange.

IV. The Proposed Rule Is Fully Consistent With The ArcaBook Order

Finally, ISE reiterates its argument that an excerpt from the Commission's ArcaBook Order demonstrates that the Proposed Rule fails to comply with the Exchange Act.¹⁷ In our January 24 letter, we explained that the ArcaBook Order *presupposes* that affiliated exchanges will at times act jointly and that they do not violate the requirements of the Exchange Act by doing so.¹⁸ Responding to this point, ISE concedes that it "makes no contention" that the Exchange Act "contains a blanket prohibition against exchanges cooperating with respect to fees in any circumstances."¹⁹ Instead, ISE's position is that, under the ArcaBook Order, "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."²⁰

Even accepting this (incorrect) interpretation of the ArcaBook Order, the Proposed Rule meets all relevant requirements of the Exchange Act. In its previous filings, Phlx has explained at length why its proposal is in the best interests of its members, all of whom will benefit from

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of another competing options exchange"—namely, the Chicago Board Options Exchange. *Id.* at 13 & n.5. This recent rule filing makes clear that exchanges can, and often do, lower prices in order to compete with other exchanges for order flow.

¹⁵ *Id.*

¹⁶ ISE Letter at 3.

¹⁷ ISE Letter at 4-7.

¹⁸ See Letter from Joan C. Conley, Senior Vice President and Corporate Secretary, Phlx, to Elizabeth Murphy, Secretary, Commission (Jan. 24, 2014), at 12-13. Joint activity among affiliated exchanges is also consistent with the antitrust laws. See *Copperweld Corp. v. Indep. Tube Corp.*, 467 U.S. 752, 771 (1984) ("the coordinated activity of a parent and its wholly owned subsidiary must be viewed as that of a single enterprise for purposes of § 1 of the Sherman Act" because "[a] parent and its wholly owned subsidiary have a complete unity of interest").

¹⁹ ISE Letter at 6.

²⁰ *Id.*

the anticipated tighter spreads and greater liquidity that is expected to result from the Proposed Rule.²¹

ISE argues that the Proposed Rule nevertheless violates the Exchange Act because it “treat[s] . . . affiliated exchanges differently than other competing exchanges.”²² There is no requirement in the Act, however, that Phlx refrain from preferring its own affiliated exchanges over other exchanges that are owned and operated by Phlx’s competitors.²³ Section 6(b)(5) of the Exchange Act merely prohibits an exchange from “unfair[ly] discriminat[ing] between *customers, issuers, brokers, or dealers*”—not other exchanges.²⁴ The portion of the ArcaBook Order cited by ISE is consistent with this conclusion, as it notes that “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.”²⁵ Nowhere does the Order suggest that an exchange must take into account the interests of its competitors before proposing a rule.

That conclusion makes sense in light of the overarching purposes of the Exchange Act. The Act protects *competition*; it does not protect *competitors* from losing business in a competitive marketplace. Indeed, the principle advanced by ISE would curtail or eliminate those competitive forces that spur innovation and offers of lower prices (like the Proposed Rule). ISE’s position may benefit ISE, but it would work to the detriment of customers who transact on the exchanges—whose interests the Exchange Act explicitly protects.²⁶

²¹ Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Offer a Customer Rebate, Exchange Act Release No. 34-70866, File No. SR-Phlx-2013-113 (Nov. 13, 2013), at 14-25; Letter from Joan C. Conley, Senior Vice President and Corporate Secretary, Phlx, to Elizabeth Murphy, Secretary, Commission (Jan. 24, 2014), at 4-7; Letter from Jeffrey Davis, Vice President & Deputy General Counsel, Phlx, to Elizabeth Murphy, Secretary, Commission (Apr. 18, 2014), at 5.

²² ISE Letter at 6.

²³ Indeed, under its current rules, The Nasdaq Stock Market, LLC (“NASDAQ”) provides market participants with a wholly voluntary routing option called “CART,” whereby the participant may specify that an order will route to NASDAQ OMX BX (“BX”) and NASDAQ OMX PSX (“PSX”), and then check the NASDAQ book, with any unexecuted shares posting to the NASDAQ book or cancelling. *See* Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Offer Additional Routing Option, 76 Fed. Reg. 9,397, 9,398 (Feb. 17, 2011).

²⁴ 15 U.S.C. § 78f(b)(6) (emphasis added).

²⁵ ArcaBook Order at 74793 (Dec. 9, 2008) (emphasis added).

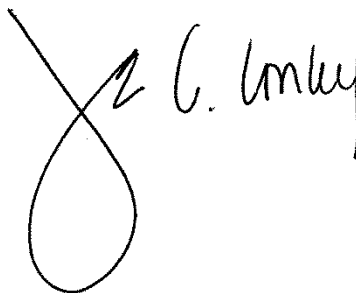
²⁶ In addition, as Phlx has explained elsewhere, the Proposed Rule does not unfairly discriminate against other exchanges that vie with Phlx and its affiliates for liquidity. *See* Letter from Joan C. Conley, Senior Vice President and Corporate Secretary, Phlx, to Elizabeth Murphy, Secretary, Commission (Jan. 24, 2014), at 7.

ISE also contends that some Phlx members will not benefit from the proposed rebate.²⁷ First, it argues, “[f]irms that do not also trade on NOM or BX, or have insufficient order flow on those exchanges to qualify for the enhanced rebates, will reap no benefits from the Proposal.”²⁸ But as Phlx has already explained, any Phlx member can qualify for the rebate by transacting the required volume *on the Phlx exchange alone*, and those market participants who do not meet the volume threshold will still benefit from increased liquidity and tighter spreads.²⁹ Second, ISE asserts that some Phlx members “may lose order flow to larger firms that consolidate order flow in order to meet the rebate thresholds.”³⁰ That possibility exists today, however, under any rebate program predicated on volume tiers and thus cannot preclude compliance with the Exchange Act—as the Commission has repeatedly approved similar volume-based rebates in the past.³¹

* * *

In sum, the Commission should approve the Proposed Rule, which increases the availability of a rebate to market participants who transact orders on Phlx. As demonstrated above, and in our previous submissions, the Proposed Rule complies with all relevant requirements of the Act: It is not unfairly discriminatory, does not place an unnecessary burden on competition, and represents an equitable allocation of fees. For these reasons, the Proposed Rule should be approved.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "J. Conley". The signature is stylized, with a large loop at the bottom and a cross-like shape at the top.

Joan C. Conley

²⁷ ISE Letter at 10.

²⁸ *Id.*

²⁹ Letter from Jeffrey Davis, Vice President & Deputy General Counsel, Phlx, to Elizabeth Murphy, Secretary, Commission (Apr. 18, 2014), at 5.

³⁰ ISE Letter at 10.

³¹ See Letter from Joan C. Conley, Senior Vice President and Corporate Secretary, Phlx, to Elizabeth Murphy, Secretary, Commission (Jan. 24, 2014), at 5-6.