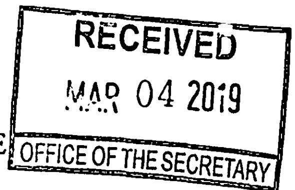


SECURITIES AND EXCHANGE COMMISSION
TRANSACTION FEE PILOT FOR NMS STOCKS; FINAL RULE
Release No. 34-84875; File No. S7-05-18
RIN 3235-0761
84 Fed. Reg. 5202 (February 20, 2019)

MOTION FOR STAY OF TRANSACTION FEE PILOT FOR NMS STOCKS BY NEW YORK STOCK EXCHANGE LLC, NYSE ARCA, Inc., NYSE AMERICAN LLC, NYSE NATIONAL, Inc., and NYSE CHICAGO, Inc.

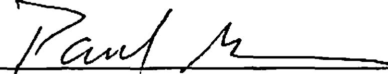
New York Stock Exchange LLC, NYSE Arca, Inc., NYSE American LLC, NYSE National, Inc., and NYSE Chicago, Inc. ("Petitioners") hereby request that the Securities and Exchange Commission stay its newly adopted final rule, amending Regulation NMS to adopt new Rule 610T thereunder, 17 C.F.R. 242.610T, known as the "Transaction Fee Pilot for NMS Stocks," including the April 22, 2019 effective date. Transaction Fee Pilot for NMS Stocks, 84 Fed. Reg. 5202 (Feb. 20, 2019). Petitioners request this stay pending final resolution of their petition for review challenging the final rule filed on February 14, 2019, in *New York Stock Exchange LLC v. SEC*, No. 19-1042 (D.C. Cir. Feb. 14, 2019).[1] Petitioners seek a stay of the final rule in its entirety and for the pendency of the litigation.

An answer to this motion is respectfully requested by March 29, 2019.

[1] Petitioners filed a protective petition for review on February 25, 2019 in the D.C. Circuit in the event the Court determines that the time to file a petition did not commence until publication of the final rule in the Federal Register. Protective Petition for Review, *New York Stock Exchange LLC v. SEC*, No. 19-1054 (D.C. Cir. Feb. 25, 2019).

Dated: March 1, 2019

Respectfully submitted,



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SECURITIES AND EXCHANGE COMMISSION
TRANSACTION FEE PILOT FOR NMS STOCKS; FINAL RULE
Release No. 34-84875; File No. S7-05-18
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84 Fed. Reg. 5202 (February 20, 2019)

BRIEF IN SUPPORT OF MOTION FOR STAY OF TRANSACTION FEE PILOT FOR NMS STOCKS BY NEW YORK STOCK EXCHANGE LLC, NYSE ARCA, Inc., NYSE AMERICAN LLC, NYSE NATIONAL, Inc., and NYSE CHICAGO, Inc.

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INTRODUCTION

The Securities and Exchange Commission (the "Commission") should stay the effective date of Rule 610T of Regulation NMS, the "Transaction Fee Pilot for NMS Stocks" (the "Rule"), during the pendency of the petition for review filed by New York Stock Exchange LLC, NYSE Arca, Inc., NYSE American LLC, NYSE National, Inc., and NYSE Chicago, Inc. ("Petitioners"). A stay is appropriate given the likelihood that Petitioners will prevail on their challenge to the Rule and because they stand to suffer immediate, irreparable injury if the Rule is implemented. Moreover, imposing a stay would not harm issuers, investors, or any other third party, and would further the public interest by avoiding the unnecessary costs and regulatory uncertainty stemming from implementation of the Rule before review by the D.C. Circuit.

Petitioners assert three compelling bases for vacating the Rule, each of which presents a strong likelihood of success. First, the Commission has not identified a sufficient basis to justify imposing the Rule's restrictions on Petitioners and other national securities exchanges. In adopting the Rule, the Commission asserted that the Rule is necessary to address what it views as a lack of data concerning the effects, if any, of the exchanges' fee-and-rebate pricing model on customer order flow. But the Commission expressed no view as to whether such effects exist, whether particular pricing models harm investors, or how specifically the Commission intends to use the data it seeks to gather. Instead, the Commission noted that *other parties* appear concerned about the fee-and-rebate pricing model, and posited that gathering data *may* clarify whether those concerns are warranted, which may or may not lead the Commission to take future action that could potentially benefit investors at some later date. Put another way, the Commission has ordered fundamental changes to the exchanges' business model and the structure of the market for trading equity securities based on the concerns of third parties not currently shared by the Commission and without a determination that those changes will help

investors. There is no basis for this type of exploratory rulemaking. The Commission is authorized to issue regulations addressing specific concerns, not to impose costly mandates related only vaguely to potential concerns that the Commission has not substantiated. Otherwise, the Commission's authority to implement regulations would be limitless.

Second, the Commission's cost-benefit analysis is fatally flawed. The Commission has a "statutory obligation to do what it can to apprise itself—and hence the public and Congress—of the economic consequences of a proposed regulation." *Chamber of Commerce of United States of Am. v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005). The Commission failed to meet that obligation because it did not realistically assess, or in some cases even attempt to predict, the cost of the Rule to investors, issuers, and exchanges. Instead, the Commission adopted a "wait-and-see" approach, asserting that categories of costs identified during the notice-and-comment period (including wider spreads and lost exchange revenue) are too hard to predict and thus better left to address after the Rule is implemented. That is insufficient. While the Commission is not obligated to quantify all future costs precisely, it cannot arbitrarily force businesses to change their business models without more seriously weighing the economic implications of doing so. The Commission's failure to perform an adequate cost-benefit analysis is a failure to engage in reasoned decisionmaking.

Third, the Rule fundamentally undermines competition. By limiting only the exchanges' ability to set fees and rebates, the Rule will artificially divert substantial order flow to off-exchange venues, which—as the Commission recognizes—are direct competitors of exchanges. Other than a few conclusory statements to the contrary, the Commission made no serious effort to explain how depriving the exchanges of a competitive tool, while allowing their competitors to use that same tool, is permissible under the Exchange Act. Moreover, the Rule will

undermine the competitive position of issuers whose securities are selected into one of its test groups. With respect to these issuers, the Commission again brushed aside the concerns of commenters, ignoring the reality that test group securities will trade at wider spreads, harming the ability of these issuers to compete with unaffected issuers for investors' capital. The Commission has failed to identify a sufficient basis—if such a basis could ever exist—for implementing a regulation that so thoroughly tips the competitive scales in favor of certain market participants.

Furthermore, implementing the Rule will cause significant and irreparable economic harm to Petitioners and other market participants. Once the Rule is implemented, off-exchange venues will attract significant order flow away from exchanges; issuers of test group securities will lose investors to other issuers; and investors will suffer lower execution quality as spreads widen and their orders are routed through less-regulated, less transparent, off-exchange trading venues. Moreover, those changes to customer order flow and investment patterns, once in place, may persist even after the Rule expires, particularly if off-exchange venues successfully attract order flow through the use of newly created economic incentives that only they would be permitted to use. The Commission acknowledged the possibility of these irreparable, harmful effects—as it must, based on substantial evidence and the input of numerous commenters. The Commission should therefore stay implementation of the Rule to avoid inflicting permanent harm during the pendency of Petitioners' challenge.

Finally, imposing a stay would not harm issuers, investors, or any other members of the public, and would instead further the public interest. The Commission cannot seriously contend that temporarily staying the Rule, which it conceded is exploratory in nature, risks imminently harming the public. Staying the Rule will far better serve the public interest by avoiding the

potentially unnecessary costs, regulatory uncertainty, and disruption that would arise if the Rule is implemented and subsequently vacated.

DISCUSSION

The Commission has broad discretion under the Administrative Procedure Act (the "APA") to stay implementation of a rule or other action when it "finds that justice so requires . . . ." 5 U.S.C. § 705. Traditionally, the Commission has applied a four-factor analysis for evaluating whether to grant a stay:

> 1. [W]hether there is a strong likelihood that a party will succeed on the merits in a proceeding . . . (or, if the other factors strongly favor a stay, that there is a substantial case on the merits);
> 2. [W]hether, without a stay, a party will suffer imminent, irreparable injury;
> 3. [W]hether there will be substantial harm to any person if the stay were granted; and
> 4. [W]hether the issuance of a stay would likely serve the public interest.

Am. Petroleum Inst., Exchange Act Release No. 68,197, 2012 WL 5462858 (Nov. 8, 2012).

However, the APA does not require strict application of the four-factor analysis, and the Commission properly employs a flexible approach to assessing a stay application based on the specific circumstances presented. *Id.* ("If the arguments for one factor are particularly strong, a stay may be appropriate even if the arguments on the other factors are less convincing."); *Order Preliminarily Considering Whether to Issue Stay Sua Sponte and Establishing Guidelines for Seeking Stay Applications*, Exchange Act Release No. 33,870, 1994 WL 117920 (Apr. 7, 1994) ("The evaluation of these factors will vary with the equities and circumstances of each case."). For example, the Commission has the discretion to stay its rules pending judicial review in the interests of justice, without taking a position on, or even addressing, the merits of a petitioner's challenge. *Bus. Roundtable*, Securities Act Release No. 9149, Exchange Act Release No.

63,031, Investment Company Act Release No. 29,456, 2010 WL 3862548 (Oct. 4, 2010). A finding that "justice so requires" a stay is sufficient. 15 U.S.C. § 78y(c)(2); 5 U.S.C. § 705.

Here, all four factors of the traditional test weigh heavily in favor of a stay, and thus a stay is appropriate regardless of how the Commission applies the test.

I. Petitioners Are Likely to Prevail on Their Petition for Review.

Petitioners advance three arguments challenging the Rule, each of which provides an independent and compelling basis for its invalidation. First, the Commission exceeded its authority because the Rule does not itself protect investors or seek to address any clear problem affecting the public interest. Second, the Rule is based on an arbitrary and capricious cost-benefit analysis. Third, the Rule is arbitrary and capricious because it fundamentally undermines competition in violation of the Exchange Act.

A. The Commission has not identified a sufficient basis to justify its costly, exploratory Rule.

The Commission exceeded its rulemaking authority by enacting the Rule without first identifying an issue necessitating agency action. It is blackletter law that an agency must demonstrate a "rational connection between the facts found and the choice made" before enacting a rule. *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm*, 463 U.S. 29, 57 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)). Inherent in the requirement that a rule bear a "rational connection to the problem identified" by the agency, *Jifry v. FAA*, 370 F.3d 1174, 1180 (D.C. Cir. 2004), is that the agency has, in fact, identified a problem. Where the Commission has not clearly explained the problem or issue in need of agency action, there is no way for a court to assess the rationality of a rule or the agency's authority to issue the rule. An agency must therefore identify a problem or issue before issuing a rule. In the context of the Exchange Act, the Commission must further ensure that its rules are

both "necessary or appropriate in the public interest" and "in addition to the protection of investors . . . will promote efficiency, competition, and capital formation." 15 U.S.C. § 78c(f). Taken together, the APA and the Exchange Act only permit the Commission to enact rules that address clearly defined issues related to investor protection, and that are calculated to promote free and competitive markets. The Rule does neither.

Rather than responding to a clear problem or issue, the Commission enacted the Rule simply to "study" third-party concerns regarding the impact of pricing models on customer order flow. Notably, the Commission took no position on whether those concerns are warranted or, if they are, how the Rule would address those concerns. *See, e.g.*, *Transaction Fee Pilot for NMS Stocks*, 84 Fed. Reg. 5202 (February 20, 2019) (hereinafter, "Adopting Release"), at 5244. Instead, the Commission found only that the concerns are worth exploring, and it has opted to explore those concerns by imposing significant restrictions on how the national securities exchanges conduct business. This approach is improper. The Commission is not permitted to impose substantial costs without making a finding, or even taking a firm stance, on whether the Rule will improve the market for investors. The D.C. Circuit has squarely rejected, for example, an analogous attempt by the Commission to "adopt[] . . . a particular rule based solely on the assertion that the existence of a rule provides greater clarity to an area that remained unclear in the absence of any rule." *Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 177–78 (D.C. Cir. 2010).

Nor does pointing to third-party concerns satisfy the Commission's responsibility to ensure that a proposed rule is in the best interest of investors and markets. It is well established that agencies cannot outsource their responsibilities to third parties, whether the industry being regulated or other stakeholders. *See State Farm*, 463 U.S. at 57 (holding that an agency cannot

outsource its rulemaking obligations to the industry that it regulates); *Ethyl Corp. v. EPA*, 306 F.3d 1144, 1149 (D.C. Cir. 2002) (holding that the agency did not have the discretion to outsource responsibility to develop emission test procedures to third parties). To allow the unexplored concerns of third parties to trigger regulatory obligations is an abdication of the Commission's statutory obligations and a recipe for agency manipulation by outside stakeholders.

At bottom, the Commission seeks to issue a rule in an attempt to discover problems sufficient to justify further rulemaking. That is an insufficient basis for agency action. Indeed, the Commission conceded that the Rule may not promote investor protection or efficient markets at all. The Commission's only argument that the Rule furthers the public interest is that the Rule may provide "additional information [that] would assist the Commission in making future regulatory decisions." Adopting Release, 84 Fed. Reg. at 5244. That justification would be inadequate under any circumstances, and it is particularly deficient here given how unsure the Commission is that this "additional information" will be of any use. The Commission acknowledged that the Rule may not lead to any future Commission action, and that the Rule may not ultimately help—*and could harm*—investors. *See id.* at 5266–67, 5282. The Commission similarly admitted that it does not know whether the Rule will promote efficiency, competition, and capital formation, and instead asserted that the Rule is justified because it will provide data concerning whether it does promote those ends. *See id.* at 5280. Moreover, the Commission has failed to specify how it will evaluate any information it gathers through the Rule, or describe its analytical model for assessing the effects of the Rule.

In short, the Commission has enacted a rule in order to evaluate whether the rule itself, or some undefined future rule, satisfies the Exchange Act. That approach is unprecedented and

improper. *See, e.g.*, *Am. Equity Inv. Life Ins. Co.*, 613 F.3d at 178 (holding that the Securities Act "asks for an analysis of whether the *specific rule* will promote efficiency, competition, and capital formation"); *see also Jifry*, 370 F.3d at 1180 (requiring "a 'rational connection between the facts found and the choice made'") (quoting *United States Air Tour Ass'n v. FAA*, 298 F.3d 997, 1005 (D.C. Cir. 2002)).

Moreover, even if an exploratory rulemaking of this type were permitted—which it is not—the Rule would still be arbitrary and capricious because it does not rationally relate to the stated exploratory purpose. In the Commission's view, the goal of the Rule is to "produce information on the impact of transaction fee-and-rebate pricing models on order routing decisions by broker-dealers, as well as their impact on execution and market quality." Adopting Release, 84 Fed. Reg. at 5244. But the Rule excludes off-exchange venues from its restrictions and reporting requirements, which the Commission acknowledged represent *nearly 40% of the entire market*. *See id.* at 5254 n.625. As a result, the Rule will not generate any data concerning the order flow patterns across nearly half of the market, which will undermine the Commission's ability to reach representative conclusions. Nor does the Rule consider, let alone measure, the role that broker-dealer commissions, payment for order flow, or volume discounts play in broker-dealer order routing decisions, which is critical to understanding how broker-dealer incentives may cause conflicts with client interests. Thus, the Rule as designed will produce, at best, skewed information concerning the impact of current pricing models on customer order flow, rendering the results of the Commission's market study incomplete and misleading. The Commission thus failed to demonstrate a "rational connection to [the] problem" purportedly addressed by the Rule. *See Jifry*, 370 F.3d at 1180.

B. The Rule's cost-benefit analysis is fatally flawed.

The D.C. Circuit has held that the Commission's "failure to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation makes promulgation of the rule arbitrary and capricious and not in accordance with law." *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (quoting *Chamber of Commerce*, 412 F.3d at 144). The Commission failed this requirement here.

a. The Commission failed to identify sufficient benefits flowing from the Rule.

The Commission admitted that the Rule may not help at all and that it *may prove harmful* to investors and the markets. The Commission conceded that it "cannot predict at this time whether [the Rule] will suggest any particular policy direction and recognizes that the results could suggest that existing exchange transaction-based fee caps and related rebates may be more beneficial to investors than the policy alternatives examined in the [Rule]." Adopting Release, 84 Fed. Reg. at 5259. Equally or more troubling, the Commission stated "that the [Rule] could harm execution quality and/or market quality," *id.* at 5266, "could potentially harm efficiency," *id.* at 5282, and "could plausibly . . . degrade price efficiency in certain test group stocks," *id.* at 5266–67. These are extraordinary concessions. The Commission failed to provide any support or precedent for enacting an experimental rule that does not address any readily identifiable issue and that the Commission believes may, on balance, harm market participants.

Even assuming—contrary to the Commission's concessions—that the Rule may provide some benefit to the public, the Commission admitted that it cannot identify those benefits or predict their significance. The primary purported benefit of the Rule is to *provide the Commission* with "data [that will] better inform its regulatory consideration of exchange transaction-based fee-and-rebate pricing models and fee changes," *id.* at 5259, without the need for "lengthy and labor-intensive collection" efforts, *id.* at 5261. The Commission cannot,

however, commit to whether the data will provide any public benefit, admitting that "many of the economic benefits [of the Rule] derive from subsequent decisions that the Commission can neither predict nor commit to at this time." *Id.* at 5259. Such speculative and indirect benefits do not support the Commission's substantial intrusion into and interference with the functioning of the markets. Moreover, the Commission provides no support for the suggestion that it can rulemake simply to make its job easier. Having failed to identify concrete, non-speculative benefits to the public flowing from the Rule, the Commission necessarily failed to conduct a proper cost-benefit analysis. *See Bus. Roundtable*, 647 F.3d at 1152; *Chamber of Commerce*, 412 F.3d at 143; *Pub. Citizen v. Fed. Motor Carrier Safety Admin.*, 374 F.3d 1209, 1221 (D.C. Cir. 2004).

b. The Commission abdicated its statutory responsibility to seriously assess the Rule's costs by repeatedly invoking the "uncertainty" of those costs.

The Commission also inappropriately discounted much of the Rule's costs because, in its view, those costs are too difficult to predict. Instead, the Commission adopted a "wait-and-see" approach to determine whether, and to what extent, costs will materialize following implementation of the Rule. That approach is insufficient and inappropriate. *See, e.g.*, *Bus. Roundtable*, 647 F.3d at 1152.

As noted by several commenters, the Rule will drive order flow to off-exchange venues, which—unlike their exchange competitors—will be permitted to offer uncapped order flow incentives. *See* Adopting Release, 84 Fed. Reg. at 5282. The Commission appeared to accept this reality, or at least that the predicted outcome is reasonable to expect, noting that "the impact of the Pilot on exchange revenues . . . *could be significant*," *id.* at 5272 (emphasis added), and that those revenue losses could be permanent, *id.* at 5273 ("The Pilot could also impact exchanges' fee revenue after the conclusion of the Pilot if as a result of the Pilot broker-dealers

permanently alter their order routing decisions after the Pilot is completed."). Similarly, the Commission acknowledged that the Rule could cause test group securities to trade at wider spreads which could, in turn, harm the ability of issuers of these securities to remain competitive with issuers of unrestricted securities, and also increase execution costs for investors. *See id.* at 5287, 5289–90. Thus, the Commission conceded that the Rule, which provides no clear public benefit, may prove both inefficient and anticompetitive, and could cause substantial, irreparable losses for a variety of market participants.

Rather than grappling with the extent and severity of the Rule's costs, the Commission took the position that it can discount or ignore those costs because they are uncertain. *See id.* at 5272 ("[D]ecreased trading volume, while one possible outcome of the [Rule], is not the only reasonable outcome, and . . . the *ex ante* effect of the Rule on trading volume is difficult to determine."); *id.* at 5277 ("[T]he Commission believes that there is significant uncertainty surrounding the effects of the Pilot on liquidity" as a result of widening spreads); *id.* ("[T]he Commission cannot predict whether investors will face higher or lower transaction costs . . . ."). This approach is impermissible. The D.C. Circuit has found that the Commission, even in the face of uncertain costs, must "exercise its expertise to make tough choices about which of the competing estimates is most plausible, and to hazard a guess as to which is correct, even if . . . the estimate will be imprecise." *Pub. Citizen*, 374 F.3d at 1221; *see also Chamber of Commerce*, 412 F.3d at 143. The Commission failed to do so here. Instead, the Commission argued, for example, that "if competitive rebalancing among trading centers occurs as a result of the [Rule], it could provide information to the Commission about order routing decision and execution quality to inform future policy actions." Adopting Release, 84 Fed. Reg. at 5282. In other words, the Commission admitted that the Rule could inflict permanent losses on certain market

participants, but it has not assessed the extent or likelihood of those losses, and it views the Rule as an experimental method of learning what those losses may be. This approach turns reasoned decisionmaking on its head.

The extent of the Commission's failure to analyze the Rule's costs and its accompanying uncertainty about those costs is striking and underscored by numerous, repeated concessions in addition to those cited above, including the following:

- "[T]he Commission cannot quantify, ahead of the Pilot, the economic impact of any changes in order routing decisions by broker-dealers that may result from the Pilot," *id.* at 5246;
- "[T]he Commission acknowledges that the Pilot could harm execution quality and/or market quality, but the impacts of the Pilot are uncertain," *id.* at 5266;
- "[T]he Commission is uncertain about whether, or among which securities, the Pilot will result in increases or decreases in quoted spreads and investor transaction costs," *id.*;
- "[T]he Commission is uncertain about how the Pilot will affect price efficiency – the Pilot could plausibly improve or degrade price efficiency in certain test group stocks," *id.* at 5266–67;
- "[T]he Commission acknowledges that the Pilot may lead to lower trading volume/market share for exchanges, which would impose a cost in terms of lost transaction fee revenue, but is unable to quantify the expected magnitude of this potential cost," *id.* at 5273;
- "[T]he Commission cannot predict whether investors will face higher or lower transaction costs" as a result of the Rule, *id.* at 5277;
- "[T]he Commission acknowledges significant uncertainty with respect to the effect of the Pilot on exchange competition," *id.* at 5286; and
- "[S]ince the Commission does not know *ex ante* how the Pilot will impact the liquidity of ETPs, it is unable to quantify the effects that the Pilot will have on competition between ETPs," *id.* at 5288.

The Commission cannot avoid assessment of a rule's costs by repeatedly invoking uncertainty as it has done here.[2] By doing so, the Commission "duck[ed] serious evaluation of the costs that could be imposed upon" market participants, *Bus. Roundtable*, 647 F.3d at 1152, and thus "neglected its statutory responsibility to determine the likely economic consequences" of the Rule, *id.* at 1148. Such failure to evaluate costs would be impermissible even where a rule has likely, identifiable benefits; it is even more improper where, as here, the agency has failed to identify any such benefits and has in fact acknowledged they might not exist at all.

c. *The Commission's conclusion that the Rule's costs are too uncertain to predict lacks a reasoned basis.*

The Commission's reliance on uncertainty about the magnitude of costs to discount them is not only impermissible but is also contrary to overwhelming economic evidence. Even if there is uncertainty about the *level* of costs the Rule would impose, there is very little uncertainty about the *existence* of costs in this case. In other words, the Commission ignores the fact that the supposedly "uncertain" costs are overwhelmingly likely to occur.

Regarding costs to exchanges, the Commission ignored compelling record evidence that the Rule will cause national securities exchanges to suffer substantial, irreparable revenue losses. Indeed, most commenters addressing the question predicted that the Rule would cause order flow to be routed off-exchange, resulting in substantial loss of revenue for exchanges. Adopting Release, 84 Fed. Reg. at 5283–87. And the only significant studies of this question contained in the administrative record—the Battalio Equity Market Study and the Nasdaq/Swan study—predict the same. *See id.* at 5248–49 (explaining Battalio study, which found that broker-dealers

[2] The closest the Commission came to seriously grappling with the costs associated with loss of exchange revenue is to note that a 10% decrease in order flow would cost the exchanges $150 million over just the course of the Rule's pilot period, before promptly concluding without support that the 10% decrease is an unreasonable estimate. *See* Adopting Release, 84 Fed. Reg. at 5274. The Commission made no further attempt to appraise those costs even at a high level.

route orders to capture liquidity rebates); *id.* at 5249–50 (explaining Nasdaq/Swan study, which found that Nasdaq lost market share in stocks when it experimented with lower fees and rebates). Notwithstanding the one-sided nature of the evidence and the obvious logical implication of the Rule's restrictions on exchange order flow, the Commission engaged in baseless speculation that *perhaps*—contrary to all available indications—the Rule *might* not result in decreased exchange order flow. *Id.* at 5284 ("Given the disagreement among commenters, the Commission believes it is possible that lower transaction fees could potentially result in more marketable order flow being routed to exchanges . . . [but] the Commission . . . is unable to determine how likely this is to occur."). That conclusion is unsupported and insufficient to support any regulatory action. *See Bus. Roundtable*, 647 F.3d at 1150.

Regarding costs to issuers, the Commission's assertion that "the [Rule] will [not] have a significant effect on the ability of issuers to raise capital" is similarly flawed. Adopting Release, 84 Fed. Reg. at 5287. In support, the Commission pointed to a single study performed by the Commission's Division of Economic and Risk Analysis ("DERA"), which found that the Commission's Tick Size Pilot—an entirely separate program unrelated to the Rule—did not cause stock price impact for affected issuers. *See id.* at 5290–91. But that study is inapplicable and analytically flawed. DERA only studied the effects of the Tick Pilot on stock price impact *for a few days before the rule even took effect.* The Commission cannot purport to understand how the Tick Pilot affected impacted securities, let alone whether issuers would experience similar impacts under the two-year duration of the Rule, without examining both a longer period of time, and one in which the Tick Pilot's restrictions were actually in effect. Moreover, commenters provided the Commission with another study that reached the opposite conclusion—*i.e.*, that affected securities experienced a price *decrease* upon implementation of the Tick Pilot

restrictions, which the Commission dismissed without reasoned explanation.[3] This type of selective engagement with the administrative record is arbitrary and capricious. *See Business Roundtable*, 647 F.3d at 1151 (finding Commission's cost-benefit analysis arbitrary and capricious, in part, because it relied on "unpersuasive studies" in support of its conclusion).

Finally, the Commission's conclusion that investors may not face higher execution costs due to higher spreads under the Rule similarly ignored substantial record evidence. Several commenters provided the Commission with concrete examples illustrating how the Rule would increase execution costs to investors, *see* Adopting Release, 84 Fed. Reg. at 5276–77, and others provided the Commission with empirical cost estimates showing the same, *see id.* at 5278–79.[4] The Commission dismissed these efforts on the basis that it "cannot predict whether investors will face higher or lower transaction costs" as a result of the Rule. *Id.* at 5277. The Commission's decision to discount empirical assessment of the Rule's costs to investors in favor of its unsubstantiated prediction has "no basis beyond mere speculation," *Bus. Roundtable*, 647 F.3d at 1150, and underscores the arbitrary and capricious nature of the Commission's cost-benefit analysis.

[3] The Commission asserted that the Albuquerque, Song, & Yao working paper contradicted "standard economic assumptions," which would purportedly predict "a negative stock price reaction for test group stocks," Adopting Release, 84 Fed. Reg. at 5290, at the time of announcement rather than the time of implementation. However, the Commission failed to identify those "standard" assumptions, cite any economic literature in support of that conclusion, or otherwise explain the basis for that statement. Indeed, rather than respond substantively to the implications of these contrary findings, the Commission simply dismissed them as "uncertain." *Id.* at 5290–91. That is inappropriate. *See Business Roundtable*, 647 F.3d at 1151.

[4] Further, in the time since the Rule was adopted, FINRA released a working paper concluding that institutional orders routed by brokers that send a relatively high percentage of orders to an affiliated ATS receive lower order fill rates and higher execution costs. *See* FINRA Working Paper: High Broker-Affiliated ATS Order Routing Associated with Lower Fill Rates, Higher Costs, *available at* http://www.finra.org/newsroom/2019/finra-working-paper-high-broker-affiliated-ats-order-routing-associated-lower-fill. Placing restrictions on exchanges' ability to attract order flow, but no similar restrictions on ATSs and other off-exchange venues, would exacerbate this result.

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In sum, the Rule is arbitrary and capricious because the Commission afforded great weight to the Rule's vague and speculative benefits, while discounting substantial costs supported by clear evidence—both by improperly deferring to purported "uncertainty," and by dismissing substantial record evidence without support. These are fatal flaws under the APA. *See id.* at 1152; *Pub. Citizen*, 374 F.3d at 1221; *Chamber of Commerce*, 412 F.3d at 143.

C. The Rule fundamentally undermines competition.

The Rule is impermissible for the additional reason that it fundamentally undermines competition. 15 U.S.C. §§ 78c(f), 78w(a)(2). While the Commission conceded that the Rule could lead to substantial market changes that would disproportionately impact exchanges and issuers, it also appears to have concluded—or at least suggested—that it does not believe the Rule will harm competition. In fact, the Rule would plainly impede competition, and the Commission provided no reasoned basis to conclude otherwise.

a. The Rule fundamentally undermines national securities exchanges' competitive position.

As discussed above, the Rule's anticompetitive effects will create significant costs for the national securities exchanges, which the Commission both conceded could be substantial and admitted that it failed to measure. However, the Commission also appears to have discounted the possibility of competitive harm by stating that the Rule will not "necessarily . . . put the equities exchanges at a competitive disadvantage." Adopting Release, 84 Fed. Reg. at 5207. It is unclear what the Commission meant by this assertion. If the Commission meant that there has been no demonstration with 100% certainty that the Rule will harm competition (as opposed to a demonstration by the *Commission* that the Rule will *not* harm competition), then the Commission has applied a wholly improper standard and engaged in impermissible burden shifting. *See, e.g.*,

Appalachian Power Co. v. EPA, 135 F.3d 791, 818 (D.C. Cir. 1998) (describing agency's "affirmative burden" to explain and justify rules). If instead the Commission meant that it thinks there is insufficient reason to be concerned about competitive harm, that conclusion is unsupported for multiple reasons.

As an initial matter, the Commission elsewhere stated that "the overall effects of the [Rule] on . . . competition are unclear." Adopting Release, 84 Fed. Reg. at 5282. Under principles of reasoned decisionmaking, the Commission cannot assert a lack of competitive harm while simultaneously declaring the question open and uncertain. *See City of Vernon, Cal. v. FERC*, 845 F.2d 1042, 1048 (D.C. Cir. 1988) (holding that an agency "is not entitled under the APA to respond with a non sequitur"); *see also Gulf Power Co. v. FERC*, 983 F.2d 1095, 1101 (D.C. Cir. 1993) ("[W]hen an agency takes inconsistent positions . . . it must explain its reasoning.").

Moreover, any assertion that the Rule will not undermine competition "runs counter to the evidence before the agency." *State Farm*, 463 U.S. at 43. Rather than *promoting* competition, restricting only the national securities exchanges' ability to offer order flow incentives will *undermine* the ability of exchanges to compete with off-exchange venues for order flow. The evidence provided to the Commission on that point is clear and overwhelming, *see supra* Part I.B.c, and the Commission's limited attempts to minimize likely competitive harm are unsupported and unpersuasive.

The Commission argued, for example, that off-exchange venues may *choose not to* increase their use of rebates in order to avoid a purported need to renegotiate their customer agreements. *See* Adopting Release, 84 Fed. Reg. at 5282. But that is unsupported speculation. The Commission provided no basis to conclude that renegotiation would be necessary at all, let

alone that renegotiation would prove too costly to justify changes in incentive structures likely to generate significant business. Indeed, it appears far more likely that off-exchange venues would readily renegotiate their agreements in order to take advantage of new Commission-granted competitive power.[5] The Commission cannot substitute bald assertions for supported, reasoned analysis. *See Amerijet Int'l v. Pistole*, 753 F.3d 1343, 1350 (D.C. Cir. 2014) ("[C]onclusory statements will not do; an agency's statement must be one of *reasoning*." (internal quotation marks omitted)); *see also State Farm*, 463 U.S. at 43.

The Commission also asserted, without support, that capping exchange access fees may have no impact on exchange order flow. *See* Adopting Release, 84 Fed. Reg. at 5283–84. In addition to defying logic, that argument ignored that two exchanges—Nasdaq and Cboe EDGA—have already experimented with lower access fees and rebates, and both experienced significant *reduction* in order flow as a result. *See id.* at 5249–50, 5284; *see also* Ex. B, Letter from E. King to B. Field Jr., at 5 (May 31, 2018) (hereinafter, "NYSE Letter"). The Commission provided no reason to believe that the compulsory caps imposed by the Rule would produce a different outcome. Where, as here, an agency is faced with empirical data supporting a logical, straightforward conclusion consistent with economic experience, the agency cannot simply assert a contrary conclusion on the basis that the theory has not yet been completely disproved and *might* prove to be correct. *See State Farm*, 463 U.S. at 52; *see also Greater Yellowstone Coal, Inc. v. Servheen*, 665 F.3d 1015, 1030 (9th Cir. 2011) (finding agency action arbitrary and

[5] Moreover, both the Battalio Equity Market Study and the Nasdaq/Swan study suggest that broker-dealer order flow moves freely between venues that offer the most appealing incentive structures. *See supra* Part I.B.c. As the Rule permits off-exchange venues to offer incentives prohibited for national securities exchanges, they would do so, and broker-dealers would readily direct order flow to the off-exchange venues to take advantage of these incentives.

capricious where the agency provided no data in support of its position even though there was "considerable data . . . pointing in the opposite direction").

Finally, there is similarly no support for the Commission's counterintuitive suggestion that exchanges may see an *increase* in their order flow if they are limited in their ability to offer rebates. *See* Adopting Release, 84 Fed. Reg. at 5284–85. As the Commission conceded, *ten separate commenters* disagreed with this position,[6] while only one commenter supported it. *See id.* at 5285 nn.912-13. The Commission ignored the majority of these commenters and concluded instead that reducing rebates "could cause liquidity to increase," which "could" cause the exchanges' share of order flow to also increase, but that "the overall effect [of the Rule on liquidity] is difficult to determine." *Id.* at 5285. The Commission cannot rely on this type of unsupported guesswork, particularly in the face of overwhelming commentary pointing in the opposite direction—including the views expressed by national securities exchanges, whose considered business decisions flatly contradict the Commission's speculation. If adjusting fees and rebates in the manner the Commission proposes really led to increased order flow, the exchanges presumably would have already *voluntarily* done so on their own (and indeed, national securities exchanges constantly alter their fee schedules to test their impact on competition). *See, e.g.*, *id.* at 5248, n.575 (noting that national securities exchanges have revised their transaction-based fees and rebates 34 times in the last five years). It was arbitrary and capricious for the Commission to set aside, without support, the informed views of experienced market stakeholders. *See State Farm*, 463 U.S. at 57; *Int'l Ladies' Garment Workers' Union v. Donovan,* 722 F.2d 795, 818 (D.C. Cir. 1983).

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[6] Those commenters include a diverse group of national securities exchanges, issuers, investment managers, broker-dealers, and a global payment and technology company.

b. *The Rule also fundamentally undermines the competitive position of issuers of test group securities.*

The Rule poses similar competitive harms to issuers of securities selected into the Rule's test groups. As raised by several commenters, the Rule will cause test group securities to trade at wider spreads, which will in turn undermine the ability of these issuers to compete for investors' capital. The Commission concluded without support that it "does not believe the [Rule] will have a significant effect on product market competition between issuers," and that it "does not believe that the [Rule] will have a significant effect on the ability of issuers to raise capital." Adopting Release, 84 Fed. Reg. at 5287. Apart from its general "belief," the Commission supported this assertion only with a cite to the DERA study, which, for reasons discussed, does not carry the weight the Commission accords it. *See supra* Part I.B.c.

Notably, for example, the DERA paper focused exclusively on the effect that wider tick sizes had on stock prices for *corporate issuers*, and not on competitive effects for other types of issuers. Here, several commenters raised concerns that the Rule will cause Exchange Traded Products ("ETPs") that are selected into a test group to trade at wider spreads compared to unrestricted ETPs. *See* Adopting Release, 84 Fed. Reg. at 5210. More so than the securities of corporate issuers, investors frequently view different ETPs as close substitutes for one another. For example, where two ETPs track the same underlying index of securities (such as the S&P 500) or other asset (such as the price of gold), an investor expects that its return on an investment in either ETP would be nearly identical, except as a result of the different fees and transaction costs associated with purchasing and selling each ETP. As a result, when deciding between similar ETPs, investors rationally opt for the ETP that carries a lower fee or trades at a narrower spread. As the Rule will artificially increase transaction costs by widening the trading spreads on some ETPs, issuers of these ETPs will be forced to compensate investors in other

ways to prevent those investors from selecting competing unrestricted ETPs. Conversely, issuers of ETPs that are not restricted by the Rule will have a competitive advantage by being able to maintain higher fees relative to competing ETPs that must lower fees to account for the artificially wider spreads.

As a result, the Rule will arbitrarily undermine the ability of certain ETP issuers to attract investors, providing an artificial pricing advantage to one group of competitors over another. The Commission did not seriously consider these significant effects on the ability of restricted ETP issuers to compete and raise capital. Thus, the Commission's conclusion that the Rule will not undermine the competitive position of issuers of test group securities also lacks a reasoned basis. *See, e.g.*, *Bus. Roundtable*, 647 F.3d at 1152 (finding rule arbitrary and capricious, in part, because agency failed to address significant problems raised during notice-and-comment period); *Int'l Ladies' Garment Workers' Union*, 722 F.2d at 818 (same).

c. The Commission failed to explain why excluding off-exchange venues is necessary.

In addition to ignoring the Rule's anticompetitive effects, the Commission also failed to explain its decision to exclude off-exchange venues from the Rule. In doing so, the Commission "treated similarly situated parties differently" without providing an adequate justification, in violation of the APA. *Comcast Corp. v. FCC*, 526 F.3d 763, 769 (D.C. Cir. 2008). The Commission asserted that gathering order flow data from off-exchange venues "would not further the Commission's evaluation of the impact of the existing regulatory regime, including, but not limited to, the Regulation NMS fee cap." *See* Adopting Release, 84 Fed. Reg. at 5207. But the Commission elsewhere stated that the purpose of the Rule is *not* limited to Regulation NMS fee caps and is instead aimed at the much broader purpose of exploring "the impact of transaction fee-and-rebate pricing models on order routing decisions by broker-dealers,

as well as their impact on execution and market quality." *Id.* at 5244. The Commission did not explain why gathering the additional data from the nearly half of the market the Rule excludes would not "further" the Rule's broad, exploratory purpose.

Moreover, including off-exchange venues under the Rule would not, as the Commission suggested, "go beyond the scope of the current regulatory framework." *See id.* at 5207. Rather, a more even-handed rule would simply cap the rebates and fees that off-exchange venues could use and require that they produce data. That approach would not expand the scope of current regulations any more significantly than the Rule does with respect to the national securities exchanges. It would simply ensure that the Commission applied its rules equally across the market, as it is required to do under the Exchange Act and the APA.[7] *See Comcast Corp.*, 526 F.3d at 769. And to the extent the Commission argued that it would be too difficult to include off-exchange venues within the scope of the Rule because they are not subject to certain existing regulations, that argument has been foreclosed by the D.C. Circuit. *See New England Power Generators Ass'n, Inc. v. FERC*, 881 F.3d 202, 212 (D.C. Cir. 2018) (holding that an agency's "complex mandate doesn't relieve it of the requirements of reasoned decisionmaking"); *see also Chamber of Commerce*, 412 F.3d at 143 (stating that a "difficulty" in determining costs did not "excuse the [Commission] from its statutory obligation").

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[7] In addition, as noted by several commenters, the Commission's concerns ring hollow in light of the fact that its Tick Pilot included off-exchange venues without triggering similar hesitations about regulatory overreach. Moreover, many other aspects of Regulation NMS also apply equally to exchanges and off-exchange trading venues. *See, e.g.*, Regulation NMS Rule 611 (requiring trading centers, including national securities exchanges, alternative trading systems and broker-dealers, to enforce policies and procedures to prevent transactions from executing at impermissible prices); Regulation NMS Rule 612 (restricting national securities exchanges, alternative trading systems, broker-dealers and others from displaying, ranking or accepting bids or offers in certain pricing increments). The Commission made no attempt to explain those inconsistencies, which renders the Rule impermissible. *See Gulf Power Co.*, 983 F.2d at 1101 (holding that an agency "must explain its reasoning" when departing from prior precedent); *see also Bus. Roundtable*, 647 F.3d at 1152; *Int'l Ladies' Garment Workers' Union*, 722 F.2d at 818.

Finally, it is entirely unpersuasive for the Commission to assert that a more equitable rule could "have the unintended and harmful effect of unnecessarily changing" off-exchange venues' business models. *See* Adopting Release, 84 Fed. Reg. at 5205. *That is the national securities exchanges' precise concern with the Rule the Commission has proposed here.* If the Commission is concerned about the Rule's intrusive effects on the free market, it can pursue any number of alternatives to studying the market suggested during notice and comment. What the Commission cannot do is apply purported concerns unequally so as to favor certain market participants over others without justification. *See Comcast Corp.*, 526 F.3d at 769.

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In sum, the Rule is impermissible because it fundamentally undermines competition in numerous ways. The Commission reached a different conclusion by mistaking purported uncertainty regarding competitive harm as a basis for discounting it, and by ignoring substantial record evidence demonstrating that competitive harm will occur.

II. Petitioners and Other Market Participants Would Suffer Imminent, Irreparable Injury if the Commission Implements the Rule.

A stay is also necessary to avoid irreparable injury. "[I]rreparable injury is suffered when monetary damages are difficult to ascertain or are inadequate." *Multi-Channel TV Cable Co. v. Charlottesville Quality Cable Operating Co.*, 22 F.3d 546, 551 (4th Cir. 1994) (quoting *Danielson v. Local 275, Laborers Int'l Union of N. Am., AFL-CIO*, 479 F.2d 1033, 1037 (2d Cir. 1973)); *see also Michael Earl McCune*, Exchange Act Release No. 77,921, 2016 WL 2997935 (May 25, 2016) (finding that the Commission's irreparable harm analysis should take into account the strength of the case on the merits). Courts routinely find irreparable harm where, as here, petitioners can demonstrate "the possibility of a permanent loss of customers to a competitor." *Multi-Channel TV*, 22 F.3d at 552; *see also Bloomberg L.P.*, Exchange Act Release

No. 83,755, 2018 WL 3640780 (July 31, 2018) (finding that petitioner established irreparable harm "because it is likely to permanently lose customers"). Petitioners have clearly demonstrated irreparable harm given the extent and permanency of their potential losses under the Rule.

First, the Commission acknowledged that Petitioners would have to spend over $2,500,000 in order to comply with the Rule. *See* Adopting Release, 84 Fed. Reg. at 5267. Unless the Commission grants a stay, Petitioners must immediately begin spending that money to ensure they have systems in place to collect and publish data in advance of the impending Pre-Pilot Period. Thus, Petitioners stand to lose substantial sums even before the Rule's effective date that they cannot recoup from the Commission even if the D.C. Circuit vacates the Rule. That weighs in favor of granting a stay. *See, e.g.*, *Va. Petroleum Jobbers Ass'n v. FPC*, 259 F.2d 921, 925 (D.C. Cir. 1958) (noting that a key consideration in determining irreparable harm is whether "adequate compensatory or other corrective relief will be available at a later date, in the ordinary course of litigation").

Second, the Commission conceded that Petitioners could lose significant revenues due to the Rule's anticompetitive effects, *see* Adopting Release, 84 Fed. Reg. at 5227, and that those revenue losses could be permanent, *id.* at 5273. As discussed, the Commission's only response is that those losses are "difficult to determine in advance." *Id.* at 5272.[8] But the Commission's purported inability to precisely quantify revenue loss that it admits is possible and "significant" does not render the harm any less irreparable. To the contrary, even crediting the Commission's

[8] The Commission also disregarded its lost-revenue estimate as unreasonable because it found that the study on which the estimate is based found "no change in overall volume or in off-exchange volume, just a migration from Nasdaq to other exchanges." Adopting Release, 84 Fed. Reg. at 5274. But even if the Commission's conclusion on this point were otherwise credited, a migration of volume from NYSE to other exchanges as a result of the Rule is still an irreparable harm that justifies the imposition of a stay pending adjudication of the Rule. *See Multi-Channel TV*, 22 F.3d at 552.

conclusion that foreseeable, potentially permanent losses are uncertain, that would further *support* Petitioners' argument that monetary damages are "difficult to ascertain" and would prove "inadequate" to address Petitioners' losses. *See, e.g.*, *Multi-Channel TV*, 22 F.3d at 552. For all these reasons, Petitioners have sufficiently demonstrated irreparable harm.

III. No Substantial Harm Would Result from the Stay, and Its Imposition Would Further the Public Interest.

Imposition of a stay would not result in substantial harm to issuers, investors, or any other party. A stay would simply "maintain the status quo pending a final determination of the merits of the suit." *See Wash. Metro. Area Transit Comm'n*, 559 F.2d 841, 844 (D.C. Cir. 1977). The Commission conceded that the Rule's benefits, if any exist, "derive from subsequent decisions that the Commission can neither predict nor commit to at this time." Adopting Release, 84 Fed. Reg. at 5259. Thus, imposing a temporary stay of the Rule during the pendency of this challenge will not harm the public, nor deprive the public of any readily identifiable benefit.

To the contrary, the *failure* to impose a stay would irreparably harm the public. For reasons previously explained by NYSE and others in detail, the Rule will distort the market in ways that harm investors. Investors and the marketplace as a whole are afforded protections and benefits under the Exchange Act and its governing regulations from transparent on-exchange trading; these are lost when trading volume moves off-exchange. The Rule risks *directing* substantial order flow to less transparent, less regulated markets, which will pose significant risks to the marketplace. *See* NYSE Letter at 5–6. Moreover, as the Commission conceded, wider spreads under the Rule could also pose substantial harm to investors and issuers. *See supra* Part I.B.b. As discussed, wider spreads will increase transaction costs for investors, *id.*, and fundamentally undermine the competitive position of restricted issuers, particularly issuers

of ETPs tracking the same indices or assets, *see supra* Part I.C.b. Imposing a stay while the D.C. Circuit considers the Rule's validity would further the public interest by preventing these unnecessary, irreparable harms to investors and issuers.

Finally, the Commission also stands to benefit from staying the Rule by avoiding the "potentially unnecessary costs, regulatory uncertainty, and disruption that could occur if the [Rule] were to become effective" and subsequently vacated by the D.C. Circuit. *See Bus. Roundtable*, Securities Act Release No. 9149, Exchange Act Release No. 63,031, Investment Company Act Release No. 29,456, 2010 WL 3862548 (Oct. 4, 2010). Indeed, the Commission should recognize that expending the effort necessary to implement the Rule before resolution of Petitioners' challenge makes little sense from a cost and efficiency perspective, particularly given the strength of Petitioners' arguments that the Rule is invalid.

Thus, the Commission should exercise its discretion to stay the Rule's effective date until Petitioners' challenge is resolved.[9]

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[9] If the Commission were to agree that staying the Rule is appropriate, Petitioners would not oppose the Commission's seeking expedited review of the Petition in the D.C. Circuit.