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VIA ELECTRONIC MAIL

March 11, 2022

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: Securities Exchange Act Release No. 93214 (September 30, 2021), 86 FR 55672 (October 6, 2021) (SR-NYSE-2021-05, SR-NYSEAMER-2021-04, SR-NYSEArca-2021-07, SR-NYSECHX-2021-01, SR-NYSENAT-2021-01) (Order of Disapproval).

Securities Exchange Act Release No. 94242 (February 14, 2022), 87 FR 9404 (February 18, 2022) (Order Granting Petition for Review).

Dear Ms. Countryman:

The Nasdaq Stock Market LLC (“Nasdaq”) submits this letter to comment on the Order of Disapproval issued by the Division of Trading and Markets (the “Division”), pursuant to delegated authority, of proposed rule changes submitted by the New York Stock Exchange LLC, NYSE American LLC, NYSE Arca, Inc., NYSE Chicago, Inc., and NYSE National, Inc. (collectively, “NYSE Exchanges” or the “Proposing Exchanges”) to establish certain co-location fees (“Order of Disapproval” or “Order”).¹ The Commission has granted a petition to review the Disapproval Order and has invited other parties to comment.²

The Nasdaq, Inc., Exchanges³ offer colocation, connectivity, and direct connectivity services that are subject to review by the Commission. These products are provided to customers on a shared basis, meaning that a customer may utilize these products and services to gain access

¹ See Securities Exchange Act Release No. 93214 (September 30, 2021), 86 FR 55672 (October 6, 2021) (SR-NYSE-2021-05, SR-NYSEAMER-2021-04, SR-NYSEArca-2021-07, SR-NYSECHX-2021-01, SR-NYSENAT-2021-01) (Order of Disapproval).

² See Securities Exchange Act Release No. 94242 (February 14, 2022), 87 FR 9404 (February 18, 2022) (Order Granting Petition for Review).

³ The Nasdaq Stock Market LLC, Nasdaq BX, Inc., Nasdaq PHLX LLC, Nasdaq ISE, LLC, Nasdaq MRX, LLC, and Nasdaq GEMX, LLC (collectively, the “Nasdaq, Inc. Exchanges”)

to any or all of the Nasdaq, Inc. Exchanges.⁴ As discussed in detail below, the Nasdaq, Inc., Exchanges allow customers to sell cabinet space to third-parties in a manner similar to that offered by the NYSE Exchanges.

Nasdaq urges the Commission to reverse the Disapproval Order. The Division disapproved the proposed fees based on a purported failure to demonstrate a competitive market, yet dismissed out of hand evidence of competition produced by the Proposing Exchanges, without conducting any independent analysis or investigation of its own. As such, the Division failed to make a “rational connection between the facts found and the choice made,” and falls short of the standard of reasoned decision-making required by either the Securities Exchange Act of 1934 (the “Securities Exchange Act”) or the Administrative Procedure Act (the “Administrative Procedure Act” or “APA”),⁵ as set forth by the DC Circuit in *Susquehanna Int’l Grp., LLP v. SEC*.⁶

Nasdaq urges the Commission to overturn the Disapproval Order, and reinstate the immediately effective fees proposed by the NYSE Exchanges.

The Division Must Articulate a Rational Connection Between the Facts Found and the Choices Made

In *Susquehanna Int’l Grp., LLP v. SEC*, the DC Circuit reviewed the Commission’s approval of a proposal by the Options Clearing Corporation (“OCC”) to increase its capital reserves and adjust its fees and refunds. The Court reviewed the Commission’s decision under the Exchange Act and the Administrative Procedure Act. The latter requires the court to “hold unlawful agency action that is ‘arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law’ or that is ‘unsupported by substantial evidence.’”⁷

To satisfy the “arbitrary and capricious” standard, an “agency must examine the relevant data and articulate a satisfactory explanation for its action including a ‘rational connection between the facts found and the choice made.’”⁸ “Merely ‘referencing a requirement is not the same as complying with that requirement.’”⁹ The Court held that the “SEC should have critically reviewed OCC’s analysis or performed its own”¹⁰ and therefore failed to engage in “the kind of reasoned decisionmaking required by either the Exchange Act or the Administrative Procedure Act.”¹¹ The Court noted that this was the same type of “flaw that led [it] to vacate an

⁴ See, e.g., Securities Exchange Act Release No. 84571 (November 9, 2018), 83 FR 57758 (November 16, 2018) (SR-NASDAQ-2018-086) (discussing colocation, connectivity, and direct connectivity services and other products).

⁵ See Pub. L. 79404, 5 U.S.C. § 500, et seq.

⁶ See 866 F.3d 442 (D.C. Cir. 2017).

⁷ 866 F.3d 442, 445 (citing 5 U.S.C. § 706(2)(A), (E)); see also *NetCoalition v. SEC*, 615 F.3d 525, 532 (D.C. Cir. 2010).

⁸ *Id.* (“quoting *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983)).

⁹ *Id.* at 446 (quoting *Gerber v. Norton*, 294 F.3d 173, 185-86 (D.C. Cir. 2002)).

¹⁰ *Id.* at 447.

¹¹ *Id.* at 443.

SEC order approving a self-regulatory organization's proposed rule change in *NetCoalition*,¹² in which the Court faulted the SEC for reaching a conclusion despite a 'lack of support in the record.'"¹³

The Proposing Exchanges compete against Hosting Users in the sale of co-location services

As described in the Proposals,¹⁴ the NYSE Exchanges offer co-location services to market participants from a data center in Mahwah, New Jersey, where their electronic trading and execution systems are located. Every market participant that purchases co-location services from one or more of the Exchanges is a "User." Some Users, called "Hosting Users," sell or repackage and sell Exchange co-location services to other customers, known as "Hosted Customers."¹⁵ Hosting Users are able to create bespoke bundles of services, offered at individualized prices, without having to file such services and fees with the Commission.¹⁶

As noted above, the Nasdaq, Inc., Exchanges also offer colocation, connectivity, and direct connectivity services. Although the Nasdaq, Inc., Exchanges do not use the specific term "Hosting User," there is a Multi-Firm Cabinet Charge, which allows firms to "sublease" cabinet space at a Nasdaq facility.¹⁷ Nasdaq understands that firms paying the Multi-Firm Cabinet Charge sublease cabinet space to third-parties for a fee, which may be bundled with other services. Like the Hosting Users located at the NYSE facility, purchasers of multi-firm cabinets at Nasdaq are in competition with the Nasdaq, Inc., Exchanges in the sale of co-location services.

The NYSE Exchanges produced evidence that "89 percent of customers receiving bundled services via the Mahwah Data Center receive them from Hosting Users, while only 11 percent purchase them from the Exchanges as one of the existing PCS bundled Options A – D."¹⁸ The Proposing Exchanges explained that "[t]he fact that the vast majority of customers obtain their bundles from Hosting Users shows that the Exchanges are subject to significant

¹² See *NetCoalition v. SEC*, 615 F.3d 525, 537-44 (D.C. Cir. 2010).

¹³ See 866 F.3d 442, 447.

¹⁴ See Securities Exchange Act Release Nos. 91034 (February 1, 2021), 86 FR 8443 (February 5, 2021) (SR-NYSE-2021-05); 91035 (February 1, 2021), 86 FR 8449 (February 5, 2021) (SR-NYSEAMER-2021-04); 91036 (February 1, 2021), 86 FR 8440 (February 5, 2021) (SR-NYSECHX-2021-01); and 91037 (February 1, 2021), 86 FR 8424 (February 5, 2021) (SR-NYSENAT-2021-01); 91044 (February 2, 2021), 86 FR 8662 (February 8, 2021) (SR-NYSEArca-2021-07).

¹⁵ Hosting Users are subject to a Hosting Fee of \$1,000 per month per Hosted Customer for each cabinet in which such Hosted Customer is hosted.

¹⁶ See Securities Exchange Act Release No. 91034 (February 1, 2021), 86 FR 8443 (February 5, 2021) (File No. SR-NYSE-2021-05).

¹⁷ See Nasdaq Rules, General 8 Connectivity, § 1, Co-Location Services.

¹⁸ Letter from Elizabeth King, Chief Regulatory Officer, ICE, to Vanessa Countryman, Secretary, SEC, re Securities Exchange Act Release no. 91785 (May 6, 2021), available at <https://www.sec.gov/comments/sr-nyse-2021-05/srnyse202105-9239894-250689.pdf>.

competitive forces in the market for bundled services.”¹⁹ Five Hosting Users are available to offer substitutes to the co-location services offered by the NYSE Exchanges.²⁰

The Division rejected evidence of a competitive market without countervailing evidence or analysis.

The Commission applies a market-based approach to determine whether proposed fees are consistent with the Act.²¹ “Under the market-based approach, the Commission considers ‘whether the exchange was subject to significant competitive forces in setting the terms of its proposal . . . , including the level of any fees.’”²² “If an exchange meets this burden, the Commission will find that its fee rule is consistent with the Act unless ‘there is a substantial countervailing basis to find that the terms’ of the rule violate the Act or the rules thereunder.”²³

In its discussion of competitive forces, the Division rejected evidence that the Proposing Exchanges compete with Hosting Users in the sale of co-location services, commenting that the cabinets sold by the Hosting Users are “controlled” by the Proposing Exchanges:

[I]t remains unclear how the presence of Hosting Users brings significant competitive forces to bear on Exchange pricing of the proposed products, if, as it appears, Hosting User access to the key services comprising the proposed Partial Cabinet Bundles is controlled by the Exchanges and the ability of a Hosting User to resell cabinet space and thereby obtain Hosted Customer business is contingent on payment of \$1,000 per Hosted Customer for each cabinet in which such Hosted Customer is hosted.²⁴

The observation that the cabinets sold by the Hosting Users are “controlled” by the Proposing Exchanges is apparently intended to imply that the Proposing Exchanges are using market power to restrain competition. But the Division did not point to any evidence or analysis to support that implication, which is readily refuted.

¹⁹ Letter from Elizabeth King, Chief Regulatory Officer, ICE, to Vanessa Countryman, Secretary, SEC, re Securities Exchange Act Release no. 91785 (May 6, 2021), available at <https://www.sec.gov/comments/sr-nyse-2021-05/srnyse202105-9239894-250689.pdf>.

²⁰ See Securities Exchange Act Release No. 93214 (September 30, 2021), 86 FR 55672 (October 6, 2021) (SR-NYSE-2021-05, SR-NYSEAMER-2021-04, SR-NYSEArca-2021-07, SR-NYSECHX-2021-01, SR-NYSENAT-2021-01).

²¹ See Securities Exchange Act Release No. 93214 (September 30, 2021), 86 FR 55672 (October 6, 2021) (SR-NYSE-2021-05, SR-NYSEAMER-2021-04, SR-NYSEArca-2021-07, SR-NYSECHX-2021-01, SR-NYSENAT-2021-01) (Order of Disapproval).

²² *Id.*

²³ *Id.*

²⁴ *Id.* (The Division further states that “[i]n order for it to offer the substitute services that the Exchanges claim will bring competitive forces to bear on fees, a Hosting User must accept the Exchanges’ operational environment, purchase the key services comprising the Partial Cabinet Bundles (e.g., cabinet space, power, bandwidth connections) from the Exchanges, and bear the applicable Hosting Fees.”).

If the NYSE Exchanges were trying to restrain competition, they would establish fees and policies that prevented the Hosting Users from competing with them. The uncontroverted evidence, however, shows the opposite. Hosting Users account for 89 percent of market share in bundled services, indicating that Hosting Users have unfettered access to the platform.

The NYSE Exchanges have not in fact restrained Hosting Users from subleasing cabinet space that would otherwise be purchased from the exchanges. Providing customers with the option of purchasing cabinet space from Hosting Users, rather than the NYSE Exchanges, creates a viable alternative to the exchanges. The world of today, where there is virtually unlimited space in a data center, is far more competitive and fairer than the world in which the trading floor was the only means of access to an exchange because the inherent limitations of space on a trading floor necessarily limited access in a way that the computer servers of today do not.

Moreover, the NYSE Exchanges' evidence and analysis make clear that, critically, there is no exercise of market power with respect to the co-location services. As the Supreme Court has observed, "[m]arket power is the ability to raise price profitably by restricting output."²⁵ Absent a restriction on output, a price increase (or a price above other competitors' prices) may simply reflect increases in the value of services, recovery of costs (including fixed costs), or an appropriate return on investment.²⁶

There is no evidence of any output restriction here. The NYSE Exchanges provide access to Hosting Users to sell services that otherwise would have been purchased from the exchanges. With no restriction on such access, there is no exercise of market power.

This conclusion is confirmed by the overall competition among exchanges in the sale of exchange services. Customers have budget constraints that require them to look at all of the costs of interacting with an exchange—not merely the cost to trade, but the entire cost of using the platform, which may include, for example, connectivity fees, market data fees, membership fees, or fees for analytic products. The precise mix depends on the customer and its use case.

The attractiveness of purchasing co-location services is determined in part by the amount of order flow routed to that exchange—the more order flow, and the more diverse the order flow, the more accurately quotes and trades reflect the state of the market as a whole, and the more valuable co-location at a particular exchange. Because “competition for order flow is ‘fierce,’”²⁷ no exchange can afford to overprice the total cost of its services without potentially losing order flow, and damaging its overall ability to compete. Each exchange operates as a unified platform

²⁵ *Ohio v. Am. Express*, 138 S.Ct. 2274, 2288 (2018).

²⁶ *Id.*

²⁷ *NetCoalition v. SEC*, 615 F.3d 525, 539 (D.C. Cir. 2010) (quoting Securities Exchange Act Release No. 59039 (December 2, 2008), 73 Fed. Reg. 74770, 74782-83 (December 9, 2008) (SR-NYSEArca-2006-21)) (“no exchange can afford to take its market share percentages for granted’ because ‘no exchange possesses a monopoly, regulatory or otherwise, in the execution of order flow from broker dealers’....”). The level of competition and contestability in the market is evident in the numerous alternative venues that compete for order flow, including sixteen self-regulatory organization markets, as well as internalizing broker-dealers and various forms of alternative trading systems, such as dark pools and electronic communication networks, as well as the continuing entrance of new market participants.

in which an alteration to the platform's input (order flow) changes the value of the platform and demand for its outputs (including co-location services), and vice versa.²⁸ As such, an analysis of the market for co-location services cannot be meaningfully separated from the overall competition among exchanges.²⁹

The NYSE Exchanges produced substantial evidence of a competitive market through the data and analysis about competition from Hosting Users and the overall competition among exchanges. The Division rejected the argument without identifying any "substantial countervailing basis" to contradict that evidence. Rejecting evidence without a rational basis is arbitrary and capricious and an abuse of discretion.

* * * * *

Although the Division rejected the proposed fees based on a purported lack of competition, the Division failed to conduct any independent analysis or investigation that undermines or even addresses the substantial evidence presented by the Proposing Exchanges establishing a competitive market for co-location services. As such, the Division failed to make a "rational connection between the facts found and the choice made," and the Disapproval Order is therefore arbitrary, capricious, and an abuse of discretion. We ask that the Commission overturn the Disapproval Order, and reinstate the fees proposed by the NYSE Exchanges.

Thank you for the opportunity to comment. Nasdaq values the opportunity to compete freely and fairly with other exchanges and non-exchange market participants and does not believe the Commission should stand in the way of NYSE's efforts to do the same.

Sincerely,



Erika Moore
Vice President and Corporate Secretary

²⁸ Nasdaq submitted an extensive discussion of the interrelationship between order flow and market data in its comment letter on a proposed regarding a fee filing by the Investor Exchange LLC ("IEX"). See Letter from Erika Moore, Vice President and Corporate Secretary, to Vanessa countryman, Secretary, SEC, re Securities Exchange Act Release No. 93883 (December 30, 2021, 87 FR 523 (January 5, 2022) (SR-IEX-2021-14), available at <https://www.sec.gov/comments/sr-iex-2021-14/sriex202114-20113079-265642.pdf>. That letter is incorporated herein by reference.

²⁹ The Exchange Act requires that the rules of an exchange "provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities." See Exchange Act, Section 6(b)(4). Nothing in the Act requires that fees be reviewed in isolation—"dues, fees, and other charges" refer to all of the fees of the exchange. Indeed, for the reasons stated, co-location data fees cannot be meaningfully understood in isolation, and therefore the purposes of the Act are advanced by reviewing these fees in the context of the overall competition for exchange services.

