SIFMA
Securities Industry and Financial Markets Association

July 10, 2008

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

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
Attention: Ms. Florence Harmon, Acting Secretary

Re: Proposed Order Approving Proposal by NYSE Arca, Inc. to Establish Fees for Certain Market Data and Request for Comment (SEC Release No. 34-57917)

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association[1] ("SIFMA") appreciates the opportunity to respond to the Commission's invitation for comment in the above-captioned release. In the release, the Commission published for comment a proposed order (the "Proposed Order") that would approve a proposal by NYSE Arca, Inc. ("NYSE Arca") to establish fees for certain market data that NYSE Arca had previously made available without charge (the "Proposed Rule"). We appreciate that this matter has been subject to review by the Commission for some time now.[2] We respectfully advise the Commission, however, that the approach the

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, D.C., and London, and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. (More information about SIFMA is available at: www.sifma.org.)

[2] We do not reiterate here all of our comments in previous letters to the Commission with respect to this matter. We, however, incorporate those letters by reference, and address here those aspects that are the focus of the Proposed Order. *See* Letter to Nancy M. Morris, Secretary, Commission, from Ira D. Hammerman, Senior Managing Director and General Counsel, SIFMA (Jan. 17, 2007); Letter to Nancy M. Morris from Ira D. Hammerman (Aug. 1, 2007); Letter to Nancy M. Morris from Marc E. Lackritz, President and CEO, SIFMA (Aug. 16, 2007); Letter to Dr. Erik R. Sirri, Director, Division of Market Regulation, Commission, from Melissa MacGregor, Vice President & Assistant General Counsel, SIFMA (Nov. 7, 2007); Letter to Nancy M. Morris from Ira D. Hammerman (Feb. 7, 2008); and Letter to Nancy M. Morris from Christopher Gilkerson and Gregory Babyak, Market Data Subcommittee Co-Chairs (Feb. 14, 2008).

Proposed Order would take is fatally flawed: its competition analysis is faulty, internally inconsistent, and wholly inadequate; and it would fail to comply with the spirit and letter of the provisions of the Securities Exchange Act of 1934 (the "Exchange Act") and the rules of the Commission promulgated thereunder which are applicable to transparency in markets, exchange fees, and Commission review of the Proposed Rule. If the Proposed Order were issued as a final order, that action would be arbitrary and capricious and would be reversible by a United States Court of Appeals as a matter of law.

A. Introduction

The matters at issue in the Proposed Order stem from fees NYSE Arca proposed to establish for its Arca Book product.[3] The instant proceeding began with SEC Staff approval of the Proposed Rule notwithstanding considerable public opposition expressed in comment letters filed with the Commission before the approval. Soon thereafter, NetCoalition, an association of Internet companies, petitioned the Commission to review and set aside the Staff approval. In what we believe to be a first, the Commission granted the petition and sought public comment. Some 32 comments were filed, most expressing opposition to the Proposed Rule and the Staff's approval. During the course of the proceeding, SIFMA filed several comments and joined the action as a party in interest.[4] On June 4, 2008, the Commission published the Proposed Order[5] and invited further comment.

The Proposed Order would introduce a "market-based" approach in which the Commission would conclude that NYSE Arca's depth-of-book data (and similar products), that is, bids below (inferior to) the highest bid and offers above (inferior to) the lowest offer, are subject to sufficient market forces in setting the fees so that the Commission does not need to do anything, such as to consider fundamental issues like NYSE Arca's costs of collecting and disseminating the data, before determining that its proposed fees are fair and reasonable, as the Exchange Act and the Commission's rules require.

A principal flaw in that approach is that the Proposed Order would find that competition among the principal or dominant exchanges, that is to say, the New York Stock Exchange (the "NYSE") with which NYSE Arca is affiliated as part of a single, common enterprise and Nasdaq, for order flow is a sufficient demonstration that there also is competition in the sale of

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[3] On May 23, 2006, NYSE Arca filed the Proposed Rule with the Commission, pursuant to Exchange Act Section 19(b)(1) and Rule 19b-4 thereunder, 17 C.F.R. §240.19b-4. SEC Release No. 34-53952 (June 7, 2006). The Division of Market Regulation, now known as Trading and Markets, approved the Proposed Rule pursuant to delegated authority on October 12, 2006 (the "Staff Approval"). SEC Release No. 34-54597 (Oct. 12, 2006). On November 6, 2006, NetCoalition filed its petition with the Commission pursuant to Rule 430 of the Commission's Rules of Practice, 17 C.F.R. § 201.430, requesting it to set aside the Staff Approval. On December 27, 2006, the Commission granted the Petition, sought additional comment and continued the effectiveness of the automatic stay of the Staff Approval provided for under Rule 431(e). SEC Release No. 34-55011 (Dec. 27, 2006).

[4] *See*, footnote 2, *supra*.

[5] SEC Release No. 34-57917 (June 4, 2008).

the resulting market data each exchange uniquely possesses. That is extrapolating apples from oranges. Whether in fact there is significant competition between the NYSE/NYSE Arca enterprise and Nasdaq for order flow is questionable, as we discuss below, but more importantly here, it is irrelevant. The assumption that competition for order flow equates to significant competition in the subsequent provision of market data is unjustified, yet it is the sole basis for the Proposed Order's conclusion that competition for depth-of-book data exists and can be relied upon, without more, to assure that pricing of the market data is "fair" and "reasonable."

As the "Economic Study of Securities Market Data Pricing by the Exchanges" (the "Economic Study") SIFMA commissioned demonstrates,[6] a copy of which is attached hereto, the Commission has improperly ignored the economic reality that the NYSE and NYSE Arca exchanges must be considered together as one enterprise for competitive purposes.[7] This combined enterprise and Nasdaq are the two dominant exchanges whose market power must be assessed with factual evidence before the Commission has a basis for declaring a relevant market to be competitive.

As the Economic Study explains, moreover, the facts do not support the supposition in the Proposed Order that there is competition for order flow between the dominant exchanges, let alone competition that assures the fairness and reasonableness of their market data fees. NYSE Arca's data and Nasdaq's data are not substitutes for one another: having data from only one dominant market does not provide sufficient information to guide investors or their advisers as to what opportunities may be available in the other dominant market. In fact, market data is security-specific and market-specific. Market professionals as well as investors seeking data to understand current securities pricing are required as a practical matter to buy from both dominant exchanges given the concentration of liquidity for different securities on each exchange.[8] Where a dominant exchange's share of liquidity (and therefore its ability to make depth-of-book quotes available) is concentrated, an investor must obtain that dominant exchange's quote data in order to view pricing beyond the thin level of liquidity reflected in the national best bid and offer (the "NBBO") for all but the most heavily traded and liquid of stocks.[9] Using the leading economic measure of competitiveness, the Economic Study measures the economic concentration in markets for individual securities as they are traded on the dominant exchanges and finds them to be orders of magnitude greater than the level identified as a concentrated market by the U.S. Department of Justice.

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6 Securities Litigation & Consulting Group, Inc., *An Economic Study of Securities Market Data Pricing by the Exchanges* (July 10, 2008).

7 *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984) (holding that a parent corporation and a wholly owned subsidiary must be viewed as a single economic unit because the parent and subsidiary always have a "unity of purpose or a common design") In this case, NYSE and NYSE Arca operate two exchanges with a unity of purpose and common design set by the parent that controls both of them.

8 *See* Economic Study at 12.

9 The thinness of the market at the NBBO is in part a result of decimalization of the pricing increment, in which there now are 100 price points to the dollar instead of the previous eight or sixteen.

Significantly, the Commission has not obtained and evaluated data concerning NYSE Arca's costs of collecting and disseminating the depth-of-book data that is the subject of this proceeding. That cost data is highly relevant to an analysis of whether competition affecting the pricing of market data is present. Without cost data, the Commission cannot properly assess whether, and if so to what extent, the proposed market data fees are or are not subject to effective competition. If, for example, it turned out that the NYSE Arca's projected revenues from sales of the data represented 80% or 90% profit, and only 10% or 20% cost, that would suggest that the pricing more likely than not represents monopoly pricing rather than competitive pricing.[10]

Without having cost data to serve as a reality check, the Commission does not have any effective basis for evaluating whether in fact the market data fees proposed by the exchanges are fair or reasonable. Instead of obtaining any cost data when evaluating whether fees proposed by the exchanges are fair and reasonable, the Commission's practice has been to compare the proposed fees to fees for other products the Commission previously approved, also without cost data. Apparently recognizing the circularity of its practice until now, the Commission has taken the new approach of declaring that the fees are competitively set by the market, thereby obviating the need for any review by the Commission of whether the fees are fair and reasonable. If in fact, as the Economic Study proves, there is not effective inter-market competition for market data among the dominant exchanges, comparing the monopoly rents of one monopolist to the monopoly rents of the other would certainly be an insufficient measure of fairness or reasonableness.

It might well be that the whole NYSE Arca pricing scheme that is the subject of this proceeding would collapse of its own weight if the true underlying costs were known. We note that, before it was acquired by the NYSE, Arca distributed its depth-of-book data for free, as a form of advertising. We suspect the costs of collecting and distributing the data are indeed trivial and that it is in part for that reason that NYSE Arca has staunchly resisted disclosing the costs. Former Commission Chairman Harvey Pitt in fact noted that the percentage of NYSE revenues derived from market data had remained at a constant 17% during a period of 70 years — which could never occur if there was competition — and he questioned whether the cost had anything to do with the setting of these rates, a question that resonates all the louder now:

> MR. PITT: I guess one model of [market data] pricing tends to be what's your cost for the production of either the product or the service, and then what's a reasonable return. Presumptively, if the costs were being set that way, it would be highly unusual if it came out to be 17 percent of total self-regulatory costs over 70 years, which suggest that the costs are being set some other way, which then leads to the question that I think some of the people who pay the fees are asking, which

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[10] The exchanges have not been required to identify these costs before, but isolating costs is not inherently difficult once there is an agreed-upon definition of which costs are to be isolated. See the discussion below of the Nasdaq/Consolidated Tape Association dispute, where the Commission has insisted on a rigorous cost allocation. Even in the case of so-called "core" data, the Commission has never set forth, much less implemented, an analysis of how core data fees are to be related to cost.

> is how are the costs set, it's not just a question of what they're funding, but how are they set and why is it appropriate to pay that amount of money . . . .[11]

The question of exchange market data costs has not received the kind of analysis former Chairman Pitt envisioned. This is just as much a problem with depth-of-book costs as it was then with costs for last sale and top-of-market quotations.

Where, in all of this, one might ask, do the investors' interests lie? The Commission is, above all, supposed to protect investors. Investors will, directly or indirectly, bear the economic burden of the economic subsidy the Proposed Order would provide to NYSE Arca, and by implication other exchanges. As the attached Economic Study shows, the NBBO fails to cover a substantial percentage of even retail orders.[12] Monopoly rents charged to securities professionals are both a burden on the securities business, making it less competitive internationally, and flow through to the retail investors securities professionals serve. Alternatively, if the data is priced too high above competitive prices, some investors may have to forego the data, which would disadvantage them in today's markets where the displayed liquidity at the NBBO is less than many retail investors' orders. As we discuss below, the Exchange Act requires more of the Commission than the *laissez-faire* approach reflected in the Proposed Order.

For these reasons and others more fully discussed below, we respectfully advise the Commission that the Proposed Order's own findings do not support its new market-based test for "non-core" data, because each dominant exchange is not subject to significant competitive forces in setting the terms of their fees for depth-of-book data (in this case NYSE Arca as part of NYSE Euronext). In the absence of such significant forces, the Proposed Rule does not comply with the Proposed Order's own alternative test since NYSE Arca has not provided a substantial basis for concluding that the terms of the proposal are equitable, fair, reasonable, and not unreasonably discriminatory.[13] Moreover, the proposed substitution of a presumption of competition for application of mandatory statutory standards is unsupported by sound economic analysis and unsupportable as a matter of law. As a result, the application of the proposed market-based standard in the context of the Proposed Rule is arbitrary and capricious. We, therefore, request

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[11] Statement of SEC Chairman Harvey L. Pitt in transcript of *SEC Meeting of the Market Structure Hearing*s, New York University, Tisch Hall (Nov. 12, 2002), available at: http://www.sec.gov/spotlight/marketstructure/mkts111202-hrg.txt.

[12] The Proposed Order, in contrast, states that "the average execution prices for small market orders (the order type typically used by retail investors) is very close to, if not better than, the NBBO." Proposed Order at 76. This is wrong on two counts. First, informed retail investors — of which there are many — frequently use limit orders. Second, the Commission's statement confuses trade execution prices with the size of orders entered by retail customers. To match the small size typically reflected in the NBBO, orders above several hundred shares in all but the most liquid and frequently traded stocks are typically chopped up into smaller trade execution sizes.

[13] In the absence of significant competitive forces, the Proposed Order would have the Commission require the exchanges to provide "a substantial basis, other than competitive forces, in its proposed rule change demonstration that the terms of the proposal are equitable, fair, reasonable and not unreasonably discriminatory." Proposed Order at 43. The Proposed Order, however, does not set forth any such demonstration.

that the Commission reconsider and reject the standards enunciated and findings proposed to be enunciated in the Proposed Order.

In the balance of this letter, we summarize the findings of SIFMA's consulting economists in the Economic Study, we discuss the Exchange Act standards that apply to the Commission's review of NYSE Arca rules, particularly the requirements that NYSE Arca's charges for market data be "fair and reasonable" and non-discriminatory, and we follow that with an analysis of competitive factors and the commercial and legal implications of having, or not having, access to depth-of-book data.

B. Economic Analysis: NYSE (including NYSE Arca) and Nasdaq Each Enjoy Respective Dominant Markets and, Therefore, Competitive Forces Cannot Be Relied upon to Set Fair and Reasonable Prices

The Economic Study shows that the reliance on competitive forces in the Proposed Order would be inappropriate for the pricing of securities market data. The qualitative and quantitative analyses in the Economic Study show that the two dominant exchanges — Nasdaq and NYSE/NYSE Arca (which the Economic Study points out should be treated and counted as a single entity, not as two) — have the ability to exert monopoly pricing power and are using this power. The Economic Study concludes that each of these two exchange entities is charging broker-dealers and the investing public fees that are well above the cost of consolidating and distributing data and, therefore, are not subject to competitive forces.[14]

In reaching those conclusions, the Economic Study analyzes supply-side conditions and demand-side conditions. It lists and describes the factors, such as the impact of decimalization in reducing the value of NBBO data for both institutional and retail investors, which led to a relatively inelastic demand for depth-of-book data. The Economic Study then explains how the supply-side and demand-side conditions for market data combine to form a market in which the two dominant exchanges exploit the opportunity to assert monopoly pricing power. The Economic Study notes that the competition for order flow among exchanges does not provide any assurance of competitive pricing for data of which an exchange has exclusive possession. The Economic Study looks to "network externalities," that is, situations in which the value of a system increases as the number of users of the system increases. Network externalities reinforce the tendency of a dominant market player to retain its dominance because its market position induces customers to deal with it rather than with a newcomer. The Economic Study notes that the NYSE and Nasdaq account for the vast majority of all equity trading in the United States. For individual securities, each exchange enjoys a dominant market share in most of the securities that are listed on that exchange. The NYSE (together with its affiliate NYSE Arca) enjoys a dominant market share in NYSE-listed securities and Nasdaq enjoys a dominant market share in Nasdaq-listed securities. These network externalities are such powerful forces that, in the

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[14] *See, Tejas Power Corp., et. Al., v. Fed'l Energy Regulatory Comm'n*, 908 F.2d 998, 1004 (D.C. Cir. 1990) ("In a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable, and specifically to infer that price is close to marginal cost, such that the seller makes only a normal return on its investment.")

presence of competition for order flow among market centers, the listing exchanges thrive as natural monopolies.

Given the network externalities, and given that each dominant exchange has exclusive possession of its own depth-of-book data, the dominant exchanges maximize their exclusive data revenues. It is impossible, the Economic Study concludes, for Nasdaq to produce NYSE depth-of-book data on a scale approaching the NYSE's own depth-of-book data product for NYSE-listed stocks and, likewise, it is impossible for the NYSE to produce Nasdaq depth-of-book data on a scale approaching Nasdaq's own depth-of-book data product for Nasdaq-listed stocks. NBBO data is not an adequate substitute for depth-of-book data since, after the introduction of decimal pricing (in which prices are quoted in pennies rather than the former eighths or sixteenths), the size displayed at the various one-cent price points away from the inside quotes became a more useful tool to assess market depth (a conclusion we note that the Proposed Order also reached).

The Economic Study notes that profit-maximization as an objective of the market data pricing policy of the dominant member-owned exchanges used to be kept in check at least somewhat by the interests of each exchange's member-owners. That all changed recently when the exchanges went public with a new ownership structure and corresponding duties to maximize shareholder wealth for persons other than their members.

In its evaluation of the approach taken in the Proposed Order, the Economic Study notes four major flaws in its methodology:

> First, the Proposed Order does not examine market share statistics for NYSE-listed stocks and Nasdaq-listed stocks separately; as a result, the market-share figures concerning Nasdaq are misleading because they do not reveal anything about the nature of competition for the trading of specific securities.
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> Second, the Proposed Order incorrectly treats the NYSE and NYSE Arca as separate economic units even though they are affiliated businesses.[15]
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> Third, the statistics on the state of competition in the U.S. equity markets aggregate all non-exchange trading venues into one category. By combining the market shares, the aggregate number does not reveal how many trading venues account for the subtotal, nor does it reveal the dispersion of market shares across these trading venues; both of these pieces of information are crucial to understanding the nature of competition and concentration within an industry.
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> Fourth, the Proposed Order's logic is flawed in concluding that the fact that 95% of the professional users of core data do not purchase depth-of-book data of a major exchange strongly suggests that no exchange has monopoly pricing power for its depth

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[15] *See Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984).

of-book order data. The Economic Study shows that the dominant exchanges are in fact able to exert monopoly pricing power for their exclusive depth-of-book data.[16]

The Economic Study finds, among other things, that if the flaws in the Proposed Order's approach were corrected, it would be clear that the Commission cannot rely on competitive forces to ensure that securities market data distributed by the exchanges was made available on fair and reasonable terms.[17] The Economic Study itself reaches that conclusion after examining the qualitative and quantitative evidence.[18]

C. Exchange Act Standards

Exchange Act Section 19(b)(2) permits the Commission to approve a proposed rule change of an exchange only if it finds the rule change to be consistent with the Exchange Act provisions applicable to the exchange.[19] If it cannot make that affirmative finding, it *must* initiate proceedings looking toward disapproval of the rule change. In a doubtful case, therefore, the statute defaults to disapproval. The Exchange Act provisions relevant to NYSE Arca's market data rules include:

a. Section 6(b)(4), which requires NYSE Arca's rules to provide for "equitable allocation of reasonable fees, dues, and other charges among its members and issuers and other persons using its facilities;" and

b. Section 11A(c)(1), under which NYSE Arca, as an "exclusive processor" of its market data, must (i) ensure the prompt, accurate, reliable, and fair collection, processing, distribution, and publication of quotation and transaction information, and the fairness and promptness of the form and content of such information, (ii) must distribute on a "fair and reasonable basis" the quotation and transaction data that it collects, processes or distributes and do so on terms that are "not unreasonably discriminatory."[20]

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16 Economic Study at 11-14.

17 *Id.* at 15.

18 There is at least one regulatory model that that the Commission could have followed in determining whether an exchange has or does not have significant market power. The Federal Energy *Regulatory* Commission ("FERC uses the Herfindahl Index as part of its assessment of market power and also requires that the capacity of a market-based rate applicant's affiliates be included in the market share calculated for the applicant affiliates). For example, *see*, United States of America Fed'l Energy Regulatory Comm'n, 18 CFR Part 284 (Docket Nos. RM05-23-000, AD04-11000; Order No. 678), Rate Regulation of Certain Natural Gas Storage Facilities (Issued June 19, 2006) at paragraphs 55, 56, 68 and 69, available at: http://www.ferc.gov/whats-new/comm-meet/061506/C-2.pdf.

19 *See Timpinaro v. SEC*, 2 F.3d 453, 456 (D.C. Cir. 1993).

20 NYSE Arca's rules must also meet two additional requirements:

In exercising its authority under Section 19(b), the Commission is subject to an additional requirement in Exchange Act Section 3(f), which provides that, whenever the Commission is engaged in the review of a rule of a self-regulatory organization (an "SRO") such as NYSE Arca, and must consider or determine whether an action is necessary or appropriate in the public interest, the Commission "shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."

The Proposed Order correctly states that "[t]he standards in Section 6 of the Exchange Act and Rule 603 of Regulation NMS do not differentiate between types of data and therefore apply to exchange proposals to distribute both core data and non-core data."[21] The "market based approach," announced for the first time in the Proposed Order, nevertheless ignores this principle and makes a fundamental distinction between "core" data (the national best bid and offer and the market-wide last sale data) and "non-core" data (all other market data, including depth-of-book data) in its proposed administration of applicable Exchange Act provisions. This approach must fail for three reasons.

1. Statutory requirements. The Commission previously has chosen to allow SROs to decide *what* additional market data they wish to display beyond what it calls the "core" data they have to provide under Regulation NMS. Whether or not that choice is itself permitted under the Exchange Act — an issue we do not discuss here —that choice has not and cannot alter the statutory standards that apply to *how* that data may be distributed, including the fees an exchange may charge for the data. Once an exchange elects to make additional data available, its rules governing that data are subject to the same exacting standards as apply to every exchange rule, as the Commission has recognized:

> Currently, the Commission typically reviews market data fees in the context of proposed fee changes filed by the three networks that disseminate market data in NMS stocks. These fee filings are published for notice and comment before Commission action. After those filings are published, the Commission determines whether the fees are fair and reasonable, not unreasonably discriminatory, and otherwise consistent with the requirements of the Exchange Act. Although most market data fee filings currently involve Network fees, *the same standard applies and the same questions arise with regard to the market data fees of an individual SRO.*[22]

> (i) Section 6(b)(5), which requires that SRO rules be designed to "remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers;" and
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> (ii) Section 6(b)(8), which prohibits SROs' rules from imposing "any burden on competition not necessary or appropriate" in furtherance of the purposes of the Exchange Act.

[21] SEC Release No. 34-57917 (June 4, 2008).

[22] *Concept Release Concerning Self-Regulation*, SEC Release No. 34-50700 (Nov. 18, 2004), in text accompanying nn. 231-2 (emphasis added).

The "market-based approach" that the Proposed Order would newly announce does not comport with these statutory standards. It gives primacy to a separate and secondary consideration, *i.e.*, the unsubstantiated and factually inaccurate assertions of what constitutes competition, in determining whether to approve an exchange rule proposal and suggests that competition, *vel non*, trumps the explicit statutory standards the Commission is commanded to assess and implement. The Proposed Order would cite the expression of congressional intent that reflects the important but subsidiary role of competition considerations, as follows:

> *a* major responsibility of the SEC in the administration of the securities laws is to 'create a fair field of competition.'… The objective [of clarifying this responsibility and strengthening the SEC's authority in the 1975 amendments to the Exchange Act] would be to enhance competition and to allow economic forces, *interacting within a fair regulatory field*, to arrive at appropriate variations in practices and services."[23]

Even if competitive considerations were on a par with the other provisions applying to exchange rule filings, the market-based approach is faulty because it exalts the competition element to the exclusion of the others. More fundamentally, there simply is no basis for the presumption in the Proposed Order that these statutory requirements are satisfied if the Commission is able to conclude that "significant competitive forces" exist in the context of an exchange fee proposal. The statement in the Proposed Order that this approach "follows the clear intent of Congress in adopting Section 11A that, whenever possible, competitive forces should *dictate* the services and practices that constitute the U.S. national market system for trading equity securities"[24] is a mischaracterization of the weight the Congress indicated should be given to competition factors. The Exchange Act states the Commission "shall consider" competition, as well as investor protection, efficiency, and capital formation. It does not state that competition is superior to those other interests, nor that this general consideration eliminates specific requirements set forth in the statute, *particularly when those requirements are directed toward remediating a lack of competition*.[25] These are separate objectives. The Commission's approach of relying solely on the natural presence of competitive forces in approving market data

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[23] 73 FR at 32762, *quoting* Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing, and Urban Affairs to Accompany S.249 (the "Senate Report on S.249"), S. Rep. No. 94-75, 94th Cong., 1st Sess. 8 (1975) (emphasis added).

[24] SEC Release No. 34-57917 (June 4, 2008) (emphasis added).

[25] The preamble to Section 11A shows that competition considerations do not control other objectives of the national market system:

> It is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure . . .
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> (ii) fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets; [and]
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> (iii) the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities.

fees is particularly misguided because the relevant law and rules are clearly intended to address the uneven playing field and absence of competitive forces when an exchange sells its exclusive market data. Indeed, even with respect to the competition objective, Section 11A is not satisfied if the Commission merely believes that competition, or "significant competitive forces," are present. The Commission's job entails performing a real economic analysis and testing whether its assumptions are correct by reviewing essential facts such as cost data, and not simply relying on an unsubstantiated belief without obtaining cost data to verify its theories. As discussed above, moreover, the economic evidence shows that the proposed reliance on competition would not satisfy the Exchange Act requirements that market data fees be "fair" and "reasonable."

With its new approach, the Proposed Order also would inappropriately interject a competition factor into independent, discrete statutory requirements. For example, the requirement that an exchange allow access to market data in a nondiscriminatory manner is not qualified by any consideration of whether the exchange can exercise market power with respect to the data at issue or is subject to competitive forces. The statutory objective of making quotation and transaction information available to brokers, dealers, and investors is a critical Commission responsibility in facilitating the development of a national market system; it cannot be delegated to the exchanges or satisfied simply by an unsubstantiated belief that competitive forces exist in relation to market data. As discussed above, moreover, the economic evidence shows that the proposed reliance on competition will not be effective in satisfying the requirements of the statute that market data fees be "fair and reasonable." The Commission is not empowered to ignore the standards that the Exchange Act mandates for the review of exchange rule filings, including market data fee filings.

The Commission, as a matter of law, also is not free to ignore other contexts in which it has interpreted the same "fair and reasonable" standard as requiring a detailed analysis of costs. In the ongoing dispute between Nasdaq and the Consolidated Tape Association (the "CTA"), the Commission interpreted "fair and reasonable" to require a detailed analysis of costs and thus it assigned the matter to an administrative law judge, who took hundreds of pages of testimony on the issue of allowable costs.[26]

It is important, therefore, to note that the Commission has criticized the industry in the instant proceeding for demanding a "strict cost accounting" when what the industry — as well as the Congress — has sought is not a strict cost accounting but rather fees "reasonably related to cost."[27] Indeed, the only entity demanding and receiving a strict cost accounting is Nasdaq in its

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[26] *See, e.g., In re Nasdaq Stock Market, LLC for Review of Action Taken by the Consolidated Tape Association (the "Nasdaq/CTA Dispute Release")*, SEC Release No. 55909 (June 14, 2007) in text at nn. 17-20, available at http://www.sec.gov/litigation/admin/2007/34-55909.pdf, and SIFMA's comment letter of August 1, 2007, available at *In re Nasdaq Stock Market, LLC for Review of Action Taken by the Consolidated Tape Association*, SEC Release No. 55909 (June 14, 2007) in text at nn. 17-20 [emphasis in original deleted; footnotes omitted] available at http://www.sec.gov/litigation/admin/2007/34-55909.pdf.

[27] *See, Concept Release: Regulation of Market Information Fees and Revenues*, SEC Release No. 34-42208 (Dec. 9, 1999) (the "1999 Concept Release"), at IV.C.:

> Congress did not include a strict, cost-of-service standard in Section 11A of the Exchange Act, opting instead to allow the Commission some flexibility in assessing the fairness and

dispute with the CTA — with the Commission's blessing. The current status of this multi-year battle is as follows. The CTA claims Nasdaq owes it $833,862. Nasdaq, operating under its strict cost accounting, claims it only owes the CTA $233,132. While conceding it owes at least $233,132, Nasdaq has argued that it will pay nothing because it believes the failure to adhere to strict cost accounting means *the CTA has failed to carry its statutory burden of establishing a fair and reasonable fee.*

Why does "fair and reasonable" mean one thing when Nasdaq is paying a fee and something altogether different when Nasdaq (or NYSE) wishes to charge a fee? The Commission has determined that a cost-based analysis is necessary in the Nasdaq/CTA instance because of the absence of competitive forces.[28] Putting aside the fact that "non-core" data is also not subject to competitive forces — as our Economic Study shows,[29] and putting aside the fact that the Proposed Order's "competition rationale" is being first articulated many years after the Nasdaq/CTA proceeding commenced, we would note that the logic of the position in the Proposed Order would demand that extensive cost information be provided to support fees for core data, which the Proposed Order would concede is not subject to competitive forces. Over the last decade, investors and broker-dealers have paid billions of dollars to the exchanges with far less empirical analysis than that being applied to the question of fairness of the proposed one-time $833,000 fee that the CTA seeks to impose on Nasdaq. How can these cost factors be unquantifiable, unknowable, and not required when Nasdaq (or NYSE Arca) proposes a fee, but be quantifiable, knowable, and required when Nasdaq (or NYSE Arca) is paying a fee?

Here, in the case of the market data fees, where the "fair and reasonable" standard is once again relevant, it appears that NYSE Arca also did not present any work papers to support its calculations, an omission the Commission specifically mentioned disapprovingly in the *CTA* case.[30] In fact, NYSE Arca did not present any calculations at all or even any cost data on which such calculations might be made.

The terms "fair" and "reasonable" cannot mean in one fee context that costs are highly relevant, but mean the opposite in another, comparable, fee context. As the Court of Appeals in *Goldstein v. Securities and Exchange Commission* held:

> reasonableness of fees. Nevertheless, the fees charged by a monopolistic provider of a service (such as the exclusive processors of market information) need to be tied to some type of cost-based standard in order to preclude excessive profits if fees are too high or underfunding or subsidization if fees are too low. Nevertheless, the fees charged by a monopolistic provider of a service (such as the exclusive processors of market information) need to be tied to some type of cost-based standard in order to preclude excessive profits if fees are too high or underfunding or subsidization if fees are too low. The Commission therefore believes that the total amount of market information revenues should remain reasonably related to the cost of market information.

[28] Proposed Order at n.219.

[29] *See*, Economic Study at 25-29.

[30] Nasdaq/CTA Dispute Release at 6.

> We ordinarily presume that the same words used in different parts of a statute have the same meaning. *See Sullivan v. Stroop*, 496 U.S. 478, 484 (1990). The Commission cannot explain why 'client' should mean one thing when determining to whom fiduciary duties are owed, 15 U.S.C. § 80b-6(1)-(3), and something else entirely when determining whether an investment adviser must register under the Act, *id.* § 80b-3(b)(3). *Cf. Mobil Oil Corp. v. EPA*, 871 F.2d 149, 153 (D.C. Cir. 1989).
>
> . . .
>
> That the Commission wanted a hook on which to hang more comprehensive regulation of hedge funds may be understandable. But the Commission may not accomplish its objective by a manipulation of meaning.[31]

In short, the Proposed Order would have the Commission fall into the same trap as in *Goldstein*: the Commission cannot have the same terms mean one thing when Nasdaq is paying a fee and something altogether different when the fee is being charged by Nasdaq (or in the case at hand, NYSE Arca, as part of the combined NYSE Euronext enterprise).[32] We very much doubt the *Goldstein* court would be sympathetic to such an approach.

2. "Core" vs. Non-Core" Data. As the Proposed Order recognizes, the Exchange Act does not distinguish between "core" and "non-core" data.[33] These terms entered the Commission's lexicon more than 25 years after the passage of the 1975 amendments to the Exchange Act, around the time of the Seligman Report[34] and the proposal to adopt Regulation NMS.[35] The Exchange Act itself deals with quotation and transaction data and mandates broadly that quote and trade data be made public.

The Proposed Order repeatedly distinguishes market data that must be consolidated from data that does not have to be consolidated. The term "consolidated," however, does not appear in the Exchange Act in connection with market data. As the Commission has recognized:

> When Congress mandated the creation of a national market system, it stated that 'communication systems, particularly those designed to provide automated dissemination of last sale and quotation information with respect to securities, will form the heart of the national market system.'… Congress did not

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31 451 F.3d 873, 882 (D.C. Cir. 2006).

32 *See*, Economic Study at 12.

33 Proposed Order at 35.

34 *Report of the Advisory Committee on Market Information: A Blueprint for Responsible Change* (Sep. 14, 2001) (the "Seligman Report").

35 SEC Release No. 34-49325 (Feb. 26, 2004).

specifically mandate the creation of a consolidated market data processor system.[36]

The Commission has specified in its rules the data that must be consolidated pursuant to national market system plans approved by the Commission, and the contexts in which consolidated data must be displayed. *See* Rule 603(b) and (c) of Regulation NMS. "Core data" is simply a convenient term the Commission uses to describe data that it set forth in its own rule some 30 years ago that *must* be consolidated.[37] Consistent with the Commission's new use of that term, all data that is not subject to the consolidation requirement is "non-core." Whatever significance these terms have in contexts such as the Commission's trade-through rule (Rule 611 of Regulation NMS), they do not have any statutory significance in the context of determining the terms and fees for the sale of market data. That statutory significance, moreover, with its emphasis on transparency and fairness to all investors, is not limited to data the Commission by rule says must be consolidated.

As articulated in the Proposed Order, the core/non-core approach to market data does not reflect, and indeed conflicts with, the will of Congress. The Proposed Order would acknowledge that the introduction of decimalization has dramatically reduced the value of "core" data.[38] Remarkably, the Proposed Order would then note that "the Commission ultimately decided that the consolidation model should be retained for core data …."[39] The Proposed Order would thus claim that the data Congress intended to make available to the public is not the expressly cited "information on quotations and securities" but rather the fraction of that data now known as consolidated "core" data — and that the Commission apparently has the authority to dispense with that as well, rendering the subject matter of the Exchange Act a nullity. In effect, the Proposed Order would hollow out the notion of "core" data to the point where it would declare the congressional market data mandate virtually extinct. That would vitiate important congressional goals embedded in Exchange Act Sections 6 and 11A and would exceed the Commission's statutory authority.

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[36] *Concept Release Concerning Self-Regulation*, *supra*, n.229 (citation omitted).

[37] SEC Release No. 34-57917 (June 4, 2008) ("Core data is the best-priced quotations and comprehensive last sale reports of all markets that the Commission requires a central processor to consolidate and distribute to the public pursuant to joint-SRO plans.").

[38] Proposed Order at 34. *See* SEC Release No. 34-49325 (Feb. 26, 2004) (describing the evolution of required data display in the "national market system"). Prior to the adoption of Regulation NMS in 2005, consolidated data included a montage of the best quotes from all reporting market centers trading a security. Rule 600(b)(13) of Regulation NMS "substantially revised the consolidated display requirement … to simply require a consolidated display that is limited to the prices, sizes, and market center identifications of the NBBO, along with the most recent last sale information." *Id.* What had been core data became non-core data. Other Commission actions have affected the scope and quality of core data. As noted above, the shift to decimal pricing significantly reduced the amount of information about market depth at the NBBO. *See, e.g.*, SEC Release No. 34-51808, *supra*. *See also* SEC Release No. 34-42914 (June 8, 2000) (framework for SROs to convert to decimal prices).

[39] Proposed Order at 39.

Instead of the core/non-core distinction that the Proposed Order would make, the Exchange Act looks at the means of distribution of data from a market center. The Congress well understood that an exclusive processor of the market data emanating from any single market center — that is to say, an exchange such as NYSE Arca — would enjoy a monopoly. It warned the Commission not to rely on "natural competitive forces" in such instances and that the antitrust laws might have to provide an answer if the Commission was unable to exercise good judgment in this area:

> Although the SEC's basic role would be to remove burdens on competition which would unjustifiably hinder the market's natural economic evolution and to assure that there is a fair field of competition consistent with investor protection, in situations in which natural competitive forces cannot, for whatever reason, be relied upon, the SEC must assume a special oversight and regulatory role. *An exclusive processor for a national market system would create such a situation and so would self-regulatory projects which are not economically self-sufficient, which enjoy an effective monopoly, or which are merchandised to members on a basis other than cost and quality of services.* The bill would give the SEC broad authority over and significant responsibility for the development and operation of such facilities, subject of course to any ultimate judicial reconciliation of the policies of the Exchange Act with those of the antitrust laws.[40]

The Congress has determined previously that competition cannot be relied on to regulate commercial conduct of exchanges as exclusive processors, regardless of whether or not there was also a consolidator of data from several exchanges. That determination of course applies to NYSE Arca, which the Commission has already found to be an exclusive processor.[41] Exchange Act Section 11A(c)(1)(C) speaks of exclusive processors, not consolidators or consolidated data, which the Congress did not mandate and in fact was not convinced was necessary.[42] The Proposed Order would unleash a "perfect storm" for setting the terms for distributing market

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[40] Senate Report on S.249 at 12 (emphasis added).

[41] Proposed Order at n.145.

[42] The Congress was leery of having an exclusive consolidator and warned about the anticompetitive dangers of such an arrangement:

> The Committee believes that if economics and sound regulation dictate the establishment of an exclusive central processor for the composite tape or any other element of the national market system, provision must be made to insure that this central processor is not under the control or domination of any particular market center. Any exclusive processor is, in effect, a public utility, and thus it must function in a manner which is absolutely neutral with respect to all market centers, all market makers, and all private firms. Although the existence of a monopolistic processing facility does not necessarily raise antitrust problems, serious antitrust questions would be posed if access to this facility and its services were not available on reasonable and nondiscriminatory terms to all in the trade or if its charges were not reasonable.

Senate Report on S.249 at 11.

data. Control of the terms of distribution would be in the hands of an exchange that has true market power: a for-profit enterprise that is an exclusive processor and the dominant market for quoting and trading the securities of a significant number of National Market System securities.[43]

The Commission itself also has recognized that "market data can have anticompetitive effects if it is sold on discriminatory terms or in an unfair manner,"[44] and that "[i]n the past, SROs have attempted to distribute market data in ways that could potentially harm competitors."[45] The Commission has previously provided an example of an NYSE rule filing to offer a new "depth of book" (*i.e.*, non-core) data product that had anticompetitive features (downstream restrictions that were in its vendor agreements at the time of the approval). The Commission ultimately approved the filing on condition that the anticompetitive features be removed.[46] But this example contradicts the approach the Proposed Order would now take. In this example, market forces by themselves did not prevent this statutorily deficient product. Nothing has changed to eliminate this anticompetitive potential of exchange market data filings and to justify the "new approach" in the Proposed Order. There also has been no change in the statute that the Commission must apply to all exchange rule filings. The application of the proposed market-based standard to the Proposed Rule would effectively obliterate important statutory standards established by the Congress and would be an arbitrary and capricious exercise of the Commission's authority.

3. Rulemaking Process. The proposed adoption of the new "market-based approach" to review exchange rule filings in fact would constitute Commission rulemaking that must be published for public notice and comment.[47] In effect, the Proposed Order would attempt to amend Rule 19b-4 without following required agency rulemaking procedures under the Administrative Procedure Act.[48]

The Commission has recognized the important public purpose its careful review of self-regulatory organization rule changes serves:

> As Congress has stated on a number of occasions, SROs are "quasi-public agencies, not private clubs, and . . . their goal is the prevention of inequitable and unfair practices and the advancement of the public interest. An important way for

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43 *See* Economic Study at 25-34.

44 SEC Release No. 34-50700 (Nov. 18, 2004), citing to Exchange Act Section 11A(c)(1)(C), id., n.230.

45 *Id.* at n.228.

46 *Id.*

47 SEC Rule of Practice 192(b), 17 CFR § 201.192(b).

48 5 U.S.C. § 553 (2008). The publication for comment of the Commission's proposed approval order for one SRO proposed rule change does not satisfy the requirement to expose for public comment a *Commission* rule that will apply to an entire class of rule filings.

the Commission to help ensure that the SROs are serving those goals is through the review of SRO rule filings."[49]

Rule 19b-4 requires all exchange proposed rule changes to be filed with the Commission on Form 19b-4.[50] The form "is intended to elicit information necessary for the public to provide meaningful comment on the proposed rule change and for the Commission to determine whether the proposed rule change is consistent with the requirements of the [Exchange] Act and the rules and regulations thereunder applicable to the [exchange]."[51]

Form 19b-4 requires statements concerning, among other things, the purpose of and statutory basis for the proposed rule change, and the impact on competition. Mere assertions that the proposed rule complies with statutory requirements are insufficient; the filing must explain why the proposed rule change is consistent with the statute and rules that apply to the exchange, including the prohibition on unfair discrimination between customers, issuers, brokers, or dealers.[52] In addition, the discussion of the burdens that the proposed rule change may have on competition must, among other things: (1) specify the particular categories or persons and kinds of businesses on which any burden will be imposed and the ways in which the proposed rule will affect them; (2) explain why any burden on competition is necessary or appropriate in furtherance of the purposes of the Exchange Act; and (3) be sufficiently detailed and specific to support a Commission finding that the proposed rule change does not impose any unnecessary or inappropriate burden on competition.[53]

The Proposed Order's "market-based approach" would substitute for the Commission review required by Rule 19b-4, and the finding required by Section 19(b)(2) that a proposed rule is or is not consistent with the provisions of the Exchange Act, a presumption of compliance with the Exchange Act and the rule if "significant competitive forces" are present. This effectively would render superfluous the statements required by Rule 19b-4. While the new proposed approach seemingly offers an easy way to streamline exchange rule review, it does not meet the Exchange Act standards.

The Commission has recognized that the competitive landscape of the securities markets is changing rapidly, and that exchanges "can be placed at a competitive disadvantage because they must wait for the completion of the public comment period and the review process before

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49 SEC Release No. 34-43860 (Jan. 19, 2001) (footnote omitted).

50 The exception is proposed rule changes submitted pursuant to Exchange Act Section 19(b)(7), which must be filed on Form 19b-7.

51 Form 19b-4, General Instruction B.

52 Form 19b-4, Item 3.

53 *Id.*, Item 4.

implementing [rule] changes" for trading systems in order to compete with non-exchanges.[54] To help expedite the exchange rule approval process, in 2001 the Commission proposed to replace Rule 19b-4 with Rule 19b-6.[55] That is an example of the procedure that is necessary and appropriate to make changes to the rule-filing process, rather than simply declaring a new review standard in the context of one exchange rule filing. We note, in that regard that the Commission has now decided not to pursue its own rulemaking and has instead adopted its own interpretive positions regarding Rule 19b-4 for certain types of proposed rule changes, which we gather are in lieu of a formal rulemaking.[56]

The level of market data fees has been a contentious issue for some time. As the Commission stated in 2005:[57]

> Many commentators recommended that the level of market data fees should be reviewed and that, in particular, greater transparency concerning the costs of market data and the fee setting process is needed. The Commission agrees.… [W]e believe that the level of market data fees is most appropriately addressed in a context that looks at SRO funding as a whole. The Commission's review of SRO structure, governance, and transparency provides a useful context in which these competing policy concerns can be evaluated and balanced appropriately.[58]

This commitment that a comprehensive review of market data fees would take place in Regulation SRO, and not Regulation NMS, is worth stressing. The Commission was assuring the public that it would undertake a serious de novo review of market data fees — a review it has never in fact undertaken. The Proposed Order, however, would claim that, in fact, the Commission had actually made these decisions even while it was counseling patience: "In 2005, however, the Commission stated its intention to apply a market-based approach that relies primarily on competitive forces to determine the *terms* on which non-core data is made available to investors."[59] This statement, however, conflates a statement in the release adopting Regulation NMS — to the effect that competitive forces would determine the terms on which other data would be made available to a Network processor[60] — into the very different "market

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54 SEC Release No. 34-43860 (Jan. 19, 2001) (proposing Rule 19b-6). The Commission discusses the present competition between exchanges (which must file rule changes with the Commission) and other markets (which do not have to file their rules) in the Proposed Order.

55 *Id.* The Commission has not taken further action on the proposal.

56 *Commission Guidance and Amendment to the Rules Relating to Organization and Program Management Concerning Proposed Rule Changes Filed by Self-Regulatory Organizations*, SEC Release No. 34-58092 (July 3, 2008).

57 Proposed Order at 5.

58 SEC Release No. 34-51808 (June 9, 2005) (adoption of Regulation NMS).

59 Proposed Order in text accompanying n.17.

60 *Id.* in text accompanying 649.

forces will determine terms on which non-core data is available *to investors*." In actuality, what the Regulation NMS release provides is that "the adopted consolidated display requirement will allow market forces, rather than regulatory requirements, to determine *what, if any, additional quotations outside the NBBO are displayed to investors*."[61] Again, the Commission did not — and could not — suggest that allowing market forces to determine whether data is provided meant that the determination to provide data removed that data from the protections of the Exchange Act.

The market-based test in the Proposed Order cannot be applied to an exclusive securities information processor that has the ability to exert monopoly pricing power over its own data, such as NYSE/NYSE Arca. Even if the presence of significant competition in the provision of depth-of-book data would be sufficient to demonstrate fairness and reasonableness (a proposition that would be difficult to sustain in the absence of cost data to validate the conclusion that significant competition was present), the Proposed Order would not put the Commission in any legally sustainable position. Given the flaws in the approach taken by the Proposed Order, as described in the Economic Study, the Commission's proposed reliance on the presence of significant competition is both inappropriate and contrary to the applicable statutory provisions and the Commission's rules and its prior interpretations, as reflected in the 1999 Concept Release.

In summary, notwithstanding the Proposed Order's statements to the contrary, the Proposed Order's proposed establishment of a new market-based approach to review exchange proposed rule changes lacks both a factual basis and a statutory basis and would be invalid. Also, the dichotomies that the Proposed Order would draw between core and non-core, and consolidated and non-consolidated, data do not affect or diminish the statutory standards that apply to exchange rule proposals dealing with any type of market data. If the presumption incorporated in its market-based approach is to be substituted for the Commission's customary application of Exchange Act standards, the Commission must at a minimum propose amendments to Rule 19b-4. Nonetheless, for the reasons discussed above, we respectfully advise the Commission that it would lack the statutory authority to amend or abridge the standards it must apply to exchange market data fee rules.

D. Best Execution

The Commission previously has described a broker-dealer's obligation to obtain best execution of customer orders as a duty to "seek the most favorable terms reasonably available under the circumstances for a customer's transaction."[62] The Proposed Order's declaration that "broker-dealers are not required to obtain depth-of-book order data to meet their duty of best execution"[63] is helpful guidance as to the minimum regulatory requirement, but does not speak to

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61 SEC Release Nos. 34-49325 (Feb. 26, 2004); 34-51808 (June 9, 2005) (emphasis added).

62 SEC Release No. 34-57917 (June 4, 2008).

63 *Id.* The Commission notes that NYSE Arca and Nasdaq "also stated their view that depth-of-book order products are not required for best execution purposes." *Id.* at n.225.

the commercial reality of finding and accessing liquidity for customers in today's fragmented market, which requires much more information. The more data investors and their brokers have concerning available liquidity, the better equipped they will be to find and access liquidity and achieve best execution. A broker without depth-of-book information may be able to meet his regulatory responsibility as defined by the Commission but would still be operating in the dark in trying to provide optimal and efficient executions to clients.

Depending on the circumstances and market conditions prevailing at the time, broker-dealers may choose to access top-of-book orders in pursuit of best execution or may choose to follow a path that also includes depth-of-book. In fact, depth-of-book executions are very much part of the best execution landscape and already integral to the best execution decision-making process. At the same time, however, Regulation NMS continues to develop and participants continue to explore when and where to access depth-of-book for best execution.

With regard to the Exchange Act, we note that the Proposed Order would not say that, in satisfying their best execution obligations, broker-dealers are never required to purchase depth-of-book data. If that were the Commission's view, there would not be any need to discuss a broker-dealer's ability to consider "the cost and difficulty of trading in a particular market, including the costs and difficulty of assessing the liquidity available in that market."[64] Because depth-of-book data is at least sometimes critical to the evaluation, the Commission itself discusses cost and difficulty of assessing liquidity. The Commission previously has declared: "[R]outine execution of customer orders at the NBBO when better prices are reasonably available can be a violation of the duty of best execution."[65] Regulation NMS addressed the availability of better prices to some extent, because top-of-book prices of all market centers must be used to determine the NBBO. Nevertheless, once the small size at the NBBO is exhausted, which will invariably happen for institutional orders and, as our Economic Study shows, even for a substantial percentage of retail orders, a broker-dealer must be able to find the best available prices to fill the orders.[66] Obviously, one way to find those prices is to obtain depth-of-book data. The Commission has never said that a broker-dealer will not be faulted for failing to obtain depth-of-book data in assessing its best execution obligations, nor has it canvassed or addressed potentially relevant federal and state statutes and regulations other than the Exchange Act.

E. Alternatives to Depth-of-Book Data

The Proposed Order also discusses various alternatives that market participants can use to assess market depth.[67] Of course, this discussion shows that assessing market depth is important

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64 *Id.* at 32768.

65 *Marc N. Geman*, SEC Release No. 34-43963 (Feb. 14, 2001). *See also Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 269-270 (3d Cir.), *cert. denied* 525 U.S. 811 (1998); *Scottrade, Inc.*, SEC Release No. 34-58012 (June 24, 2008).

66 *See* Economic Study at 20-21 ("about 36% of retail orders (market and marketable limit) encounter insufficient NBBO size when they are submitted. . . .[M]arketable limit orders encounter insufficient NBBO size more often (46%) than market orders (34%)").

67 SEC Release No. 34-57917 (June 4, 2008).

to many market players, such as broker-dealers attempting to execute institutional-sized orders. One of the alternatives cited in the Proposed Order is "pinging" non-displayed pools of liquidity, *e.g.*, "dark pools." As Trading and Markets Division Director Erik R. Sirri has commented, however, "[t]he only way to know whether a dark pool has liquidity is to route an order to the pool. Routing this type of pinging order is a less efficient means to assess liquidity than viewing a consolidated montage of displayed quotes from all quoting venues."[68] Pinging, of course, requires capital commitment — if you hit a quote, you buy or sell stock. In addition, relying on pinging rather than information dissemination exalts opacity over transparency, which effectively contravenes the policy objectives embodied in Exchange Act Section 11A.

Another alternative cited in the Proposed Order is the independent distribution of order data by securities firms and data vendors. The possibility of such independent distribution is speculative, implausible, and unsubstantiated. The large exchanges each list thousands of companies, and orders are handled by hundreds of broker-dealers. For broker-dealers to aggregate depth-of-book data in a manner that is comparable to the depth-of-book data possessed by exchanges in the ordinary course of the exchanges' business would involve overwhelming logistical challenges and transaction costs. Indeed, the broker-dealers may not be able to collaborate in the manner suggested in the Proposed Order without exposing themselves to significant antitrust scrutiny and serious legal risk. Thus, the hypothetical possibility of such an unannounced entry is not timely, likely, and sufficient so as to pose a current competitive constraint on market data pricing.[69]

The issues at stake here are vital to the national market system and to investors generally. The market information at issue is critical to the ability of a broker-dealer to serve its clients appropriately. The advent of a decimalized market has meant that the volume displayed at each market's best bid or best offer is a relatively small amount, which conveys dramatically less information than had previously been the case. That makes depth-of-book data all the more important to investment intermediaries and to investors themselves, because a significant proportion of retail orders encounter insufficient NBBO size.

E. Conclusion

As we have discussed above, the Commission cannot rely on competition to assure the fairness or reasonableness of exchange market data rates without having cost data to validate the

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[68] Erik R. Sirri, *Keynote Speech at the SIFMA 2008 Dark Pools Symposium* (Feb. 1, 2008), at 7.

[69] In the European Union, several key dealers have formed BOAT, a consortium that collects and disseminates equity market data. That does not provide any reliable indication of what could occur in the United States, however, because of important differences in the legal and regulatory environment. First, the Market in Financial Instruments Directive ("MiFID") does not require dealers to turn their data over to exchanges for free, unlike the requirements in the United States. As a result, the BOAT participants are not put in a position where they have to compete with exchanges that have been given the same data for free. Secondly, it may well be that the same antitrust issues are not present in Europe with the same force in connection with BOAT as could well apply to a similar combination in the United States. *See, e.g.*, *National Collegiate Athletic Ass'n v. Bd. of Regents*, 468 U.S. 85, 120 (1984); *Ariz. v. Maricopa County Medical Soc.*, 457 U.S. 332 (1982); *United States v. Visa U.S.A., Inc.*, 344 F.3d 229 (2d Cir. 2003).

assumption that competition is having that effect. In addition, we have discussed the Exchange Act requirements for NYSE Arca rulemaking and have shown that the Proposed Order does not comply with the Exchange Act. Finally, we have shown that the Proposed Order's discussion of best execution duties does not adequately address the problem that for execution quality and competitive reasons, investment professionals and investors are not free to ignore depth-of-book data. For these reasons, we respectfully advise the Commission that the Proposed Order does not correctly analyze the legal issues involved in the Proposed Rule and that if the Commission were to issue the Proposed Order, its action would be reversible by a United States Court of Appeals as a matter of law.

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We would welcome an opportunity to discuss our views with the Commission and the Staff. I can be reached in this regard at 202-962-7300.

Respectfully submitted,

[SIGNATURE REMOVED]

Ira D. Hammerman
Senior Managing Director and
General Counsel

Appendix: Securities Litigation & Consulting Group, Inc., An Economic Study of Securities Market Data Pricing by the Exchanges (July10, 2008)

cc: The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Kathleen L. Casey, Commissioner
The Hon. Elisse B. Walter, Commissioner
Dr. Erik R. Sirri, Director, Division of Trading and Markets
Robert L.D. Colby, Esq., Deputy Director, Division of Trading and Markets
Daniel A. Gallagher, Esq., Deputy Director, Division of Trading and Markets
Elizabeth K. King, Esq., Associate Director, Division of Trading and Markets
Heather A. Seidel, Esq., Assistant Director, Division of Trading and Markets
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