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December 5, 2003

<u>BY FEDERAL EXPRESS</u>

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Re: Petition for Rulemaking submitted by the <u>International Securities Exchange Inc. on November 1, 2002</u>

Dear Mr. Katz:

As counsel to Dow Jones & Company, Inc. ("Dow Jones"), we respectfully submit these comments on the petition of the International Securities Exchange, Inc. ("ISE"), dated November 1, 2002, to amend Rule 19c-5 under the Securities Exchange Act of 1934 (the "Exchange Act"). Dow Jones creates, maintains and publishes over 3,000 indexes, including the world-famous Dow Jones Industrial Average stock index (the "DJIA"). Dow Jones opposes the ISE proposal to amend Rule 19c-5, which would have the effect of prohibiting providers of securities indexes from exclusively licensing exchanges to trade options on those indexes, because:

- the right exclusively to license the use of intellectual property is an inherent attribute of ownership, and an economic incentive to continued creativity that maximizes consumer choice in tradable and investable index products.

- The exclusive licensing of the right to trade options on securities indexes is pro-competitive. These exclusive licenses reflect the *result* of competition among the exchanges for the right to offer such products. not the *foreclosure* of competition.

- The ISE proposal is anti-competitive, because it would eliminate competition among exchanges for the exclusive right to trade index options and impose a disincentive to index providers to continue creating and maintaining indexes, to the detriment of the investing public.

- The ISE proposal would require the SEC to invade established intellectual property rights protected by federal and state law, and entangle the SEC in ongoing regulation in areas beyond its institutional competence and statutory jurisdiction.

For these reasons, Dow Jones believes that the ISE's proposal, far from improving competitive conditions in the securities markets, is merely an attempt by the ISE to tilt the bargaining leverage in its favor to the disadvantage of both competing exchanges and index providers. The result is likely to be a reduced output of index products and a diminution in consumer welfare, which is contrary to the fundamental tenets of both United States competition policy, intellectual property law, and the goals and purposes of the Exchange Act.

I. THE ISE PROPOSAL WOULD STRIP INDEX PROPRIETORS OF ESTABLISHED INTELLECTUAL PROPERTY RIGHTS

The present Rule 19c-5 is "IP neutral" in that it leaves index providers free to exercise whatever rights are afforded them by intellectual property law to control the use of their products, and does not entangle the SEC in questions regarding the validity or exercise of those rights. The ISE proposal would have the SEC summarily strip away some of those rights without compensation, by prohibiting securities index proprietors from granting an exchange an exclusive or preferential license to list options based on securities indexes as well as to use the index proprietor's trademarks to promote the trading of such products. The ISE petition proceeds on an assumption that exclusive licensing of index options is an anomaly, a regulatory loophole that can be corrected by a simple act of redrafting Rule 19c-5. Yet the persistence of exclusivity in index options, unlike most other options, following the adoption of Rule 19c-5 reflects the fact that securities indexes, unlike other vehicles used for options trading, are protected by intellectual property rights owned by the index provider.

A. Indexes and Index-Based Investment Products Have Flourished Under IP Protection

Those rights were the subject of litigation in the early 1980s when derivative products based on stock indexes were first popularized. In <u>Standard & Poors Corporation, Inc. v. The Commodity Exchange Inc.</u>, 683 F.2d 704 (2d Cir. 1982) ("<u>Comex</u>"), the Court of Appeals enjoined Comex from using S&P trademarks to promote a stock index futures contract based on the S&P 500 index that was being offered without the consent of S&P. In the same decision, the Second Circuit acknowledged that S&P also presented a serious claim of common law proprietary rights in the trading of derivatives based on its stock index, which also supported the preliminary injunction against Comex. Id. at 711. One year later, in Board of Trade of the City of Chicago v. Dow Jones & Company, Inc., 456 N.E.2d 84 (Sup. Ct. Ill. 1983), the Illinois Supreme Court held that Dow Jones' common law proprietary rights in the DJIA were powerful enough to restrain misappropriation by the Board of Trade of the DJIA for purposes of offering a stock index futures contract without the permission of Dow Jones. The Court grounded its ruling on the desire to encourage the development of new indexes "specifically designed for the purpose of hedging against the 'systematic risk' present in the stock market." Id. at 90.

At the time of the litigation with the Board of Trade, Dow Jones was unwilling to license the DJIA or its other index products for trading purposes. At that time and for several years thereafter, Dow Jones was wary of engaging in such licensing principally out of concern that its reputation as a disinterested provider of business and financial news might be tainted in the event of attempted or suspected manipulation of its indexes by persons seeking to gain unfair advantage in the trading of derivative products.

Since the early 1980s, and, Dow Jones believes, in large part because of the Board of Trade and Comex rulings, new markets arose for the trading of various instruments based on indexes. As the SEC is well aware, an entire world of tradable and investable products based on indexes has evolved that would have been almost unimaginable just 25 years ago, including stock index futures, index options, exchange traded funds and options thereon. The great majority of index-linked exchange-traded products are based on exclusive licenses from the index providers.

With the passage of time and the acceptance by the investing public of a wide array of indexed investment products without demonstrable damage to the interests of the independent index proprietors, Dow Jones re-evaluated its early reluctance to license its indexes for trading purposes. In the last decade, Dow Jones has created a new business unit, Dow Jones Indexes, both to maintain and distribute its first generation indexes such as the DJIA, as well as to develop, promote and license new indexes. At the time of the Board of Trade ruling, Dow Jones published seven indexes.[1] Today, on a global basis, Dow Jones either alone or in partnership with others publishes well over 3,000 indexes. Among those indexes, approximately 65 are presently licensed globally for use in some 180 exchange-traded and investment products, including futures, options and exchange-traded funds. Dow Jones' indexes are also licensed as the basis of at least 200 outstanding variable and equity-indexed annuities and structured products such as OTC options, swaps, warrants, equity-linked notes and public/private debt. (A recent listing of exchange-traded products based on Dow Jones' licensed indexes is annexed as Exhibit A).

[1] The Dow Jones Industrial Average, the Dow Jones Utilities Average, the Dow Jones Transportation Average, the Dow Jones Composite Average, the Dow Jones Bond Average, the Dow Jones Futures Index, and the Dow Jones Spot Index.

Dow Jones is not the only business entity that has contributed to the proliferation of new indexes and new index trading products in the past two decades. Both independent index providers as well as some of the exchanges themselves have created a wide variety of new indexes, many of which are now used to provide a robust menu of trading and investment alternatives. This development provides a textbook example of the fundamental premise of intellectual property protection in action: the grant of exclusive rights to the creator of intellectual property stimulates creativity and ultimately increases consumer welfare by providing a wider array of products than would otherwise exist.

B. Index Proprietors and Their Licensees Have Invested Heavily in the Creation and Maintenance of Indexes

The ISE petition claims that index options licensed by index providers are associated with higher trading fees than is the case with other options. That may be so, but the fees merely reflect the intellectual property in indexes that is not at stake when simple equities are optioned.[2] Those indexes cost money to create and maintain, and someone has to pay those costs or the index will no longer be published. The ISE does not contest the fact that an index originator such as Dow Jones incurs substantial costs in the creation, maintenance and distribution of stock indexes. For example, Dow Jones Indexes presently employs a staff of some 40 statisticians and other professionals for the purpose of designing new indexes, monitoring existing indexes to assure that they continue accurately to reflect the cross-section of the market that they are intended to represent, and calculating thousands of indexes on both a real-time and end-of-day basis.

Creation of an index requires, among other tasks:

- identification and definition of a market or market segment that will be traded;
- determining an appropriate number of constituent securities ("components") that will accurately reflect the breadth, depth and liquidity of the market in question using a practical number of components;
- determining selection criteria for components to promote stability, predictability and consistency;[3]
- determining index size to promote tradability and investability;

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2 As the court observed in <u>Golden Nugget v. American Stock Exchange</u>, 825 F.2d 585 (9th Cir. 1987), equity derivatives are different from index derivatives because the latter, but not the former, are protected by intellectual property rights (expressly distinguishing the <u>Board of Trade</u> decision).

3 In <u>Dow Jones & Company, Inc. v. Board of Trade of the City of Chicago</u>, 546 F. Supp. 113, 116 (S.D.N.Y. 1982), the court held that "[d]ue to the effort and judgment expressed in their composition, and the non-functional purposes to which they are put, Dow's lists [of component stocks in the DJIA] are copyrightable."

- establishing rules to deal with mergers, takeovers, spin-offs and other extraordinary corporate events experienced by the constituents of the index.

(Summaries of the methodology of selected Dow Jones index families are annexed as Exhibit B).

Once an index is launched, it must be maintained. Experts employed by Dow Jones must monitor the component securities on an ongoing basis to adjust for corporate actions and to ensure that substitutions in the component list are made in compliance with the indexes' selection criteria.

Dow Jones also incurs more than a million dollars in costs annually to purchase real-time data feeds from the exchanges and other sources in order to obtain the securities price data necessary to calculate index values and other supporting data to be able to maintain the indexes. It incurs hardware and software costs. In addition, Dow Jones pays significant sums to various entities to distribute the index values in real time.

Dow Jones incurs costs in the creation of indexes in yet another way. As in many other industries dependent on intellectual property, such as book publishing and motion pictures, the licensing of indexes is characterized by a few "hits" that subsidize a lot of "misses." Dow Jones believes that, to maintain credibility as an independent publisher of securities indexes, it needs to offer a full line of indexes that track essentially all major aspects of the global securities markets. That philosophy underlies its creation of thousands of indexes. And yet, only a small fraction of those indexes have been successfully licensed and are generating returns to Dow Jones. Those returns, in the form of license fees, must pay not only the costs of creating and maintaining the licensed indexes, but also the many others that continue to be published but have not been licensed.

Finally, Dow Jones spends heavily for educational and promotional activities to develop a marketplace for its indexes. Those activities are essential to establishing the transparency and familiarity that builds confidence in the product on the part of issuers, traders and, ultimately, investors. For example, Dow Jones maintains a website and publishes literature explaining the methodology that underlies its indexes and promoting their use as the basis of trading and investment vehicles (examples of Dow Jones' promotional materials are annexed as Exhibit C). Dow Jones has participated in "road shows" with its licensees such as the Chicago Board Options Exchange (CBOE) to educate traders in the construction of Dow Jones's indexes so the traders understand what underlies the licensees' investment products. Finally, Dow Jones' licensees engage extensively in advertising and other marketing initiatives to expose these products to potential users and develop market depth and liquidity.

C. Licensing Rights Are An Essential Attribute of Intellectual Property

Dow Jones would not have created 3,000 new indexes in the past decade were it not for the assurance that it would enjoy intellectual property protection with respect to both its trademark as applied to those products, as well as its common law proprietary right to control the licensing of those indexes for use as the basis of trading of investment products which was confirmed in the Board of Trade case. Inherent in intellectual property rights is the ability to decide whether, to whom and on what terms to license the use of the property. Because the premise of intellectual property protection is to afford an economic return to those who are willing to risk their resources in the creation of new products, it is essential that those creators know in advance that they will be able to engage in a profit-maximizing licensing strategy once a new product is created. In some instances, the profit-maximizing strategy may be to license the intellectual property on a non-exclusive basis, collecting relatively smaller royalties from a number of users. In other instances, the profit-maximizing strategy will be to license the property on an exclusive basis for a particular use, collecting a relatively higher fee from the single user.

Index proprietors have followed both strategies in the licensing of various products depending on the nature of the particular market in which the licensing occurs. Dow Jones has entered into non-exclusive licenses with numerous licensees for the use of Dow Jones indexes in a variety of structured products that are not exchange-traded, such as swaps, variable annuities, and debt-based instruments (a schedule listing the index-based products that are customarily licensed by Dow Jones on a non-exclusive basis is annexed as Exhibit D). In the case of options and futures, by contrast, where the cost of launching the products is typically higher, Dow Jones has made the business decision that exclusive licensing of the right to offer trading instruments is in Dow Jones' best interest because it maximizes licensee incentive to develop the product.

Dow Jones' alternative strategies of exclusively licensing certain investment products based on its indexes, while non-exclusively licensing others, reflects a rational business strategy and demonstrates that index providers, without regulatory compulsion, make profit-maximizing choices that do not necessarily result in exclusive trading. For example, in the case of ETFs, Dow Jones, in most cases, has exclusively licensed indexes to a single entity to create and issue shares in a fund based on such indexes, while it has non-exclusively licensed multiple exchanges to trade those shares. In the ETF market, the entity that is licensed to create shares in such funds is in a position to earn significant fees in addition to those based on the trading of the product. Accordingly, an index provider such as Dow Jones can be assured that multiple trading of ETF shares through non-exclusive licensing of exchanges is not likely to undermine the incentive of the issuer to accept an exclusive license to create and promote the product. By contrast, Dow Jones recognized that in the options and futures markets, a licensed exchange will have little incentive to develop a market in index-based products if other exchanges could immediately step in to freeload on its efforts. As a result, if Dow Jones cannot exclusively license an exchange to use one of its indexes as the basis of options trading, it will be extremely difficult to persuade any exchange to make the necessary investments to commercialize the product.

II. EXCLUSIVE LICENSING OF INDEXES IS PRO-COMPETITIVE

The competition policy of the United States recognizes that licensing of intellectual property, including the exclusive licensing of such property, is normally pro-competitive. For example, the 1995 Antitrust Guidelines for the Licensing of Intellectual Property issued by the Department of Justice and FTC (the "Licensing Guidelines"), under a heading entitled "Pro-Competitive Benefits of Licensing," explain that:

> Field-of-use, territorial, and other limitations on intellectual property licenses may serve pro-competitive ends by allowing the licensor to exploit its property as efficiently and effectively as possible. These various forms of exclusivity can be used to give a licensee an incentive to invest in the commercialization and distribution of products embodying the licensed intellectual property and to develop additional applications for the licensed property. The restrictions may do so, for example, by protecting the licensee against free-riding on the licensee's investments by other licensees or by the licensor. Licensing Guidelines at § 2.3.

The economic considerations that underlie this policy are self-evident. Intellectual property offers a stimulant to creativity by giving creators an assurance that they will he able to commercialize their creations in order to achieve a return on their sometimes highly speculative investments. Exclusive licensing is one of the most common means of commercializing intellectual property. While the ISE focuses on the supposedly higher trading fees charged by exclusively-licensed exchanges, it forgets the all-important tradeoff: allowing index providers to maximize profit through exclusive licensing incentivizes the creation of new indexes and leads to a wider variety of options on ***different*** indexes among which traders and investors can pick and choose.

The fact that one index has been placed under exclusive license for a particular trading product does not impede other index providers from offering competing indexes that track the same market segment, nor does it impede the ability of the other exchanges to develop their own indexes. There are no barriers to entry into the index-provider business. Here, instead of paying a third-party index provider for the use of an existing index or to custom-build one for **ISE,** ISE can hire its own personnel and create its own index. Nearly infinite combinations of components and other parameters can be selected to create **an** index to track any given market segment without copying existing indexes or index methodologies or infringing existing trademarks. In short, recognizing and respecting the IP rights of existing providers will not exclude from the market would-be creators and users of new indexes.

The result of exclusive trading rights is, therefore, an enhancement of inter-brand competition in which multiple index products, often addressing the same market niche, become available.[4] For example, options are currently available for trading on no less than five technology-related stock indexes on four different exchanges: the CB-Tech Index (TXX), which was created by and is traded on the **CBOE;** the Goldman Sachs Technology Index (GTC), also

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[4] Dow Jones goes to great lengths to promote its own index products as superior to competitive indexes that track the same **or similar** markets (examples are annexed as Exhibit **E).**

traded on the CBOE; the Morgan Stanley Hi-Tech Index (MSH) traded on the Rmex; the Semiconductor Index (SOXX) traded on the Philadelphia Exchange; and the PSE Tech Index (PSE) created by and traded on the Pacific Exchange. Thus, investors seeking option products related to the technology segment of the stock market now have five products to choose from, all in a position to compete with one another and offered on a number of exchanges. We doubt that such a robust menu of offerings in this or any other field would exist today if exclusive licensing were banned.

III. THE ISE PROPOSAL IS ANTI-COMPETITIVE

The exclusive contracts that typically exist today between index proprietors and individual exchanges represent not a *foreclosure* of competition, but the result of competition. That competition exists at the time an index is offered for licensing. In Dow Jones' experience, when such an offer is made, typically a number of exchanges will bid against one another for the right to the contract.[5] The successful bidder is the one that places the highest value on the exclusive right to the intellectual property, either because it is more efficient than its rivals and therefore can offer to pay more for the intellectual property rights while still making a profit, or because it anticipates earning greater profit than its rivals because it has new and better ideas on how to commercialize the product. This is an efficient and consumer welfare–enhancing result that should be promoted, not obstructed, by SEC regulation.

The ISE proposal, however, would eliminate all competition among exchanges for the right to list options based on indexes. Like a purchasing cartel, the exchanges would be able to drive license fees down to the vanishing point. The diminution in the aggregate fees paid to index proprietors would not expand consumer welfare, but would simply take dollars out of the pockets of index proprietors and place them in the hands of the less efficient exchanges that were less willing or able to bid for the exclusive rights to these indexes. The decrease in fees payable to index proprietors would cause marginal index products to be abandoned and fewer new products to be developed, because the diminished fees generated from non-exclusive licensing will not be sufficient to fund the creation, maintenance and dissemination of at least some indexes. Moreover, none of the exchanges would have an incentive to invest in the education and promotional services necessary to develop a market in any product, because all of the other exchanges could free-ride on those efforts. The ISE petition does not even attempt to make the case that the purported benefits of multiple trading outweigh the costs of such a regime.

For example, Dow Jones entered into an exclusive license with the CBOE to use the DJIA as the basis for options trading. CBOE has invested considerably in educating its own traders and customers in the nature of the product and the advantages to trading it. Ongoing promotion, advertising, and education remain necessary to develop the market in this product. CBOE would have little incentive, however, to engage in such market-making activities if any other exchange could free-ride on those efforts. Once liquidity is established and the commercial

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[5] For example, it was recently reported that the Philadelphia Stock Exchange "beat out the competition to win exclusive nghts to trade options on the popular NASDAQ Composite Index." Wall Street Journal, Sept. 9, 2003 at p. C15.

success of the new product is evident, a ban on exclusive licensing would permit other exchanges to cherry-pick the most successful products. Such cherry-picking has become easier today as the cost of listing a product has diminished due to modern electronic infrastructure. Exchanges not willing to accept the risk and cost of popularizing a new trading product therefore would find it quite simple to cherry-pick the most successful products, free-riding on the investment in market-making activities by the initial licensee. As a result, exchanges will have less incentive to invest in such market-making activities that are essential to establishing new products in the first place.

The reduced output of indexes that would likely flow from the refusal to protect index proprietors' intellectual property rights would not merely harm the public by diminishing the number of available trading products. Even when indexes are not used directly as the basis for a trading product, they are valuable to the public as information. The expertise and effort that goes into the creation and maintenance of an index creates a means of tracking the movements in securities markets more effectively than a mere listing of individual securities prices can ever do. The original premise of stock indexes, dating back to Mr. Charles Dow in 1896, is that a moving single index number generated from a carefully selected group of stocks can provide the investing public with a useful piece of information to make investment decisions and, more generally, to gain an understanding about the state of and trends in the capital markets. The more indexes that exist, the more useful information is available to the investing public as well as to those performing historical research or analysis concerning the securities markets. Any regulatory action that would undermine incentives to continue to create indexes would diminish that information flow to the detriment of the public.

IV THE ISE PROPOSAL WILL DENY INDEX PROVIDERS A FAIR RETURN ON THEIR INVESTMENT

The **ISE** says it does not ***to*** want to "limit" the ability of index providers "to achieve a fair return for their development of an index," but its petition does not explain how this will happen. What constitutes a "fair return" on the use of any property is normally determined by the price that results from the interplay of market forces, such as the robust bidding that has typically occurred when index providers make indexes available to the exchanges for trading purposes. If normal market forces are not permitted to take hold, some alternative mechanism must be established to assure a return on the index providers' investment.

For example, the Copyright Act establishes a number of compulsory license regimes whereby the owner of the copyright is deprived of the right exclusively to license its use; if the owner commercializes its work, it is required to permit others to use its property on a non-exclusive basis in exchange for a "reasonable **royalty.**"[6] That system is analogous to the one implicitly proposed by the **ISE.** What is present in the Copyright Act compulsory license regime, however, but absent **from** the **ISE** proposal, is a mechanism to assure that the owner of the rights that have been compulsorily licensed can achieve a fair return on its investment. In the

6 See 17 U.S.C. §§ **114,** 115, 116, 118 **and** 119.

case of the Copyright Act, that mechanism is the establishment of Copyright Arbitration Royalty Panels, whose job it is to assess and adjust royalty rates based on industry conditions on a regular basis.[7] That regulatory mechanism is a recognition that in any compulsory license system, an independent third party must set the prices in order to ensure the licensor a fair return on the licensed rights.

The ISE proposal suffers from a glaring omission in that there is no mechanism whereby to assure index providers a "fair return" on the licensed rights. It is not an acceptable answer to suggest that the ISE proposal should simply be supplemented by the creation of such a mechanism. The notion that the SEC would go into business as a royalty tribunal to set non-exclusive license fees chargeable by index proprietors would propel the Commission into areas far beyond its institutional competence and, at minimum, impose new costs and expert staffing requirements on the SEC.[8]

V. THE ISE PROPOSAL WOULD REQUIRE THE SEC TO ACT BEYOND ITS STATUTORY JURISDICTION

The ISE proposal would propel the SEC into the regulation of matters beyond not only its institutional competence but its statutory authorization as well. Although section 23(a)(2) of the Exchange Act requires the SEC to consider the competitive impact of rules it wishes to promulgate, that is a far cry from authorizing the SEC to enact any and all regulations that it believes will enhance competition among the exchanges. Even if the SEC were of the view that the ISE proposal would foster rather than deaden competition among the exchanges, it should reject the proposal for lack of statutory authorization.

The present petition seeks rulemaking with even less statutory basis than that struck down by the D.C. Circuit as *ultra vires* the Exchange Act in Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990). The regulation in question required exchanges to refuse to list the securities of issuers that failed to provide a "one-share/one-vote" system for their shareholders. The Court of Appeals held that that regulation was an invasion of corporate governance traditionally regulated by state law and beyond the authority of the SEC under the Exchange Act. As in the present case, the regulation struck down in Business Roundtable purported only to affect the rules of securities exchanges that are undoubtedly within the purview of the SEC, but the effect of the SEC regulation was to invade the rights of other parties that were traditionally regulated by state law. Far worse than in Business Roundtable, the ISE proposal, although nominally directed at the rules of the exchanges, would have the direct effect

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7 See 17 U.S.C. §§ 801-03.

8 That is not to suggest that even a properly-constructed and statutorily-authorized compulsory license regime would be desirable. Compulsory licenses are at best a poor substitute for the operation of the market in setting prices. Even as a remedy for a proven case of illegal monopolization, "the [compulsory license] remedy is a severe one, and should be imposed only where less drastic means appear unlikely to suffice." In re Borden, Inc., 92 F.T.C. 669 (1978), enforced, 674 F.2d 498 (6th Cir. 1982).

of dissolving and restricting intellectual property and contract rights of index providers that are traditionally protected by both federal and state law. There is no indication that Congress contemplated giving any such authority to the Commission.

The Senate Report that accompanied the 1975 Amendments to the Exchange Act acknowledges that competition among the exchanges is "not . . . paramount to the great purposes of the Exchange Act. . . ." S. Rep. No. 75, 94th Cong., 1st Sess. at 13-14. Although several provisions of the Exchange Act as amended require the SEC to assess the competitive impact of its rulemaking and to avoid imposition of regulatory burdens on competition not necessary or appropriate in furtherance of the purposes of the Act, there is no general grant of authority to the SEC to enact any and all regulations that it believes will foster such competition. And the SEC's authority to act should be scrutinized carefully when such regulation would trample upon rights traditionally regulated by state law, such as the proprietary rights that the Illinois Supreme Court confirmed in Board of Trade v. Dow Jones as well as the contract rights that empower Dow Jones and other index proprietors to license their indexes to whom they choose and under terms they find appropriate.

The proposed regulation would also invade a domain controlled by both federal and state trademark laws, under which trademark owners are entitled to license their marks either exclusively or non-exclusively. Choosing among potential users, and excluding those with whom they do not wish to be associated, is precisely what owners of intellectual property are authorized to do, and with good reason. In the case of a trademark license, the licensor has an intense interest in limiting the use of its trademark – which may be among its most valuable assets – to users whom it considers reliable and reputable. One reason is that, under trademark law, a trademark licensor must exercise quality control over the products and services sold by the licensee lest it be deemed to have abandoned the mark. See e.g., Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368,387 (5th Cir. 1977):

> Courts have long imposed upon trademark licensors a duty to oversee the quality of licensees' products. The rationale for this requirement is that marks are treated by purchasers as an indication that the trademark owner is associated with the product. Customers rely upon the owner's reputation when they select the trademarked goods. If a trademark owner allows licensees to depart from his quality standards, the public will be misled, and the trademark will cease to have utility as an informational device. A trademark owner who allows this to occur loses its right to use the mark.

Here, the index provider may not wish to devote its resources to overseeing the activities of several exchanges, as opposed to only one, with respect to quality control for a given index product. More importantly, there are a variety of non-financial considerations that may influence the licensor's decision whom to license. For example, Dow Jones may repose greater confidence in a particular exchange's ability to commercialize a particular Dow Jones index in a manner desired by Dow Jones. The proposed regulation would upset these customary perquisites of property ownership and coerce index providers to lend their trademarks and indexes to all comers.

Finally, the ISE proposal would interdict not only "exclusive" licensing of indexes and trademarks of index providers, but also such licensing on a "preferential basis." That clause would involve the SEC in ongoing disputes as to whether particular license terms were in fact "preferential." For example, one exchange could assert that license terms, although offered by an index provider to all exchanges, were tailored to the needs or circumstances of another exchange in violation of the proposed rule. The SEC would be required to resolve all such disputes. Here, too, the proposal would propel the SEC into areas far from its institutional competence without any authorizing basis in the Exchange Act.

CONCLUSION

The ISE proposal is fundamentally antagonistic to the established property rights of index providers, and to the goals of promoting competition among exchanges, and, most importantly, consumer welfare. Dow Jones urges the Commission not to propose a rule of the type requested by the ISE. If you have any questions, please feel free to contact the undersigned or Rosemary Spano, Dow Jones' Deputy General Counsel, at (212) 416-3807.

Respectfully submitted,

Robert P. LoBue

Robert P. LoBue

cc: The Honorable Chairman, William H. Donaldson
Commissioner Cynthia Glassman
Commissioner Harvey Goldschmidt
Commissioner Paul Atkins
Commissioner Roel Campos
Ms. Annette L. Nazareth, Director, Division of Market Regulation
Robert L.D. Colby, Deputy Director, Div. of Market Regulation
Ms. Elizabeth King, Associate Director, Div. of Market Regulation
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