NetCoalition.com

September 14, 2007

U.S. Securities and Exchange Commission
100 F Street, N.W.
Washington, DC 20549

Attention: Ms. Nancy M. Morris, Secretary

**Re: In the Matter of NetCoalition, File No. SR-NYSEArca-2006-21**

Dear Chairman Cox and Commissioners:

NetCoalition writes once again in this matter, this time to respond to comments made by The Nasdaq Stock Market in its May 18, 2007 letter (the "May Nasdaq Letter").[1] We hope our comments will be helpful to the Commission in its review of this important matter.

**Roundtable.** The Commission in recent years has hosted a number of Roundtable discussions. By all accounts, these Roundtables have proved valuable in assisting the Commission on a host of issues. Given the importance of market data decisions to investors and the markets -- and given the lack of transparency surrounding this process -- the public would be well-served by a Roundtable to explore publicly these critically important issues.

**Should the Public Have Access to Essential Depth of Book Data?** Nasdaq's basic argument is that there are two types of market data under the Exchange Act, consolidated data and proprietary data and that each is to be treated differently to the other for purposes of complying with the statutory standards applicable to Nasdaq as a national securities exchange. That argument is incorrect as a matter of law.

Nasdaq's first proposition, that the market data the Commission did not require the exchanges to publish — that is, depth-of-market data — is therefore the property of exchanges is false. The fact that an exchange is not required to publish data does not mean that the data is proprietary. As we pointed out in our Petition, the Supreme Court decided unanimously in the *Feist* case[2] to reaffirm our nation's historic position that facts, the building blocks of information, cannot be owned. As Justice O'Connor stressed, this is a constitutional requirement.[3] For years, the exchanges have fought a

1 NetCoalition is a public policy voice for some of the world's most innovative companies on the Internet. Its trustees include CNET Networks, Bloomberg L.P., Google, IAC/Interactive Corp. and Yahoo!.

2 Feist *v. Rural Telephone Service Company, Inc.*, 499 U.S. 340 (1991).

3 *Id.* at 347.

rearguard action to overturn the *Feist* holding through the so-called database legislative proposals. The Congress has turned that away repeatedly.[4]

It is easy to see why the exchanges want to overturn *Feist,* as it is impossible for the exchanges to assert an ownership right in factual market data as long as *Feist* is the law of the land. Indeed, this reality was underscored only a few weeks ago in the decision by the United States Court of Appeals for the Second Circuit in *New York Mercantile Exchange, Inc. v Intercontinental Exchange.*[5] In reliance on *Feist* -- and reflecting the settled policy that prices cannot be owned -- the Second Circuit upheld the judgment of the United States District Court for the Southern District of New York that the New York Mercantile Exchange settlement prices can not be copyrighted. The nature of the equity markets would clearly make the argument of "ownership" even less likely to withstand judicial scrutiny than the failed argument in the commodity context. The importance and breadth of this holding is illustrated by the *Amicus Curiae* brief of the United States in support of the Register of Copyright's position that this market data could not be copyrighted:

> The United States has a substantial interest in the resolution of this appeal. It has numerous responsibilities related to the proper administration of the intellectual property laws, as well as primary responsibility for enforcing the antitrust laws, which establish a national policy favoring economic competition. Accordingly, the United States has an interest in properly maintaining the "delicate equilibrium", Computer Assocs. Int'l v. Altai, Inc., 982 F.2d 693, 696 (2nd Cir. 1992), Congress established with the copyright law, between protecting private ownership of expression to encourage creativity and enabling the free use of information for future creativity. See Twentieth Century Music Corp. v. Aiken, 422 U.S. 151, 156 (1975). The claims in this case seeking copyright protection for a commodity exchange's individual determinations of futures contract settlement prices threaten that equilibrium.[6]

The Commission itself stated in its Concept Release on market data fees that whatever rights the exchanges have in market data originating from their members is nevertheless subject to the overriding policies of the Securities Exchange Act of 1934 (the "Exchange Act"):

> In summary, Congress granted the Commission broad flexibility in the 1975 Amendments in determining whether the fees charged by an exclusive processor for market information are 'fair and reasonable,' 'not unreasonably discriminatory,' and an 'equitable allocation' of reasonable fees among persons

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4 *See* NetCoalition Petition, pp. 17-20, and authorities cited therein.

5 *New York Mercantile Exchange, Inc., v Intercontinental Exchange, Inc.*, U.S. Court of Appeals for the Second Circuit, Docket No. 05-5585-ev (August 1, 2007).

6 *New York Mercantile Exchange, Inc. v Intercontinental Exchange, Inc.*, U.S. Court of Appeals for the Second Circuit, Docket No. 05-5585-cv Brief *Amicus Curiae* of the United States of America in Support of Defendant-Appellee Intercontinental Exchange, Inc.

> who use an SRO's facilities. The most important objectives for the Commission to consider in evaluating fees are to assure (1) the wide availability of market information, (2) the neutrality of fees among markets, vendors, broker-dealers, and users, (3) the quality of market information — its integrity, reliability, and accuracy, and (4) fair competition and equal regulation among markets and broker-dealers.[7]

In adopting Regulation NMS the Commission did not — and without congressional changes to the Exchange Act could not — abandon that approach. When it allowed the exchanges to decide the threshold question of what data these exclusive processors would make available below the mandatory top-of-book, the Commission stated:

> The consolidated information on quotations and trades must be provided in an equivalent manner to any other information on quotations and trades provided by a securities information processor or broker-dealer. Beyond disclosure of this basic information, *market forces, rather than regulatory requirements, will be allowed to determine what, if any, additional data from other market centers is displayed.* In particular, investors and other information users ultimately will be able to decide whether they need additional information in their displays.[8]

The Commission did not say, "Once exchanges decide to publish this data, exchanges are free to ignore the statute and the underlying goal of public access which is why broker-dealers are compelled to bring exchanges the data in the first place." The Commission did not say, "We'll rely on market forces, even where there are none." The Commission did not say, "We plan on ignoring long-settled, constitutionally grounded, intellectual property holdings, especially those expressly related to market data." The Commission did not — and could not — say or imply that exchanges would therefore be free of the statutory standards applicable to ***all*** published market data, that is, the standards in Exchange Act Sections 6(b) and 11A, the very standards the Commission emphasized in its 1999 Concept Release as the core principles governing the distribution of market data.

Nasdaq incorrectly asserts that the Commission's decision to allow market forces to determine whether and how depth-of-market data would be distributed was meant to replace the statutory standards governing the fees exchanges could charge:

> And, if the free market should determine whether, proprietary data is sold to broker-dealers at all, it follows that the price at which such data is sold should be set by the market as well. Moreover, permitting regulation, rather than the market, to set the fees charged for proprietary market data would undermine the

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7 Regulation of Market Data Fees and Revenues, Securities Exchange Act Release No. 42208 (December 9, 1999), in text following n.81.

8 Securities Exchange Act Release No. 51808 (June 9, 2005) in text following n.650 [emphasis added].

> very free-market efficiencies the Commission hoped the separate selling of proprietary data would create.[9]

The Exchange Act, and the clear congressional intendment behind it, would not have allowed the Commission to make that leap — which defies both the statute and logic. While Nasdaq may be at liberty to decide what data to disseminate, it does not "follow" that Nasdaq is at liberty to ignore both the securities laws and our intellectual property laws by asserting an "ownership" right which the courts have once again emphatically rejected, and which would defeat the underlying reason for the implementation of the 1975 Act.

All exchange rules governing fees are subject to the standards in Section 6(b) — there is no exception for what Nasdaq characterizes as its "proprietary" data. Once an exchange elects to publish its depth-of-market data, regardless of whether it is obliged to do so, it brings upon itself the full panoply of Exchange Act duties with respect to that data.

Exchange rules must meet the standard for use of their facilities set out in Exchange Act Section 6(b)(4):

> the rules of the exchange [must] provide for the equitable allocation of reasonable dues, fees, and other charges among the members and issuers and other persons using its facilities.

Exchange Act Section 3(a)(2) defines "facility" to clearly cover, *inter alia*, all market quotation data:

> the term 'facility' when used with respect to an exchange includes its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service.

Thus, if exchanges are going to make depth-of-book data available, Section 6 does not permit a different standard to be used for accessing the consolidated book as opposed to depth-of-book. The view Nasdaq has now asserted, that exchanges are free to charge what they will for "proprietary" data they are not obliged to publish, flies in the face of both the language of Exchange Act Section 6 and the congressional intent underlying that section. Indeed, in its May letter Nasdaq conjures up a nightmare for investors, but a dream for a for-profit monopoly, namely freedom from regulation for data brought to them by other market participants under compulsion of law:

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9 May Nasdaq Letter, at 10.

> These newly-relaxed requirements, the Commission made clear, 'will allow market forces, rather than regulatory requirements, to determine what, if any, additional quotations outside the NBBO are displayed to investors.' In other words, Regulation NMS implements the very distinction that Congress anticipated in enacting the 1975 amendments — that proprietary data will exist in a minimal regulatory environment.[10]

That interpretation of the Securities Acts Amendments of 1975 ("the 1975 Amendments") is both strikingly novel and entirely incorrect. The Commission, of course, has not acceded to, or even suggested, such an extra-statutory position and, indeed, if it accepted Nasdaq's position, its action would be reversible as a matter of law.

It is worth recollecting the circumstances that so troubled the Commission and the Congress in 1975, resulting in the passage of what up to then stood as the most significant overhaul of the Exchange Act since 1934. In the early 1970s, the largest exchange in the country, the New York Stock Exchange (the "NYSE"), claimed an ownership right in market data. This data, particularly quotation data, was not widely available to the public. Transparency and efficiency suffered. Investors were in the dark. Capital markets were fragmented.

With the ardent support of the Commission, the Congress acted decisively. The 1975 Amendments crafted a bargain. The first half of the bargain was that broker-dealers were required to provide their customers' market data to the exchanges immediately and without compensation. The second half was that exchanges were required to consolidate that data and make it available to the public according to the statutory protections we have described at length. The objective of the 1975 Amendments was the creation of a national market system with maximum transparency to benefit investors.

It is often said that the dominant exchanges seek a de facto repeal of the 1975 Amendments, often by self help. That is only half right. The exchanges want to repeal the second half of the bargain — which protects the public from abuse by these government-sponsored monopolies. The exchanges are ardent supporters of the first half of the bargain — which gave them their government-sponsored monopolies over market data in the first place, compelling others to provide exchanges with raw materials, empowering the exchanges to issue regulations governing their competitors, and providing a partial anti-trust exemption as well.

With all the exchanges' raising concerns about international competition, it is striking how U.S. exchanges continue to embrace the first half of the 1975 bargain at a time when European markets are poised to promote at least potential competition by allowing broker-dealers to collaborate *without* a mandate to provide market data to exchanges.[11] This enforcement of half a bargain here in

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10 *Id.* at 4.

11 "One aspect of the MIFID directive which is rarely discussed is its impact on the financial market data business. MIFID not only abolishes the concentration rule for trading of equity securities, but also for market data generated from these trades. Whereas today market data on equity transactions is primarily controlled by the exchanges, MIFID leaves open how and by whom this information will be consolidated in the future." Karel

the United States is no doubt why nothing like Project BOAT seems to be developing in the United States.[12] How do broker-dealers collaborate to produce basic data to compete with the exchanges when broker-dealers bear costs in collaboration while exchanges receive those raw materials without cost though government mandate?

In short, the 1975 Amendments were animated largely by a recognition that dominant exchanges are not subject to "market forces" and that, in the absence of regulation, information vital to investors will be withheld. The 1975 Amendments were about containing, not facilitating, exchange abuse. That is why the exchanges opposed it so vociferously and fought a rearguard battle to forestall the development of a composite quote system.[13] The hypothesis that the 1975 Amendments were about liberating exchanges to provide data on whatever terms they choose is completely wrong. If the exchanges want to re-write the 1975 Act to match their misrepresentation,

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Lannoo, Financial Market Data and MIFID, ECMI Policy Brief, No. 6/March 2007, available at: http://www.eurocapitalmarkets.org/?q=node/285 .

12 "BOAT was formed in September 2006 by nine leading investment banks — ABN AMRO, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, Merrill Lynch, Morgan Stanley and UBS. It was launched to create a central platform for the collection, collation, validation, storage and distribution of pre- and post-trade information as required by investment firms operating off-exchange as allowed under MIFID." The Trade News April 5, 2007.

13 The most notorious opponent of public transparency — particularly of quotations, was the NYSE itself, which was keen on preserving the time-and-place advantages its Floor members uniquely enjoyed. The Senate commented at the time:

> The SEC's authority to foster the implementation of a composite tape and composite quotation system has been questioned by the primary exchanges and certain vendors of market information. For example, after the SEC expressed its objections to the original composite tape plan filed by the exchanges and the NASD, the NYSE responded by stating:
>
> > we are proceeding on the basis of our sincere desire to satisfactorily resolve the problems inherent in the creation of a consolidated tape, on a voluntary and cooperative basis, but the Exchange is not waiving—and hereby expressly reserves—its right to object to provisions of Rule 17a-15 [concerning the composite tape] and the Commission's assumption of authority in this area.
>
> Arguments about the SEC's authority are not in the best interest of investors or the industry, for they can only result in substantial delays in implementing the communications systems necessary for the national market system. S 249 is designed to make the SEC's authority over such systems and the operations of a national market system clear.

Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing, and Urban Affairs to Accompany S. 249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 9 (1975).

they should propose that and we should have a public debate about the Act.[14] The exchanges are not at liberty to re-write the Act unilaterally.

**Is "Sole Source" Data, Sole Source? Are "Exclusive Processors" Exclusive?** Nasdaq's further argument, that exchanges do not have monopoly power with respect to the data their members give them also is false. The fact, which no one contests, that exchanges vie with one another to attract order flow, does not mean that an exchange that obtains quotation and last sale information from its members is not thereafter the sole source of that information. Competition in one sector — attraction of order flow — does not equate to competition in another, publication of market information. Nasdaq's analogies to automobiles and other consumer hard goods are unavailing. There is no effective substitute for information that is solely in Nasdaq's or the NYSE's possession concerning quotations and transactions in their respective markets. As the August 1, 2007 SIFMA letter points out, unlike Hondas and Fords, market data from one exchange is not a possible substitute for data from another. Particularly given the Commission's repeated admonition to brokers and investment advisers alike to observe scrupulously a duty of best execution, the securities industry has noted that securities professionals have little choice but to buy significant data products that are offered to them.[15]

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14 The NYSE was rumored to have conducted a substantial rearguard action in the early to mid-1970s to deflect the Congress from enacting the reform legislation that became the 1975 Amendments. As reported in the press at the time, the SEC publicly mentioned suspicions that the NYSE had deliberately subverted the legislative process:

> Suggestions that the New York Stock Exchange acted in bad faith in pretending to go along with the ending of fixed brokerage commissions rates while doing everything possible to defeat authorizing legislation were placed today in the record of a Securities and Exchange Commission hearing on the controversial issue.
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> Careful to explain that he was not making the accusation, the S.E.C.'s chairman, Ray Garrett, Jr., invited the exchange's chairman, James J. Needham, to refute 'the suspicion' of some in Washington that the Big Board did not want unfixed commissions on any terms 'but thought it was good politics pretend' that it did and 'couple it with conditions that could not be met.' He did not identify the source of the suggestions.
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> 'This leads some to observe,' said Mr. Garrett, 'that the New York Stock Exchange is in the well-known position of the child who murders his parents and then throws himself on the mercy of the court because he is an orphan. I think it only fair to give you an opportunity openly and publicly to say whatever you can about that particular idea.'
>
> **'Terribly disappointed'**
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> Far from grasping the opportunity, Mr. Needham said he was 'terribly disappointed, saddened and distressed' that an agency for which he held such high regard should use the current hearings to explore irresponsible gossip.

Felix Belair, Jr., "S.E.C. Chief Cites 'Suspicion' on Fees," N.Y. Times, Dec. 12, 1974 at 73.

15 *See* letter from SIFMA (January 17, 2007), at 5-6.

Again, for the reasons SIFMA letter set out, Nasdaq's analogies to other public utilities such as telecommunications, railroad and airlines are similarly incorrect.[16] Unlike unique securities market data possessed by only one provider, the pricing of goods and services in those other industries is indeed constrained by the presence of effective competitive alternatives, which are lacking in the case of market data.

The assertion that quotes below the top-of-book found on Nasdaq or NYSEArca are not exclusive and hence are subject to market forces is also simply wrong. The Commission, little over a year ago, addressed this question:

> [T]he Commission believes that NYSE Market and [NYSE] Arca LLC are acting as exclusive processors as defined in Section 3(a)(22)(B) of the Exchange Act because they are engaging on an exclusive basis on behalf of NYSE LLC and NYSE Arca, respectively, in collecting, processing, or preparing for distribution or publication information with respect to transactions or quotations on, or effected or made by means of, a facility of NYSE LLC or NYSE Arca, as applicable.[17]

The Commission's conclusion of course underscores that NYSEArca is a monopolist in its market data. Nothing has happened in the last 14 months to justify changing that conclusion. As a monopolist, regardless of whether it competes in other venues — e.g., for company listings or for order flow, NYSEArca should be regulated as such, in keeping with the congressional admonition:

> Any exclusive processor is, in effect, a public utility. . . . 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. Therefore, in order to foster efficient market development and operation and to provide a first line of defense against anti-competitive practices, Sections 11A(b) and (c)(1) would grant the SEC broad powers over any exclusive processor and impose on that agency a responsibility to assure the processor's neutrality and the reasonableness of its charges in practice as well as in concept. . . . [I]n situations in which natural competitive forces cannot, for whatever

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16 Nasdaq's misrepresentations strike us as inappropriate for a submission of this gravity. Nasdaq asserted that the FCC has held that "traditional tariff regulation….is not only unnecessary to ensure just and reasonable rates, but is actually counterproductive…". The FCC actually held that "traditional tariff regulation **of nondominant carriers** is not only unnecessary to ensure just and reasonable rates, but is actually counterproductive..". By editing out the operative phrase " of nondominant carriers" Nasdaq's affirmatively misleads on a very material point.

17 Securities Exchange Act Release No. 53856 (May 24, 2006) in text following n.13.

> 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.[18]

The Congress was correct to underscore that "the SEC must assume a special oversight and regulatory role" over exclusive processors. If that was the case when exchanges were not-for-profit entities, potentially restrained by broker-dealer members, then supervision is more urgently needed in where we have for-profit exchanges operating without that restraint. Far from effective oversight, what we have at present is chameleon-like exchanges seeking to have it both ways in order to exploit their government-sponsored monopoly status and regulatory power to unfairly gain commercial advantage. Nasdaq's recent unsuccessful efforts to assert sovereign immunity from lawsuits, even where those complaints relate to private commercial conduct, illustrate this effort.[19] The proper and legally sustainable policy response, of course, is to separate an exchanges' monopoly functions from its competitive functions, as has been urged by commentators and as the Commission established in its policy in the matter of Nasdaq's FSI exemption.[20]

Just as the SEC has found that exchanges are exclusive processors regarding this information, the competition authorities of the United Kingdom Office of Fair Trading (OFT) and the Competition Commission (CC) have concluded that "an exchange is a monopolist of its proprietary information," (such as real-time market data, including prices and trading volumes of securities listed on the exchange):

> An exchange is a monopolist of its proprietary market information. Of necessity the available market data sets will vary as between exchanges. As such, information from other exchanges is complementary and cannot substitute for exchange-specific information.[21]

Dr. Erik Sirri, shortly after concluding his service as chief economist of the SEC, articulated the same perspective on the monopolistic nature of depth of book products, and the likely implication of that fact on exchange conduct. Without rendering a judgment as to an ultimate policy prescription, Dr. Sirri observed:

> Until the facts become clearer, all that can be said is that the property rights associated with one of the core functions of an exchange, the production of market data, remain clouded. The salient point is that the pricing and availability

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18 Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing, and Urban Affairs to Accompany S.249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 11-12 (1975).

19 *Weissman v. National Ass'n of Securities Dealers,* 468 F.3d 1306 (11th Cir. 2006).

20 Securities Exchange Act Release No. 42713 (April 24, 2000) (2000 SEC LEXIS 807).

21 *See* the OFT decision dated March 29, 2005 relating to the anticipated acquisition by Deutsche Börse AG of the London Stock Exchange plc, at ¶ 93, available at: http://www.oft.gov.uk/shared_oft/mergers_ea02/2005/deutsche.pdf .

> of such data will have a great deal to say about subsequent market structures. *As a monopolist, the NYSE will charge a price high enough to stifle competition and to under-produce liquidity services.*[22]

Dr. Sirri's observation has, unfortunately, proven prophetic. Each exchange continues to benefit from its unique regulatory status as the exclusive processor and sole source of the data that it compiles from the price information it extracts, under regulatory compulsion, from broker-dealers. Broker-dealers and investors have no other place to go for this sole-source, compiled market data. The NYSE and Nasdaq are the dominant liquidity centers in the United States for equity securities. There is no effective competition possible between the in-depth quote price data controlled by NYSE and the in-depth quote price data controlled by Nasdaq. An investor who wants to understand fully what is happening in the largest liquidity centers for a given security (i.e., transparency) and to make the best investment decision needs speedy access to current quote pricing information at each of these dominant exchanges. Having data from one is not a substitute for having data from the other.[23]

Indeed, if exchanges were not exclusive processors of this data, it is hard to understand why, in the release adopting Regulation NMS, the Commission provided the following explanation of the policy goals of Rule 603:

> The 'fair and reasonable' and 'not unreasonably discriminatory' requirements in adopted Rule 603(a) are derived from the language of Section 11A(c) of the Securities Exchange Act. Under Section 11A(c)(1)(C), the more stringent 'fair and reasonable' requirement is applicable to an 'exclusive processor,' which is defined in Section 3(a)(22)(B) of the Exchange Act as an SRO or other entity that distributes the market information on an exclusive basis.[24]

In instances where regulators have reversed settled decisions and found a previously uncompetitive market to be competitive, what process was engaged in to ensure that competition existed and hence that the public was protected? Let's look at the FCC example misrepresented by

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22 "What glory price? Institutional form and the changing nature of equity trading," Erik R. Sirri (Federal Reserve Bank of Atlanta 2000 Financial Markets Conference on e-Finance, October 15-17, 2000) at p. 29, available at: http://www.frbatlanta.org/filelegacydocs/ACF125A.pdf (emphasis added).

23 The implications of this monopoly downstream, and possible structural remedies are thoroughly explored in a paper submitted by Bloomberg LP and prepared in consultation with Dr. Sirri and Dr. George Hay, Former Director of Economics of the Economic Policy Office of the Antitrust Division of the United States Department of the Department of Justice, entitled *Competition, Transparency, and Equal Access to Financial Market Data* (September 24, 2002). ("This paper demonstrates that exchanges, and the NYSE and Nasdaq in particular, are abusing their government-conferred monopolies over the collection of trading data to restrict competition in the downstream market in which trading data and related products are sold to investors....To prevent the exchanges' abuse of their monopolies over the collection of trading data, we respectfully recommend that any exchange that wishes to compete in the downstream market for financial information be required to do so through a separate corporate entity, much as the SEC required in the Financial Systemware, Inc. ("FSI") exemption...".)

24 Exchange Act Release No. 51808, 70 Fed. Reg. 37496, at 37567 (June 29, 2005).

Nasdaq. The Federal Communications Commission's determination that the interexchange (long distance) telephone service market was competitive occurred at the end of a process that took approximately sixteen years.[25] In 1979, the FCC proposed differing levels of regulation for dominant and non-dominant carriers, the latter being largely deregulated.[26] AT&T was the only long distance carrier placed in the dominant category. In the years following the Bell System divestiture in 1984, the FCC had occasion to consider whether increasing competition enabled it to reclassify AT&T as non-dominant. The assessments of AT&T's market power occurred over eleven years, with determinations that it faced sufficient competition to be regarded as non-dominant occurring market segment-by-segment. In 1991, most of AT&T's services to business customers were designated as non-dominant.[27] In 1995, in separate examinations, the remainders of AT&T's services were categorized as non-dominant.[28] In the process of an assessment covering more than 100 pages in the FCC Record, the FCC indicated that it considered six "primary factors" in gauging whether the level of long distance competition was sufficient to relax regulation:

> (1) demand elasticity; (2) supply elasticity (and in particular the supply capacity of existing competitors); (3) the relationship of AT&T's prices to its price cap; (4) AT&T's market share; (5) relative cost structures of AT&T and its competitors; and (6) AT&T's size and resources.[29]

We note with interest the naming of James Overdahl as SEC Chief Economist and head of the Commission's Office of Economic Analysis. The announcement was accompanied by a statement of renewed commitment to "...ensure that rigorous economic analysis is fully integrated into the Commission's rulemaking and policy process."[30] That rigorous economic analysis will need to be particularly compelling to reach a new conclusion in the market data context in light of Congressional findings, the Commission's own holdings, court rulings and the real-world experience of both traditional and non-traditional market participants.

**Do Investors Need Depth of Book Data?** Nasdaq has argued that investors do not need market data below the top-of-book. Certainly the exchanges have priced their product to reflect that belief, as the annual cost for investors to access relevant data has skyrocketed to over $1,000

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25 *See* Motion of AT&T Corp. to Be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271, 3273-3285 (1995).

26 Competitive Carrier Rulemaking, Notice of Proposed Rulemaking, 77 FCC 2d 308 (1979), First Report & Order, 85 FCC 2d 1 (1980). The deregulation of non-dominant firms occurred gradually, principally in terms of diminishing FCC review of their proposed rates, terms, and conditions.

27 1991 Report on Interexchange Competition, 6 FCC Rcd 5880 (1991).

28 Motion of AT&T Corp. to Be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271 (1995).

29 Id., at 3278.

30 SEC Press Release 2007-150 (July 26, 2007).

annually,[31] despite a statutory structure which is intended to ensure public availability of data. The for-profit exchanges are exploiting decimalization to the detriment of investors. With 100 price points instead of eight, the liquidity at each price point is drastically reduced. An investor who previously could have seen consolidated quote data from the NYSE, Nasdaq and the American Stock Exchange for $36 annually — while getting ECN data for free — now pays over $1,000 to see the 12-1/2 cents of liquidity that used to be available at the top of book.

The Commission's rejection of Nasdaq's proposed "hybrid model" of data dissemination in the context of Regulation NMS is instructive as to the Commission's sense of the importance of this data and the absence of market forces. Nasdaq proposed to deconsolidate all trade reports and all quotations other than the NBBO. Individual SROs would have separately distributed and established fees for that SRO's trade and quotation data. In rejecting this, the Commission stated:

> [C]omprehensive trade and quotation information, even beyond the NBBO, is vital to investors. The Commission remains concerned that an SRO with a significant share of trading in NMS stocks could exercise market power in setting fees for its data. Few investors could afford to do without the best quotations and trades of such an SRO that is dominant in a significant number of stocks.[32]

Nothing has occurred in the last two years to diminish the "vital" nature of this data to investors, just as nothing has occurred that should diminish the Commission's well founded concern that an SRO could "exercise market power in setting fees." We would urge the Commission to consider ways to restore some of the transparency that investors looking at the top-of-the book have lost due to decimalization. Certainly, the Exchange Act does not envision for-profit monopolies exploiting their government granted market power to further diminish the availability of data the Commission rightly has deemed "vital" to investors.

**Do the Same Statutory Terms Mean Different Things Depending Upon Whether Nasdaq is Collecting or Paying Fees?** Nasdaq asserts the "fair and reasonable" standard in Exchange Act Section 11A(c)(1)(C) does not imply a need to relate market data fees to the costs of collecting and disseminating the data:

> Congress did not explicitly define what is a 'fair and reasonable' or 'unreasonably discriminatory' rate, and the Commission should therefore consult the Exchange Act's structure and history, its regulations, and comparable regulatory contexts to give those terms content. Those sources show that the Commission should determine that an exchange's proprietary market-data fee is reasonable so long as the exchange provides a reasoned explanation for imposing the fee and considers

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31 Comment Letter from SIFMA re: In the Matter of NetCoalition, File No. SR-NYSEArca-2006-21 at Appendix A (January 17, 2007).

32 Regulation NMS Release, in text following n.575.

statutorily required factors, such as the promotion of efficiency, competition, and capital formation.

That is of course absurd. "Fair and reasonable" cannot have one meaning when applied to exchange market data fees and an entirely different meaning elsewhere. Commissioner Nazareth, when she was Director of the Division of Market Regulation, provided the following guidance to the Consolidated Tape Association with respect to the fees to be charged to new entrants pursuant to its Plan:

> The Division believes that the process for determining a proper entrance fee should be transparent to ensure fairness to potential new participants and to address potential anti-competitive concerns. New entrant fees should not pose an unnecessary competitive burden or barrier to entry on new entrants. We therefore believe that the Plan should be amended to include solely objective standards for determining new entrant fees. In particular, the Plan should delineate the method for determining (1) the specific costs current Plan participants have incurred in the development, expansion, and maintenance of CTA-related facilities and/or systems, (2) the portion of those costs participants can legitimately recoup from a new entrant, and (3) the costs incurred or to be incurred for modifying systems to accommodate the new participant (which are not otherwise required to be paid or reimbursed by the new participant). The Plan should not otherwise include any subjective criteria, or objective factors designed to compensate for the costs of operating the systems prior to the time the new participant joins the Plan, or for 'goodwill' or any future benefits to the new entrant.[33]

As the August 1, 2007 SIFMA letter points out, in a later action, an exchange challenged the CTA's fees for not having sufficient cost justification. Which exchange was that? Nasdaq itself. The Commission concluded that the entry fees should be "fair and reasonable" and that a rigorous cost-based analysis was therefore required. On March 17, 2005, the Commission, by delegated authority, approved the Entry Fee Amendments, which were incorporated into the CTA Plan as Section III(c). In its adopting release, the Commission stated that "the main purpose of a participation fee is to require each new party to the [CTA and CQ] Plans to pay a fair share of the costs previously paid by the CTA for the development, expansion, and maintenance of CTA's facilities." It stated further that the CTA and CQ Plan participants "should only consider the costs of tangible assets that could have been treated as capital expenditures under GAAP in the fee calculation, and if so treated, would have been amortized for a five-year period preceding the new party's admission to the Plans."

The Commission cautioned, however, that participants "must not consider any historical costs of operating the systems prior to the time a new party joins the Plans, or any subjective or intangible costs such as 'good will' or any future benefits to the new party." The Commission concluded that "the proposed new standards, if appropriately employed by the [p]articipants, should foster a fair and

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33 Letter dated August 3, 2004 from Annette Nazareth to Thomas E. Haley, Chairman, CTA.

reasonable method for determining the amount of a new [p]articipant's entrance fee to be paid to the Plans."[34]

In that regard, the Commission noted with apparent disapproval that the CTA had not presented work papers to support its calculations of cost.[35] The Commission concluded that it had insufficient cost data to properly assess whether CTA's fees were "fair and reasonable" and it referred the matter to an administrative law judge to preside over the proceeding.[36]

In contrast, 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 proposes a fee, but be quantifiable, knowable, and required when Nasdaq is paying a fee?

Now, in the case of the market data fees, where the "fair and reasonable" standard is once again relevant, it appears that NYSEArca also did not present any work papers to support its calculations. In fact, it did not present any calculations at all or even any cost data on which such calculations might be made.

The term "fair" and "reasonable" cannot mean in one fee context that costs are highly relevant, but mean something quite different in another fee context. As the Court of Appeals in *Goldstein v. Securities and Exchange Commission* stated:

> 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).
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> 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.[37]

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34 Securities Exchange Act Release No. 55909 (June 14, 2007) in text at nn. 17-20 [emphasis in original deleted; footnotes omitted].

35 *Id.* in text following n. 22.

36 *Id.* in text at n. 35.

37 451 F.3d 873, 882 (D.C. Cir. 2006).

In short, the Commission cannot have the same terms mean one thing when Nasdaq is paying a fee and something all together different when the fee is being charged by Nasdaq.

**Deference.** Nasdaq asserts that the Commission should show "deference" to the exchange on the matter of fees. SIFMA does an excellent job of underscoring that the statute expressly rejects this peculiar notion of deference.[38] The Congress rejected this notion of deference even at a time when the public enjoyed a measure of protection from exchange abuse by virtue of the not-for-profit status of exchanges and the restraint imposed on exchanges by their broker-dealer members.[39] Indeed, for years the exchanges argued — consistent with the statute — that the "real issue" was "the apportionment of costs of generating market data among broker-dealers and investors" and that protection from abuse was to be found "in the fact that those who approve the Exchange's budget and market data (and other) fees are the ones who pay."[40] Obviously, the end of those protections argues for greater Commission scrutiny, not less.

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38 SIFMA Letter at 2.

39 The Congress envisioned a system of regulation "largely performed" by self-regulatory organizations — "representative organizations of investment bankers, dealers, and brokers" — with the SEC "exercising appropriate supervision in the public interest." *See Regulation of Over-the-Counter Markets,* Report of the Senate Comm. on Banking and Currency to Accompany S. 3255, S. Rep. 75-1455, 75th Cong., 3d Sess. 4 (1938). In fact, in commenting on the Commission's proposed Regulation SRO, The Bond Market Association stated that the Commission's repeated efforts to diminish member control of exchanges are inconsistent with the Exchange Act and would not survive challenge in court:

> With these proposals, the SEC has turned the requirement that an SRO 'assure a fair representation of its members in the selection of its directors and administration of its affairs' on its head. This provision was intended to protect broker-dealers' ability to participate in the self-regulatory process. Congress specifically sought to assure that members have "reasonable representation in all phases of [the SRO's] operations.' Its intent was certainly not the opposite — to abdicate control of the self-regulatory process to independent members of the public. In this regard, Congress specifically rejected a provision that would have required greater participation of the public in the self-regulatory process. Therefore, we cannot agree with the SEC that its interpretation of the fair representation requirement appropriately comports with the intended definition of the phrase. Indeed, we believe the SEC's proposal exceeds its statutory authority and would not survive a challenge in court.

Letter to the Commission from The Bond Market Association (March 8, 2005) in File No. S7-40-04 [footnotes omitted], available at: http://www.sec.gov/rules/concept/s74004/mgross030805.pdf; *see also* letter to the Commission from Securities Industry Association and The Bond Market Association (February 2, 2006) in File No. SR-NYSE-2005-77, available at http://www.sec.gov/rules/sro/nyse/nyse200577/melackritz020206.pdf (similar points about Commission's approach to governance of exchanges in letter concerning NYSE business combination with Arca Exchange).

40 *Market Data: Implications to Investors and Market Transparency of Granting Ownership Rights over Stock Quotes: Hearing before the House Subcommittee on Capital Markets and Government Sponsored Enterprises of the House Committee on Financial Services,* 107th Cong. (2001) (statement of Richard P. Bernard, Vice President and General Counsel, NYSE).

This anti-competitive call for "deference" manifests itself in many ways. As discussed in the NetCoalition Petition and in numerous submissions by other concerned parties, it manifests itself in the Nasdaq Compliance Packages, where Nasdaq overturned an SEC holding by simply deeming the controversy "non-controversial" and hence circumventing public comment by making significant rules "effective upon filing."[41]

It also manifests itself in Nasdaq's call for a not clearly defined "streamlining" of rules.[42] We believe the Commission has already articulated a policy that would address this "streamlining" and "deference" issues in a way that protects the public interest. As mentioned before, that policy is to separate monopoly functions from competitive functions, as the Commission did in the matter of Nasdaq's FSI exemption.[43] Specifically, when Nasdaq purchased an order-management system, the Commission was concerned that Nasdaq could use its market data control to leverage competitive acceptance of the order-management system. The SEC addressed this conflict by imposing a structural separation. The FSI exemption order underscores that, when an exchange competes in the market for financial information by selling trading data (or products based on those data) that can be obtained only from that exchange, the exchange must do so through an entity that is separate from the exchange. The separation must be implemented through an independent and separately capitalized corporate structure with strict firewalls providing for independent operation and an arm's length relationship with the exchange.

Separation exemplified by the FSI exemption would allow a massive streamlining of rules governing competitive functions. Otherwise, increased ongoing supervision will be necessary to ensure that "streamlining" doesn't simply facilitate abuse by these now for-profit monopolies.

**Last Sale.** We continue to hear that some kind of last sale proposal will be included in a recommendation from the Division of Market Regulation. As NetCoalition observed in January, upon reviewing the NYSE last sale proposal, "the proposed rule, however, does not lessen the need to

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41 *See* letters of Bloomberg L.P. and the Securities Traders Association to the Commission dated November 17, 2005 (File No. 10-131) commenting on Securities Exchange Act Release No. 52559 (October 4, 2005), "The Nasdaq Stock Market Inc., Notice of Filing of Amendments Nos. 4 and 5 to its Application for Registration as a National Securities Exchange under Section 6 of the Securities Exchange Act of 1934 as amended"; letters of NetCoalition dated August 9, 2006, Bloomberg L.P. dated July 14 and August 22, 2006 and SIA dated July 14, 2006 to the Commission re: File No. SR-NASD-2006-056; SEC Release No. 34-54003 (June 16,2006) (the Nasdaq Analytics Data Package) and File No. SR-NASD-2006-072: SEC Release No. 34-54002 (June 16, 2006) (the Trading and Compliance Data Package); NetCoalition, Petition for Review (November 4, 2006) in File No. SR-NYSEArca 2006-21; letters of NetCoalition dated January 17, 2007, Bloomberg L.P. dated January 17, 2007, SIFMA dated January 17, 2007, U.S. Chamber of Commerce dated May 3, 2007, all in File No. SR-NYSEArca 2006-21.

42 *See*, "A Global View: Examining Cross Border Exchange Mergers," Testimony of Adena Friedman, Executive Vice President, Global Strategy and Data Products, The NASDAQ Stock Market, Inc., before the Subcomm. on Securities, Senate Comm. on Banking, Housing and Urban Affairs (July 12, 2007, available at: http://banking.senate.gov/_files/friedman.pdf.

43 Securities Exchange Act Release No. 42713 (April 24, 2000) (2000 SEC LEXIS 807).

address the critical, underlying issues regarding the cost and availability of monopoly market data that are the subjects of the NetCoalition petition. While the discussions that led to this proposal are a positive development, it does not lessen the need to address the critical underlying issues regarding the cost and availability of monopoly market data."[44]

Our conviction and concerns in this regard have only grown since filing the Petition. The point and purpose of the 1975 Act was to spur public access to the "oxygen" of the market. A deal which provides last sale information to the public while empowering for-profit exchanges to withhold information that the Commission itself has deemed to be "vital" to investors would disadvantage the consumers served by NetCoalition's members while undermining both the statute and the promise of the Internet. Indeed, as NetCoalition has indicated in previous communications, the Commission should use recent advances in technology to work toward eliminating the dichotomy between information available to investors on Wall Street and information available to investors on Main Street. Contrary to the exchanges' unsupported assertions, there are no "market forces" at play here.[45]

**Conclusion.** The current record in this proceeding does not support the staff's action by delegated authority. If the Commission were to affirm the staff's approval of the instant NYSEArca rules, the Commission's action would be reversible as a matter of law. Likewise, a resolution liberating the exchanges from the requirements of the Exchange Act would also be reversible as a matter of law.

Respectfully submitted,

Markham C. Erickson
Executive Director and General Counsel

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44 NetCoalition Letter of January 17, 2007, In the Matter of NetCoalition, File No. SR-NYSEArca-2006-21.

45 "We suppose market forces, like beauty, are in the eye of the beholder. Prior to filing the Petition, NetCoalition's members were being given an ultimatum by a government-sponsored monopoly. After filing the petition — and demonstrating the potential of exercising our legal rights to hold the exchanges to the standards in the statute — we have seen modest progress. A fair conclusion to draw from this experience is that monopolies need rigorous oversight and supervision. We see no evidence of market forces." NetCoalition letter of March 6, 2007.