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Bloomberg L.P. 731 Lexington Avenue Tel +1 212 318-2000
New York, NY 10022 Fax +1 917 369 5000
bloomberg.com

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

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Attention: Ms. Nancy M. Morris, Secretary

Re: In the Matter of NetCoalition etc., Order Granting Petition for Review of File No. SR-NYSEArca-2006-21

Ladies and Gentlemen:

We appreciate the opportunity to respond to the Commission's invitation in its order granting the petition of NetCoalition.com ("NetCoalition") for review of the action of the Division of Market Regulation in approving by delegated authority File No. SR-NYSEArca-2006-21,[1] a rule change proposed by NYSEArca, Inc. ("NYSEArca") to establish fees for the receipt and use of certain market data that Arca formerly made available free of charge.

Bloomberg congratulates the Commission on its order granting NetCoalition's Rule 431 petition.[2] It is our understanding that such an order is extraordinarily unusual, if not without precedent. That underscores the Commission's accurate assessment of the far-reaching and important foundational issues raised by this petition.

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1 Securities Exchange Act Release No. 55011 (December 27, 2006), available at: http://www.sec.gov/rules/other/2006/34-55011.pdf. The Commission published NYSEArca's proposal for comment in Securities Exchange Act Release No. 53952 (June 7, 2006); File No. SR-NYSEArca-2006-21; 71 FR 33496 (June 9, 2006). The Division of Market Regulation published its approval order in Securities Exchange Act Release No. 54597 (October 12, 2006); 71 FR 62029 (October 20, 2006). NetCoalition's petition ("the "Petition") was published in Securities Exchange Act Release No. 54597 (October 12, 2006), File No. SR-NYSEArca 2006-21, available at http://www.sec.gov/rules/other/2006/34-55011.pdf.

2 In its letter to Chairman Cox of November 8, 2006, NYSEArca argued that NetCoalition lacked standing to seek Commission review under Rule 430 of the SEC Rules of Practice. We note that NYSEArca's arguments on standing go against the weight of precedent and the Commission's rejection of that argument was appropriate. See, e.g., *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 207 (1984); *Investment Company Institute. v. Camp, Comptroller of the Currency*, 401 U.S. 617; *Chamber of Commerce of the United States v. Securities and Exchange Comm'n*, 443 F.3d 890 (D.C. Cir 2006); *Consumer Federation of America v. FCC*, 348 F.3d 1009, 1011-12 (D.C. Cir. 2003); *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir 1990).

Cost justification for fees. NYSEArca's proposed rule change, the specific matter before the Commission, raises the same issues as market-data fee proposals recently filed with the Commission by the New York Stock Exchange, Nasdaq and the American Stock Exchange. Referring to the NYSEArca filing, NetCoalition correctly states that "[t]he cumulative impact of this and other pending and recently approved market data proposals threaten to place this critical data, which should be readily available to the general public, altogether beyond the reach of the average retail investor."

Having submitted comments to the Commission on a number of these related filings,[3] we think that NetCoalition places the NYSEArca filing in the proper context for the Commission to consider its broader policy implications, among them the role of cost-based analysis and the "fair and reasonable" standard. We note with interest press reports of a potential market data pilot which the NYSE may submit to the Commission.[4] While we look forward to analyzing this proposal, the fruits of that particular negotiation can not address the underlying structural issues raised by the petition nor obviate the need for Commission engagement.

With regard to the role of cost-based analysis, the Commission offered a comprehensive consideration of the matter in Securities Exchange Act Release No. 42208 (December 14, 1999) (the "Market Data Concept Release")[5] and has provided further reflections on this important issue in the Concept Release Concerning Self Regulation, Securities Exchange Act Release No. 50700 (November 18, 2004).[6] The Commission's position in the Market Data Concept Release underscores the fundamental role a rigorous cost-based analysis must play in justifying market data fee filings:

> 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 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. The Commission therefore believes that the total amount of

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3 Letters of Bloomberg L.P. to the Commission dated July 14 and August 22, 2006 (File Nos. SR-NASD-2006-056 and SR-NASD-2006-072) re: Nasdaq's Market Analytics Proposal and its Trade Compliance Data Package; and letter of Bloomberg L.P. 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."

4 "NYSE Test May Give Investors Real-Time Quotes via the Web," *The Wall Street Journal*, January 12, 2007, page C3.

5 Available at http://www.sec.gov/rules/concept/34-42208.htm.

6 Available at http://www.sec.gov/rules/concept/34-50700.htm.

> market information revenues should remain reasonably related to the cost of market information. . . .[7]

And yet, despite the legislative record and the Commission's clear statement of the importance of a cost-based analysis, NYSEArca — and the SROs filing market data fee rules — have not provided even the most rudimentary cost-based analysis. In addition, NetCoalition identifies an even more fundamental infirmity in the instant NYSEArca filing, its failure to observe the disclosure requirements in the Commission's own Form 19b-4. NYSEArca does not provide disclosure regarding either burdens on competition that may result from its proposed fees or a justification for the proposed fees as required for Rule 19b-4 filings.

Specifically, with respect to burdens of competition, NetCoalition observes:

> NYSEArca fails to provide any discussion or any demonstration at all that its does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. This lack of substantiation does not satisfy the requirements of the Commission's Form 19b-4 that such burdens be explained and justified in detail [citation omitted].[8]

With respect to justification of fees, NetCoalition notes:

> There is no information provided to help guide the Commission in determining whether the fees bear any relationship to costs, or whether the fees represent an equitable allocation of the costs associated with using exchange facilities. . . . Without this information, the staff and the Commission lack a legally sufficient foundation to approve the proposed fee.[9]

The idea advanced by NYSEArca in its letter to Chairman Cox of November 8, 2006 that these issues have already been decided by the staff and therefore should not be revisited by the Commission would stand the Rule 430/431 procedure on its head. Those rules contemplate that the Commission can revisit and, if appropriate, reverse a prior staff position. We agree with NetCoalition and the Commission that this is such a case.

Downstream abuses of monopoly power. The instant proceeding provides the Commission with the opportunity to reaffirm the necessity of a serious review of burdens on competition, as well as the necessity of a cost-based analysis in the review and approval of SRO market-data fee proposals. In addition to criticizing excessive fees, the NetCoalition petition

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[7] Market Data Concept Release in text accompanying n. 119 [footnote omitted].

[8] Petition at 6-7.

[9] Petition at 8-9.

also highlights possible "downstream" abuse by for-profit exchanges of their government sponsored monopoly power over market data. The Petition observes:

> We would suspect instead that there would be a net diminution of innovation as the NYSE and Nasdaq attempt to leverage their monopolies over regulatory and sole-source data downstream into the value added market or simply use their government-sponsored monopoly to cross-subsidize ventures in historically competitive markets…The Commission might best spur innovation and the exploitation of market forces by exploring the separation of monopoly functions from competitive functions. In fact this is exactly what the Commission wisely did in its decision in the matter of Nasdaq's FSI exemption.[10]

As referenced in the NetCoalition petition, the FSI exemption provides a model and a set of principles that advance the fundamental goals of the Exchange Act in a manner that is essential in an era of for-profit exchanges. Specifically, where an exchange competes in the market for financial information by selling trading data (or products based on that 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 independently capitalized corporate structure with strict protections providing for independent operation and an arm's-length relationship with the exchange. The affiliated entity must have access to data and information on the same terms as its competitors.[11]

Commercial use of regulatory data. The concern about leveraging monopoly power is not hypothetical. As the NetCoalition Petition discuses, the Commission has permitted to go effective two Nasdaq proposed rule changes which pose precisely this challenge:

> Other proposals — the Nasdaq Analytics Package and the Nasdaq Trading and Compliance Data Package — would leverage exchange monopolies over regulatory and other sole source data downstream in an effort to gain an anti-competitive advantage in the value-added data market. Both efforts run afoul of not only the Exchange Act, but also the congressional rejection of a proposed new property right in facts.[12]

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[10] Petition at 14.

[11] *See* Securities Exchange Act Release Nos. 44201 (April 18, 2001) and-42713 (April 24, 2000) (conditional exemption granted to NASD and Nasdaq to operate a software development company, Financial Systemware, Inc. ("FSI"), to market certain financial services software) (the "FSI Exemption").

[12] Petition at 19, 20. *Compare* Securities Exchange Act Release No. 53128 (January 13, 2006) in text following n. 136 (approval of Nasdaq exchange registration), available at http://www.sec.gov/litigation/opinions/34-53128.pdf, *with* Securities Exchange Act Release No. 54003 (June 16, 2006), File No. SR-NASD-2006-56 (Nasdaq analytics package), available at http://www.sec.gov/rules/sro/nasd/2006/34-54003.pdf. *See* Securities Exchange Act Release No. 54002

(Footnote continued)

Indeed, the Commission articulated a practical application of the policy considerations underlying the FSI Exemption in precisely this context in its January 13, 2006 order approving Nasdaq's exchange application (the "Nasdaq Exchange Approval Order").[13] The Commission then clearly articulated the terms under which the NASD might make OATS data available:

> The Commission shares commenters' concerns about the use by the Nasdaq Exchange of OATS information for non-regulatory purposes, particularly since it includes information about members' trading activities on competitors of the Exchange. The Nasdaq Exchange's OATS rules would require Exchange members to report, on a daily basis, extensive information with respect to the handling of orders for Nasdaq securities, including when all or portions of orders are executed on markets other than the Nasdaq Exchange. A member's failure to provide this information could give rise to disciplinary action by the Exchange pursuant to its authority as a self-regulatory organization under the Exchange Act. Because this information is obtained from members through the exercise of the Exchange's regulatory powers, the Commission does not believe it should be used for non-regulatory purposes, *unless the NASD makes available such OATS data to other market participants on the same terms as it is provided to the Exchange* [emphasis added].[14]

The Commission reported commenters' concerns regarding use of OATS data by the Nasdaq exchange and defined clear and unambiguous boundaries to what it would constitute commercial use of OATS data:

> Nasdaq responded to commenters' concerns [that Nasdaq should not be permitted to use OATS data for non-regulatory purposes] by reaffirming its commitment not to use OATS data for commercial purposes. Nasdaq, however, believes that its use of OATS data by Nasdaq's Department of Economic Research to study public policy issues, such as subpenny trading and decimalization, does not constitute commercial use of the data. The Commission believes that any non-regulatory use of the data would have a commercial benefit.[15]

(Continued footnote)

(June 16, 2006), File No SR-NASD-2006-72, available at http://www.sec.gov/rules/sro/nasd/2006/34-54002.pdf.

13 Securities Exchange Act Release No. 53128 (January 13, 2006).

14 *Id.* in text following n. 136.

15 *Id.* at n. 136.

We applaud the Commission for its understanding that this sole source data must be made available to all market participants on equal conditions, and for its consideration of the concerns raised by market participants. As noted above, however, notwithstanding the Commission's unequivocal stance in the Nasdaq Exchange Approval Order, Nasdaq filed with the Commission within a very few months thereafter a proposed fee increase for anticipated enhancements to its Compliance Data package, a product that includes OATS data as well as a proposed analytics package that includes share data not visible in its existing quote and order data feeds or in its quote montage (Nasdaq Market Analytics Package). Nasdaq filed both proposals for immediate effectiveness under Section 19(b)(3)(A)(iii) of the Exchange Act and Rule 19b-4(f)(6) thereunder, characterizing its Compliance Package as establishing a change in a fee and its Market Analytics Package as a "non-controversial" rule change.

Nasdaq's filings, both in the failure to strip out OATS data from the Compliance Package and in the inclusion of regulatory data in the Market Analytics Package, contravened the express terms of the Approval Order. For that reason alone the filings should have been rejected and not published. The comments submitted by SIFMA, NetCoalition and Bloomberg identified fundamental policy issues raised by both Nasdaq filings. Yet, despite the infirmities of the filings and the important issues they raised, the 60-day period for Commission summary abrogation was allowed to lapse and Nasdaq was allowed both to flout the Commission's express policy in the Nasdaq Exchange Approval Order and to subvert the public procedure Section 19(b) requires.[16]

What to do now? The NetCoalition petition affords the Commission a new opportunity to scrutinize these filings and to consider and clearly articulate the principles that should guide their review. We respectfully suggest that the SROs should forbear filing any further market data proposals until the Commission has articulated standards for review, and that the Commission fashion a process to reconsider under its new standards prior exchange filings pertaining to market data, including those already approved or that became immediately effective upon filing.[17] The Commission also should inform the SROs that they will not be permitted to

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[16] This may suggest that the Commission should revisit its decision to add paragraph (f)(6) to Rule 19b-4 and thereby to trust the SROs to correctly identify rule proposals that do not "significantly affect the protection of investors or the public interest." Exchange Act Section 19(b)(3) authorizes the SROs to file for immediate effectiveness interpretive rules, fee rules, housekeeping rules and other rules the Commission designates as being consistent with Section 19(b). The Commission's addition of paragraph (f)(6) was designed to be read in light of its limited purpose, to allow SRO rules to go effective upon filing if they did not raise significant policy concerns. It was by no means intended to encourage the abuses it apparently has engendered.

[17] We find more than a little disturbing the apparent closeness of Nasdaq and the NASD when it comes to data sharing and what might be called "logrolling". The NASD is sharing with Nasdaq, apparently on an exclusive basis, regulatory data available to the NASD as a regulator and Nasdaq is using that data to put together products that are to be sold to the NASD members regulated by the NASD. Not only is there an element of implied coercion there, but there also is a noticeable degree of implied partnership that casts

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enforce market data fee rules currently in effect unless they have been refiled with proper cost justifications.

There is indeed a pressing need for the Commission to comprehensively review its principles and procedures regarding SRO rulemaking. The Commission should ask for public comment on how the exchanges should be able to use the data from their markets to develop and sell market analytics and other value-added products in ways that would add value to the markets without exploiting their advantages as monopolies and as regulators. That is a particularly complex problem given the implicit message that using a regulator's product may lessen the risk of problems in inspections and possible enforcement activity down the road. The public interest would not be served by allowing exchanges to leverage their government-sponsored monopolies into competitive adjacent markets. The release should specifically ask in each case whether the exchange's proposed product or service provides for fair competition and is consistent with the protection of investors and the public interest.[18]

Conclusion

In light of the increasing commercial activities of for-profit exchanges, as demonstrated by the NYSEArca filing, Bloomberg respectfully recommends that the Commission take the following actions:

1. **Set aside the Staff's approval of the NYSEArca rule change**. We submit that, by applying to the NYSEArca proposal the proper standards already articulated by the Commission, there is not an adequate basis for the Commission to find that the proposal is consistent with the requirements of the Exchange Act, or that it promotes competition. Accordingly, unless NYSEArca withdraws the rule proposal, the Commission must institute proceedings pursuant to Section 19(b)(2)(B) to determine if the rule change should be disapproved.

2. **Adopt a policy to reject (and direct the staff to reject) any proposed rule change, including fee filings pursuant to Section 19(b)(3)(A) or Rule 19b-4(f)(2) thereunder, as not properly filed under Rule 19b-4 if the proposed rule filing raises substantive issues and does not contain full cost justifications and a thorough discussion of the burdens on competition that will result if the rule change is implemented**. The

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(Continued footnote)

doubt on the effectiveness of the Nasdaq/NASD separation. The NASD filed some papers in Delaware attesting to the separation, but it seems little has changed in fact.

[18] Nasdaq has extended to listed companies as well its efforts to coerce those it regulates to buy its products. *See* Securities Exchange Act Release No. 54752 (Nov. 14, 2006) and comment letter from Marc R. Paul and Margaret R. Blake of Baker & McKenzie on behalf of PR Newswire (December 11, 2006), available at http://www.sec.gov/comments/sr-nasdaq-2006-040/nasdaq2006040-100.pdf.

Commission should achieve the suspension of those products already approved that do not comply with this standard.

3. **Comprehensively review its principles and procedures for reviewing SRO rule filings, with a special focus on market data fee-related filings**. This review should include an assessment of existing SRO fees for market data and related products.[19]

Respectfully submitted,

Sanjiv Gupta by R.D.B

cc: The Hon. Christopher Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Roel C. Campos, Commissioner
The Hon. Annette L. Nazareth, Commissioner
The Hon. Kathlene L. Casey, Commissioner
Dr. Erik R. Sirri, Director
Division of Market Regulation
Robert L. D. Colby, Esq., Deputy Director,
Division of Market Regulation
David Shillman, Associate Director
Division of Market Regulation
Mr. Stephen L. Williams, Economist,
Division of Market Regulation
Dr. Chester Spatt, Chief Economist
Brian G. Cartwright, Esq., General Counsel

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[19] We endorse SIFMA's recommendations in its letter dated January 17, 2007.