SENT VIA ELETRONIC AND OVERNIGHT MAIL

June 3, 2009

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File Nos. SR-NASDAQ-2009-043 & SR-BATS-2009-014

Dear Ms. Murphy:

Direct Edge ECN LLC ("Direct Edge")[1] welcomes the opportunity to submit its thoughts to the Securities and Exchange Commission ("Commission") on the above-referenced rule filings of the NASDAQ Stock Market LLC ("NASDAQ") and BATS Exchange ("BATS") to provide for an optional display period for marketable orders prior to the routing, cancellation, or posting of said orders. While there are fundamental technical and commercial differences in the products to be rolled out by NASDAQ and BATS under these filings, similar rules underpin the operation of Direct Edge's Enhanced Liquidity Provider ("ELP") program.

In particular, Direct Edge seeks to respond to the comments proffered by NYSE Euronext (the "NYSE") "to review not just the proposed NASDAQ and BATS functionality, but similar functionality used by [Direct Edge] that provide non-public order information to a select class of market participants at the expense of a free and open market system" and to, pending such review, abrogate the NASDAQ and reject the BATS filings respectively as "not non-controversial."[2]

[1] Direct Edge is a subsidiary of Direct Edge Holdings LLC, and an affiliate of EDGX Exchange, Inc. and EDGA Exchange, Inc., two entities that have filed applications with the Commission to become registered national securities exchanges pursuant to Section 6 of the Securities and Exchange Act of 1934.
[2] Letter from Janet M. Kissane, Senior Vice President, Legal & Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated May 28, 2009 ("NYSE Letter") at 1.

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Introduction

Liquidity-aggregation products like Direct Edge's ELP program seek to bring together traditional and non-traditional liquidity in a consolidated, easy-to-access manner designed to maximize the potential for execution, reduce implicit and explicit transaction costs, and otherwise improve execution quality for our customers. "Dark pools" and other sources of off-exchange liquidity have long existed, but now can be integrated into the displayed market through products such as these. This empowers customers, giving them the option to interact with these sources of liquidity on their own terms while having the ultimate certainty of an exchange execution. Direct Edge believes such products serve the Congressional mandate to assure economically efficient execution of securities transactions, fair competition between exchange markets and markets other than exchange markets; to remove impediments; and to perfect the mechanism of a free and open market.

Direct Edge believes the NYSE's comments are factually inaccurate, are logically inconsistent, and contradict their own market structures, prior policy statements, and marketing materials. At their root the NYSE's comments appear to be in fact a criticism of the practice of internalization generally, given that many of its arguments strike against a market structure where any transaction is executed away from exchange facilities. While Direct Edge would always welcome dialogue between the Commission and market participants regarding emerging market structure trends, the Commission should be wary of this review request based on such a foundation.

In response to the NYSE's call for immediate Commission action to abrogate the NASDAQ and BATS rule filings, Direct Edge respectfully submits that the NYSE's comments should be viewed in the context of the competition it is engaged in with Direct Edge, NASDAQ and BATS for market share and customer order flow. Moreover, the NYSE's ability to deem the rule filings as "not non-controversial" has been comprised by its repeated efforts in several media and other venues to manufacture controversy over said filings and related liquidity-aggregation products offered by Direct Edge and others. These rule filings seek to replicate products currently in use by other exchanges and are not controversial. Direct Edge believes it would set a harmful precedent if an exchange that fomented controversy about the rule filings of a competitor were allowed to benefit from such efforts by a Commission finding that such a filing was "not non-controversial."

The NYSE's policy arguments are based either on factual inaccuracies or distortions of Regulation NMS and are inconsistent with current NYSE practices and previous statements.

The NYSE makes a variety of arguments and allegations in its attempt to cast the NASDAQ and BATS programs, and by proxy Direct Edge's ELP program, in a negative regulatory light. Direct Edge offers its summary responses to each of the principal arguments, in the order put forth in the NYSE Letter:

> The NYSE claims such products "circumvent the original purpose of Regulation NMS, which.... seeks to reinforce 'the fundamental principle of obtaining the best price when such price is represented by automated quotations that are **immediately accessible.**'"[3]

This is a misstatement of the emphasis of the Order Protection Rule of Regulation NMS, which was an "emphasis on the principle of best price" and on "strengthened assurance that orders will be filled at the best prices,"[4] rather than the assurance of execution priority for any one particular displayed limit order. The Commission was focused on price priority only, not time or any other form of customer priority. The prohibition on "trade through" was never meant to prohibit a "trade at." While ensuring that limit orders are executed before other trades occur at inferior prices was deemed essential to "give investors, particularly retail investors, greater confidence" and "promote deep and stable markets,"[5] it was never intended to restrict the liberty of a trading center to internally execute or otherwise handle a customer order at the price of an accessible quotation displayed elsewhere. To accept the NYSE's argument would call into question any internalization or other order-handling practice that did not immediately result in the routing of a customer order to execute against contra-side marketable orders displayed on away exchanges. The Commission itself put it best:

> "Price priority alone, however, would not cause nearly as significant an impact on competition among markets [as would strict price/time priority] because **it allows price-matching by competing markets**.... [P]rice priority... merely requires the routing of... orders that would otherwise be executed at inferior prices."[6]

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[3] NYSE Letter, *supra* n.2, at 3 (emphasis added by the NYSE). *See also* id. at 4 (stating the concern that "Displayed limit orders at the NBBO in other market centers may not receive an execution because the willing contra-side interest in NASDAQ or BATS is being held for the benefit of those market centers. Therefore, displayed limit orders on other markets may be disadvantaged, which defeats the purpose of Reg. NMS.").

[4] SEC Release No. 51808, 70 FR 37496 (June 29, 2005), at 11 (Final Reg NMS Adopting Release) (emphasis added).

[5] *Id.*

[6] *Id.*, at 131 (emphasis added).

The NYSE's "NYSE Classic" market does not adhere to a universal principle of absolute execution priority for the best-priced displayed limit order, even on its own order book, as such "setting interest" orders that establish the best price on the exchange only receive guaranteed priority against the first 15% of inbound contra-side marketable orders, allowing Designated Market Makers and Floor Brokers to trade at parity with said orders.[7] Direct Edge finds no regulatory fault with the market model of NYSE Classic, as differences in execution priority or other distinctions among exchange participants could potentially serve valid member and investor interests. Direct Edge makes the point only to highlight that the NYSE does not give universal preference to the limit order that sets the best price on its own market. Accordingly, concerns regarding the products offered by other exchanges or market centers that do not give NYSE limit orders such preference seem disingenuous.

> The NYSE claims these products "provide a closed circuit of participants with an electronic advance 'look' at the order."[8]

The data dissemination of pre-routing display products offered by Direct Edge, NASDAQ and BATS may differ in their technical implementation, but they all have one thing in common – **the data is available to every member**. This is in compliance with the "fair access" and non-discrimination requirements all exchanges and other trading centers abide by under Reg NMS and a panoply of other securities regulations. NYSE-operated broker-dealers are members of Direct Edge and recipients of our general depth-of-book data feed and would likewise be able to subscribe to the data feed that facilitates our ELP program participation, should they choose to do so. NASDAQ and BATS also broadly distribute their proprietary data feeds to any recipient who wishes to receive the data. Direct Edge and BATS provide these data feeds without charge to recipients, further promoting wide access. NYSE claims that Direct Edge "holds orders within a limited Direct Edge community"[9] or that NASDAQ or BATS would make information accessible to only "selected groups of participants"[10] are false.

By contrast, the NYSE openly promotes its selective access to third-party order data as part of its own routing products. In March 2008, NYSE Arca issued a client notice promoting its ability to provide routing based on indications of interest (IOIs) from third parties, and touted its "extraordinary access to liquidity with 29 confirmed participants," and "access to 3½ times the number of routing destinations than the nearest competitor's offering."[11] Query why distribution of actionable order messages by exchanges to all its subscribers is problematic, while NYSE Arca's receipt of similar messages from third parties is worthy of promotion.

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[7] *See generally* New York Stock Exchange Rule 104T.
[8] NYSE Letter, *supra* n.2, at 3.
[9] Id., at 5.
[10] Id., at 3.
[11] *See* NYSE Arca to Provide Indication of Interest (IOI) Routing, March 12, 2008, *available at* http://www.nyse.com/pdfs/IOI_Routing.pdf. ("NYSE Arca IOI Routing Announcement").

The NYSE asserts that "in the case of a limit order routed to a market center, if such order is marketable when entered it should be executed, even if that means routing all or a portion of the order" to avoid missing potential executions[12]

This argument ignores the execution preferences of market participants and many existing exchange products that cater to these needs. Rather than indiscriminately routing a marketable limit order to away markets, a market participant may instead prefer another permissible option, including without limitation: (i) cancellation; (ii) price adjustment and display; (iii) conversion of the order into a non-displayed order and placement on the exchange order book; and (iv) selective routing to away markets chosen by the customer through use of a defined order type. NYSE-operated markets offer all these alternatives in some way shape or form. Take, for example, the "Post No Preference Blind" ("PNP B") order type available on NYSE Arca:

> "The PNP B order is an **undisplayed limit order priced at or through the Protected Best Bid and Offer (PBBO)**, with a tradable price set at the contra side of the PBBO. **When the PBBO moves away from the price of the PNP B and the prices continue to overlap, the limit price of the PNP B will remain undisplayed and its tradable price will be adjusted to the contra side of the PBBO.** When the PBBO moves away from the price of the PNP B and the prices no longer overlap, the PNP B shall convert to a displayed PNP limit order."[13]

Again, this is not to find fault with this particular order type, as it is a response to customer needs to balance a variety of execution-quality and business objectives in managing their order flow. It is merely meant to illustrate that requiring exchanges to immediately route marketable limit orders to away exchanges on order receipt is not currently prevalent market structure policy or the practice of the NYSE.

While it is true that customers could miss an execution by using order types that do not call for indiscriminate routing, Direct Edge that believes that our customers, not ourselves or anyone else, are best equipped to choose among the various available order types we offer and the benefits and risks associated therewith. That the NYSE alludes to the need for customer education or other risk disclosure to customers using these products is quite condescending,[14] and raises the question whether the disparate execution priority and fee structures of the "NYSE Classic" market model warrants similar disclosures beyond the detailed descriptions of functionality and order types offered by all exchanges.

[12] NYSE Letter, *supra* n.2, at 4.
[13] *See* http://www.nyse.com/equities/nysearcaequities/1157018931913.html (emphasis added).
[14] NYSE Letter, *supra* n.2, at 4.

The NYSE suggests that "reducing publicly available liquidity in this way may impact bid-offer spreads and the execution costs to customers."[15]

This line of argument is a veiled attack on the practice of internalization generally, which has long been an accepted component of equities market structure. The existence of additional and non-traditional liquidity off of exchange facilities has meaningfully existed since the implementation of Exchange Act Rule 19c-3 in 1979. Direct Edge's ELP program and the products NASDAQ and BATS currently offer (such as BATS DarkScan) all seek in some form to integrate these types of liquidity while simultaneously offering the certainty of an exchange execution. In many ways, these products have democratized access to "upstairs" liquidity, as through these products even retail investors can now have their orders executed against pools of liquidity previously unavailable to them in any meaningful form. These all work to actually improve investor choice and lower transaction costs through price improvement, size improvement, lower exchange fees, and reduced market impact.

Again, the NYSE has acknowledged this in selling its own products that access these forms of liquidity, stating they provide "increased potential for filling orders" and the "potential for price improvement."[16]

NYSE claims that the NASDAQ and BATS filings are not non-controversial should be viewed in their competitive context.

Competition between market operators is probably more intense at this point in time than ever before in the history of modern market structure. The duopoly of the NYSE and NASDAQ has been broken by the emergence of Direct Edge and BATS, who collectively garnered over 22.7% matched market share of all U.S. cash equity transaction volume in May 2009.[17] This competitive environment has been of direct benefit to the nation's investors and their intermediaries, through improved technology, lower execution costs, and greater product innovation.

While delivering several improvements to their products and offering pricing initiatives, the NYSE has continued to lose ground in this competitive battle. During NYSE Euronext's 4th quarter 2008 earnings conference call, NYSE officials stated a target goal of 50% market share in the trading of NYSE-listed securities by the end of 2009.[18] Year-to-date, actual NYSE market share in these stocks has declined from 43.4% in

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[15] *Id.*, at 6.
[16] NYSE Arca IOI Routing Announcement, *supra* n. 11.
[17] Sourced from Direct Edge internal data and BATS data available at www.batstrading.com.
[18] *See* Q4 2008 NYSE Euronext Earnings Conference Call transcript, February 9, 2009, at 10, *available at* http://library.corporate-ir.net/library/12/129/129145/items/324530/6E8D4E89-327C-42DE-BE4B-539FB17F0204_NYX_Transcript_20090209.pdf.

December 2008 to 39.3% in April 2009.[19] While a decline in the average price of many securities and other environmental factors have likely contributed in part to this decline in market share, the pressure it places on an organization to respond in any way possible is acute.

The NYSE has increasingly made public statements that regulatory inconsistencies are somehow a cause of its current competitive position, and has suggested that regulatory action may be warranted to correct it.[20] In this context the NYSE now takes an interest in the products of exchanges and other market operators that seek to execute potentially-routable orders against subscriber trading interest prior to routing. Despite the existence of such products on other stock and option exchanges for several years,[21] the NYSE has chosen now as the time to claim that "our market structure has gone astray" through increased usage of such products, through which "liquidity has been driven underground."[22]

The competitive rationale driving the NYSE's policy position is fairly obvious to discern. By definition, any execution that occurs through such products prior to routing inherently means said order will not be routed to a third-party exchange for execution. Simply put, any order executed by Direct Edge, NASDAQ, or BATS through these programs potentially prevents order flow from being routed to NYSE-operated markets for execution. It is thus unsurprising that the NYSE would be opposed to these competitor products purely on grounds of self-preservation.

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[19] *See* NYSE Euronext Announces Trading Volumes for December 2008 and NYSE Euronext Announces Trading Volumes for April 2009, *available at* http://www.nyse.com/press/2_2009.html.

[20] "It's clear we have ATSs and ECNs and exchanges that have ownership that doesn't necessarily need to have a profit in that entity. We are for profit. So when you have, for example, dealers who own exchanges, and let's pretend that they have a five percent market share in that exchange but they could get a lever into decreasing prices into the other 95 percent, there is a conflict there. It's not necessarily a bad thing. It's just something we need to be careful about, particularly when regulatory burdens are not the same in every kind of entity that we have. It's something that public policy needs to take a look at to make sure there is a level playing field." Remarks of Larry Leibowitz, Group Executive VP and Head of U.S. Markets and Global Technology, NYSE Euronext, addressing the Securities Industry and Financial Markets Association Market Structure Conference, May 20, 2009, transcript *at* http://www.nyse.com/about/nyseviewpoint/1243591675565.html.

[21] *See, e.g.,* CBOE Stock Exchange Rule 51.8 and 52.6; ISE Rule 803.2. The NYSE counters that "continued growth in Direct Edge's market share and its proposal to register as an exchange" raise the prospect that "a limited functionality may become the norm for equities trading." NYSE Letter, *supra* n.1, at 5. Query why NYSE had no concern until a competitor offering these products became successful?

[22] *See supra* n. 20.

The NYSE effectively admits its self-interested motivation, suggesting it will offer its own similar products should the Commission not take its advice:

> "If the Commission does not abrogate the NASDAQ filing and reject the BATS filing, to remain competitive, NYSE Euronext may also need to add similar functionality to one or more of its market centers."[23]

While carefully written, this is tantamount to a direct admission that these types of innovative products can have a significant competitive impact on the NYSE, compromising their ability to offer objective comment on the related policy matters.

The Commission has several interests to balance in furtherance of the purposes of the Exchange Act, including competition "among exchange markets, and between exchange markets and markets other than exchange markets."[24] The exchange rule-making process gives each exchange operator the potential ability to distort that competition through lobbying efforts with the Commission to delay or otherwise thwart the innovations of their competitors under the cloak of advocacy for the greater public good. Direct Edge believes that customers should eventually decide who the winners and losers should be.

Even should a general review of post-Regulation NMS market structure trends be deemed to be an appropriate action, such a review should not take a form that would alter the competitive balance among market participants, especially where such action would overturn prior Commission decisions. Again, the NYSE said it best when noting that "[t]he need to address broader… questions… should not trigger a reversal of a well-reasoned SEC approval order. Instead, the industry should debate the issue in a way that will not cause disruption."[25]

Direct Edge's ELP program and the products to be offered by NASDAQ and BATS are part of a broader strategic competitive battle regarding the liquidity-aggregation and other innovative products offered to their customers. We respectfully suggest that any claims of "controversy" regarding the products offered in this light.[26]

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[23] NYSE Letter, *supra* n. 2, at 6, footnote 7. Query why any exchange would seek to introduce products or rule changes that they truly believe are not in the interest of their customers or investors.

[24] Exchange Act §11A(a)(1)(C)(ii).

[25] Letter from Mary Yeager, Corporate Secretary, NYSE, to the Hon. Christopher Cox, Chairman, Commission, November 8, 2006, at 3 (in response to the NetCoalition.com Notice of Intention to Petition for Review of SR-NYSEArca-2006-21).

[26] In further examining any existence of "controversy" outside any direct NYSE statements or advocacy, we respectfully request the Commission to consider the level of effort used by the NYSE to highlight its position and views on this topic, through outreach to the media, use of its web site and its "Exchanges" web blog (exchanges.nyse.com) and other methods. This has stirred a certain "controversy about the controversy" that should not be confused with a policy concern rooted in the public interest.

Conclusion

Direct Edge would summarize its position as follows – the NASDAQ and BATS rule filings should not be abrogated as not non-controversial, and allowed to be implemented into the market under Commission oversight (as all exchange rules and products are). While the Commission should continue to monitor market trends regarding the operation of "dark pools" and other sources of non-traditional activity, and engage in continued dialogue with the industry on this and other topics of current interest, no further discreet action is required at this time. Direct Edge would like to thank the Commission again for providing us with the opportunity to comment on these rule proposals, and we would welcome the opportunity to discuss our comments with the Commission.

Sincerely yours,

William O'Brien
Chief Executive Officer

cc: James Brigagliano, Acting Co-Director, Division of Trading and Markets
Daniel Gallagher, Acting Co-Director, Division of Trading and Markets