April 30, 2012

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

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

COMMENT LETTER AND PETITION FOR DISAPPROVAL

Re: Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Re-organize NASDAQ's Rules Governing the Fees Applicable to NASDAQ's Depth-of-Book Market Data, File No. SR-NASDAQ-2012-042, Exchange Act Release No. 66740, 77 Fed. Reg. 21609 (filed March 23, 2012; published April 10, 2012).

Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Modify the Fees Applicable to Non-Display Usage of Certain NASDAQ Depth-of-Book Market Data, File No. SR-NASDAQ-2012-044, Exchange Act Release No. 66724, 77 Fed. Reg. 21125 (filed March 26, 2012; published April 9, 2012).

Dear Ms. Murphy:

SIFMA[1] and NetCoalition[2] appreciate the opportunity to comment on the above-captioned notices, under which the Nasdaq Stock Market ("Exchange") proposed two rule changes related to non-display usage of certain Nasdaq depth-of-book data (together, the "Notices"). The proposed rule changes are purported to become effective upon filing with the U.S. Securities and Exchange Commission (the "Commission") under Section 19(b)(3)(A) of the Securities Exchange Act of 1934, as amended (the "Exchange Act").[3]

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1 The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to develop policies and practices which strengthen financial markets and which encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

2 NetCoalition is the public policy voice for some of the world's most innovative companies on the Internet. NetCoalition represents the interests of Internet and technology companies, including Amazon.com, eBay, Google, Bloomberg L.P., IAC/Interactive, and Yahoo!.

3 15 U.S.C. § 78s(b)(3)(A) (2010).

Because the Notices are not simply imposing a fee change and, instead, constitute a new and substantial change to Nasdaq's policies, they should not be deemed effective upon filing. Under Exchange Act rules, the Notices must be first published for public comment thus enabling Nasdaq and the Commission to resolve significant inconsistencies and confusion the Notices have already created.

For these reasons, set out in more detail below, and because the Exchange's actions are inconsistent with the decision of the United States Court of Appeals for the District of Columbia Circuit in *NetCoalition v. Securities and Exchange Commission*,[4] we respectfully petition the Commission to temporarily suspend these rule changes under Section 19(b)(3)(C) of the Exchange Act[5] and institute proceedings to disapprove (or properly approve) those changes under Section 19(b)(2)(B) of the Exchange Act.[6]

Time is of the essence in the need for the Commission to suspend the effect of these rule changes. The Commission staff may not accept such rule change filings as complete, and such rule changes cannot become effective upon filing, if on their face they are unlawful. These rule changes are unlawful because they are based on invalid grounds omitting cost data and they otherwise violate the Exchange Act as interpreted by the D.C. Circuit in *NetCoalition*. We therefore urge the Commission to act immediately to suspend these rule changes until the Commission and the public have had ample time to determine whether they should be disapproved.

A. The Notices Should Not be Deemed Effective Upon Filing Because They Constitute Substantial Changes to Nasdaq Policy.

The Notices should not be deemed effective upon filing under Exchange Act Rule 19b-4(f), and should instead be filed for notice and comment. In fact, the Notices do not "Constitut[e] . . . a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule," but instead adopt an entirely new policy related to the "non-display usage" of certain depth-of-book products which has not previously been interpreted in this way.[7] Previously, Nasdaq did not require counting devices on which the data is received and many firms paid a flat monthly fee of $30,000 a month for internal distribution of data for non-display use by an unlimited number of devices within the applicable firm. With this proposed modification, a new policy has been introduced whereby firms are required to count any device that accesses or uses the data without access or use of a display by a natural person, and – if those devices add up to 250 or more – the monthly fee more than doubles to $75,000 (or $900,000/year as compared to the previous $360,000/year).

The changes in this proposal became effective and operative on April 2, 2012, just 7 days after the Notice was filed on March 26, 2012. Pursuant to Rule 19b-4(f)(6)(iii), a rule filed

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4 615 F.3d 525 (D.C. Cir. Aug. 6, 2010).

5 15 U.S.C. § 78s(b)(3)(C) (2010).

6 15 U.S.C. § 78s(b)(2)(B) (2010).

7 Exchange Act Rule 19b-4(f)(1).

effective upon filing may not "become operative for 30 days after the date of the filing." By those terms, the earliest this proposal could have become effective would have been on April 26, 2012.

At this time, there continues to be much confusion about how to implement this new policy which is rife with differing interpretations of how to count devices and terminology. Per the proposed rule change, the new pricing structure applies where there are 250+ "Subscribers", not 250+ "devices." On March 26, 2012, Nasdaq attempted to clarify the discrepancy in an issue of its Data News as follows:

> "Subscriber" is defined as a computer terminal or an automated service which is entitled to receive Information. NASDAQ OMX also uses the terms "Interrogation Device" or "Device" or "Access". Distributors may count the following for usage reporting:
>
> - Number of physical devices ("Interrogation Device" or "Device")
>
> - Number of Unique User IDS and Password combinations that are not shared by multiple people and cannot simultaneously log-on to multiple devices ("Accesses")
>
> Distributors are to report the total number of Subscriber with the ***potential*** to access the Information, unless the Distributor is able to technically track actual usage for each Subscriber.[8]

Data News 2012-4 also gives examples of Non-Display Usage as including, but not being limited to, usage for operations control programs, program trading, investment analysis, order verification, surveillance programs, risk management, order-routing activities, automated order generation and/or order pegging, price referencing for algorithmic trading, and price referencing for smart order routing. While devices and servers used in the "transportation, dissemination or aggregation of data" are not necessarily fee liable, there is enormous ambiguity as to what cannot be counted validly, and the burden is on the Distributor to ensure that the exception applies.

Furthermore, Data News 2012-4 also failed to make important clarifications critical to our members and also made changes not included in the proposal. For example, the term "device" became a defined term with a capital "D" which it had not previously been in the Nasdaq policies. Also, the definition of "Non-Display" is currently defined as "any device that benefits from the NASDAQ Depth Data information, regardless of whether that information is displayed." Although "device" is suddenly defined in the current context (differently), it is still unclear what "benefiting" means.

In an era of changing technology, where firms use cloud computing (including as a cost saving measure in order to leverage free CPU cycles in servers and avoid purchasing new hardware where possible) and multiple cored servers (which could be counted as one or

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[8] Nasdaq OMX Data News #2012 – 4 (Mar. 26, 2012) ("Data News 2012-4") (emphasis added).

many devices), the likelihood is that individual firms will count differently and be charged differently based on their individual negotiations with Nasdaq. This result is patently not fair or reasonable, as some firms may be charged at least $500,000 more than other firms with substantially similar usage.

In addition to the concerns with inconsistencies between the Notices and Data News 2012-4, there are also inconsistencies with the NASDAQ Global Data Policies. We note that Nasdaq frequently updates its NASDAQ Global Data Policies and posts them to its website but does not provide any tracking for changes or access to previous versions of the policies. As a result, it is nearly impossible to understand a member's responsibilities on any given day unless the firm happens to have the applicable version of the policies saved locally or printed out. There is no way of knowing how often or when these policies are actually updated. For example, at some point following the release of Data News 2012-4, the NASDAQ Global Data Policies were again updated, and state "published March 29, 2012."

The NASDAQ Global Data Policies were not updated to conform to the Notices until days later and are still left unclear as of the date of this letter. For example: "Subscriber" formerly was titled "Subscriber or Access" and defined as "the computer terminal, pager or other automated service which is entitled to receive NASDAQ OMX Information. . . ." In the current Nasdaq Global Data Policies, the definition is now simply "Subscriber" with no further explanation. In addition, "Non-Display" is defined differently than previously.

Further, Data News 2012-4 clearly contemplates that Distributors (customer firms) have a method in place to count servers. This is an erroneous assumption and would be at great additional expense. Such a system would be either in addition to or different from other counting and entitlement systems used by others within the industry. Implementing a counting system for only Nasdaq purposes is extremely impractical. Finally, some firms have both Direct Access and Indirect Access data feeds, and do not have the ability to submit usage reporting for Subscribers.

Finally, although Nasdaq has told firms individually that it will clear up inconsistencies and apply those retroactively, SIFMA and NetCoalition ask that those inconsistencies be resolved through notice and comment, and not on an individual one-off basis with firms. Industry-wide resolution is needed to avoid differential application and unfair burdens on some competitors but not others. The imposition of this burden on competition means that the Notices should be subject to notice and comment and not be deemed effective upon filing. Such additional time will give the industry the opportunity to comment publicly, and require Nasdaq to uniformly and publicly resolve these issues such that all customers are treated fairly.

B. The Exchanges Have Not Shown that These Market Data Fees are Constrained by Competitive Forces.

Under the Exchange Act, the SEC has a duty to ensure that the proposed fees are, among other things, "fair and reasonable."[9] SIFMA disagrees with any notion that the recent

[9] Exchange Act, Sections 11A(c)(1)(C) (fees must be "fair and reasonable" and not "unreasonably discriminatory") & 6(b)(4) (exchange must also "provide for the equitable allocation of reasonable dues, fees, and other charges among . . . persons using its facilities").

amendment to Section 19(b)(3)(A) of the Exchange Act in Section 916 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act")[10] reflects a presumption that all fees are constrained by competition and that the Commission is therefore relieved of its obligation to ensure that the data fees are "fair and reasonable" within the meaning of Sections 11A(c)(1)(C) of the Exchange Act.[11] Neither the plain language of the recent amendment to Section 19(b)(3)(A) of the Exchange Act, nor the available legislative history of that amendment, supports the Exchange's contention that the amendment reflects such a presumption.[12]

The Commission has not required the Exchange to show, and the Exchange has not shown, that it is subject to significant competitive forces that would limit the Exchange to charging reasonable fees for this market data. *NetCoalition* made clear that the costs incurred in providing data are relevant in assessing the reasonableness of the fees an exchange charges to provide data because "in a competitive market, the price of a product is supposed to approach its marginal cost, i.e., the seller's cost of producing one additional unit."[13] As such, "[s]upracompetitive pricing may be evidence of 'monopoly,' or market power . . . Thus the costs of collecting and distributing market data can indicate whether an exchange is taking 'excessive profits' or subsidizing its service with another source of revenue . . . ."[14] The cost of producing market data would be direct evidence of whether competition constrains the ability to impose supracompetitive fees.[15] The Notices, however, do not contain any evidence of the Exchange's costs of collecting and distributing the market data and do not provide the Commission with the type of evidence the *NetCoalition* court to sustain the Commission's approval of an exchange rule seeking to impose a market data fee.

1. The Exchange's "joint products" theory is conjectural and fundamentally flawed.

The Exchange's "platform competition" approach to pricing data products is inconsistent with the Exchange Act, contradicts economic reality, and is unsupported by substantial evidence. The "platform competition" approach is inconsistent with the "fair and reasonable" requirement of Section 11A(c)(1)(C) of the Exchange Act because under the platform approach to pricing, the Exchange may set market data prices at supracompetitive levels as long as they charge less for other services,[16] even though some users of the data may consume only data services, but not other services such as trade execution. This approach to pricing would therefore immunize data fees from review by wrapping them

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10 Pub. L. No. 111-203, H.R. 4173 (June 29, 2010).

11 15 U.S.C. § 78k-1(c)(1)(C) (2010).

12 For a full discussion of these arguments, please see Letter from Ira D. Hammerman to Florence Harmon (SEC) re: Exchange Act Release No. 62887 and Exchange Act Release No. 62908 (Oct. 8, 2010).

13 *NetCoalition*, 615 F.3d at 537.

14 *Id.*

15 *Id.*

16 *See* 77. Fed. Reg. at 21612-13; 77 Fed. Reg. at 21128-29.

together with fees for other services and would thus nullify the "fair and reasonable" standard.

In addition, the "platform competition" theory is flawed because market data is bought and sold separately from execution services, as evidenced by the fact that SIFMA member firms' customers often buy market data on its own, and NetCoalition members do not purchase the exchanges' order execution services. In fact, the price of two products that are bought and sold separately is the result of the distinct competitive conditions confronting each product.[17]

In any event, there is no substantial evidence here to support the Exchange's "platform competition" theory, only the same type of conclusory statements dismissed by the D.C. Circuit in *NetCoalition*.[18]

2. The Rule Change cannot be sustained based on the theory that order flow constrains the price of market data.

The Exchange does not provide any evidence that these data fees are subject to competitive forces, but concludes there must be competition because order flow data is a component of market data, and the market for order flow is subject to competitive forces.[19] Moreover, the Exchange notes that market data fee competition must exist because broker-dealers have numerous venues available to which they may route order flow and those venues produce market data of various types.[20] The Court in *NetCoalition* rejected this order flow argument because, like here, there was no support for the assertion that order flow competition constrains the ability of the exchange to charge supracompetitive prices for market data. In rejecting the argument, the Court discounted the statements made by various exchanges to the effect that the exchanges consider the impact on attracting order flow in setting data prices: "The self-serving views of the regulated entities . . . provide little support to establish that significant competitive forces affect their pricing decisions."[21]

3. The Exchange does not support its contention that there are reasonable substitutes for the market data.

The Exchange also asserts that several alternatives to the data products at issue are available,[22] but does not provide any evidence that the alternatives are reasonable substitutes for the market data at issue here, such that pricing of the data is constrained by competitive forces. Under the Court's holding in *NetCoalition*, a market data provider must evaluate the

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17 *See Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 929 (2d Cir. 1982).

18 *See* 615 F.3d at 541 (noting the "lack of support in the record" and characterizing proffered support as "conclusion[s], not evidence").

19 77 Fed. Reg. at 21128; 77 Fed. Reg at 21612-63.

20 *Id.*

21 *NetCoalition*, 615 F.3d at 541.

22 77 Fed. Reg. at 21129; 77 Fed. Reg. at 21613.

number of potential users of its data and assess how those users might react to changes in the price of that data.[23] The Exchange provides no evidence, only theories, as to how broker-dealers might react to changes in the prices of its data products.

C. Conclusion

The Notices constitute a new and substantial change to Nasdaq's policies, not a simple fee change, thus they must be first published for notice and comment prior to becoming effective. This additional time will enable Nasdaq and the Commission to resolve the significant inconsistencies and confusion the Notices and corresponding newsletters have already created.

In addition, we believe *NetCoalition* requires the Commission to review cost data as an essential element of considering whether there is substantial evidence to meet the Commission's "competitive forces" test, before approving these or any other future market data fee filings. Neither the Commission nor the exchanges should circumvent the court's findings in *NetCoalition* through the procedural mechanism of Section 19(b)(3)(A). The failure to address the court's concerns regarding the market forces test renders these market data rule filings unenforceable under Section 19(b)(3)(C).[24]

For the reasons set out above, and given the absence of cost data or any other evidence supporting the Exchange's contention that these data fees are constrained by competitive forces, we respectfully request that the Commission temporarily suspend the proposed rules under Section 19(b)(3)(C) of the Exchange Act, and institute proceedings to disapprove the proposed rule under Section 19(b)(2)(B) of the Exchange Act.

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23 *NetCoalition*, 615 F.3d at 542.

24 As noted above, Section 19(b)(3)(C) provides: "Any proposed rule change of a self-regulatory organization which has taken effect pursuant to subparagraph (A) or (B) of this subparagraph may be enforced by such organization to the extent it is not inconsistent with the provisions of this title, the rules and regulations thereunder, and applicable federal and state law."

If you have any questions or you would like to discuss these matters further, please call Melissa MacGregor, Managing Director and Associate General Counsel at SIFMA, at 202-962-7385.

Respectfully submitted,

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