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Securities Industry and
Financial Markets Association

NetCoalition.com

December 8, 2010

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

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Attention: Florence E. Harmon, Deputy Secretary

COMMENT LETTER AND PETITION FOR DISAPPROVAL

Re: Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NYSE Arca, Inc. Relating to Fees for NYSE Arca Depth-of-Book Data, File No. SR-NYSEArca-2010-97, Exchange Act Release No. 63291 (Nov. 9, 2010) (the "Notice")

Dear Ms. Harmon:

We appreciate the opportunity to comment on the above-captioned notice, under which NYSE Arca, Inc. ("NYSE Arca" or the "Exchange") proposed a rule change to authorize market data fees for the receipt and use of depth-of-book market data that NYSE Arca makes available.¹ The proposed rule change became 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").² The Commission published the Notice for comment on November 17, 2010.³ For the reasons set forth below, and because NYSE Arca's actions are inconsistent with the recent decision of the United States Court of Appeals for the District of Columbia Circuit in *NetCoalition v. Securities and Exchange Commission* ("*NetCoalition*"),⁴ we respectfully petition the Commission to temporarily suspend the proposed rule change under recently-amended Section 19(b)(3)(C) of the Exchange Act⁵ and institute proceedings to disapprove (or properly approve) those changes under Section 19(b)(2)(B) of the Exchange Act.⁶

¹ *Self Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NYSE Arca, Inc. Relating to Fees for NYSE Arca Depth-of-Book Data*, Exchange Act Release No. 63291; File No. SR-NYSEArca-2010-97 (Nov. 9, 2010); 75 Fed. Reg. 70311 (Nov. 17, 2010).

² 15 U.S.C. § 78s(b)(3)(A) (2010).

³ See 75 Fed. Reg. 70311 (Nov. 17, 2010).

⁴ 615 F.3d 525 (D.C. Cir. 2010).

⁵ 15 U.S.C. § 78s(b)(3)(C) (2010).

⁶ 15 U.S.C. § 78s(b)(2)(B) (2010).

I. BACKGROUND AND OVERVIEW

In *NetCoalition*, the D.C. Circuit held that the Commission lacked a sufficient basis to approve NYSE Arca's proposed rule change as "fair and reasonable" under the Exchange Act. While purporting to comply with the *NetCoalition* decision, the proposed rule raises the same arguments that were rejected by the Court, refuses to follow the Court's teaching that costs should be considered in assessing the reasonableness of the fees, and supplies no new or substantial evidence to support the conclusion that the proposed fees are "fair and reasonable" and otherwise compliant with the Exchange Act.⁷ NYSE Arca also erroneously suggests that the Dodd-Frank Act insulates the proposed fees from Commission scrutiny.

In re-proposing the same fees that were previously rejected as unsubstantiated, NYSE Arca shows total disregard for the ruling of the D.C. Circuit. Based on the "seriousness of [the] order's deficiencies," the appeals court vacated the Commission's earlier Direct Order approving the NYSE ArcaBook fees⁸ and remanded for "further proceedings consistent with this opinion."⁹ NYSE Arca, supported by the Commission, then sought panel rehearing, arguing that the relief ordered by the Panel – vacatur as opposed to remand – was unwarranted and that NYSE Arca should be allowed to supplement the record on remand while continuing to charge the disallowed fees.¹⁰ On October 25, 2010, the D.C. Circuit denied the petition for rehearing, and on November 9, 2010, the Court's mandate issued. The effect of the Court's vacatur is that the prior order is "annulled, voided, rescinded, or deprived of force."¹¹ Nonetheless, NYSE Arca proposes to *continue to assess the very same fees* that have been in effect since the Direct Order.¹² The result is that investors continue to be subjected to fees that have not been determined to be "fair and reasonable," as the Exchange Act requires.

As we have previously conveyed to the Commission, time is of the essence in the need for the Commission to suspend the effect of these and other similar market data fee rule changes proposed by self-regulatory organizations based on invalid grounds and without

⁷ Under the Exchange Act, the SEC has a duty to ensure that the proposed fees are, among other things, "fair and reasonable." See 15 U.S.C. § 78k-1(c)(1)(C) (fees must be "fair and reasonable" and not "unreasonably discriminatory"); 15 U.S.C. § 78f(b)(4) (exchange must also "provide for the equitable allocation of reasonable dues, fees, and other charges among . . . persons using its facilities").

⁸ See *Self Regulatory Organizations; NYSE-Arca, Inc.; Order Setting Aside Action by Delegated Authority and Approving Proposed Rule Change Relating to NYSE-Arca Data*, Exchange Act Release No. 59039 (December 2, 2008), 73 Fed. Reg. 74770 (December 9, 2008) (the "Direct Order").

⁹ 615 F.3d at 544.

¹⁰ See Int. Pet. Panel Reh'g, Case No. 09-1042, Doc. 1266631 (Sept. 17, 2010); Resp't Resp. to Pet. Panel Reh'g, Case No. 09-1042, Doc. 1271143 (Oct. 12, 2010).

¹¹ See *AFL-CIO v. Chao*, 496 F.Supp.2d 76, 85 (D.D.C. 2007).

¹² See 75 Fed. Reg. at 70312.

any consideration of cost data.¹³ The proposed rule constitutes an end-run around the remand process contemplated by the D.C. Circuit and, if allowed to stand, would be in direct conflict with the Court's ruling. We therefore urge the Commission to act immediately to suspend these and other similar fee rule changes until the Commission and the public have had ample time to determine whether they should be disapproved.

II. THE DODD-FRANK ACT DOES NOT IMMUNIZE THE PROPOSED FEES FROM SCRUTINY.

Before discussing the merits, we address the Notice's erroneous contention that the recent 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")¹⁴ 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.¹⁵ 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 contention that the amendment reflects any such presumption. It is true, as the Commission knows, that Section 916 of the Dodd-Frank Act amended paragraph (A) of Section 19(b)(3) of the Exchange Act by inserting the phrase "on any person, whether or not the person is a member of the self-regulatory organization" after "due, fee or other charge imposed by the self-regulatory organization."¹⁶ As a result, all SRO rule proposals establishing or changing dues, fees, or other charges are effective immediately upon filing regardless of whether such dues, fees, or other charges are imposed on members of the SRO, non-members, or both and also regardless of whether such dues, fees or other charges are or are not consistent with the provisions of the Exchange Act applicable to the Exchange. To protect against the evident risk of abuse, Section 916 also amended paragraph (C) of Section 19(b)(3) of the Exchange Act to read, in relevant part, as follows:

¹³ See *Self Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NASDAQ OMX PHLX, Inc. Relating to Market Data Feeds*, Exchange Act Release No. 62887; File No. SR-PHLX-2010-121 (September 10, 2010) ("PHLX Notice"); 75 Fed. Reg. 57092 (Sept. 17, 2010); *Self Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by The NASDAQ Stock Market to Establish an Optional Depth Data Enterprise License Fee*, Exchange Act Release No. 62908; File No. SR-NASDAQ-2010-111 (September 14, 2010) ("NASDAQ Notice"; 75 Fed. Reg. 57321 (Sept. 14, 2010); *Self Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by The NASDAQ Stock Market to Modify Rule 7019*, Exchange Act Release No. 34-62907; File No. SR-NASDAQ-2010-110; (September 14, 2010); 75 Fed. Reg. 57314 (September 20, 2010). By letter of October 8, 2010, SIFMA and NetCoalition commented on the PHLX and NASDAQ Notice and those comments are incorporated herein.

¹⁴ Pub. L. No. 111-203, H.R. 4173 (June 29, 2010).

¹⁵ 15 U.S.C. § 78k-1(c)(1)(C) (2010).

¹⁶ 15 U.S.C. § 78s(b)(3)(A) (2010).

At any time within the 60-day period beginning on the date of filing of such a proposed rule change in accordance with the provisions of paragraph (1) [of Section 19(b)], the Commission summarily may temporarily suspend the change in the rules of the self-regulatory organization made thereby, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title. If the Commission takes such action, the Commission shall institute proceedings under paragraph (2)(B) [of Section 19(b)] to determine whether the proposed rule should be approved or disapproved.¹⁷

There is no basis for NYSE Arca's statements in the Notice that Congress amended Section 19(b)(3)(A) of the Exchange Act to deem the fees an exchange imposes to be subject to competitive forces and therefore *per se* fair and reasonable. The plain language of Section 19(b)(3)(A)(ii) does not refer to competitive forces in permitting rules imposing exchange fees to become effective upon filing with the Commission. NYSE Arca does not cite to, and we are not aware of, any legislative history of the Dodd-Frank Act that suggests that proposed exchange rules establishing or changing fees may become effective immediately because such fees are deemed to be subject to competitive forces. The Dodd-Frank Act, moreover, did not amend Section 11A(c)(1)(C), which imposes on the Commission a duty to ensure that fees imposed by an SRO, such as NYSE Arca are, among other things, "fair and reasonable."¹⁸

Furthermore, NYSE Arca asserts that the *NetCoalition* decision "does not address the statutory amendments encompassed by the Dodd-Frank Act in any way," and that "[n]o questions relating to the operation or effect of those amendments were before the D.C. Circuit" in connection with the decision.¹⁹ But if NYSE Arca believed that the Dodd-Frank Act gives an exchange unfettered authority in charging market data fees, and effectively moots any challenge to or review of an exchange's proposed fee filings, it behooved NYSE Arca to have made that view clear to the D.C. Circuit at some point before the Court's decision became final.²⁰ Instead, NYSE Arca actively litigated the *NetCoalition* matter on the merits, hoping to prevail, then sought rehearing after it did not. Never once did NYSE Arca (or the Commission) suggest, including on petition for rehearing, that the Dodd-Frank Act rendered the D.C. Circuit's decision largely

¹⁷ As discussed below, Section 19(b)(C) also provides that a proposed rule change that has become effective immediately may be enforced by the self-regulatory organization "to the extent it is not inconsistent with any provision of [the Exchange Act], the rules and regulations thereunder and applicable federal and state law." Accordingly, such a rule could not be enforced, and fees could not lawfully be collected, if the rule did not meet those standards, including, for example, applicable federal and state antitrust law.

¹⁸ 15 U.S.C. § 78k-1(c)(1)(C) (2010); *see also NetCoalition*, 615 F.3d at 534.

¹⁹ *See* 75 Fed. Reg. at 70314 n.17.

²⁰ The Dodd-Frank Act took effect on July 21, 2010, prior to the D.C. Circuit's decision in *NetCoalition*.

meaningless on the grounds that the exchanges could simply ignore vacatur, by-pass remand proceedings altogether, re-file the same proposed fees with the same purported justifications as before, and continue to charge those same fees, as if the *NetCoalition* decision did not exist.

III. NYSE ARCA HAS NOT SHOWN THAT MARKET DATA FEES ARE CONSTRAINED BY COMPETITIVE FORCES.

As the Commission itself has acknowledged, “it obviously would be inappropriate for the Commission to rely on non-existent competitive forces as a basis for approving an exchange proposal.”²¹ An exclusive processor, such as NYSE Arca,²² enjoys a government-conferred regulatory monopoly over market data that broker-dealers are required by law to provide to them for free; accordingly, its fee proposals should be granted, if at all, only on the clearest evidence that actual, not theoretical, competition effectively constrains the exchange’s pricing power.

Yet again here, as in *NetCoalition*, NYSE Arca relies entirely on unsubstantiated and analytically flawed theory and speculation to support its contention that significant competitive forces constrain its pricing of its ArcaBook product. Again here, NYSE Arca refuses to support its proposal with any evidence of the cost of collecting and distributing the market data that comprise the ArcaBook product, despite the *NetCoalition* Court’s admonition that such costs are directly relevant to whether an exchange is able to charge a market-based rate or a supracompetitive rate for ArcaBook. Again here, NYSE Arca argues for the existence of “alternatives” that the *NetCoalition* Court found were not substitutes at all.

NYSE Arca also continues to advance the conclusory argument that “order flow competition,” and a related theory of “platform competition,” justify the proposed fees, despite the fundamental errors in these theories and the lack of evidence to support them. Moreover, those theories essentially eliminate any oversight function by the Commission of any fee charged by any exchange. Because the alleged constraints of order flow/platform competition will *always* exist, acceptance of NYSE Arca’s argument means that *any* fee proposed by an exchange for the use of *any* of its facilities, whether market data or otherwise, will be deemed valid and not subject to challenge. The result would be a lack of any semblance of review by the Commission and an abdication of its supervisory role in assessing the fairness and reasonableness of an exchange’s facility charges.

A. NYSE Arca Should Have Submitted Cost Data To Support Its Fee Proposal.

Although NYSE Arca once again fails to submit cost data to support its assertions of competitive pricing, it does not and cannot dispute the relevance of such data. As the Court in *NetCoalition* held, the costs incurred in collecting and distributing depth-of-book

²¹ 73 Fed. Reg. 74770, 74787 (Dec. 9, 2008).

²² See 15 U.S.C. § 78c(a)(22)(B); *NetCoalition*, 615 F.3d at 531.

data itself are relevant in assessing the reasonableness of the fees an exchange charges for the 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.”²³ As the Court stated:

Supracompetitive 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 . . .²⁴

Thus, the cost of producing market data would be direct, if not the best, evidence of whether competition constrains NYSE Arca’s ability to impose supracompetitive fees. Moreover, as the *NetCoalition* Court found, the need for cost data “appears to be elevated” because of the risk that NYSE Arca, as an “exclusive” provider of its proprietary depth-of-book market data, could exercise market power.²⁵

Rather than complying with the *NetCoalition* Court’s admonitions about the relevance and need for cost data, the Notice continues to assert that the alleged “impracticability” of “cost-based pricing” justifies ignoring costs.²⁶ As in *NetCoalition*, this argument attacks a straw man, as it has never been our position that the Exchange Act requires strict, cost-of-service ratemaking. Thus, the “several documents attesting to the difficulty of cost-based pricing in this area” cited in the Notice²⁷ sweep wide of the mark. Rather, we have consistently maintained that a proposed fee’s relationship to cost is relevant to the competitive-constraint theory, particularly where, as here, the market is essentially a new one and the proponent of the fee has proffered little or no evidence of actual market behavior.

Moreover, citing NYSE Arca’s own words, the *NetCoalition* Court noted that the Exchange must have taken into consideration, in setting its fees, the very costs that it claims are too difficult to obtain. *See* 615 F.3d at 538 (citing statements that “NYSE Arca believes that the proposed market data fees would reflect an equitable allocation of its overall costs to users of its facilities,” that, in setting fee levels, NYSE Arca considered “the contribution that revenues accruing from Arca Book Fees would make toward meeting the overall costs of NYSE Arca’ operations,” and that “market data revenues compare favorably to the markets’ *cost of producing the data*”) (emphasis added).²⁸ Indeed, the Commission conceded, at oral argument in the *NetCoalition* case, that NYSE Arca does, in fact, have the ability to assess the cost of its ArcaBook product:

²³ 615 F.3d at 537.

²⁴ *Id.*

²⁵ *Id.* at 538.

²⁶ *See* 75 Fed. Reg. 70311 at 70317.

²⁷ 75 Fed. Reg. 70311; 70317 & n.44.

²⁸ *See also* Comment Letter of Mary Yeager, Corporate Secretary, NYSE Arca, Inc. at 12 (Feb. 6, 2007) (NYSE Arca’s market data fees “enable [it] to recover the

JUDGE EDWARDS: – obviously the folks who want to increase the fee have figured out something because they said we want to charge fees because our costs have gone up. So, they figured out something.

MR. PENNINGTON: But they haven't done any kind of an allocation that would be a rate making –

JUDGE EDWARDS: Well, then how do they know their costs went up?

...

JUDGE EDWARDS: No, but what I'm saying is they made the proposal on a significant, significantly because they said they were incurring increased costs, so obviously –

MR. PENNINGTON: Yes.

JUDGE EDWARDS: – someone figured it out in house, and I bet you they can figure it out in house.

MR. PENNINGTON: Well, they can –

JUDGE EDWARDS: I'd be stunned if they couldn't.

MR. PENNINGTON: No, they can figure it out. I'm sure that whatever their increase[d] discrete cost is they know that.

JUDGE EDWARDS: Right.²⁹

In any event, as the *NetCoalition* Court rightly held, “an agency may not shirk a statutory requirement simply because it may be difficult.” 615 F.3d at 539; *see also NASD, Inc. v. SEC*, 801 F.2d 1415, 1420-21 (D.C. Cir. 1986) (“[t]hat it may be difficult to allocate costs does not provide an excuse for refusing to do so”).

In all likelihood, the reason NYSE Arca has not been willing to provide data to the Commission, at least for publication in their market data rule filings, is not the difficulty of determining those costs but rather the reality that the costs of collecting and disseminating depth-of-book data are insignificant. Indeed, the whole NYSE Arca pricing scheme may well collapse of its own weight if the true costs were known. One would have thought that the marginal cost to NYSE Arca of implementing a depth-of-book product using its existing infrastructure, which is already funded amply by consolidated book and other market data revenue, would be *de minimis*. This is especially true where NYSE Arca or its predecessor had distributed the product free of charge for a long period of time, as a form of advertising. One cannot reasonably conclude that NYSE Arca's marginal cost is greater now than when it charged nothing.

Following the *NetCoalition* decision, NYSE Arca cannot maintain, either in accordance with binding law or credibly, that “[n]o one has demonstrated why the Commission needs to be the arbiter of [an exchange's costs] to enforce its responsibilities under Section 19

resources that [it] devoted to the technology necessary to produce Arca Book data”) (attached hereto as Exhibit A).

²⁹ Oral Arg. Tr. at 34-35 (attached hereto as Exhibit B).

of the Exchange Act.”³⁰ The Commission should suspend this and similar proposed rule changes³¹ and require the exchanges to submit cost data sufficient to demonstrate the fairness and reasonableness of their proposed fees. To that end, we urge a straight-forward and specific definition of which costs should be included in such an analysis: The cost of collecting, consolidating, and distributing the data. Other costs should be funded by listing fees, trading fees, and regulatory fees, not by fees for exclusive market data products sold to a captive audience.

B. NYSE Arca Does Not Support Its Contention That There Are Reasonable Substitutes For Its Depth-Of-Book Data.

In *NetCoalition*, the exchanges and Commission posited the existence of several so-called “substitutes” for depth-of-book data that allegedly constrain an exchange’s exercise of market power, namely (1) core data; (2) depth-of-book data from other exchanges; (3) “pinging” orders and (4) the threat of independent distribution of order data by securities firms and data vendors acting in concert.³² The D.C. Circuit rejected each of these arguments, holding that “the SEC had insufficient evidence before it to conclude that a trader interested in depth-of-book data would substitute any of the four alternatives (or simply do without) instead of paying a supracompetitive price.”³³

While continuing to maintain that ArcaBook fees “are fair and reasonable” because “market participants have alternatives to purchasing ArcaBook data,”³⁴ the Notice, by conspicuous omission, effectively abandons core data, “pinging,” and potential collaborative ventures as proffered meaningful alternatives. Instead, the Notice purports to cite new anecdotal “evidence” (and a hypothetical) to support its claim that depth-of-book data from other trading venues, such as BATS or Nasdaq, effectively constrains NYSE Arca’s pricing of ArcaBook. The Notice falls well short of making the required showing.

According to the Notice, for a one-month period in June 2010, “ten of the top 30 users of intermarket sweep orders” (“ISOs”), which are typically used by institutional rather than retail investors, did not subscribe to ArcaBook, supposedly evidencing that “they believe they have adequate sources of data to submit ISOs without purchasing ArcaBook data.”³⁵ This anecdotal evidence actually undermines the “substitutability” claim. The same evidence cited in the Notice indicates that 20 firms, accounting for 93% of all PNP ISOs (and over half of NYSE Arca Tape A and Tape B trading volume), *do* purchase

³⁰ 75 Fed. Reg. at 70318.

³¹ See n.13, *supra*.

³² See 615 F.3d at 542.

³³ *Id.* at 544.

³⁴ 75 Fed. Reg. at 70314.

³⁵ 75 Fed. Reg. at 70315.

ArcaBook.³⁶ The ten firms that do not subscribe account for only 7% of ISO orders and 1% of Tape A and Tape B trading volume.³⁷

NYSE Arca's anecdotal evidence thus corroborates the notion that most professional traders *do* regard the ArcaBook product as essential and that, in NYSE Arca's own words, the product was created in response to "customer demand for depth-of-book data," was "a new standard," and is "what investors want and *need* in today's marketplace."³⁸ Certainly for most serious investors, who are seeking to maximize trading profits, ArcaBook is a unique product for which no substitutes exist.³⁹

Moreover, for the ten firms that did not subscribe to ArcaBook, the Notice provides no information indicating whether those firms ever subscribed to ArcaBook, when or why they stopped subscribing if they previously did, and whether they are, in fact, purchasing depth-of-book data from alternative trading venues. It may be that firms are doing without the data (which is not the same as substitution) because its supracompetitive price has driven them out of the market.⁴⁰

³⁶ *Id.*

³⁷ According to the Notice, the top 30 firms (including the ten who did not purchase ArcaBook) comprise 56% of Tape A and B volume, and the 20 who did subscribe account for 54.72%, leaving the ten non-subscribing firms to account for about 1% of Tape A and B volume. *See* 75 Fed. Reg. at 70315.

³⁸ Press Release, New York Stock Exchange, *The New York Stock Exchange Receives SEC Approval for NYSE OpenBook Real-Time* (April 4, 2006), available at www.nyse.com/press/1144146242211.html (emphasis added). Similarly, NASDAQ touts its exclusive TotalView product, which displays depth-of-book data for execution in NASDAQ, as "the standard-setting data feed for serious traders," and asks: "Can you really afford to trade with anything less than TotalView?" *See Best View of NASDAQ* (Sept. 2007) (attached hereto as Exhibit C).

³⁹ *See FTC v. Whole Foods Markets, Inc.*, 548 F.3d 1028, 1038 (D.C. Cir. 2008) ("[I]n appropriate circumstances, core customers can be a proper subject of antitrust concern. In particular when one or a few firms differentiate themselves by offering a particular package of goods or services, it is quite possible for there to be a central group of customers for whom 'only [that package] will do.'") (citing *United States v. Grinnell Corp.*, 384 U.S. 563, 574 (1966)).

⁴⁰ *See* William M. Landes & Richard A Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev. 937, 960-61, 978-79 (1981) (explaining that, at certain prices, every monopolist faces elastic demand for its products). *See also Pacific Mailing Equipment Corp. v. Pitney Bowes, Inc.*, 499 F. Supp. 108, 111 n.3 (N.D. Cal. 1980) ("The Court does not consider the alternative of doing without mailing machines to be properly includable within the relevant market . . . That choice is available to some degree to consumers in nearly every market; to incorporate it in the relevant market would lead to ridiculous results."). NYSE Arca contends that the fact that it lost subscribers when it began charging a fee for ArcaBook establishes that its current fees are at the competitive level because it cannot raise

The Notice “does not reveal the number of potential users of the data or how they might react to a change in price,”⁴¹ or “how many traders accessed NYSE Arca’s depth-of-book data during the period it was offered without charge – and thus how many traders might be interested in paying for ArcaBook.”⁴² Nor does it provide any empirical evidence of “whether the traders who want depth-of-book data would decline to purchase it if met with a supracompetitive price.”⁴³ In short, NYSE Arca has done nothing to supply the kind of actual “evidence of trader behavior” that the *NetCoalition* Court indicated was needed to support its untested theories.⁴⁴

NYSE Arca’s “hypothetical” does not demonstrate that alternatives constrain the fees for depth-of-book data.⁴⁵ The hypothetical assumes a 40% cancellation rate, and overall revenue loss, following a price increase from \$10 to \$15. But in a truly competitive market, a price increase of that magnitude – 50% – should cause almost all users to switch. The test for whether there are substitutes for a product is whether users will switch when faced with a “small but significant non-transitory increase in price,” generally assumed to be around 5%.⁴⁶ The hypothetical figures selected by the Exchange are of no consequence.

Depth-of-book data from other trading venues simply are not an economic substitute for NYSE Arca’s depth-of-book data. Each exchange’s data are unique to that exchange. Every vendor, Internet portal or broker-dealer must obtain NYSE Arca’s depth-of-book data from NYSE Arca alone. And while market data for each exchange are sold as a package, trading is done by security, so a trader will need to buy several data packages to have a full picture of liquidity for a given security he or she wishes to trade. Thus a trader who buys only Nasdaq’s depth-of-book feed will be at a significant disadvantage when trading in NYSE-listed stocks as to which NYSE has greater depth of book. As even NYSE Arca acknowledges, “the displayed depth-of-book data of one trading center does not provide a complete picture of the full market for the security.”⁴⁷

Furthermore, it is not correct that retail investors do not need or want access to depth-of-book data. Retail investors generally rely on their brokers to select an execution venue

its prices any higher. *See* 75 Fed. Reg. at 70315. As indicated above, given high enough prices, every monopolist faces elastic demand for its products. Thus, the fact that NYSE Arca is allegedly constrained at its current price from increasing its fees says nothing about whether the current fees are set at the competitive level.

⁴¹ 615 F.3d at 542-43.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ 75 Fed. Reg. at 70314.

⁴⁶ *See* 2010 Horizontal Merger Guidelines at 8-13 (Aug. 19, 2010), available at <http://www.ftc.gov/os/2010/08/100819hmg.pdf>; *see also NetCoalition*, 615 F.3d at 542.

⁴⁷ Comment Letter of Mary Yeager, Corporate Secretary, NYSE Arca, Inc. at 17 (Feb. 6, 2007).

for their orders, but they very much rely on depth-of-book data to value their portfolios and to assess the quality of executions their brokers achieve.

In sum, to have a reasonably comprehensive picture of liquidity below the top of the book, investors need depth-of-book data from *all* exchanges with substantial trading. There can be no dispute that NYSE Arca is a significant trading venue with substantial liquidity.⁴⁸ As the Commission itself has recognized, “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.”⁴⁹

The availability of depth-of-book data from other trading venues therefore does not effectively constrain the prices that significant venues such as NYSE Arca can charge for their own depth-of-book data. The Notice’s continued assertion that depth-of-book data from other trading venues is a substitute for NYSE Arca’s depth-of-book data is without legal or factual basis.

C. NYSE Arca Still Provides No Evidence That Order Flow Competition Constrains Market Data Fees.

The Notice does not claim, nor could it, that order flow is a substitute for depth-of-book data. Rather, the Notice resurrects the argument, rejected by the court in *NetCoalition*, that competition for order flow and trade execution provides an effective constraint on the level of fees the Exchange can charge for its market data products. That reasoning remains flawed: the fact that an exchange competes for order flow to increase liquidity and transaction revenue does not, and cannot, demonstrate the separate and disconnected proposition that depth-of-book data pricing drives order flow.

In fact, there is no “direct connection” between the price of depth-of-book data and the level of order flow. While increased liquidity increases the value of and importance of the depth-of-book data, there is no basis for the assumption that causation operates in the other direction. As the Court in *NetCoalition* held, the Commission failed to establish that “the connection works both ways.”⁵⁰ That is because the price of depth of book data does not and could not affect marginal decisions to send orders to a particular exchange. Trading orders are placed on a transaction specific, security-specific basis. As a result,

⁴⁸ According to the Commission’s own statistics in the *NetCoalition* case, NYSE Arca reported 16.5% of the share volume in U.S.-listed equities during June 2008, the third highest among all exchanges. *See* 73 Fed. Reg. at 74783, Table 1. If considered together with affiliate NYSE, NYSE and NYSE Arca enjoy even greater liquidity: approximately one-third of share volume in all U.S.-listed equities, and almost 45% of volume of NYSE-listed equities. *See id.* But whether considered by itself or with its affiliate, NYSE Arca has substantial liquidity, and it has an economically relevant monopoly over its own depth-of-book data. *See id.*

⁴⁹ 70 Fed. Reg. 37496, 37559 (June 29, 2005).

⁵⁰ 615 F.3d at 539.

the factors considered in placing trades on a particular exchange are transaction fees (including rebates), as well as other factors potentially affecting trader choices at the point of trade, such as the exchange's execution speed, ease of access, and customer service.⁵¹

In contrast, depth-of-book data are not paid for on a transactional basis, but instead are sold in monthly subscriptions, typically based on a fixed monthly fee per device or subscriber.⁵² Data fees are thus a fixed or sunk cost that has already been incurred prior to the point of trade. That cost does not vary based on the extent to which those data are used to place orders, or whether the trader examines the depth-of-book data for one security, all securities, or some number in between. An increase or decrease in the monthly subscription fee for depth-of-book data therefore does not change a trader's marginal cost or incentive to purchase or sell a particular security on a particular exchange. Depth-of-book data is thus not a marginal cost of trading but a fixed cost – a necessary fixed input for the optimization of trading profits – for which a monopoly price can be charged.

Again, the Exchange's "new" evidence undercuts its own position. The Notice contends that "more recent data" shows that competition for order flow "has intensified," creating even more volatility in the shares of total trading volume on each of the various trading venues.⁵³ If that is true, it only serves to emphasize the need for traders to buy depth-of-book data, and pay the fixed monthly subscription fee, prior to the point of trade execution. As discussed above, traders need to buy the unique depth-of-book data of any exchange with significant liquidity. The more volatile and unpredictable the liquidity of each exchange, the greater the need to buy *all* venues' data, in advance, to ensure a full picture of the liquidity available for a particular security on a particular venue if and when it comes time to place an order for that security. Greater demand for an exchange's unique depth-of-book data can only serve to increase that exchange's market power over the pricing of such data.

The "hypothetical" NYSE Arca supplies to support its order flow theory is no more probative than the one it supplied regarding substitutability. NYSE Arca's hypothetical "suppose[s] that [an] increase in the price of depth-of-book data caused a reduction in order flow and net trading revenue."⁵⁴ Of course, that merely assumes the very

⁵¹ See David S. Evans, *An Economic Assessment of Whether "Significant Competitive Forces" Constrain an Exchange's Pricing of its Depth-of-Book Data* at 15-16 (July 10, 2008) ("*Economic Assessment*") (attached hereto as Exhibit D). See also David S. Evans, *Response to Ordoover and Bamberger's Statement Regarding the SEC's Proposed Order Concerning the Pricing of Depth-of-Book Market Data* at 9 (Oct. 10, 2008) ("*Response*") (attached hereto as Exhibit E). Both reports were submitted by Petitioners in *NetCoalition* and were part of the record on appeal.

⁵² ArcaBook is offered on a monthly subscription basis. See 75 Fed. Reg. at 70312-13. See also *Economic Assessment* at 16; *Response* at 10.

⁵³ 75 Fed. Reg. at 70316.

⁵⁴ 75 Fed. Reg. at 70315.

conclusion NYSE Arca is trying to establish. And the figures are not based on reality; they are simply conjecture. Moreover, the hypothetical blithely *assumes* “the availability of alternatives to an exchange’s depth-of-book data,” and as we have shown, that assumption is unsupported. Thus, even if it is true that “users of depth-of-book data account for significant trading volume, even though they only amount to a small percentage of all traders,”⁵⁵ those core traders cannot simply forgo buying the market data of an exchange with significant liquidity; they need the data in order to optimize trading profits. And their ability to switch orders to another trading venue does not prevent an exchange from charging supracompetitive prices for its unique depth-of-book data.

The Notice also recycles two anecdotes it claims support its order flow argument, but as the Court in *NetCoalition* held, neither of them remotely proves the point. Once again, NYSE Arca claims that the example of how Island ECN lost 50% of its market share eight years ago when it stopped displaying its order book to the public, somehow proves that NYSE Arca is today required by competitive constraints to charge a competitive price for its data. But as the *NetCoalition* Court properly concluded, the Island example merely shows that “depth-of-book market data is apparently important enough to at least some traders that it must be made available;” it “say[s] nothing about whether an exchange like NYSE Arca is constrained to price its depth-of-book data competitively.”⁵⁶ That is, at most, the Island example suggests that an exchange cannot go completely “dark” with respect to market data (or charge an infinite price that no one would pay) without jeopardizing its trading volume. It does not alter the fact that an exchange with significant liquidity, such as NYSE Arca, can charge supracompetitive prices and that it is currently doing so.

That the Island example is documented in a study by “well respected academics,” even an “exhaustive, refereed, published, and publicly available” one, is beside the point.⁵⁷ The study was directed at the single example of Island ECN.⁵⁸ Whether or not the study adequately and exhaustively describes the Island experience, it still fails to demonstrate the Notice’s theory of competitive constraint. Indeed, reliance on this same study was a key component of NYSE Arca’s petition for rehearing in *NetCoalition*, which the D.C. Circuit denied.

Finally, the fact that BATS, a “recent entrant,” has pursued a strategy of providing its depth-of-book data for free in order to gain order flow⁵⁹ proves only that the value of market data from trading venues that supply little liquidity is very limited and that the cost of collecting, consolidating and disseminating this data is likely trivial. As the

⁵⁵ *Id.*

⁵⁶ 615 F.3d at 541.

⁵⁷ 75 Fed. Reg. at 70316.

⁵⁸ See 75 Fed. Reg. at 70316 (citing Terrence Hendershott & Charles M. Jones, *Island Goes Dark: Transparency, Fragmentation, and Regulation*, 18 Rev. of Fin. Studies 743 (2005)).

⁵⁹ *Id.*

NetCoalition Court observed, it does not rebut the point that an exchange with significant liquidity can charge supracompetitive prices for its exclusive depth-of-book data.⁶⁰

In sum, the Notice provides no new or substantial evidence that competition for order flow acts as a meaningful competitive constraint on an exchange's depth-of-book data fees.

D. The “Joint Products” Theory Does Not Support The Contention That NYSE Arca’s Data Prices Are Constrained By Competition.

In an offshoot of its order flow argument, NYSE Arca, based on a NASDAQ-commissioned study, claims that market data and trade executions are “joint products” with “joint costs” that are linked on a “platform basis” and that competition among different trading “platforms” somehow constrains pricing for each exchange’s unique depth-of-book data.⁶¹ Under this theory, an exchange could price its data fees higher and execution fees lower, or vice versa, but would allegedly be constrained by competitive forces from pricing those fees in the aggregate above the price of joint products on other exchanges or trading venues.⁶² Like the theory that order flow competition constrains depth-of-book data fees, the joint products theory is fundamentally flawed and does not support the proposed fees.

First, the platform competition approach is inconsistent with the “fair and reasonable” requirement of Section 11A(c)(1)(C) of the Exchange Act.⁶³ The theory is that exclusive processors may set depth-of-book data prices that exceed competitive levels so long as they charge less for other services. Allowing so-called platform competition to immunize monopolistically-priced data fees from review by wrapping them together with fees for other services would nullify the “fair and reasonable” requirement.

Second, while the *NetCoalition* Court did not need to address the platform theory because the Commission did not rely on it in the proceedings below,⁶⁴ the Court made clear that in assessing the fairness and reasonableness of market data fees, the pricing and accompanying costs of *market data itself*, not some aggregation of market data with the fees for all of an exchange’s other products and facilities, is what is relevant. *See* 615 F.3d at 537 (“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”); *id.* at 538 (noting “the risk that NYSE Arca could exercise market power appears to be elevated in the pricing of its *proprietary non-core data*”).

⁶⁰ 615 F.3d at 541.

⁶¹ 75 Fed. Reg. at 70317.

⁶² *See* 75 Fed. Reg. at 70317 (adopting the discussion of “joint products” set forth in the *Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NASDAQ OMX PHLX, Inc. Relating to Market Data Feeds*, Exchange Act Release No. 62887; 75 Fed. Reg. 57092 (Sept. 17, 2010)).

⁶³ 15 U.S.C. § 78k-1(c)(1)(C).

⁶⁴ 615 F.3d at 541 n.16.

Third, the platform theory is flawed as a matter of economics. Order-execution services and market data are bought and sold separately, at different times in different proportions and by different consumers. Indeed, for firms that act as intermediaries between trading platforms and the public but do not trade themselves, such as Google and Yahoo!, the price of depth-of-book data stands entirely on its own.⁶⁵ Where two products are bought and sold separately, the price of each is the result of the distinct competitive conditions confronting each product, and competition for one does not constrain the pricing of the other.⁶⁶

Fourth, as with its order flow competition theory, NYSE Arca's platform competition theory wrongly assumes that traders can readily switch orders to another "platform" in response to a price increase in market data, and thereby lower their overall trading costs. But directing trade execution to a different platform does not save the trader the costs of purchasing market data from the first platform if he or she needs to obtain that platform's market data to optimize trading profits. And for those investors who purchase only market data from a platform and no other services, there is no aggregate cost of using an exchange, just the cost of the data it purchases. Their only choice is to pay the increased data prices imposed by the exchange or stop buying the data entirely.

Finally, the evidence does not support the platform competition theory. Although market share for order flow is volatile and changes dramatically, the Notice identifies no such volatility in the market for depth-of-book data. That market shares for order flow and depth-of-book data do not move in tandem further demonstrates that these two products are not jointly bought and sold, undercutting the entire premise of the "platform competition" theory.

IV. NYSE ARCA'S OTHER MISCELLANEOUS ARGUMENTS ARE WITHOUT MERIT.

NYSE Arca advances a number of arguments which purport to be evidence that fees for ArcaBook are fair and reasonable. Those arguments are flawed and cannot justify the proposed rule change.

A. A Comparison To Other Markets' Fees Is Irrelevant.

NYSE Arca continues to advance the discredited argument that the fees for ArcaBook are "fair and reasonable because they compare favorably to fees that other markets charge for similar products."⁶⁷ This argument is entirely circular, as it depends on prices that were

⁶⁵ *Economic Assessment* at 14; *Response* at 9.

⁶⁶ *See Response* at 14-15; *see also Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 929 (2d Cir. 1982) ("Competition between money market funds for shareholder business does not support an inference that competition must therefore also exist between adviser-managers for fund business. The former may be vigorous even though the latter is virtually non-existent. Each is governed by different forces.").

⁶⁷ 75 Fed. Reg. at 70313.

themselves not set by market forces and were not subject to scrutiny. As a matter of law, economics, or real-world business, one monopoly rent is not competitive simply because it is comparable to another monopoly rent.

B. Alleged Product Innovations Do Not Evidence Competition.

NYSE Arca also contends that “the history and continued schedule of product innovation are consistent with the presence of competition.”⁶⁸ However, exchanges do not create data. Rather, this input is created by investors in conjunction with their broker dealers and only then is it provided to the exchanges – for free, as required by law. There is little innovation in the NYSE Arca market data product or any other depth-of-book data products. The value of depth-of-book data comes not from an exchange’s innovation in terms of creating a new “product,” but rather from the exchange’s regulatory *uniqueness* arising from its status as an *exclusive* processor of data registered with and regulated by the Commission. Furthermore, innovation as a defense to a claim of market power “is often a speculative proposition.”⁶⁹ Moreover, even if true, innovation by one with market power is not an unqualified good.⁷⁰ In any event, so-called “innovation” of data products merely underscores the importance of depth-of-book data as a fixed input to optimization of trading profits and the ability of an exchange to charge a monopoly price for it.

C. NYSE Arca’s Attack on Data Vendors Is Baseless.

NYSE Arca asserts that the primary objectors to the 2006 Rule Change and Direct Order were data vendors “whose business interests lie firmly rooted in reselling the exchanges’ market data at significant mark-ups” and who faced “[n]o statutory standard constrain[ing] the amounts that those vendors may charge investors.”⁷¹ But SIFMA members and NetCoalition members are private sector intermediaries who compete without the benefit of government mandates, without government regulatory power, without antitrust immunity and without a captive rate base. In short, these private intermediaries are subject to competitive forces – the very competitive forces of which the D.C. Circuit could find no evidence in the context of exchange market data products.

V. CONCLUSION

It is time for the exchanges to accept, rather than continue to resist, the holding of the D.C. Circuit in *NetCoalition*. For the reasons set out above we respectfully request that the Commission temporarily suspend the proposed rules establishing NYSE Arca’s ArcaBook market data fees 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

⁶⁸ *Id.* at 70314.

⁶⁹ *FTC v. H.J. Heinz Co.*, 246 F.3d 708, 722 (D.C. Cir. 2001).

⁷⁰ *See United States v. Microsoft*, 253 F.3d 34, 57 (D.C. Cir. 2001) (“because innovation can increase an already dominant market share and further delay the emergence of competition, even monopolists have reason to invest in R&D”).

⁷¹ 75 Fed. Reg. at 70315.

EXHIBIT A

Mary Yeager
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February 6, 2007

VIA Electronic Submission and U.S. Mail

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, NW
Washington, DC 20549

**Re: Response to NetCoalition Petition for
Commission Review of SR-NYSEArca-2006-21**

Dear Chairman Cox:

On December 27, 2006, the Commission granted a Petition (the "Petition") of NetCoalition.com ("NetCoalition") for Commission Review of the action of the Division of Market Regulation in approving by delegated authority fees that NYSE Arca, LLC ("NYSE Arca") proposed to establish for its Arca Book product (the "Arca Book Fees").¹ We thank the Commission for this opportunity to comment on the Petition.

The Petition uses a shotgun approach in contesting the exercise of discretion by the Division of Market Regulation and the Commission. Many of the Petition's points have no bearing on NYSE Arca's Arca Book fee filing² whatsoever or apply to matters well beyond an assessment of whether Arca Book Fees meet the statutory requirements under the 1934 Act and Regulation MMS.

In this letter, we first describe the environment for the provision of market data over the internet and explain that market-based solutions have mooted the Petition's concerns. Then, we comment that, as a matter of law, NetCoalition had no standing under SEC Rules of Practice to bring the Petition. Following that, we voice our agreement with the Approval Order's conclusion that the Arca Book Fees meet the statutory standards for fee filings, as they are fair and reasonable and not unreasonably discriminatory. Finally, we seek to debunk some of the misconceptions that pervade the Petition.

¹ Release No. 34-54597; File No. SR-NYSEArca-2006-21 (October 12, 2006; the "Approval Order").

² See Release No. 34-53592; File No. SR-NYSEArca-2006-21 (June 9, 2006; the "Arca Book Fee Filing").

I. Industry Responsiveness.

By laying out a complex web of dissociated arguments, the Petition complicates what is really a simple comment: The essence of the Petition is that Arca Book Fees and other developments have:

- A. hampered the ability of investors to access real-time data by eliminating large internet portals' access to real-time data; and
- B. jeopardized the advertisement-sponsored business models of internet portals in the market data arena.

To dispel both of these notions, we wish to place the business models of NetCoalition's internet portals into the historical context of the market data business and to demonstrate that investors have ready access to real-time prices, generally for free. We also wish to describe how the long-standing tradition of market-based solutions has again responded to the needs of the markets' customers.

A. Market Forces and Industry Dynamism.

The supply of real-time data to investors, if market forces were allowed to interact without interference, would be contingent upon two things: the willingness of the markets to make their proprietary data available to intermediaries, such as vendors, broker/dealers and internet portals, and the willingness of those intermediaries to make the data available to investors. If data distribution does not serve the business interests of both the markets and the intermediaries, then investors will not receive the data. The combination of the markets' charges and the intermediaries' charges determines the amounts that investors pay for market data. Notably, Congress and the Commission regulate the markets' data fees, but allow the intermediaries to charge whatever the market will bear.

In addition, the business of real-time data distribution is dynamic, not static. Markets craft new market data products and find new and more efficient ways to provide access to that data. Intermediaries change their business models. New competitors enter the industry. The needs of investors change frequently. The markets develop solutions to meet those changing needs. We submit that they do so best when unencumbered by industry regulation.

B. Nonprofessional Subscriber Fees for Consolidated Data.

For trading-quality, consolidated data – data on which investors can make trading decisions – the markets that participate in the four national market system plans that govern market data (the “NMS Plans”)³ made important product changes nearly ten years ago. Those changes promoted the widespread availability of consolidated last sale price

³ The CTA Plan, the CQ Plan, the OPRA Plan and the Nasdaq/OTC Plan.

information and consolidated quotation information to nonprofessional investors. It did so by drastically reducing the fees applicable to the receipt of consolidated data by nonprofessional investors. For example, the Network A Participants did two things: They reduced the rate payable for consolidated real-time Network A prices and quotes to \$1/month per nonprofessional investor, and they introduced a "pay-as-you-go" model of \$.0075 cents per quote. In addition, they determined to continue their long-standing practice of permitting displays of 20-minute-old last sale prices free of charge.

Broker-dealers have coupled these low fees with other trading tools as a strategy to encourage customers to self-direct their accounts. The move toward self-directed accounts has enabled broker-dealers to eliminate a huge expense by vastly reducing the number of brokers that they require, to reduce commission rates substantially, and to provide real-time consolidated NMS Plan data to investors for no charge. Broker-dealers absorb the NMS Plan nonprofessional investor fees because doing so is in their economic best interests. Providing investors with free access to the data has stimulated trading activity and commission revenue. In turn, the significant rise in broker-dealer commission revenues has contributed to the further reduction in commission rates. There is no economic dysfunction and the investing public has benefited.

C. Internet Portals.

At the same time, a new category of intermediary has entered into the marketplace: internet portals. Yahoo Finance, Google Finance, and a host of other internet sites with no trading or order-entry capabilities now provide a very efficient means for providing investors the ability to monitor stock prices and other financial news. They compete not for trading commissions but for eyeballs to their sites. For many investors, internet portals have replaced the newspaper stock tables of an earlier era.

The internet portals convert their site visitors into revenue through advertising revenue, "click" revenue, or mark-ups on market data services. Until recently, visitors to internet sites only had access to the trading-quality real-time consolidated NMS Plan data described above. Some internet portals, like Yahoo, decided to pass the NMS Plan fees along to consumers with a mark-up. Yahoo packaged Network A data with Network B data and data made available under the OPRA Plan and the "Nasdaq/UTP Plan"⁴ and charged each investor \$13.95 per month, \$9.95 more than Yahoo paid to the NMS Plans for that package of data. Because the Commission does not regulate vendors and their right to mark prices up, market forces drove Yahoo's success at attracting investors to its \$13.95 service. This is as it should be. Yahoo provided investors with the alternatives of purchasing the \$13.95 real-time service from Yahoo, accessing delayed prices that Yahoo and hundreds of other internet sites make available without charge, or receiving real-time data from their broker-dealers without charge.

⁴ That is, the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotations and Transaction Information for Nasdaq-Listed Securities Trading on Exchanges on an Unlisted Trading Privilege Basis.

Several years ago, certain electronic communications networks ("ECNs") began to make their real-time quotes available for free in order to gain visibility in the market place. The quotes did not represent the high-quality, consolidated information that the Commission requires for making trading decisions. However, some internet portals determined that the free availability of these quotes made them suitable for distribution to visitors to their internet sites. These internet portals displayed the real-time ECN quotes along with delayed data from the NMS Plans.

At certain times, the ECN quotes aligned relatively well with the prevailing NMS Plan quotes; at other times they did not. Despite the fact that the quality of the real-time ECN quote may have rendered it more misleading than helpful, the real-time banner associated with it was important to the business models of the internet portals. It was another way in which they attracted viewers that they could convert into revenue.

D. The NYSE Internet Proposal.

As internet access was developing, the Commission proposed and adopted Regulation NMS. Rule 603 of Regulation NMS amends its predecessor statute so as to allow markets to vend their own last sale price information outside of the national market system plans, so long as the single-market prices are not made available in the context of trading or order-routing functionality (an "SRO-Only Prices Service").⁵ NYSE Arca and other markets applaud this change because it allows us to create new and innovative products for investors.

With this new distribution right in hand, NYSE contemplated the implementation of NYSE-only last sale price services. In a practice that is consistent with the advent of many market data products over the years, Google and CNBC approached NYSE about their internet portal needs.⁶ They asked NYSE to craft a real-time last sale price product that they could use without the administrative burdens that the NMS Plans attach to their products. Because neither of them supports trading or order-entry functions, they also made clear that they prefer not to pay for the trading-quality consolidated data stream that the NMS Plans make available. Though Google and CNBC had access to real-time quotes from ECNs, they considered NYSE real-time prices to be superior. For them, the NYSE brand has considerable value and furthers their own business objectives.

⁵ See Rule 603(c)(1) under Regulation NMS.

⁶ It is worth noting that neither NetCoalition nor any of its members (other than Google) ever approached NYSE Arca or NYSE to ask for a real-time product for their internet needs. By going directly to the Commission without first approaching the markets, NetCoalition has hampered the markets' ability to respond, has impeded NYSE Arca's ability to compete with other markets, and has chilled the willingness of markets to propose new products. Fortunately, one NetCoalition member had the foresight to approach NYSE directly, an action that has resulted in a market solution rather than a regulatory mandate.

In response to that dialog with Google, CNBC and other internet portals, NYSE recently submitted to the Commission a proposed product (the "NYSE Internet Proposal") that would meet the needs of internet portals and add to the number of choices that are available to intermediaries and investors for their receipt of real-time prices.⁷ The NYSE Internet Proposal responds to the requests of the internet service providers for a product that provides unlimited real-time prices at a fixed price and that eliminates the administrative burdens associated with NMS Plan products. Both Google (a NetCoalition member) and CNBC have enthusiastically endorsed the NYSE Internet Proposal and have indicated that they will provide NYSE last sale prices for free on their internet sites.

NYSE Arca, like NYSE and other markets, continues to have incentives to promote the widespread distribution of its information. When the data-distribution models currently available to access real-time data no longer suit the marketplace, or if a category of intermediaries feels that current methods do not fit its business needs, NYSE Arca will work with them to craft new ones. Market forces, not regulation, will best respond to changing market needs.

E. Mooting NetCoalition's Argument.

The confluence of investors' pervasive access to internet portals, the Commission's recent green light to SRO-Only Prices Services, internet portals' search for means of access to data that is suitable to their business models, and the markets' search for innovative new products that meet the needs of their constituents has resulted in NYSE's submission of the NYSE Internet Proposal. At least one other exchange has responded as well,⁸ evidencing that competitive forces are alive and well.

Most importantly, the NYSE Internet Proposal provides a significant benefit to investors. It adds to the data-access alternatives available to them and improves the quality, timeliness and affordability of data that they can receive over the internet. For the markets and the rest of the securities industry, not to mention the investing public, that is a significant development. It also indicates that markets can find solutions to issues if given the opportunity to do so.

One can measure whether prices comply with the "fair" and "reasonable" standards in many different ways. In the realm of proprietary market data products,⁹ the laws of supply and demand provide an appropriate basis for determining whether fees are fair and reasonable. In response to internet portals' request for a product suitable for internet service providers, NYSE submitted the NYSE Internet Proposal to the Commission. After discussions with those internet portals, NYSE established the price

⁷ See File No. SR-NYSE-2007-04, which NYSE submitted to the Commission on January 12, 2007. the Commission has yet to rule on the NYSE Internet Proposal.

⁸ See File No. SR-Nasdaq-2006-060.

⁹ That is, products that individual exchanges make available outside of NMS Plans and that are not essential to making trading decisions.

and other terms and conditions for which it was willing to make its proprietary information available. Some major internet portals determined that paying that price and complying with those terms and conditions are in their best business interests. This interaction of market forces makes the price fair and reasonable. For internet portals, this approach would enhance the ability for hundreds of millions of investors to access real-time prices free of charge. Everybody wins. Let the markets work.

In sum, the NYSE Internet Proposal moots the Petition. NetCoalition can no longer claim that NYSE Arca's business decision to convert Arca Book into a fee-liable product harms visitors to internet sites or jeopardizes the internet portals' advertisement-sponsored business models. It also stands as testimony to the success of market-based solutions to industry needs.

II. NetCoalition Has No Standing to Petition the Commission.

Rule 430 of the SEC Rules of Practice (the "Rules") allows a party to an action made pursuant to delegated authority, or any person aggrieved by that action, to seek Commission review of the action by filing a notice of intention to petition an action taken by the staff of the Commission pursuant to delegated authority. On November 6, 2006, NetCoalition.com ("NetCoalition") submitted such a notice to seek Commission review of the Division of Market Regulation's approval of Arca Book fees on authority delegated by the Commission. The Commission's grant of the Petition triggered an automatic stay of the approval of the Arca Book fees pursuant to Rule 431. As a result of the stay, NYSE Arca finds itself at a competitive disadvantage relative to exchanges that the Commission has allowed to charge for market data products that are substantially similar to Arca Book.

NYSE Arca submits that NetCoalition's Petition does not satisfy the statutory requirements for the submission of a petition under Rule 430 and that the Petition is therefore invalid as a matter of law.

A. NetCoalition Is Not an Aggrieved Person.

NetCoalition is not a "party to an action made pursuant to delegated authority" and is not "a person aggrieved by such action," as required by section (b)(1) of Rule 430 of the Rules. Under that section, NetCoalition must show, not only that it is a person, but that it is a person *aggrieved*. This, it has failed to do. In fact, the Petition fails to identify a single NetCoalition member that was receiving Arca Book data at the time that NYSE Arca submitted the Arca Book Fee Filing.

Commission opinions addressing Rules 430 and 431 have not focused on whether the party seeking review of a decision made pursuant to delegated authority was a "person aggrieved."¹⁰ Arguably, this is because few parties have brought petitions

¹⁰ See, e.g., GB Holdings, Release No. 34-49549, 2004 WL 1207928 (Apr. 9, 2004) (reversing the decision of the Commission, pursuant to delegated authority, on the

pursuant to Rules 430 and 431, and those that have were persons that the Commission action directly affected; i.e. people who were *clearly* aggrieved.

Nevertheless, the Commission has, itself, argued in other contexts (i.e., matters not involving Rules 430 and 431) that whether a person is aggrieved is, fundamentally, a question of standing.¹¹ The Commission's position in these cases is that a person must have standing to be "aggrieved", and without standing, there is no basis for a challenge to Commission actions.

Standing requires a showing of (1) an injury in fact,¹² that (2) is causally connected to the challenged conduct,¹³ and (3) for which a favorable decision will redress the injury.¹⁴ When an organization or association wishes to assert associational standing on behalf of its members, as NetCoalition seeks to do, it must demonstrate that:

ground that the Division of Market Regulations had mistakenly concluded that there had been no objections to the application of GB Holdings to withdraw certain notes from listing and registration on the American Stock Exchange; objection had been made by, and petition was brought by, 10 percent owner of the stock of GB Holdings); Knight Trading Group, Inc., Release No. 34-46609, 2002 WL 1961282 (Aug. 23, 2002); *In re. S.E.C. ex rel. Glotzer*, 374 F.3d 184, 188-189 (2d Cir. 2004).

¹¹ See, e.g., *Indep. Investor Protective League v. Securities and Exch. Comm'n*, 495 F.2d 311 (2d Cir. 1974) (holding that investor league which challenged the Commission's grant of exemptions to various applicant companies under the Investment Company Act of 1940 was not "aggrieved" within the meaning of that act, and therefore had no standing to challenge the Commission's actions); *Option Advisory Serv., Inc. v. Securities and Exch. Comm'n*, 668 F.2d 120 (2d Cir. 1981) (per curiam) (same); *Fund Democracy, LLC v. Securities and Exch. Comm'n*, 278 F.3d 21 (D.C. Cir. 2002) (same).

¹² An "injury in fact" is "an invasion of a legally protected interest that is concrete and particularized and, thus, actual or imminent, not conjectural or hypothetical." *DH2, Inc. v. United States Securities and Exch. Comm.*, 422 F.3d 591, 596 (7th Cir. 2005).

¹³ Causal relation requires that "the injury can be fairly traced to the challenged action of the defendant." *Id.*

¹⁴ *DH2, Inc. v. United States Securities and Exch. Comm'n*, 422 F.3d 591, 596 (7th Cir. 2005). In *DH2*, the plaintiff challenged a Commission rules release which required mutual fund companies to estimate current fair prices of securities when the market price at which those securities closed had become unreliable. The plaintiff argued that such a rule would cause it economic harm, because the companies in which it invested would be required, under the rule, to engage in subjective, estimated pricing of their securities. The court held that the claimed injury was too attenuated, and dismissed the case for lack of standing.

its members would otherwise have standing to sue in their own right, the interests it seeks to protect are germane to the organization's purpose, and neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit.¹⁵

In *Indep. Investor Protective League*, the court held that a claim that "it is quite conceivable that in the future" its members would be investors was an insufficient basis for standing. Rather, "a plaintiff must allege that he has been or will in fact be perceptibly harmed by the challenged agency action, not that he can imagine circumstances in which he could be affected."¹⁶

The market for Arca Book quotations, and therefore the individuals and organizations that the Arca Book Fees will directly impact, are the broker-dealer members of NYSE Arca and other market professionals and institutional investors. NetCoalition, by contrast, is a "public policy" lobbying group for certain major internet companies, including "CNET Networks, Bloomberg L.P., Google, IAC/Interactive Corp., and Yahoo!"¹⁷

In another case, the Court of Appeals for the District of Columbia Circuit considered who or what constitutes a "person aggrieved" the 1934 Act. In *Nat'l Ass'n of Securities Dealers, Inc. v. Securities and Exch. Comm'n*, 431 F.3d 803 (D.C.Cir. 2005), NASD, via its National Adjudicatory Council ("NAC"), had disciplined two of its members for, among other things, engaging in a manipulative scheme. The disciplined members sought review before the Commission, which reversed the decision of NAC. NASD then petitioned for review in court, claiming that its Market Regulation Department ("MRD") would be frustrated in its mission if the Commission's reversal were permitted to stand, because the MRD would be unable to take disciplinary action against members and associated persons, except in the very narrow circumstances covered by the decision of the Commission.

The court refused to consider NASD's petition on the merits, because it concluded that NASD lacked standing to sue, and it therefore dismissed the case. Specifically, the court held that NASD was not a "person aggrieved," within the meaning of §25(a) of the 1934 Act,¹⁴ and therefore could not establish standing. NASD had claimed that it was a "person aggrieved" because the definition of "person" in the 1934 Act includes juridical persons (i.e. companies).¹⁴ The court rejected this argument, concluding, first, that NASD was not a "person" because the 1934 Act separately defined "self-regulatory organization[s]" such as NASD,¹⁴ and, more importantly, NASD was not a person *aggrieved* because any adjudicative authority that NASD had was entirely derivative of the authority vested in the Commission.

¹⁵ *Fund Democracy, LLC*, 278 F.3d at 25.

¹⁶ 495 F.2d at 312.

¹⁷ Petition, p. 1, note 1.

At best, the Petition makes the unsubstantiated claim that “[t]he instant proposal imposes fees that put NYSEArca quotations beyond the reasonable economic reach of an advertiser-supported medium like the Internet, thereby harming the investors and the internet service providers that are Petitioner’s members.”¹⁸ This claimed “injury” is speculative at best, and certainly does not rise to the level of a cognizable injury in fact.

Similarly, NetCoalition cannot assert institutional standing because none of its members have standing in their own right.¹⁹ In fact, NetCoalition concedes that the proposed Arca Book Fees may not be prohibitive to investors,²⁰ in which case advertising revenues will not be lost and NetCoalition’s members will suffer no harm.

Combining NYSE’s suitable proposed alternative (i.e., the NYSE Internet Proposal) with the Petition’s failure to cite a single NetCoalition member who used Arca Book data for internet displays at the time that NYSE Arca proposed the Arca Book Fees leads to the inescapable conclusion that the Arca Book Fees imposed no harm on either NetCoalition or its members. NetCoalition must do more to establish standing than “imagine circumstances in which [it] could be affected” by the proposed fee.²¹ Indeed, it must allege that it “has been or will in fact be *perceptibly* harmed by the challenged” fee.²² This, it has not done.

Therefore, NYSE Arca respectfully submits that NetCoalition lacks standing as an aggrieved person to challenge the Commission’s actions pursuant to delegated authority, and that the Commission erred in granting the Petition.

B. The Findings Are Those of the Commission, Not the Staff.

The Commission derives its authority to delegate certain functions to the Division of Market Regulation pursuant to paragraph (a)(12) of Rule 30-3 (“Delegation of Authority to Director of Division of Market Regulation”) of the Commission’s Rules of Organization and Management. That delegation authorizes the Division of Market

¹⁸ Petition, p. 3.

¹⁹ *See Fund Democracy, LLC, supra.*

²⁰ *See, e.g.,* Petition p. 15 (“Relatively few of our members’ customers are going to purchase market data at \$75 per month [an amount proposed for access to Nasdaq data]. It is unclear how many would buy NYSEArca data at \$9 per month, but clearly even at \$1 per month – *where one might expect more user participation* – the Commission staff is authorizing a transfer from retain investors to a for-profit monopoly of hundreds of millions of dollars annually, with literally zero showing of any cost basis.”) (emphasis added).

²¹ *Indep. Investor Protective League, 495 F.2d at 312.*

²² *Id.* (emphasis added.)

Regulation to act on the Commission's behalf to "publish" and "approve" SRO proposed rule changes.²³

However, the Petition alleges that the Division of Market Regulation did more than publish and approve the Arca Book Fee Filing. It intimates that the Division of Market Regulation, and not the Commission, made the determinations and findings set forth in the Approval Order.²⁴ That reading of the Approval Order conflicts with its plain language. The Approval Order states that the Commission, not the Division of Market Regulation, made, *inter alia*, the following findings and conclusions:

1. Arca Book Fees are consistent with the requirements of the 1934 Act and the rules and regulation under the 1934 Act;
2. Arca Book Fees are consistent with section 6(b)(4) of the 1934 Act;
3. NYSE Arca has not failed to justify NYSE Arca Fees; and
4. Arca Book Fees will not diminish market transparency or impede competition.

After attributing those findings to the Commission, the Approval Order attributes the issuance of the Approval Order to "the Division of Market Regulation, pursuant to delegated authority."²⁵

Aside from the fact that the statutory delegation of authority does not delegate to the Division of Market Regulation the authority to make findings and conclusions on behalf of the Commission, the history of the Arca Book Fee Filing belies the Petition's notion that the Division of Market Regulation made the findings and conclusions. The Arca Book Fee Filing was the result of a deliberative process, a process in which the Commissioners played a role. The process included several comments letters, two

²³ 17 CFR 200.30-3. That delegation of authority reads as follows:

[T]he Securities and Exchange Commission hereby delegates . . . the following functions to the Director of the Division of Market Regulation to be performed by him or under his direction by such person or persons as may be designated by the Chairman of the Commission:

- (a) With respect to the Securities Exchange Act of 1934 . . .
 - (12) Pursuant to Rule 19b-4 (§ 240.19b-4) of this chapter, to publish notices of proposed rule changes filed by self-regulatory organizations and top approve such proposed rule changes.

²⁴ Petition, p. 2.

²⁵ Approval Order, p. 2.

responses to those letters from NYSE Arca, numerous discussions between NYSE Arca staff and Commission staff, reports to NYSE Arca staff of conversations between Commission staff and Commissioners, and a four-month interlude between filing and approval. NetCoalition was well aware of this process, as it submitted one of the comments letters. We believe that it is disingenuous of NetCoalition to ascribe the Approval Order's findings and conclusions to Commission staff.

III. Applying the Statutory Standards.

The 1934 Act and Commission rules under the 1934 Act subject market data fees to the following standards:

- A. NYSE Arca must provide for the "equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities."
- B. Rule 603(a)(2) of Regulation NMS requires NYSE Arca to provide market data on terms that are not unreasonably discriminatory.
- C. Rule 603(a)(1) of Regulation NMS requires that market data fees must be fair and reasonable.

The Arca Book Fees meet all of these standards. For one thing, they represent the first time that NYSE Arca has established a fee that a person or entity other than an Arca member or listed company must pay. By imposing fees on those who use the facilities of NYSE Arca but do not otherwise contribute to NYSE Arca's operating costs, the Arca Book Fees provide an equitable allocation of fees and charges.

The Arca Book Fees subject all professional subscribers to the same fees and all nonprofessional subscribers to the same fees. The only "discrimination" that takes place is that professional subscribers would pay higher Arca Book Fees than nonprofessional subscribers. However, the Commission and the industry have long deemed discrimination in favor of nonprofessional subscribers to be reasonable.

That leaves the "fair" and "reasonable" standards. The Petition goes on at length about the failure of the Arca Book Filing to justify Arca Book Fees. We disagree. The Arca Book Filing states that the level of the proposed Arca Book Fees is justified because:

- A. they compare favorably to the level of fees that other U.S. markets and the CTA and Nasdaq/UTP Plans impose for comparable products;
- B. the quantity and quality of data the NYSE Arca includes in Arca Book compares favorably to the data that other markets include in their market data products; and

- C. the fees will enable NYSE Arca to recover the resources that NYSE Arca devoted to the technology necessary to produce Arca Book data.

These justifications are consistent with industry norms. The Commission has approved a number of filings with these sorts of justification arguments. In the Approval Order, the Commission stated, "the Commission disagrees with commenters' assertion that the Exchange has failed to justify its proposed fees."²⁶

In setting the level of Arca Book Fees, NYSE Arca did not act arbitrarily or capriciously, as the Petition suggests.²⁷ Rather, NYSE Arca studied what other markets charge for comparable products and took into consideration a number of additional factors, including:

- (1) consultation with some of the entities that NYSE Arca anticipated would be likely to take advantage of Arca Book Fees;
- (2) the contribution that revenues accruing from Arca Book Fees would make toward replacing the revenues that NYSE Arca stands to lose as a result of the removal of the NQDS service from the Nasdaq/UTP Plan;²⁸
- (3) the contribution that revenues accruing from Arca Book Fees would make toward NYSE Arca's market data business;²⁹

²⁶ Approval Order, p. 11

²⁷ Petition, p. 6

²⁸ As a consequence of the Commission's approval of the exchange registration of the Nasdaq Stock Market, Inc. ("Nasdaq") in 2006, the NQDS service moved from the Nasdaq/UTP Plan to Nasdaq. (See Release No. 34-53128; File No. 10-131 (January 13, 2006; the order by which the Commission approved Nasdaq's registration as an exchange) and Release No. 34-53250; File No. S7-24-89 (February 7, 2006; the order by which the Commission approved the move of the NQDS service from the Nasdaq/UTP Plan to Nasdaq).)

NYSE Arca's portion of the revenues attendant to the NQDS service under the Nasdaq/UTP Plan amounted to approximately \$8 million per year. Because of the move, NYSE Arca loses those revenues. NYSE Arca projects that Arca Book revenues will initially enable NYSE Arca to recapture only a portion of its lost NQDS revenues.

²⁹ While NYSE Arca cannot predict the amount of revenues that NYSE Arca will collect from Arca Book Fees, NYSE Arca anticipates that its market data revenue as a percent of its total revenue is likely to remain close to its 2005 total, which was about 17 percent of NYSE Arca's revenues, slightly less than industry norms. See Section IV(D)(d) of the Self-Regulation Concept Release. The rest of NYSE

- (4) the contribution that revenues accruing from Arca Book Fees would make toward meeting the overall costs of NYSE Arca's operations;
- (5) projected losses to NYSE Arca's business model and order flow that might result from marketplace resistance to Arca Book Fees; and
- (6) the fact that Arca Book is primarily a product for market professionals, who have access to other sources of market data and who will purchase Arca Book only if they determine that the perceived benefits outweigh the cost.

In short, NYSE Arca's review of the arguments that the Petition makes does not change NYSE Arca's view that Arca Book Fees reflect an equitable allocation of NYSE Arca's overall costs to users of its facilities.

IV. Debunking Misconceptions.

A. There Is No Cost-Based Pricing Mandate.

The Petition would have the reader believe that Arca Book Fees must be subjected to a "rigorous cost-based analysis."³⁰ Out of the Securities Exchange Act Amendments of 1975, the hundreds of pages of legislative history underlying those amendments, the many concept releases, committee reports and rules proposals regarding market data, and the hundreds of Commission orders approving SRO and NMS market data fee filings that pre-date the Petition, NetCoalition is able to cite only one instance to support this claim.³¹ In its 1999 Concept Release on Market Data Fees and Revenues, the Commission proposed a framework for setting market data fees that it would base on a flexible application of costs. In the context of promoting that flexible cost-based approach, that Commission added a sentence that noted that Congress did not impose a cost-of-service standard, but that "the Commission . . . believes that the total amount of market information revenues should remain reasonably related to the cost of market information."

Arca's 2005 revenues consisted of revenues from transaction fees (82 percent) and revenues from listing and other sources (one percent).

³⁰ Petition, p. 10.

³¹ The Petition also cites the Concept Release concerning Self-Regulation (Release No. 34-50700; File No. S7-40-04 (November 18, 2004; the "Self-Regulation Concept Release")) to support the notion that the Commission has concluded that a cost-based standard is required to justify a market data fee. However, the Self-Regulation Concept Release says no such thing. See Section IV(D)(d) of that release.

The Petition states that Commission “staff has departed markedly from this wise counsel,”³² interpolating the Commission’s 1999 statement to mean that the Commission has somehow imposed a strict cost-based standard for market data fees since the 1999 Concept Release.

We disagree. The Petition’s intimation that the staff has failed to apply the Commission’s standard since 1999 and that the Commission has failed in its oversight of the staff’s application of the standard is simply untrue. Neither Congress nor the Commission has ever adopted such a standard. Nor should it. The Petition fails to mention that a significant portion of the industry soundly rejected cost-based market data pricing in response to the 1999 Concept Release,³³ that the Commission raised the subject again in 2000 by forming a committee of industry experts³⁴ to study that and other market data questions and that that committee soundly rejected the concept of cost-based pricing.³⁵ The Commission again raised the question of a flexible cost-based pricing

³² Petition, p. 11.

³³ See, for example, letter from Michael Atkin, Vice President, Financial Information Markets, Software and Information Industry Association, to Jonathan G. Katz, Secretary, Commission, dated March 30, 2000; letter from Sara Banerjee and Ralph Bassfeld of Telekurs Financial Information Ltd to Jonathan G. Katz, dated March 28, 2000; letter of Kenneth S. Spierer of Merrill Lynch, Pierce, Fenner & Smith Incorporated to Jonathan G. Katz, dated March 31, 2000; letter of Wendy L. Gramm and Susan E. Dudley of The Regulatory Studies Program of the Mercatus Center at George Mason University to Arthur Levitt, Chairman, Commission, dated March 31, 2000; letter of Thomas J. Jordan, President, Jordan & Jordan to Jonathan G. Katz, dated April 7, 2000, and letter of James E. Buck, Senior Vice President and Secretary, NYSE, to Jonathan G. Katz, dated April 10, 2000.

³⁴ The Advisory Committee on Market Information (the “Advisory Committee”) included high-ranking representatives of academia, securities markets, market data vendors, online and traditional broker-dealers, institutional investors, a consulting firm and an industry trade association. Gerald Putnam, then the Chief Executive Officer of Archipelago (NYSE Arca’s predecessor), was one of the representatives. The industry trade association that participated took an active part in the Advisory Committee’s deliberations and today is part of the Securities Industry and Financial Markets Association, a trade association that has joined NetCoalition in opposing Arca Book Fees.

³⁵ The Advisory Committee rejected utility rate-making in general and the flexible cost-based approach in particular. It dismissed the approach as “unwise,” “unworkable,” “disfavored,” “resource-intensive” and “distortive.” (See “Report of the Advisory Committee on Market Information: A Blueprint for Responsible Change” (September 14, 2001) at p. 93.)

standard as part of its Self-Regulation Concept Release and as part of its Regulation NMS initiative.³⁶ Once Again, a significant portion of the industry opposed the concept.

NYSE Arca concurs with the many others commenters who oppose the establishment of a cost-based approach.³⁷ In its April 10, 2000, response to the 1999 Concept Release (the "NYSE Response"), NYSE commented that the cost-based approach that the Commission has proposed "simply will not work. It would inappropriately burden both the government and the industry, stifle competition and innovation, and in the end, *raise* costs and, potentially, fees." NYSE Arca shares this view and refers the Commission to Part I(B) of the NYSE Response and to Appendices C, C-1 and C-2 to the NYSE Response for a solid explanation of the many reasons why NYSE Arca believes that NetCoalition's assertion that market data fees should be cost-based is not in the best interests of the industry.

B. Comparisons Are a Proper Basis for Justifying Fees.

The Petition would have the reader believe that the Arca Book Filing failed to provide adequate justification for the level of the proposed Arca Book Fees. In light of the Commission's finding in the Approval Order that the Arca Book Filing adequately justified the proposed level of Arca Book Fees, the Petition seemingly asks the Commission to substitute NetCoalition's judgment for that of the Commission.³⁸ It asserts that justification of fees by comparing them to other fees does not satisfy the statutory requirement.

We disagree. The Arca Book Fees compare favorably to those that NYSE charges for OpenBook and Nasdaq charges for TotalView. It also compares favorably to the fees that the American Stock Exchange has recently proposed for its depth-of-book product.³⁹ As the Commission has written, the fees that United States securities markets charge compare favorably to those that foreign exchanges charge and market data revenues constitute a smaller portion of the total revenues of United States securities markets than those of foreign countries.⁴⁰ The revenues that all securities markets collect from the sale of market data compare favorably to the revenues that market data vendors receive for acting as intermediaries in providing the markets' data to their subscribers.⁴¹

³⁶ Release No. 34-51808; File No. S7-10-04 (the "Regulation NMS Adopting Release").

³⁷ See footnote 32.

³⁸ The Approval Order concludes, "Accordingly, the Commission disagrees with commenters' assertion that the Exchange has failed to justify its proposed fees."

³⁹ See File No. SR-AMEX-2006-100.

⁴⁰ See Section IV(D)(d) of the Self-Regulation Concept Release.

⁴¹ NYSE Arca notes that NetCoalition lists Bloomberg LLP as a Trustee. On average, a broker pays Network A approximately \$25 per month per device for the receipt and use of Network A data. That broker typically pays Bloomberg

The markets' revenues represent a tiny fraction of the vendors' revenues.⁴² The revenues that market data currently contributes to the markets' collective revenue pool compare favorably with their historic contribution.

Most notably, market data revenues compare favorably to the markets' cost of producing the data. Although the Petition asserts that increases in transaction fees have generated sufficient fees to offset the modest costs of consolidating and disseminating market data, the reality is that, if the Commission were to require markets to cost-justify their market data fees, the costs would be far from modest. Because producing market data is a primary exchange output, most amounts that an exchange spends on systems, infrastructure and development is properly allocated to market data production. The production costs represent the costs of attracting order flow to that market. For NYSE Arca, market data covered approximately 18 percent of total NYSE Arca expenses for 2005.

In our view, these comparisons are not misplaced. They provide a sound and appropriate basis for asserting that fees are fair and reasonable.

C. Arca Book Fees Are Not an Exercise of Monopoly Power.

If the scattered approach of the Petition can be said to focus on any one thing, it is the allegation that Arca Book Fees amount to an exercise of monopoly pricing power. This is a misconception. Markets compete with one another by seeking to maximize the amount of order flow that they attract. The markets base the competition for order flow on such things as technology, customer service, transaction costs, ease of access, liquidity and transparency. In recent months, significant changes in market share, the rush to establish trade-reporting facilities for the reporting of off-exchange trades, frequent changes in transaction fees and new market data product proposals have provided evidence of the intensity of the competition for order flow.

The following description of how many brokerage firms typically handle the orders that they receive illustrates one aspect of competition in the securities industry:

\$1500 to \$2000 per month to act as an intermediary in getting the Network A data (and other markets' data) to the broker.

We also note that supporting the broad-based pricing initiatives set forth in the Petition, such as cost-based pricing, comports with comments that Bloomberg has made for years and serves Bloomberg's business model nicely.

⁴² In the Commission's Self-Regulation Concept Release, the Commission pointed out that "in 1998, the total SRO market data revenue . . . represented a very small portion of the securities industry's total expenses for the year -- less than 1/4th of one percent." See Section IV(D)(d) of the Self-Regulation Concept Release.

- When a brokerage firm receives an order, its first preference is to internalize its execution. This allows it to avoid exchange fees and to earn a “dealer” profit.

However, internalization requires a price on which to base the trade. The price that the markets discover under the NMS Plans is always a safe price for the brokerage firm to use.

If successful in internalizing the order, the brokerage firm can simply post the trade to the NASD.

- If the brokerage firm is unable to internalize the trade, typically, it next takes the order to dark pools, crossing networks, ECNs, alternative trading systems, or other non-traditional execution facilities to search for an execution.
- If the brokerage firm is unable to execute the order at any of those locations, it resorts to its safety net: traditional exchanges. Currently, eleven exchanges trade listed securities in the United States.
- If NYSE Arca is successful in having the brokerage firm chose to send the order to it rather than another exchange, the order follows one of three paths:
 1. NYSE Arca will create a trade price and execute the order immediately;
 2. if the order cannot be executed immediately, the brokerage firm may elect to have NYSE Arca display the order in Arca Book, which contains a compilation of all limit orders that broker-dealers have submitted to NYSE Arca for display; or
 3. the brokerage firm may elect to have NYSE Arca hold a portion of the order as hidden interest that NYSE Arca holds in reserve, which means that NYSE Arca will not include the undisplayed portion of the order as part of the Arca Book display.

As a result of all of the choices and discretion that are available to brokers, the displayed depth-of-book data of one trading center does not provide a complete picture of the full market for the security. It displays only a portion of all interest in the security. A brokerage firm has potentially dozens of different information sources to choose from in determining if, where, and how to represent an order for execution. Singling out depth-of-book information for utility-type regulation harms the markets providing the information to investors, and furthers the business agendas of brokers who wish to use the depth-of-book information to compete against the markets that provide it.

The Commission has prescribed top-of-the-book consolidated market data as the data required for best execution purposes and the NMS Plans make that data available.⁴³ While some brokers may wish to supplement that data with depth-of-book and other information to facilitate their order-routing decisions, no regulatory requirement makes this anything other than optional. In addition, those who choose to use Arca Book data as part of an order execution strategy have no obligation to send their order flow to NYSE Arca for execution. For instance, they may opt to internalize the order, essentially free riding on the Arca Book information, rather than to send their order flow to NYSE Arca.

The marketplace is the best determinant of the amount of reward for quality and innovation. If NYSE Arca were to set Arca Book Fees too high, broker-dealers and other professionals would forego Arca Book data and would choose to receive the depth-of-book service of other markets. If too many market professionals reject Arca Book as too expensive, NYSE Arca would have to reassess the Arca Book Fees because Arca Book data provides transparency to NYSE Arca's market, transparency that plays an important role in the competition for order flow. In short, the monopoly power that the Petition asserts does not exist.

More importantly, any suggestion that NYSE Arca or any other exchange holds a monopoly in the order-execution business is simply wrong. The order-execution business is highly competitive. Firms choose how to execute their orders and have no obligation to route them to a particular exchange for execution. While the Arca Book Fees entitle the recipient to receive Arca Book limit order information for Network A securities, Network B securities and Network C securities (i.e., stocks listed on Nasdaq), NYSE Arca does not maintain a dominant share of the market in any of the three networks.⁴⁴

Assuming, *arguendo*, that NYSE Arca holds monopoly pricing power, the Petition's assertion that the exercise of this power harms investors is also misplaced. The overwhelming majority of retail investors are unaffected by the inter-market competition over proprietary depth-of-book products. For them, the consolidated top-of-the-book data that the markets make available under the NMS Plans provides adequate information on which they can base trading decisions. The industry makes that market data widely

⁴³ In connection with its adoption of Regulation NMS, the Commission reviewed, and submitted for comment, whether to mandate the markets' distribution of top-of-the-book data and depth-of-book data. It affirmed (again) its long-standing policy of requiring the markets to make consolidated national best bids and offers available, but leaving distribution of a market's depth-of-book data to the market's discretion, subject to standards of fairness and reasonableness. See Section V(A)(4) of the Regulation NMS Adopting Release.

⁴⁴ During 2005, NYSE Arca enjoyed the following percentages of shares traded:

- Network A: 3.6 percent
- Network B: 30 percent
- Network C: 23 percent

available, and at no direct cost to the investor.⁴⁵ Products such as that proposed in the NYSE Internet Proposal provide them with a source of price information that keeps them sufficiently abreast of the market. The few retail investors who feel they need depth-of-book information can simply purchase it. In the Arca Book filing, that would cost the investor as little as \$5 per month.

The Commission designed Regulation NMS, in part, to promote innovation in the market data arena. This initiative has already yielded positive results, as markets have proposed several new and innovative products since the adoption of Regulation NMS.⁴⁶ This burgeoning creativity benefits the marketplace but contradicts the Petition's assertions of monopoly power in the market data industry. Ironically, the Petition has blocked this progress by preventing new market data products from reaching consumers.

D. Arca Book Fees Will Not Impose a Burden on Competition.

Arca Book Fees do not discriminate unreasonably and therefore do not impose a burden on competition on broker-dealers, other market professionals or any other party that wishes to receive Arca Book data. Each recipient must pay the same fees as every other recipient.

The Approval Order specifies that "the Commission does not believe that the imposition of fees for NYSE Arca data will diminish market transparency or impede competition." We agree. In fact, the establishment of Arca Book Fees represents the epitome of competition. It reflects the interplay of market forces at work. NYSE Arca believes that the revenues that NYSE Arca receives from Arca Book Fees will enable NYSE Arca to compete better with markets that have larger revenue sources than NYSE Arca. So does the NYSE Internet Proposal and other innovative market data products that markets have recently introduced or will soon be introducing.

In turn, the establishment of Arca Book Fees will reduce burdens on competition for markets that elect not to charge for their depth-of-book data. They will have less competition when seeking parties to take their data.

E. Per-Terminal Fees Are Not Intended for Unregistered Use.

The Petition would have the reader believe that Arca Book Fees would impose exorbitant charges on internet users. It suggests that the exchanges would receive about

⁴⁵ For example, the ten largest online brokers provide CTA and CQ data to their clients free of charge.

⁴⁶ For example, the NYSE Internet Proposal, the NYSE Retail Trading Product and Program Trading Product (File No. SR-NYSE-2006-32; Release No. 34-54055), the AMEX depth-of-book proposal (File No. SR-AMEX-2006-100), and Nasdaq's proposed Nasdaq Custom Data Feeds (Release No. 34-54959; File No. SR-NASDAQ-2006-056).

\$44 billion dollars in revenue as the result of per-terminal internet fees.⁴⁷ Of course, this is nonsense.

NYSE Arca targeted the Arca Book service primarily for professional subscribers. Current consumption of order-book products by nonprofessional investors demonstrates that very few nonprofessional investors find value in these products. While internet portals may elect to make it available to nonprofessional users at the nonprofessional rates, NYSE Arca only imposes the nonprofessional subscriber charge in respect of those investors who wish to receive it. To receive the service, an interested investor must register to use the product and execute an agreement to do so. In addition, NYSE Arca imposes the nonprofessional fees on the vendor intermediary rather than on the end user. As is the case today with nonprofessional subscriber fees under the NMS Plans, the intermediaries may absorb those fees, may pass them through to the end-users, or may mark them up, as NetCoalition-member Yahoo does. In performing its math, the Petition assumes that all 49 million Americans that visit financial sites would subscribe and pay.⁴⁸ That calculation misconstrues the process.

F. NYSE Arca Will Not Impose Fees Retroactively.

The Petition would have the reader believe that NYSE Arca would impose the Arca Book Fees retroactively. NYSE Arca has never represented that it would do so and has no intention of doing so.

G. Market Data Revenues Have Remained Stable.

A letter of the Securities Industry and Financial Markets Association ("SIFMA") comments on the Petition.⁴⁹ In that letter, SIFMA comments that market data revenues of NYSE Group (the parent company of NYSE Arca and NYSE) for the third quarter of 2006 rose 33.7 percent from the year-earlier (i.e., 2005) three-month period. However, that statistic does not mean that NYSE or NYSE Arca recognized a significant increase in market data revenues during 2006. It only reflects that 2005 market data revenues for NYSE Group, unlike its 2006 counterpart, does not include NYSE Arca market data revenues (since NYSE Arca's merger with NYSE had not yet been consummated). In fact, the combined market data revenues for NYSE and NYSE Arca showed a slight decline from 2005 to 2006.⁵⁰

⁴⁷ Petition, p. 14

⁴⁸ *Id.*

⁴⁹ See letter from Ira Hammerman, Senior Managing Director and General Counsel, SIFMA, to Nancy Morris, Secretary, Commission, dated January 17, 2007 (the "SIFMA Letter").

⁵⁰ Pro forma results disclose that NYSE Arca and NYSE received a combined \$242 million in 2005, while NYSE Group received \$235 million for 2006.

H. Users Receive COS Data and Arca Book Data at Similar Speeds.

The SIFMA Letter comments about the speed with which the Arca Book data feed will allow recipients to receive Arca Book data, noting that NYSE Arca has advertised that the unconsolidated Arca Book feed is faster than the consolidated feed that the markets make available under the CQ and Nasdaq/UTP Plans. However, the variations in speed are measured in milliseconds, a time difference that only the most sophisticated order-routing engines would notice. From a display perspective, the difference is imperceptible. Furthermore, the CQ Plan participants have undertaken a technology upgrade that will reduce latency for the CQ data feed. It will thereby reduce the difference in speed between the Arca Book feed and the CQ Plan feed. The CQ Plan participants currently anticipate that they will complete the upgrade later this month. They anticipate that the upgrade will reduce the latency of the CQ Plan feed from several hundred milliseconds to approximately 30 milliseconds. As data-distribution speed continues to grow in importance, market forces will motivate markets to devote the resources necessary to increase further their distribution speeds, to the benefit of the investing public.

* * *

Arca Book Fees fit comfortably into the matrix of fees that other markets charge for depth-of-book data. They are fair and reasonable and represent an equitable allocation of NYSE Arca dues, fees and charges. As a legal matter, NetCoalition had no standing to submit the Petition. In addition, the Petition relies upon a panoply of misconceptions, including that NYSE Arca exercises monopoly pricing power and that market data fees are subject to a cost-based standard. It seeks to impose government rate-regulation, which would stifle innovation of market data products that provide value to the marketplace. It fails to recognize the availability of alternative sources of information for NetCoalition's internet service providers.

The Petition's more "cosmic" market data-pricing arguments go well beyond the question of whether NYSE Arca is proposing to set Arca Book Fees at an appropriate level. Those arguments are not appropriate considerations in the context of what is essentially a "me too" fee filing. The NYSE Internet Proposal makes moot the one argument in the Petition that is relevant to a determination of whether Arca Book Fees comply with regulatory standards. Namely, it eliminates NetCoalition's argument that Arca Book Fees jeopardize the advertisement-sponsored business models of internet portals in the market data arena and hamper the ability of investors to access real-time data by eliminating large internet portals' access to real-time data. The stay places NYSE Arca at a competitive disadvantage to those markets that the Commission allows to charge for depth-of-book services and violates the 1934 Act goal of "fair competition . . . among exchange markets."⁵¹

⁵¹ See section 11A(a)(1)(C)(ii) of the 1934 Act.

For all of these reasons, we urge the Commission to affirm its approval of Arca Book Fees and to remove the stay.

Sincerely,

A handwritten signature in black ink, appearing to read "Erik Sirri", with a long horizontal flourish extending to the right.

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. Kathleen L. Casey, Commissioner
Erik Sirri, Director, SEC Division of Market Regulation
Robert Colby, Deputy Director, SEC Division of Market Regulation

EXHIBIT B

1 UNITED STATES COURT OF APPEALS
2 FOR THE DISTRICT OF COLUMBIA CIRCUIT
3

4 NETCOALITION,

5 Petitioners,

6 v.

Nos. 09-1042 et al.

7
8 SECURITIES AND EXCHANGE
9 COMMISSION,

10 Respondent.

11 Tuesday, February 16, 2010
12 Washington, D.C.

13 The above-entitled matter came on for oral
14 argument pursuant to notice.

15 BEFORE:

16 CIRCUIT JUDGES KAREN LeCRAFT HENDERSON AND
17 MERRICK B. GARLAND AND SENIOR CIRCUIT JUDGE
18 HARRY T. EDWARDS

19 APPEARANCES:

20 ON BEHALF OF THE PETITIONERS:

21 CARTER G. PHILLIPS, ESQUIRE

22 ON BEHALF OF THE RESPONDENT:

23 MARK PENNINGTON, ESQUIRE

24 ON BEHALF OF THE INTERVENOR:

25 DOUGLAS W. HENKIN, ESQUIRE

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P R O C E E D I N G S

1
2 THE CLERK: Case number 09-1042. et al.,
3 NetCoalition, Petitioner v. Securities and Exchange
4 Commission. Mr. Phillips for the Petitioners; Mr. Pennington
5 for the Respondent; and Mr. Henkin for the Intervenor.

6 JUDGE HENDERSON: Mr. Phillips, good morning. I
7 think --

8 ORAL ARGUMENT OF CARTER G. PHILLIPS. ESQ.

9 ON BEHALF OF THE PETITIONERS

10 MR. PHILLIPS: Good morning, Your Honors. May it
11 please the Court, my name is Carter Phillips, and I'd like to
12 reserve three minutes for rebuttal, please.

13 JUDGE HENDERSON: All right.

14 MR. PHILLIPS: I'd like to start, I think, where we
15 have common ground among the parties. First of all, it is
16 accepted by all sides that the New York Stock Exchange Arca is
17 an exclusive processor of information, and therefore subject
18 to regulation by the Securities Exchange Act under Section 3A;
19 and second, that the depth of book data fees that are at the
20 issue in this are in fact reviewable under a fair and
21 reasonable standard, so that there is some form of rate making
22 that has to be applied. All of the parties agree to that
23 extent.

24 The point at which we come to disagreement,
25 obviously, is the extent to which a fair and reasonable

1 assessment can be made without any regard to costs whatsoever,
2 particularly in a market that is a brand new market, where
3 we've never had any efforts to sell this particular type of
4 data before, and we're trying to evaluate whether or not the
5 fees are fair and reasonable.

6 And it seems to me that the sort of fundamental
7 question you would ask yourself in that situation is if you
8 had a reasonable allocation of the fees and you said, you
9 know, that this basically represents a 10 percent profit and
10 90 percent of the costs then you would say okay, that's a
11 pretty reasonable way to proceed. But if you on the other
12 hand thought that this was 10 percent of the cost and 90
13 percent of the profit then the only conclusion you would draw
14 from that is obviously that this is a not fair and reasonable
15 fee under those circumstances, or at least you would have to
16 take a harder look at the basis on which those fees are being
17 determined.

18 And that's particularly true, it seems to me, in
19 this case where New York Stock Exchange Arca specifically said
20 in its application that part of the reason why we're asking to
21 put in fees, because we didn't charge anything for this
22 historically, the reason we're doing this is because of
23 increased costs that we've incurred. Now, that seems under
24 those circumstances perfectly sensible in the absence of a
25 completely deregulated environment to say fine, if there are

1 additional costs that justify these particular data being
2 charged then put forward those costs, let us see what they
3 look like, and then we can make an assessment of whether or
4 not it's a fair and reasonable evaluation.

5 It seems to me that is the fairest and most
6 reasonable understanding of what a rate making rule requires.
7 Just and fair and reasonable rates typically start with the
8 notion of cost, as courts established that on a number of
9 occasions. Historically that's what Congress would have
10 understood in 1975 when it imposed this kind of a requirement.
11 We're talking about exclusive processors.

12 The legislative history is quite clear that they
13 should be treated like any other kind of regulated industry
14 where it's, you know, you have essential information that's
15 not accessible by any other source, and under those
16 circumstances the right solution is to regulate it. It may
17 turn out in time after you've regulated for awhile that you
18 can comfortably conclude that there's a place to deregulate,
19 and you've certainly seen that in the electric and natural gas
20 oil pipeline situations where because there were clear
21 substitutes available that ultimately the agencies that
22 regulated those particular activities could conclude that they
23 could rely on the market.

24 But here we don't have any direct market substitutes
25 for this exclusive data that NYSE Arca has put forward in the

1 circumstances of this case. And in the absence of something
2 that we can turn to that says yes, we are confident that these
3 prices will be constrained then it seems to me a complete at
4 least abuse of discretion, if not contrary to the statute
5 itself for the SEC not to insist on having some cost
6 information made available to it so that it can evaluate that,
7 and then be in a position to make a judgment, at least in the
8 first instance that these are just and reasonable rates.

9 JUDGE EDWARDS: Mr. Phillips, part of what --

10 JUDGE HENDERSON: Is that the same case --

11 JUDGE EDWARDS: I'm sorry.

12 JUDGE HENDERSON: Is that the same case with
13 NASDAQ's total view that the SEC approve that in 2002?

14 MR. PHILLIPS: Those are the, yes, the same basic
15 problem is embedded in that.

16 JUDGE HENDERSON: So, I thought you began by saying
17 this is a brand new field. Am I incorrect that back in 2002
18 SEC, the SEC approved exactly this type of market based
19 approach with respect to the NASDAQ depth --

20 MR. PHILLIPS: Depth of book.

21 JUDGE HENDERSON: -- of non-core date?

22 MR. PHILLIPS: Right. In 2002 the portion of the
23 SEC acting on delegated authority --

24 JUDGE HENDERSON: Right.

25 MR. PHILLIPS: -- approved this, and it wasn't

1 subsequently reviewed under those circumstances, so it was
2 allowed to go into effect. If the Court were to conclude in
3 this case that some form of cost analysis is appropriate for
4 any kind of rate setting for fees for depth of book it would
5 be available to the parties to go back and ask the SEC to take
6 another look at it, and frankly, it would be in the authority
7 of the SEC to take another look at it, and candidly I assume
8 that they would.

9 I mean, it's interesting that the rationale that was
10 put forward by NYSE Arca in this case in the first instance
11 was, you know, our fees are reasonable because they're less
12 than the fees that were charged by other monopolists under
13 these circumstances. Now, the Commission didn't embrace that
14 particular perspective, and I think that makes a lot of sense.
15 But, you know, the reality is, is that we're talking about
16 three major players in this field who have significant ability
17 to influence or control the costs that they're going to impose
18 on users of this information, and the Commission's answer is
19 ultimately to say well, I just don't know how much everybody
20 needs this information.

21 Well, that's all well and good, but we know that at
22 least 19,000 subscribers are out there, and significantly want
23 the information. I can represent quite confidently because of
24 my clients that there are lots more who would do so if the
25 prices were more reasonable than they are today. And if you

1 look back and you think about sort of the regulatory history,
2 I mean, my guess is that whenever the railroad started up
3 there were probably not 19,000 people using the railroads,
4 there were probably just a few hundred, and everybody else
5 used wagons to get things across, and over time it became more
6 and more popular.

7 So, it is in the nature of this kind of undertaking
8 when you start a new market, and you create a new opportunity
9 people have to learn about it, they have to develop the
10 expertise in order to be able to use this particular tool as
11 they go forward in their investment decision making.

12 And so, you know, to sit here and say well, we'll
13 just leave it in the hands of the market rather than take some
14 evaluation of the actual costs it seems to me to simply sort
15 of cast all of those people aside and to constrain a market
16 that would otherwise be in a position hopefully to develop in
17 a proper way so that you can make an assessment down the road
18 whether or not --

19 JUDGE EDWARDS: Let me see if I understand some of
20 this. Part of what I think the Agency says is if this price
21 is too large or too high they'll go to one of the other
22 processes for the same, similar data.

23 MR. PHILLIPS: Right. But while they will say -- I
24 mean, they don't actually say that --

25 JUDGE EDWARDS: Right.

1 MR. PHILLIPS: -- because you can't do that, because
2 their data is their data. I mean, the New York Stock Exchange
3 knows what's on their market, and NYSE Arca knows what's on
4 its. They don't, you know, buying one isn't a substitute for
5 the other, so they just say it has some sort of generic
6 ability to constrain, so you can at least get some --

7 JUDGE EDWARDS: All right. So, you're --

8 MR. PHILLIPS: -- information.

9 JUDGE EDWARDS: -- rejecting that suggestion that
10 you can move from process A to process B --

11 MR. PHILLIPS: Right. Clearly, that's not --

12 JUDGE EDWARDS: -- because they're not offering the
13 same thing.

14 MR. PHILLIPS: Right. It's not the same data, it's
15 fundamentally different data.

16 JUDGE EDWARDS: And then I think you're also saying
17 to the, I want to make sure I understand this, to the extent
18 that they are offering some things that are similar, they all
19 have rocket power, for want of a better term, the price is set
20 too high then there are groups of people who will be excluded
21 from using all three, they just can't.

22 MR. PHILLIPS: Right. Absolutely. And some of them
23 can't even use one, much less all three. But the reality is,
24 you know, if you want to be in a position to make use of this
25 tool you really do need from all three, and so therefore you

1 really are at the mercy of whatever race they said. And the
2 notion that the three of them now are basically in this
3 situation where they're pegging against each other and saying
4 well, as long as my rates are slightly less than the next
5 rates it will just continue to escalate up and the rates will
6 continue on, particularly given the ruling now from the
7 Commission that's under review in this specific case, in
8 contrast to the ruling that came out in the previous decision
9 by the Division. Because now they have said we have concluded
10 that because there is competition for orders all of the
11 exchanges are subject to some kind of a constraint on the
12 costs they're going to be able to impose, and therefore
13 presumptively whatever number they come up with is basically a
14 number they get to make the call on, and then we'll see
15 whether or not there are any supervening considerations that
16 would justify a different undertaking in this context.

17 But the Court, I mean, the Commission, you know,
18 doesn't come to a, you know, to the, you know, leaves that
19 issue, you know, basically now to the market.

20 JUDGE EDWARDS: Well, your order flow argument
21 you're saying I think the Commission will hear from them,
22 they're relying very heavily on that, and you're saying that
23 doesn't really constrain the fee setting at all.

24 MR. PHILLIPS: No, because the decision as to where
25 you're going to place an order is securities and transaction

1 specific. If I want to buy Goggle, I want to buy Google. You
2 know, somebody, you know, I'm a broker/dealer, my customer
3 says I want to buy Google, so what am I going to do? I'm
4 going to go look and see where I can execute the best
5 opportunity for Google.

6 The question of whether or not I'm going to get
7 depth of book data for a particular exchange is something I
8 will have made months ago because I have to subscribe on a
9 monthly basis. And so, I have to have that information
10 available to me. Will I use --

11 JUDGE GARLAND: Okay, isn't their argument that if
12 you want to buy Google and you want the best deal, and you
13 think depth of book is required that you'll go to the exchange
14 that offers depth of book, and you'll ignore NYSE because
15 they're not making their exchange attractive? That's their
16 argument, right?

17 MR. PHILLIPS: I guess that, I mean, I don't know
18 that they make that precisely that way, because the problem
19 is, is that that doesn't make any sense because without -- if
20 you go to the place that gives you the depth of book it may be
21 the smallest exchange, and its depth of book could be 10
22 shares. They may not have any more than 10 shares available.
23 Whereas, for Google, which I think is a NASDAQ, on the NASDAQ,
24 let's assume that for purposes of argument, you know, that's
25 where all the liquidity is, and if you really want to buy

1 thousands of shares of it, the only place you can find that
2 out is by going to the NASDAQ --

3 JUDGE GARLAND: So, their --

4 MR. PHILLIPS: -- depth of book.

5 JUDGE GARLAND: Assuming I'm understanding their
6 argument, their argument that this is an element by which
7 exchanges differentiate themselves and make themselves more
8 attractive doesn't really work, that is that depth of book is
9 not the relevant factor with respect to where you're going to
10 trade?

11 MR. PHILLIPS: Right. I think at the margins it can
12 be a relevant factor for the unusually small exchanges and
13 operations. But once you get to a certain level of strength,
14 and the NYSE Arca, NASDAQ, New York Stock Exchange clearly are
15 in that category where nobody can make, or you don't have the
16 option of saying I'm not going to trade on those exchanges,
17 that's just not something any realistic person can do. And
18 so, you're going to have to buy the depth of book, and since
19 it is an exclusive processor for each one of them, and since
20 just a reasonable rate, or fair and reasonable rate making is
21 the statutory requirement then it seems to me it's incumbent
22 on the Commission to say look, we'll look at the cost data,
23 we'll make an assessment, and then we'll decide whether or not
24 these are fair and reasonable rates. We're not going to
25 simply leave it --

1 JUDGE GARLAND: Well, can I ask you on --

2 MR. PHILLIPS: -- unregulated.

3 JUDGE GARLAND: -- on that point, are you
4 withdrawing, or am I misconstruing your argument from numeral
5 one, as compared to your argument in roman numeral three?

6 That is --

7 MR. PHILLIPS: Yes.

8 JUDGE GARLAND: You're nodding to suggest at least
9 you understand what I'm asking which is --

10 MR. PHILLIPS: Right.

11 JUDGE GARLAND: -- the way you're putting the
12 argument now is that yes, perhaps competition could be a way
13 of guaranteeing just and reasonable rates, there isn't enough
14 evidence here that there is competition, therefore arbitrary
15 and capricious, that's roman number three.

16 MR. PHILLIPS: Right.

17 JUDGE GARLAND: Roman numeral one, at least as I
18 read it was --

19 MR. PHILLIPS: Is a statutory interpretation
20 argument.

21 JUDGE GARLAND: -- statutory has to be, can't be
22 dependent on competition.

23 MR. PHILLIPS: Right. What the Court said in
24 Goldstein v. SEC is pretty much the way I come out in this
25 particular case, because in that case the Court said even if

1 the Act doesn't foreclose the Commission's interpretation, the
2 interpretation, you know, is outside the bounds of
3 reasonableness, and so it doesn't matter whether you sort of
4 look at it as the statute --

5 JUDGE GARLAND: Well, it --

6 MR. PHILLIPS: -- you're looking at --

7 JUDGE GARLAND: Of course it does matter, but it
8 matters in a sense if we held the way --

9 MR. PHILLIPS: But it matters for the long haul, it
10 doesn't matter --

11 JUDGE GARLAND: Yes.

12 MR. PHILLIPS: -- for the specifics of this case.
13 Right.

14 JUDGE GARLAND: Which unfortunately matters to us
15 because we're writing an opinion.

16 MR. PHILLIPS: Well, it would matter to me, too, and
17 my client --

18 JUDGE GARLAND: Yes.

19 MR. PHILLIPS: -- in the long run. So --

20 JUDGE GARLAND: But --

21 JUDGE EDWARDS: What Goldstein was saying no matter
22 how you look at it, it fails, which is also to say fails under
23 Chevron I/II. I mean, I remember it quite well.

24 MR. PHILLIPS: Right.

25 JUDGE EDWARDS: What Judge Garland is asking you,

1 are you pretty much moving away from the Chevron I/II
2 argument, and resting primarily on arbitrary and capricious
3 and lack of --

4 MR. PHILLIPS: Yes. I'm not abandoning the Chevron
5 I argument, it just seems to me for purposes of what Judge
6 Edwards you asked about earlier, how do you write this
7 opinion? If it were me I would write this opinion to say we
8 don't need to decide whether or not the statute precludes
9 that, that's an argument for another day, but we do need to
10 decide that cost is a fundamental element of any kind of fair
11 and reasonable rate making, that's statutorily mandated. And
12 until we are fully convinced, and the Commission can make a
13 showing based on a mature market that cost isn't a
14 consideration, or it doesn't need to be a consideration, the
15 statute demonstrably pushes us in favor of regulation.

16 JUDGE GARLAND: All right. But that's still a
17 different question. So, under what I regard as roman numeral
18 one, cost is relevant because in regulated industries we look
19 at costs and we give some return above cost, that's how it's
20 done. If I look at your roman numeral three argument, the
21 argument is cost is relevant because super competitive profits
22 indicate lack of competition. Those are two very different
23 ways to --

24 MR. PHILLIPS: Well, I agree with that.

25 JUDGE GARLAND: -- look at cost.

1 MR. PHILLIPS: I agree with that, Judge Garland.
2 And, you know, my basic, you know, my first argument is still
3 I think that Congress intended that there would be in fact
4 cost regulation. But I recognize that even in other
5 situations where fair and reasonable rate making is part of
6 the practice, at some point it is possible that the Commission
7 might be in a position where it could deviate from a pure cost
8 based analysis to something else, because there's a lot of
9 precedent that suggest that. I don't think that's the way
10 this statute was teed up, but if the Court were not prepared
11 to accept my statutory argument then at a minimum it has to
12 recognize that the statute provides more than indifference as
13 to whether or not there ought to be a regulatory scheme in
14 place that protects consumers and ensures that the rates are
15 fair and reasonable under those circumstances.

16 JUDGE GARLAND: Can I ask you one more question? As
17 I understand it depth of book information, the SEC has not
18 required it to be published, is that right?

19 MR. PHILLIPS: That is correct.

20 JUDGE GARLAND: So, if you were to win, and they
21 were to decide okay, we're just not going to produce this
22 stuff, could they do that?

23 MR. PHILLIPS: Yes, they could do that. Obviously,
24 we would have to go back to the Commission and make a pitch
25 that we think that's a terrible mistake, and that the

1 Commission --

2 JUDGE GARLAND: So, what if they were --

3 MR. PHILLIPS: -- ought to add it --

4 JUDGE GARLAND: Right.

5 MR. PHILLIPS: -- to the depth of, ought to add it
6 to the consolidated data.

7 JUDGE GARLAND: But at least they could do it during
8 the period of the rate making, or whatever it is we are going
9 to call this proceeding. So, you could -- and given our
10 experience with rate making in other cases this could be
11 multiple years before you come out with a rate that you regard
12 as having been, and forget about whether you regard it, but
13 the Agency regards it as --

14 MR. PHILLIPS: Right.

15 JUDGE GARLAND: -- being just and reasonable, other
16 than purely competitive, is that right? I mean, we could be
17 three or four years from now before any depth of book data is
18 published.

19 MR. PHILLIPS: Yes. Although I don't know that
20 that's necessarily the assumption I would make. Because
21 again, remember, when they filed the application, NYSE Arca
22 specifically said that we were doing this to recover specific
23 costs that we have in mind. I don't know why it would be
24 particularly different if they had that information back when
25 they filed the application why they couldn't simply release

1 those data now --

2 JUDGE GARLAND: Well, you would undoubtedly disagree
3 with the data, I mean, your argument is about marginal cost.

4 MR. PHILLIPS: Right.

5 JUDGE GARLAND: And say almost all economists agree
6 that in the real world it's very difficult to evaluate what
7 marginal cost is, right?

8 MR. PHILLIPS: Well, I think it's harder, actually,
9 to allocate fixed costs to --

10 JUDGE GARLAND: Okay.

11 MR. PHILLIPS: -- rather than it is to --

12 JUDGE GARLAND: Well, we'll add that to it.

13 MR. PHILLIPS: -- determine marginal costs. But --

14 JUDGE GARLAND: But that doesn't suggest that the
15 rate making proceeding is going to be very easy, or quick. I
16 mean, they may have a view about what their costs are, you are
17 very unlikely to agree with it. So, there --

18 MR. PHILLIPS: Right.

19 JUDGE GARLAND: -- has to be a proceeding, right?

20 MR. PHILLIPS: Right. But I don't know that that
21 necessarily requires that it be a three to four year
22 proceeding, because --

23 JUDGE GARLAND: What's the typical --

24 MR. PHILLIPS: -- we're not asking for pure rate,
25 you know, a pure regulated rate making process to be

1 undertaken. Our basic position here is that you cannot make a
2 determination of whether something is fair and reasonable
3 without at least some assessment of what the thing costs to
4 begin with. And, you know, it --

5 JUDGE GARLAND: I guess what I'm trying to get at
6 is --

7 MR. PHILLIPS: You know, I realize that once you
8 open the box --

9 JUDGE GARLAND: Yes.

10 MR. PHILLIPS: -- you've got the pandora problem.

11 JUDGE GARLAND: Exactly.

12 MR. PHILLIPS: I understand that.

13 JUDGE GARLAND: And what I'm asking about is, you
14 know, we want data to be out there.

15 MR. PHILLIPS: Yes.

16 JUDGE GARLAND: We want -- and there's going to be
17 all different kinds of data over the next few years that may
18 be good to be out there, might not. And if in each situation
19 there has to be the kind of proceeding that you're talking
20 about aren't we slowing down the release of the data?

21 MR. PHILLIPS: Well, I think the alternative way to
22 think about it is that it very well may be that the Exchanges
23 would recognize that their costs for this are virtually non-
24 existent, and that they will then adopt the view that
25 previously existed, which was to offer those data for free in

1 order to better serve transparency and protect the consumers'
2 interests. I think that's just as legitimate and likely
3 outcome of this as the alternative, which was that we're going
4 to have to slog through all the rate making.

5 JUDGE GARLAND: So, you think that the Exchanges
6 have this sort of elimuncinary (phonetic sp.), or whatever the
7 pronunciation of the word is, attitude about things that
8 they're going to release it for free just because they like
9 transparency? That's not the approach you're taking in your
10 brief in terms --

11 MR. PHILLIPS: No, no.

12 JUDGE GARLAND: -- of their motives.

13 MR. PHILLIPS: No. To be sure. I understand that.
14 But I think what they'll recognize is this goes back to the
15 same point the Commission made about the relationship between
16 the people who use the exchanges, and the exchanges
17 themselves, there's obviously an interaction there. Now,
18 these are for profit enterprises, so those interactions have
19 changed to some extent, but we're still basically their
20 customers, and if we really want that information, if there's
21 a significant call for it my guess is they will realize that
22 it's in their best interests not necessarily in a profit loss
23 basis, but just simply in the best interests of protecting
24 their customer base to go forward and provide the information
25 for free.

1 JUDGE GARLAND: Okay. One more question, this is a
2 fact question I'm not sure I understand. With respect to the
3 core data --

4 MR. PHILLIPS: Yes.

5 JUDGE GARLAND: -- the brief suggested that the fees
6 for that are negotiated, not determined on the basis of costs.

7 MR. PHILLIPS: So far they have been, yes.

8 JUDGE GARLAND: And is that because the Agency's
9 been unable to figure out what the cost is, or --

10 MR. PHILLIPS: No, that's because the Agency I think
11 has placed a fair amount of pressure on the parties to come to
12 some kind of an agreement as to the cost, and they've done
13 that so far successfully. But obviously if at some point the
14 negotiations were to break, or those understandings were to
15 break down then I think the Commission would have to undertake
16 a pure cost based analysis in the same way it does with the
17 tape, you know, with the consolidated tape where the
18 exchangers provide the information, and they get it back they
19 have to pay the fees for that. I mean, the fair and
20 reasonable approach in that situation according to the
21 exchanges absolutely requires an analysis of the costs in
22 order to come up with something that's fair and reasonable.
23 All we're asking is whatever's good for the exchanges when
24 they have to pay a fee ought to be good for their customers
25 when we have to pay a fee.

1 JUDGE GARLAND: Are there proceedings to determine
2 that? And how --

3 MR. PHILLIPS: Yes, there are proceedings.

4 JUDGE GARLAND: -- long do they take?

5 MR. PHILLIPS: The Commission's order asking for an
6 analysis of 10 or 12 questions was a year or so ago, as I
7 recall.

8 JUDGE GARLAND: Thanks.

9 MR. PHILLIPS: Thank you, Your Honor.

10 JUDGE HENDERSON: All right. Thank you. Mr.
11 Pennington.

12 ORAL ARGUMENT OF MARK PENNINGTON, ESQ.

13 ON BEHALF OF THE RESPONDENT

14 MR. PENNINGTON: Good morning. Mark Pennington for
15 the Securities and Exchange Commission. It was thrilling to
16 hear the words elimuncinary and the securities market in the
17 same sentence.

18 In 1972 when the Commission first recognized that
19 market data technology had reached the point where it would
20 make sense to tie all the markets together and to create a
21 national market system it recognized at that time that there
22 was always going to be this tension between unification and
23 diversity, and their downsides of monopolization and
24 fragmentation. And as it's gone through the last 30 or 40
25 years of implementing the national market system that's the

1 issue that comes up constantly, and it comes up here. You
2 have market data that is useful to investors, you could
3 require it all to be disclosed; you could leave the exchanges,
4 the markets to just decide what to disclose; or you can come
5 up with some balance. And the Commission has come up with the
6 concept of core data, which is basically "last transactions,"
7 requires that to be distributed, and then leaves the non-core
8 data, including depth of book data, like we have here, up to
9 the individual markets, or up to the individual markets to
10 decide whether they want to distribute it or not, and whether
11 they want to charge for it or not.

12 And it's subject to the Commission's oversight, it
13 has to be among other things the fees have to be fair and
14 reasonable. And the Commission has not deregulated the area,
15 it has set up a two step test that starts by asking is there a
16 competitive market, are there competitive pressures on the
17 exchanges that will keep them from overcharging, from charging
18 monopolistic fees for this data. And if so, and if there's no
19 countervailing arguments then we rely on the market.

20 Let me talk for a just a minute about the statutory
21 issue, which would be roman numeral one I think in both
22 briefs. The language of the statute is, is it requires the
23 fees to be fair and reasonable; and it doesn't say there has
24 to be a cost based analysis; and the statute in fact, Section
25 6(E) (1) (b) of the Exchange Act which was added in 1975 at the

1 same time expressly does say consider costs when you're
2 deciding whether to allow the exchanges to set commissions, so
3 Congress had that in mind, sometimes cost based rate making is
4 essential, sometimes it's not. And this Court has held in a
5 number of cases, particularly in the natural gas and
6 electricity area that when there's a competitive market the
7 regulator can rely upon market based prices in lieu of cost of
8 service regulations to assure a just and reasonable rate of
9 return. So, we think the statute permits us to do this, and
10 we think -- so I'd like to turn then to the second issue,
11 which is sort of the APA issues.

12 And I'd like to point out first of all that the
13 Commission, there are no sort of administrative law issues in
14 terms of the Commission here noticed this matter three times,
15 first, when it was submitted; second, when it decided to take
16 the matter from delegated authority; and then third, took the
17 extremely unusual, perhaps unique or nearly unique step of
18 putting out its proposed order and says this is what we're
19 thinking about adopting, give us any further thoughts if you
20 have, and each time obtained additional information. So, the
21 Commission has really looked hard at this. What's more, it's
22 been looking at this very issue, how much to charge for market
23 data, really since the National Market System Act was passed
24 in 1975. So, we come to it with a lot of experience, and a
25 lot of hard thought.

1 And the Petitioners say well, what you're really
2 required to do either as an absolute matter of statutory
3 interpretation, or at least until you get some more experience
4 with this type of data is first of all, just figure out the
5 costs, after all, what could be more reasonable than that,
6 than you have a yardstick you can measure it against, you can
7 hold it against --

8 JUDGE GARLAND: Can you focus on the roman numeral
9 three --

10 MR. PENNINGTON: Yes.

11 JUDGE GARLAND: -- argument, which has basically
12 been retreated to? So, that is why costs don't have to be
13 evaluated for purposes --

14 MR. PENNINGTON: Right.

15 JUDGE GARLAND: -- of determining whether there
16 really is competition here, and not whether --

17 MR. PENNINGTON: Right.

18 JUDGE GARLAND: -- costs have to be evaluated for
19 purposes of setting up regulatory rate.

20 MR. PENNINGTON: Well, I think the first, the
21 threshold problem with the Petitioner position is their
22 assumption is it would be easy to figure costs, just figure
23 that out. But what the Commission has found is that it's
24 virtually impossible to figure costs, you may be able to
25 figure out depending on how the market is set up the sort of

1 you think of as a market as generating market data, and then
2 the market decides to start selling its data, so they say
3 well, we'll come up with some kind of a connector to connect
4 our market to the world. You might be able, depending on how
5 that's done, to figure out that sort of direct cost. But
6 that's not how rate making is done. If you're going to figure
7 out costs you have to allocate a reasonable amount of other
8 relevant costs of operating the market, which generates the
9 data to the market data. And that was what the Commission
10 talked about in the 1999 release, it said we haven't ever done
11 this, the parties have always agreed on the prices, would it
12 be helpful if we came up with a, if we laid out some standards
13 for figuring out costs? And the industry said no, it's a
14 meaningless exercise. And the Commission pointed --

15 JUDGE GARLAND: Well, what is to prevent under that
16 theory cross subsidization?

17 MR. PENNINGTON: Well, the theory is, or the belief
18 is if there's a competitive market that acts as a check on the
19 price, that's --

20 JUDGE GARLAND: But the competitive market is not
21 for depth of book data, it's overall -- your argument about it
22 is it's one exchange against another.

23 MR. PENNINGTON: Well, our argument is, though, that
24 they won't -- our argument is that the order flow, and the
25 depth of book are, as one of the commentators said, two sides

1 of the same coin, that the exchanges use -- you can't really
2 even separate them out. The markets operate and they generate
3 this data which has value. But if you don't distribute the
4 data you don't get the order flow, and consequently you don't
5 have a business, which is -- and that's by far their largest
6 profits come from the order flow, from the order flow itself.

7 JUDGE GARLAND: Right. But your own, you know, part
8 of your argument for why you should let this go is it's not
9 that important, not that many people want depth of book data,
10 only five percent of the NASDAQ customers buy it.

11 MR. PENNINGTON: Right.

12 JUDGE GARLAND: What else did you -- a similar line
13 said 99 percent of the shares traded at the NBBO --

14 MR. PENNINGTON: Right.

15 JUDGE GARLAND: -- that suggests that depth of book
16 is, to coin a phrase, the tail wagging the dog here. It's
17 not --

18 MR. PENNINGTON: Well --

19 JUDGE GARLAND: -- very important for order flow.

20 MR. PENNINGTON: Well, if it's -- well, but if it's
21 not very important, or if it's not very important, I mean, if
22 it's not important for, if it's not important to investors
23 then you can't exercise monopoly pricing over it. The point
24 would be --

25 JUDGE GARLAND: Well, you can for the investors who

1 it's important to you can. I mean, just because things are
2 unimportant doesn't mean that you can't get a monopoly price
3 for it.

4 MR. PENNINGTON: Right. And if to the extent that
5 it is important there's a competitive market among the markets
6 the sort of combined product of order flow and depth of book
7 data, which are inter-related, to the extent that it's not
8 important there's no ability to exercise --

9 JUDGE GARLAND: No, but --

10 MR. PENNINGTON: -- monopoly power.

11 JUDGE GARLAND: -- I guess it depends on --

12 JUDGE EDWARDS: That just isn't, it isn't following.

13 JUDGE GARLAND: I guess it depends on how many
14 people it's important to. If it's only --

15 JUDGE EDWARDS: Right.

16 JUDGE GARLAND: -- important to a small number of
17 people then it may not matter for order flow, but you still
18 may be able to make a profit off of those people.

19 JUDGE EDWARDS: Right.

20 MR. PENNINGTON: Well, let's look at what the
21 evidence ahead -- first of all, let's look at what the
22 evidence was that the Commission relied on, because I don't
23 know that it got into quantifying that amount, but that --
24 what you have to bear on the other hand is that the cost is
25 not going to be a perfect substitution, it's not going to be a

1 solution to the problem. In other words, you say perhaps
2 there are some people out there who can't get this data that
3 would like it, so why don't we just figure out the cost? But
4 we don't think we can meaningfully come up with the cost. So,
5 you're going to distort the market by coming up with what
6 looks like a cost number, but it's artificial. I mean, you're
7 in an area where you don't know, you can't tell exactly what
8 you're going to do to the market. But the Commission had a
9 substantial basis for believing that the competition for order
10 flow, and given how many people are going to want it, is going
11 to be a useful check on the price.

12 JUDGE GARLAND: Where's the evidence --

13 JUDGE EDWARDS: Where's the evidence of that?

14 JUDGE GARLAND: -- on how many --

15 MR. PENNINGTON: All right.

16 JUDGE GARLAND: -- people are going to want it?

17 MR. PENNINGTON: Well, the evidence we have is that
18 not very many people buy it.

19 JUDGE GARLAND: Well, there you go. That hurts,
20 doesn't help.

21 MR. PENNINGTON: No. The evidence that the
22 competition for order flow will be a sufficient check on the
23 price for the data.

24 JUDGE EDWARDS: Why?

25 MR. PENNINGTON: This is the record evidence that

1 the Commission relies on, which is testimony, or the --
2 starting with back in 2001 they had the special advisory
3 committee, and they brought up themselves that the motivation
4 to enhance shareholder value by the profits, the concern was
5 that the exchanges are now for profit, so they're going to
6 start charging a lot for this data, because they're not just
7 selling it to their members. The motivation to enhance
8 shareholder value by increasing market data fees will be
9 checked by the need to make data available to generate order
10 flow and attract listings.

11 JUDGE GARLAND: Well, that's just a conclusive, but
12 what's the evidence of that, other than this advisory
13 committee statement what's --

14 MR. PENNINGTON: Well --

15 JUDGE GARLAND: -- the evidence?

16 JUDGE EDWARDS: It's a self-serving statement, too,
17 isn't it?

18 MR. PENNINGTON: I mean, Your Honor, this brings us
19 back to --

20 JUDGE EDWARDS: You wouldn't have expected them to
21 say otherwise.

22 MR. PENNINGTON: Well, no, this was an advisory
23 committee that was put together across the range, and there
24 was a division within the committee, but it wasn't just the
25 markets, maybe it was just the markets who thought it would be

1 adequate, but everybody here has an interest. The Commission
2 has --

3 JUDGE EDWARDS: I mean, the reason we're asking this
4 is that when we read the briefs on work flow I'm not getting
5 the argument. I mean, one point of the argument makes sense,
6 when you flip it it doesn't. I just don't see the connection,
7 so that's why I think Judge Garland asked you where's the
8 evidence, what are you pointing to? And now you're saying
9 well, an advisory committee speculated.

10 MR. PENNINGTON: No, it was the judgment of people
11 who were experts in the industry that this -- I mean, there
12 are no numbers, so it's a judgment about how much --

13 JUDGE EDWARDS: Right.

14 MR. PENNINGTON: -- influence does it have. Second,
15 when NYSE Arca, again, this is certainly self-interested, but
16 when they filed, or in connection with their application they
17 said this is a factor we've considered when we decided what
18 price to set. And other --

19 JUDGE GARLAND: Well, I mean, that really, with
20 respect, that's not worth anything, that's the other side
21 saying, you know, leave us alone from regulation because don't
22 worry, we're competitive. I mean, I'm not saying they're,
23 that doesn't mean they're right or wrong, but it's not
24 evidence. I mean, your opponent cites a lot of quotations
25 from the exchanges saying how, you know, how important the

1 depth of book data is going to be, and all that stuff, and you
2 blow that off as not important because that's just marketing
3 information. So, I mean, to what extent are we going to take
4 views of the exchanges on this?

5 MR. PENNINGTON: Well, they have a reasoned
6 position, and the Commission was persuaded by it, and then in
7 response to the final notice there was an economic study
8 submitted that came to the same conclusion that this would be
9 an effective competitive market, to the extent that it
10 matters, the price will be checked. I mean, we don't have
11 numbers, but the alternative solution, we don't have cost
12 numbers either. As I say there's going to be --

13 JUDGE EDWARDS: Was there any determination made in
14 this study as to the number of folks who might want it, who
15 would be foreclosed?

16 MR. PENNINGTON: No.

17 JUDGE EDWARDS: And that --

18 MR. PENNINGTON: And the market price will foreclose
19 some people. Everybody, if you charge something you're going
20 to foreclose somebody. The evidence is you're not foreclosing
21 a lot of people because not a lot of people want to stay
22 there, and if they want to get it somewhere else there are
23 available substitutes for it. So, our judgment is it's not
24 essential data, and we are satisfied based on the evidence
25 that was available to us that there was competition for order

1 flow will be sufficient to check the possibility of monopoly
2 pricing.

3 JUDGE GARLAND: What was your answer to their --
4 they cite, let's see, on page 46 of their brief, the NYSE
5 Arca's marketing document saying now more than ever in order
6 to see and estimate true market liquidity you need to look
7 beyond just the top of book price. I mean --

8 MR. PENNINGTON: Well, the evidence is if you look,
9 the --

10 JUDGE GARLAND: So, then it is necessary, it is --

11 MR. PENNINGTON: No.

12 JUDGE GARLAND: -- now essential.

13 MR. PENNINGTON: No, I mean, if you look at NASDAQ
14 which offers this, and this is the company that has five
15 percent of the people buy the security that was giving the
16 stuff away. I'm sorry, ISE was giving the data away and got
17 15 percent. I mean, it's a relevant factor, some people use
18 it, mostly professionals who are in the business, this is not
19 something that's, it's essential to ordinary investors, or
20 most ordinary investors. There may be somebody somewhere who
21 would like to get this who can't afford the fee and won't have
22 it available. But the alternative is to either say you can't
23 charge for it, in which case you run the risk that it's not
24 going to be distributed, or you're distorting the market by
25 using a cost based mechanism that is not going to come up with

1 a number that you can say well, that's useful. I mean, even
2 if we come up with the cost, I guess, you still have this
3 question of you can't quantify it exactly, the Agency has to
4 make a judgment based on what's the record before it, and
5 what's its experience with this type of data.

6 JUDGE EDWARDS: See, it really sounds like your
7 argument, you're going back and forth, and I'm not sure, it
8 sounds like your argument it's essential, it's not essential,
9 and we can't figure it out anyway, so let them do what they
10 want to do. That's what I keep hearing. It's not essential,
11 it's like who cares, and we can't figure it out.

12 MR. PENNINGTON: Well, I think --

13 JUDGE EDWARDS: Now, obviously --

14 MR. PENNINGTON: -- I think that's right --

15 JUDGE EDWARDS: -- obviously the folks who want to
16 increase the fee have figured out something because they said
17 we want to charge fees because our costs have gone up. So,
18 they figured out something.

19 MR. PENNINGTON: But they haven't done any kind of
20 an allocation that would be a rate making --

21 JUDGE EDWARDS: Well, then how do they know their
22 costs went up?

23 MR. PENNINGTON: I -- they --

24 JUDGE EDWARDS: You should have accepted, you
25 shouldn't have accepted --

1 MR. PENNINGTON: We didn't base it --

2 JUDGE EDWARDS: -- their proposal.

3 MR. PENNINGTON: We didn't base it on their cost
4 representations, we based it on the judgment that we would let
5 the cost be set by a competitive market.

6 JUDGE EDWARDS: No, but what I'm saying is they made
7 the proposal on a significant, significantly because they said
8 they were incurring increased costs, so obviously --

9 MR. PENNINGTON: Yes.

10 JUDGE EDWARDS: -- someone figured it out in house,
11 and I bet you they can figure it out in house.

12 MR. PENNINGTON: Well, they can --

13 JUDGE EDWARDS: I'd be stunned if they couldn't.

14 MR. PENNINGTON: No, they can figure it out. I'm
15 sure that whatever their increase discrete cost is they know
16 that.

17 JUDGE EDWARDS: Right.

18 MR. PENNINGTON: But the Commission has said since
19 1999 that the harder problem, the impossible problem so far is
20 to allocate the common costs, the cost of operating the
21 market, some part of that would have to be paid for. So, the
22 Commission --

23 JUDGE GARLAND: Can you tell me where is that, I was
24 just looking for that. Is that in the final order?

25 MR. PENNINGTON: Which?

1 JUDGE GARLAND: The SEC's conclusion that it would
2 be impossible, or very difficult to figure out costs?

3 MR. PENNINGTON: Yes, it's --

4 JUDGE GARLAND: Can you just help me with that? I'm
5 not saying -- I'm sure it is in here, I'm just trying to focus
6 on that now that you're emphasizing it. It starts at J.A. 688
7 of the order.

8 MR. PENNINGTON: Well, I've --

9 JUDGE GARLAND: Maybe I'll give the Intervenor a
10 chance --

11 MR. PENNINGTON: There's a quotation from the
12 special study, and it's where the Commission, it talked about
13 the -- there's a discussion in the opinion, I can't lay my
14 finger on it, but --

15 JUDGE GARLAND: Okay.

16 MR. PENNINGTON: -- it is in there about how in 1999
17 we proposed it, nobody had a solution, the industry was
18 against it, the advisory committee was against it, it's not,
19 has not -- there's nobody has come up with a practical way to
20 do it. So, if you have to make a choice between letting some
21 theoretical people be deprived of data that's professional
22 data, and it's not essential data, alternatively to undertake
23 this cost allocation process that nobody knows how to do our
24 choice is that we believe it's a competitive market, and we
25 believe there are available alternatives, and that all in all

1 the best result here is to allow competition to solve the
2 problem.

3 JUDGE GARLAND: Okay. After you sit down if you
4 could just take a quick look and -- or maybe the next speaker
5 will know where to point us to. Thank you.

6 JUDGE HENDERSON: All right. Mr. Henkin.

7 ORAL ARGUMENT OF DOUGLAS W. HENKIN, ESQ.

8 ON BEHALF OF THE INTERVENOR

9 MR. HENKIN: Good morning, may it please the Court,
10 Douglas Henkin representing the Intervenors. I wanted to jump
11 to Judge Garland, your question. I believe the place that you
12 were looking for, although it was just based on a quick look,
13 starts on page 61 of the order. But to jump into some of
14 the --

15 JUDGE GARLAND: Thank you.

16 MR. HENKIN: -- issues that were being addressed,
17 under anti-trust law, and this is something that has not yet
18 been really dealt with by any of the speakers, one of the
19 important options that has to be considered in assessing
20 competition is market participants' abilities to just say no
21 to a product. And that's really where the action has been on
22 this, Judge Garland, I agree with your point about the tail
23 wagging the dog, because this is, depth of book fees are a
24 very, very, very small aspect of the market, they're not the
25 core fees, they don't represent core data. The SEC explained

1 back in Reg. NMS in 2005 that it was going to allow
2 proprietary data to be sold by the exchanges under exactly the
3 rule and the regime that it set forth here.

4 So, just saying no is an option, and when you look
5 at the evidence that exists in the record that goes to in the
6 ISE case that when it was free, when ISE was giving the data
7 away only 15 percent of the professional, of the participants
8 took the data, NASDAQ only five percent buy the data. When
9 Island went dark, and the Petitioners say when it went dark
10 completely, that's actually not true, it was a more controlled
11 experiment than that, when Island stopped displaying market
12 data for three ETF funds their market share for order flow
13 with respect to those three funds declined by 50 percent. And
14 the SEC also looked at --

15 JUDGE GARLAND: So, how do those two things fit
16 together?

17 JUDGE EDWARDS: Right.

18 JUDGE GARLAND: That there's only a few people want
19 it, but when you go dark all together you increase by 50
20 percent.

21 MR. HENKIN: Decrease.

22 JUDGE HENDERSON: Decrease.

23 JUDGE EDWARDS: Decrease.

24 JUDGE GARLAND: I mean decrease by 50. Yes, you
25 decrease by 50 percent. How do those two fit together? If

1 only a few people want it why does going dark lead to a
2 decrease of 50 percent?

3 MR. HENKIN: Well, with respect to Island, I can't
4 speak to precisely why, the point is that it demonstrates the
5 connection between order flow and market data.

6 JUDGE GARLAND: The Island one does, but --

7 MR. HENKIN: Correct.

8 JUDGE GARLAND: -- how does that make up, how does
9 that -- what do I do with the five percent figure? That seems
10 like it's not particularly relevant to order flow, otherwise
11 more people would buy it.

12 MR. HENKIN: It is, because it's indicative that the
13 SEC was correct about the importance of depth of book data,
14 and more importantly, who it's important to. It's important
15 to people who are trading very large market sizes. This is
16 not about the retail investors, you need to look at the actual
17 market here, and all of the evidence is, including one piece
18 that I'm going to get to in a moment, all of the evidence
19 confirms that the SEC's views of the way this part of the
20 market works were right.

21 JUDGE GARLAND: Okay. So, just so -- this is
22 actually is an explanation --

23 MR. HENKIN: Uh-huh.

24 JUDGE GARLAND: -- and that explanation is that for
25 the big investors it matters, and where they go matters, that

1 is it matters to which exchange they would go to. So, let me
2 ask two questions about that.

3 JUDGE EDWARDS: Do you agree with that?

4 JUDGE GARLAND: Is that what you're saying?

5 MR. HENKIN: It depends by the word matters. When
6 you say it matters for in terms of competition for order flow,
7 yes.

8 JUDGE GARLAND: Yes, that's what I mean.

9 MR. HENKIN: Whether the depth of book data is
10 actually important for their trading decisions I'm not sure I
11 would agree with, at least --

12 JUDGE GARLAND: Well, then why --

13 MR. HENKIN: -- on a universal basis.

14 JUDGE GARLAND: -- is order flow affected by that
15 if --

16 JUDGE EDWARDS: Right.

17 JUDGE GARLAND: -- it doesn't affect?

18 MR. HENKIN: Well, order flow is affected by it
19 because when a, depending upon what data, what market data a
20 participant gets that will determine or help determine where
21 it sends its orders. And if the quality of the data that it's
22 not getting, if the quality of the data that it gets from one
23 market center is better than the quality of the data that it
24 gets from another center, all else being equal, that will tend
25 to nudge the orders to the market center where the better data

1 is coming from. So --

2 JUDGE GARLAND: So --

3 MR. HENKIN: -- they're competing in that sense.

4 JUDGE GARLAND: All right. So, you're saying that
5 depth of book is important in the sense that it nudges you,
6 could nudge you from one exchange to another?

7 MR. HENKIN: My only question is with the word
8 important. It is something that is competitively of value.
9 The data itself isn't important. Where I'm struggling is
10 whether it's important for the trade execution decisions
11 because the Petitioners' argument focused on evaluating their
12 best execution obligations, and what the SEC concluded is that
13 it's --

14 JUDGE GARLAND: Well, then leave --

15 MR. HENKIN: Yes.

16 JUDGE GARLAND: I understand. Leave that part
17 aside. But for purposes of evaluating why else are you going
18 to be pushed from one exchange to another based on whether it
19 has depth of book if not because it's important to your
20 trading decisions?

21 MR. HENKIN: Well, it could be because it's
22 important to where you steer the business, that is --

23 JUDGE GARLAND: Yes.

24 MR. HENKIN: -- one possibility. And then all of
25 the other aspects that go into markets, or participants

1 deciding where to route their orders. And the SEC went
2 through a long list, and actually NYSE's submission in the
3 record went through a long list of how market participants
4 direct their data, first they try -- their orders, first they
5 try to internalize it, then they try to send it to non-
6 exchange markets like ECNs and alternative trading systems.
7 Only after they've gone through all of those do they then try
8 to send it to exchanges. That's the way the analysis goes
9 when they're trying to determine where to send the orders.
10 And in there, within there the availability of market data and
11 the quality of that market data can be a factor, and that's
12 why the competitive position that the --

13 JUDGE GARLAND: All right. So, this raises two
14 questions in my mind. The first question is it sounds like
15 you're saying that with respect to retail there isn't really
16 any, there is no competitive effect here.

17 MR. HENKIN: There is no competitive effect for
18 retail investors because they very, very rarely, and the
19 record clearly shows this, have any need for depth of book
20 data. On an access basis, though, the proposal doesn't treat
21 them differently if they feel that it's necessary for them.

22 JUDGE GARLAND: I thought the fee is different,
23 isn't it?

24 MR. HENKIN: The fee is different for professional
25 versus non-professional, but it's --

1 JUDGE GARLAND: Right.

2 MR. HENKIN: -- available to both if they want it.

3 JUDGE GARLAND: Right. But the fee for non-
4 professional you're saying there's no competitive pressure on
5 it.

6 MR. HENKIN: Well, there is competitive pressure
7 because if nobody buys it then the exchanges won't sell it.

8 JUDGE GARLAND: That's different. In other words,
9 the order flow pressure doesn't exist.

10 MR. HENKIN: It is less in the individual investor
11 prospective, but that is primarily. And the record also shows
12 why this is true. The individual investors generally don't
13 determine where their orders go, their broker/dealers usually
14 determine where brokers go.

15 And so, if you look for example in the record one of
16 the things that the SEC relied on was the Schwab data, and we
17 also mentioned this in the Intervenor's brief. The Schwab
18 data that showed that I think it was 94 percent of orders were
19 directed by Schwab not to an exchange at all, and that
20 therefore there was no effect on, that depth of book data
21 could have asserted on those orders. So, it really is a
22 broker/dealer issue, not a retail investor issue.

23 JUDGE GARLAND: Mr. Phillip's other argument was,
24 that this raised in my mind is some things like his example,
25 at least hypothetical example was Google was traded with

1 enough liquidity only in one exchange, so that there really,
2 this could not be, the order flow couldn't be a competitive
3 factor with respect to that, is that right or wrong?

4 MR. HENKIN: With respect to that we just disagree,
5 and we think the record disproves it. There has been
6 declining market share, and basically the theory goes, the
7 theory that the Petitioners are relying on is this notion that
8 listed markets have a monopoly, and listing markets have a
9 monopoly in trades of the shares that are listed in the first
10 instance on those markets. The SEC looked at that, and looked
11 at it exhaustively in terms of statistics and concluded that
12 in fact those market shares had been declining, and that no
13 market, no listing market has a majority, or a monopoly share
14 of trading in its listed shares.

15 And in fact, from NYSE's perspective that share had
16 dropped from about just under 80 percent to around 30 percent
17 in just a few years. And you contrast that with something
18 like the BATS (phonetic sp.) exchange, which is also
19 discussed in the record, which went from zero to just under 10
20 percent in about three years in part by offering some of its
21 market data for free.

22 So, there is an extraordinary amount of fluidity in
23 the order flow as between exchanges, and the main reason for
24 this is that the SEC has as part of shepherding the national
25 market system allowed for unlisted trading privileges, and

1 that's one of the things that has caused all the fluidity
2 between the markets in terms of where the order flow goes
3 versus where a security might be listed in the first instance.
4 We just think that the Petitioners have got the data wrong in
5 that regard, and the record clearly reflects that the SEC was
6 right. Thank you.

7 JUDGE HENDERSON: All right. Does Mr. Phillips have
8 any time left?

9 THE CLERK: Mr. Phillips does not have any time
10 left.

11 JUDGE HENDERSON: You have --

12 MR. PENNINGTON: Do you want the pages now?

13 JUDGE HENDERSON: You have the answer to the
14 question? All right. Why don't you go ahead and tell Judge
15 Garland that.

16 MR. PENNINGTON: In the opinion on page number 74
17 around notes 254, and page number 100, note 313.

18 JUDGE GARLAND: Yes, I got the 100. Thank you.

19 JUDGE HENDERSON: All right. Mr. Phillips, why
20 don't you take a couple of minutes.

21 ORAL ARGUMENT OF CARTER G. PHILLIPS, ESQ.

22 ON BEHALF OF THE PETITIONERS

23 MR. PHILLIPS: Thank you, Your Honor. I appreciate
24 it. I will try to be brief. Your Honor, first of all, Judge
25 Garland, you asked the question about the tail wagging the dog

1 in this particular context, and I think ultimately that's the
2 core problem with the Commission's approach in this case,
3 because what it's basically saying is that this is too small
4 an enterprise for us to spend any time worrying about it.
5 Candidly, that sounds an awful lot like what the Federal
6 Energy Regulatory Commission said about in the Texaco case,
7 which is that the small producers are just too small, and it's
8 too important for us to let them go out and handle their
9 operations, so what we're going to do is we're just going to
10 deregulate it. And what the Supreme Court said there was
11 that's fine, go tell Congress that you have the authority to
12 deregulate it, and then you can proceed along that path. But
13 what you can't do is set up a scheme in which you're supposed
14 to make a determination of the fair and reasonableness of the
15 rates, and then decide unilaterally that you're not going to
16 do that because either they're too small, or too unimportant
17 under these circumstances.

18 The reality is there is a market there, there are
19 people, they are captive, they have to go and look at depth of
20 book data as their own marketing materials say, and it may not
21 be true for everyone, but for those for whom it is true they
22 are subject to the monopoly pricing. You specifically asked
23 the question how do we know that there is no cross-
24 subsidization going on here? The answer is we can't know
25 because we have no idea what the costs are, and under those

1 circumstances the assumption ought to be that there is the
2 possibility of cross-subsidization, something specifically
3 that Congress precludes in this particular scheme.

4 I see my time is up. I'd urge the Court to set
5 aside the Commission's order.

6 JUDGE HENDERSON: All right.

7 JUDGE GARLAND: Thank you.

8 MR. PHILLIPS: Thank you.

9 JUDGE HENDERSON: Thank you.

10 (Recess.)

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DIGITALLY SIGNED CERTIFICATE

I certify that the foregoing is a correct transcription of the electronic sound recording of the proceedings in the above-entitled matter.

Paula Underwood

Paula Underwood

February 28, 2010

DEPOSITION SERVICES, INC.

EXHIBIT C

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SAMPLE LEVEL 2 DISPLAY

SYMBOL	AMAT	Applied Materials (NGS)
LAST SALE	20.15 q	NASDAQ Bid Tick (+)
NATIONAL BBO	20.15 q	20.16 q 6900 x 3000
MPID	Bid	Size
MSOQ	20.15	3000
ARCX	20.15	2600
BEST	20.15	1500
NITE	20.15	1400
CINN	20.15	1200
BOYA	20.15	1000
AUTO	20.14	5000
LEHM	20.14	1000
ABLE	20.14	1000
SCHO	20.14	500
GSCO	20.14	100
RAJA	20.12	1200
TDCM	20.12	1000
MONR	20.12	1000
SWST	20.12	1000
MDRT	20.12	400
JPMS	20.12	100
PLRT	20.11	800
PIPR	20.11	100
PRUS	20.10	500
FGCO	20.09	1400
GOVW	20.09	600
HDSW	20.09	400
UBSW	20.09	400
MPID	Ask	Size
MSOQ	20.16	2000
ARCX	20.16	1500
TDCM	20.16	1000
OPRO	20.17	2100
URAR	20.17	1000
CLYP	20.18	2000
SCHO	20.18	1500
NITE	20.18	1100
DAW	20.18	100
TEJS	20.18	100
MSCO	20.19	1500
JPMS	20.19	100
BEST	20.20	1200
MFCO	20.20	1000
FACT	20.20	100
UBSW	20.21	1100
GSCO	20.21	1000
FBDO	20.21	100
LEHM	20.21	100
BRCO	20.21	100
WCHV	20.22	1200
GLBT	20.22	1000

Data highlighted in block is unique to TotalView.

SAMPLE TOTALVIEW DISPLAY

SYMBOL	AMAT	Applied Materials (NGS)			
LAST SALE	20.15 q	NASDAQ Bid Tick (+)			
NATIONAL BBO	20.15 q	20.16 q 6900 x 3000			
Bid Price	Total Depth	Ask Price	Total Depth		
20.15	6900	20.16	2000		
20.16	2100	20.17	2100		
20.17	2100	20.18	1500		
20.18	1500	20.19	1500		
20.19	1500	20.20	1500		
20.20	1500	20.21	1500		
20.21	1500	20.22	1500		
MPID	Bid	Size	MPID	Ask	Size
MSOQ	20.15	3000	MSOQ	20.16	2000
ARCX	20.15	2600	ARCX	20.16	1500
BEST	20.15	1500	TDCM	20.16	1000
NITE	20.15	1400	OPRO	20.17	2100
CINN	20.15	1200	URAR	20.17	1000
BOYA	20.15	1000	CLYP	20.18	2000
AUTO	20.14	5000	SCHO	20.18	1500
LEHM	20.14	1000	NITE	20.18	1100
ABLE	20.14	1000	DAW	20.18	100
SCHO	20.14	500	TEJS	20.18	100
GSCO	20.14	100	GSCO	20.18	100
RAJA	20.12	1200	MSOQ	20.19	2000
TDCM	20.12	1000	JPMS	20.19	100
MONR	20.12	1000	BEST	20.20	1200
SWST	20.12	1000	MFCO	20.20	1000
MDRT	20.12	400	MSOQ	20.20	2000
JPMS	20.12	100	FBDO	20.20	100
PLRT	20.11	800	CLYP	20.18	2000
PIPR	20.11	100	NITE	20.18	1100
PRUS	20.10	500	FACT	20.20	100
FGCO	20.09	1400	UBSW	20.21	1100
GOVW	20.09	600	GSCO	20.21	1000
HDSW	20.09	400	MSOQ	20.21	2000
UBSW	20.09	400	ARCX	20.16	1500
			MSOQ	20.21	2000
			TDCM	20.21	1000
			OPRO	20.21	2100
			URAR	20.21	1000
			CLYP	20.21	2000
			SCHO	20.21	1500
			NITE	20.21	1100
			DAW	20.21	100
			TEJS	20.21	100
			MFCO	20.21	1000
			JPMS	20.21	100
			BEST	20.21	1200
			MFCO	20.21	1000
			FACT	20.21	100
			UBSW	20.21	1100
			GSCO	20.21	1000
			FBDO	20.21	100
			LEHM	20.21	100
			BRCO	20.21	100
			WCHV	20.22	1200
			GLBT	20.22	1000

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When you don't know the true depth of the market, you miss the opportunity to see when to get in and out of a stock. The more you know about underlying price pressure on a stock, the more trading strategies become visible to you, and the more confidence you'll have in those strategies. There are many examples of how trading with TotalView reveals more profit opportunities than trading with just Level 2. Here is an example using real data from TotalView:

Two traders — one using Level 2 and one using TotalView — suspect Tellabs, Inc. (TLAB) might be headed up sharply. They are trying to decide whether to go long up to 1,000 shares by looking for buy-side pressure in the market. At 12:06 p.m., Eastern Time (ET), the inside quote for TLAB is:
bid 7.76 ask 7.77 size 12,400 x 6,800.

The TotalView trader has an advantage over the Level 2 trader — he can see almost four times the liquidity available for immediate execution within three cents of the inside. In particular, he can see large pockets of extra depth at the second, third and fourth price levels that aren't visible in Level 2. Knowing there is significant price pressure on the bid, he buys 800 shares. On the other hand, the Level 2 trader doesn't see the buy-side pressure because Level 2 displays only modest depth at the second, third and fourth price levels. As a result, he doesn't anticipate a run-up in price and doesn't place a buy order.

Over the next several hours, there is a run-up in the TLAB stock price. At 2:54 p.m., ET, the stock is trading at:
bid 8.02 ask 8.03 size 4,500 x 3,000.

Bottom line: Without the information TotalView provides, the Level 2 trader misses a valuable profit opportunity. The TotalView trader sells his 800 shares for a tidy profit of \$200. A profit made possible only with TotalView.

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Assyn LLC	CoverTrade	IG Global Securities	MoneyW1	EquityPlus
Bank of America Securities	eSignal	IG Global Securities	MoneyW1	Thomson Financial
Best Systems & Co.	Exec Trader	IG Global Securities	MoneyW1	TradeStation
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	ExoTrade	IG Global Securities	MoneyW1	UDX

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EXHIBIT D

**AN ECONOMIC ASSESSMENT OF WHETHER
“SIGNIFICANT COMPETITIVE FORCES”
CONSTRAIN AN EXCHANGE’S PRICING OF ITS
DEPTH-OF-BOOK MARKET DATA**

Dr. David S. Evans

**LECG, LLC
Head of Global Competition Policy Practice
Managing Director**

**University College London
Executive Director, Jevons Institute for Competition Law and Economics
Visiting Professor**

**University of Chicago Law School
Lecturer**

July 10, 2008

I. INTRODUCTION¹

NYSE Arca, Inc. (Exchange) requested that the Securities and Exchange Commission (SEC) approve a proposed rule change (the “Proposal”) that would allow the Exchange to establish certain fees for depth-of-book market data (also known as unconsolidated, or non-core, data).² The SEC has issued a Notice that presents a Proposed Order to approve that request and the SEC’s basis for doing so.³

In the Proposed Order, the SEC describes what it calls a “market-based” approach to its oversight of depth-of-book data pricing and other terms.⁴ The SEC bases its analysis on whether the exchange is subject to “significant competitive forces”⁵ in setting the terms, including any applicable fees, of its proposal for unconsolidated data. If it believes the answer is yes, then the SEC will approve the proposal unless it determines there is a “substantial countervailing basis to find that the terms nevertheless fail to meet an applicable requirement of the Exchange Act or the rules thereunder.”⁶ If it believes that the answer is no, then the SEC will require the exchange to provide “a substantial basis, other than competitive forces, in its proposed rule change demonstrating that the terms of the proposal are equitable, fair, reasonable, and not unreasonably discriminatory.”⁷

Based on this framework, the SEC presents its preliminary findings with respect to the Exchange’s Proposal. The SEC concludes that “[a]t least two broad types of significant competitive forces applied to NYSE Arca in setting the terms of

¹ This Report was prepared at the request of NetCoalition.

² Filing of Proposed Rule Change Relating to Approval of Market Data Fees for NYSE Arca Data, SEC Release No. 34-53952, 71 FR 33496 (June 9, 2006). As I discuss below, for the purpose of analyzing competition among exchanges, all exchanges owned by the same corporate parent should be aggregated because they are controlled by the same economic agent, which seeks to maximize the profits of the combined operations. Thus, for purposes of economic analysis, NYSE Arca and NYSE should be considered a single entity, NYSE Group.

³ Proposed Order Approving Proposal by NYSEArca, Inc. to Establish Fees for Certain Market Data and Request for Comment, SEC Release No. 34-57917, 73 Fed. Reg. 32751 (June 4, 2008) [hereinafter “Proposed Order”].

⁴ *Id.* at 32761.

⁵ *Id.* at 32762. For the purposes of this Report, I am assuming as correct the standard that is specified in the Proposed Order—that proposed terms for the sale of depth-of-book data are “equitable, fair, reasonable, and not unreasonably discriminatory” if those terms are subject to “significant competitive forces.” In particular, I am not addressing whether depth-of-book data necessarily constitute a relevant antitrust market but am addressing only whether “significant competitive forces” would necessarily constrain the setting of depth-of-book fees by the exchanges and thereby prevent the exercise of market power over those fees.

⁶ *Id.*

⁷ *Id.*

its Proposal.⁸ One source of competitive constraint claimed by the SEC is the availability of alternatives to an exchange's depth-of-book data. The other source is competition for order flow among trading venues, including exchanges, electronic communication networks (ECNs) and alternative trading systems (ATSS).

This Report examines whether the SEC's conclusion is sound as a matter of economics and whether it is supported by the evidence the SEC presents. I have been asked to assume that the SEC is correct that competition exists for order flow and to address the question of whether that assumed competition would preclude an exchange from exercising significant market power over the pricing of depth-of-book market data.⁹

I find that the SEC's preliminary conclusion regarding the existence of significant competitive constraints on the Exchange's pricing of depth-of-book data is not supported by the analysis and evidence that the SEC presents. On the contrary, the economics and evidence indicate that:

- the Exchange likely has significant market power over the pricing of its depth-of-book market data;
- the availability of the alternative sources of depth-of-book data that the SEC identifies would not constrain that market power; and
- competition for order flow would not constrain that market power.

The remainder of this Report is organized as follows. Section II explains the flaws in the SEC's conclusion that economically significant alternatives to an exchange's depth-of-book data exist and that such alternatives constrain the exchange's pricing of its depth-of-book data. Section III explains the flaws in both

⁸ *Id.* at 32763.

⁹ Market power refers to the ability to charge a price that exceeds the price that would be charged under competitive conditions. See DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 642 (4th ed. 2005). Since most firms have some limited market power, economists typically focus on significant market power. Under the *Horizontal Merger Guidelines*, the ability to raise price above the competitive level by 5-10 percent for a sustained period of time is considered significant market power. See U.S. DEP'T. OF JUSTICE AND THE FED. TRADE COMMISSION, *HORIZONTAL MERGER GUIDELINES* (1992, Revised 1997).

the SEC's premise and conclusion that competition for order flow constrains the pricing of depth-of-book data. Section IV concludes.

II. THE ALTERNATIVES IDENTIFIED BY THE SEC DO NOT SIGNIFICANTLY CONSTRAIN THE PRICING OF AN EXCHANGE'S DEPTH-OF-BOOK DATA AND ARE NOT SUBSTITUTES.

The SEC concludes that alternative sources of information "impose significant competitive pressures on an exchange in setting fees for its depth-of-book order data."¹⁰ It identifies four categories of data that are supposedly alternatives that constrain an exchange in pricing its depth-of-book data:

1. depth-of-book data from other trading venues;
2. the exchange's own consolidated data;
3. "pinging" the various markets by routing oversized marketable limit orders; and
4. the threat of independent distribution of depth-of-book data by securities firms and data vendors.¹¹

A. The SEC Does Not Adequately Support Its Claims of Alternative Products.

The SEC does not present any evidence to support its claim that the four alternatives that it identifies are in fact economic substitutes for depth-of-book data that would constrain an exchange's pricing of that data. Ordinarily, an analysis of whether two products are substitutes for each other would consider whether consumers would readily switch between products in response to changes in relative prices. The SEC provides no evidence that any of the alternative sources of data it mentions are treated as substitutes by market participants, allow market participants

¹⁰ Proposed Order, *supra* note 3, at 32766.

¹¹ *Id.* at 32765.

to achieve the same objective, or have similar costs. The SEC simply lists alternatives and asserts that they are substitutes. That is not enough.

Common and well-accepted methods are used to determine whether products are sufficiently close substitutes such that an increase in the price of one product would lead consumers to substitute another product and thereby make that price increase unprofitable. A basic inquiry is whether products serve the same purpose from the standpoint of the customer. If a consumer were considering the substitutes for a BMW, she probably would not consider a bicycle as a substitute because, for virtually all uses, a BMW and a bicycle do not serve the same purposes in a reasonably interchangeable way. Even within the category of automobiles, low-end automobiles such as Kias may not be substitutes for high-end cars such as BMWs because potential buyers of BMWs would not usually consider a Kia as a reasonably substitutable alternative to a BMW.

As an alternative to the principle of reasonable interchangeability, the SSNIP (small but significant non-transitory increase in price) test is commonly used by the U.S. Department of Justice, the Federal Trade Commission, the European Commission, and many other competition authorities to identify which products are sufficiently close substitutes so as to constrain the exercise of market power.¹² The SSNIP test poses the hypothetical question of whether a producer could profitably increase the price of a product or group of products by 5-10 percent above the competitive level. If it is possible, then that product or group of products constitutes a market and products outside that market are not sufficiently strong substitutes to defeat an attempted price increase. If it is not possible, then other products must provide good enough substitutes and should be included in the market as competitive forces that constrain the exercise of market power.

The SEC neither purports to define a relevant market nor presents any evidence that demonstrates that its proffered alternatives to an exchange's depth-of-book data are reasonably interchangeable with such data or would constrain the

¹² ENEER ELHAUGE & DAMIEN GERADIN, GLOBAL COMPETITION LAW AND ECONOMICS 287-288 (2007).

pricing of such data under the SSNIP (or any other) test. As I discuss next, none of those alternatives is likely a significant constraint on the exchanges' pricing of depth-of-book data.

B. The Alternative Sources of Depth-of-Book Data Identified by the SEC Are Likely Not Substitutes for an Exchange's Depth-of-Book Data.

The purpose of assessing whether substitutes exist for NYSE Arca (or any other exchange's) depth-of-book data is to identify products that will act as competitive constraints if the Exchange attempts to exercise market power in its pricing of depth-of-book data. The relevant substitutes must therefore come from independent competitors that set prices independently of the Exchange. If another potential source of depth-of-book data is controlled by the same corporate entity, that product does not provide an effective competitive constraint—the corporate entity's profit-maximizing incentive is to coordinate the pricing of both products, not to use one to compete with the other.¹³

For the purposes of analyzing market power over depth-of-book data, the combined share of NYSE and NYSE Arca is relevant, not their respective individual shares. The pricing of depth-of-book data for both NYSE and NYSE Arca are controlled by the same corporate entity, NYSE Group. To the extent that, hypothetically, a price increase in NYSE Arca's depth-of-book data results in shifts to purchases of NYSE's depth-of-book data, those are revenues that are retained by the same corporate entity.

The SEC observes that NYSE and NYSE Arca "operate as separate trading centers with separate limit order books, and each distributes its depth-of-book order data separately for separate fees."¹⁴ That is beside the point. Even if NYSE and

¹³ For that reason, related corporate entities are treated as a single economic actor for antitrust purposes. *Cf. Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769-72 (1984). In *Copperweld*, the Supreme Court rightly observed that, where entities are not "separate economic actors pursuing separate economic interests," they should be considered "a single actor" on the marketplace. *Id.* at 769-70. The Court further stated that "there can be little doubt that the operations of a corporate enterprise organized into divisions must be judged as the conduct of a single actor. . . . A division within a corporate structure pursues the common interests of the whole, rather than interests separate from those of the corporation itself." *Id.* at 770.

¹⁴ Proposed Order, *supra* note 3, at 32763, n.184.

NYSE Arca are operated as separate exchanges, the same corporate entity controls and profits from both exchanges and will coordinate the pricing of the two. Aggregating the shares of distinct products sold by the same firm is the routine practice in merger review and in the antitrust case law.

I now consider the four data sources that the SEC claims are alternatives that significantly constrain the pricing of an exchange's depth-of-book data.

1. Depth-of-book data from other trading venues

The SEC first asserts that depth-of-book data from other trading venues constrain the Exchange's pricing of its own depth-of-book data. At the outset, we note that each exchange's depth-of-book data are unique to that exchange. Depth-of-book data from NYSE, for example, reflect different orders from depth-of-book data from Nasdaq or BATS or Direct Edge. To have a reasonably comprehensive picture of liquidity below the top of the book, depth-of-book data from all exchanges with substantial trading are required. That proposition underlies the rules and regulations that have led to the consolidated tape—*i.e.*, the requirement that all trading venues contribute their data so that the national-best-bid-and-offer and the last-transaction data can be compiled and displayed to the investment community.

In addition, depth-of-book data from different trading venues reflect liquidity of substantially different magnitudes and quality. Nasdaq and NYSE Group, for example, operate by far the leading exchanges for trading in U.S.-listed equities. Based on the statistics reported by the SEC for December 2007, NYSE accounts for 22.6 percent of all trading volume and NYSE Arca accounts for 15.4 percent. Thus, the NYSE Group accounts for 38.0 percent of all trading volume.¹⁵ Nasdaq accounts for 29.1 percent of all trading volume.¹⁶ NYSE Group and Nasdaq control the only

¹⁵ *Id.* at 32763 (Table 1). NYSE is in the process of acquiring the American Stock Exchange, which accounts for a further 0.8 percent. Press Release, NYSE Euronext, NYSE Euronext to Acquire the American Stock Exchange (Jan. 18, 2008), available at <http://www.nyse.com/press/1200568235016.html>.

¹⁶ *Id.* at 32763 (Table 1). Nasdaq has also announced the pending acquisition of the Philadelphia Stock Exchange, which accounts for a further 0.1 percent. See Press Release, NASDAQ, NASDAQ to Acquire Philadelphia Stock Exchange (Nov. 7, 2007), available at <http://www.nasdaq.com/newsroom/news/newsroomnewsStory.aspx?textpath=pr2007ACQPMZ200711070730P RIMZONEFULLFREED130788.htm&year=11/07/2007%20+7%3a30AM>.

trading venues of any significant size. While there are smaller trading venues—primarily BATS and Direct Edge—they account for substantially less trading volume.

In analyzing market power over depth-of-book data, it is important to recognize that the depth-of-book data for a given stock are unique. The depth-of-book data on trading in AT&T are distinct from the depth-of-book data on trading in Google. A trader interested in trading AT&T stock needs data on AT&T trading—if one exchange has a significant share of trading in AT&T, data from another exchange that has a significant share of trading in Google is not directly pertinent to the AT&T investment decision.

The dominance of NYSE Group and Nasdaq in pertinent liquidity is even more apparent when we consider separately trading in NYSE-listed and Nasdaq-listed stocks. For trading in NYSE-listed stocks in December 2007, NYSE Group exchanges had a 53.6 percent share and Nasdaq had a 18.4 share.¹⁷ By contrast, the SEC reported shares for BATS of 5.1 percent and for Direct Edge of 3.0 percent for trading in NYSE-listed stocks.¹⁸ For trading in Nasdaq-listed stocks in December 2007, Nasdaq had a 45.4 percent share and NYSE Group had a 14.8 percent share.¹⁹ By contrast, the SEC reported shares for BATS of 7.9 percent and for Direct Edge of 6.9 percent.²⁰

A broker-dealer interested in depth-of-book data is unlikely to ignore the depth-of-book data available from the leading trading venues. The value of the depth-of-book data from trading venues that have a significant share of trading volume in a significant group of securities is higher than the value of depth-of-book data from a trading venue that does not have such a share.

The availability of data from other trading venues therefore does not effectively constrain the prices that significant venues can charge. This finding is

¹⁷ I have used the same source and time period for these shares as reported by the SEC. See ArcaVision, available at <http://www.arcavision.com>. NYSE had a share of 41.2% while NYSE Arca had a share of 12.4%.

¹⁸ Proposed Order, *supra* note 3, at 32763.

¹⁹ See ArcaVision, available at <http://www.arcavision.com>. NYSE does not offer trading of Nasdaq-listed stocks.

²⁰ Proposed Order, *supra* note 3, at 32763.

confirmed by the asymmetry that the SEC acknowledges in the pricing of depth-of-book data by different trading venues.²¹ Venues without significant liquidity in a substantial number of securities may have difficulty charging significant (or any) prices for their market data and may have difficulty getting their market data distributed (in the absence of regulatory requirements) while venues with significant liquidity—NYSE Group and Nasdaq—can and do charge significant prices for their data as I discuss further below.

2. Consolidated data

The SEC's second claimed alternative is consolidated data. The consolidated data consist of the national best bid and offer for a stock and the last sale for a stock reported in any market.²² Depth-of-book data, however, reflect liquidity *below the top-of-book* that is different from, and in addition to, the liquidity reflected by consolidated data. As NYSE Arca explains:

Now more than ever, in order to see and estimate true market liquidity, you need to look beyond just the top of book price. When comparing all available liquidity at the inside to ArcaBook, you'll see that within five cents of the NBBO, ArcaBook data may provide six times more liquidity than is offered by all market centers' top of book at the market inside.²³

The customers that purchase depth-of-book data are those that need the significant additional information on liquidity provided by depth-of-book data.²⁴ No rational purchaser would pay significant fees in excess of the fees that he or she pays for consolidated data to acquire depth-of-book data if the two were good substitutes.

²¹ *Id.* at 32769; see also Section III for a discussion of this issue.

²² *Id.* at 32770.

²³ See ArcaBook: Speed, Depth and Value at a Competitive Price, available at <http://www.nyxdata.com/nysedata/DesktopModules/Bring2mind/DMX/Download.aspx?PortalId=0&EntryId=6095>.

²⁴ The SEC also states that "only 19,000 professional users purchase Nasdaq's depth-of-book data product and 420,000 professional users purchase core data in Nasdaq-listed stocks." (As I discuss below, see *infra* note 41, this figure may understate the number of professional users of all of Nasdaq's depth-of-book data products.) The SEC believes that this strongly suggests that no exchange has monopoly pricing power for its depth-of-book data because the substantial majority of professional users either do not believe they need the data or that the cost exceeds the value they place on the data. That is the wrong conclusion to draw. Monopolists commonly set prices to restrict output—the fact that a monopolist is selling only to a subset of potential customers is consistent with its having set prices above competitive levels so that only those that value its product highly will purchase the product.

If the price of depth-of-book data were increased, the consumers of those data would not increase their purchases of consolidated data since they already consume those data and the data do not reflect additional liquidity. Likewise, if the price of depth-of-book data were decreased, the consumers of those data would not likely purchase less consolidated data. Thus, consolidated and depth-of-book data are not economic substitutes and the former cannot constrain the pricing of the latter.

3. "Pinging"

"Pinging" orders are "oversized marketable limit orders [designed] to access an exchange's total liquidity available at an order's limit price or better."²⁵ Pinging orders are used to expose liquidity that is hidden in reserve orders on an exchange. A pinging order will execute against any hidden liquidity, and thus reveal depth information that is not available from the exchange's depth-of-book data. Pinging orders find liquidity that is not displayed. They do not gather information on depth-of-book data that are available for purchase.

The SEC asserts that the use of pinging may be expanded into a viable substitute for an exchange's depth-of-book data. The SEC appears to argue that, because pinging orders extract data that are not available from the exchange's depth-of-book data, and is superior in *that* respect, pinging can also serve as a substitute to the depth-of-book data. But the SEC has provided no evidence that pinging provides a viable alternative that would significantly constrain the pricing of depth-of-book data by the exchanges.

In fact, pinging does not appear capable of replicating an exchange's depth-of-book data. First, pinging places limit orders that incur the risk of execution to gather the data. If the execution is not optimal, the trade can involve a cost greater than the market data.

Second, the information on liquidity returned from a pinging order is substantially different from the information provided by an exchange's depth-of-

²⁵ Proposed Order, *supra* note 3, at 32765.

book data. When a pinging order is executed, the execution reveals only that the number of shares specified in the order were available at the specified price. The executed order does not indicate whether more liquidity at that price was available or whether any liquidity beyond that price remains available.

Alternatively, when a pinging order is not executed, one knows only that the specifically requested liquidity at that price is not available. But that information does not indicate if a lesser amount of liquidity at or beyond that price is available.

Pinging is thus an inferior substitute, if a substitute at all, for depth-of-book data. Despite the SEC's suggestion, an increase in the price of depth-of-book data would not plausibly result in a significant increase in pinging, and a decrease in the price of depth-of-book data would not plausibly result in a significant decrease in pinging. The SEC has not presented any evidence to the contrary.

4. Collaboration

The SEC's claim that the threat of potential entry by a collaborative venture of securities firms currently imposes a significant competitive constraint on the Exchange's pricing of its depth-of-book data is speculative, implausible, and unsubstantiated.

The U.S. Department of Justice and the Federal Trade Commission's *Horizontal Merger Guidelines* require entry to be "timely, likely, and sufficient in its magnitude, character and scope to deter or counteract" attempts to exercise market power.²⁶ To be timely, entry needs to take place within two years.²⁷ To be likely, entry needs to be profitable at competitive prices.²⁸ And to be sufficient, entry needs to deter or counteract the exercise of market power.²⁹

²⁶ U.S. DEP'T. OF JUSTICE AND THE FED. TRADE COMM'N., *HORIZONTAL MERGER GUIDELINES* § 3.0 (1992, Revised 1997).

²⁷ *Id.* § 3.2.

²⁸ *Id.* § 3.3. Specifically, the *Horizontal Merger Guidelines* use profitability at pre-merger prices as the relevant standard.

²⁹ *Id.* § 3.4.

The SEC has provided no evidence that the threat of entry by a collaborative effort is timely, likely or sufficient so as to impose a current competitive constraint on the Exchange's pricing of depth-of-book data. In fact, securities firms almost certainly could not successfully collaborate in a timely and sufficient manner so as to impose a significant constraint on the ability of the Exchange to exercise market power over its depth-of-book data.

Consider the hurdles and expense that the securities firms would face to provide complete depth-of-book data through collaboration. To provide such depth-of-book data, hundreds of securities firms would have to come together, agree to join a collaborative effort, and provide the depth-of-book data on a timely basis. To form a collaborative enterprise, one or more securities firms would have to act as entrepreneurs to organize their direct competitors, enlist still other securities firms in the venture, establish governance and voting structures, and form an on-going joint venture that compiles and distributes comprehensive data on a timely basis. The organizational costs of doing so are likely prohibitive.

The competing firms, which are diverse, would also have to agree how to split the costs and revenues associated with supplying the depth-of-book data. The process of securing such an agreement on acceptable business terms would likely be time-consuming, challenging, and costly. Forming successful joint ventures of two firms is ordinarily difficult; forming one among hundreds of competitors would be more difficult by far. For example, the venture may fail if only one significant securities firm refuses to participate or if large securities firms, recognizing this, refuse to participate in the absence of receiving a disproportionate share of the net benefits. In addition, the joint venture would have to address the numerous regulatory issues associated with collaborations among direct competitors.³⁰

Even if the large competitor collaboration could be formed, its product may be of a quality that is inferior to that of the exchanges. To serve as an economically relevant substitute for depth-of-book products, the hypothetical collaboration's

³⁰ See, e.g., U.S. DEP'T. OF JUSTICE AND THE FED. TRADE COMM'N, *Antitrust Guidelines for Collaborations Among Competitors* (April 2000).

depth-of-book data must be substantially comprehensive across exchanges, which in turn would require virtually industry-wide participation. In the likely event that the hypothetical collaboration's depth-of-book product is not substantially comprehensive, its incomplete information on available liquidity may well not serve as a viable substitute for an exchange's complete offering.

Moreover, the exchange would have to believe that the collaborative effort could provide the depth-of-book data at such a price that the exchange would not be able to exercise market power. The collaborative venture, however, would face a significant cost disadvantage relative to the exchanges. The exchanges obtain the depth-of-book data for free as a byproduct of their being SROs. The collaborative venture would collect the depth-of-book data at a higher cost and less efficiently than the exchanges. The collaborative venture would therefore confront a higher cost structure with greater logistical challenges than those of an exchange and, as a result, would not likely impose a significant constraint on the Exchange's pricing of depth-of-book data.

5. Summary on the availability of substitutes

Competition authorities and courts consider the availability of only close substitutes—ones that consumers would, in fact, turn to in the face of a price increase—as constraints on the exercise of significant market power. The SEC's analysis ignores that established framework and asserts, with no economic or factual basis, that several alternatives are substitutes for the depth-of-book data. The SEC seems to further assume that any degree of substitution (*e.g.*, bicycles for cars as modes of transportation) can constrain market power without any consideration of whether the products at issue are reasonably interchangeable for the relevant end use or whether one can defeat a price increase of the other.

**III. COMPETITION FOR ORDER FLOW DOES NOT SIGNIFICANTLY
CONSTRAIN THE EXCHANGE'S DEPTH-OF-BOOK DATA
PRICING.**

In this section, I consider whether competition for order flow significantly constrains the pricing of an exchange's depth-of-book data, the other supposed competitive constraint that the SEC has identified in the Proposed Order. The SEC has claimed that competition for order flow and the pricing of depth-of-book data are "two sides of the same coin" and, therefore, competition for order flow is a significant constraint on any market power the exchanges possess over depth-of-book data. Both the SEC's premise and its conclusion are wrong.

**A. The SEC's Premise that Order Flow and Depth-of-Book Data Are
"Two Sides of the Same Coin" Is Wrong.**

The lynchpin of the SEC's argument is that order flow competition and depth-of-book data are "two sides of the same coin" insofar as a strong and direct relationship exists between the two. That is wrong. The relationship between the two is neither strong nor direct.

An exchange has at least three sources of revenue relevant to the Proposed Order: liquidity providers, liquidity takers, and depth-of-book market data purchasers. The provision and taking of liquidity generates order flow and constitutes the trading process. Market data are a byproduct of the trading process.

A strong and direct relationship exists between order flow and prices for liquidity providers and liquidity takers. Liquidity providers are given rebates and other incentives to provide liquidity to the exchanges; those price incentives directly affect the volume of liquidity provided. Liquidity takers are charged for using this liquidity; those fees directly affect the volume of liquidity taken.

Depth-of-book data, by contrast, are a byproduct of the process of providing and taking liquidity (*i.e.*, order flow). Depth-of-book data do not directly lead to order flow and they are not priced to encourage order flow. Rather, depth-of-book data pricing reflects the value of the information provided—that is, the extent of liquidity disclosed. Exchanges charge fixed fees for each person using the data

independent of the amount of orders generated by that individual. Firms responsible for high trading volume are charged the same as firms that use the data for research purposes and do not trade at all.³¹ I explain these points in more detail below.

An exchange's trading platform depends on the participation of traders.

Some trading participants provide liquidity to the exchange and other trading

participants take liquidity. A trade takes place only when a party offering to buy or

sell at a given price meets another party that is willing to take the other side of the

trade at that price. (Traders may be both liquidity providers and liquidity takers at

different times for different trades.) Liquidity providers and takers are not

symmetric, however, in their importance to the platform. The providers of liquidity

attract users of liquidity, as well as other providers of liquidity, all of which generate

trading activity for the platform.

We therefore expect prices to favor the side that is more important—orders

that provide liquidity.³² And, in fact, we observe pricing practices that offer

significant incentives for liquidity providers. NYSE and Nasdaq, for example, both

pay rebates to liquidity providers. For NYSE, in 2007, liquidity rebates totaled \$626

million, in comparison with its net revenues of \$317 million from fees for trading and

access to the trading platform.³³ For Nasdaq, in 2007, liquidity rebates totaled

\$1,050 million, in comparison with its net revenues of \$322 million from fees for

trading and access to the trading platform.³⁴

³¹ Indeed, the Proposed Order suggests that charging differing prices for market data depending on the purchaser's placement of order flow may be unreasonably discriminatory. See Proposed Order, *supra* note 3, at 32762, 32768. Our point here, however, is that fees are currently structured in a manner that does not have a direct effect on order flow.

³² Jean-Charles Rochet & Jean Tirole, *Two-Sided Markets: A Progress Report*, 37 RAND J. OF ECON. 645 (2006).

³³ NYSE Burouct, Annual Report (Form 10-K) (March 25, 2008). Gross revenues for NYSE Group in the United States related to cash trading were \$1,165 million in 2007, with net revenues of \$317 million after \$626 million in liquidity rebates (including payments to specialists) and \$222 million in routing and clearing fees. (NYSE Group also received \$86 million related to derivatives trading.)

³⁴ Nasdaq OMX Group, Inc., Annual Report (Form 10-K) (Feb. 25, 2008). Gross revenues for Nasdaq in the United States related to trading were \$1,903 million in trading fees and \$77 million in platform access fees. Nasdaq had net trading related revenues of \$322 million after \$1,050 million in liquidity rebates, \$35 million in tape fees revenue shared with market participants for placing orders and reporting trades to Nasdaq (under two separate programs), and \$575 million in brokerage, clearance and exchange fees.

Smaller trading venues offer even more aggressive liquidity rebates. For example, the BATS ECN pays a \$0.0024 rebate per executed share for orders that add liquidity for Tapes A and C securities and charges a \$0.0025 fee per executed share for orders that remove liquidity.³⁵ That is, of the \$0.0025 transaction fee it receives from the taker of liquidity, it pays \$0.0024 out to the trader that provided the liquidity. For Tape B securities, BATS pays *more* in a rebate (\$0.0030) than it takes as a transaction fee (\$0.0025).

NYSE Arca recently announced similar pricing. For Tape A and C securities, the pricing structure is inverted, including a rebate of \$0.0028 for orders that add liquidity and a fee of \$0.0027 for orders that take liquidity. For Tape B securities, the rebate is \$0.0023 for orders that add liquidity and the fee is \$0.0028 for orders that take liquidity.³⁶

As the Proposed Order observes, orders that provide liquidity attract other traders to the platform. The more liquidity and trading on a given platform, the greater the number of traders that are interested in participating on that platform. Trading venues compete to attract liquidity, which generates trading volume, which in turn generates trading revenues for the platform. Accordingly, the prices that are most relevant to attracting order flow are the transaction fees, including the liquidity rebates, associated with placing orders on a trading venue.

The pricing behavior reviewed above confirms that competition for order flow among trading venues is reflected most directly in the transaction fees they charge and the liquidity rebates they offer. Each trading venue sets its transaction prices and liquidity rebates to provide direct incentives for market participants to

³⁵ See BATS Fee Schedule, Effective July 1, 2008, available at http://www.batstrading.com/subscriber_resources/BATS%20Fee%20Schedule%20-%20effective%20July%201,%202008.pdf. BATS also charges a routing charge of \$0.0029 for orders routed to other venues.

³⁶ These are NYSE Arca's fees for its most active tier of trading customers. The fees for other tiers also reflect significant liquidity rebates. NYSE Arca also charges a routing fee of \$0.0029 for orders executed by another market center or participant, except on the NYSE where the routing fee is \$0.0008 (or \$0.0006 for customers using NYSE Arca's Primary Sweep Order). These fees are effective July 1, 2008. See NYSE Group, NYSE Arca Announces Unified Equities Transaction Pricing, Effective July 1 (June 19, 2008), available at <http://www.nyse.com/press/1213870771815.html>.

offer liquidity to and place orders on that venue. Supply and demand forces work as expected—fees are decreased and rebates are increased to attract more order flow.

Fees for depth-of-book data, however, do not vary with the purchaser's order flow generally or with the purchaser's order flow on the providing exchange. The exchanges therefore do not use depth-of-book data to stimulate trades, as they use rebates and fees for liquidity providers and takers. Rather, depth-of-book data are typically priced on a fixed monthly fee per device subscribed. In addition, some exchanges offer an option for an enterprise license to cover all users, a per company maximum fee cap, and a per company access fee.³⁷ I am not aware of exchanges' pricing their depth-of-book data based on the extent to which those data are used for orders.

B. The SEC's Conclusion that Order Flow Competition Significantly Constrains Depth-of-Book Data Pricing Is Wrong.

Based on the faulty premise that order flow and market data are two sides of the same coin, the SEC draws the conclusion that competition for order flow limits an exchange's ability to set prices for depth-of-book data. That is wrong.

Although an exchange may have an incentive to make available its depth-of-book data, the exchange nevertheless can charge prices above competitive levels for those data if the exchange is not constrained by significant competitive forces in their sale and such data have value to customers by reflecting substantial liquidity. Once a seller makes a product available, the price that the seller charges for the product is a function of the demand for the product and whether economically significant substitutes are available. In the case of depth-of-book data, the exchange will identify the profit-maximizing price for the data even if that price is higher than would be paid by a significant number of potential purchasers. The SEC implicitly recognizes that important point by noting that Nasdaq's depth-of-book product, which is presumably profitably priced, is purchased by a small percentage of Nasdaq's professional users.³⁸

³⁷ SEC Release No. 34-53952, *supra* note 2, at 33496-33497.

³⁸ See *infra* note 41.

Nasdaq's publicly reported revenue information confirms that exchanges with significant order flow have significant pricing power for their unconsolidated data.³⁹ In 2007, Nasdaq received consolidated data revenue of \$87 million and unconsolidated data revenue of \$88 million.⁴⁰ Thus, of its market data revenue, *more than half* was received from consumers of unconsolidated data. This figure is particularly striking because, according to the SEC, "only 19,000 professional users purchase Nasdaq's depth-of-book data product and 420,000 professional users purchase core data in Nasdaq-listed stocks."⁴¹ That means that Nasdaq was able to extract more than 50 percent of its 2007 market data revenue from its sale of unconsolidated data, even though *less than 5 percent* of professional users purchased its depth-of-book data.

Furthermore, we would not expect pricing for market data to be constrained by "fierce" competition for order flow. Order flow competition implies that traders can and do switch easily among many alternative trading venues and that an exchange would have little or no leverage to charge higher prices to its trading participants. That competition appears to be reflected in the exchanges' transaction pricing and the substantial rebates they pay to liquidity providers.

By contrast, as discussed above, an exchange with substantial liquidity maintains significant leverage over the consumers of its depth-of-book data.⁴² That dynamic—significant leverage over market data customers and little or no leverage over providers and takers of liquidity—results in prices for market data that reflect

³⁹ I discuss Nasdaq's revenues as NYSE does not report its revenues from consolidated versus unconsolidated data.

⁴⁰ This is net of \$46 million in consolidated data fees that Nasdaq collects and is required (as a result of its role as the Securities Information Processor for Nasdaq-listed securities) to share with other trading venues based on their respective shares of trading in Nasdaq-listed securities.

⁴¹ Proposed Order, *supra* note 3, at 32766. The SEC's reference to 19,000 professional users of Nasdaq's depth-of-book data may be an understatement. The Nasdaq letter cited by the SEC indicates that there were 19,000 professional users of TotalView. The Nasdaq letter did not indicate how many professional users purchased its other depth-of-book data products. See Letter from Jeffrey Davis, Vice President and Deputy General Counsel, The Nasdaq Stock Market, dated May 18, 2007, at 6.

⁴² I have already shown in Section II that the purported alternatives offered by the SEC do not in fact provide economic substitutes for depth-of-book data and thus do not significantly constrain depth-of-book data pricing.

significant market power and prices for order flow that reflect competitive conditions.⁴³

C. The Evidence on Which the SEC Relies Does Not Support the SEC's Conclusions.

The SEC presents four sources of support for its conclusion that order flow competition constrains pricing for depth-of-book data:

1. An industry textbook.
2. The Report of the SEC Advisory Committee on Market Information.
3. The strategy followed by BATS (an ECN) of not charging for market data.
4. Island's choosing not to display its order book to avoid being subject to the Inter-market Trading System (ITS) regulations and losing significant order flow.⁴⁴

None support the SEC's conclusions.

The first two sources are statements to the effect that, in the absence of the regulatory requirement for *consolidated* data from all trading venues to be displayed, many data vendors would not display data from smaller trading venues and that those venues would therefore find it difficult to compete for order flow. Those statements do no more than acknowledge: (1) that the pricing power of market data derives from the significance of the liquidity that the market data reflect; and (2) that some degree of transparency may be an important component of a platform that is appealing to traders. Both points were discussed above, and neither establishes that competition for order flow constrains market data pricing.

⁴³ The SEC asserts that, if "NYSE Arca were truly able to exercise monopoly power in pricing its non-core data, it likely would not choose a fee that generates only a small fraction of the transaction fees that admittedly are subject to fierce competitive forces." See Proposed Order, *supra* note 3, at 32769. That is a non-sequitur. That a firm charges fees for one product that result in total revenue that is greater or less than the total revenue from the sale of another product says nothing about the firm's market power over either product.

⁴⁴ *Id.* at 32764.

The third reference is to statements by the BATS ECN regarding its strategy of not charging for market data. That strategy is hardly surprising, as market data reflecting little liquidity have little value and the smaller trading venues that supply such data have little pricing power.

And the fourth reference is to the experience of the Island ECN when it chose not to display its order book at all to avoid the Inter-market Trading System (ITS) regulations and lost significant order flow. That experience hardly establishes that order flow constrains the prices of market data. As discussed above, even if a viable trading venue must make some of its market data available, the prices that can be charged for those data depend both on the significance of the liquidity that the data reflect and on the availability of economically significant substitutes.

Indeed, the Report of the SEC Advisory Committee on Market Information itself confirms that the larger exchanges retain market power over their data even if the smaller trading venues do not:

Supporters of the Display Rule point out, however, that while the abandonment of the rule plainly would take away any artificial market power of the non-primary markets, it is unlikely to be a significant restraint on the pricing power of the primary markets. To the extent that market participants need the data generated by, for example, the NYSE or Nasdaq, they would still be forced to buy it. Accordingly, the absence of the Display Rule would not ensure the appropriate level of fees for the primary markets' data.⁴⁵

In sum, the evidence proffered by the SEC suggests only the following unremarkable propositions:

- smaller exchanges cannot charge significant prices for depth-of-book data because those data do not reflect significant liquidity; and
- larger exchanges can charge prices above competitive levels for depth-of-book data because they control—as noted in Section II—a significant portion of the liquidity for each stock (*e.g.*, 53.6 percent in the case of

⁴⁵ SEC ADVISORY COMMITTEE ON MARKET INFORMATION, REPORT OF THE ADVISORY COMMITTEE ON MARKET INFORMATION: A BLUEPRINT FOR RESPONSIBLE CHANGE (Sept. 14, 2001).

NYSE Group for NYSE-listed stocks) and are not constrained by the availability of reasonably interchangeable substitutes.⁴⁶

The SEC has presented no evidence or analysis that could support its claim that order flow and depth-of-book data are “two sides of the same coin” and that, therefore, “fierce” order flow competition necessarily constrains the exercise of significant market power in the provision of depth-of-book data.

IV. CONCLUSIONS

Scholarly literature and case law provide an analytical framework for assessing whether firms can exercise significant market power over prices and whether substitutes or other constraints discipline that market power. The SEC does not rely on that framework (or substitute a coherent one of its own) to reach its conclusion that the Exchange necessarily charges “equitable, fair, reasonable, and not unreasonably discriminatory” prices for its depth-of-book data because of “significant competitive forces.”

To the contrary, economics and the relevant facts establish:

- the Exchange likely has significant market power over the pricing of its depth-of-book market data;
- the availability of the alternative sources of depth-of-book data that the SEC identifies would not constrain that market power; and
- competition for order flow would not constrain that market power.

I therefore conclude, as a matter of economics, that the SEC has presented no credible analysis or evidence to support the position that the pricing of depth-of-book data is subject to significant competitive forces.

⁴⁶ Indeed, comparing the absolute prices of several products, as the SEC does with respect to the depth-of-book products of NYSE, Nasdaq, and NYSE Arca (*see Proposed Order, supra note 3, at 32769*), does not speak to whether the price of any of the products reflects significant market power. The price of a given product relative to another product is a function of the demand for the given product, all else being equal. Sellers of products for which demand is relatively greater will be able to set relatively higher prices, and vice versa, even assuming the absence of economically significant substitutes for both products.

EXHIBIT E

**RESPONSE TO ORDOVER AND BAMBERGER'S
STATEMENT REGARDING THE SEC'S PROPOSED
ORDER CONCERNING THE PRICING OF DEPTH-
OF-BOOK MARKET DATA**

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October 10, 2008

I. INTRODUCTION¹

NYSE Arca, Inc. (NYSE)² requested the Securities and Exchange Commission (SEC) to approve a proposed rule change that would allow NYSE to establish certain fees for depth-of-book market data (also known as unconsolidated, or non-core, data).³ The SEC has issued a Notice that presents a Proposed Order to approve that request and the basis for doing so.⁴

In my previous Report, I demonstrated that the Proposed Order's preliminary conclusion that significant competitive forces constrain NYSE's pricing of depth-of-book data is not supported by the analysis and evidence presented by the Proposed Order.⁵ To the contrary, the economics and evidence show that:

- NYSE likely has significant market power over the pricing of its depth-of-book market data;
- the supposedly alternative sources of depth-of-book data that the Proposed Order identifies would not significantly constrain market power over depth-of-book data; and

¹ This Report was prepared at the request of NetCoalition.

² For the purpose of analyzing competition among exchanges, all exchanges owned by the same corporate parent should be aggregated as under the control of the same economic agent, which seeks to maximize the profits of the combined operations. Indeed, NYSE Euronext itself has criticized Nasdaq for "totally ignor[ing] the NYSE Arca trading in NYSE-listed securities." Press Release, NYSE Euronext (last visited Oct. 9, 2008), http://www.nyse.com/pdfs/NYSE_Response_Letter1.pdf [hereinafter "NYSE Euronext Press Release"]. Thus, for purposes of economic analysis, the NYSE Arca and New York Stock Exchange trading venues should be considered a single entity. Ordover and Bamberger do not appear to dispute this conclusion.

³ Filing of Proposed Rule Change Relating to Approval of Market Data Fees for NYSE Arca Data, SEC Release No. 34-53592, 71 Fed. Reg. 33,496 (June 9, 2006).

⁴ Proposed Order Approving Proposal by NYSE Arca, Inc. to Establish Fees for Certain Market Data and Request for Comment, SEC Release No. 34-57917, 73 Fed. Reg. 32,751 (June 10, 2008) [hereinafter "Proposed Order"].

⁵ Dr. David S. Evans, An Economic Assessment of Whether "Significant Competitive Forces" Constrain an Exchange's Pricing of Its Depth-of-Book Market Data (July 10, 2008) [hereinafter "Report"].

- competition for order flow would not prevent the exercise of significant market power over depth-of-book data.

On August 1, 2008, Nasdaq submitted a letter to the SEC urging approval of the Proposed Order and attaching a supporting Statement of Janusz Ordover and Gustavo Bamberger.⁶ Those authors reach three principal conclusions:⁷

- “[E]ven though market information from one platform may not be a perfect substitute for market information from one or more other platforms, the existence of alternative sources of information can be expected to constrain the prices platforms charge for market data.”⁸
- “[A] trading platform cannot generate market information unless it receives trade orders. For this reason, a platform can be expected to use its market data product as a tool for attracting liquidity and trading to its exchange.”⁹
- Competition among exchanges constrains the “total return” each exchange earns from its “sale of joint products,” and thus the “total price of trading on that platform” is constrained by the “total price of trading on rival platforms.”¹⁰

⁶ Statement of Janusz Ordover and Gustavo Bamberger (Aug. 1, 2008) [hereinafter “Statement”].

⁷ The argument that platform competition constrains the total return of the exchange is one that Ordover and Bamberger make throughout their submission but is not presented in their conclusions, which instead focus on the first two arguments.

In addition to the economic flaws in Ordover and Bamberger’s total return analysis that are discussed in Section IV below, Ordover and Bamberger ignore an important part of the relevant landscape—namely the legal framework within which exchanges must operate. For example, NetCoalition has advised me that Congress, by way of the Exchange Act, requires an “exclusive processor” of market data (such as NYSE) that distributes quotation and transaction data to do so on terms that are “fair and reasonable” and “not unreasonably discriminatory.” Proposed Order, *supra* note 4, at 32,760 & n.156.

By arguing that a relatively low price for transaction services effectively offsets a relatively high price for market data, *see* Statement, *supra* note 6, ¶¶ 8, 23 & nn.23–24, Ordover and Bamberger ignore the above-referenced statutory mandate and thereby make their economic argument largely irrelevant within the context in which U.S. exchanges must operate.

⁸ Statement, *supra* note 6, ¶ 38.

⁹ Statement, *supra* note 6, ¶ 38.

¹⁰ Statement, *supra* note 6, ¶¶ 7 & 23.

Those conclusions are conceptually flawed, and the authors provide no meaningful factual support for any of them.

In Section II, I address Ordover and Bamberger's flawed claim that alternative sources of depth-of-book data act as a significant competitive constraint on the prices that a given exchange can charge for its depth-of-book data. They do not, and could not, present evidence to support that claim. Neither Nasdaq nor any smaller exchange provides depth-of-book data that are reasonably substitutable for NYSE's depth-of-book data.

In Section III, I show that Ordover and Bamberger's claim that competition for order flow acts as a significant competitive constraint on an exchange's pricing of its depth-of-book data is analytically flawed and factually inconsistent with how exchanges work. Ordover and Bamberger assume a symmetrical demand relationship between order flow and depth-of-book data where none exists. Depth-of-book data prices do not affect the marginal incentive to place orders and, therefore, do not significantly affect order flow decisions. On the other hand, depth-of-book data revenue can be used to offset the costs of liquidity rebates and discounts that attract more order flow. Additional order flow increases the value of, and the prices that an exchange can charge for, its depth-of-book data.

In Section IV, I show that Ordover and Bamberger's "total return" analysis is based on the incorrect assumption that the price of depth-of-book data is part of the marginal cost faced by broker-dealers in making trading decisions. Even if one were to assume that depth-of-book data prices were one component of the "total price of trading" on a platform, that component does not affect the marginal incentives to

execute a trade. Because depth-of-book data prices are not part of the marginal cost of executing a trade, depth-of-book data prices are not constrained by inter-platform competition for orders. Further, even if depth-of-book data and trade execution services are “joint products” with “joint costs,” the price of one does not necessarily constrain the price of the other because they are sold separately and face distinct competitive conditions.

II. PRICES FOR DEPTH-OF-BOOK DATA FROM ONE EXCHANGE ARE NOT SIGNIFICANTLY CONSTRAINED BY THE AVAILABILITY OF DEPTH-OF-BOOK DATA FROM OTHER EXCHANGES

Ordover and Bamberger claim that: “[E]ven though market information from one platform may not be a perfect substitute for market information from one or more other platforms, the existence of alternative sources of information can be expected to constrain the prices platforms charge for market data.”¹¹

Ordover and Bamberger provide no evidence to support their claim, other than asserting that they “understand” that “many ‘professional’ traders . . . view depth-of-book information from NYSE Arca and Nasdaq as reasonable substitutes because all depth-of-book products are effectively proxies for liquidity that would be available should the current NBBO change.”¹² That assertion is contrary to what happens in the marketplace.

As an initial matter, Ordover and Bamberger’s claim applies to depth-of-book data only from NYSE and Nasdaq. That is, even assuming Ordover and Bamberger

¹¹ Statement, *supra* note 6, ¶ 38.

¹² Statement, *supra* note 6, ¶ 32.

were correct that the price of NYSE's depth-of-book data constrains Nasdaq's depth-of-book data prices, that would imply a duopoly over depth-of-book data. Except for special circumstances that Ordover and Bamberger have not identified or documented, duopolies do not have competitive prices. Indeed, the variety of prices for depth-of-book data indicates the lack of a market-clearing price that one would expect in a competitive market with significant substitution among products. Highest among depth-of-book data prices are those charged by Nasdaq and NYSE, reflecting their market power over their respective depth-of-book data products, while smaller trading venues have no choice but to charge little or nothing for their depth-of-book data.¹³

Moreover, Ordover and Bamberger present no empirical evidence to support their claim as to substitutability between NYSE and Nasdaq. They do not attempt to show, for example, that traders actually do substitute between depth-of-book data from NYSE and Nasdaq, and marketplace evidence is to the contrary.

While depth-of-book data from NYSE and from Nasdaq both provide information about liquidity if the price of a security changes from the NBBO, NYSE's and Nasdaq's respective depth-of-book data reflect liquidity of different magnitudes and quality. Although Ordover and Bamberger assert that Nasdaq's and NYSE's depth-of-book data are "proxies" for each other, that assertion is contradicted by differences in the quantity and quality of liquidity across equities and

¹³ The SEC cited evidence in its Proposed Order that suggested that small trading venues may have difficulties getting distribution of their market data in the absence of display rules governing the distribution of consolidated data. See Proposed Order, *supra* note 4, at 32,764 n.195 (citing Larry Harris, *Trading and Exchanges, Market Microstructure for Practitioners* 99 (2003)).

by their own evidence of the volatility of the exchanges' shares of trading volume.¹⁴ If, as Ordover and Bamberger suggest, trading volume in NYSE-listed and Nasdaq-listed stocks constantly shifts, one exchange's depth-of-book data will not provide a reliable proxy for the other's data, which may reflect significantly different liquidity as a result of volatile competition for order flow.¹⁵

The Security Traders Association ("STA") observes that, as a matter of marketplace reality, a broker-dealer needs the depth-of-book data feeds from each significant venue on which a given security trades for a useful perspective of available liquidity:

We do not believe that the depth-of-book feeds from the various exchanges are fungible. Depth-of-book feeds are not substitutes for one another: NASDAQ's depth-of-book data for IBM will be different from the NYSE depth-of-book data for IBM. On the contrary, each depth-of-book data feed reflects the market conditions for a particular security on that particular venue. For a full appreciation of the liquidity available in the entire marketplace . . . as a commercial and competitive matter, a broker-dealer needs the depth-of-book feeds from each significant venue on which the security trades.¹⁶

Moreover, as I explained in my previous report, a market professional's need for information about a particular security can be satisfied only by data about that particular security. For example, market information about the market depth of the

¹⁴ Statement, *supra* note 6, ¶¶ 10-12.

¹⁵ For example, NYSE Euronext touts itself as the "the dominant source of liquidity in NYSE-listed securities, especially in thinly traded issues" with "more volume than NASDAQ in 99.4% of NYSE-listed stocks." NYSE Euronext Press Release *supra* note 2. A customer interested in assessing the liquidity and market depth of stocks listed on the New York Stock Exchange therefore could not satisfy that interest by purchasing only Nasdaq's depth-of-book data.

¹⁶ Bart M. Green & John Giesea, STA Comment Letter at 3 (Sept. 11, 2008), <http://www.sec.gov/comments/34-57917/3457917-15.pdf>. [hereinafter "STA Comment Letter"].

securities of Microsoft would not be useful to a trader seeking to determine the market depth of IBM securities. Ordover and Bamberger, however, do not address the broad variations in the liquidity of individual securities across exchanges. Nor do they explain how one set of depth-of-book data for all securities on one exchange could be reasonably substitutable for depth-of-book data for all securities on another exchange.

In sum, Ordover and Bamberger provide no meaningful evidence to demonstrate that the depth-of-book data from other trading venues significantly constrain the pricing of depth-of-book data from NYSE or Nasdaq. In my previous submission, I demonstrated that the other three supposedly alternative sources of depth-of-book data identified by the Proposed Order (NYSE's own consolidated data; "pinging" the various markets by routing oversized marketable limit orders; and the threat of independent distribution of depth-of-book data by securities firms and data vendors) are not material substitutes for an exchange's depth-of-book data.¹⁷

I thus conclude that no reasonably substitutable alternatives to NYSE's depth-of-book data are available to act as the "significant competitive forces" that the Proposed Order required to presume that the proposed NYSE prices are "equitable, fair, reasonable, and not unreasonably discriminatory."¹⁸

¹⁷ Report, *supra* note 5, Section II.

¹⁸ Proposed Order, *supra* note 4, at 32,751.

III. PRICES FOR DEPTH-OF-BOOK DATA ARE NOT SIGNIFICANTLY CONSTRAINED BY COMPETITION FOR ORDER FLOW

In my previous submission, I demonstrated that competition for order flow does not significantly constrain an exchange's market power over depth-of-book data—that order flow and market data are *not* “two sides of the same coin.”¹⁹

Without addressing my analysis, Ordover and Bamberger reach the opposite conclusion, claiming that competition for attracting liquidity and trading constrains prices for depth-of-book data.²⁰ They rely on two propositions. First, Ordover and Bamberger state that “a trading platform cannot generate market information unless it receives trade orders.”²¹ Second, they assert that, “[f]or this reason, a platform can be expected to use its market data product as a tool for attracting liquidity and trading to its exchange.”²²

Ordover and Bamberger provide no economic analysis or evidence as to why the second proposition should follow from the first. In economic terms, Ordover and Bamberger are asserting that a change in the price of depth-of-book data would have a similar impact on demand for order flow as a change in the price of order flow would have on the demand for depth-of-book data. That symmetrical and reciprocal relationship does not, in fact, exist.

The following propositions demonstrate that the relationship between the demand for depth-of-book data and the demand for order flow is asymmetrical.

¹⁹ Report, *supra* note 5, Section III.

²⁰ See, e.g., Statement, *supra* note 6, ¶ 6 (“In Section II, we show that competition between trading platforms constrains the price of market data sold by each platform.”).

²¹ Statement, *supra* note 6, ¶ 38.

²² Statement, *supra* note 6, ¶ 38.

(1) *The input relationship between order flow and depth-of-book data is asymmetrical.* The price of depth-of-book data is at most only one of many factors considered in placing trades. NYSE has itself explained that “[t]he markets base competition for order flow on such things as technology, customer service, transactions costs, ease of access, liquidity, and transparency.”²³ Changing the price of only depth-of-book data is thus unlikely to have a significant effect on the demand for transactions.

Market data are also used for purposes other than trading and, in that regard, are not an input to order flow at all. As Ordover and Bamberger explain, market data are “useful in a number of ways” that do not involve trading, including “valuing securities and portfolios,” “evaluating the performance of a broker or trader,” or obtaining a “barometer of market sentiment.”²⁴ They acknowledge that market data are useful to “firms that act as intermediaries between trading platforms and the public but do not trade themselves,” such as Google and Yahoo!²⁵ For customers purchasing depth-of-book data and not placing trades on an exchange, the depth-of-book data price thus stands entirely on its own.

In contrast, order flow is the sole input for generating and increasing the value of depth-of-book data. Indeed, depth-of-book data are a byproduct of order flow. Without order flow, depth-of-book data would not exist.

²³ Proposed Order, *supra* note 4, at 32,764 n.193 (citing Letter from Mary Yeager, Corporate Secretary, NYSE Arca, to the Honorable Christopher Cox, Chairman, Commission, dated February 6, 2007, at 16).

²⁴ Statement, *supra* note 6, ¶¶ 20-21.

²⁵ Statement, *supra* note 6, ¶ 20 n.21.

(2) *The effects of changes in prices of trading on the demand for depth-of-book data, and vice versa, are also asymmetrical.* Depth-of-book data are priced and sold separately from trade execution services. Depth-of-book data are sold in monthly subscriptions and are typically based on a fixed monthly fee per device.²⁶ That fixed subscription fee is independent of the amount of orders generated by the subscriber and is not expressed as part of, or affected by, trade execution services.

An exchange charges subscribers the same per-device fee whether or not they place orders on the exchange. Indeed, as the SEC recognizes, an exchange may not “unreasonably discriminate among types of subscribers, such as by favoring participants in the NYSE Arca market or penalizing participants in other markets.”²⁷ In addition, each monthly subscription provides data on all securities traded on an exchange, and customers are charged the same price whether or not they examine the depth-of-book data for one security, all securities, or some number in between.

In contrast, each trade is executed with respect to an individual security, and exchanges charge fees (with separate discounts and rebates for trade execution services) that are separate from depth-of-book data subscription fees. The trade execution fees are determined on a transactional basis and are designed specifically to affect trading incentives and attract liquidity. Those transaction-based fees for order flow allow traders to assess the costs and benefits of placing a given trade for a given security on a given venue and thus affect traders’ marginal incentives to direct order flow among exchanges.

²⁶ In addition, there may be a cap on the total monthly data fees paid by each company. There may also be per-company fees for access to the datafeeds from the exchange’s servers. SEC Release No. 34-53592, *supra* note 3, at 33,496-33,497.

²⁷ Proposed Order, *supra* note 4, at 32,768.

An increase or decrease in the monthly subscription fee for depth-of-book data, however, does not change a trader's marginal cost to purchase or sell a particular security on a particular exchange. That is, in choosing where to place the next trade, an entity would not consider the cost of the subscription fee. Likewise, in setting the depth-of-book monthly subscription fee, the exchange would consider the effect of that fee on the marginal incentive to subscribe to depth-of-book data, but not on the marginal incentive to trade generally or for a particular security.²⁸

*(3) The asymmetrical relationship between the demand for order flow and depth-of-book data is illustrated by considering the consequence of a small but significant price increase for each product.*²⁹ A five percent increase in the monthly subscription fee for depth-of-book data would not have any material effect on the demand for order flow for two reasons. First, as noted above, the increase in the price of depth-of-book data would have no effect on the price of, and therefore the marginal demand for, order flow. Second, as also noted above, depth-of-book data are just one of many inputs into the demand for order flow.

On the other hand, a five percent increase in the price of transactions might well have a material effect on order flow and thus on the demand for depth-of-book data. If increasing the price of transactions would reduce the amount of orders, it would thereby reduce the amount of, and value of, depth-of-book data. In such a

²⁸ My position here and in my prior Report does not assume that no relationship whatsoever exists between the pricing of depth-of-book data and the volume of order flow. Even if some traders may deem an exchange to be a non-viable trading venue if it declines to make depth-of-book data available at all (or at an extremely high price), the level of depth-of-book data pricing within a range that includes the exercise of significant market power will not affect traders' marginal incentives as to where to place their next buy or sell order.

²⁹ A price increase of approximately five percent is generally viewed as small but significant. See U.S. Dep't of Justice and Fed. Trade Comm'n, Horizontal Merger Guidelines §1.11 (Rev. 1997).

case, the willingness of customers to pay for depth-of-book data would decline, especially if those data reflected a significant reduction in liquidity.

* * * * *

Ordover and Bamberger, and the Proposed Order, have ignored the asymmetry discussed above and thus have erred in their assessment as to whether an exchange can exercise market power over depth-of-book data. Although Ordover and Bamberger recognize that depth-of-book data are a direct byproduct of order flow,³⁰ they do not explore the important implication of that byproduct relationship.

That relationship indicates that competition for order flow will not constrain an exchange's depth-of-book data prices and may serve to increase them. Lower order flow prices generally will increase order flow, which, in turn, will increase the value of depth-of-book data. That is, by attracting additional order flow, an exchange will not only gain the transaction fees associated with the order flow, it will also increase the amount it can charge for its depth-of-book data.

Increased depth-of-book revenue can be used to offset the costs of liquidity rebates and discounts that attract order flow. Indeed, the STA observes that "raising the market data fees would enable [the exchanges] to pay higher rebates and thus, attract more order flow."³¹ We see that observation empirically verified in the case of consolidated tape data. Trading venues use revenue from consolidated tape data to compete for order flow. As Nasdaq states: "Participants in the UTP Plan have used

³⁰ Statement, *supra* note 6, ¶¶ 7 & 17.

³¹ STA Comment Letter, *supra* note 16, at 3.

tape fee revenues to establish payment for order flow arrangements with their members and customers.³²

The economically rational strategy for exchanges, given the asymmetrical relationship of order flow and depth-of-book data, is thus to set lower prices for order flow, which has the effect of increasing the value of, and the prices the exchanges can charge for, their depth-of-book data.

IV. PRICES FOR DEPTH-OF-BOOK DATA ARE NOT SIGNIFICANTLY CONSTRAINED BY INTER-PLATFORM COMPETITION

Ordover and Bamberger focus on the “total return” or “aggregate return” that a platform receives from trade execution services and depth-of-book and other market data.³³ They claim that the “total price of trading” on a platform is constrained by the total price of trading on alternative platforms.³⁴ Ordover and Bamberger include in the price of trading the prices of (at least) market data and trade execution.³⁵ Ordover and Bamberger thus appear to argue that, even if an exchange charges relatively high prices for market data, inter-platform competition will cause those market data prices to be effectively offset by relatively low prices for other products or services offered by the exchange, such as providing access to liquidity.³⁶

³² Nasdaq Stock Market, Inc., Annual Report (Form 10-K), at 17 (Feb. 25, 2008).

³³ Statement, *supra* note 6, ¶ 7.

³⁴ Statement, *supra* note 6, ¶ 23.

³⁵ Statement, *supra* note 6, ¶ 23 & nn.23-24.

³⁶ Statement, *supra* note 6, ¶¶ 7-8, 23 & nn.23-24.

Even if one assumes that depth-of-book data prices are a component of the “total price of trading,” as discussed in the previous section, that component does not affect the marginal incentives of a broker-dealer to execute a trade. On the other hand, transaction fees can and do affect order flow decisions. Thus, while inter-platform competition for trading may constrain the prices of trade execution services, it does not significantly constrain depth-of-book data fees.

Ordover and Bamberger further attempt to advance their “total return” argument by characterizing trade execution services and market data as “joint products” with “joint costs” and by asserting that trading platform competition will necessarily constrain the total return from those joint products.³⁷ To the contrary, where two “joint products” of the same facility are sold separately—as trade execution services and depth-of-book data are—the pricing of each product is determined by the distinct competitive conditions that each product confronts.

A classic example of joint products with joint costs is the production of wool and mutton. Wool and mutton are joint products of a sheep, and many of the costs of producing both products (*i.e.*, the care, feeding, and handling of the sheep) are the same. However, the demand conditions for wool could be independent of those for mutton.

Suppose, for example, that market conditions are such that only one firm can produce desirable wool (because its sheep have much better wool than its competitors’ sheep), while many firms can produce desirable mutton (because the

³⁷ Statement, *supra* note 6, ¶ 7 (“Competition among trading platforms can be expected to constrain the aggregate return each platform earns from its sale of joint products . . .”).

mutton from all sheep is perfectly substitutable). Under those conditions, the competition to produce mutton, however intense it might be, will not significantly constrain the monopoly wool producer's pricing of wool. If other firms cannot produce wool of satisfactory quality, the monopoly wool producer will face no competition in the pricing of wool, even as the pricing of mutton faces intense competition. Of course, that is unlikely to be the case for sheep farmers—our point is only that the existence of joint costs/joint products does not ensure a particular competitive outcome in either product market.

In the case of trading venues, competition for order flow does not significantly constrain depth-of-book data pricing simply because they are viewed as joint products. Regardless of competitive conditions for trade execution, an exchange can charge supracompetitive prices for depth-of-book data if the exchange does not face significant competitive constraints in the sale of such data and such data have value by reflecting substantial liquidity. As demonstrated in my previous report and Sections II and III above, that is the case here.

V. CONCLUSION

As explained above, Ordovery and Bamberger's unsupported assertion that supposedly alternative sources of depth-of-book data act as a competitive constraint on an exchange's depth-of-book data is contradicted by empirical evidence. Data from different trading venues are not meaningfully substitutable. Exchanges with significant liquidity thus may charge prices for depth-of-book data that would exceed competitive levels.

In addition, Ordover and Bamberger's claim that competition for order flow acts as a significant competitive constraint on an exchange's pricing of its depth-of-book data incorrectly assumes a symmetrical and reciprocal relationship between the demand for, and the pricing of, order flow and depth-of-book data. In fact, their relationship is asymmetrical and results in an incentive to charge lower order flow prices and higher depth-of-book data prices.

Finally, Ordover and Bamberger's assertion that depth-of-book data prices are constrained by inter-platform competition for trading incorrectly assumes that the cost of depth-of-book data is part of the marginal cost of trading. In fact, depth-of-book data prices do not affect broker-dealers' marginal incentives to place trades. Nor does labeling depth-of-book data and trade execution services as "joint products" with "joint costs" make one a constraint on the pricing of the other. Each must be assessed in light of the individual competitive conditions that it confronts. Here, the lack of reasonably interchangeable sources of depth-of-book data provides exchanges with significant market power over the pricing of those data.

I conclude by reiterating the main propositions from my prior Report:

- NYSE likely has significant market power over the pricing of its depth-of-book market data;
- the supposedly alternative sources of depth-of-book data that the Proposed Order identifies would not significantly constrain market power over depth-of-book data; and
- competition for order flow would not prevent the exercise of significant market power over depth-of-book data.