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Regulation NMS: Has the SEC Exceeded its Congressional Mandate to Facilitate a “National Market System” in Securities Trading?

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Abstract

The SEC is currently holding hearings on sweeping changes to the micro-structure of the country's securities trading markets - modifying the trade through rule, for example. Professor Oesterle argues that the SEC should not be in the business of so structuring the country's securities markets in the first place. In the piece he chronicles the SEC's expansive interpretation of its power under Congress's 1975 National Market System Amendments to the 1934 Securities and Exchange Act and questions whether Congress intended to grant the SEC such a mandate.

Regulation NMS: Has the SEC Exceeded its Congressional Mandate to Facilitate a “National Market System” in Securities Trading?

Dale A. Oesterle¹

In 1975 Congress, after active and far reaching hearings on the nation’s securities markets, adopted significant amendments to the Securities and Exchange Act of 1934 (1975 amendments). The amendments marked a major turning point in the regulation of the securities industry. Congress “directed” the Securities and Exchange Commission (the SEC) to “facilitate the establishment” a “national market system” for the trading of securities.² The mandate still dominates the SEC’s regulatory philosophy. The SEC has ceremonially referenced the mandate, abbreviated to the now well-known acronym “NMS,” ever since in most all its rule proposals or concept releases on market structure.³

What is curiously absent, however, in SEC releases and in the literature in general on market structure is any close analysis on the contours of the Congressional mandate. The issue is particularly poignant at present given the SEC’s current proposed Regulation NMS, which, if implemented, would effect a major overhaul of the structure of our public trading markets.⁴

The 1975 Congressional amendments vested substantial discretion in the SEC to flesh out and implement Congress’s admittedly hazy, inchoate vision of what a national market system ought to be. Congress did indicate unequivocally that it was directing the SEC to make progress on two fronts. First, Congress directed the SEC to encourage better communication among the various markets. And second, Congress directed the SEC to eliminate inappropriate burdens on competition among securities trading market centers.

The SEC was, after its successful attack in 1975 on fixed brokerage commissions,⁵ very deliberate in pursuing the second objective. It waited, for example,

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² Section 11A(a)(2) of the Securities Exchange Act of 1934, 15 U.S.C. 78K-1.

³ The newest SEC rule-making initiative, a stunner, uses an abbreviation of the Congressional language in its title, proposed Regulation NMS. See Securities Exchange Act Release No. 34-50870 (Dec. 16, 2004), 69 Fed. Reg. 77424 (Dec. 27, 2004), www.sec.gov/rules/proposed/34-50870.htm (hereinafter SEC Rel. No. 34-50870, page numbers refer to the online document). The first version of the proposal had an extended discussion of the national market system. See Securities Exchange Act Release No. 34-49325 (Feb. 2004), 69 Fed. Reg. 11126 (Mar. 9, 2004), www.sec.gov/rules/proposed/34-49325.htm at page 9-15 (hereinafter SEC Rel. No. 34-49325; page references in the article will be to the sec.gov online htm documents). The other major milestones in the SEC’s development of the NMS are the creation of the consolidated system from disseminating market information in the 70s, the incorporation of the Nasdaq Stock Market, Inc. securities into the NMS in the 80s, and the adoption of the Order Handling Rules in the 90s. Id. at 5

⁴ See SEC Rel. No. 34-50870, repropounding SEC Rel. No. 34-49325 (Feb. 26, 2004).

⁵ For a discussion of fixed commission rates see, e.g., William F. Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public*, 22 Stan. L. Rev. 675 (1970); G. William Schwert, *Public Regulation of the National Securities Exchanges: A Test of the Capture Hypothesis*, 8 Bell. J. Econ. 128 (1977). On May 1,

until 2000 to eliminate the last vestiges of the New York Stock Exchange's off-board trading restrictions.⁶ Critics have, over the years, disparaged the SEC's caution.⁷

The SEC has, however, been much more aggressive in acting on the first charge, moving quickly to establish market linkage systems and steadily nurturing and growing those linkages over time. Indeed, the SEC has been so active that it, in my view, has exceeded even the wide mandate of the 1975 legislation. Critics have been largely silent here.⁸ Many have taken issue with the wisdom of specific SEC decisions⁹ but few have questioned whether the SEC has the authority to do what it has done and is attempting to do. This essay develops the position.

The discussion will begin with the history and language of the 1975 amendments, followed by a summary of the highlights of the SEC's application of its power under the amendments. A short section on a speculative alternative history concludes the analysis.

Before proceeding with the argument, however, a short note on the important subtleties on the issue of federal agency authorization. The essay takes two distinct positions on authorization depending on the SEC regulation. First, the essay argues that the SEC was operating outside its statutory authority when it approved the inter-market *order routing and execution* system. The proposed Regulation NMS "trade-through rules," discussed below, fall in this category. Second, the essay argues that the SEC may have been operating inside its literal grant of authority when it approved inter-market

1975, NYSE commission rates became freely negotiable and immediately dropped by about 25%. Gregg A. Jarrell, *Change at the Exchange: The Causes and Effects of Deregulation*, 27 J.L. & Econ. 273, 280 (1983).

⁶ See Order Approving Proposed Rule Change to Rescinded NYSE Rule 390, Exchange Act Release No. 34-42728 (May 5, 2000), 65 Fed. Reg. 30175. Prior to 1975, our national stock exchanges had rules in place that prohibited their members from trading anywhere but on the exchange. For a discussion of the SEC's slow nibbling away at the prohibition that culminated with the 2000 release see Mark Borrelli, *Market Making in the Electronic Age*, 32 Loy. U. Chi. L.J. 815, 838 – 840 (2001). Similarly, the NYSE retained a stringent version of Rule 500 governing the delisting of stocks, requiring a 66.6% vote of the outstanding shares and less than a 10% negative vote, until 1997. Press Releases, NYSE (November 6, 1997 and October 1, 1998); www.nyse.com/press/press.html. There are numerous other examples. It took the SEC 15 years to put in place a system of unlisted trading privileges in Nasdaq securities on the national exchanges. Joint Industry Plan: Order Approving Proposed Reporting Plan for Nasdaq/NMS Securities Traded on an Exchange on an Unlisted or Listed Basis, Exch. Act Rel. 34-28146 (June 26, 1990).

There is some academic commentary that Congress and the SEC have miscalculated the costs and benefits of these types of exchange rules. E.g., Paul G. Mahoney, *The Exchange as Regulator*, 83 Va. L. Rev. 1453 (1997) (restrictive rules may be consistent with shareholder welfare). I have disagreed. E.g., Dale Oesterle, *Comments on the SEC's Market 2000 Report*, 19 J. Corp. Law 483 (1994) (discussing, in addition to NYSE Rules 360 and 500, the resistance to decimalization). In any event, this issue is reserved in this essay.

⁷ E.g., Borrelli, *supra* note 6; Jonathan R. Macey & David D. Haddock, *Shirking at the SEC: The Failure of the National Market System*, 1985 U. Ill. L. Rev. 315 [noting exchange rules against delisting and restrictions on off-board trading].

⁸ There are two important exceptions. See Norman S. Poser, *Restructuring the Stock Markets: A Critical Look at the SEC's National Market System*, 56 N.Y.U. L. Rev. 883 (1981); Walter Werner, *Adventure in Social Control of Finance: The National Market System for Securities*, 75 Colum. L. Rev. 1233 (1975).

⁹ E.g., Mark Klock, *The SEC's New Regulation ATS: Placing the Myth of Market Fragmentation Ahead of Economic Theory and Evidence*, 51 Fla. L. Rev. 753 (1999).

trade reporting and quote display systems, but that it has deviated from Congress's expressed hopes and goals when doing so, both in relying on single rather than competitive inter-market systems and in micro-managing the details of trading market structure in running those systems. The Regulation NMS quotation "access rules" and "market data" rules, discussed below, are in this category.

On the first argument, I do not and cannot claim that the federal courts, given their track record of deference to agency authority,¹⁰ will agree. It is highly unlikely that any court will follow, or even listen to, this analysis. Nor will Congress act to bring the SEC into compliance with the '75 mandate, with new hearings and legislation; there is no current political interest in the issue. My claim is that of a resigned academic; in my view the agency has strayed outside its authority and we have come too far to do much about it -- it is the proverbial water over the dam.

One could argue that my second claim is technically not an argument over legal authority at all but rather more like simple displeasure by a principal over the direction of decisions made by an authorized agent. The agent, although authorized in its action, has not been sympathetic to, or consistent with the principal's anticipated outcomes or its fundamental hopes and wishes. Congress thought the SEC would take a different tack than the one it took.

One could also take a third, more moderate, position, and simply note that, given the history noted below, the SEC, although technically authorized to do what it has done, also has the authority to reverse its course. The SEC is not itself bound by its own past policy mistakes given its mandate. That is, the 1975 amendments do not require the course of action that the SEC has chosen to undertake. The amendments are open-ended enough to justify a SEC strategy that is much less market intrusive than the path the SEC has chosen. The SEC is not bound to the past by a doctrine of precedent (*stare decisis*) as are the courts. It would take a very strong, dedicated SEC Chairman to reverse course, however, bucking those with vested interests in the current market structure. Again, this does not appear to be in the cards.

Realistically, I am left only with the same remark made by a British play-by-play golf commentator on the completion of a putt by a competitor for an eleven on a short hole in a major tournament. The commentator had been silent since the competitor's fifth or sixth shot on the par three. On the sinking of the putt he said simply and quietly: "Pity."

The History of the 1975 Amendments

¹⁰ See, e.g., *Domestic Sec. v SEC*, 333 F.3d 239,248-249 (D.C. Cir. 2003)(deference to SEC's approval of the Nasdaq Nasdaq Market Center (successor to the SuperMontage) Trading System); *NASD v SEC*, 801 F.2d 1415 (D.C. Cir. 1986)(deference to SEC decision on NASD fess for ECN access to quotes on NMS securities). See also *United States v Chestman*, 947 F.2d 551, 557-58 (2nd Cir. 1991)(deference to SEC "legislative regulations" unless "arbitrary, capricious or manifestly contrary to the statute," citing *Chevron v Natural Resources Defense Council*, 467 U.S. 837 (1984)).

In 1968 and 1969 brokerage houses on Wall Street went through what is now known as the “Back Room Crisis.” Trading volume in shares increased exponentially at a time when the mechanism for settling or clearing trades still required the physical transfer of certificates from one place to another and the creation and transfer of a flood of related papers (among other things, a floor report, a comparison, transfer instructions, contract sheets, and a settlement statement).¹¹ In the late ‘60s, the cumbersome physical process broke down and trades began to fail in extraordinary numbers.¹² The loss of control over securities also invited massive theft.¹³ More than two hundred brokerage houses, some storied old houses, failed.¹⁴

Congress, looking for a culprit, asked the SEC to study the market activity of institutional investors.¹⁵ The SEC produced its multi-volume 1971 Institutional Investor Study that largely let the institutional investors off the hook.¹⁶ In the SEC’s transmittal letter to Congress, however, the SEC dropped a bombshell. The SEC came out in favor of “the creation of a strong central market system for securities of national importance, in which all buying and selling interest in these securities could participate and be represented under a competitive regime.”¹⁷ The SEC sought the creation of an overarching communications system that would include all the existing exchanges and their specialists, over-the-counter market makers, and anybody else for that matter, and in which dealers would compete with each other for order flow.

The participation of competing dealers in the central market will ...reduce the element of monopoly power which has accompanied past efforts to establish a central market and will make it possible for potential abuses of such monopoly power to be controlled not only by regulation but to an increasing degree by competition. An essential characteristic of such a system would be the prompt reporting of all securities trades to the public on a comparative basis...[O]ur objective is to see a strong central market system created to which all investors have access, in which all qualified broker-dealers and existing market institutions may participate in accordance with their respective capabilities, and which is controlled not only by appropriate regulation but also by the forces of competition.¹⁸

¹¹ For a discussion see Marshall E. Blume, Jeremy J. Siegel & Dan Rottenberg, *Revolution on Wall Street: the Rise and Decline of the New York Stock Exchange*, Ch. 7 (1993). Professor Werner attacks the Consolidated Tape Plan. Werner, note 8 *supra* at 1280-82. He would be stunned at how far regulation has come since.

¹² Up to 40% of the trades failed. Blume, *supra* note 11 at 117.

¹³ From 1966 to 1970, the New York City Police estimated that \$100 million worth of securities were stolen or just disappeared. The SEC and FBI valued the missing securities at more than \$400 million. Blume, *supra* note 11 at 121.

¹⁴ *Id.* at 120.

¹⁵ Pub. L. No. 90-438 (July 29, 1968).

¹⁶ Institutional Investor Study Report of the Securities and Exchange SEC, H.R. Doc. No. 64, 92d Cong., 1st Sess. (1971)(institutions had only gradually increased their share of outstanding equity securities over time and their holdings were concentrated in the larger companies). The study did ask for increased institutional reporting of securities holdings by institutional investors, however.

¹⁷ *Id.* at xxii.

¹⁸ *Id.* at xxv.

Over the next few years the SEC conducted hearings aimed at defining what later came to be known as the “national market system” concept. The NYSE attempted first to stonewall the initiative¹⁹ and, when that failed, produced its own recommendation, known as the Martin Report, that all trading should be consolidated on one national exchange.²⁰ The SEC continued its campaign, issuing a Statement on the Future Structure of the Securities Markets in February of 1972. In the Statement the SEC defined its goal as:

A system of communications by which the various elements of the marketplace, be they exchanges or over-the-counter markets, are tied together. It also includes a set of rules governing the relationships which will prevail among market participants.²¹

The centerpiece of the SEC proposal was a call for a nationwide system for disclosure of market information designed to make trading price and volume information in all markets universally available. The policy, as announced, was sorely in need of some meat on its bones so in the Statement the SEC established three advisory committees to report on the best means of implementing the SEC’s goal.

After the advisory committees reported, the SEC issued in 1973 a detailed plan for the achievement of its central market system goal.²² The Policy Statement described how a consolidated transaction reporting system would operate and what rules would be necessary to ensure that information disseminated through that system would not be misleading. The Policy Statement also described a national system for disclosing price quotations (bids and offers) on exchange traded securities, a new wrinkle in the proposal that had originally focused only on reporting the prices of actual trades (last sales). Both systems have now been put in place, as detailed below, but two additional proposals in the 1973 report have not.

The Policy Statement also recommended an “auction trading rule” that would provide price priority protections for all public orders entered into a proposed central electronic repository and a “public preference rule” in which public orders entered in the repository would have preferential treatment over orders by professionals acting as principals unless the professionals bettered the public bids or offers. This was dramatic stuff – the SEC was considering rules that controlled order routing and execution for all the country’s markets.

It was the beginning of the SEC’s many musings on a perfect national order execution system for securities. The SEC has pursued the national system with a two-

¹⁹ Blume, *supra* note 11, at 164.

²⁰ Martin, Jr., *The Securities Markets, a Report with Recommendations* (1971). The report recommended an integration of the NYSE, the AMEX, and the regional exchanges and could be “composed of two divisions.” The report added that the NYSE and the AMEX ought to be the divisions.

²¹ Statement of the Securities and Exchange SEC on the Future Structure of the Securities Markets (1972), 37 Fed Reg. 5286.

²² Policy Statement of the Securities and Exchange SEC on the Structure of a Central Market System (1973).

part strategy. Part one has consisted of a periodic series of grand scale concept releases on various national execution system proposals that are floated and not adopted.²³ Part two has been a succession of detailed rule making initiatives that build a national system piece-by-piece, from the bottom up. The part two initiatives have been adopted. Implicit threats came in the part one, grand proposals: “Work with us on the details or you may get a system you really do not want.” And payoffs came in SRO participation in and assent to the SEC’s technical rules in the part two proposals.²⁴ The SEC history of rule making initiatives on market structure is worthy of careful study.

The SEC transmittal letter with the Institutional Investor Study of 1971 and the 1972 Statement set the conceptual stage. But the detail work began in late 1972. When a joint task force of the national and regional exchanges and the National Association of Securities Dealers²⁵ (which operated the then “over-the-counter” (OTC) market²⁶) dissolved in jurisdictional squabbles, the SEC took the bit and, in late 1972, promulgated Rule 17a-5, ordering all exchanges and the NASD to submit proposals for a transaction-reporting plan.²⁷ The SEC’s authority to do so was questionable; the SEC grounded the initiative in the market participant record keeping and reporting requirements of Section 17(a) of the 34 Act, a real stretch. The only proposal submitted created a “Consolidated Tape Association plan” (CTA plan) run by the Securities Industry Automation Corporation (SIAC), a subsidiary of the NYSE and the American Stock Exchange (AMEX).²⁸ The Consolidated Tape, reporting trades, opened on a limited basis in June of 1975 and was fully operational by 1976.

²³ See the SEC Reports in 1972, 1973, 1978, 1991, 1994, 2000 cited in notes 21,22,93, & 128. For a discussion of the 1991 and 1994 Reports see Dale A. Oesterle, Comments on the SEC’s *Market 2000 Report*, 19 J. Corp. L. 483 (1994).

²⁴ This creates the SEC’s convenient position, often heard at conferences, that the SEC is only “facilitating” not “mandating” or “creating” a national market system; that is, the SEC is working with the trading community in an innocent, public spirited mediator style role to structure the national market. A related position is that the SEC changes are “incremental” and “modest” compared to what the SEC “could do.” I am confident that SEC staff, present and past, believe these positions. Given pace of incremental changes, like a boulder rolling downhill, I would suggest that the number and nature of the incremental changes is now an avalanche and that, viewed as a whole, the SEC role is now controlling. See the Conclusion, below.

²⁵ The NASD is a national securities association registered with the SEC under Section 15A of the Securities and Exchange Act, 15 U.S.C. § 78o-3 (). The organization provides, among other things, self-regulation of the OTC market.

²⁶ In 1971, NASD formed the Nasdaq system, a computerized securities information center. The system rationalized the OTC market by providing up to date quotation information from market makers on liquid (heavily traded) OTC securities. By 1984 the Nasdaq system began to provide automatic execution of some trades. See generally, *NASD v SEC*, 801 F.2d 1415, 1416-1418 (D.C. Cir. 1986)(history of Nasdaq).

²⁷ The history of the Consolidated Tape is in Collection and Dissemination of Transition Reports and Last Sale Data, Exch. Act Rel. No. 16,589 (Feb. 19, 1980).

²⁸ Notice of Receipt of Plan, Exch. Act Rel. No. 34-10026 (March 6, 1973), 36 Fed. Reg. 6443; Notice of SEC Action Declaring Effective a Consolidated Tape Plan Filed Pursuant to Rule 17a-5 and the Securities Exchange Act of 1934, Exch. Act. Rel. No. 34-10,787 (May 10, 1974), 39 Fed. Reg. 17799.

The Consolidated Tape collected executed trade information for national exchange-listed stocks in all the markets.²⁹ NASD's participation in the CTA plan at the time came through the so-called "third market," the trading of national exchange listed securities by NASD market makers. At the same time, the SEC requested proposals for a consolidated quotation system reporting quotes, the prices market makers were currently offering to potential buyers and sellers. The NYSE, although resigned to the inter-market trade reporting system, resisted the inter-market quotation system proposal vigorously, arguing that the proposal was "beyond the authority of the SEC under the existing provisions of the Securities and Exchange Act of 1934" and that it was an illegal taking of private property in violation of the due process clauses in the Constitution.³⁰

The SEC's answer to the NYSE's charges came in the 1975 amendments.³¹ Concurrent with the SEC proposals, Congress was holding hearings on the structure of the securities markets. Subcommittees of both houses of Congress issued comprehensive reports containing conclusions and recommendations³² and the SEC had significant influence in the committees. The subcommittee recommendations formed the basis of legislative proposals that were enacted into law as the 1975 amendments.³³

The 1975 amendments inserted Section 11A into the text of the Securities Exchange Act of 1934. Section 11A contains an explicit statutory commitment to the establishment of a "national market system" and clarified and strengthened the SEC's authority to implement such a system. The 1975 amendments did not, however, define the term national market system nor did they mandate the components of such a system.³⁴ Congress did, however, specify basic underlying principles that were to govern the creation of that system. They were

1. The economically efficient execution of transactions;
2. Fair competition among broker-dealers, among exchanges, and between exchanges and other markets;
3. The ready availability of quotation and transaction information to broker-dealers and investors;
4. The ability of broker-dealers to execute orders in the best market; and

²⁹ Eligible securities included all those listed on the two largest national exchanges, the NYSE and the AMEX, and those admitted to unlisted trading privileges on a national exchange if they substantially meet the listing requirements of the NYSE and the AMEX.

³⁰ Blume, *supra* note 11, at 167. The NYSE continues to make the property argument today in various forms.

³¹ See Senate Report No. 94-75 at 187 noting the NYSE position on the Consolidated tape plan.

³² Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, *Securities Industry Study*, 92nd Cong. 2d Sess. 117-130 (1972); Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, *Securities Industry Study*, 93rd Cong., 1st Sess. 89-135 (1973).

³³ For a history of the 1975 Amendments see Harvey A. Rowen, *The Securities Acts Amendments of 1975: A Legislative History*, 3 *Sec. Reg. L. J.* 329 (1976). An amusing anecdote is the cause of the failure of the legislation to pass in 1975. A key proponent of the bill had a dentist appointment that he would not miss and the legislation failed in the House Rules Committee, 6 yes, 6 no, and 1 not voting. *Id.* at 342.

³⁴ See Senate Committee on Banking, Housing and Urban Affairs, *Report to Accompany S. 249*, S. Rept. No. 94-75, 94th cong., 1st Sess. 7 (1975).

5. The opportunity, consistent with the other goals, for investors to execute orders without the participation of a dealer.³⁵

As noted in the Committee reports, Congress passed the amendments with a scathing assessment of the condition of the national markets at the time. The House report, for example, condemned the markets' "stunted and distorted" evolutionary process and technological obsolescence that resulted in "misallocations of capital, widespread inefficiencies, and potentially harmful fragmentation of trading markets."³⁶ As noted in the House report, Congress's solution was to "enhance competition [among trading markets] and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations of practices and services."³⁷ Congress made it very clear that it did not want to pre-determine an outcome for the competition; it did not want to favor one trading market over another.

Neither the markets themselves nor the broker-dealer participant in these markets themselves should be forced into a single mold. Market centers should compete and evolve according to their own natural genius and all actions to compel uniformity must be measured and justified as necessary to accomplish the salient purposes of the Securities and Exchange Act, assure the maintenance of fair and orderly markets and to provide price protection for the orders of investors.³⁸

In the Senate report there was a similar sense of regulatory humility:

This is not to suggest that under S. 249 the SEC would have either the responsibility or the power to operate as an "economic czar" for the development of a national market system. Quite the contrary, for a fundamental premise of the bill is that the initiative for the development of the facilities of a national market system must come from private interests and will depend upon the vigor of competition within the securities industry as broadly defined.³⁹

During the hearings, the NYSE argued that the legislation include a provision requiring all trading in exchange listed securities be confined to registered exchanges, statutorily eliminating the third market. The prohibition made it into the Senate version of the bill. The SEC and the Antitrust Division of the Justice Department opposed the provision and carried the day⁴⁰ but only after agreeing to a statutory provision that gave the SEC the power to eliminate the third market on specified factual findings.⁴¹ The SEC, fortunately, has never exercised the power.

³⁵ Securities and Exchange Act, Section 11A(a)(1)(C), 15 U.S.C. 78k-1(a)(1)(C).

³⁶ House Report No. 94-123, 94th Cong., 1st Sess., 1975, at 49-50. See also Senate Report No. 94-75, 94th Cong., 1st Sess., 1975, at 1.

³⁷ Id. at 50.

³⁸ Id. See also Senate Report at 7 ("it is not the intention of the bill to force all markets for all securities into a single mold.")

³⁹ Senate Report at 12.

⁴⁰ Id. at 338.

⁴¹ Section 11A(a)(3)(A) of the Securities Exchange Act of 1934, 15 U.S.C. 78k-1(a)(3)(A). The SEC had to find that the third market "affected [the fairness or orderliness of the markets in listed securities] contrary

Congress anticipated that the core component of a national market system would be through an electronic communication linkage of existing markets.⁴² In often-underestimated provisions added in Section 11A by the 1975 amendments, subsections (b) and (c)(1) and (2), Congress empowered the SEC to register and regulate “securities information processor[s].”⁴³ The subsections on information processors, with numerous divisions, make up over one-half the total statutory language added by the 1975 amendments to the 34 Act. The comparison of this length and detail with the single sentence in (c)(4) on anticompetitive practices, which attracts the bulk of academic commentary on the legislation, is telling.⁴⁴

In subsection (b) Congress requires securities information processors to register with the SEC unless a processor is not an “exclusive processor of any information with respect to quotations for or transactions in securities”⁴⁵ (and the SEC has not found it necessary to register non-exclusive processors). Congress knew, given the SEC version of a Consolidated Tape Plan already in the start up stages when the legislation passed, that there might be only one dominating cross-market information processor. Congress implied in (b), however, that if competing processors did appear on the scene, the SEC could substantially lighten its regulations.

In the reports that accompanied the legislation, Congress referred to an exclusive cross-market information processor as a “public utility” that “should be regulated accordingly.”⁴⁶ The Senate report also noted that an exclusive central information processor “should not be under the control or domination of any particular market center.”⁴⁷

Implicit in these comments and the language of the statute itself is an unmistakable Congressional preference for *competing* last sale and quotation inter-market reporting services. This preference has never been realized. Indeed, from what I can tell, competing systems had never been mentioned in any SEC public initiatives or releases

to the public interest or the protection of investors,” that no rule on any exchange “impairs the ability of any dealer to solicit or effect transactions ... or unreasonably restricts competition among dealers” in listed securities, and that “the maintenance or restoration of fair and orderly markets in such securities may not be assured through other lawful means.”

⁴² See, e.g., Senate Report, *supra* note 31, at 3. There was a mild preference for auction-type trading. See Securities and Exchange SEC, Development of National Market System, Exch. Act. Rel. No. 34-14416 (Feb. 1, 1978), 43 Fed. Reg. 4354, at 4356. See also Section 11A(c)(3) of the 34 Act (empowering the SEC to abolish the third market if such trades are contrary to the “public interest or the protection of investors”).

⁴³ The 1975 amendments added a definition of a securities information processor to Section 3(a)(22)(A) of the 34 Act. A securities information processor is any person engaged “in the business of (a) collecting, processing, or preparing for distribution or publication, or assisting, participating in, or coordinating the distribution or publication of, information with respect to transactions in or quotations in any security (other than an exempted security) or (b) distributing or publishing (by means of a ticker tape, a communications network, a terminal display device, etc.) on a current and continuing basis information with respect to such transactions or quotations.”

⁴⁴ E.g., Macey, *supra* note 7.

⁴⁵ Section 11A(b)(1), 15 U.S.C. 78k-1(b)(1).

⁴⁶ Senate Report 94-75 at 11; Conference Report 94-229 at 93.

⁴⁷ See Senate Report 94-75 at 11; Conference Report 94-229 at 93.

until 2004, when it was considered and rejected.⁴⁸ We are left today with only one inter-market reporting system for trades, begun in mid 1975, and only one inter-market reporting system for quotations, started in 1978.

The statute's registration provisions on securities information processors also enabled the SEC to gather information necessary to the application, hear complaints and directed the SEC to grant the registration if the SEC finds that the processor "is so organized, and has the capacity, as to be able to assure the prompt, accurate, and reliable performance of its functions...comply with the provisions of this title and the rules and regulations hereunder, carry out its functions in a manner consistent with the purposes of this section, and, insofar as it is acting as an exclusive processor, operate fairly and efficiently."⁴⁹

Note what is missing in the legislation. Nowhere in the legislation is a mention of an inter-market order routing and execution system.⁵⁰ Indeed, Congress, as is evident in the express language of the statute on securities information processors, assumed that the securities information processors would convey only last sale transaction data and market quotations. There is no mention of an order routing or execution function for the information processors. Even the title "securities information processors" conveys the sense that Congress was not sanctioning or encouraging electronic order routing and execution systems. And one can read the various goals stated in subsection (a)(1) consistently: The statutory goal in subsection (a)(1) of "brokers executing investors' orders in the best market" does not require a single centralized market, but only that brokers have public information on all available markets.⁵¹

The omission of any language on order routing in the 1975 statute is notable in light of the SEC's prior 1973 Policy Statement that had proposed order routing and execution rules. It is no answer therefore, to claim, as some do, that technology was so unsophisticated in 1975 that Congress could not have anticipated an inter-market order routing system similar to what is possible today and, therefore, that new advances in

⁴⁸ See text at notes 79-87 below.

⁴⁹ Section 11A(b)(3), 15 U.S.C. 78k-1(b)(3).

⁵⁰ There is some evidence against the statement in the text. One can find some references in the Congressional Committee Reports to a "centralized" trading mechanism. E.g., Senate Report No. 75, 94th cong., 1st Sess. at 17. The Senate Report does not, however, state that the SEC ought to be authorized to develop such a mechanism and the statute changed the language of "central" market system to "national" market system, a much less intrusive concept. Critics could also point to language in the statute itself, quoted above, gives as a goal the "opportunity for investor's orders to be executed without the participation of a dealer." Some could argue that this assumes a *centralized* NMS. I disagree. Note that in the statute the language of a central market system was replaced by a national market system. The change is significant. Moreover, the goal of minimizing the role intermediaries could be achieved in a system that has multiple market centers, as long as some of the centers are automated ECNs that allow customers to interact directly with each other or some are auction exchanges in which those in the crowd interact with each other.

⁵¹ Some claim that a "best execution" obligation, found in the statutory language, is a key concept of the national market system. Section 11A(a)(1)(D). See Poser, *supra* note 8, at 911. The term refers to the common law duty of an agent to obtain for a customer the best price discoverable in the exercise of reasonable diligence. See *Opper v Hancock Sec. Corp.*, 250 F. Supp. 668, 676 (S.D.N.Y. 1966), *aff'd*, 367 F.2d 157 (2d Cir.).

communication technology require the SEC, authorized under the statutes' open-ended grants of authority, to fashion modern, adaptive rules. Order routing proposals were floating around at the time of the legislation that are not all that dissimilar to those proposed today. Moreover, the SEC had its first inter-market order routing system in place only three years later, by 1978.

Finally, the change in language from a *central* market system as proposed in the early '70s SEC reports to a *national* market system as is found in the legislation is significant. Consistent with the Committee reports, a national market system has room for many competitive trading centers. A central market system concept, on the other hand, could justify an extreme centralization of orders under one universal routing and execution system.

The SEC's initiatives on order routing and centralized execution systems,⁵² seem to depend for their authorization under the 1975 amendments on the definition of a single term, "linking," from in the legislation in Section 11A(a)(1)(D). The Section calls for the "linking of all markets for qualified securities through communication and data processing facilities" to "foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate offsetting of investor's orders, and contribute to best execution of such orders."⁵³ Do these provisions empower the SEC to establish mandatory order routing and execution systems? If so, it is a slender reed of support, indeed.

One could also argue, persuasively in my view as it is more consistent with the history and language of the 1975 amendments, that Congress intended for the SEC to link the markets through information processing only -- exchanges of data on transactions and quotations -- and did not intend the SEC to link the markets though government mandated order routing and execution systems. Under this vision, individual markets and market makers could choose to route orders to each other but their decision to do so and the mechanism of choice for doing so would not be at the government's direction. The decision to "offset...orders" and the obligation of "best execution" remains with the local markets and is not a call for an automatic centralized order routing and execution system.⁵⁴

Similarly there is no express direction in the 1975 amendments that the SEC specify and approve the details of an inter-market information processor's operations and how individual markets interact with a central processor. I recognize that a sympathetic

⁵² See the discussion of the ITS or its stronger alternatives, a black box, CLOB or common message switch in the next section.

⁵³ Section 11A(a)(1)(D), 15 U.S.C. 78k-1(a)(1)(D). One could also point to Section 11A(c)(1)(e) that empowers the SEC to assure that all exchange members, brokers and dealers "transmit and direct orders ... consistent with the establishment of a national market system." The section assumes the goals of subsection (a)(1) in defining the concept of a national market system, however.

⁵⁴ In this regard note the language that authorizes the SEC to "facilitate" offsetting orders and to "contribute" to best execution. This is not a Congressional direction to *establish* a centralized mechanism for *effecting* offsetting orders and best execution.

court may find such power, erroneously in my view, in other provisions, on the SEC's authority to deal with how information processors interact with the various trading market centers.⁵⁵ One could read these examples, consistent with the legislative history, however, to imply much more modest scope and purpose for SEC inter-market system regulations than the SEC has established.⁵⁶

The SEC's Exercise of Its New Powers Under the 1975 Amendments

The SEC, in the [thirty years](#) since the 1975 amendments, has, in my view, taken the broad, sweeping, cosmic grant of authority in the legislation to implement a national market system and, amazingly, managed to exceed it by a considerable margin.⁵⁷ There are three overarching regulatory failures and a host of specific ones. I will focus on the overarching failures and leave the specific ones to other authors.⁵⁸

⁵⁵ The SEC did get broad rule-making power over processors in subsection (c)(1):

(A) to prevent the use, distribution or publication of Fraudulent, deceptive and manipulative information..., (B) assure prompt, accurate, reliable, and fair collection, processing, distribution, and publication of information..., (C) assure that all ...processors may...obtain on fair and reasonable terms such information with respect to quotations and transactions in such securities as is collected, processed, or prepared for distribution or publication by any exclusive processor..., (D) assure that all exchange members, brokers, dealers ... and all other persons may obtain on terms which are not unreasonably discriminatory such information..., (E) assure that all exchange members, brokers and dealers transmit and direct orders for the purchase or sale of qualified securities in a manner consistent with the establishment and operation of a national market system; and (F) assure equal regulation of all markets for qualified securities and all exchange members, brokers, and dealers...

And subsection (c)(2) also empowers the SEC to require any person "to report such purchase or sale to a registered securities information processor, national securities exchange, or registered securities association and require such processor...to make appropriate distribution and publication of information with respect to such purchase or sale."

I view these as anti-Fraud and anti-restraint of trade provisions, not as general. In support of my view note that the Senate report listed as examples of legitimate SEC rules under these sections "the hours of operation of any type or quotation system, trading halts, what and how information is displayed and qualifications for the securities to be included on any tape or within any quotation system." Senate Report at 189.

⁵⁶ One could, of course, argue on the other side that the "what and how information is displayed" language in the Senate Report language noted, *supra*, in note 39, for example, justifies detailed SEC rules on each systems interaction with each covered trading market. I believe the spirit of the passage is to the contrary.

⁵⁷ I admit that federal courts could find statements in the legislative history that justify, effectively, complete deference to the SEC. See, e.g., Conference Report No. 94-229 at 92 ("The Senate Bill [which the Conference adopted] relied on an approach designed to provide maximum flexibility to the SEC and the securities industry in giving specific content to the general concept of the nation market system.") I submit that the delegation in the 1975 Amendments has some limits, however, inherent in the language and history of the legislation.

⁵⁸ See, e.g., Borrelli, *supra* note 6; Laura Nyantung Beny, *U.S. Secondary Stock Markets: A Survey of Current Regulatory and Structural Issues and A Reform Proposal to Enhance Competition*, 2002 Col. Bus. L. Rev. 399.

The three overarching failures are: First, the SEC's complete absence of any effort to facilitate competition among cross-market securities information processors. There is, and has always been, only one exclusive, primary information processor for transaction data (the CTA) and one for quotation data (the CQS). Second, the SEC did not have a mandate from Congress to force the markets to participate in an inter-market trade execution system. Congress did not authorize the creation of an Intermarket Trading System (ITS) and its potential progeny (a CLOB system, for example). And third, Congress did not intend for the SEC to so pervasively micro-manage the details of the behavior of the participant markets in a national market system. Independent computerized markets have been the recent objects here; the SEC is attempting to limit their habitat.

Each of the failures is discussed sequentially below.

The Consolidated Data Dissemination Systems: The CTA, CQ, and Nasdaq UTP Plans

The first part of a national, consolidated information system on the price and volume in actual securities sales, was, as noted above, created by a joint-industry task force in 1972. The Consolidated Tape Association (CTA) Plan, up and running in its experimental stages even before the passage of the 1975 amendments, has continued and is now registered as an information processor under the amendment's new Section 11A(b)(2) of the Securities Exchange Act.⁵⁹ The SEC eventually replaced old Rule 17a-15 with new Rule 11A3-1 in 1980.⁶⁰

The Consolidated Tape (CT), run by the Consolidated Tape Association, continues to collect and disseminate trade information in all exchange-traded stock (including listed stock and stock admitted to unlisted trading privileges). All national and regional exchanges and the NASD, as owner of the Nasdaq,⁶¹ participate in the plan. The Consolidated Tape provides "last sale" information, or the price at which the last transaction in a covered stock occurred on participating markets. A separate reporting plan operated by Nasdaq, the "Nasdaq System," provides transaction data on all Nasdaq securities.

The CT uses technology supplied by SIAC, a subsidiary of both the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX). A board manages CTA's operations. Until 1980, the NYSE and the AMEX had two votes each on the board and the other four members (Chicago, Pacific, Philadelphia and NASD) had one.⁶² Moreover, until 1980 both the NYSE and AMEX had effective veto power over plan amendments. In 1980, the CTA added two new members (Boston and Cincinnati, now

⁵⁹ Notice of Application for Registration, SEC. Exch. Act Rel. No. 34-11779 (Oct. 30, 1975), 40 Fed.Reg. 215; Order Granting Registration as Securities Information Processors, SEC Exch. Act Rel. No. 34-12035 (Jan. 22, 1976), 41 Fed. Reg. 4372.

⁶⁰ See Collection and Dissemination of Transaction Reports and Last Sale Data, Exch. Act Rel. No. 16,589 (Feb. 19, 1980).

⁶¹ NASD market makers trading in exchange listed stock, the "third market," report under the plan.

⁶² Consolidated Tape Plan, Order Approving Amendments to Plan, SEC Exch. Act Rel. No. 34-16983 (July 16, 1980), 45 Fed. Reg. 49414.

National) and both of the national exchanges lost their extra vote and their veto power. The Plan, with the addition of the Chicago Board Options Exchange in 1991,⁶³ now has nine members.⁶⁴ No amendments are “effective” unless executed by each of the Plan participants, however.

The next SEC initiative involved a consolidated system for disseminating quotes, bids and offers for securities, by national exchanges. The SEC established a quotation reporting system shortly after the adoption of the 1975 amendments and the implementation of the trade reporting system, CTA Plan. The SEC adopted Rule 11Ac1-1 in January of 1978, requiring the public dissemination of quotations by exchanges and NASD market makers.⁶⁵ The NYSE and the AMEX filed a plan for a Consolidated Quotation System (CQS) with the SEC on July 25 of that same year.⁶⁶ The plan, creating a Consolidated Quotation Association (CQA) that while technically separate from the CTA has the same membership, is the basis for the CQS in place today. The CQS provides quotation information from all participating markets for exchange-listed stocks.⁶⁷

The SEC standardized the trade and quote reporting requirements by system participants in 1980.⁶⁸ With standardization came SEC control over the minute details of trade and quote reporting requirements. Control over quote reporting in particular necessarily gave the SEC significant influence over the details of how each market trading center had to structure its basic trading. In the 2004 proposed Regulation NMS the SEC seeks to take its power over quotations standardization and, in the new “Trade-Through” Rules discussed below,⁶⁹ dictate dramatic changes in market structural.

In 1981, the SEC adopted Rule 11Aa2-1, introducing the concept of National Market System (NMS) securities.⁷⁰ The initiative extended the consolidated reporting system from exchange-listed securities to a selected segment of heavily traded securities in the over-the-counter (OTC) market. The Rule, as amended in 1987, identifies a class of securities eligible for inclusion in the national market system. Exchange traded or NASD traded securities subject to a “reporting plan” approved by the SEC are designated NMS securities and subject to specifically tailored transaction

⁶³ Order Approving the Fifteenth Amendment to the Consolidated Tape Association Plan, SEC Exch. Act Rel. No. 34-28808 (Jan. 28, 1991), 56 Fed. Reg. 3124.

⁶⁴ Current CTA plan participants are Amex (American Stock Exchange), BSE (Boston Stock Exchange), CBOE (Chicago Board Options Exchange), CHX (Chicago Stock Exchange), NSX (National Stock Exchange), NASD, NYSE (New York Stock Exchange), PCX (Pacific Stock Exchange) and Phlx (Philadelphia Stock Exchange). See SEC Rel. No. 34-48987 (Dec. 23, 2003), 68 Fed. Reg. 75661 (Dec. 31, 2003).

⁶⁵ Dissemination of Quotations for Reported Securities, Exch. Act Rel. No. 34-14,415 (Jan. 26, 1978), 43 Fed. Reg. 4342 (Feb. 1, 1978).

⁶⁶ Temporary Order, SEC Exch. Act Rel. No. 34-15009 (Aug 7, 1978), 43 Fed. Reg. 34851.

⁶⁷ Network A is for NYSE listed securities; Network B is for securities listed on the Amex and other national exchanges.

⁶⁸ Securities and Exchange Act Release No. 34-16590 (Feb. 13, 1980), 445 Fed. Reg. 12391 (Feb. 19, 1980).

⁶⁹ See text at notes 132-140.

⁷⁰ Designation of National Market System Securities, SEC Exch. Act Rel. No. 34-17,549 (Feb. 17, 1981).

and quotation reporting rules. In complying with the Rule, the NASD designated securities as Nasdaq/NMS securities and created a distinct national market segment of Nasdaq.⁷¹ The Nasdaq System now provides quotation information for Nasdaq stocks under a third plan, known as the Nasdaq UTP Plan.⁷² Recently NASD also opened, under an order from the SEC, an “alternative display facility” (ADF) for ECNs to provide quotes and report trades on Nasdaq stock.⁷³

There are currently three “Networks” for disseminating market information on NMS stocks: Network A securities are those listed on the NYSE; Network B securities are those listed on AMEX and the regional exchanges; and Network C securities are traded on Nasdaq.⁷⁴ For each security included the networks offer national best bid and offer (NBBO) with prices, sizes and market center identification, best bids and offers from each participating market also with prices, sizes and market center identification, and consolidated trade reports (last sale information).⁷⁵ Each network has a monopoly over the consolidated, national reporting of covered securities.

The CT, CQ and Nasdaq Systems all provide for the collection of fees from vendors and subscribers for the dissemination of market data and for the allocation of the revenue among members. Vendors enter into contracts with the networks and pay access and administrative fees. The subscribers, typically broker/dealers or institutional investors, receive information from the vendors in exchange for a fee that the vendor then passes back to the network. The fees and how the fees are shared among members are subject to SEC approval and a source of constant attention and tension.⁷⁶

The struggle over fees is a necessary part of the SEC “public utility” oversight of exclusive securities information processors. Just as a state public utility regulates the fees electric and gas companies charge retail customers, the SEC regulates the fees the CTA, CQA and Nasdaq charge vendors. With no easy analogies to the prices in competitive markets, the SEC has, for years, struggled with a theoretical and practical basis for such

⁷¹ Order Approving Proposed Designation Plan for National Market System Securities, SEC Exch. Act Rel. 34-18,399 (Jan.7, 1982). Nasdaq SmallCap securities are not covered by the NASD plan and are therefore not considered NMS securities.

⁷² Under the Nasdaq UTP Plan, NASD administers a CQ, Network C for unlisted, but qualified NASD securities, so called NMS securities. The quotes are included in the CQ Plan data stream. See Order, SEC Exch. Act Rel. No. 34-16518 (Jan. 22, 1980), 45 Fed. Reg. 6521. The Nasdaq System also includes transaction and quotation information for Nasdaq Smallcap securities and other OTC securities that are not NMS.

⁷³ Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. To Extend Operation of NASD's Alternative Display Facility on a Pilot Basis, SEC Exch. Act Rel. 34-47663 (April 10, 2003). The ECNs cannot quote exchange listed stock on the ADF, however.

⁷⁴ Consolidated Tape Association, SEC Exch. Act Rel. No. 34-44615 (Aug. 6, 2001), 66 Fed. Reg. 41058.

⁷⁵ See SEC Rel. No. 43-49325 at 83.

⁷⁶ E.g., Approval of an Amendment to the Consolidated Tape Plan Establishing Non-Professional Fees, SEC Exch. Act Rel. No. 34- 20386 (Nov. 28, 1983), 48 Fed. Reg. 53616; Order Approving the Fifteenth Amendment to the Consolidated Tape Association Plan, SEC Exch. Act Rel. No. 34-28808 (Jan. 28, 1991), 56 Fed. Reg. 3124. See also, *NASD v SEC*, 801 F.2d 1415 (D.C. Cir. 1986)(Instinct contested Nasdaq fees).

fee calculations.⁷⁷ The disputes over fees by participants finally led the SEC in 2004 to consider whether or not to break the consolidated network monopolies. Led to the brink of change, the SEC balked however. This history is telling.

In 1999 the SEC, seeking to quell intense squabbling among market centers, proposed a “flexible, cost based” system for regulating market data fees.⁷⁸ But what costs are included? Are regulatory and surveillance costs included? The NYSE, claiming an ownership interest in the data, argued in response to the initiative that it should be free to set its own fees and that the CTA should be dissolved. Discount brokers argued that the fees were excessive and greatly exceed the costs of gathering the information and discriminate against online firms and that the fees were used to improperly fund surveillance costs. Both sides used creative accounting calculations in their arguments.

An advisory committee created in 2000 to develop recommendations on the issues, after eight hearings, ended in 2001 by rejecting the SEC’s cost-based initiative with tepid support for status quo standards and calculations.⁷⁹ A majority of a badly split committee, however, supported a dramatic change, a move to “competing information processors,” more in line with the 1975 Congress’s desires.^{80 81} In the competing consolidators model, each major market center⁸² would be allowed to separately establish its own fees, enter into and administer its own market data contracts, and provide its own data distribution facility. Data vendors (competing consolidators) could purchase data from the individual market centers, consolidate the data and distribute it to investors and other data users. A minority group of the Committee favored radical change, a deconsolidation model that would eliminate the consolidated data system entirely.⁸³

In 2004, three years later, the SEC, in proposed Regulation NMS, accepted many of the Advisory Committee technical recommendations for the three networks but rejected the Committee majority’s recommendation for competing consolidators and rejected the minority group’s deconsolidation model.

⁷⁷ See Borrelli, *supra* note 6, at 903 – 905.

⁷⁸ E.g., Regulation of Market Information Fees and Revenues, Exch. Act Rel. 34-42,208 (Dec. 9, 1999) at 11-12, 64 Fed. Reg. 70613.

⁷⁹ E.g., Mary Schroeder, Market Data Report Backs Multiple Consolidators, *Sec. Indus. News*, Oct. 1, 2001. See Report of the Advisory Committee on Market Information: A Blueprint of Responsible Change (Sept. 14, 2001), (available on www.sec.gov).

⁸⁰ E.g., Market Data Committee Supports Competition, *Sec. Indus. News*, Oct. 8, 2001 (there were two distinct minority views).

⁸¹ In 2003, the Nasdaq added fuel to the flame when it petitioned the SEC for recognizing surveillance costs as legitimate deductions from data revenue. E.g., Isabelle Clary, “Nasdaq Seeks Uniform Rules,” *Sec. Indus. News*, May 5, 2003. This is a Nasdaq solution to its belief that it bears a disproportionately large part of the regulatory costs for the national market in Nasdaq stocks without adequate compensation. The Nasdaq has asked the SEC to aggregate all markets’ regulation costs and to deduct these costs from the data collection revenue. Since the Nasdaq has over \$80 million a year in costs, far larger than any other participant, the effect is to increase the Nasdaq portion of the collected vendor revenues.

⁸² Technically, those centers that were self-regulatory organizations (SROs). SEC Rel. No. 34-49325 at 85.

⁸³ Advisory Committee Report, *supra* note 79, section VII.B.1.

In rejecting the deconsolidation model the SEC noted that the problem of market power by some market centers such as the NYSE in creating quote and trade information would lead to monopoly like fees. It also worried about the confusion that a lack of standardization would inflict on retail investors.⁸⁴ In rejecting the “competing consolidators” model, the SEC projected that the model would cause investors to pay higher fees for lower quality information.⁸⁵ The information would be lower quality because of a potential lack of uniformity of data presentation among the competing consolidators; the information would cost more because the dominant market centers would raise their fees to all the consolidators unless the SEC intervenes.⁸⁶ SEC intervention would require the regulation of ten market center fees schedules rather than the three of the networks in the consolidated system.⁸⁷

Reading the legislative history and language of the 1975 amendments and comparing it to the CTA, CQS and Nasdaq Plan one cannot help but be struck by the resistance on the part of the SEC to do what Congress clearly seemed to prefer. Congress had hoped, first, that there would be multiple primary security information processors and, second, that if there was only one, it would not be owned by the major markets that it serviced. The SEC carried out neither of the wishes nor has even attempted to do so.⁸⁸

One has to ask: Why is there not at least one non-market center controlled processor that collects and integrates *primary* transaction and quote data from individual market centers and market makers? There are several new, creative private *secondary* information services.⁸⁹ The SEC had the power to facilitate such arrangements and the power to require the market centers and market makers to provide them with the appropriate information.⁹⁰

At the root of the SEC’s concerns in rejecting the competing consolidators model is the market power of the primary market centers, the NYSE and the Nasdaq in particular, to charge excessive fees and the lack of objective standards for the Commission in evaluating fees across the centers. If the SEC can, as it now does, set fees for each of the three networks, step one, and then allocate those fees among individual participating market centers using a complex formula, step two, one should ask why the same fee allocation formula mechanics (a complicated algorithm based on a mix of trading activity and NBBO quotes) could not be used to establish primary level fee regulation. Just combine step one and step two; calculate a total fee for data

⁸⁴ SEC Rel. No. 34-50870 at 23, citing the discussion in SEC Rel. No. 34-49325 at 84-87.

⁸⁵ SEC Rel. No. 34-49325 at 86.

⁸⁶ Id. at 86. The SEC also rejected a “hybrid model” in which the networks would continue to disseminate only NBBO information. Other trade and quote information would be disseminated by individual market centers. Id. at 86-87.

⁸⁷ Id. at 143-144.

⁸⁸ A cynic might argue that by creating a “public utility” that had to be closely watched, the SEC augmented its power as a regulator.

⁸⁹ The successful Lava Trading Inc.’s Colorbook service is an example. See *Consolidating Fragments*, Traders Mag., April 1, 2003 (interview with Rich Korhammer, Lava COS).

⁹⁰ For a general discussion see Joel Seligman, *Rethinking Securities Markets: the SEC Advisory Committee on Market Information and the Future of the National Market System*, 57 Bus. Lawyer 637 (Feb. 2002)(Dean Seligman was the Chairman of the advisory committee).

dissemination on any one stock and allocate the fees among the markets that trade the stock.

The deeper problem, however, is one of antitrust enforcement. The SEC has, as noted below, by its regulations facilitated the creation and the entrenchment of market centers with dominate market power over certain securities. The SEC should have long ago more robustly employed fundamental antitrust principles in its market regulations and their enforcement. But it gets worse. By requiring one or more consolidators to include *all* market centers in their data package, as the SEC now does, and/or by requiring broker/dealers to find the best price across *all* markets for customers, as the SEC wants to do in Regulation NMS,⁹¹ the SEC necessarily exposes retail investors to monopolistic pricing problems from *every* market center, large or small. A mandatory inclusion rule at either the consolidator or broker/dealer level makes each market center a monopolist with respect to the provisions its own trade and quote data.⁹² By creating the network monopolies, or ten monopolies under the new proposals (every market center becomes a monopoly), the SEC can claim authority over rigid fee structure control -- in our best interest, of course.

The answer may lie in less SEC control, not more. The minority report of the Advisory Committee that recommended a deconsolidation model had a partial answer. The minority recommended suspending the requirement that market centers work together to provide consolidated data, and suspending the requirement that data purchasers purchase data from all markets, opening up the markets raw data competition. Competitive forces would determine data products, fees and market center revenues. The other half of the answer is to address the problem of market power by the larger market centers. The SEC, in tandem with a deconsolidation model, would have to loosen its other market structure regulations that limit competition among market centers, using basic antitrust analysis as it guide, to make the model work. Two of these SEC initiatives, for example, would have to loosen the trade-through rule and the regulation of ECNs, our next topics below. A deconsolidation model would work only if it were part of a boarder package of proposed rules that open up market competition among market centers in the trading of any given security.

But the SEC, rather than loosening its control over market structure has proposed, in Regulation NMS, to tighten it up. And in tightening up control over market structure the SECs reinforces its claim that it must necessarily control data dissemination and set fees. See how the argument works? It is circular and a tightening spiral at that. If and when SEC Regulation NMS is put it place, we will be so far down the road to a government structured secondary trading market that we may find it virtually impossible to ever turn back.

Trade Execution Among Market Centers: The Inter-market Trading System (ITS)

⁹¹ See the text, *infra* notes 132-140, on the SEC's proposed Trade-Through and Access Rules below.

⁹² Cf. Bob Greifeld, Millions of Momentary Monopolies, Wall. St. J., Dec. 8, 2004 at A12 (making a similar point on the proposed access rules).

After Congress's 1975 amendments to the 34 Act, the SEC also moved forward on its earlier proposal for some form of an electronic communications network that would "link" the major markets. The word "link", which could refer only to data exchanges, has come to mean something much more -- that participants in one market can execute orders, buy and sell securities, on another. On January 26, 1978, the SEC issued a statement calling for, among other things, the prompt development of a comprehensive market linkage and order routing system to permit the efficient transmission of orders for qualified securities among the various market centers.⁹³ In the 1978 release, the SEC floated several proposals for a centralized order routing scheme -- a central execution system with strict price and time priority for every order (known by some as "the black box"),⁹⁴ a Consolidated Limit Order Book (the CLOB),⁹⁵ and wanted to settle, at minimum, for a "common message switch."⁹⁶

Existing trading markets resisted vigorously the proposals and, with the threat of unilateral SEC action in the background, negotiated a compromise, the Inter-market Trading System or ITS.⁹⁷ The NYSE, seeking a compromise that would preserve their superior market position, proposed the ITS, in which members of the various exchanges had reciprocal trading privileges in each other's markets.⁹⁸ The ITS permits a dealer on one market to transmit an order to another when a dealer in the other market is displaying a better price quote. The ITS began on a pilot basis on April 17, 1978, with the NYSE and the Philadelphia Stock Exchanges trading eleven stocks.⁹⁹ By mid-1978 four other exchanges had joined the system and gradually more stocks were added.¹⁰⁰ The Cincinnati (now National) Stock Exchange joined in 1981, NASD joined in 1982 and the Chicago Board Options Exchange joined in 1991.¹⁰¹

⁹³ Development of a National Market System, SEC Exch. Act Rel. No. 34-14416 (Jan. 26, 1978), 43 Fed. Reg. 4354 (Feb. 1, 1978). See also Dale Oesterle, *Securities Markets Regulation: The Time to Move to a Market-Based Approach*, Cato Institute, Policy Analysis, No. 374 (June 21, 2000).

⁹⁴ See Policy Statement on the Structure of a Central Market System (1973). The SEC proposed a central location where all orders for one stock converged. The central computer would automatically match and execute orders when prices matched, giving price and time priority to orders.

⁹⁵ See Request for Proposals for a Consolidated Limit Order Book, SEC Exch. Act Rel. 34-12159 (March 2, 1976). In a CLOB there would be a single national book in which all orders for a given stock at a given price would be entered. A consolidated limit-order book would have created major disruptions in the structure of the trading markets and the NYSE specialists would have lost significant business. See Blume, *supra* note 11, at 175.

⁹⁶ See Development of a National Market System, *supra* note 93, at 4358. With a common message switch, a computer would automatically route any order to the market displaying the best prices. See Blume, *supra* note 11, at 177.

⁹⁷ Securities Exchange Act Release No. 34-14661 (April 14, 1978), 43 Fed. Reg. 17419 (April 24, 1978)(initial temporary approval) and No. 34- 19456 (Jan 27, 1983), 48 Fed. Reg. 4938 (Feb. 3, 1983)(final permanent approval).

⁹⁸ See Blume, *supra* note 11, at 177.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ All national securities exchanges and the NASD are members of the ITS except the new International Securities Exchanges, which trades options not covered by the plan. SEC Rel. No. 34-49325 at 162, note 17.

As initially drafted, the ITS did not provide for automatic execution of orders across markets. As now operated, however, the ITS requires each plan participant to provide electronic access to its best bid or offer quotes to other participants and to provide an automated mechanism for routing orders (“commitments”) to reach the displayed quotes.¹⁰² In 1981, the ITS adopted a rule that changed the essential nature of the ITS system from a voluntary execution system, in which a market maker in one market could choose to execute trades in other markets, to a mandatory execution system, in which a market maker in one market center, under some circumstances, was forced to execute trades in other markets. The rule, now known as the controversial “trade-through rule,”¹⁰³ requires that a market maker whose price is inferior to the National Best Bid or Offer (NBBO) price—and who has a customer market order—either match the better price or make a “commitment to trade” on the market posting the better price.¹⁰⁴ In other words, it is an illegal “trade-through” when a member of an ITS participant market center initiates a purchase (or sale) on the exchange of a security covered by the ITS at a price that is higher (or lower) than the price at which the security is quoted at the time of the transaction in another ITS participant market center.¹⁰⁵

Frustrating SEC grand plans for the system, the ITS trade volume has always been inconsequential, however, at never more than three and one-half percent of the total trade volume on the member markets.¹⁰⁶ This should not be a surprise as the rule requires market makers in one market to give trades to their competitors in another market, with a resultant loss in the first market makers’ fees and in her markets’ network fee allocations. Rather than route trades to a competitor, market makers in one market with inferior quotes to another market usually just match (execute at) the better prices or refuse the trade. Most of the ITS trades that do occur are in one direction, routed by the smaller markets to the NYSE. There have been constant rumblings over time that markets posting the best prices on ITS get ignored by market makers located in other competing markets.¹⁰⁷

The SEC and ITS board have been frequently at odds at how the inter market system should function. Again, this should not be a surprise. The SEC envisions an expanding role for the ITS as a precursor to an integrated central trading market and the participating members of the ITS seek to use the body as a classic guild, entrenching historic market segmentation. For example, SEC and the ITS board fought for twenty-five years over mechanics of the addition of the NASD to the ITS. The Nasdaq had developed an automatic order execution system, the Computer Assisted Execution

¹⁰² SEC Rel No. 43-49325 at 162, note 17.

¹⁰³ It is really an anti-trade-through rule, as it prohibits dealers from trading through or ignoring posted open orders when executing orders of their own clients.

¹⁰⁴ See SEC Exchange Act Releases Nos., 34-17704 (April 9, 1981), 46 Fed. Reg. (April 17, 1981)(national exchanges), 34-19249 (Nov. 17, 1982), 47 Fed. Reg. 53552 (Nov. 26, 1982)(NASD)

¹⁰⁵ The ITS rules has significant gaps in coverage. It does not, for example, cover large block transactions (10,000 shares or greater).

¹⁰⁶ Supporters of the ITS argue that trade volume is not the measure of success. The true measure of success must include all those trades in which a dealer in one market improves her price on execution for a client to match a dealer in another market quoting on the ITS.

¹⁰⁷ E.g., Gretchen Morgenson, “Is the Big Board Getting Creaky,” N.Y. Times, April 27, 2003, Sec. 3, at 1,11.

System (CAES), and any linkage of ITS to CAES meant that orders in listed stocks could be automatically executed away from the established exchanges. The SEC, in 1999, after the ITS board had once again refused to budge on the matter (it operated on a unanimity voting requirement), itself ordered the ITS to include a linkage to CAES in all listed securities.¹⁰⁸ The breach threatens to turn into a flood as the ITS has now admitted a computerized electronic facility (known as an ECN for electronic communications network or an ATS for alternative trading system¹⁰⁹), Archipelago, and included “remote specialists” on the regional exchanges.¹¹⁰

ECNs complain, however, that the NYSE uses the ITS structure and the SEC’s rules to effectively block ECNs from executing trades in exchange listed shares.¹¹¹ They make two arguments. First ECNs using CAES must adapt to the outdated technology of CAES and pay a hefty fee to a competitor, the Nasdaq, for the questionable privilege of accessing the ITS system. Second, the ITS trade-through rule disables ECNs from trading listed stock that is not exempted from the rule. ECNs cannot be programmed to wait for exposure to non-automated auction markets such as the NYSE.¹¹² ECNs therefore floated, in 2002, a proposal to allow ECNs to quote listed securities on the NASD’s Alternative Display Facility (ADF system), whose members are not subject to a trade-through rule.¹¹³ Thus many of the ECNs do not trade ITS stocks or do so only if there is a specialized exemption from the rule. ECNs can trade selected high-volume, derivatively priced Exchange Traded Funds (ETFs) (specifically QQQs, SPDRs and Diamonds)¹¹⁴ or very small volume in a covered security.¹¹⁵

¹⁰⁸ Adoption of Amendments to the Intermarket Trading System Plan to Expand the ITS/CAES Linkage to All Listed Securities, SEC Exch. Act Rel. No. 34-42212 (Dec. 16, 1999), 64 Fed. Reg. 70297-01. The ITS had included only “Rule 19c-3” securities (securities listed on exchanges after 1979) since 1982.

¹⁰⁹ I will use the more common ECN acronym.

¹¹⁰ Intermarket Trading System: Order Granting Approval of the Eighteenth Amendment to the ITS Plan Relating to the Pacific Exchange, Inc.’s Implementation of the ARCA Facility, Exch. Act Rel. No. 34-44923 (Oct. 22, 2001), 66 Fed. Reg. 53455; Intermarket Trading System: Order Granting Approval of the Nineteenth Amendment to the ITS Plan Relating to the Philadelphia Stock Exchange, Inc.’s Implementation of a Remote Specialist Program, SEC Exch. Act Rel. No. 34-46474 (Sept. 25, 2002), 67 Fed. Reg. 60282. A remote specialist operates off the physical trading floor of a regional exchange, communicating with the floor electronically. The Boston Stock Exchange has had remote specialists in place since 1994.

¹¹¹ E.g., Eric Moskowitz & Jenny Anderson, “ECNs Want Piece of Battered Big Board Business,” N.Y. Post, April 25, 2003, at 37.

¹¹² Instinet makes the following claim: ECNs, which are automatic, cannot wait on execution by dealers in manual markets that are offering better prices. They have to refuse to trade all stocks in which a specialist in a manual market is offering a better price. Instinet’s major market in listed securities is in ETFs, exchange traded funds, that are subject to a special trade-through rule exemption. See Securities Exchange Act Release No. 46428 (August 28, 2002), 67 FED. REG. 56607 (September 4, 2002) (Order Pursuant to Section 11A of the Act and Rule 11Aa3-2(f)) (Granting a De Minimis Exemption for Transactions in Certain ETFs from the ITS Trade-Through Provisions.)

¹¹³ See Isabelle Clary, “SEC Extends ADF Pilot for Nasdaq Stocks Only,” Sec. Indus. News, April 21, 2003.

¹¹⁴ Securities Exchange Act Rel. No. 34-46428 (Aug. 2002), 67 Fed. Reg. 56607 (Sept 14, 2002). The rule contained a de minimis exemption for prices that were within 3 cents of the NBBO. Many observers thought that a de minimis rule would be extended to all exchange traded securities. The SEC chose another tack in Regulation NMS, however, excluding all manual trades from the trade-through rule, which surprised many.

By contrast, the Nasdaq UTP Plan does not contain a trade-through rule and, despite SEC pressure,¹¹⁶ there is no intermarket trade-through rule on Nasdaq securities. The result is that ECNs now dominate the trading market in Nasdaq securities. ECNs continue, on the other hand, to have a very minor position in the trading markets for exchange listed securities. In Regulation NMS, the SEC now seeks to impose a trade-through rule on the Nasdaq.¹¹⁷ In so doing, as discussed in the next section, the SEC had to satisfy the complaints of the ECNs, primarily by applying the rule only to quotations that are immediately accessible through automatic execution.

The history of the evolution of the ITS is sobering, for it is the proverbial nose of the camel under the tent. The SEC is using the ITS as a vehicle to develop, increment by increment, a full-blown centralized trading system. Regulation NMS is the latest SEC maneuver in this steady progression. Since 1972 the SEC has periodically repeated its preference for strengthening the ITS system by asking for comments on stronger versions of the system. In a 2000 Concept Release,¹¹⁸ for example, the SEC requested comments on among other things a CLOB, a message switch with price and time priority, and an order exposure rule modification for the ITS. I wrote in 2002 that "Some day the SEC may get its way."¹¹⁹ In Regulation NMS, the SEC has decided to go for broke with its proposed "Access Rules."¹²⁰ With the Access Rules, the SEC has effectively proposed turning the ITS into a surrogate CLOB.

To understand the current SEC proposals one first has to consider the SEC's historical flirtations with market centralization proposals. Advocates of centralized markets tend to favor one of three particular arrangements. First, there are advocates of the "black-box" approach. Devotees of that approach envision the single market to be one all-encompassing computer trading system (sometimes referred to as a strict time-priority central limit order book, or "hard CLOB").¹²¹ Second, there are those who favor a stronger overarching ITS with more stocks and more automatic routing and execution.¹²² Enthusiasts argue that time priority can also be imposed on competing

¹¹⁵ ECNs are not required to follow the rule with respect to a covered security until they have 5% or more of the average daily trading volume in that security over a six month period. Regulation ATS, Section 301 (B)(3), 17 CFR 242.310 to 303.

¹¹⁶ E.g., SEC Rel. No. 34-22412 (Sept 16, 1985), 50 Fed. Reg. 38640.

¹¹⁷ SEC Rel. No. 34-50870 at 12-17.

¹¹⁸ "SEC Request for Comment on Issues Relating to Market Fragmentation", Rel. No. 34-42450 (February 23, 2000).

¹¹⁹ See Dale A. Oesterle, Congress's 1975 Directions to the SEC for the Creation of a National Market System: Is the SEC Operating Outside the Mandate?, American Enterprise Institute Monograph (May 2003) at 17.

¹²⁰ SEC Rel. No. 34-50870 at 17- 20.

¹²¹ The most mature of the proposals comes from J.W. Peake. In his proposal an issuer would have the exclusive right to determine, for five-year periods, a single exchange for the trading of its securities.

¹²² Professor Jeremy J. Siegel of the Wharton School of Business argues that the SEC should establish an inter-market trading system on which the highest bid and lowest offer for every stock, no matter where they originate, should be displayed on a screen available to all investors around the clock. Jeremy J. Siegel, "The SEC Prepares for a New World of Stock Trading," *Wall Street Journal*, September 27, 1999, at A34. Professor Siegel's view seems to have piqued the SEC's interest as Regulation NMS makes bid and ask prices for ITS linked stocks available for all investors.

markets by forcing all trading through a computerized message switch that monitors the timing of quote updates and routes orders accordingly. And third, those in current positions of superior market power, principally the NYSE, urge the SEC to consolidate order flows of selected securities in specified markets. There are several versions of the third position. Historically the NYSE consolidated order flow in listed stocks on its exchange with internal no-compete rules; members of the exchange had to agree not to trade listed shares off the exchange. With the loss of the rules and their remnants, the NYSE now has urged the SEC to terminate the ITS system, recognizing that the NYSE could easily maintain its dominate market position in listed shares if it was not required to integrate with other markets.¹²³ Modern versions of this proposal include a version that would give corporations the right and power to list their shares on only *one* market, the market of their choice.

Historically the SEC had flirted with version one, resisted version three, and settled on version two, a growing ITS system. The concept of an overarching ITS does have a certain superficial appeal. But, the ITS system shares many of the problems of any self-regulatory organization (SRO) regime.¹²⁴ The ITS, is itself, a combination of otherwise independent trading markets.¹²⁵ If all exchanges were required to belong to the ITS, and the ITS maintained exclusive rules for membership and a dominant market position, that system could easily become an anti-competitive combination of otherwise independent competitors. One can make a good case for the proposition that in the past the ITS system has been a major tool used by the national exchanges to stifle competition in exchange-listed securities. When the SEC recently announced an initiative to give NASD dealers full access to trading NYSE listed securities over the ITS, the SEC Chairman commented that the change was “long overdue and, frankly, should have been accomplished some time ago through the voluntary efforts” of the ITS membership.¹²⁶ Currently, ECNs claim that the ITS’s trade-through rules are anti-competitive.¹²⁷

Centralizing trading through a time-priority message switch -- that is, a modified ITS -- raises all the same issues as centralizing trading in a central limit order book, the CLOB version of the "black box" approach. It requires expensive new infrastructure and bureaucracy, precludes competition and innovation, and leaves the market dependent on a government-imposed technology. Moreover, a time-priority rule does not take into account other attributes of the participating markets that are relevant to execution choice. Another concern with time priority is that it prevents competition on factors other than price. In other words, the trading market that is first in line gets the order, regardless of whether other markets offer enhanced liquidity, faster or more reliable systems, lower rates of failed trades, or better credit, to name a few of the many factors on which markets compete today. Under a time-priority rule, the better markets will pressure the

¹²³ Greg Ip, "NYSE, in a Break With Heavyweights, Calls for End to System Linking Markets," *Wall Street Journal*, April 7, 2000, at C1.

¹²⁴ See Dale Oesterle, "Securities Markets Regulation: The Time to Move to a Market-Based Approach," Cato Institute, Policy Analysis, No. 374 (June 21, 2000).

¹²⁵ Under the rules governing the ITS, each exchange, for example, has a veto over all ITS rule changes.

¹²⁶ *Id.*, op. cite, December. 9, 1999.

¹²⁷ See, supra note 112.

SEC to mandate rules that either “shape-up” or eliminate the sloppier markets -- a sure recipe for ever more intrusive SEC micro-market regulation

What is the best ITS system? Surely the SEC ought not to be the final arbitrator on these critical operation issues, nor should an exclusive trade association of all the old-line exchanges. It is questionable whether a SEC micro-managing the operating characteristics of a super-ITS system will make the right technical decisions. For example, the overarching ITS system as envisioned by many of its advocates would have the same quote display problems that so bedeviled the SEC in its efforts to promulgate Regulation ATS. Can participants quote different prices for different amounts? Would traders be required to display their entire position or could they dribble out their sales? Would all brokers have ITS access? Should *strict* time/price priority be enforced through an ITS (option six in the SEC’s Concept Release on Market Fragmentation)?¹²⁸ Should an order exposure rule be applied through an ITS (option three in the SEC’s Concept Release on Market Fragmentation)?¹²⁹ If the answers do not accord with the desires of large traders, those traders will go to London or Brussels unless the ITS system has overwhelming market power, that is, a monopoly maintained through government regulations.

The SEC’s proposed solution to the potential problems of a strengthened ITS is contained in Regulation NMS. In the Regulation the SEC has offered a dramatic restructuring of the national securities markets, using the ITS. In so doing, the SEC seeks openly to regulate the ITS system as if it were a public utility. (We have already noted above the public utility style regulation favored by the SEC in trade and quote information dissemination.¹³⁰) In Regulation NMS the SEC seeks to create an all - inclusive, market-dominant ITS and regulate it like a state public utility authority

¹²⁸ To assure a high level of interaction of trading interest, the SEC could order the establishment of a national market linkage system that would provide price/time priority for all displayed trading interest. Under this option, the displayed orders and quotations of all market centers would be displayed in the national linkage system (NLS). All NLS orders and quotations would be fully transparent to all market participants, including the public. Orders and quotations displayed in the NLS would be accorded strict price/time priority. Market makers could execute transactions as principals only if they provided price improvement over the trading interest reflected in the NLS. Trading interest in the NLS could be executed automatically; however, the NLS would not be a market center itself: executions would continue to occur at the level of individual market centers. Public access to the NLS would be provided through self-regulatory organizations, alternative trading systems, and broker-dealers. The NLS could be administered and operated by a governing board made up of representatives from the public and relevant parts of the securities industry. “SEC Request for Comment on Issues Relating to Market Fragmentation,” Rel. No. 34-42450 at IV. C.2.F. (February 23, 2000).

¹²⁹ As a means to enhance the interaction of trading interest, the SEC could require that all market centers expose their market and marketable limit orders in an acceptable way to price competition. As one example of acceptable exposure, an order could be exposed in a system that provided price improvement to a specified percentage of similar orders over a specified period of time. As another example of acceptable exposure, a market maker, before executing an order as principal in a security whose quoted spread is greater than one minimum variation, could publish for a specified length of time a bid or offer that is one minimum variation better than the NBBO. “SEC Request for Comment on Issues Relating to Market Fragmentation,” Rel. No. 34-42450 at IV. C.2c. (February 23, 2000).

¹³⁰ See Borrelli, *supra* note 6, at 886-888 & 903-04. Borrelli is very critical of the initiative [“Direct SEC involvement in ratemaking would be unworkable.”]. *Id.* at 903.

regulating water or electric service; the SEC will establish and approve changes in membership criteria, fees and basic operational structure and procedures.

Proposed Regulation NMS contains five new initiatives; a new trade-through rule for the ITS, new access rules for the CQ; a prohibition on quotes in fractions of a penny, and a new method of allocating fees collected by consolidated data reporting services.¹³¹ Of the initiatives, the new trade-through and access rules are the most far reaching. The trade-through rules offer three major changes¹³²: First, trade-through protection is *extended* to Nasdaq, covering all NMS stocks, to very large block trades and to very small trades (100 share blocks). Second, the trade-through protection is *limited* to automated trades, excluding quotations in manual markets. Third, the trade-through protections may be extended to depth of book (DOB) quotations, quotations in any market center that are inferior to the market's best bid and offer (BBO), at the choice of individual markets.¹³³ To protect the integrity of the new trade-through rules, the SEC had to, however, open up market access to the protected quotes on controlled fees. The access rules therefore prohibits market centers from controlling their own membership; the centers must accept all private links from even non-members on "non-discriminatory" terms and at SEC proscribed fees (\$.003 per share).¹³⁴

These changes, if adopted, will restructure the market, effecting the most dramatic changes since the passage of the New Deal legislation that put the markets under federal regulation.¹³⁵ Some changes will be predictable and many will not. There is heavy speculation on who the "winners and losers" will be under the new rules.¹³⁶ The SEC Commissioners themselves split on the adoption of the rule.¹³⁷

The floor brokers on the NYSE and Amex would appear to be the big losers as the traditional open out-cry auction exchanges will be forced to automate a higher percentage of their trades to get the benefit of trade-through rule protection. Moreover, modern ECNs will be able to trade exchange-listed securities on an equal basis with the exchanges for the first time in their young history. It may be the beginning of the end for the manual auction market on these storied exchanges. NYSE seat prices hit a nine year

¹³¹ See SEC Rel. No. 43-50870 at 5-6.

¹³² *Id.* at 28-88.

¹³³ The SEC, in the Regulation NMS release, repeatedly underlined the word "voluntarily" to emphasize that the agency is not proposing the markets be required so disseminate their DOB quotations. E.g., *Id.* at 65.

¹³⁴ *Id.* at 17-20.

¹³⁵ The changes will dwarf the effect of the 1996 Order Handling Rules initiative that gave the ECNs room to operate. Securities and Exchange Act Rel. No. 43-46280 (July 29, 2002), 67 Fed. Reg. 50739 (Aug. 2002).

¹³⁶ Kate Kelly & Deborah Solomon, New SEC Rules Create Winners (And Losers), *Wall St. J.*, Dec. 9, 2004 at C1 (NYSE floor brokers, Nasdaq may be losers; institutional investors, small retail investors may be winners).

¹³⁷ Deborah Soloman, Changes in the Trade-through Rule Spark Divisions Within the SEC, *Wall St. J.*, Dec. 16, 2004 at C3 (the rules passed 4-1 with Commission Paul Atkins dissenting)

low in January as a result of the anticipated changes.¹³⁸ Other losers may include the smaller ECNs trading NMS shares on Nasdaq¹³⁹; they will lose order flow to the larger markets in those shares. Consolidation of the automated markets trading Nasdaq shares appears inevitable. Finally, all traditional market makers (specialists on the exchanges and manual market makers on the NASD) will lose privileged access to quote information if the DOB system is widely adopted.

The biggest winner under Regulation NMS will be the SEC, who has made a permanent position of enhanced importance for itself; it will be the eight-hundred pound gorilla of our trading markets.¹⁴⁰ The NYSE and Nasdaq will become *de facto* operating branches of the SEC.

The SEC's various centralized order routing proposals, of which Regulation NMS is the most current, share a common problem. A central market would be a government-sponsored monopoly (or in more positive terms, a "public utility") and it would be resistant to innovation.¹⁴¹ At best, one ought to doubt whether the SEC has the foresight to create a market that would be superior to one created by a more competitive process among private parties. Nobody knows currently which, if any, of the proposed trading market systems will prove best. The SEC is more likely than not to pick the wrong system and trading will be less efficient than if it had been left to market forces.¹⁴² Or, even if the SEC picks the correct system for the moment, it will be the wrong system for tomorrow and difficult to change. At worst, the SEC will be captured and corrupted by the interests behind whatever market manages to establish itself as the only game in town.¹⁴³

Some of the SEC's most ardent critics unwittingly aided the SEC's role as final arbitrator of market structure. The SEC's market-structure-by mandate satisfies few in the industry. Unfortunately, many of the SEC most vocal critics favor an even more centralized market on which all stock of any issuer can be traded.¹⁴⁴ Those who advocate these solutions bemoan the dangers of "market fragmentation." They argue that only

¹³⁸ Kate Kelly & Jed Horowitz, NYSE Seat Fetches Only \$1Million, A Nine-Year Low, Wall St. J., Jan. 7, 2005. See also Jenny Anderson, Cheap Seats Provide View of Troubles At Exchange, N.Y. Times, Jan. 10, 2005 at C1.

¹³⁹ Which could include the Nasdaq itself (!) because the larger ECNs, ArcaEx and Instinet, currently have more volume and better prices.

¹⁴⁰ See Bob Greifeld, Millions of Momentary Monopolies, Wall St. J., Dec. 8, 2004 at A12 (CEO of Nasdaq recognizing the shift.)

¹⁴¹ See generally Robert B. Ahdieh, *Making Markets: Network Effects and the Role of Law in the Creation of Strong Securities Markets*, 76 S. Cal. L. Rev. 277 (2003) [describing the tendency of trading markets to resist innovation].

¹⁴² A new entrant in the market, for example, is Nasdaq's Primex system. Primex is an electronic system that mimics the NYSE's own auction-market process. When an order is sent to Primex, participants bid for it by attempting to better the best price then prevailing in any other market.

¹⁴³ Such a system would, in the long run, be inherently unstable since overseas markets will develop that offer more attractive venues and prices

¹⁴⁴ If one reads the full letter from Steve Wunsch noted infra note 161, he seems also to be complaining about the SEC not centralizing the market. This makes his letter odd indeed for it is only through laws that a market will be centralized. Left on its own the market for trading systems will have numerous participants.

such a market will be orderly, liquid, and deep, with narrow price spreads. Moreover, only in a single market will traders know with certainty that they have received the best executions of their orders and that no one else offers a better price.

Advocates of a centralized trading system often argue from “tension” between competition for orders and competition among trading market centers. The advocates claim that optimal competition for orders requires that they all interact in one trading market. The argument assumes the SEC can establish and keep current an efficient central market, an unrealistic premise given the inherent problems of government micro regulation. The so-called tension is a false one: The optimal competition for orders will come pragmatically through an ever-evolving competition among market centers for orders. The 94th Congress recognized it and the SEC should be more honest to the vision.

The problems of designing an all-inclusive ITS demonstrate why it would be better to have competition not only among trading markets for traders but also among inter-market trading networks for the participation of trading markets. An SEC-mandated ITS would eliminate two aspects of competition: first, how competitors use any given inter-market trading system, and second, how competing inter-market trading systems evolve.

Evidence of the strength of the first form of competition in the market, competition inside a trading network, is seen in the joint venture between Archipelago and the Pacific Stock Exchange’s stock trading business.¹⁴⁵ The deal gives Archipelago, an ECN, direct access to the current CQS and ITS as an exchange (ArcaEx)¹⁴⁶. ArcaEx has advertised several exchange innovations. First, members in the current system can execute in-house all incoming orders as long as they match the best price in the system; they do not have to route orders to the market that first displayed the best price. But the Archipelago program promises to automatically route incoming orders to whichever market has first posted an opposite order at the best price. That is, Archipelago may

¹⁴⁵ In March 2000 Archipelago gave the PCX \$40 million in cash and a 10% stake in Archipelago Holdings, creating a joint venture that allowed Archipelago to operate ArcaEx as an equity exchange. Now, Archipelago Holdings is going to purchase the rest of the PCX including the options trading floor. It plans to close the trading floor and offer traditional equity securities and options on the same all-electronic platform. Jenny Anderson, *Deal to Acquire Pacific Exchange is Expected*, New York Times, January 4, 2005, Section C1.

¹⁴⁶ The Archipelago joint venture with the Pacific Stock Exchange in 2000 was the first in a series of mergers between ECNs and Exchanges or ECNs with each other. In September 2004, Nasdaq purchased the Brut ECN for \$190 million from Sungard Data Systems. This purchase gave Nasdaq access to the full depth of Brut’s trading book, a smart-routing system that allows other ECN’s to trade on the Nasdaq Market System, and a broker/dealer that will allow it access to ArcaEx, and potentially, the NYSE. Instinet Group purchased the Island ECN in 2002, creating the INET ECN. Instinet Group also owns Instinet, a broker-dealer for institutions. Together these two entities form the most promising ECN in the market today. Instinet Group entertains a variety of mergers, acquisitions, and joint ventures for INET in the current market. The wave of mergers of ECNs and broker dealers is likely to continue as proposed Regulation NMS all but makes automated markets necessary to continue to be viable. Schmerken, *Making Markets Move- The race to become a fast market may lead exchanges to join forces with ECNs*, Wall Street & Technology, August 1, 2004, p. 14.

voluntarily offer strict time priority in an effort to woo customers.¹⁴⁷ Second, Archipelago also eliminated the specialist position in favor of competing market makers on its exchange. And third, traders have more options in how to present their trading positions in the system:¹⁴⁸ reserve orders,¹⁴⁹ discretionary orders,¹⁵⁰ immediate or cancel orders,¹⁵¹ now orders,¹⁵² and pegged orders¹⁵³ in addition to the standard limit orders, stop orders, and market orders. The SEC did not need to “facilitate” or otherwise order any of the practices or innovations. The NYSE, otherwise a very cautious innovator, has responded with a new Liquidity Quote of its own.¹⁵⁴

Additional evidence of competition inside a trading network is the explosion in trading centers featuring Nasdaq stock. The NASD System of trade and quotation reporting has, until now, not contained a trade-through rule and, as is noted in the next section, Nasdaq stock is now traded on the exchanges, through the Nasdaq Market Center, formerly known as the SuperMontage System, and on the NASD’s ADF system. The ADF system is an information processor that is separate from the Nasdaq Market Center so, although they are both ruled by the NASD, they are in a sense competitors. As a consequence, there are now three significant trading venues for Nasdaq securities competing head to head for market share—Nasdaq Market Center, INET, and ArcaEx.¹⁵⁵ And, most importantly perhaps, several services access directly the multiple venues for traders;¹⁵⁶ in essence, the ECNs, responding to customer demand, have put in a version of a trade-through rule *on their own*,¹⁵⁷ all without an SRO or SEC mandate.¹⁵⁸

¹⁴⁷ The exchange risks losing brokerage clients that want payments for order flow but will hope to draw customers based on increases in execution speed, decreases in cost, and increase in execution quality.

¹⁴⁸ The order forms are evolving and subdividing in response to traders requests. See www.archipelago.com for an updated catalogue and description. Currently, ArcaEx can handle 24 different order types.

¹⁴⁹ A trader can enter a larger order than it wishes to have displayed in the system.

¹⁵⁰ A trader can enter a more aggressive price without “exposing its hand” to the market.

¹⁵¹ The order is executed immediately if Arca’s book has the best insider price, otherwise it is cancelled.

¹⁵² Now orders are treated like IOC orders with the addition of a pool of pre-qualified market makers other to Arca’s book.

¹⁵³ A trader can enter an order pegged, indexed, to quotes or other prices.

¹⁵⁴ Mary Schroeder, “SEC Back Bloomberg Liquidity Quote View,” *Sec. Indus. News*, April 7, 2003 (traders can now provide quotes of substantial size on the exchange that are executable).

¹⁵⁵ Isabelle Clary, “Nasdaq Market Center (successor to the SuperMontage) Tech Garners Praise Amid Slump,” *Sec. Indus. News*, April 28, 2003.

¹⁵⁶ E.g., Clary, *supra* note 155 (discussing Track Data Securities); *Consolidating Fragments*, *supra* note 72 (discussing the Lava Colorbook). ArcaEx also offers to route its trades to the best market under specified order directions. The order routing among ECNs has been the subject of some acrimony, however. See Isabelle Clary, “SEC Probes ECN Access, Pricing,” *Sec. Indus. News*, April 14, 2003 (Island sued Archipelago over nonpayment of access fees and Archipelago counterclaimed with an anti-trust suit).

¹⁵⁷ Indeed, some traders fault the Nasdaq Market Center (successor to the SuperMontage) system for not, on its own, providing a version of a trade-through rule. See Amy Baldwin, “Once-hot Nasdaq Fights to Reverse Slide,” *Chicago Tribune*, April 28, 2003, at *Bus. Sec.*, p.6.

¹⁵⁸ The proliferation of trading centers in Nasdaq stock has led to an increase in locked and crossed markets, however. In a locked market the bid and offer quotes are the same; in a crossed market the inside bid price is greater than the inside sell price. There is some debate over how harmful such situations are and, if harmful, how to deal with them. E.g., Isabelle Clary, “STA: Ban Fees on Locked Markets,” *Sec. Indus. News*, March 31, 2003.

Evidence of the strength of the second form of competition, competition among information processors, comes from Internet businesses that interconnect various retail markets to offer customers the best price alternatives. The travel market, consisting of airline tickets, hotels, rental cars, and tourist event tickets, is the best example. Anyone can log on to one of these popular Internet sites and compare prices from a variety of businesses. The securities trading markets can and will develop competing market linkage sites that will not only include American markets but also markets abroad (London, for example) that trade American stocks. Indeed, as noted above, there are several very creative information processors, such as the Lava Colorbook,¹⁵⁹ that combine the quotes from the various trading markets now. The SEC should not retard the development of either of these two forms of competition.

Trading markets are no different from any other service markets: the more competition the better, the less government intervention the better. The majority of the SEC's critics who demand a black box or CLOB have it upside down.¹⁶⁰ The SEC is too intrusive already and trying too much now to micro-manage an order routing linkage of the various trading markets.

I have argued in the previous section that the concept of a centralized order routing procedure is inconsistent with the intentions of the 94th Congress when it enacted the 1975 amendments, that is, that the SEC is not authorized by the 1975 amendments to create a centralized routing procedure. I also believe that the 94th Congress was correct on its policy preferences. So even if one believes, as the federal courts will undoubtedly find, that the 1975 amendments do authorize the SEC's ITS initiatives, I, as a fall back position, also suggest that the SEC has made a series of policy mistakes and needs to rethink the conceptual paradigm of its program.

The SEC's Micro-structuring of Individual Market Center Routing and Execution Practices: Case Studies of the Regulation of Quote Form and of ECNs

¹⁵⁹ See supra note 156.

¹⁶⁰ There is a reoccurring proposal to consolidate market trading without the creation of an over-arching linkage system. Called a "competition for listing" proposal, the advocates would have individual firms choose, for five-year periods, the exclusive trading markets for their shares. E.g., Laura Nyantung Beny, U.S. Secondary Stock Markets: A Survey of Current Regulatory and Structural Issues and a Reform Proposal to Enhance Competition, 2002 Colum. Bus. L. Rev. 399; Morris Mendelson & Junius W. Peake, Intermediaries' or Investors': Whose Market Is It Anyway?, 19 J. Corp. L. 443 (1994). The proposals assume, first, that firms would only list in one market (they could choose to list in several), second, that the intermarket linkage systems would be dismantled, third, that moving from one trading market to another would be easy (the new delisting rules on the NYSE have not encouraged a move off the market), and, fourth, that foreign markets would not take up the slack, trading in unlisted shares in American companies. The first and second problems are interwoven: Intermarket linkages would remain an issue if issuers under such a system choose to list in more than one market. There may also be some unintended consequences from such a proposal: Absolute firm control over listing would add another agency problem to the trading markets that does not now exist; management could abuse the privilege to obtain personal advantage at the expense of their shareholders (list on a market whose rules prohibit hostile takeovers?). There are other corporate governance issues as well (Could a firm opt out of making such a choice?).

The SEC is not content to just arbitrate the design of the CTA, CQS and ITS links. The SEC also writes rules on how market participants must use the links. This gives the SEC an open license to micro-structure the internal features of the market centers that are connected by the systems. SEC rules for accessing and using the inter-market links become trading rules for each of the individual trading markets. One of the true innovators of the ECN, Steve Wunsch, the President of the computerized Arizona Stock Exchange, defined the issue well in October 29, 1999 letter to the *Wall Street Journal*. Wunsch criticized the SEC for “playing God.”

In pursuit of such nebulous concepts as “transparency,” “efficiency” and “fairness,” the SEC and its academic advisers have relentlessly intervened to redesign the market structure. But, just as it is difficult to design a better eye or grain, attempts to turn the stock market into a “level playing field” ... have produced only a slew of unintended consequences.... Why not let the market structure result from competition rather than mandates from on high?¹⁶¹

In practice, the SEC reads the 1975 national market system mandate to empower it to craft a plethora of regulations on the operation of the individual markets. There are regulations on, among other things, member and subscriber access, price quote and trade display practices, listing requirements, execution fee schedules, best execution obligations of brokers, order routing practices, limit order procedures — in short, regulations on much of the essence of the market structure. It is indeed amazing what rules the SEC justifies in the name of promoting a national market system. And the number and scope of the rules continues to grow. Moreover, with the speed of the changes in the market, the SEC, unless it reverses course, will find itself constantly tinkering with the rules in a struggle both to keep structure current with technology and to eliminate what have proven to be past regulatory blunders. The pace of SEC rule making is at present, not keeping current with market developments.¹⁶²

Examples of the SEC national market system regulations bleeding into the regulation of market center internal structures are numerous. A few significant ones are mentioned below.

Consider first the SEC’s rules on quotation practice. The link between markets provided by the CQS led the SEC to adopt, in 1978, rule 11Ac1-1 on market makers’ quotation practices. The rule requires market makers’ quotes to be “firm,” to obligate the quoting market maker (or specialist) to execute a transaction at the quoted price. The rule also requires all quotes to include a size for which a price is firm.¹⁶³ The rule sounds straightforward, but it is not.

Numerous administrative problems have led to repeated amendments to the rule. The cost burdens of the rule required SEC amendments, for example, that exempted

¹⁶¹ Steven Wunsch, Letter to the Editor, *Wall Street Journal*, October 29, 1999, at A19.

¹⁶² E.g., Isabelle Clary, “Nasdaq Pushes SEC to Rule on its Status,” *Sec. Indus. News*, March 17, 2003 (Nasdaq has waited over 20 months on its application to be an exchange).

¹⁶³ This is often the minimum required by each exchange or NASD.

market makers and exchanges that do less than one percent of the volume in a covered security, and that protected market makers in periods of usually rapid price movements.¹⁶⁴ There was also a modification for the firm quote obligation when market makers were executing one order and a second appeared before the market maker had revised her quote.¹⁶⁵ Exceptions for modern innovative securities such as ETFs were required. More changes were to come.

In September of 1996, the SEC promulgated its so-called Order Handling Rules, an initiative it often points to with some pride.¹⁶⁶ The Order Handling Rules, prompted by the SEC's concern over market fragmentation,¹⁶⁷ adopted the Display Rule and the ECN amendment. The Display Rule requires market-makers and specialists to display customer limit orders and their size when the orders are priced better than the market-maker's or specialist's quote.¹⁶⁸ The ECN amendment attempts to eliminate "hidden markets." It requires specialists and market-makers who place orders with an ECN at a price better than her public quotation either (1) make the better price publicly available or (2) to use an ECN that will publicly disseminate its prices and allow other broker-dealers access to its system.

In this case, the SEC had it right. The Display Rule has had very positive effects for the Nasdaq. The Display Rule forced Nasdaq market makers to display customer limit orders and that, combined with Nasdaq's new automated trading programs, has caused a significant increase in customer to customer transactions, transactions without a dealer as an intermediary.¹⁶⁹ This lowers trading costs and makes the market more attractive to traders. Moreover, the Display Rule put ECNs in direct competition with traditional Nasdaq market makers in the business of attracting customer limit orders. The competition among markets drove down market making fees and charges and encouraged market structure innovations.

The SEC's regulations on quotation practice also affect the details of the country's more innovative automatic execution systems. By way of illustration, consider the "SOES Bandit" problems of the early '90s. The SOES Bandits proved in the early '90s that clever traders could beat the SEC's quote rule.

Nasdaq added a Small Order Execution System in 1985, the SOES.¹⁷⁰ The NASD designed SOES to make it easier for small investors to obtain an automated execution of their orders. Participation of a market maker in SOES was initially voluntary, but once a

¹⁶⁴ See SEC Rule 11c1-1(a)(25), (b)(1) & (b)(3).

¹⁶⁵ SEC Rule 11c1-1(c)(3)(i)B & (ii)B.

¹⁶⁶ The Order Handling Rules provided a short-term shot in the arm to the business of ECNs.

¹⁶⁷ The SEC expression of this concern is always a signal that order routing requirements are in the offing.

¹⁶⁸ SEC Rule 11Ac1-4. The Rule applies only to Nasdaq or exchange listed securities. See Order Execution Obligations, Exch. Act Rel. No. 34-37,619A (Sept. 6, 1996).

¹⁶⁹ E.g., Gretchen Morgenson, "At Big Board a Disturbing Investigation of a Lesser Sin," N.Y. Times, April 24, 2003, at C1 [dealers only involved in 43% of Nasdaq trades].

¹⁷⁰ Order Approving Proposed Rule Change, Exch. Act Re. 34-21,742 (Feb. 12, 1985). See also Order Approving Proposed rule Change to Define Professional Trader for the Purposes of SOES, SEC Exch. Act Rel. 34-26,361 (Dec. 15, 1988).

market maker chose to participate in the system, she could not withdraw without the consent of the NASD. Later SOES became mandatory for NMS stocks, and unexcused withdrawals now receive a penalty of a twenty-day suspension.¹⁷¹

As a result of the SEC's firm quote rule and the 1988 rule changes to SOES, a group of savvy traders took advantage of the system's automatic execution features to generate huge trading profits at the expense of the market makers who had trouble updating their quotes fast enough in a volatile market. There followed a five-year tug of war between the NASD, attempting to protect its market makers, and the SEC worried that the NASD's solutions would stratify the SOES market.¹⁷² In the end, the SEC blocked almost all of the NASD proposed solutions. The NASD now attempts to discourage SOES bandits through disciplinary actions with some continuing resistance by the SEC.¹⁷³ One can take sides in the dispute or just note that the SEC's quote rule inevitably caused some unexpected problems for the creation of a workable automated system.

NASD has since created a SuperSOES (which became the "SuperMontage" system and now the "Nasdaq Market Center") and the cascade of SEC rules tweaking and tinkering with the NASD automated execution system continues unabated.¹⁷⁴ This is discussed further below. A recent quotation, for example, was the NYSE's demand that data vendors who want to disseminate their new Liquidity Quotes not integrate those quotes with other market center's quotes.¹⁷⁵ The SEC refused the request.¹⁷⁶ Also heavily contested, to the point of litigation, are the SEC rules on removing ECN quotes from the Nasdaq Market Center system to prevent "locked" or "crossed" markets.¹⁷⁷

In any event, rather than letting individual market centers establish their own quotation procedures, the SEC is now well on its way to the creation and enforcement of a national rule on quotation practice. The SEC creates the CQS, then a firm quote rule, then exceptions to the rule and fights the consequences of its rule-making in the trenches of technical problems with the affected markets. A better practice would be a SEC rule

¹⁷¹ See Order Granting Accelerated Approval to Proposed Rule Change, SEC Exch. Act Rel. 34-25,791 (June 9, 1988).

¹⁷² For a history see the Report Pursuant to Section 21(a) of the Securities and Exchange Act of 1934 Regarding the NASD and the Nasdaq Market, Exch. Act Rel. 34-37,542 (Aug. 8, 1996) at 213-55. The NASD wanted to ban trades from a "professional trading account" in the SOES system and wanted to give market-makers a fifteen second grace period between executions. The SEC approved the rules and, stung by criticism from the Court of Appeals for the District of Columbia Circuit, reversed itself and repealed them. In 1994, The SEC approved a one-year pilot program and then refused to renew it in 1995.

¹⁷³ *Id.*

¹⁷⁴ Michael Schroeder & Greg Ip, "Plan to Upgrade Nasdaq Trading Passes the SEC," *Wall St. J.*, Jan 11, 2001, At C1.

¹⁷⁵ See Schroeder, *supra* note 178.

¹⁷⁶ Although the SEC seems to have permitted the NYSE to require segmented reported of its Openbook (limit order) quotes.

¹⁷⁷ See *Domestic Securities v SEC*, 333 F.3d 239 (D.C.Cir. 2003)(contesting "decrementation"). A locked market occurs when the highest quoted bid price equals the lowest quoted ask price. A crossed market occurs when the highest bid price is greater than the lowest quoted ask price. Locked or crossed markets temporarily stall market trading until the market is unlocked or uncrossed.

that mandates continuous¹⁷⁸ trading markets and that provides quotes to all inter-market systems that will pay for them and that *enforces* whatever quote practices each market chooses to develop, implement, and advertise. A market that does not itself offer traders some sensible version of quotation practice will not last long.

My second example of SEC rules that micro-structure trading markets is the SEC's rules for automated order execution services, [also known as ECNs](#) (or ATSS). While the problems with the quote rule are distracting, the SEC's regulations on ECNs are serious business. These rules affect the most innovative part of our national securities markets, the part of our markets that will determine whether the United States maintains its international pre-eminence in the world's financial markets. And the SEC has become very aggressive in regulating ECNs. In new regulations for ECNs, the SEC attempted to regulate the wind; that is, it took on the task of regulating computerized trading technology.

As noted above, since 1972, the SEC has thought about some form of centralized market. While the SEC has been unable to order the use of a preferred centralized system, it is inching inexorably towards one with a growing package of specialized rules. It is a bottom-up strategy. A top-down strategy would define and enforce a detailed best execution obligation for market participants; but such an obligation is too hard to define with the concreteness necessary for a day-to-day direction of trading practices.¹⁷⁹ A bottom-up strategy, accumulating rules in specific situations, is more politically feasible.

The SEC's bottom-up strategy, if that's what it is, seems to have two parts. First, the SEC mandates order routing links through the ITS for listed securities and through the Nasdaq National Market Execution System System (or ADF) for NMS securities. Second, the SEC imposes individual obligations on market participants to direct their orders through these systems pursuant to a growing body of operating rules. While the first step was discussed above (Regulation NMS is the SEC's boldest step in this strategy and takes the agency very close to its goal, a centralized national trading market system), the second step means that the SEC must take increasing control over the *details of the operating systems* of the ITS participants or National Center.

Prior to proposing Regulation NMS in 2004, the SEC had considered seriously rules on internalization,¹⁸⁰ payment for order flow,¹⁸¹ order exposure,¹⁸² and trade-

¹⁷⁸ A pure non-continuous, periodic auction market ought not have to provide open quotes; it does not have any.

¹⁷⁹ A broker-dealer that receives a customer order has a duty of best execution under the common law of agency and, if the doctrine is still viable, the "shingle theory." A broker-dealer hangs out its shingle when it offers to deal with customers. See *Charles Huges & Co. v SEC*, 139 F.2d 434, 437 (2d Cir. 1943). See generally Roberta S. Karmel, *Is the Shingle Theory Dead?*, 52 Wash. & Lee L. Rev. 1271 (1995). The duty cannot be confined to obtaining the best price, it also includes other aspects of order handling, such as speed and certainty of execution. See *Disclosure of Order Routing and Execution Practices*, Exch. Act Rel. 34-43,084 (July 28, 2000) at 5-9.

¹⁸⁰ The practice of a broker-dealer routing orders to its own market-making desk or to an affiliate for execution.

through.¹⁸³ It had adopted none of the proposals and settled for a more traditional SEC approach to confounding regulatory problems, a new detailed public disclosure rule. In November of 2000, the SEC adopted a Disclosure Release that requires market makers and broker-dealers to make extensive public disclosures regarding order routing and execution practices.¹⁸⁴

Rule 11Ac1-5 requires “market centers” to make specified information available to the public on a monthly basis in electronic form and Rule 11Ac1-6 requires broker-dealers to disseminate quarterly reports on their routing practices. Rule 11Ac1-6 also requires, among other things, broker-dealers to reveal material aspects of their relationship to market centers, including arrangements of payment for order flow or other profit sharing arrangements. The SEC hopes the disclosure will discipline market makers with publicity, provide a vehicle for enforcement actions against misbehaving market makers,¹⁸⁵ and encourage traders to select market makers with preferred execution practices.¹⁸⁶

But the Disclosure Release has been a temporary (although welcome) respite. The SEC has also been piecing together a quilt of very specific order execution practices in selected contexts. The SEC’s biggest recent leap in regulating execution practices has been in the regulation of ECNs. In the past decade, entrepreneurs with expertise in telecommunications and computers have developed a variety of alternative securities trading systems that have the potential for becoming substitutes for traditional securities exchanges. These computerized trading systems now handle **over 50%** of the orders in securities listed on the Nasdaq and almost seven percent of the orders in all exchange-listed securities.¹⁸⁷

The ECN sector has evolved rapidly over the few years in which it has been robust. There were over a dozen ECNs operating in the late ‘90s and there are only six ECNs left today. The year 2002 was marked by heavy consolidation. Of the six ECNs left only three have substantial volume. One of the three ECNs, Archipelago, has joined with the Pacific Stock Exchange to become ArcaEx. The other two ECNs, both divisions of Instinet, operate as quasi-exchanges. Instinet itself, is the only major participant on the

¹⁸¹ The practice of market-makers providing compensation to broker-dealers that route the order for execution. Payments for order flow may take many forms other than cash. A market-maker may, for example, offer clearing services to the directing broker-dealer.

¹⁸² An order exposure rule would require a broker-dealer, before executing an order as a principle, to expose the order to trade interest on another market center. The NYSE has periodically proposed such a rule.

¹⁸³ A trade-through rule would require broker-dealers executing customer orders to route the order to the market center that is providing the best price. At present in the ITS system, a market maker has the option of meeting another market’s best price rather than routing an order to that market.

¹⁸⁴ Disclosure of Order Execution and Routing Practices, Exch. Act Rel. 34-43,590 (Nov. 17,2000).

¹⁸⁵ A market maker who is misbehaving is also likely to lie on the disclosures and a suit based on lying is easier to bring and prove.

¹⁸⁶ The new filings have been a valuable source of information that otherwise might not be public. Rule 11A(c)1-5 filings of the NYSE, for example, an exchange that is historically very parsimonious with its internal operating data, has opened a few eyes.

¹⁸⁷ SEC Release No. 34-50700: Concept Release Concerning Self-Regulation Nov. 18, 2004.

NASD alternative display facility (ADF) and its division, INET, is the only big player left on the National Stock Exchange (formerly the Cincinnati Stock Exchange). Nasdaq achieved ECN status by merging with BRUT. As a result of proposed Regulation NMS more consolidations no doubt lay ahead¹⁸⁸ this is exacerbated by the fact that several of the major players are reporting operating losses.¹⁸⁹

The SEC struggled in the late '90s with the problem of how to regulate the new, emerging ECNs. Traditional market centers, asking the SEC to stifle these dangerous new competitors, complained about market fragmentation and an unequal regulatory playing field. The ECNs just asked the SEC to be left alone; they knew they could compete successfully with traditional market makers. The only rule holding ECNs up was the ITS trade through rule on exchange listed securities.

The first big SEC action affecting ECNs was not directly aimed at them, the Order Handling Rules of 1996.¹⁹⁰ The Rules were aimed at traditional market makers and their refusal to publicly quote limit orders that bettered their displayed quotes. Forcing OTC market makers to display their BBO limit orders created a temporary boon to ECNs that were used by market makers to post alternative quotes. Four ECNs registered with the NASD immediately after the release.

The SEC's major directive aimed directly at ECNs came a few years later. After releasing three major series of proposed rules, each over one hundred text pages, the SEC settled on rules that became effective on April 21, 1999.¹⁹¹ In essence, the SEC gives an ECN two options. First, an ECN can choose to register as national securities exchange and meet the very expensive licensing requirements of the Securities and Exchange Act.¹⁹² Or, second, an ECN can choose to register as a "broker/dealer" and comply with

¹⁸⁸ There are repeated rumors of merger talks between NASD's Nasdaq Market Center (successor to the SuperMontage) System and Archipelago. E.g., "Nasdaq Sets Sight on Acquisitions," *Fin. Times Info. Global News Wire*, March 11, 2003.

These rumors ended with Nasdaq's acquisition of the BRUT ECN. INET, the largest and most powerful of the remaining independent ECNs, is likely to file for SRO status, or merge with one of the other regional exchanges. See Schmerken, *supra* note 146.

¹⁸⁹ In the last quarter of 2002, Instinet reported an operating loss of \$10 million. In 2002, Instinet posted a net loss of \$735 million, which included a one-time charge of \$102 million for the purchase of Island. See Isabelle Clary, "Reuters Mulling Instinet's Future," *Sec. Indus. News*, Feb. 17, 2003.

[Reuters continues to mull over the possibility of selling the Instinet Group, and the combination ENC/broker dealer remains available for the right buyer. Anderson, Owner of Big Stock Trading System is Said to be for Sale, New York Times, November 18, 2004, Section C2.](#)

[AMEX which had a net loss of \\$14.3 million from 2001 to 2003 has been spun-off by NASD to its members as of January 2005. Jed Horowitz, NASD Completes its Sale of Amex to Member Group, New York Times, January 4, 2005, Section C3.](#)

¹⁹⁰ Securities and Exchange Act Rel. No. 34-37619A (Sept. 6, 1996), 61 Fed. Reg. 48290 (Sept 12, 1996)

¹⁹¹ Sec. Exch. Act Rel. No. 43-40760 (December 8, 1998).

¹⁹² Consider the operations of a basic ECN. The owner of a large capacity computer writes software to match buyers and sellers, software that the owner believes will appeal to a large number of traders. Traders, both buyers and sellers, subscribe, pay a fee, log on, and place bid and ask orders. The computer matches the trades that it can in a pre-established format. The traders are then notified of the matches. Unmatched traders are either cancelled after a set period of time or forwarded to other markets. The software programs can and, without SEC involvement, would differ from one another in many respects: the

the special licensing requirements of a new Regulation ATS.¹⁹³ Both options come with substantial costs.

Under Regulation ATS, an ECN can participate in the ITS through the NASD/CAES outdated routing platform or through a regional exchange, in both cases paying a competitor access fees. An ECN trading in Nasdaq stock can post on the NASD System as a market maker or list on the new NASD Alternative Display Facility (ADF), paying substantial NASD fees in both cases. All but one of the existing ECNs, ArcaEx, has opted for Regulation ATS status rather than register as a securities exchange.¹⁹⁴ The ECNs complain that the NASD access fees add substantial costs to their operations and that the NASD equipment is “old and clunky.”¹⁹⁵ As a consequence, one ECN has

type of trader that the program allows to log on; the types of display of the size, price and participant identity for any pending orders; the types of access non-subscribers have to price quotes; the publication of the size, price and identity of participants in any successfully matched trade; and the mechanics of the matching process.

There are many variations of matching processes that might be used to attract traders. A software program could run a call auction at set times (the Arizona Stock Exchange), a continuous matching system with first-in-time priority (INET), or a crossing system that matches unpriced orders at a single price established in another market (Posit), for example. One of the more innovative systems that began with much fanfare and failed was the OptiMark system that allows traders to post orders for different amounts of securities at different prices.

If an ECN chooses to register as an exchange, it must develop a self-regulatory organization side to its business, an SRO. Consider what this entails. The SRO must include an internal compliance system for its owners and subscribers. The compliance system must include a “fair procedure” for any disciplinary actions. The SRO would also have to develop a package of rules designed, among other things, to prevent fraudulent and manipulative practices, to allocate fees for access to the ECN, and to regulate trading by owners and employees.

But why should the SEC require the owner of such a system to form an SRO? There is no traditional exchange membership to discipline. The ECN sells its services to subscribers and should be allowed to terminate subscribers at will or under other conditions set forth in the subscriber contracts. There are far fewer insiders to monitor. An ECN replaces floor brokers and specialists by a machine and technicians. There are minimal listing requirements for the stock traded. The drastic reduction in manpower at the point of trade in an ECN suggests that there need only be laws that require an ECN to operate free from fraud and to record an audit trade for trades (to detect insider trading and the like). Such a law might require that any ECN be honestly advertised to subscribers and deliver on its promises. There is no longer a need for complex monitoring and compliance systems on each trading system. If each ECN creates an SRO there will be, at minimum, excessive duplication among the various regulatory bodies of each ECN and an unnecessary cost burden on each ECN that must be passed on to subscribers in the form of higher fees.

¹⁹³ If an ECN chooses that alternative, it will fall under the jurisdiction of the NASD’s huge SRO, the NASDR, that covers all brokers/dealers in the securities industry. If an ECN attempts to avoid the burdens of creating and maintaining an SRO by not registering as an exchange, then it must register as a broker/dealer and be subject to the SRO subsidiary of NASD, the NASDR. Yet NASD ran two competing markets, the Nasdaq and the AMEX until January 2005, when the AMEX was spun-off to NASD members. See Horowitz, *supra* note 189. To eliminate potential conflicts of interest, the NASD took pains to separate the operation of its trading markets from the operation of its disciplinary arm through a holding company structure. Yet the parent corporation is still run by securities professionals who may have interests in one or more of the trading markets. (The logic of the separation of the divisions is obvious and ought to mature into a total separation of the two functions. NASD ought not run the NASDR.)

¹⁹⁴ INET continues to consider the possibility. See Schmerken, *supra* note 146.

¹⁹⁵ E.g., Robert Sales, *The Big Picture—ECN Evolution*, Wall Street & Technology, Feb. 1, 2003 at D6.

jumped to the ADF and another posts on a regional exchange. ECNs also attack the ADF system as using “obscure technology.”¹⁹⁶

Despite regulatory burdens, ECNs continue to take Nasdaq market share in trading volume. NASD first sought regulatory relief, complaining to the SEC of “regulatory arbitrage” and seeks to have a uniform set of rules across the various markets trading Nasdaq listed securities.¹⁹⁷ When the SEC balked, NASD fought back by spending \$100 million to develop the SuperMontage System (predecessor to the Nasdaq National Market Execution System) that is its own version of an ECN. In the original NASD proposal, however, the new system subordinated executions of large classes of ECN trades.¹⁹⁸ The NASD proposal discriminated against trades submitted to the new system by ECNs that did not accept automatic order executions. The SEC, barraged by angry ECN complaints, responded with a proposal that discriminated against only those ECNs that charged access fees.¹⁹⁹ A donnybrook ensued with ECNs negotiating for eight amendments to the SuperMontage proposal before the SEC adopted the new system. The amendment proposals continue post-adoption.²⁰⁰ As negotiated, the SuperMontage was not the threat to the large ECNs that people thought it would be; it has hurt the smaller ECNs, however.²⁰¹

The final SuperMontage system emerged with a complex labyrinth of trading choices. It was a Solomonic compromise of the highest order. “Directed” orders, orders sent to specific market centers, have to be oversized to limit dual liability problems. Parties sending “undirected” orders have four choices: (1) the usual order algorithm of the system; (2) the order exposed, successively, with time priority to defined market tiers;²⁰² (3) the order exposed, successively, with size priority to defined market tiers; and (4) a reduced priority for ECNs charging separate access fees unless the ECN’s quote net of fees is still the best price.

There is much potential mischief in the SEC’s role of monitoring ECNs. The SEC cannot resist the temptation to tinker with the operating characteristics of ECNs —

¹⁹⁶ See Domestic Securities, note 10 supra, at 249.

¹⁹⁷ See Clary, infra note 201.

¹⁹⁸ See generally Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Exch. Act Rel. 34-42,166 (Nov. 22, 1999); Securities Exchange Act Release No. 43863 (January 19, 2001), 66 Fed. Reg. 8020 (January 26, 2001).

¹⁹⁹ For a history see Borrelli, supra note 6, at 869- 878.

²⁰⁰ The most recent is Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Clarifying the Operation of the Daily Opening Process in Nasdaq’s Nasdaq Market Center (successor to the SuperMontage) System, SEC Rel. No. 34-47735, April 24, 2003. Another important request is Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Regarding Fees for the Reporting of Nasdaq Market Center (successor to the SuperMontage) Transactions through the Automated Confirmation Transaction Service (“ACT”), SEC Exch. Act Rel. No.34-47621, April 2, 2003[Nasdaq is asking to lower access fees for reporting internalized orders to compete with lower fees charged, among others, Island by the National Stock Exchange].

²⁰¹ Isabelle Clary, “Track, NexTrade Cut Trading Fees,” Sec. Indus. News (Jan. 6, 2003).

²⁰² The tiers are (i) quotes or orders of market makers and ECNs and UTP agency orders; (ii) reserve size of market makers and ECNs; and (iii) principal quotes of UTP (Unlisted Trading Privilege) exchanges.

all in the name of consumer welfare, of course. For example, in a classic misstep, the SEC required all ECNs registered under Regulation ATS to publicly display the full size of its best buy and sell orders if the ECN volume in a security is five percent or more of the security's average daily volume.²⁰³ Thus if an ECN grows significantly, processing a higher volume of orders, it may have to alter its operating system to allow for such display. Moreover, a five percent volume limits an ECN to using a "reserve system" method of hiding full order size if a trader wants to retain the ability to post single large orders in a way that does not immediately come to the attention of other dealers. The SEC has also required Regulation ATS ECNs to afford non-subscribers execution access to ECN quotes for "fair fees" again at a five percent threshold.²⁰⁴ But an ECN's control over its subscriber base is a crucial aspect of its overall business strategy.

The SEC, in settling the dispute between NASD and the ECNs, found itself in the too comfortable position of arbitrating a dispute between competitors that, in essence, micro-structured the new computerized trading markets. These tortured, nuanced negotiations over the routing practices of the SuperMontage System were just the beginning of a larger negotiation. Just as the basic procedure of the Foreign Corrupt Practices Act of 1977, narrowly applied to control bribery abroad, produced the Sarbanes-Oxley Act of 2002 that broadly applied the same procedure to all internal accounting and disclosure procedures, the SuperMontage rule making presaged a much larger negotiation over computerized order routing and execution market wide that manifest in Regulation NMS. The new Regulation may give the SEC the breakthrough precedent it has sought for so long—the opportunity to fashion the creation and operation of an over-arching national computerized market system.

So where are we? The existing structure of the securities markets in the United States is excessively complex and it has been created primarily by, or with the approval of, the SEC. Years of particularized rule making have accumulated to encrust our securities markets. Traders and trading centers now engage in regulatory arbitrage, seeking loopholes in the regulatory system,²⁰⁵ for short-term advantages and the SEC struggles with the cries of injured participants. And yet with each new initiative, the SEC claims it has acted with self-restraint, modestly, only at the margins, and in cooperation with market participants.²⁰⁶ So the SEC can claim, after having overseen the creation of a cumbersome, overly-regulated system, with multiple tiers and sub-tiers, that with each new rule it will "let the markets work" and act "incrementally."²⁰⁷

An Alternative SEC History

²⁰³ Regulation ATS, 63 Fed.Reg. 70844 (1998) at 70847; 17 CFR 242.301(b)3).

²⁰⁴ Reg. ATS, 63 Fed. Reg. at 70847; 17 CFR 242.301(b)4). An ECN must open its membership if it trades over twenty percent of the average daily volume in a security. Id. at 70873. 17 CFR 242.301(b)5). The SEC has proposed in Regulation NMS to lower the threshold to 5%. SEC Rel. No. 34-50870 at 117-118.

²⁰⁵ E.g., Clary, *supra* note 150 (ECNs reporting on regional exchanges have lower reporting fees, lighter regulatory burdens, and a more permissive short-sale rule).

²⁰⁶ E.g., SEC Rel. No. 34-50870 at 10 ("Commission has sought to avoid the extremes...").

²⁰⁷ Id. at 11 ("The Commission ... [creates] intermarket 'rules of the road' [to] establish a framework within which competition among individual markets can flourish...").

One of my favorite books on the Civil War speculates on the outcome of the Battle of Gettysburg and the War itself given different decisions by Confederate Generals of each major day of the battle.²⁰⁸ It is a great read, provocative, and, in a way, pointless. In the same vein, one can ask where would we be had there been an alternate SEC after 1975 -- a SEC that followed a less ambitious path on the creation of a national market system, a SEC that in my view stayed within the outlines of Congress's purpose and intent behind the 1975 Amendments.

Consistent with the analysis above, there would be competing cross-market information processors collecting last sale and other transaction data and collecting quotations from independent trading market centers. The market centers themselves would not have any ownership or management positions in the processors. Individual processors could ask for, process, and package the information from trading centers as they saw fit and negotiate on fees. The SEC would monitor the accuracy of the processors and watch for anti-competitive fee arrangements. The market centers could publish initially their transaction and quotation data themselves or provide it to the processors for initial publication. There would no be discrimination in fees charged any processors by any of the market centers unless based on objective, neutral business related criteria. If centers do choose to self-publish the data, the SEC would ensure that processors could republish the information.²⁰⁹

Order execution systems would depend entirely on market center designed processes, accurately communicated to traders. The SEC would monitor the accuracy of the disclosures and enforce rules against misleading practices or conduct. Order execution systems that were the most efficient would attract the most traders. Each center would be responsible for creating, on its own or with others, an audit trail for surveillance purposes.

All market center rules and practices designed to restrain members, market makers, broker-dealers, traders, securities, or firms from acting in several markets or from routing trades easily from one market to another or among markets would have been eliminated. Refusals to deal and cartels would be disfavored and subject to traditional antitrust analysis and scrutiny. There could, for example, be no execution discrimination in one market of trades originating in another or of trades originating with non-members if not based on some neutral criteria such as price or time priority. Any market center could list and trade any security and could choose to qualify or otherwise classify listed securities under neutral, objective criteria. Mergers among market centers would be subject to a monopolization (Clayton Act) test.

Any order routing procedures between market centers would occur naturally, as market center affiliates could choose to be members of each other, or be negotiated at the market level, the subject of joint venture agreements, both with minimal SEC direction and involvement. Only if a joint venture raises anti-competitive concerns under a

²⁰⁸ Alternate Gettysburgs (Brian Thomson & Martin Greenberg eds. 2002)

²⁰⁹ At no charge? This would encourage the centers to negotiate with processors for fees for the data.

traditional anti-trust merger analysis should the SEC intervene.²¹⁰ Otherwise traders are free to route orders to the market of their choice using their own market comparison systems and their own routing procedures. Market makers and other broker-dealer intermediaries would have to accurately describe to customers and traders their routing practices and preferences.²¹¹ The SEC's primary role would enforce the quality and truthfulness of the disclosures.

I suspect that under such a system, several, privately-owned²¹² computerized execution systems would dominate the trading market and that they would come and go as technology improves and as traders' preferences change. Customers with sophistication could choose to use a preferred system without resort to financial intermediaries. We would not have open outcry pits or auction floors, nor would we have a geographical convergence in New York or Chicago.

But, as noted above, this speculation is, in a sense, pointless. We are well down another path, one to a quasi-centralized trading market, with very powerful interest groups holding a stake in existing and evolving structures. The SEC having chosen and groomed this path is now committed, ironically, to acting "incrementally." To this author it appears that the SEC is unlikely to retrace its steps.

Conclusion

The SEC has currently in its hands and extraordinary array of rule requests and initiatives on essential elements of the United States securities market structure.²¹³ Market participants wait while the SEC ponders.²¹⁴ With each new SEC pronouncement, the market participants will adapt; some will get or maintain a step and some will lose a step in the competition. And there will be a new round of rule requests with affected parties seeking modifications and exemptions, whatever the SEC decision.

²¹⁰ The stranglehold of an ITS on trading listed stock would not happen, as markets in which market makers could route orders to markets offering better prices would occur naturally. Moreover, order routing could occur either through an ITS like system or through a system of diffuse, privately developed communication channels or both.

²¹¹ Pressure from customers would cause intermediaries to establish and advertise their own form of best execution practices.

²¹² They could be privately-held, publicly-traded or not-for-profit trade associations, as the NYSE is now. I suspect that the publicly-traded companies would have a competitive advantage over the other two forms and that the publicly-traded form will dominate.

²¹³ To list some of them: The Nasdaq wants exchange status and has also petitioned for "uniform rules" for all markets trading Nasdaq listed shares; ECNs want rules rewritten to enable them to trade listed shares; market centers want a new division of data revenue fees and market participants want lower market access fees; ECNs are contesting each other's access fees; Nasdaq is becoming an ECN and competing with other ECNs over which its parent NASD regulates and provides reporting services; Nasdaq's declining market share in its listed stock; mergers among the few remaining ECNs; the NYSE seems to want to eliminate the intermarket links, the CTA, CQS, and ITS; problems with locked and crossed markets in Nasdaq stock; problems with specialists behavior on the NYSE; questions about the governance procedures of the NYSE and other exchanges; requests to modify the trade-through rule on the ITS; and the never receding recommendations of academics for one centralized, automated trading market.

²¹⁴ Proposed Regulation NMS attempts to answer several of the questions. If the Regulation is implemented, however, there will be more.

The SEC would be well advised to consider the current predicament of the Federal Communications Commission, a federal agency that has made a hash out of regulating the exploding technology in the telecommunications business.²¹⁵ Clever regulatory ideas for telecommunications have turned into business straightjackets.²¹⁶ Business niches now flourish or dry up with each regulatory pronouncement.²¹⁷ No one in the industry is happy and yet proposals for sensible regulatory changes create nothing but logjams as offsetting powerful, vested interests square off in the political arena.²¹⁸

At issue is whether the SEC will stumble into a similar thicket.

Professor Walter Werner wrote in exasperation on the debate over the 1975 amendments that “[t]he best thing that can be said about government’s past regulation of market structure is that the market survived it.... But the markets may not continue to be so durable.”²¹⁹ His words ring true today.

²¹⁵ E.g., David C. McCourt, *The Telecom (Better Later Than Never) Revolution*, *Wall St. J.*, Jan. 4, 2005, at B8.

²¹⁶ Steven Rosenbush et al., *What Hath the FCC Wrought?*, *Bus. Wk.*, March 10, 2003 at 38.

²¹⁷ See *Health of Telecommunications Sector: Hearing Before the House Energy and Commerce Comm’n*, (Feb. 5, 2003)(statement of Robert C. Atkinson, Director of Policy Research-CITI, Columbia University)(describing the “legal gridlock” effects on the telecom sector).

²¹⁸ See, e.g., Steve Rosenbush & Peter Elstrom, *8 Lessons From the Telecom Mess*, *Bus. Wk.*, Aug. 13, 2001

²¹⁹ Werner, *supra* note 8, at 1297.