

# Securities Regulation Daily Wrap Up, EXCHANGES AND MARKET REGULATION—S.D.N.Y.: Court dismisses attempt to short circuit administrative process in HFT suit, (Apr. 29, 2015)

By John M. Jascob, J.D.

A federal district court has dismissed a plaintiff's attempt to short circuit the SEC's administrative process by bringing breach of contract claims directly against equities exchanges for providing an unfair data advantage to high frequency traders. Judge Katherine Forrest of the Southern District of New York held that the comprehensive federal scheme for regulating the securities markets preempted state law claims that the exchanges had breached their contract with the plaintiff by making market data available to preferred data customers more quickly than other customers, thereby violating Regulation NMS. Accordingly, Judge Forrest held that the plaintiff's claims against the exchanges must be adjudicated in the first instance by the SEC, and not the courts ([Lanier v. BATS Exchange, Inc.](#), April 28, 2015, Forrest, K.).

**Background.** The suit is [one of several](#) that have followed the 2014 publication of author Michael Lewis's bestselling book, *Flash Boys*, which argued that high-frequency traders (HFTs) have been able to gain an unfair advantage in the U.S. equities market because equities exchanges have permitted HFTs to pay premium prices to obtain and trade on market data faster than other investors. In this suit, plaintiff Harold Lanier brought a purported class action against BATS Exchange, Inc. and several other equities exchanges, making the novel factual allegation that the exchanges have allowed certain "preferred data customers" to receive unconsolidated market data before that data arrives at the processor responsible for consolidating it and distributing it to other customers. Lanier further alleged that in an effort to increase profits through subscription fees or the volume of market activity on their exchanges, the defendants breached their contractual promise under state law to provide him and other subscribers

with the market data in a non-discriminatory manner by enabling preferred data customers such as HFTs to have advance access to the information.

**Exclusive federal scheme.** The court held, however, that Lanier's claims were preempted by the Exchange Act and Regulation NMS thereunder. The court observed that Rule 603 of Regulation NMS requires self-regulatory organizations such as the exchanges to act jointly under plans approved by the SEC to disseminate, on a non-discriminatory basis, consolidated information regarding quotations for or transactions in national market system (NMS) stocks. When a party believes he or she has been aggrieved by another's failure to comply with Regulation NMS, that party may apply to the SEC for review. SEC administrative decisions can then be appealed to a federal court of appeals.

Lanier contended that the exchanges violated their contractual obligations to him under his subscriber agreement by providing unconsolidated data to preferred data customers via proprietary feeds, enabling them to receive data as much as 1,499 microseconds earlier than other subscribers. The problem with this argument, the court reasoned, was that the SEC has acknowledged that the SROs' use of proprietary feeds may allow certain traders to gain speed advantages but has, nonetheless, approved their use in a number of Exchange Act releases. Awarding Lanier relief on his breach of contract claim would require the court to determine that the exchanges were violating the plans, even though the SEC's Exchange Act releases indicate that the SEC does not believe that this conduct violates the plans. If Lanier were to succeed on his contract claims, therefore, there would be a conflict between state law and federal law.

Moreover, the court continued, it was clear that Congress intended to create a comprehensive federal regulatory scheme governing the dissemination of data in a national market system. This intent is revealed by the breadth and depth of the scheme, which encompasses rules and regulations developed by both the SEC and SROs, SEC oversight, and an SEC adjudication process subject to appeal to in federal court. The court noted that Rule 608 of Regulation NMS provides Lanier with a means of seeking redress for his concerns before an SEC tribunal and obtaining relief consistent with that

authorized by Congress. Accordingly, the court held that Lanier's claims were preempted and must be dismissed.

The case is [No. 14-cv-3745 \(KBF\)](#).

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Companies: BATS Exchange, Inc.; EDGA Exchange, Inc.; Chicago Board Options Exchange, Inc.; NASDAQ OMX BX, Inc.; National Stock Exchange, Inc.

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