Securities Regulation Daily Wrap Up, TOP STORY—S.D.N.Y.: Trading venues say HFT case for SEC, appeals courts, (Nov. 4, 2014)

Securities Regulation Daily Wrap Up

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By Mark S. Nelson, J.D.

Exchanges accused of letting high frequency trading (HFT) firms engage in activities that may flaunt securities regulations have asked a federal district court judge to dismiss a class action complaint filed against them earlier this year. The exchanges said the court lacks jurisdiction because the securities laws endow the SEC and federal appellate courts with power to hear or review these claims. The broker-dealer defendant said claims against it ought to be dismissed too because they mimic a state attorney general's separate law suit and fail to state any actionable claims (*City of Providence, et al. v. BATS Global markets, Inc. et al.*, November 3, 2014 [Barclays]; *City of Providence, et al. v. BATS Global markets, Inc. et al.*, November 3, 2014 [Exchanges]).

Exchanges' regulatory duties. According to the exchanges, the district court lacks subject matter jurisdiction over the plaintiffs' HFT claims, which must be pursued under the Exchange Act's administrative track. That means an aggrieved party must bring their claims first to the SEC; a losing party can then ask a federal appellate court to review the SEC's final order.

Lawyers for the exchanges said the plaintiffs' claims implicate public interest and investor protection concerns that fall within the SEC's "plenary" Exchange Act authorities. Many of the HFT activities flagged by the plaintiffs also fall within the SEC's authority to review actions taken by exchanges under Regulation NMS. As for the use of proprietary data feeds, the exchanges said the SEC interprets Regulation NMS to mean that data feeds cannot be sent to a vendor before they are sent to a processor, but that exchanges need not worry over when end users get the data.

Moreover, said the exchanges, cases decided in Second and D.C. Circuits, and in the Southern District of New York, hold that claims like the ones alleged here cannot be heard in federal district courts because this would upset Congress's overall scheme for the regulation of exchanges.

The exchanges also invoked absolute immunity from private damages suits for exercising their delegated, quasi-governmental powers. The federal securities laws generally confer immunity on exchanges for performing these duties, but exchanges' actions can be reviewed by the SEC and federal appeals courts. According to the exchanges, they are immune from claims about their dissemination of market data (a core regulatory function) and for their role in permitting complex orders and payment for order flow programs (part of their market oversight duties and other delegated powers).

The exchanges also countered the plaintiffs' bid to "plead around" absolute immunity by citing Second Circuit precedent holding that the exchanges' profit motive is inapt when judging immunity matters. In a footnote, the exchanges said the SEC approved their for-profit status.

Lastly, the exchanges told the court the plaintiffs did not state any claims. Exchange Act Sec. 6(b) claims should fail, they said, because although a private cause of action under this law once existed, mid-1970s amendments to the law, plus later Second Circuit cases and the Supreme Court's growing reluctance to imply private actions, all counsel against implying one here.

As for Exchange Act Sec. 10(b) and Rule 10b-5 claims, the exchanges said the plaintiffs cannot bring aiding and abetting claims, but they also failed to allege manipulation or deception. Likewise, the exchanges said the plaintiffs did not allege they bought or sold specific securities, failed to allege reliance based on the fraud-on-the-market doctrine (market for specific security was efficient) and could not rely on *Affiliated Ute*'s presumption, nor could the plaintiffs' vague allegations of loss causation and scienter be strong enough to avoid dismissal.

Copycat suit versus broker-dealer. Lawyers for Barclays PLC (Barclays) said the banks' broker-dealer division was the victim of a law suit cloned from one filed by New York's Attorney General. The original complaint here never made substantive allegations against Barclays, but it did refer to the bank. Barclays even raised a question about whether the plaintiffs' investigation of their Barclays allegations met FRCP Rule 11.

Meanwhile, New York's Attorney General (NYAG) filed a suit against Barclays in June of this year claiming that Barclays operated a dark pool that violated the Martin Act and Executive Law (state laws that do not require proof of typical securities fraud elements). Barclays has since asked the New York state judge hearing the suit to dismiss it for a variety of reasons, including the arguments it made last month to deflect ones NYAG lawyers made in an effort to persuade the judge to let the state case go forward.

Barclays asked the court here to strike the plaintiffs' allegations against it because they were copied nearly "verbatim" (including transcription errors) from the still unresolved NYAG suit. Barclays noted that the plaintiffs' amended complaint dropped the HFT firms and all of the broker-dealers, except for Barclays.

Barclays also asked to court to dismiss the amended complaint because the plaintiffs failed to allege misrepresentation with particularity. Barclays denied that it misled clients about the ways it could protect them from HFTs. Scienter allegations, said Barclays, relied on a flimsy economic profit motive or were too vague. Barclays deflected loss causation allegations by directing the court from away from the acts of its own alternative trading system (ATS) and instead pointed to the market-wide activities of electronic liquidity providers, whom it said the plaintiffs' seemed to admit most likely caused their losses.

Barclays also took a parting shot at the plaintiffs' reuse of allegations from the NYAG suit. Barclays said the NYAG suit, which invokes laws that do not require proof of many securities fraud elements, cuts in favor of dismissal.

Lastly, Barclays said it should not be held liable for the acts of HFT firms. For reasons akin to those raised by the exchanges, Barclays said Supreme Court precedent barred the plaintiffs from bringing private aiding and abetting claims. Moreover, Barclays said the plaintiffs failed to allege with particularity that it was primarily liable for the HFTs' acts because Barclays, as an ATS, tells its dark pool participants when trades are executed, but it sells no access to data about pending orders.

The case is No. 1:14-cv-02811-JMF [Consolidated Amended Complaint]; [Barclays's Motion to Dismiss]; [Exchanges' Motion to Dismiss].

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Companies: City of Providence, Rhode Island; Plumbers and Pipefitters National Pension Fund; State-Boston Retirement System; Employees' Retirement System of the Government of the Virgin Islands; Forsta AP-fonden; Chicago Stock Exchange, Inc.; Direct Edge ECN, L.L.C.; BATS Global Markets, Inc.; The Nasdaq Stock Market L.L.C.; Nasdaq OMX BX, Inc.; New York Stock Exchange, L.L.C.; NYSE Arca, Inc.; Barclays PLC

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