

Securities Regulation Daily Wrap Up, EXCHANGES AND MARKET REGULATION—2d Cir.: SEC weighs in against absolute immunity for exchanges, (Nov. 30, 2016)

Securities Regulation Daily Wrap Up

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By [Anne Sherry, J.D.](#)

Exchanges should not enjoy absolute immunity from suit for conduct that does not relate to their self-regulatory functions, the SEC argued in an amicus brief to the Second Circuit. The court invited the SEC to opine on certain issues in the private litigation against several large exchanges for advantaging high-frequency traders ([City of Providence v. Bats Global Markets, Inc.](#), November 28, 2016).

Catering to high-frequency traders. Institutional investors sued Bats Global Markets, the Chicago Stock Exchange, Direct Edge ECN, NYSE Arca, the NYSE, Nasdaq OMX, and Nasdaq for market manipulation. The suit alleges the exchanges committed fraud by providing proprietary services to high-frequency traders, allowing them faster access to market data. Specifically, the plaintiffs challenge the exchanges' provision of co-location services, proprietary data feeds, and certain complex order types.

On the plaintiffs' appeal from the Southern District of New York, the Second Circuit asked the SEC to file a brief setting forth its views on whether the district court had subject-matter jurisdiction and whether the exchanges had absolute immunity from the suit.

Jurisdictional issues. The SEC maintains that the securities laws do not divest the district court of subject-matter jurisdiction. Congress created a detailed scheme of administrative and judicial review for challenges to certain actions of SROs, but did not authorize the SEC to adjudicate fraud lawsuits brought by private parties against SROs.

No absolute immunity outside of self-regulatory function. Furthermore, the agency takes the position that the exchanges do not enjoy absolute immunity from suit for the challenged conduct. Absolute immunity is appropriate when exchanges are engaged in their self-regulatory functions; for example, an exchange should be immune when it disciplines its members for misconduct or suspends members from trading in listed securities. But that immunity does not extend to functions performed by an exchange in the operation of its own market, or to the sale of products and services arising out of those functions.

In 1998, the SEC expressed that registered exchanges could structure themselves as for-profit organizations; all of the exchanges subsequently did so. The brief notes that while the exchanges retained some regulatory functions, "they are also now businesses that compete with each other and with alternative trading systems to offer various products and system features for customers." Proprietary feeds and co-location services are products and services created and sold by the exchanges themselves, not a means of regulating brokers' conduct. In an environment of electronic trading, the SEC continues, complex order types are better understood as aspects of the exchanges' electronic system of processing, routing, and matching orders.

When an exchange is operating its own market and engaging in its own conduct, it is acting as a regulated entity, not a regulator. The SEC agrees that "the fact that an SRO has authority to regulate an activity does not imply that the SRO is acting as a regulator when it itself engages in that same activity" (*Lanier v. BATS Exchange, Inc.*, S.D.N.Y. 2015).

Preemption and preclusion would, however, protect SROs when a plaintiff's claims conflict with or otherwise obstruct the SEC's regulation of the exchanges, in the Commission's view. For example, if the SRO acted in accordance with rules subject to SEC oversight and supervision through the applicable statutory scheme, those

doctrines would apply. The SEC took no position of the outcome of such an analysis in the present case, citing the early stages of the litigation and its own enforcement activities.

The case is [No. 15-3057](#).

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Companies: City of Providence, Rhode Island; Employees' Retirement System of the Government of the Virgin Islands; Plumbers and Pipefitters National Pension Fund; Bats Global Markets, Inc.; Direct Edge ECN, LLC; Chicago Stock Exchange Inc.

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