Securities Regulation Daily Wrap Up, July 5, 2022, (Jul. 5, 2022)

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Securities Regulation Daily Wrap Up, TOP STORY—D.C. Cir.: Appeals court vacates SEC's order approving consolidated NMS plan, (Jul. 5, 2022)

By Anne Sherry, J.D.

The national securities exchanges filed a plan to consolidate market data even though they objected to the SEC's terms. An appeals court found that one of those terms required scrapping the whole plan.

The SEC exceeded its statutory authority when it ordered the national securities exchanges and FINRA to come up with a consolidated plan for market data that included non-SRO representatives. The Exchange Act specifically authorizes the SEC to include SROs when regulating the national market system but is silent on other industry participants, suggesting their exclusion. While the exchanges lost their other arguments for why the consolidated plan is invalid, the D.C. Circuit court could not sever the offending part, and thus vacated the entire order (*The Nasdaq Stock Market LLC v. SEC*, July 5, 2022, Henderson, K.).

In 2020, on the tenth anniversary of the market "flash crash," the SEC ordered the equity exchanges and FINRA to submit a new national market system plan (NMS plan) with a modernized governance structure for the production of public consolidated equity market data and the dissemination of trade and quote data from trading venues. This plan was subject to minimum terms and conditions, notably that the operating committee include individuals representing: (1) an institutional investor; (2) a broker-dealer with a predominantly retail investor customer base; (3) a broker-dealer with a predominantly institutional investor customer base; (4) a securities market data vendor; (5) an issuer of NMS stock; and (6) a person who represents the interests of retail investors. The SEC also required that the plan group SROs for voting based on corporate affiliation and that the plan's administrator be independent of any SRO that sells equity market data products.

The exchanges objected to these three terms, but they carried on with drafting a plan while reserving their rights to challenge its legality. Last August, the SEC issued an order approving the NMS plan.

Committee requirement invalid. The D.C. Circuit examined the three provisions of the plan challenged by the exchanges and concluded that the SEC lacked authority to require non-SRO representatives as voting members of the operating committee. The court skipped step one of its *Chevron* analysis (determining whether the enabling statute is silent or ambiguous) and went straight to step two: assessing whether the SEC's interpretation of the statute is reasonable.

The enabling statute, Exchange Act Section 11A, authorizes the Commission to "authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under the Exchange Act in planning, developing, operating, or regulating a national market system." The specific call-out of SROs implicated the canon of statutory construction *expressio unius est exclusio alterius*: by mentioning SROs, the statute impliedly excludes non-SROs. While this canon of construction is "sensitive to statutory context, especially in the administrative realm," the court determined that the context cut against the SEC's interpretation.

First, the implicit inclusion of non-SROs in the statute would render the mention of SROs superfluous. Second, the statute's focus on "matters as to which they share authority" qualifies the SROs' quasi-regulatory authority while explaining why they are granted such authority; the non-SROs lack similar statutory and regulatory

obligations. And third, other provisions of Section 11A authorizing the SEC to create advisory committees and employ outside experts, including establishing a "National Market Advisory Board" comprising certain non-SROs, suggest that Congress considered the possibility of allowing non-SROs a quasi-regulatory role in the NMS and decided against it.

Entire plan scrapped. The exchanges lost their challenges to the other two plan provisions: the allocation of SRO votes according to corporate affiliation and the requirement of an independent plan administrator. The former did not contravene Section 11A, and while the SEC did deviate from its past practice, it explained why it did so. As to the latter, the Commission was not required to consider the costs of the independence requirement in formulating a prophylactic rule.

Finding only one part of the plan invalid, the court considered whether to sever that provision from the plan or vacate the entire thing. It determined not to sever, observing that the SEC was focused on arriving at a single, consolidated plan including the three governance features and left other terms to the SROs. The court doubted that the SEC would have allowed the plan to be implemented piecemeal and lacking the committee representation requirement.

Furthermore, it was questionable whether the plan could function sensibly with the remaining two provisions in the absence of the committee governance provision. The plan requires that representatives of non-SROs hold one-third of the voting power on the committee and provides for an "augmented majority" voting structure that requires a two-thirds majority of all votes and a majority of SRO votes. If the court severed the order, this provision would require a two-thirds majority and a simple majority of the same contingent of SROs. "This one example highlights how the challenged features of [the plan] are 'intertwined' in such a way that makes severance problematic," the court wrote.

As to the order that started it all—the one directing the exchanges and FINRA to come up with a plan—that order remains in effect, but without the non-SRO representation requirement.

The case is No. 21-1167.

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