

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-61174)

Order Granting Application for Extension of a Temporary Conditional Exemption Pursuant to Section 36(a) of the Exchange Act by the International Securities Exchange, LLC Relating to the Ownership Interest of International Securities Exchange Holdings, Inc. in an Electronic Communications Network

December 16, 2009

I. Introduction

On December 22, 2008, the Securities and Exchange Commission (“Commission”) approved a proposal filed by the International Securities Exchange, LLC (“ISE” or “Exchange”) in connection with corporate transactions (the “Transactions”) in which, among other things, the parent company of ISE, International Securities Exchange Holdings, Inc. (“ISE Holdings”), purchased a 31.54% ownership interest in Direct Edge Holdings LLC (“Direct Edge”), the owner and operator of Direct Edge ECN (“DECN”), a registered broker-dealer and electronic communications network (“ECN”).<sup>1</sup> Following the closing of the Transactions (the “Closing”), Direct Edge’s wholly-owned subsidiary, Maple Merger Sub LLC (“Merger Sub”) began to operate a marketplace for the trading of U.S. cash equity securities by Equity Electronic Access Members of ISE (the “Facility”), under ISE’s rules and as a “facility,” as defined in Section 3(a)(2) of the Securities Exchange Act of 1934 (“Exchange Act”),<sup>2</sup> of ISE.<sup>3</sup>

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<sup>1</sup> See Securities Exchange Act Release No. 59135 (December 22, 2008), 73 FR 79954 (December 30, 2008) (order approving File No. SR-ISE-2008-85).

<sup>2</sup> 15 U.S. C. 78c(a)(2).

<sup>3</sup> Under Section 3(a)(2) of the Act, the term “facility,” when used with respect to an exchange, includes “its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service.”

DECN, which operates as an ECN and submits its limit orders to the Facility for display and execution, is an affiliate of ISE through ISE Holdings' equity interest in DE Holdings. DECN also is a facility, as defined in Section 3(a)(2) of the Exchange Act, of ISE because it is an affiliate of ISE used for the purpose of effecting and reporting securities transactions. Because DECN is a facility of ISE, ISE, absent exemptive relief, would be obligated under Section 19(b) of the Exchange Act to file with the Commission proposed rules governing the operation of DECN's systems and subscriber fees.

On December 22, 2008, the Commission exercised its authority under Section 36 of the Exchange Act to grant ISE a temporary exemption, subject to certain conditions, from the requirements under Section 19(b) of the Exchange Act with respect to DECN's proposed rules.<sup>4</sup> On June 19, 2009, the Commission extended this temporary exemption for an additional 180 days, subject to certain conditions.<sup>5</sup>

On November 16, 2009, ISE filed with the Commission, pursuant to Rule 0-12<sup>6</sup> under the Exchange Act, an application under Section 36(a)(1) of the Exchange Act<sup>7</sup> to extend the relief granted in the June Extension for an additional 180 days, subject to certain conditions.<sup>8</sup> This order grants ISE's request for a temporary extension of the relief provided in the June Extension, subject to the satisfaction of certain conditions, which are outlined below.

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<sup>4</sup> See Securities Exchange Act Release No. 59133 (December 22, 2008), 73 FR 79940 (December 30, 2008) ("Exemption Order").

<sup>5</sup> See Securities Exchange Act Release No. 60152 (June 19, 2009), 74 FR 30334 (June 25, 2009) ("June Extension").

<sup>6</sup> 17 CFR 240.0-12.

<sup>7</sup> 15 U.S.C. 78mm(a)(1).

<sup>8</sup> See letter from Michael J. Simon, General Counsel and Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated November 16, 2009 ("Extension Request").

II. Application for an Extension of the Temporary Conditional Exemption from the Section 19(b) Rule Filing Requirements

On November 16, 2009, ISE requested that the Commission exercise its authority under Section 36 of the Exchange Act to temporarily extend, subject to certain conditions, the temporary conditional exemption granted in the June Extension from the rule filing procedures of Section 19(b) of the Exchange Act in connection with ISE Holdings' equity ownership interest in DE Holdings and the continued operation of DECN as a facility of ISE.<sup>9</sup>

The Extension Request notes that on May 7, 2009, EDGA Exchange, Inc., and EDGX Exchange, Inc. (together, the "Exchange Subsidiaries"), two wholly-owned subsidiaries of DE Holdings, filed with the Commission Form 1 applications (the "Form 1 Applications") to register as national securities exchanges under Section 6 of the Exchange Act.<sup>10</sup> According to the Extension Request, DECN intends to file a "Cessation of Operations Report" with the Commission and to cease operations as an ECN shortly following any Commission approval of the Form 1 Applications and the Exchange Subsidiaries commencing operations as national securities exchanges.<sup>11</sup>

Because DECN will cease operations as an ECN if the Commission approves the Form 1 Applications, ISE expects that DECN will continue to operate as a facility of ISE for a relatively brief period.<sup>12</sup> In addition, ISE believes that it would be unduly burdensome and inefficient to require DECN's operating rules to be separately subject to the Section 19(b) rule filing process because the published rules of the Exchange Subsidiaries "substantially align with DECN's

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<sup>9</sup> See Extension Request at 1.

<sup>10</sup> Id. at 2. The Form 1 Applications have been published for notice and comment. See Securities Exchange Act Release No. 60651 (September 11, 2009), 74 FR 47827 (September 17, 2009) ("Form 1 Applications Notice").

<sup>11</sup> See Extension Request at 2.

<sup>12</sup> Id.

operations in practice and DECN is only operating temporarily as a facility of ISE while the Commission considers the Form 1 Applications.”<sup>13</sup>

ISE has asked the Commission to exercise its authority under Section 36 of the Exchange Act to grant ISE a 180-day extension of the June Extension’s relief, subject to certain conditions, from the Section 19(b) rule filing requirements that otherwise would apply to DECN as a facility of ISE.<sup>14</sup> The extended temporary conditional exemption would commence immediately and would permit the continued operation of DECN while the Commission considers the Form 1 Applications that, if approved, would allow the Exchange Subsidiaries to operate in place of DECN.<sup>15</sup> ISE believes that the extended temporary conditional exemption will help to ensure an orderly transition from DECN to the proposed Exchange Subsidiaries.<sup>16</sup>

ISE states, in addition, that the extended exemption will not diminish the Commission’s ability to monitor ISE and DECN.<sup>17</sup> In this regard, ISE notes that to the extent that ISE makes changes to its systems, including the Facility, during the extended temporary exemption period, or thereafter, it remains subject to Section 19(b) and thus obligated to file proposed rule changes with the Commission.<sup>18</sup> Further, in the Extension Request, ISE commits to satisfying certain conditions, as outlined below, which are identical to the conditions in the Exemption Order and

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<sup>13</sup> Id.

<sup>14</sup> Id.

<sup>15</sup> According to ISE, it would be impracticable for DECN to display its limit orders other than on the Facility. See Extension Request at 2-3.

<sup>16</sup> See Extension Request at 3.

<sup>17</sup> Id.

<sup>18</sup> Id.

the June Extension.<sup>19</sup> For example, as a condition to the extended temporary exemption, ISE will be required to submit proposed rule changes with respect to any material changes to DECN's functions during the exemption period.<sup>20</sup> ISE notes, however, that neither ISE nor DECN anticipates any material changes to DECN's functionality during the extended temporary exemption period.<sup>21</sup>

### III. Order Granting Extension of Temporary Conditional Section 36 Exemption

In 1996, Congress gave the Commission greater flexibility to regulate trading systems, such as DECN, by granting the Commission broad authority to exempt any person from any of the provisions of the Exchange Act and to impose appropriate conditions on their operation.<sup>22</sup> Specifically, NSMIA added Section 36(a)(1) to the Exchange Act, which provides that “the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of [the Exchange Act] or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.”<sup>23</sup> In enacting Section 36, Congress indicated that it expected that “the Commission will use this authority to promote efficiency, competition and

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<sup>19</sup> ISE also represents that it has complied with the conditions in the Exemption Order and the June Extension and that it will continue to comply with these conditions during any extension of the relief granted. See Extension Request at 3.

<sup>20</sup> See Extension Request at note 6.

<sup>21</sup> See Extension Request at note 5.

<sup>22</sup> 15 U.S.C. 78mm(a). Section 36 of the Exchange Act was enacted as part of the National Securities Markets Improvements Act 1996, Pub. L. No. 104-290 (“NSMIA”).

<sup>23</sup> 15 U.S.C. 78mm(a)(1).

capital formation.”<sup>24</sup> It particularly intended to give the Commission sufficient flexibility to respond to changing market and competitive conditions:

The Committee recognizes that the rapidly changing marketplace dictates that effective regulation requires a certain amount of flexibility. Accordingly, the bill grants the SEC general exemptive authority under both the Securities Act and the Securities Exchange Act. This exemptive authority will allow the Commission the flexibility to explore and adopt new approaches to registration and disclosure. It will also enable the Commission to address issues relating to the securities markets more generally. For example, the SEC could deal with the regulatory concerns raised by the recent proliferation of electronic trading systems, which do not fit neatly into the existing regulatory framework.<sup>25</sup>

As noted above, in December 2008 the Commission exercised its Section 36 exemptive authority to grant ISE a temporary exemption, subject to certain conditions, from the 19(b) rule filing requirements in connection with the Transaction.<sup>26</sup> On June 19, 2009, the Commission extended ISE’s temporary exemption for an additional 180 days.<sup>27</sup> In addition, the Commission previously granted similar exemptive relief in connection with Nasdaq’s acquisition of Brut, LLC, the operator of the Brut ECN.<sup>28</sup>

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<sup>24</sup> H.R. Rep. No. 104-622, 104<sup>th</sup> Cong., 2<sup>d</sup> Sess. 38 (1996).

<sup>25</sup> S. Rep. No. 104-293, 104<sup>th</sup> Cong., 2<sup>d</sup> Sess. 15 (1996).

<sup>26</sup> See Exemption Order, supra note 4.

<sup>27</sup> See June Extension, supra note 5.

<sup>28</sup> See Securities Exchange Act Release No. 50311 (September 3, 2004), 69 FR 54818 (September 10, 2004). Although granting the ISE’s Extension Request would result in a temporary exemption longer than the exemption granted in connection with Nasdaq’s acquisition of Brut, LLC, the Commission believes that an extended exemption is warranted, in this case, to provide adequate time to address the regulatory issues raised by ISE’s ownership structure. In this regard, the Commission notes that, as a result of ISE’s equity ownership interest in Direct Edge, the non-U.S. owners of ISE will have an indirect ownership interest in Direct Edge and in the Exchange Subsidiaries, as well as in ISE. When the Commission approved the 2007 transaction in which ISE Holdings became a wholly-owned indirect subsidiary of Eurex Frankfurt AG, the corporate governing documents of ISE Holdings and its parent company, U.S. Exchange Holdings, and corporate resolutions adopted by the non-U.S. owners, included provisions (the “Regulatory Provisions”) designed to maintain the independence of the regulatory function of ISE, the sole national securities exchange then owned by ISE Holdings. See

Section 19(b)(1) of the Exchange Act requires a self-regulatory organization (“self-regulatory organization” or “SRO”), including ISE, to file with the Commission its proposed rule changes accompanied by a concise general statement of the basis and purpose of the proposed rule change. Once a proposed rule change has been filed with the Commission, the Commission is required to publish notice of it and provide an opportunity for public comment. The proposed rule change may not take effect unless approved by the Commission by order, unless the rule change is within the class of rule changes that are effective upon filing pursuant to Section 19(b)(3)(A) of the Act.<sup>29</sup>

Section 19(b)(1) of the Exchange Act defines the term “proposed rule change” to mean “any proposed rule or rule change in, addition to, or deletion from the rules of [a] self-regulatory organization.” Pursuant to Section 3(a)(27) and 3(a)(28) of the Exchange Act, the term “rules of a self-regulatory organization” means (1) the constitution, articles of incorporation, bylaws and

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Securities Exchange Act Release No. 56955 (December 13, 2007), 72 FR 71979 (December 19, 2007) (File No. SR-ISE-2007-101). In connection with ISE Holdings’ subsequent purchase of an ownership interest in Direct Edge, ISE has filed proposed changes to the governing documents of ISE Holdings and U.S. Exchange Holdings that apply the Regulatory Provisions to any national securities exchange, or facility there of, controlled, directly or indirectly, by ISE Holdings. *See, e.g.*, Securities Exchange Act Release Nos. 59135 (December 22, 2008), 73 FR 79954 (December 30, 2008) (File No. SR-ISE-2008-85) (approving changes to the Certificate of Incorporation and Bylaws of ISE Holdings); and 61005 (November 16, 2009) (notice of filing of File No. SR-ISE-2009-90) (proposing changes to Trust Agreement and to the Certificate of Incorporation and Bylaws of U.S. Exchange Holdings). Similarly, the Form 1 Applications included forms of supplemental corporate resolutions, to be adopted by the non-U.S. owners prior to any Commission approval of the Form 1 Applications. These supplemental corporate resolutions will apply the Regulatory Provisions to the Exchange Subsidiaries. Accordingly, the amended corporate governing documents of ISE Holdings and U.S. Exchange Holdings, and the supplemental corporate resolutions of the non-U.S. owners, will apply to the Exchange Subsidiaries following any Commission approval of the Form 1 Applications. In light of the time required to amend the corporate governing documents of ISE Holdings and U.S. Exchange Holdings, and to supplement the corporate resolutions of the non-U.S. owners, the Commission believes that it is appropriate to grant the ISE’s Extension Request.

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15 U.S.C. 78s(b)(3)(A).

rules, or instruments corresponding to the foregoing, of an SRO, and (2) such stated policies, practices and interpretations of an SRO (other than the Municipal Securities Rulemaking Board) as the Commission, by rule, may determine to be necessary or appropriate in the public interest or for the protection of investors to be deemed to be rules. Rule 19b-4(b) under the Exchange Act,<sup>30</sup> defines the term “stated policy, practice, or interpretation” to mean generally “any material aspect of the operation of the facilities of the self-regulatory organization or any statement made available to the membership, participants, or specified persons thereof that establishes or changes any standard, limit, or guideline with respect to rights and obligations of specified persons or the meaning, administration, or enforcement of an existing rule.”

The term “facility” is defined in Section 3(a)(2) of the Exchange Act, with respect to an exchange, to include “its premises, tangible or intangible property whether on the premises or not, any right to use such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service.”

In its Extension Request, ISE acknowledges that since the Closing, Merger Sub has operated the Facility as a facility of ISE.<sup>31</sup> Absent an exemption, Section 19(b) of the Exchange Act and Rule 19b-4 thereunder would require ISE to file proposed rules with the Commission to allow ISE to operate DECN as a facility of ISE.

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<sup>30</sup> 17 CFR 240.19b-4(b).

<sup>31</sup> See Extension Request at 1. As discussed above, ISE owns a 31.54% ownership interest in DE Holdings, the sole owner of Merger Sub.

In its Extension Request, ISE notes that the Exchange Subsidiaries have filed Form 1 Applications, which have been published for comment,<sup>32</sup> and that DECN intends to cease operations as an ECN shortly after any Commission approval of the Form 1 Applications and the Exchange Subsidiaries' commencement of operations as national securities exchanges.<sup>33</sup> Accordingly, ISE expects that DECN will continue to operate as a facility of ISE for a relatively brief period of time.<sup>34</sup> ISE represents that it has complied with the conditions in the Exemption Order and the June Extension and that it will continue to comply with these conditions during an extension of the relief granted in the June Extension.<sup>35</sup>

The Commission believes that it is appropriate to grant a temporary extension of the relief provided in the June Extension, subject to the conditions described below, to allow DECN to continue to operate as a facility of ISE without being subject to the rule filing requirements of Section 19(b) of the Exchange Act for a temporary period.<sup>36</sup> Accordingly, the Commission has determined to grant ISE's request for an extension of the relief provided in the June Extension, subject to certain conditions, for a period not to exceed 180 days. The Commission finds that the temporary extended conditional exemption from the provisions of Section 19(b) of the Exchange Act is appropriate in the public interest and is consistent with the protection of investors. In particular, the Commission believes that the temporary extended exemption should help promote

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<sup>32</sup> See Form 1 Applications Notice, supra note 10.

<sup>33</sup> See Extension Request at 2. The Commission must approve an application for registration as a national securities exchange, or institute proceedings to determine whether the application should be denied, within 90 days of publication of notice of filing of the application, or within such longer period as to which the applicant consents. See Exchange Act Section 19(a)(1), 15 U.S.C. 78s(a)(1).

<sup>34</sup> Id. at 2.

<sup>35</sup> Id. at 3.

<sup>36</sup> In granting this relief, the Commission makes no finding regarding whether ISE's operation of DECN as a facility would be consistent with the Exchange Act.

efficiency and competition in the market by allowing DECN to continue to operate as an ECN for a limited period of time while the Commission considers the Form 1 Applications. In this regard, the Commission notes ISE's belief that it would be unduly burdensome and inefficient to require DECN's operating rules to be separately subjected to the Section 19(b) rule filing and approval process because DECN will operate only temporarily as a facility of ISE while the Commission considers the Form 1 Applications. In addition, the Commission notes that the Form 1 Applications, which include the rules of the Exchange Subsidiaries, were published for comment on September 17, 2009.<sup>37</sup> According to ISE, the rules of the Exchange Subsidiaries "substantially align" with DECN's operations in practice.<sup>38</sup> Accordingly, the publication of the Form 1 Applications should help to mitigate any concerns regarding transparency with respect to the rules under which DECN operates temporarily as a facility of ISE.

To provide the Commission with the opportunity to review and act upon any proposal to change DECN's fees or to make material changes to DECN's operations as an ECN during the period covered by the extended temporary exemption, as well as to ensure that the Commission's ability to monitor ISE and DECN is not diminished by the extended temporary exemption, the Commission is imposing the following conditions while the extended temporary exemption is in effect.<sup>39</sup> The Commission believes such conditions are necessary and appropriate in the public interest for the protection of investors. Therefore, the Commission is granting to ISE an extended temporary exemption, pursuant to Section 36 of the Exchange Act, from the rule filing

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<sup>37</sup> See Securities Exchange Act Release No. 60651 (September 11, 2009), 74 FR 47827 (September 17, 2009).

<sup>38</sup> See Exemption Request at 2.

<sup>39</sup> See Extension Request at note 6.

requirements imposed by Section 19(b) of the Exchange Act as set forth above, provided that ISE and DECN comply with the following conditions:

- (1) DECN remains a registered broker-dealer under Section 15 of the Exchange Act<sup>40</sup> and continues to operate as an ECN;
- (2) DECN operates in compliance with the obligations set forth under Regulation ATS;
- (3) DECN and ISE continue to operate as separate legal entities;
- (4) ISE files a proposed rule change under Section 19 of the Exchange Act<sup>41</sup> if any material changes are sought to be made to DECN's operations. A material change would include any changes to a stated policy, practice, or interpretation regarding the operation of DECN or any other event or action relating to DECN that would require the filing of a proposed rule change by an SRO or an SRO facility;<sup>42</sup>
- (5) ISE files a proposed rule change under Section 19 of the Exchange Act if DECN's fee schedule is sought to be modified; and
- (6) ISE treats DECN the same as other ECNs that participate in the Facility, and, in particular, ISE does not accord DECN preferential treatment in how DECN submits orders to the Facility or in the way its orders are displayed or executed.<sup>43</sup>

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<sup>40</sup> 15 U.S.C. 78o.

<sup>41</sup> 15 U.S.C. 78s.

<sup>42</sup> See Section 19(b) of the Exchange Act and Rule 19b-4 thereunder. The Commission notes that a material change would include, among other things, changes to DECN's operating platform; the types of securities traded on DECN; DECN's types of subscribers; or the reporting venue for trading that takes place on DECN. The Commission also notes that any rule filings must set forth the operation of the DECN facility sufficiently so that the Commission and the public are able to evaluate the proposed changes.

<sup>43</sup> See Extension Request at note 6.

In addition, the Commission notes that the Financial Industry Regulatory Authority is currently the Designated Examining Authority for DECN.

For the reasons discussed above, the Commission finds that the extended temporary conditional exemptive relief requested by ISE is appropriate in the public interest and is consistent with the protection of investors.

IT IS ORDERED, pursuant to Section 36 of the Exchange Act,<sup>44</sup> that the application for an extended temporary conditional exemption is granted for a period of 180 days, effective immediately.

By the Commission.

Florence E. Harmon  
Deputy Secretary

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<sup>44</sup> 15 U.S.C. 78mm.