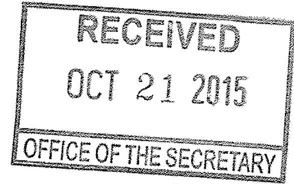

Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Petitions of: BATS Global Markets, Inc. BOX Options Exchange LLC KCG Holdings, Inc. Miami International Securities Exchange, LLC and Susquehanna International Group, LLP	)	File No. SR-OCC-2015-02

REPLY MEMORANDUM IN FURTHER SUPPORT OF PETITIONERS' MOTION FOR AN ORDER (1) REFERRING THIS MATTER TO A HEARING OFFICER FOR THE TAKING OF ADDITIONAL EVIDENCE, AND (2) DIRECTING DISCOVERY IN ADVANCE OF THE HEARING

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Petitioners[1] respectfully submit this reply memorandum in further support of their motion pursuant to Rule 452[2] of the Rules of Practice for an order (1) referring this matter to a hearing officer for the taking of additional evidence, and (2) directing discovery in advance of the hearing.

INTRODUCTION

OCC's opposition to Petitioners' motion does not dispute the obvious holes in the administrative record. These include, among others, OCC's failure to produce: (i) any data concerning its *current* capital levels or financial condition, which would likely confirm that OCC is close to achieving its inflated Target Capital Requirement in the next six months *without the Plan*; (ii) the consultant's report that OCC claims was the basis for the Plan, which would likely show that OCC's Target Capital Requirement is dubious; and (iii) details concerning alternative plans for raising capital, which would likely demonstrate that OCC chose (through a conflicted process) to approve the high-cost Plan that enriches its Exchange Owners over less costly plans that were more favorable to OCC and public investors. Without these basic facts – all of which are in the exclusive possession of OCC and/or its Exchange Owners – the administrative record before the Commission is insufficient for the Commission to make the reasoned decision on the propriety of OCC's proposed Plan that the Exchange Act requires.

OCC admits that the Commission has the authority to supplement the record and grant the relief Petitioners request,[3] but urges the Commission not to do so. OCC argues that Petitioners are attempting to delay implementation of the Plan, and have not shown that the

[1] Unless otherwise defined herein, capitalized terms have the meaning ascribed to them in Petitioners' moving brief.

[2] 17 CFR § 201.452.

[3] OCC Opp. at 7.

evidence they seek is "material" or explained why they did not seek that evidence earlier. Contrary to OCC's contentions, Petitioners do not seek to "delay" the proposed Plan, but rather have been explicit in seeking to *reverse* it, particularly now that the limited available evidence appears to confirm that OCC's recent and projected capital levels render the Plan moot.

More fundamentally, all of the evidence Petitioners seek is directly relevant to the grounds for reversing the Plan – that the Plan is unnecessary in light of OCC's projected capital levels; that OCC's Target Capital Requirement is inflated, pretextual, and unjustified; and that the Plan is the product of a conflicted process manipulated by the Exchange Owners for their own financial benefit at the expense of the investing public. OCC is thus wrong in arguing that the evidence Petitioners seek is not "material." Indeed, Petitioners' motion is expressly tailored to procuring the precise and essential information that the Commission needs to properly determine whether to approve or disapprove the Plan.

OCC is also wrong in contending that Petitioners cannot invoke Rule 452 because they have not explained why they failed to adduce the evidence sought previously. The rule language OCC invokes is not applicable here because there have been no prior hearings or other opportunities when the parties could have elicited evidence from each other. Nor can OCC reasonably claim that Petitioners should have filed this motion earlier. OCC's suggestion that Petitioners should have undertaken the bizarre and unprecedented step of moving the Commission to compel testimony and the production of documents in the midst of a comment period of a Section 19(b) rulemaking process cannot be taken seriously. At the comment stage, Petitioners were not "parties" that could file such a motion. Thereafter, while Petitioners' petitions for review were pending, it would have been premature to ask for a hearing to obtain evidence to aid the Commission's review before the Commission agreed to undertake that

review. Indeed, it is beyond dispute that throughout both the comment and petition processes, Petitioners have repeatedly identified factual gaps in the record,[4] and OCC has repeatedly declined opportunities to fill those gaps with relevant factual information. Regardless, Petitioners' motion is timely because Rule 452 provides that a "party may file a motion for leave to adduce additional evidence *at any time prior to the issuance of a decision by the Commission.*"[5]

As reflected previously,[6] using OCC's tax rate assumptions, in just seven years it is projected that the Exchange Owners will receive a cumulative dividend exceeding $180 million – $30 million more than their aggregate capital contributions. Extrapolating beyond seven years, the Exchange Owners will receive more than $1 billion in cumulative dividends alone (without even considering capital account increases) within the next 24 years (and a second billion dollars over the following 12 years),[7] an extraordinary and gratuitous payment, especially considering

[4] *See, e.g.*, Letter from Richard J. McDonald, Chief Regulatory Counsel, Susquehanna Investment Group (February 27, 2015), at 2 ("[T]here remains the opportunity to more thoughtfully present and deliberate the critical, unprecedented issues and impacts of this rule filing. Accordingly, we respectfully request the opportunity to address these points with the Commissioners before a decision is reached in this matter."); Letter from Howard L. Kramer on behalf of Belvedere Trading, CTC Trading Group, IMC Financial Markets, Integral Derivatives, Susquehanna Investment Group, and Wolverine Trading, (February 20, 2015), at 2-5, 7-8; Letter from Tony McCormick, CEO, BOX Options Exchange (February 19, 2015), at 2-5; SIG Petition for Review, at 3, 4-5, 15-16, 23-24, 26, 27; SIG Opp. to Mot. to Lift Automatic Stay, at 10, 13, 20-21; BATS Petition for Review, at 3-5, 10, 13-19; KCG Petition for Review, at 8-9; MIAX Petition for Review, at 5-6, 9, 10; BOX Petition for Review, at 3, 8-9.

[5] 17 CFR § 201.452 (emphasis added).

[6] SIG Opp. to Mot. to Lift Stay, at 20.

[7] This estimate is based on a conservative average annual budget increase rate of 4%. While OCC claimed to project a 2.3% annual rate of increase, this is unrealistic and self-serving in view of its historical annual budget increase rate of 6.5% and its 15% average rate over the last few years, and contradicts OCC's dire representations of regulatory expense increases. OCC's artificially low estimate also ignores the upward pressure from the conflicted Exchange Owners who would stand to receive higher dividends under the Plan the more OCC's expenses increase. Moreover, listed option volume more than tripled from 2004 to 2014 and had more than tripled in the ten years prior, and is expected to continue to grow appreciably.

that the Plan is no longer needed. Thus, the Commission currently has before it OCC's proposal to fundamentally transform a monopoly SRO and thereby effectuate *a billion dollar wealth transfer from the marketplace to the five Exchange Owners that control OCC*. The Commission should decline OCC's invitation to decide this important matter of public policy based on a record of unsupported statements and fragments of information OCC has unilaterally decided to share. That would not be reasoned decision-making, as the Exchange Act, the Administrative Procedures Act, and controlling appellate precedent require. Instead, the Commission should grant this motion so that the record can be supplemented with the critical, fundamental information and data that are currently missing and are necessary for the Commission's review.

ARGUMENT

As Petitioners demonstrated in their moving brief, the Exchange Act requires the Commission to make affirmative findings before it can approve an SRO's proposed rule change,[8] and the Commission cannot make those required findings if the record before it is insufficient. OCC does not dispute these points. Nor does OCC "dispute that the Commission has the authority to allow the record to be supplemented under Rule 452, or that there have been cases where such supplementation was warranted."[9] This is precisely such a case. Petitioners have shown with particularity numerous categories of material information that OCC has failed to provide, and demonstrated why that information is necessary and relevant to the Commission's review.

[8] 15 U.S.C. § 78s(b)(2)(C)(i).

[9] OCC Opp. at 7.

I. The Evidence the Petitioners Seek Is Material To The Commission's Review

A. The Commission Should Obtain Additional Evidence Concerning OCC's Current Capital Levels

It is self-evident that the Commission should have before it all of the facts concerning OCC's current and projected financial condition before deciding whether to approve or reverse OCC's transformative and controversial Plan. It is difficult to imagine evidence that is more fundamental to the Commission's review. Determining whether the growth in OCC's capital levels as a result of its fee increases has rendered (or will soon render) the Plan moot is critical to assessing whether the Plan is consistent with the Exchange Act.

OCC buries its response to this issue on page 14 of its memorandum, and addresses it in less than one page. Incredibly, OCC still refuses to (i) explain how it calculated the approximately $150 million in "adjusted shareholders' equity" it reported as of August 31, 2015, (ii) include refundable clearing fees in its capital calculations, (iii) provide any information concerning its *current* capital levels, or (iv) provide any information concerning its projected capital levels at year-end or beyond. Nor does OCC challenge Petitioners' argument – based on OCC's own figures – that OCC will reach its inflated Target Capital Requirement in six months *without the Plan.* Instead, OCC responds with the following: "OCC has provided information concerning its financial standing as of August 31, 2015, and has stated that [as of late 2014 it had concluded that] it would not achieve the level of capital provided by the Capital Plan until 2017."[10] This vague, outdated, conclusory statement is emblematic of the paucity of data and opacity in the record concerning OCC's current and projected capital levels, and demonstrates why discovery and an evidentiary hearing are necessary.

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[10] OCC Opp. at 14; *see also* Letter from James Brown, EVP and General Counsel, OCC (February 23, 2015), at 6 (letter in response to market maker firms).

In addition, OCC does not dispute that it omitted accrued and unpaid rebates for the last two years from its shareholders' equity calculation. OCC argues that including those rebates – which are projected to total at least $66 million by year-end – as available capital is "critically flawed" in that it ignores "taxes that would be due on retained fees."[11] The goal of this red herring is simple – to avoid the key question of when OCC will reach its Target Capital Requirement.

OCC's shareholders' equity (without accrued and unpaid rebates) grew from $97 million at the end of 2014 to approximately $150 million by August 31, 2015 (8 months later). This represents a nearly $20 million increase every quarter. Accrued and unpaid rebates were $33 million for 2014, equivalent to over $8 million in accrued and unpaid rebates every quarter. After being taxed at a 35% rate, over $5 million in post-tax accrued and unpaid rebates would be available every quarter to increase OCC's capital levels. Therefore, OCC's capital levels are increasing at an after-tax rate of $25 million per quarter and $100 million per year.

As of August 31, 2015, OCC stated its current shareholders' equity was approximately $150 million, and as of that date, it had 20 months of accrued and unpaid rebates equaling $35.75 million after taxes ($5.3625 million/3 months * 20 months). Based on the above calculations, from August 31, 2015 to year-end 2015 (4 months), capital levels will increase from $185.75 million to nearly $220 million. In another four months (April 2016), capital levels will increase to over $253 million, surpassing OCC's Target Capital Requirement.

Finally, in its opposition papers, OCC argues that Petitioners have "refused to acknowledge the value to OCC and the investing public of the Exchange Owners'

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[11] OCC Opp. at 14.

Replenishment Capital, which ranges from $117 million to $200 million . . . ."[12] But Petitioners have shown that the existence of a contractual commitment underlying the Replenishment Capital does not add meaningful value because the contingency it addresses is so demonstrably and exceedingly remote, and because there are numerous, viable, and less expensive ways to address that contingency without such a contractual commitment.[13] Indeed, as Petitioners have stated numerous times, the proposed amendments to Rule 17Ad-22 require only a "plan" for raising equity; not a firm commitment to do so. OCC also still refuses to provide any basis for including an expensive contractual commitment for Replenishment Capital of this amount in their proposal. OCC has not provided any data, facts, or analyses supporting the level of Replenishment Capital purportedly required ($117-$200 million). And OCC does not deny that the undisclosed consultant's report upon which its inflated Target Capital Requirement is based played no role in developing the Replenishment Capital amount.

The Commission should have the benefit of all available evidence justifying or relating to OCC's calculation of its need for Replenishment Capital. OCC's failure to provide this material evidence indicates that the level of Replenishment Capital serves only to inflate OCC's purportedly required capital and to provide a pretext for the Plan and the lining of the Exchange Owners' pockets at the expense of the investing public. This is critical because, as a government-approved monopoly, an overstatement of OCC's capital needs imposes an unnecessary tax on the investing public.

[12] *Id.*

[13] While OCC criticizes Petitioners for attempting to "predict the future," OCC Opp. at 14, value assessments based on the likelihood of future events are commonplace among option traders and in business generally. OCC's summary and unsupported value assumptions should be subject to careful scrutiny in light of the self-interest of OCC's owners in obtaining approval of a plan that gives them a billion dollar windfall.

B. The Commission's Review Requires Consideration of Alternative Capital Plans, and Additional Evidence From OCC Is Required To Evaluate Available Alternatives

The issue of alternative capital plans is not "merely a question that Petitioners wish to explore," as OCC contends.[14] Rather, the Commission's assessment of alternatives to the Plan is a legal precondition to the Commission's finding whether the Plan is consistent with the Exchange Act. The Commission must explore alternatives based on the fundamental principles of law under the Administrative Procedures Act – specifically, that "where a party raises facially reasonable alternatives . . . the agency must either consider those alternatives or give some reason . . . for declining to do so."[15] Consideration of alternative capital plans is required here because Exchange Act Section 17A(b)(3)(I) mandates that the rules of a registered clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Commission cannot determine whether the burden on competition imposed by the Plan[16] is "necessary or appropriate" without considering whether the Plan's objectives could be achieved in a less costly or burdensome manner. This scrutiny is of particular importance where, as here, it involves the actions of a government-approved monopoly free from the tempering force of competition.

From the outset of the review process, Petitioners brought to the attention of the SEC Staff the existence and cost advantages of CBOE's alternative capital raising plan, and that it had been blocked by OCC's Board.[17] Significantly, OCC does not dispute that there were less costly

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[14] *Id.* at 10.

[15] *See Chamber of Commerce of U.S. v. S.E.C.*, 412 F.3d 133, 145 (D.C. Cir. 2005).

[16] The Staff has already acknowledged that the Plan imposes a burden on competition. *See* Securities Exchange Act Release No. 74452 (March 6, 2015), 80 FR 13058, 13068 (March 12, 2015) (SR-OCC-2015-02).

[17] Greenberg Aff. ¶¶ 17-18.

alternatives to the Plan, or that the Plan will result in higher costs to the investing public. Indeed, OCC seems to concede that other plans were less costly, stating that the factors its Board considered were "not limited to cost," and that the Board's approval of the Plan was proper "*[w]hether or not less expensive alternatives were considered.*"[18] OCC submitted with its opposition the Declaration of Craig Donohue (OCC's Executive Chairman), in which OCC provided – for the first time – limited information about a less costly alternative plan ("Alternative B"). The Declaration provides only a cursory description of "Alternative B," stating that it would have provided the necessary equity capital from organic growth by maintaining fees at current rates until 2017 (*as estimated by OCC*) – as opposed to borrowing $150 million from the Exchange Owners in return for paying the Exchange Owners exorbitant dividends exceeding $1 billion and increasing into perpetuity.[19] OCC does not provide any further detail concerning this alternative, including any underlying documentation or data, or any assessment of costs and benefits.

The Donohue Declaration also addresses in cursory fashion the less costly alternative capital plan proposed by Exchange Owner CBOE, which was described in detail in the Affidavit of Joel Greenberg submitted by Petitioners in support of this motion. As set forth therein, CBOE proposed providing OCC with a capital infusion of $150 million for 2-2.5 years for an annual return of 8% to 9%, but one or more Exchange Owners vetoed, or threatened to veto, the proposal in favor of the more expensive Plan.[20] Mr. Donohue dismisses the CBOE plan and

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[18] OCC Opp. at 10.

[19] Donohue Decl. ¶¶ 7, 9.

[20] Greenberg Aff. ¶¶ 9-10, 13-14, 22.

incorrectly argues that it would not have satisfied the requirement of raising capital through liquid net assets "funded by equity" as required by proposed) SEC Rule 17Ad-22(e).

The Donohue Declaration's statements are so cryptic and its discussion of the CBOE plan and "Alternative B" so cursory that the Declaration raises more questions than it answers, and reflects that there are factual disputes concerning the terms of the proposed CBOE plan. The Declaration thus *supports* referral to a hearing officer and pre-hearing discovery in order to develop an adequate administrative record and resolve the factual disputes.

As an initial matter, it is telling that OCC responded with a Declaration from its Chairman who played no role in developing or proposing CBOE's alternative plan, instead of with a declaration from a representative from CBOE, the Exchange Owner that actually proposed the Plan. Moreover, the Declaration is silent as to the reaction of OCC's "Advisory Group" to CBOE's proposal, and it essentially acknowledges that CBOE's plan was never proposed to OCC's Board and that one or more Exchange Owners effectively vetoed it before it could be presented.

The Donohue Declaration does not address or dispute the statement in Mr. Greenberg's Affidavit that he understood that the OCC Board did not consider alternatives to the Plan due to perceived time pressure form the SEC Staff to approve a plan that involved raising capital.[21] To the extent that the Plan was approved as a result of such perceived pressure, this is another factual issue that should be addressed in discovery and an evidentiary hearing.

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[21] Greenberg Aff. ¶ 15. To the extent that the CBOE plan or other alternatives were not considered as a result of perceived pressure from the Staff, such pressure was not based on any rule in effect and, to the extent it was based on the proposed rule, it did not consider the language of the proposed rule or the relevant guidance that, as described *infra* pages 11-12, would have made the CBOE plan a viable alternative if OCC had wanted to explore it and structure it to comply with the proposed rule.

The Declaration also avoids any specifics as to who from CBOE said what to the Advisory Group, and it creates factual issues by disputing Mr. Greenberg's Affidavit and asserting that CBOE's plan "was never fully developed" because, among other things, it lacked an interest rate. In contrast, Mr. Greenberg's Affidavit asserted that CBOE would have provided capital to OCC at the 8% to 9% level over 2-2.5 years, which supports Petitioners' contention that the Plan was needlessly expensive, not protective of investors, and not otherwise consistent with the Exchange Act. Referral to a hearing officer is necessary to resolve this factual dispute, and for the Commission to obtain the full record concerning the true terms of the CBOE plan, and what consideration it was given (or not given) by OCC and why. Indeed, the details of any alternative plans, as well as their costs and benefits and the reasons why they were rejected, should be disclosed and made part of the record. The Commission's meaningful review of the Plan requires consideration of this missing evidence.

Finally, the Commission should reject the legal conclusion in Mr. Donohue's Declaration that CBOE's alternative plan "would have failed" and "was flawed"[22] because it did not provide for liquid net assets "funded by equity." As described below, there was no shortage of ways that CBOE's proposal could have been acceptable to the Commission and permissible under the proposed rule, had OCC *wanted* to explore financing terms that were better than those offered by the Plan. OCC evidently did not. Referral to a hearing officer is required to determine why not, and the impact of that decision on investors.

As Petitioners have stated previously, the "funded by equity" language appears in a *proposed* amendment to Rule 17Ad-22(e)(15) that is not in effect because it has not been adopted. There was no good reason to categorically exclude CBOE's proposal as "not equity"

[22] Donohue Decl. ¶ 6.

and noncompliant with an unadopted rule, the key terms of which remain in flux – especially considering that in less than six months, OCC will have accumulated the necessary capital through fees.[23] Moreover, the most instructive guidance on interpreting the term "funded by equity," which was not defined in the proposed rule, strongly indicates that the CBOE proposal could have been treated as equity for purposes of the proposed rule. Guidance under Rule 15c3-1, for example, makes clear that subordinated debt counts as good capital and, when contributed by an owner, is treated as equity.[24] The proposed financing by CBOE, in other words, could have been structured this way to satisfy the hypothetical requirements of the proposed rule if OCC had not summarily dismissed this alternative.

Even if the Commission accepted OCC's narrow and ill-founded view of equity in the proposed rule and hypothetically treated the proposed rule as final, OCC's rejection of CBOE's proposal because it did not provide for "equity" was still improper. The "funded by equity" language of proposed Rule 17Ad-22(e)(15) relates solely to "business risk."[25] OCC has represented that the unnamed consultant on whom OCC relied in proposing the Plan explicitly stated that OCC could "manage business risk to zero."[26] Indeed, the only risks that the

[23] Principle 15 provides similar flexibility in meeting the "funded by equity" requirement. In fact, the explanatory notes to Principle 15 permit non-equity funding to meet its requirements: "If the FMI's corporate structure is such that it cannot legally or institutionally raise equity . . . , it should ensure an equal amount of equivalent loss absorbing financial resources is available." *See* Principle 15, Explanatory Note 3.15.5, n. 134, *available at* http://www.bis.org/cpmi/publ/d101a.pdf.

[24] *See* 17 CFR § 240.15c3-1(c)(2)(ii), 15c3-1(d) ("[A] satisfactory subordination agreement entered into by a partner or stockholder which has an initial term of at least three years and has a remaining term of not less than 12 months shall be considered equity . . . ."). The CBOE plan would have qualified merely by restructuring it to extend the term of the financing to 3 years rather than the proposed 2-2.5 years.

[25] The Commission defined business risk as "the risk of potential losses arising from the covered clearing agency's administration and operation as a business enterprise." Securities Exchange Act Release No. 16866 (March 12, 2014), 79 FR 16866, 16906 n.300 (March 26, 2014).

[26] Securities Exchange Act Release No. 74452 (March 6, 2015), 80 FR 13058, 13059 (March 12, 2015) (SR-OCC-2015-02).

consultant identified to justify the Plan were operational risk ($226 million) and pension risk ($21 million). "Operational risk" is governed by a separate provision of the proposed Rule (Rule 17Ad-22(e)(17)) that does not require liquid assets "funded by equity." Therefore, none of the risks that the consultant identified are covered by proposed Rule 17Ad-22(e)(15)'s equity requirement. And the only other "funded by equity" requirement of the proposed Rule 17Ad-22(e)(15) – six months operating expenses, or the "Baseline Capital Requirement" of $117 million – has already been satisfied by OCC *without the Plan*, as OCC concedes that it had approximately $150 million at August 31, 2015.

Finally, the proposed rule and its "funded by equity" language remain very much in flux even now. One of the principal commenters on the language (DTCC, which operates the only US equity clearing agency) recommended the Commission give a "broad definition of equity capital" so that only "unaffiliated third-party debt" would be deducted from shareholders' equity – with such an interpretation "necessary and important to provide a range of capital support and replenishment options to covered clearing agencies . . . ."[27] Indeed, OCC itself argued for the same flexibility in March 2014: "[W]e urge the Commission to not take too narrow a view of what sources of funding would be considered 'equity' funding under Rule 17 Ad-22(e)(15)."[28] OCC went on to state that:

> We determined that increasing our retained earnings by eliminating clearing fee discounts was the most certain and pragmatic approach to generating adequate resources to generate a six-month cushion over the short term. . . . We believe that, for example, non-cumulative preferred stock that is redeemable at OCC's discretion after five years should be considered an appropriate source of "equity"

[27] *See* Letter from Larry E. Thompson, Managing Director and General Counsel, DTCC (May 27, 2014), at 10.

[28] *See* Letter from James E. Brown, Executive Vice President, General Counsel and Secretary, OCC (May 27, 2014), at 13.

> funding under the rule. This would be a highly efficient and effective mechanism for OCC to comply with the rule.[29]

In light of OCC's past statements, its current use of a narrow, unadopted, and ill-founded view of "equity" to summarily reject CBOE's proposal reveals the pretextual nature of its objection to that proposal and makes clear yet again that it had no intention to give fair consideration to financing proposals that competed with the Plan.

Simply put, the Commission cannot determine the consistency of the Plan with the Exchange Act without understanding the viability of the CBOE proposal and any other alternatives. The Donohue Declaration does nothing to dispel what appears obvious from the (incomplete) record—that substantially better terms than those of the Plan were available, but that OCC steadfastly opposed considering those alternatives and was instead fixated on enriching the Exchange Owners through adoption of the Plan.

C. The Commission Should Obtain Evidence Concerning Whether OCC's Approval of the Plan Was Tainted by a Conflicted Process that the Exchange Owners Manipulated at the Expense of the Public Interest

As previously explained, the Exchange Owners each had veto power over any proposed capital plan, and used that power or the threat thereof to manipulate OCC's Board approval process to ensure that the Board agreed to the Plan that provided the Exchange Owners with an extraordinary financial windfall at the expense of the investing public. Before turning to that process, it is important to recognize the "heads I win, tails you lose" strategy through which OCC protected the Plan from comparison with the less expensive alternatives. Superior proposals to supply capital via equity could be vetoed as dilutive under OCC's organizational documents, while better financing terms through debt could be deemed deficient "as a matter of

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[29] *Id.* at 13-14.

law" based on OCC's misconstruction of the term "funded by equity" under the proposed rule. Here, the credible, less expensive proposal advanced by CBOE seems to have taken fire from both barrels of OCC's shotgun: it was apparently deemed deficient "as a matter of law"[30] based on OCC's newly adopted narrow view of "equity" and extinguished before it could reach OCC's Board for consideration based on the threat of a veto by one or more of the other Exchange Owners.[31]

Whatever supposed formalities may have been followed and whatever their purported sufficiency under Delaware law, OCC's conflicted Board approval process cannot be called SRO governance that protects investors from the market power of a monopoly. The conflicted process by which OCC approved the Plan (as opposed to less costly alternatives) is directly material to the Commission's analysis of whether the Plan is in the public interest, particularly given the potential for OCC to exploit its monopoly power and status as an SRO vested with delegated governmental authority to impose rules on its members. As Petitioners have previously shown, OCC's selection of the higher cost capital-raising alternative will injure public investors because it will inevitably lead to wider spreads as market makers incorporate increased transaction costs into their quotes. For example, last year OCC added, on average, over two cents per contract to transaction fees for each cleared contract. In response, option market makers generally added the expense into their quote calculations for the 600,000 option series in which they publicly quoted. It is estimated that the price hike caused market maker quotes to be displayed worse than otherwise (wider, less size, or both) in over 20,000 series at any given time.[32]

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[30] Donohue Decl. ¶ 6

[31] Greenburg Aff. ¶¶ 13-14.

[32] In reaching the over 20,000 series result, a conservative two cent minimum was applied, which translates to 2% of each price point (i.e., two cents on the dollar). Thus, 2% of 600,000 bids = 12,000

Petitioners have identified with particularity the evidence relevant to the conflicted Board process that should be part of the record for the Commission to conduct a meaningful review, including: documents and communications concerning the process by which the Plan was approved; agendas, presentations, board packages, minutes of all relevant meetings; documents showing the composition of the Board; and documents relating to conflicts or potential conflicts.[33] OCC weakly states that this issue has been "thoroughly briefed by the parties to this proceeding *based on the facts they chose to submit for the record*,"[34] but this only serves to highlight the point: Petitioners could not submit evidence *they did not have*. Relevant evidence solely in OCC's possession will become part of the record only if the Commission orders OCC to produce it before or during an evidentiary hearing.

OCC further argues that the conflicts of interest in the Board's approval process do not matter because the process was purportedly consistent with OCC's interpretation of its By-laws, Delaware law, and a legal opinion on which OCC's governance counsel relied.[35] But it simply cannot be that the Commission's review of the Plan – which entails the monetization of OCC's monopoly power and *a billion dollar wealth transfer* – is limited to confirming that OCC actually believes that its corporate formalities were observed and that the process producing the Plan otherwise complied with Delaware law. Indeed, OCC admits that there was a conflict of

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bids and 2% of 600,000 offers = 12,000 offers. Assuming a 5% overlap within the same series (where both the bid and offer are affected) the total amount of affected series is over 20,000 option series. For example, if a bid for a series was derived to be at .9901 and a 2% price point is added, the result would be a calculated bid of .9899. For option quoting purposes by market makers, this bid value would most likely round down to the next price point, which would create a .98 bid where a .99 bid would otherwise have been disseminated by the respective market maker(s). This differential is borne by the investing public.

[33] Pet. Motion at 11-13.

[34] OCC Opp. at 11 (emphasis added).

[35] *Id.* at 12.

interest, and admits that the Board rejected or did not consider cheaper alternatives that would have avoided a financial windfall for the Exchange Owners. Given these circumstances, and the need to protect the public from overreaching by the self-interested Exchange Owners, the Commission should carefully scrutinize the Board approval process to protect the public interest. This careful scrutiny can occur only if there is a complete evidentiary record available for the Commission's consideration.

II. This Motion Was Timely Made Once the Commission Agreed to Review The Plan

OCC misstates Rule 452 to argue that Petitioners' motion is untimely because Petitioners allegedly could have "adduce[d] ... evidence previously."[36] Rule 452 provides that a "party may file a motion for leave to adduce additional evidence *at any time prior to the issuance of a decision by the Commission*."[37] Accordingly, Petitioners' motion is timely. Indeed, based on a review of SEC Releases for the last 20 years, the Commission has denied a motion to adduce additional evidence only when there had been a prior hearing before an administrative law judge or SRO at which the parties had the opportunity to produce evidence.[38] There has been no such

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[36] *Id.* at 15.

[37] 17 CFR § 201.452 (emphasis added).

[38] *See, e.g.,* John Thomas Capital Management Group LLC, Securities Exchange Act Release No. 73819, 2014 WL 6985130 (December 11, 2014) (granting petitions for review of an administrative law judge's initial decision, and stating "to the extent that any party contends that the record compiled before the law judge is incomplete or inadequate, we direct that relief under Rule 452 be sought promptly"); Anthony Fields, Securities Exchange Act Release No. 74344, 2015 WL 728005 (February 20, 2015) (rejecting a party's attempt to proffer additional evidence on appeal of an administrative law judge's initial decision because the party had the "opportunity" to adduce the evidence at a prior hearing but failed to do so); Mark Feathers, Securities Exchange Act Release No. 73634, 2014 WL 6449870 (November 18, 2014) (rejecting a party's attempt to proffer additional evidence on appeal of an administrative law judge's initial decision because he could have proffered the same evidence during a prior hearing); North Woodward Financial Corp., Securities Exchange Act Release No. 72828, 2014 WL 3937496 (Aug. 12, 2014) (rejecting an applicant's attempt to proffer additional evidence while appealing FINRA's disciplinary action imposed after a hearing because "these exhibits were not part of the record before FINRA").

prior proceeding here, so the parties have not had *any* opportunity to acquire any relevant evidence or testimony.

Nor could Petitioners have filed their motion earlier, including during the "comment periods," as OCC argues.[39] Rule 452 allows only a "party" to move for additional evidence, and the Commission's definition of "party" does not include a person or entity submitting a comment letter during the comment period.[40] Moreover, the Commission recently granted the Petitioners' petitions for review of the Plan on September 10, 2015, and requested additional statements supporting or opposing the Plan by October 7, 2015 – the same date that Petitioners' filed the motion. It would have been both presumptuous and illogical for the Petitioners to ask the Commission to supplement the record for the Commission's review before the Commission agreed to conduct the review.[41]

Finally, OCC's recent revelations have provided further justification for discovery and an evidentiary hearing at this stage. Specifically, just last month, OCC stated that, as of August 31, 2015, its "adjusted shareholders' equity would be $149,613,874."[42] This statement raises numerous questions, such as how OCC calculated that figure (including whether it includes refundable clearing fees and, if not, why not); and based on the trajectory that increased its shareholders' equity from $25 million on December 31, 2013 to approximately $150 million less than two years later, what OCC's shareholders' equity will be at year-end. Finally, as discussed

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[39] OCC Opp. at 5.

[40] 17 CFR § 201.101(a)(8).

[41] Similarly, OCC's argument that Petitioners could have moved for additional evidence under Rule 110 falls short. OCC Opp. at 5, 17. That rule merely provides that the Commission may order a hearing officer to preside over a proceeding; it does not address discovery or additional evidence, and does not allow a party to make a motion.

[42] OCC Opp. to Mot. to Reinstitute Automatic Stay at 11.

above, OCC has also just recently revealed information, albeit limited, about alternative capital plans that it rejected or declined to consider. These partial disclosures highlight the deficiencies in the record, and thus the need to supplement the record with additional evidence so that the Commission can make a reasoned decision in its review of the Plan.[43]

CONCLUSION

Petitioners have repeatedly identified[44] material evidence that the Commission should order to be produced to complete the record. For example, OCC has failed to produce the consultant's report that serves as the basis for the Plan that OCC asks the Commission to approve. How can the Commission decide if the capital levels called for under the Plan are appropriate if OCC fails to provide the report supporting those capital levels? Similarly, OCC has failed to provide *any* information concerning its *current* capital level. How can the Commission decide if OCC needs to raise *additional* capital – and if so, how much – if OCC will not disclose how much capital it currently has?

OCC attempts to justify its transformative and costly Plan through conclusory assertions while withholding critical facts and data that are necessary to the Commission's review of

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[43] In addition to Rule 452, the relief requested by Petitioners is authorized under Commission Rule 100(c), which provides that "[t]he Commission, upon its determination that to do so would serve the interests of justice and not result in prejudice to the parties to the proceeding, may by order direct, in a particular proceeding, that an alternative procedure shall apply or that compliance with an otherwise applicable rule is unnecessary." 17 CFR § 100(c).

[44] *See* SIG Petition for Review at 23-24 ("It appears that OCC has drastically overstated its capital requirements, as it has not provided detail for these calculations."); SIG Opp. to Mot. to Lift Automatic Stay at 10 ("OCC offers no meaningful data, projections, or analysis to ground its purported concerns with regard to capital adequacy."); SIG Opp. to Mot. to Lift Automatic Stay at 13 ("Nor has OCC offered any explanation of exactly what capital must be raised as a result of 'its obligations as a SIFMU' and why, other than vague references to new hires and consultants, which some of the fee increases of 2014 were meant to address."); Petitioners' Mot. for an Order Referring this Matter to a Hearing Officer at 2 ("The basis for OCC's purported $247 million of capital under the Plan is an unknown consultant's supposed analysis utilizing an unspecified methodology based on undisclosed assumptions. At the very least, OCC should be required to produce to Petitioners and the Commission the consultant's report.").

whether the Plan is necessary and consistent with the Exchange Act. OCC's motivation for withholding key facts has become plain – to push through the approval process, without scrutiny, the Plan that enriches its Exchange Owners with an extraordinary windfall, more than a billion dollars over time at the expense of public investors and marketplace participants. The Commission's role as regulator of the industry requires obtaining all relevant evidence necessary to complete a robust and reasoned review of the Plan under the Exchange Act.

For these reasons, and those set forth above and in Petitioners' moving papers, Petitioners request that the Commission grant this motion and (1) refer this matter to a hearing officer for the taking of additional evidence, and (2) direct discovery in advance of the hearing.

Respectfully submitted,

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