

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Petition of

CITADEL SECURITIES LLC,
RONIN CAPITAL, LLC,
SUSQUEHANNA INVESTMENT GROUP,
and SUSQUEHANNA SECURITIES

Admin. Proc. File No. 3-17189

**BRIEF FOR NASDAQ OMX PHLX LLC PURSUANT TO
THE COMMISSION'S APRIL 1, 2016 ORDER**

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INTRODUCTION

Citadel Securities LLC, Ronin Capital, LLC, Susquehanna Investment Group, and Susquehanna Securities (collectively, “Petitioners”) have filed a Petition for Administrative Remedy (“Petition”) with the Commission. Petitioners ask the Commission to order NASDAQ OMX PHLX LLC (“Nasdaq”), along with the Chicago Board of Options Exchange, Incorporated, International Securities Exchange, LLC, NYSE Arca, Inc., and NYSE MKT LLC (with Nasdaq, collectively, the “Exchanges”) to pay certain amounts that allegedly were improperly collected and disbursed pursuant to exchange rules.

Goldman Sachs & Co. and Merrill Lynch mismarked certain orders on the Exchanges. Petition ¶¶ 23-24, 27. In its capacity as a self-regulatory organization (“SRO”), Nasdaq sanctioned these entities for the mismarking. Petitioners allege that, as a consequence of the mismarking, they were improperly charged payment for order flow (“PFOF”) fees that supposedly would not have been charged if the orders had been marked correctly. *See* Petition ¶ 1. Petitioners seek recovery of those allegedly improper fees—not from those responsible for the miscoding, but from Nasdaq and the other Exchanges.

Nasdaq submits this brief in response to the Commission’s April 1, 2016 order directing the filing of briefs on the question “whether the Commission has jurisdiction to entertain [the Petition] in a proceeding as defined in Rule 101(a)(9) of the Commission’s Rules of Practice, and, if so, under what authority.”

The Commission has jurisdiction over Petitioners’ claims. At its core, the Petition alleges that the Exchanges violated their own rules when they charged the PFOF fees at issue. In *Citadel Securities, LLC v. Chicago Board Options Exchange, Inc.*, 808 F.3d 694 (7th Cir. 2015), the Seventh Circuit recently confirmed that these exact allegations fall within the Commission’s

jurisdiction under Section 19 of the Exchange Act to take appropriate remedial action against an SRO that “has violated or is unable to comply with . . . its own rules,” 15 U.S.C. § 78s(h)(1). Pursuant to that statutory authority, the Commission may institute proceedings within the meaning of Rule of Practice 101(a)(9) in which Petitioners’ claims can be addressed.

The Commission should therefore treat the Petition as a request to institute proceedings under Section 19, and assert jurisdiction over Petitioners’ claims. The Commission should then proceed to reject the Petition without further delay, because extended proceedings are not necessary to resolve the Petition. The relevant facts appear in the Petition or are matters of public record. And Petitioners’ claims are fatally deficient on their face: Nasdaq’s own rules preclude Petitioners’ claims, and Nasdaq did not violate its rules with respect to PFOF fees. On these grounds, the Commission can reject Petitioners’ claims at the threshold. That said, if the Commission does see fit to institute further proceedings, Nasdaq requests the issuance of a scheduling order allowing it to move to dismiss the Petition. Nasdaq would ask for 60 days from the date of the scheduling order to file its motion, with appropriate time thereafter for Petitioners to oppose and Nasdaq to reply.

ARGUMENT

I. The Commission Has Jurisdiction Over Petitioners’ Claims.

The Exchange Act and an abundance of precedent demonstrate that the Commission has jurisdiction over Petitioners’ claims. Petitioners allege at bottom that the Exchanges violated their own rules. Petitioners say that “[n]o rule, regulation or agreement allowed the Exchanges to charge Exchange PFOF Marketing Fees” on the alleged mismarked orders, but that the Exchanges nonetheless “charged [Petitioners] Exchange PFOF Marketing Fees on those mismarked orders that were not part of the Exchange PFOF Program and not subject to such

fees.” Petition ¶¶ 18, 32. The PFOF fees were imposed pursuant to Nasdaq’s rules, which have been filed with the Commission. *See* 68 Fed. Reg. 141 (Jan. 2, 2003) (PHLX PFOF program).

Petitioners’ original state-court complaint—the substance of which has carried through to the Petition—confirms the point. *See* Complaint for Declaratory and Other Relief, *Citadel Sec. LLC v. Chicago Bd. Options Exchange, Inc.*, No. 13 CH 13246 (Ill. Cir. Ct. May 22, 2013). Petitioners expressly sought a declaration that the Exchanges would be liable if they assessed PFOF fees “in violation of their own rules,” *id.* ¶ 8; they referred to “the Exchanges’ revenue-generating activity that violate[d] their own rules and/or fee schedules,” *id.* ¶ 48; and they asserted that a dispute existed over “whether the Exchanges are required to comply with their rules and fee schedules,” *id.* ¶ 59.

By its plain terms, the Exchange Act gives the Commission jurisdiction over allegations that an SRO has failed to comply with its own rules. Section 19(g)(1) requires an SRO to “comply with the provisions of this chapter, the rules and regulations thereunder, and its own rules.” 15 U.S.C. § 78s(g)(1). And Section 19(h)(1) directs the Commission—not a trial court—to consider appropriate remedial action when an SRO “has violated or is unable to comply with any provision of this chapter, the rules or regulations thereunder, or its own rules.” 15 U.S.C. § 78s(h)(1).

Two federal courts have told these Petitioners, specifically, that they must take their claims to the Commission. First, the Northern District of Illinois explained what is already clear from the Petition and the Exchange Act: Petitioners seek “to enforce the [Exchanges’] duty to follow their own PFOF programs, a duty imposed by the Exchange Act.” Order, D.E. 32 at 4, *Citadel Sec., LLC v. Chicago Bd. Options Exch., Inc.*, No. 13-5833 (N.D. Ill. Aug. 4, 2014). The court accordingly reasoned that, because Petitioners’ claims fell within the Commission’s

jurisdiction under Section 19 “to ensure that SROs properly enforce their own rules,” Petitioners had to exhaust their remedies before the Commission. *Id.* at 4-5.

The Seventh Circuit affirmed. *Citadel Sec., LLC v. Chicago Bd. Options Exch., Inc.*, 808 F.3d 694 (7th Cir. 2015). The court observed that “the Exchange Act provides a comprehensive administrative review process for decisions rendered by [SROs].” *Id.* at 698. Citing Section 19 of the Act, the court explained that “[t]here is little question that the PFOF fees are imposed pursuant to [the Exchanges’] own rules,” and that “the plain language of the Exchange Act calls for SEC review of [Petitioners’] allegations of improper PFOF fees.” *Id.* at 699. The court rejected Petitioners’ attempts to distance their claims from the Commission’s jurisdiction, noting that “[w]hat matters is whether [the Exchanges] are operating under their own rules.” *Id.* at 700. The court therefore concluded that Petitioners were “required to exhaust administrative remedies” at the Commission. *Id.* at 699.

That conclusion is consistent with the many cases holding more generally that claims based upon an SRO’s alleged failure to comply with its own rules fall within the Commission’s jurisdiction. *See, e.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. NASD*, 616 F.2d 1363, 1366 (5th Cir. 1980) (claims “that the NASD was breaking its own rules”); *MFS Sec. Corp. v. NYSE*, 277 F.3d 613, 616 (2d Cir. 2002) (claims that SRO “actions violated both the Exchange Act and the rules of the NYSE”). As the Second Circuit has explained, “[c]hallenges to SROs’ rules must proceed exclusively before” the Commission. *Santos-Buch v. FINRA*, 591 F. App’x 32, 33 (2d Cir. 2015). And hence the Commission must “determine whether a self-regulatory organization . . . is properly discharging its duties and responsibilities in compliance with all applicable rules, regulations and federal law.” *Cook v. NASD Reg., Inc.*, 31 F. Supp. 2d 1245, 1249 (N.D. Ill. 1998).

Moreover, Congress's allocation of review authority to the Commission benefits both the Commission and SROs in the performance of their duties. "Congress saw self-regulation as a means of achieving expeditious and flexible enforcement of legal and ethical standards," which would be defeated by "resort to federal court." *Merrill Lynch*, 616 F.2d at 1371. Commission review therefore "allows the administrative agency to utilize its discretion and apply its expertise." *PennMont Sec. v. Frucher*, 586 F.3d 242, 245 (3d Cir. 2009) (citation omitted). The Commission's expertise with respect to SROs is considerable, as demonstrated by the "close oversight" that it exercises over them, including the power to approve and amend SRO rules, and the power to sanction SROs for any failures to comply with those rules. *In re Series 7 Broker Qualification Exam Scoring Litig.*, 548 F.3d 110, 112 (D.C. Cir. 2008). Adjudication of Petitioners' claims requires consideration of Nasdaq's own rules and a determination of what, if any, remedies might be appropriate—subjects that are uniquely within the Commission's expertise. That confirms that the Commission is the proper forum for Petitioners' claims.

Indeed, the Commission itself has endorsed this general division of authority in analogous cases. For instance, in *Altman v. SEC*, the Commission argued—and the Second Circuit held—that the Exchange Act "suppl[ies] the jurisdictional route that [one] must follow to challenge" Commission action that falls within applicable provisions of the Act. 687 F.3d 44, 46 (2d Cir. 2012) (per curiam). Similarly, in *American Benefits Group, Inc. v. National Association of Securities Dealers*, the Commission successfully argued that challenges to the Commission's approval of certain SRO rules fell within the Commission's jurisdiction. No. 99-4733, 1999 WL 605246, at *5-*6 (S.D.N.Y. Aug. 10, 1999). That argument went hand-in-hand with the SRO's argument—also successful—that claims based on the subsequent application of those rules also

fell within the Commission's jurisdiction. *Id.* at *8. Petitioners' claims are similarly based upon the application of exchange rules, which further supports the Commission's jurisdiction here.

II. The Commission May Exercise Its Jurisdiction In A "Proceeding" Under The Rules of Practice.

The Rules of Practice provide ample means for the Commission to exercise its manifest jurisdiction over Petitioners' claims. For example, Rule 101(a)(9)(i) defines a "proceeding" to include "any agency process initiated" by "an order instituting proceedings." 17 C.F.R. § 201.101(a)(9)(i). And the Commission may issue an order instituting proceedings by stating (among other information) "the legal authority and jurisdiction under which the hearing is to be held." *Id.* § 201.200(b). As explained above, the Commission has legal authority and jurisdiction under Section 19 of the Exchange Act over claims that an SRO has violated its own rules, and hence the Commission may institute proceedings on the Petition pursuant to that authority.¹

The Commission has instituted proceedings pursuant to Section 19 on numerous occasions, which confirms the availability of that option here. *See, e.g., In re Certain Activities of Options Exchanges*, SEC Release No. 43268, 2000 WL 1277616, at *1 (Sept. 11, 2000) ("The Securities and Exchange Commission . . . deems it appropriate, in the public interest, and for the protection of investors that public administrative proceedings be instituted pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934."); *In re NYSE*, SEC Release No. 67857, 2012 WL 4044880, at *1 (Sept. 14, 2012) (same); *In re Chicago Stock Exchange, Inc.*, SEC Release No. 70214, 2013 WL 4182596, at *1 (Aug. 15, 2013) (same). The Commission should therefore treat the Petition as a request to institute proceedings pursuant to Section 19.

¹ The Commission may also determine that the Petition falls under Rule 101(a)(9)(iii) or (vi). *See* 17 C.F.R. § 201.101(a)(9)(iii) & (vi).

III. The Commission Should Promptly Reject Petitioners' Claims.

The Commission can exercise its jurisdiction over the Petition and proceed to reject Petitioners' claims at the threshold, on a number of grounds that do not require further submissions.²

First, Nasdaq's Commission-approved rules preclude liability for any loss that Petitioners might have sustained as a result of improperly charged PFOF fees. *See* 74 Fed. Reg. 69,185, 69,186 (Dec. 30, 2009). In particular, PHLX Rule 652 disclaims liability "for any damages sustained by a member, member organization, or person associated with any of the foregoing, arising out of or relating to the use or enjoyment by such person or entity of the facilities afforded by the Exchange to members for the conduct of their business." By its plain terms, this rule precludes Petitioners' claims. *See also* 15 U.S.C. § 78c(a)(2) (defining "facility" to include "any service" of an exchange "for the purpose of effecting or reporting a transaction").³

The Commission approved this rule because, among other reasons, it furthers the Exchange Act's goals. Under the Exchange Act, any exchange rule must "promote just and equitable principles of trade" and "remove impediments to and perfect the mechanism of a free and open market." 15 U.S.C. § 78f(b)(5). In addition, with exceptions not relevant here, SROs must submit "any proposed rule or any proposed change in, addition to, or deletion from the rules" to the Commission for approval. *Id.* § 78s(b)(1). And "[t]he Commission, by rule, may abrogate, add to, and delete from . . . the rules of a self-regulatory organization . . . as the Commission deems necessary or appropriate to insure the fair administration of the self-

² Nasdaq reserves its right to raise other grounds for dismissal should the Commission require additional briefing.

³ Significantly, Petitioners do not ask the Commission to change its rules, or Nasdaq's Commission-approved rules.

regulatory organization.” *Id.* § 78s(c). Consistent with these statutory provisions, the Commission has determined that Nasdaq’s rules—including the rule precluding liability for losses arising from the use of the facilities of the exchange—promote free and fair markets. *See* 74 Fed. Reg. 69,185, 69,186 (Dec. 30, 2009). The Commission should therefore apply this rule to reject Petitioners’ claims.

Second, Nasdaq did not violate its own rules concerning PFOF fees in the first place. To the contrary, consistent with its rules, Nasdaq relied on its members to correctly mark orders, and then assessed and distributed the PFOF fees accordingly. When it became apparent that certain entities were incorrectly marking orders, Nasdaq exercised its authority as an SRO to discipline those entities for failing to comply with the rules. Because Nasdaq did not violate its own rules at any point, there is no basis for Petitioners’ claims.

Third, Nasdaq did not retain any of the fees, and Petitioners’ request in the alternative that “the Commission order disgorgement of the improperly charged fees” is improper. *Petition at 15*. Petitioners admit that the fees did not become exchange revenue, *Petition ¶ 21*, and thus there is nothing for Nasdaq to disgorge.


Fourth, Petitioners admit that other entities—not Nasdaq—mismarked the orders at issue. *See Petition ¶¶ 1-2, 12, 23, 27, 31*. And it was those entities’ conduct and allegedly improper receipt of PFOF fees—not Nasdaq’s disbursement of the fees pursuant to rule—that purportedly caused Petitioners harm. Petitioners have not pursued any remedies against those entities responsible for the mismarking. Rather, they essentially seek to hold Nasdaq (and the other Exchanges) as an insurer of losses suffered by one market participant at the hands of another. That obligation would clash with the policies underlying the Exchange Act, including Nasdaq’s proper role as an SRO.

CONCLUSION

For these reasons, the Commission should exercise jurisdiction here, and then reject Petitioners' claims against Nasdaq. But if the Commission would prefer more detailed briefing, Nasdaq requests that the Commission set a briefing schedule that would allow it to move to dismiss the Petition. In particular, Nasdaq requests 60 days from the date of the scheduling order to file its motion, and appropriate time thereafter for Petitioners to file their oppositions and Nasdaq to file its reply.

Dated: April 15, 2016

Respectfully submitted,



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[PROPOSED ORDER]

**UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION**

SECURITIES EXCHANGE ACT OF 1934

Release No. ____ / _____, __, ____

Admin. Proc. File No. 3-17189

In the Matter of the Petition of

**CITADEL SECURITIES LLC,
RONIN CAPITAL, LLC,
SUSQUEHANNA INVESTMENT GROUP,
and SUSQUEHANNA SECURITIES**

**[PROPOSED] ORDER
EXERCISING JURISDICTION
AND DISMISSING ALL CLAIMS
AGAINST NASDAQ OMX
PHLX LLC**

Citadel Securities LLC, Ronin Capital, LLC, Susquehanna Investment Group, and Susquehanna Securities (collectively, "Petitioners") have filed a Petition for Administrative Remedy ("Petition") requesting that the Securities and Exchange Commission ("Commission") order the Chicago Board of Options Exchange, Incorporated, International Securities Exchange, LLC, NASDAQ OMX PHLX LLC, NYSE Arca, Inc., and NYSE MKT LLC to pay damages concerning certain exchange fees that allegedly were improperly charged. In the alternative, Petitioners request that the Commission order disgorgement of those fees.

The Commission determines that it has jurisdiction over the Petition pursuant to Section 19 of the Securities Exchange Act of 1934, 15 U.S.C. § 78s. After considering the Petition and the parties' submissions, the Commission further determines that Petitioners' claims against NASDAQ OMX PHLX LLC are meritless. The Commission therefore dismisses Petitioners' claims against NASDAQ OMX PHLX LLC.

By the Commission.

Brent J. Fields
Secretary

CERTIFICATE OF SERVICE

I hereby certify that, on April 15, 2016, a copy of the foregoing Brief for NASDAQ OMX PHLX LLC Pursuant to the Commission's April 1, 2016 Order was served upon the following by first-class mail with a courtesy copy by electronic mail, because counsel are not based in Washington, D.C., addressed as follows:

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