UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

In The Matter of:

The Application of TREEHOUSE REAL ESTATE INVESTMENT TRUST,

For Review of Action Taken by New York Stock Exchange

Admin. Proc. File. No. 3-19192

BRIEF IN SUPPORT OF APPLICATION FOR REVIEW OF ACTION BY THE NEW YORK STOCK EXCHANGE

Carmen J. Lawrence
Richard H. Walker
King & Spalding LLP
1185 Avenue of the Americas
New York, New York 10036
(212) 556-2100
clawrence@kslaw.com
rwalker@kslaw.com

Attorneys for TREIT

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

LEGISLATIVE MATERIALS

OTHER AUTHORITIES

PRELIMINARY STATEMENT

Treehouse Real Estate Investment Trust ("TREIT" or the "Company") respectfully submits this brief in support of its application for review of action by the NYSE denying TREIT the opportunity to apply to have its shares listed on the NYSE. TREIT requests that the Commission set aside that action and require the NYSE to consider and review TREIT's listing application in accordance with the requirements of Section 19(f) of the Securities Exchange Act (the "Exchange Act") and the NYSE rules.

This application raises novel procedural and substantive questions of first impression involving the NYSE's process and policies for listing a company's shares for trading on its exchange. Our research has not uncovered any prior applications to the Commission for review of a denial by the NYSE of an application for listing.

TREIT is a real estate investment trust ("REIT") that leases real estate to state-licensed cannabis companies. The NYSE has denied TREIT the opportunity to list on its exchange based on an unwritten blanket "policy" not to list any companies that engage, directly or indirectly, in the cannabis industry in the United States. Yet, the NYSE has *already* listed companies on its exchange, contrary to its unwritten policy, that engage directly and indirectly in the cannabis industry. Of particular import, in 2016, the NYSE listed Innovative Industrial Properties ("IIPR"), a REIT with an identical business model to TREIT that, like TREIT, leases property to state-licensed cannabis companies. And on May 16, 2019, just *after* the NYSE denied TREIT the opportunity to apply for a listing, the NYSE listed a cannabis exchange-traded fund ("ETF"), which lists among its top 10 holdings companies doing business in the cannabis industry, including, significantly, IIPR. The NYSE then listed two more ETFs in July that also track the cannabis industry and have holdings in IIPR.

The NYSE's unwritten policy against listing companies that engage, directly or indirectly, in the cannabis industry is being applied in an arbitrary and discriminatory fashion, granting some companies the benefits and services of being listed on the NYSE, while denying that access to others similarly situated, without reasonable justification.

Not only does the NYSE's policy not survive scrutiny in terms of its discriminatory and arbitrary application, but the NYSE's policy is, in effect, a rule, which it has instituted without undergoing the required rulemaking process for Commission review and approval and without any discernible standards to guide the NYSE in its application. The NYSE's lack of policies and procedures enables it to make "pocket" denials of requests to be listed without any record, while at the same time making it very difficult for applicants to achieve review by the Commission on a developed record.

The result is that those denied the opportunity to list are left at a serious competitive disadvantage in a rapidly growing market with strong investor demand and future growth potential. This is flatly inconsistent with Section 19(f) of the Exchange Act, other Exchange Act provisions, and Commission priorities to remove burdens on competition, bring companies to market, expand investor choice, and provide investors opportunities based on full disclosure of risks.

The Commission should set aside the NYSE's determination because (A) it imposes an inappropriate burden on competition to the detriment of TREIT and the investing public that is not necessary or appropriate in furtherance of the Exchange Act; (B) the determination is not in accordance with the NYSE rules because (1) the NYSE has circumvented the rule-making process for their unwritten blanket policy, and (2) the NYSE has inconsistently and arbitrarily applied its policy; (C) the NYSE policy and its arbitrary application is wholly inconsistent with

the Exchange Act; and (D) the specific reasons for the NYSE's determination do not exist in fact. If the Commission finds in TREIT's favor for any one of these reasons, the Commission should set aside the NYSE decision.

BACKGROUND

A. TREIT's Business and Its Relation to the Rapidly Growing Cannabis Industry

1. TREIT

TREIT is incorporated in Maryland and maintains its principal place of business in Los Angeles, California. TREIT is one of a growing number of companies that is engaged in the fast-growing cannabis industry. TREIT is not directly engaged in the purchase or sale of medical or adult-use recreational cannabis. The Company acquires, owns, and manages real estate subject to long-term leases with state-licensed cannabis operators engaged in the growth and sale of both medical and adult use, recreational marijuana. The Company requires that its lessees are fully licensed, regulated, and compliant with all applicable state and local laws and regulations.

In January 2019, TREIT raised $133.5 million through an offering of common stock. The offering was made to "qualified institutional buyers" as defined in Rule 144A under the Securities Act of 1933 (the "Securities Act") and to persons outside the United States in offshore transactions in reliance on Regulation S under the Securities Act. The remainder of the shares were offered by TREIT pursuant to a private placement to "accredited investors" as defined in Rule 501 under the Securities Act, raising approximately $45.5 million in a transaction that closed on March 18, 2019. Also in June 2019, TREIT finalized a debt facility with a federally insured commercial bank.

2. Listed Cannabis Companies

At present, there are more than 30 companies listed on the NYSE and the Nasdaq that provide a wide variety of direct and indirect products and services relating to the cannabis industry.[1] Direct providers include not just adult-use recreational or medical cannabis companies in Canada, but also companies engaged in related cannabis products such as hemp, CBD, and cannabinoid pharmaceuticals.[2] Other companies provide indirect or ancillary products and services to the cannabis industry such as vaporizer and consumption products, fertilizer, hydroponic equipment, pest control, technology, consulting, and leases to cannabis businesses. In addition to the cannabis related companies listed in the United States, there are more than 182 cannabis companies listed on the Canadian Stock Exchange, [3] including many American companies.[4]

And the pace of new listings of cannabis related entities continues to accelerate. In just the last few months, the NYSE has listed three new ETFs that track the cannabis industry. One,

---

[1] At the time of TREIT's Memorandum in Support of U.S. Listing ("TREIT Memo"), there were at least 29 companies listed on the NYSE and Nasdaq that openly engaged, either directly or indirectly, in the cannabis industry. The TREIT Memo is included as Exhibit 1 to TREIT's Application for Review and also contained in the NYSE certified record. The newly listed companies include Greenlane Holdings, Inc., Akerna Corp., Sundial Growers Inc., KushCo Holdings Inc. (application filed on July 8, 2019), The Cannabis ETF, AdvisorShares Pure Cannabis ETF, and Amplify Seymour Cannabis ETF.

[2] TREIT Memo, at 6-11.

[3] Canada has legalized adult-use recreational cannabis, effective October 17, 2018. Medical cannabis was legalized in 2001.

[4] TREIT's Motion for Leave to Adduce Additional Evidence Pursuant to Commission Rule of Practice 452 ("TREIT Motion"), Ex. CC (Canadian Securities Exchange (CSE) Marijuana List, last accessed Aug. 5, 2019).

YOLO, was listed just days after the NYSE denied TREIT the opportunity to apply to be listed on its exchange, and two more were listed in July.

B. Evolving Legal Landscape of Cannabis Regulation

The legal landscape governing the regulation of the cannabis industry is rapidly evolving but marked by a fundamental dichotomy between federal and state law. In brief, under federal law, cannabis is a Schedule I controlled substance under the Controlled Substances Act ("CSA"). 21 U.S.C. § 812, Schedule I. These drugs are regulated by the Drug Enforcement Administration, and the inappropriate use, sale, manufacture, or possession of any controlled substance is a prosecutable offense under the CSA.

In sharp contrast to federal law, 11 states (Alaska, California, Colorado, Illinois, Maine, Massachusetts, Michigan, Nevada, Oregon, Vermont, and Washington) and the District of Columbia have adopted legislation legalizing recreational use cannabis, and many others have decriminalized cannabis use.[5] In addition, thirty-three states have legalized medical-use cannabis.[6]

The dichotomy between federal and state law has created uncertainty and some confusion but, importantly, has not stifled the growth of the cannabis industry or investor appetite for stocks in this sector. This appears to be based on the fact that the risk of prosecution of a state-legal cannabis company is remote, based on historical experience. There have been no criminal prosecutions of state-legal cannabis businesses operating in compliance with state law, and the

[5] TREIT Memo, at 17 (Illinois legalized in June 2019).

[6] *Id.*, at 11.

Department of Justice has signaled very strongly that it does not intend to bring prosecutions against parties who have relied on, and are compliant with, state law.[7]

At the same time, there are multiple pro-cannabis bills currently before Congress, one of which would legalize marijuana by removing it from the list of controlled substances and another of which would amend the CSA to apply only when state law applies as well.[8] And, finally, the vast majority of presidential candidates are strongly in favor of legalizing adult-use recreational cannabis. Twenty current or former candidates have publicly supported federal legalization of recreational cannabis. And the others support some form of change, either decriminalization or the states' right to decide (including President Trump).[9]

The Commission has not issued any special guidance for registering shares of companies engaged in the cannabis industry. Rather, the Commission handles registration of such companies in the same way it has traditionally processed registration of any other company. The Commission's focus is on ensuring accurate and robust disclosures are in place to protect investors and protecting the public interest. TREIT has fully disclosed the risks applicable to its operations to the Company's investors, including that if there is a change in "the federal government's enforcement position, we could be subject to criminal prosecution, which could lead to imprisonment and/or the imposition of penalties, fines, or forfeiture." TREIT also

---

[7] TREIT Memo, at 13 (discussing Attorney General William Barr's public statements regarding not intending to pursue enforcement actions against state-legal businesses).

[8] *See, e.g.*, the Marijuana Justice Act, S.597/H.R. 1456, 116th Cong. (2019) (bill to remove marijuana from list of controlled substances) and STATES Act, S.1028/H.R. 1456, 116th Cong. (2019) (bill to amend CSA to only apply when state law also applies).

[9] TREIT Motion, Ex. J (Leafly article, dated June 26, 2019); *Id.*, Ex. I (Medical Marijuana, Inc. News article, dated June 24, 2019).

emphasizes that cannabis remains illegal under federal law.[10] TREIT's Risk Factor disclosures mirror IIPR's Risk Factor disclosures, which were subject to review and comment before the Commission approved its registration statement.[11]

C. TREIT's Efforts to Apply for a NYSE Listing

With this background regarding TREIT's business and the cannabis industry, we turn to TREIT's efforts to list its shares on the NYSE. In March 2019, following an introductory telephone conversation between Richard Walker, counsel to TREIT, and John Carey, Senior Director, Vice President of Legal at NYSE Regulation, Mr. Walker emailed Mr. Carey the TREIT Memo, a formal memorandum explaining the reasons why the NYSE should list TREIT.

On April 30, 2019, Mr. Walker and Carmen Lawrence, also counsel to TREIT, spoke with Mr. Carey and Carolyn Saacke, Chief Operating Officer, Capital Markets at the NYSE, to discuss next steps for listing TREIT. During this call, Ms. Saacke told Mr. Walker and Ms. Lawrence that the NYSE was uncomfortable listing TREIT on its exchange due to its cannabis-related business operations and that TREIT was therefore ineligible to apply to be listed.[12]

Under NYSE rules, before being permitted to apply to list on the NYSE, a company must undergo a review of eligibility.[13] If, after that review, the NYSE determines a company is

---

[10] TREIT Memo, at 5 (citing TREIT Final Offering Memorandum (Jan. 3, 2019), at 41).

[11] *Id.*, at 22 (citing Innovative Industrial Properties, Inc, Letter from Foley & Lardner to Jennifer Gowetski, Senior Counsel, Office of Real Estate and Commodities, Division of Corp. Finance (Nov. 7, 2016), at 7).

[12] Application for Review, Ex. A, Walker Declaration, para 4.

[13] NYSE Listed Company Manual, Section 104.00.

eligible to list on its exchange, it will provide a written "clearance letter" permitting the company to file a formal listing application.[14]

After Mr. Walker requested a formal statement of denial of eligibility, on May 9, 2019, Mr. Carey and Ms. Saacke called Mr. Walker. During that phone call, Mr. Carey told Mr. Walker that the NYSE does not issue letters denying clearance to list on the NYSE, and thus the NYSE would not issue a denial letter for TREIT. Ms. Saacke stated that the decision to deny TREIT the opportunity to list on the NYSE was a "policy decision" by the NYSE not to list companies engaged either directly or indirectly in the cannabis business. Also during that phone call, Mr. Carey told Mr. Walker that the NYSE would not provide TREIT an opportunity for a hearing or further review of this denial of listing opportunity, and that TREIT had exhausted all administrative remedies within the NYSE for this determination because the NYSE has no appellate procedure or process for review within the NYSE for a determination of this nature.[15]

Because there was no written record of the NYSE's denial of TREIT's request to be listed and no appellate procedure or process within the NYSE to review this determination, Mr. Walker asked Mr. Carey what TREIT should tell the Commission in any application for review to the Commission. Mr. Carey stated that Mr. Walker should inform the Commission that the "NYSE is not intending to list any company that is directly or indirectly involved in the marijuana industry in the United States."[16] The NYSE stated that this "policy" was the sole

---

[14] *Id.*, Section 702.00. Based on our conversations with the NYSE, we understand that its actual practice may vary. In lieu of an official clearance letter, the NYSE may simply continue processing the listing application once clearance has been achieved.

[15] Application for Review, Ex. A, Walker Declaration para. 7, 8.

[16] *Id.*, para 9.

basis for its determination not to allow TREIT to apply to be listed, and that it did not have any issue with the company or its financial position for listing, though it had not reviewed those.

D. Similar Companies "Directly or Indirectly" Involved in the Cannabis Industry Are Already Listed on the NYSE and Nasdaq

1. Companies, Like TREIT, That Are Indirectly Involved in the Cannabis Industry

The NYSE and Nasdaq already list numerous companies that do not engage in the growing, cultivation or sale of cannabis, but provide products or services to companies that do.

IIPR. The NYSE listed IIPR in November 2016. IIPR is a REIT that primarily acquires real estate assets that are leased or may be leased to state-licensed cannabis operators. There is no meaningful difference between the operations of IIPR and the operations of TREIT.

IIPR promotes itself as the "the first and only real estate company on the New York Stock Exchange (NYSE: IIPR) focused on the regulated U.S. cannabis industry."[17] TREIT and IIPR have identical business models. Both acquire properties and then lease them back to tenants, operating their businesses as REITs for U.S. federal income tax purposes.[18] Both companies thus operate in a niche market with a focus, in part, on specialized real estate assets, which are leased to tenants licensed through the state-regulated cannabis industry for both adult-use and medical-use cannabis.[19]

---

[17] TREIT Motion, Ex. M (IIPR press release, dated June 21, 2019), at 1, and Ex. N (IIPR press release, dated July 9, 2019), at 1.

[18] *See* TREIT Memo, at n. 3 (citing Innovative Industrial Properties, Inc., Registration Statement (Amend. No. 4 to Form S-11) (Nov. 25, 2016), at 1); *Id.*, at n. 8 (citing TREIT Final Offering Memorandum (Jan. 3, 2019), at 1, 26).

[19] *See* TREIT Memo, at n. 6 (citing Innovative Industrial Properties, Inc., Annual Report (Form 10-K) (March 14, 2019), at 5); *Id.*, at n. 8 (citing TREIT Final Offering Memorandum (Jan. 3, 2019), at 1).

In addition to sharing a common business model, TREIT and IIPR also compete for the acquisition of properties, and tenants for those properties, within a limited geographic area in the United States. For example, TREIT and IIPR both target start-up businesses as potential tenants and currently have properties in California, Nevada, New York, and Arizona.[20] IIPR currently operates in other geographies that would be potential markets for TREIT's strategic expansion in the future. TREIT has disclosed that "there may only be a limited number of cannabis related properties operated by suitable tenants available for us to acquire." IIPR's presence in the states in which TREIT operates therefore creates competition for those tenants and impacts this risk.[21] Accordingly, TREIT's business is necessarily impacted by any competitive advantage afforded to IIPR.

Scotts Miracle-Gro. Listed on the NYSE since February 1992, Scotts Miracle-Gro ("Scotts") is a leading American lawn and garden company that specifically markets to and sells products to the cannabis industry in the United States.

Scotts has several cannabis ventures. Its subsidiary, Hawthorne Gardening, is based in New York and is actively engaged in, and markets to, the cannabis industry. Bloomberg reported that Hawthorne generates about 90% of its sales from the cannabis industry (not including its AeroGrow indoor-gardening business).[22] Scotts also acquired Sunlight Supply in 2018, a Canadian-based company with locations in the U.S. that is a primary provider of

---

[20] *See* TREIT Memo, at n. 8 (citing TREIT Final Offering Memorandum (Jan. 3, 2019), at 31); *Id.*, at n. 6 (citing Innovative Industrial Properties, Inc., Annual Report (Form 10-K) (March 14, 2019), at 14); TREIT Motion, Ex. K (TREIT press release, dated June 18, 2019); *Id.*, Ex. L (IIPR Website, last accessed Aug. 8, 2019, with page title "Our Portfolio").

[21] *See* TREIT Memo, at n. 8 (citing TREIT Final Offering Memorandum (Jan. 3, 2019), at 18).

[22] *Id.*, at 8 (citing Kristine Owram, "Scotts Miracle-Gro Tests Whether It Can Make Pot Grow Too," Bloomberg (Aug. 23, 2018)).

hydroponic solutions to the cannabis industry.[23] A Scotts subsidiary is building an R&D facility targeted at testing its products on cannabis plants in partnership with a Canadian cannabis cultivator.[24]

NYSE's Cannabis ETFs. The NYSE has also listed several ETFs that specifically track the cannabis industry. In 2017, the NYSE Arca listed MJ: ETFMG Alternative Harvest ETF (referred to as "MJ"). MJ markets itself as the "first U.S. and world's largest ETF to target the global cannabis industry." MJ's holdings include IIPR and Scotts.[25]

In just the last few months, even after the NYSE denied TREIT the opportunity to list, the NYSE has listed three more cannabis ETFs: AdvisorShares Pure Cannabis ETF (NYSE: YOLO) on May 16, 2019, the Cannabis ETF (NYSE: THCX) on July 8, 2019, and Amplify ETF (NYSE: CNBS) on July 23, 2019. All three of these ETFs' holdings include companies that operate in the state-legal cannabis space.

YOLO, listed on NYSE Arca on May 16, 2019 is an actively managed ETF that "seeks growth opportunities by investing in equities of U.S. and foreign cannabis-related companies engaging in legal business."[26] At the time of this filing, YOLO's holdings include IIPR and Greenlane Holdings.[27] Greenlane, a leading distributor of premium vaporization products and consumption accessories, recently listed by the Nasdaq on April 18, 2019, is a Florida-based

---

[23] *Id.*, at 8 (citing Scotts Miracle-Gro, Press Release, "ScottsMiracle-Gro Reports Strong First Quarter Sales; U.S. Consumer Sales Increase 9%; Acquisitions Push Hawthorne Up 84%" (Jan. 30, 2019)).

[24] Application for Review, at 2.

[25] TREIT Motion, Ex. O (ETFMG Alternative Harvest ETF Fund Fact Sheet, dated June 30, 2019).

[26] *Id.*, Ex. A (YOLO Fund Fact Sheet, dated May 31, 2019).

[27] *Id.*, Ex. B (YOLO Daily Holdings Data, last accessed Aug. 12, 2019).

company that specifically targets the cannabis industry and its clients include licensed cannabis cultivators, processors, and dispensaries in the United States and Canada.[28]

The Cannabis ETF was listed by NYSE Arca on July 8, 2019 (NYSE: THCX). The Cannabis ETF was "constructed to make investing in cannabis easier by helping investors get exposure to a pure-play basket of stocks that are expected to benefit from the burgeoning hemp and legal marijuana industries."[29] The ETF's holdings include IIPR, Greenlane, and Scotts MiracleGro.[30]

CNBS was listed by NYSE Arca on July 23, 2019.[31] CNBS invests at least 80% of its assets in securities of companies that derive 50% or more of their revenue from the cannabis and hemp ecosystem.[32] The ETF's holdings include IIPR.[33]

Other Companies. The NYSE also lists several other companies that sell products or have partnered with companies who operate in the cannabis industry. For example, HP, Inc. (NYSE: HPQ) sold hardware to software firm FlowHub, which launched a product specifically designed for the cannabis industry.[34] Salesforce.com Inc. (NYSE: CRM) is a cloud-based software company headquartered in San Francisco, California that markets "Cultivate by CloudMJ," an application built on the Salesforce App Cloud that is specifically designed for the

---

[28] *Id.*, Ex. C (Greenlane Holdings Form 10-Q filing, dated May 9, 2019).

[29] *Id.*, Ex. D (Cannabis ETF Fund Fact Sheet, dated July 31, 2019).

[30] *Id.*, Ex. E (Cannabis ETF Holdings, last accessed July 25, 2019).

[31] *Id.*, Ex. F (NYSE Regulatory Bulletin, dated July 23, 2019).

[32] *Id.*, Ex. G (CNBS Fund Summary, last accessed Aug. 8, 2019).

[33] *Id.*, Ex. H (CNBS Daily Holdings Data, last accessed Aug. 8, 2019).

[34] TREIT Memo, at 10 (citing Gene Marks, "HP finds an opportunity in the marijuana industry," Washington Post (Apr. 13, 2018)). The TREIT Memo mistakenly lists HP as a company listed on the Nasdaq, but HP is listed on the NYSE.

cannabis industry.[35] And CBRE Group Inc. (NYSE: CBRE), a commercial real estate services and investment firm headquartered in Los Angeles, California, has "overseen a provincewide expansion of a leading private cannabis retailer" in Canada.[36]

2. Companies Directly Engaged in the Cannabis Industry

Both the NYSE and Nasdaq also list companies that are directly involved in the cannabis industry. The NYSE lists companies that cultivate and distribute medical and recreational cannabis in Canada (these companies do not operate within the United States),[37] pharmaceutical companies researching and developing drugs using cannabinoids,[38] and United States companies that manufacture and sell products containing hemp.[39]

ARGUMENT

NYSE's denial to provide TREIT with a pre-certification letter to list on the NYSE violates Section 19(f) of the Exchange Act in that (A) it imposes an inappropriate burden on competition to the detriment of TREIT and the investing public that is not necessary or

---

[35] *Id.*, at 8 (citing Salesforce.com, AppExchange, "Cultivate," https://appexchange.salesforce.com/listingDetail?listingId=a0N3000000DXzzhEAD (last accessed Mar. 21, 2019))

[36] *Id.*, at 8-9 (citing CBRE Group, Inc., Sales Representative Profile, Paige Mersereau, http://www.cbre.us/people-andoffices/paige-mersereau (last accessed Mar. 21, 2019)).

[37] Compass Diversified Holdings, CannTrust Holdings, Canopy Growth Corporation, Aurora Cannabis, Aphria, HEXO Corporation, and Pyxus International Inc. In addition, Altria Group Inc., a U.S. company, acquired a 45% stake in Cronos Group (a Nasdaq-listed Canadian company that cultivates and sells medicinal marijuana). TREIT Memo, at 6 n. 10 (citing Altria Group, Press Release, "Altria Becomes Largest Shareholder in Cronos Group, a Leading Global Cannabinoid Company" (Mar. 8, 2019)).

[38] India Globalization Capital Inc. and 22nd Century Group subsidiary Botanical Genetics. TREIT Memo, at 6 n. 12.

[39] Level Brands, Turning Point Brands Inc. and 22nd Century Group (subsidiary Botanical Genetics). *Id.*, at 6 n. 11.

appropriate in furtherance of the Exchange Act; (B) the determination is not in accordance with NYSE rules because (1) the NYSE has circumvented the rule-making process for their unwritten blanket policy, and (2) the NYSE has inconsistently and arbitrarily applied its policy; (C) the NYSE policy and its arbitrary application is wholly inconsistent with the Exchange Act; and (D) the specific reasons for the NYSE's determination do not exist in fact.

A. NYSE's Determination Imposes an Inappropriate Burden on Competition to the Detriment of TREIT and the Investing Public

The NYSE's inconsistently applied cannabis policy is discriminatory and imposes a burden on competition that is not necessary or appropriate in violation of Section 19(f). The NYSE's actions provide those cannabis-related companies permitted to list a competitive advantage over those denied listing, without reasonable justification and without any connection to the regulatory purpose of the Exchange Act. The NYSE rightly listed these other cannabis-related companies, given both Congress' and the NYSE's commitment to innovative and emerging growth companies, [40] the appeal of such lucrative companies to investors,[41] and the current political and enforcement climate that is favorable to the cannabis industry.[42] However, the NYSE erred in excluding TREIT from the ranks of these listed companies.

Competition has long been a hallmark of this country and no less so of our markets. The Exchange Act places a strong emphasis on removing barriers to competition. Congressional intent was clear when amending the Exchange Act in 1975: Congress intended to "break down the unnecessary regulatory restrictions which . . . restrain competition among markets and market

---

[40] TREIT Memo, at 23-27.

[41] *Id.*, at 24 (discussing the enormous profits of a Canadian-listed company, Charlotte's Web, that raised $100 million via an IPO in Canada).

[42] *Id.*, at 11-21.

makers . . .." S. Rep. No. 94-75, 94th Cong. (1975), at 12. At the time, the House of Representatives emphasized that competition is key, stating "in the securities industry undue emphasis has been placed on regulation instead of competition. We find that such emphasis has been unwarranted. ... in the economic areas affecting the securities industry, competition, rather than regulation, should be the guiding force." H.R. Rep. No. 94-123, 94th Cong. (1975), at 47. In affirming the Commission's commitment to removing barriers to competition, then-Commissioner Philip A. Loomis stated that "[f]air competition is...one of the primary objectives of the national market system which is to be established."[43]

In furtherance of this objective, Congress enacted Section 19(f) as one of the amendments to the Exchange Act in 1975 to require the Commission to set aside any stock exchange rule or policy that imposes a "burden on competition not necessary or appropriate." 15 U.S.C. § 78f(b)(8). To survive Commission review, any burden on competition must be clear and connected to a regulatory purpose. *See, e.g., In re the Application of Domestic Securities, Inc.*, Rel. No. 34-37559, Admin. Proc. File No. 3-8702 (Aug. 13, 1996), at 4 (finding that the basis for the exchange action denying modification of a restrictive agreement regarding a member's market making activities was not clear, and accordingly, "[w]ithout a connection to a regulatory purpose, such a broad-based limitation on Domestic's ability to function .... appears to impose a burden on competition 'not necessary or appropriate in furtherance of the purposes' of the [Exchange Act].").

Even before the 1975 amendments to the Exchange Act, the Supreme Court observed that the NYSE's unjustified use of its immense power could lead to substantial competitive injury. In

[43] *See* TREIT Motion, Ex. Y (Statements from then-Commissioner Philip A. Loomis, dated Nov. 18, 1975).

Silver v. NYSE, a seminal case in the antitrust realm, the Supreme Court reviewed certain anticompetitive actions undertaken by the NYSE with no notice and without disclosure of the reason behind these actions, which resulted in a loss of business for the petitioners,[44] noting that,

> Enforcement of exchange rules, particularly those of the New York Stock Exchange **with its immense economic power**, may well, in given cases, **result in competitive injury to an issuer**, a nonmember broker-dealer, or another when the imposition of such injury is not within the scope of the great purposes of the Securities Exchange Act. Such unjustified self-regulatory activity can only diminish public respect for and confidence in the integrity and efficacy of the exchange mechanism.

Silver, 373 U.S. 341, 359 (1963) (emphasis added).

Here, the NYSE's inconsistent application of its so-called "policy" has created clear competitive advantages that come with being a NYSE listed company for those cannabis companies that are permitted to list and significant disadvantages for those, like TREIT, who are not. These disadvantages are exacerbated for TREIT because IIPR, whose shares are listed, is a competitor. In fact, IIPR's and TREIT's businesses are identical. There is no supportable basis – and NYSE has not asserted one - for differentiating between the two companies under NYSE listing standards or its "policy."

There are clear advantages of listing on the NYSE that would significantly contribute to TREIT's growth, including much-improved visibility and higher volume-based liquidity.[45] The

---

[44] *Silver's* holding that the courts could review the NYSE action under anti-trust laws has since been superseded by the 1975 amendments to the Exchange Act that require the SEC to take competition into account in rulemaking and when reviewing rules of exchanges, including 15 U.S.C. §§ 78c(f), 78w(a)(2) (*Friedman v. Salomon/Smith Barney*, 313 F.3d 796, 800 (2d Cir. 2002)).

[45] "Moving to the NYSE or Nasdaq has its advantages, including much-improved visibility and higher volume-based liquidity. That can lead to lower volatility and make it easier for investors to get in or out of mainstream-listed marijuana stocks, should they choose. Perhaps most important, being listed on a prominent exchange, side by side with time-tested businesses, often encourages Wall Street firms to initiate coverage and/or make an investment. These firms often avoid OTC-listed companies, which means making the jump can have a major impact on how

NYSE touts itself as the place where the "world's best businesses, leaders and problem-solvers walk through [its] doors to raise the capital required for innovation and progress in communities across the globe."[46] NYSE further advertises as offering both credibility and worldwide visibility, which contributes to companies' access to institutional investors.[47] And investors equally view NYSE as the gold standard.[48]

Indeed, institutional investors sometimes avoid companies listed on the OTC ("Pink Sheets"), and many large U.S. brokers will not trade in securities listed on the CSE or OTC, which are considered more speculative.[49] IIPR has reaped substantial benefits from its listing on the NYSE. Such benefits – not only for IIPR but for investors as well – underscores the wisdom of the NYSE's listing of IIPR. The listing also promotes Commission policies of bringing new companies to the market to increase investor opportunities.

IIPR expressly touts its competitive advantage and has repeatedly advertised itself as the "the first and only real estate company on the New York Stock Exchange (NYSE: IIPR) focused on the regulated U.S. cannabis industry."[50] Indeed, as a result of the monopoly that the NYSE

---

investment-worthy a marijuana stock is viewed by Wall Street." TREIT Motion, Ex. V (The Motley Fool article, dated May 24, 2019), at 2.

[46] *Id.*, Ex. W (NYSE article, last accessed Aug. 12, 2019).

[47] *Id.*, Ex. X (NYSE website, last accessed Aug. 12, 2019).

[48] For example, the CEO of Canopy Growth, another company involved in the marijuana industry has stated that one of the "primary drivers" of its listing on the NYSE was access to U.S. institutional investors, emphasizing that the NYSE "has a bit more history and cache [than other exchanges]... ." *Id.*, Ex. T (Bloomberg article, dated May 14, 2018).

[49] *Id.*, Ex. U (Wall Street Journal article, dated July 8, 2019); Ex. BB (Real Money article, dated Jan. 7, 2019); and Ex. V (The Motley Fool article, dated May 24, 2019).

[50] *Id.*, Ex. M (IIPR press release, dated June 21, 2019) and Ex. N (IIPR press release, dated July 9, 2019).

has provided to IIPR, IIPR is trading at significantly higher rates than the average of the 232 REITs listed on the NYSE and Nasdaq. Comparing IIPR to this industry average shows that:

- IIPR's price to earnings ratio is 59% higher than its peer average;
- IIPR trades at a price to funds from operations ratio 173% higher than its peer average; and
- IIPR trades at a price to book ratio 81% higher than its peer average.[51]

And, as yet another example of IIPR's competitive advantage in the cannabis REIT market, IIPR is included in all four publicly listed ETFs that target the cannabis industry. Two of these ETFs (THCX and YOLO) include IIPR in their top 10 holdings (and the top 10 holdings are predominately comprised of companies listed on the Nasdaq and NYSE, rather than the OTC). ETFs, like YOLO and MJ, state they will only trade in stocks listed on the NYSE, NYSE America, Nasdaq, TSX Exchange, and TSX Venture Exchange. [52]

TREIT, on the other hand, has been foreclosed from any of the benefits that IIPR enjoys. The unfair burden on competition resulting from the NYSE's arbitrary denial of access to TREIT stands in marked contrast to other cases where the Commission has not found an inappropriate or unnecessary burden on competition.[53] Without a clear basis or justification, the NYSE's

---

[51] *Id.*, Ex. S (Market capitalization and pricing data based on publicly available information for the 232 REITs listed on the NYSE and Nasdaq, as of July 12, 2019). Specifically, comparing IIPR to this industry average shows that IIPR trades at a price to earnings ratio of 132.7 versus a peer average of 83.4, that it trades at a price to funds from operations ratio of 59.2 versus a peer average of 21.7, and that it trades at a price to book ratio of 4.9 versus a peer average of 2.7. *Id.*

[52] MJ also trades stocks listed on the ASX. *Id.*, Ex. Q (Legal Opinion prepared for YOLO ETF, dated April 15, 2019), at 4, and Ex. R (Legal Opinion prepared for MJ ETF, dated May 1, 2019), at 4.

[53] *Cf. In re the Application of Jon Symon J.G. Symon & Companies* and *In re the Application of James Lee Goldberg* finding no unfair competitive advantage in denying the applicants' request for a waiver of the financial qualification exam requirement for registered representatives because "all other similarly situated applicants" were treated in the same way: all were required

determination as to TREIT is clearly an undue burden on competition that is not necessary or appropriate.

B. The NYSE Determination Was Not in Accordance with NYSE Rules

The NYSE's decision to deny TREIT the opportunity to list on the NYSE was based solely on an unwritten policy of the NYSE, specifically: "NYSE is not intending to list any company that is directly or indirectly involved in the marijuana industry in the United States."[54] The NYSE's policy is not reasonably and fairly implied by any existing NYSE rule and is therefore a new rule for which it failed to obtain SEC approval. As such, it is unenforceable.

1. Exchange Act Requirements for Adopting Stock Exchange Rules

The Exchange Act has procedures in place to ensure the NYSE is operating within the confines of its delegated authority. Section 19(b) of the Exchange Act establishes the appropriate mechanism by which an exchange can promulgate a rule or change their governing rules. 15 U.S.C. § 78s(b). To initiate the process, the exchange is required to file any proposed rule change with the SEC "accompanied by a concise general statement of the basis and purpose of such proposed rule change." The SEC is then required to publish notice of the proposed rule change and give interested individuals an opportunity to comment prior to approving or disapproving the rule. *Id.*

The NYSE cannot evade these requirements by relying on an unwritten policy. Under Exchange Act Rule 19b-4(c), any "stated policy, practice, or interpretation of the self-regulatory

---

to take the applicable examinations before being issued licenses. *Symon*, Rel. No. 41285, Admin. Proc. File No. 3-9609 (Apr. 14, 1999), at 5 (denying application where registration lapsed) and *Goldberg,* Rel. No. 66549, Admin. Proc. File No. 3-14544 (Mar. 9, 2012), at 12 (denying application where former waiver was withdrawn).

[54] Application for Review, Ex. A, Walker Declaration, para 9.

organization shall be deemed to be a proposed rule change unless (1) it is reasonably and fairly implied by an existing rule of the self-regulatory organization or (2) it is concerned solely with the administration of the self-regulatory organization and is not a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization." 17 CFR § 240.19b-4.

In adopting Rule 19b-4(c), the Commission acknowledged that some commenters had criticized its rule proposal for its "vagueness" and stated that the "reasonably and fairly implied" exception would be evaluated on a case-by-case basis. The Commission further advised that "a stated policy, practice, or interpretation that prescribes extensive and specific limitations on particular types of transactions or conduct that are not apparent from the face of the existing rule is not 'reasonably and fairly implied' by the rule." Securities Exchange Act Release No. 17258, (Nov. 7, 1980), 45 FR 73906, 73913.

2. NYSE Has Circumvented the Commission's Rule Making Process

The NYSE's stated policy is not "reasonably" or "fairly implied by an existing rule" nor is it solely concerned with the NYSE's administration. Section 101 of the NYSE Listed Company Manual provides that:

> The Exchange has broad discretion regarding the listing of a company. The Exchange is committed to list only those companies that are suited for auction market trading and that have attained the status of being eligible for trading on the Exchange. Thus, the Exchange may deny listing or apply additional or more stringent criteria based on any event, condition, or circumstance that makes the listing of the company inadvisable or unwarranted in the opinion of the Exchange. Such determination can be made even if the company meets the standards set forth below.[55]

Looking beyond Section 101, we could find no existing NYSE rules containing any prohibition, implicit or explicit, on the listing of a company either directly or indirectly involved in the

[55] NYSE Listed Company Manual, Section 101.00 ("Section 101").

cannabis industry. Instead, apparently relying on its vast discretion over listing decisions, the NYSE has cited a blanket policy applicable to the entire cannabis industry and those doing business with it that, in the SEC's words, "prescribes extensive and specific limitations on particular types of conduct or transactions." *See* Securities Exchange Act Release No. 17258, Nov. 7, 1980, 45 FR 73906, 73913. Such a blanket and broad sweeping policy cannot "reasonably and fairly" be implied unless it is "apparent from the face of the existing rule." *Id.* Here, it is clearly not.

In *Higgins*, the NYSE argued that an unwritten policy that prohibited direct telephone communications between Exchange members on the floor and non-members off the floor constituted a "stated policy, practice or interpretation" that was "reasonably and fairly implied" by existing NYSE rules, and thus, qualified as a rule under the Exchange Act. *In the Matter of the Applications of William Higgins*, Release No. 34-24429, Admin. Proc. File No. 3-6609 (May 6, 1987). The Commission disagreed, finding that "[a]ny such comprehensive rule or policy plainly would have to be submitted for Commission review under the requirements of Section 19(b) of the Exchange Act and Rule 19b-4 ... [s]ince the policy was never published by the NYSE as a stated policy, practice or interpretation, it does not have any binding effect on NYSE members or other persons." *Id.*, at 8, 9. In evaluating the NYSE's argument that the "reasonably and fairly implied" standard applied to the Exchange's telephone access policy, the Commission found that no such "policy [would be] apparent from the face of [the] provisions [cited by the Exchange]" and that from the face of the provisions, "a reasonable person would assume that the issue of telephone access to non-members *has not been addressed at all by the NYSE*." *Id.*, at 10 (emphasis added). The Commission further found that general enabling and empowering provisions in the NYSE's Constitution cited by the Exchange did not bestow it with

administrative discretion to set forth new policies not found in those sections, and the Commission set aside the NYSE denial of access to services and ordered the NYSE to install the telephone links the applicant's requested. *Id.*, at 14 (noting that "Under Section 19(f) we must set aside any SRO action that imposes a limitation on access when the action is not taken pursuant to a rule of the SRO.")

When the issue of improper rule-making has come before the courts, the analysis has been the same. For example, in *General Bond & Share Co. v. SEC,* 39 F.3d 1451 (10th Cir. 1994), the SEC alleged that a market maker's acceptance of compensation in exchange for listing a security in the pink sheets was conduct prohibited by a general provision of NASD's Rules of Fair Practice regarding members' observation of certain ethics and trade standards. The Court found, however, that the NASD did not file any documents with the SEC to seek approval regarding this new prohibition. As a result, the Court found that NASD's interpretation was a "rule change" that was not filed with the SEC and therefore enforcement of the rule was invalid. The Court reasoned that the market maker's conduct was not so "inherently deceptive" that a ban against it was "clearly implied" by the general provision regarding its members ethical conduct. *See also Fiero v. Fin. Indus. Regulatory Auth., Inc.*, 660 F.3d 569, 577 (2d Cir. 2011) (invalidating a NASD rule change that authorized FINRA to judicially enforce the collection of its disciplinary fines rather than just impose sanctions on its members under the Exchange Act and FINRA's rules and bylaws, because it was never properly promulgated by the NASD and was a "substantive new rule that affected the rights of barred and suspended members," not simply a policy change).

Similarly here, the NYSE's unwritten policy is not "clearly implied" by its existing rules. Taking the NYSE's broad discretion into account, reading Section 101 to permit such a

sweeping, unwritten policy as reasonably and fairly implied by Section 101 would swallow Rule 19b-4(c) entirely. In making its determination, the NYSE applied only its blanket policy and did not go further to consider any other facts and circumstances regarding TREIT. Such blanket policies cannot properly form the basis of the NYSE's listing determination. (*Cf. JJFN* upholding a NASD decision to deny the company's application for inclusion of its securities on a Nasdaq market based on the felony tax conviction of its controlling shareholder, noting that it was based on "a reasoned decision made on consideration of all of the facts and circumstances presented, and does not reflect a blanket rule." *In the Matter of the Application of JJFN Services, Inc.,* Release No. 34-39343, Admin. Proc. File No. 3-9229 (Nov. 21, 1997), at 3).

While the NYSE has broad discretion in listing decisions, that discretion is cabined by the Commission's rule making requirements.[56] In other words, the NYSE cannot circumvent the required rule-making process by implementing a blanket policy concerning the listing of cannabis companies under the guise of that discretion.

3. The NYSE Has Inconsistently and Arbitrarily Applied Its "Policy"

The NYSE described its position as a blanket black-and-white policy, yet as detailed in Section D, above, it has observed this policy in the breach, listing companies that are "directly or indirectly involved in the marijuana industry in the United States both before and after denying TREIT the opportunity to have its shares listed." The NYSE's listings of IIPR, Scotts, and four

[56] This discretion is provided to the NYSE, in part, to allow the NYSE to serve its mission of preserving and strengthening the quality of and public confidence in the market, in order to protect investors and the public interest. But denying TREIT listing does not serve to protect future investors when companies similarly situated are allowed to list, without any reasonable basis for the distinction. And the Commission, who also has an investor protection function, has declared effective the registration statements of companies who operate in the cannabis industry.

ETFs that are cannabis focused and have significant holdings in IIPR, cannot be reconciled with a blanket policy to deny listing companies engaged in the cannabis industry.

To the extent the NYSE has in fact adopted this policy, it is certainly not apparent to the market. In legal opinion letters filed with the Commission for two of the ETFs listed on the NYSE, the following representation regarding the NYSE's position with respect to cannabis companies undercuts, at a minimum, knowledge of the NYSE's so-called policy by parties directly involved in the listing process:

> The NYSE is a worldwide market that lists about 80% of U.S. securities. ... The NYSE Exchanges **are open to listing companies involved in the cannabis industry who are involved in biotech (22nd Century Group: XXII); investment in the industry outside of United States (Canopy Growth Corp.: CGC; the Fund: MJ); the agricultural sector (Scott's Miracle Grow Co.: SMG); and the real estate sector (Industrial Properties, Inc.: IIPR). United States based companies that "touch the plant" (i.e., those that grow or distribute cannabis) are not eligible to list at this time.**[57]

This detailed and delineated position is flatly inconsistent with the blanket rule not to list *any* company involved, directly or indirectly, in the cannabis industry that was asserted by the NYSE as the sole reason for disallowing TREIT the opportunity to apply for a listing.

The Commission has previously discussed the need for clear listing standards, which are of "substantial importance to financial markets and the investing public."[58] The NYSE's non-

---

[57] TREIT Motion, Ex. Q (Legal Opinion prepared for YOLO ETF, dated April 15, 2019), at 4, and Ex. R (Legal Opinion prepared for MJ ETF, dated May 1, 2019), at 4 (emphasis added). This same quote appeared in both legal opinions, although the YOLO opinion lists additional examples of companies that the NYSE has listed.

[58] "The development and enforcement of meaningful listing standards for an exchange is of substantial importance to financial markets and the investing public. Among other things, listing standards provide the means for an exchange to screen issuers that seek to become listed, and to provide listed status only to those that are bona fide companies with sufficient public float, investor base, and trading interest likely to generate depth and liquidity sufficient to promote fair and orderly markets. Meaningful listing standards also are important given investor expectations regarding the nature of securities that have achieved an exchange listing, and the role of an exchange in overseeing its market and assuring compliance with its listing standards." Release No. 34-65709, File No. SR-NYSE-2011-38 (Nov. 8, 2011), at 13.

transparent and inconsistently applied policy that allows for the listing of IIPR and ETFs that hold IIPR but not TREIT lacks any guidelines or standards mandated by the Commission and violates the NYSE rules and the Exchange Act.

C. NYSE Determination Is Inconsistent with the Exchange Act

Another reason to set aside NYSE's action is because the discriminatory and selective application of NYSE's unwritten policy is inconsistent with the basic principles upon which the national exchanges were founded, including to ensure that markets are open and orderly. The "basic goals" of the Exchange Act are:

> to provide fair and honest mechanisms for the pricing of securities, to assure that dealing in securities is fair and without undue preferences or advantages among investors, to ensure that securities can be purchased and sold at economically efficient transaction costs, and to provide, to the maximum degree practicable, markets that are open and orderly.

Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S.249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 11 (1975), at 3.

Section 6(b)(5) of the Exchange Act similarly requires rules of the national securities exchanges to be designed, among other things "to promote just and equitable principles of trade, ... to remove impediments to and perfect the mechanism of a free and open market and a national market system, and ... to protect investors and the public interest." 15 U.S.C. § 78f(b)(5).

In determining whether the NYSE applied its rules in a manner consistent with the Exchange Act, the Commission must look to whether the NYSE's application of its rules were applied in a discriminatory or unfair manner. In *Richardson*, the Commission noted that

> Congress clearly intended that the substantive fairness of NASD deliberations [were] subject to the Commission's review; one of the goals of the 1975 Amendments was to

> strengthen the Commission's oversight of SROs. The Commission has an obligation to ensure "that [self-regulatory power] is used effectively to fulfill the responsibilities assigned to the self-regulatory agencies, and that it is not used in a manner inimical to the public interest or unfair to private interests." Among the Commission's responsibilities in reviewing SRO actions under Section 19(f) is to determine whether the rules of the SRO have been applied "in a discriminatory or unfair manner," i.e., whether the action is substantively fair.

In the Matter of the Application of Harry M. Richardson, Release No. 51236, Admin. Proc. File No. 3-11437 (Feb. 22, 2005), at 4.[59] The Exchange Act also requires that the exchanges promote "just and equitable principles of trade," and "protect investors and the public interest." 15 U.S.C. § 78f(b)(5).

For the reasons detailed at pages 14-19, the NYSE's action denying TREIT the opportunity to apply for a listing was both discriminatory and unfair. The fact that NYSE has listed other, similar entities that are indirectly engaged in the cannabis industry, both before and after TREIT's application was denied, forcefully demonstrates that NYSE is applying its blanket policy in an arbitrary manner that is not just, nor equitable, and does not promote open and orderly markets. The requirements of the Exchange Act must be administered fairly and even-handedly to avoid the risk of a perception that the exchanges are picking winners and losers, placing investor confidence and our free market system at risk.

Furthermore, denying eligible companies the opportunity to list in the United States, forces these companies to list on foreign exchanges where comparable protections for investors may be less rigorous or even absent. This is hardly consistent with the Exchange Act goals of protecting investors. American exchanges dominate global market capitalization, and this competitive edge is largely driven by the premise that foreign exchanges have looser regulations.

---

[59] *See* also *In the Matter of the Application of Paul Edward Van Dusen*, Release No. 34-18284, Admin. Proc. File No. 3-5946 (Nov. 24, 1981), at 3 ("[W]e must determine whether or not the Association's application of its rules was 'unfair.'").

Significantly, the CSE has become a hub for U.S. cannabis companies. According to a recent article, the CEO of the CSE, Richard Carleton, stated that around 170 cannabis companies are trading on the CSE, and that roughly 40% of those firms have material operations in the U.S.[60] And a recent BNN Bloomberg article noted that investors should be aware that companies that list on the CSE may be riskier than issuers that opt for the TSX or other exchanges.[61] It is indeed unfortunate that legitimate companies are being driven to foreign trading venues that lack the stature and credibility of U.S. markets.

The NYSE's stated intention to deny listing of companies like TREIT is also contrary to the clear policy goals of current legislation—like the JOBS Act[62]—and Commission priorities to bring small companies to market and provide investors with expanded investment opportunities. These priorities were recently highlighted by Chairman Clayton, who stated "the SEC should be keenly focused on helping small businesses from coast to coast access capital to grow, create new jobs, and, in turn, provide investors, including our Main Street investors, expanded investment opportunities."[63] The Director of SEC's Corporation Finance Division, William

---

[60] TREIT Motion, Ex. Z (CNN article, dated June 10, 2019)

[61] *Id.*, Ex. AA (BNN Bloomberg article, dated Oct. 26, 2018).

[62] On the legislative side, Congress made its intent clear that emerging growth companies should have a less restrictive path to funding and investment when it passed the Jumpstart Our Business Startups (JOBS) Act a few short years ago. TREIT Memo, at 24 (citing "Jumpstart Our Business Startups Act," 126 Stat 306 (2012)). The JOBS Act eases securities regulations in an attempt to encourage funding of, and investment in, small businesses. It also aims to boost market access for innovative companies and emerging growth companies, like those in the cannabis sector.

[63] *Id.*, at 22 (citing SEC Chairman Jay Clayton, "Remarks on Capital Formation at the Nashville 36/86 Entrepreneurship Festival" (Aug. 29, 2018)).

Hinman, has echoed these priorities, highlighting the need for a "regulatory approach that both fosters innovation and protects investors."[64]

The NYSE's selective application of its unwritten policy denies small businesses in the cannabis industry fair treatment under our regulatory system, and U.S. investors, current and prospective, should benefit from the innovation and growth the industry has to offer.

D. The Basis for the NYSE Determination Does Not Exist in Fact

The Commission should further set aside the NYSE's determination because there is no record that demonstrates that the NYSE's determination is based in fact. Unlike a successful eligibility determination where a pre-clearance letter is received, a negative eligibility determination results in no written record of a denial.[65] Moreover, a company determined to be ineligible has no recourse within the Exchange as there is no internal administrative process for review. This process results in the pocket denial that occurred in this case.

The complete lack of any process by the NYSE – no opportunity for a hearing, no findings, no opportunity for review, not even a written denial – compounds the unfairness of the NYSE's actions. As the Supreme Court noted in *Silver*:

> No policy reflected in the Securities Exchange Act is, to begin with, served by denial of notice and an opportunity for hearing. Indeed, the aims of the statutory scheme of self-policing—to protect investors and promote fair dealing —are defeated when an exchange **exercises its tremendous economic power without explaining its basis for acting, for the absence of an obligation to give some form of notice and, if timely requested, a hearing creates a great danger of perpetration of injury that will damage public confidence in the exchanges.**

Silver, 341 U.S. at 361.

---

[64] *Id.*, at 23 (citing SEC Director of Div. of Corp. Finance William Hinman, "Testimony on 'Oversight of the SEC's Division of Corporation Finance'" (Apr. 26, 2018)).

[65] NYSE Listed Company Manual, Section 702.00.

The Commission has set aside exchange decisions when the basis for the exchange's determination does not exist in the record. In *CleanTech*, the Nasdaq staff had delisted CleanTech on the basis that the company failed to provide material documents in response to exchange requests during its listing application, and the staff also cited the Nasdaq's broad discretionary authority to delist companies. But the Commission set aside Nasdaq's delisting decision, finding that the record was insufficient to support the conclusion that the staff had requested the documents. *In the Matter of the Application of CleanTech Innovations, Inc.*, Release No. 69968, Admin. Proc. File No. 3-14640 (July 11, 2013) ("The record does not show that the specific grounds on which NASDAQ based its delisting decision exist in fact, and the considerable discretion afforded to NASDAQ therefore does not permit its delisting decision.").

In *Eagle Supply*, Eagle appealed an NASD denial of its listing application based on the fact that two of Eagle's control persons were found, in criminal and civil actions, to have violated the securities laws 25 and 27 years prior to the application. *In the Matter of the Application of Eagle Supply Group, Inc.,* Release No. 34-39800, Admin. Proc. File No. 3-9313 (Mar. 25, 1998). The Commission concluded that NASD's basis for denial was not clear because Nasdaq "did not explain how, or even whether, [the disciplinary history] factored into its decision" and "did not explain why it believed that securities law violations that occurred twenty-five and twenty-seven years ago would create the potential for similar misconduct in the future... ." The Commission recognized the NASD's discretion, but stated that the "NASD must articulate a basis for concluding that individuals who have engaged in past misconduct may be predisposed to engage in future violations of the securities laws or otherwise present a risk to the integrity of the Nasdaq Stock Market. The NASD's decision and the record here do not reveal the basis for its conclusion." *Id.,* at 3. Accordingly, the Commission set aside the listing denial and remanded to

the NASD for further consideration and an explanation of the basis for its findings. *See also*, *In the Matter of the Application of Domestic Securities, Inc., Exch. Act Rel.* No. 34-37559, Admin. Proc. File No. 3-8702 (Aug. 13, 1996), at 4 (setting aside the NASD action denying Domestic's request to expand the number of securities it was authorized to market in part because the Commission was unable to discern the path by which the NASD arrived at its conclusion).

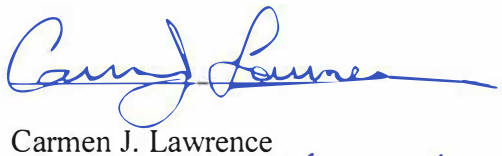
Similar to the Nasdaq in *CleanTech* and *Eagle Supply*, the NYSE has not articulated any explanation for why its unwritten policy of not listing companies directly or indirectly involved in the cannabis industry in the United States would prevent TREIT from listing on its exchange, when entities *already* (e.g. IIPR) and *subsequently* (several ETFs) listed on the NYSE are involved in the cannabis industry in the United States. For this reason alone, the Commission should set aside the NYSE determination.

CONCLUSION

Accordingly, TREIT requests that the Commission set aside the NYSE action and require NYSE to consider and review TREIT's listing application in accordance with the requirements of Section 19(f) of the Exchange Act and NYSE rules.

Dated: August 15, 2019

Respectfully submitted,



Carmen J. Lawrence
Richard H. Walker
King & Spalding LLP
1185 Avenue of the Americas
New York, New York 10036
(212) 556-2100
clawrence@kslaw.com
rwalker@kslaw.com
Attorneys for TREIT

CERTIFICATE OF SERVICE

I, Carmen J. Lawrence, Esquire, hereby certify that on August 15, 2019, I caused a true and correct copy of the foregoing brief in support of application for review to be served on the following via hand delivery (Office of the Secretary, NYSE) and email (NYSE).

Vanessa Countryman
Secretary
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Via hand delivery

Elizabeth King, General Counsel
Daniel Z. Mollin, Associate General Counsel
Martha Redding, Assistant Secretary
New York Stock Exchange
11 Wall Street
New York, NY 10005

Via hand delivery and email

Carmen J. Lawrence

CERTIFICATE OF COMPLIANCE

I, Carmen J. Lawrence, Esquire, hereby certify that the foregoing TREIT's Brief in Support of Application for Review of Action by the New York Stock Exchange (Admin. Proc. File. No. 3-19192) complies with the length limitation set forth in SEC Rule of Practice 450(c). I have relied on the word count feature of Microsoft Word in verifying that this brief contains 10,428 words.

Dated: August 15, 2019

Carmen J. Lawrence
King & Spalding LLP
1185 Avenue of the Americas
New York, New York 10036
(212) 556-2100
clawrence@kslaw.com

ADDENDUM OF AUTHORITIES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 69968 / July 11, 2013

Admin. Proc. File No. 3-14640

In the Matter of the Application of

CLEANTECH INNOVATIONS, INC.
c/o Paula D. Shaffner
Joshua R. Dutill
Stradley, Ronon, Stevens & Young, LLP
2600 One Commerce Square
Philadelphia, PA 19103

For Review of Action Taken by
The NASDAQ Stock Market, LLC

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE—DELISTING FROM THE NASDAQ STOCK MARKET, LLC

Intentionally Withholding Documents Requested by NASDAQ Staff

National securities exchange delisted issuer's securities based on its finding that issuer intentionally withheld documents requested by staff of exchange while staff was considering issuer's listing application. *Held*, delisting decision *set aside*.

APPEARANCES:

Paula D. Shaffner and *Joshua R. Dutill*, Stradley, Ronon, Stevens & Young, LLP, for CleanTech Innovations, Inc.

Edward S. Knight, *John M. Yetter*, *Arnold P. Golub*, and *T. Sean Bennett*, for The NASDAQ Stock Market, LLC.

Appeal filed: November 28, 2011
Last brief received: March 1, 2012

I.

CleanTech Innovations, Inc. seeks review of the decision of The NASDAQ Stock Market, LLC[1] to delist CleanTech's common stock from the NASDAQ Capital Market. NASDAQ based its delisting decision on its finding that CleanTech intentionally withheld documents requested by NASDAQ staff while the staff was considering CleanTech's application to list its shares and thus violated NASDAQ Listing Rules 5205(e) and 5250(a)(1).[2] We base our findings on an independent review of the record.

II.

This case concerns CleanTech's provision of information about financing transactions involving affiliates of Benjamin Wey, allegedly a promoter of reverse takeovers,[3] that closed on December 13, 2010 (the "December Financing"). NASDAQ staff repeatedly sought information about CleanTech's involvement with Wey while CleanTech's listing application was under review, and CleanTech responded to those information requests. On December 10, 2010, NASDAQ staff informed CleanTech that its listing application had been approved. One business day later, the December Financing closed, and three days after that, CleanTech filed a Form 8-K with the Commission disclosing the December Financing. NASDAQ staff then contacted CleanTech and obtained nearly 200 e-mails related to the December Financing that had not previously been disclosed, the earliest of which was written on November 30, 2010. NASDAQ found that by failing to provide documents about the December Financing before the listing was approved, CleanTech had intentionally withheld documents requested by the staff. The staff characterized this conduct as "an extremely serious violation of the Company's obligations under Nasdaq's rules," and delisted CleanTech's securities.[4]

A. CleanTech applied for NASDAQ listing.

CleanTech, through wholly owned subsidiaries in China, designs, manufactures, tests, and sells structural towers for on-land and off-shore wind turbines and other specialty metal products. The company was formed in July 2010 by a reverse merger of a Chinese entity and a United States shell company; it traded in the Pink Sheets.[5]

---

1 The name of the market appears in the record as both "Nasdaq" and "NASDAQ." For consistency, we use "NASDAQ," except in quotations.

2 Rules 5205(e) and 5250(a)(1) provide that NASDAQ may deny an issuer initial or continued listing if any communication by the issuer to NASDAQ contains a material misrepresentation or omits material information necessary to make the communication to NASDAQ not misleading.

3 *See infra* note 9 and accompanying text (discussing Wey).

4 *CleanTech Innovations, Inc.*, No. NQ 5872C, at 8 (unnumbered) (NASDAQ July 22, 2011).

5 The Pink Sheets was the name commonly associated with an electronic quotation system that displayed quotes and last sale information for many over-the-counter securities. It is now operated by OTC Markets Group, Inc. with three operating systems: OTCQX, OTCQB, and

(continued...)

On July 14, 2010, shortly after its formation, CleanTech filed a listing application with NASDAQ. The application asked CleanTech to provide, among other things, a list of bridge financings and private placements consummated within the prior six months. The application also required a company officer of CleanTech to sign a certification that he or she would "notify NASDAQ promptly of any material changes to the information provided in the application."[6] Bei Lu, CleanTech's Chief Executive Officer, signed this certification. The law firm of Stevens & Lee, PC ("Listing Counsel") represented CleanTech in seeking NASDAQ listing.

B. NASDAQ staff reviewed CleanTech's application.

As the staff reviewed CleanTech's application, it contacted the company from time to time to request additional information. Some of the staff's requests were written, others were made orally in telephone calls or meetings. The record contains very little contemporaneous evidence of the exact terms of the oral inquiries. In many instances, the best evidence about oral requests and responses is provided by an affidavit by William W. Uchimoto, a partner with CleanTech's Listing Counsel, that was submitted in the delisting appeal before NASDAQ.[7]

On August 28, 2010, while NASDAQ staff was considering CleanTech's application, *Barron's* published an article about the growing frequency with which Chinese mid-market companies were reverse-merging with registered United States shell corporations to gain entrance to United States securities markets.[8] The article specifically discussed, and criticized, Benjamin Wey, introducing him as "[o]ne of the most controversial promoters of Chinese reverse takeovers" and identifying CleanTech as "Wey's latest success story."[9]

(...continued)
OTC Pink. *See History of the OTC Markets Group,* http://www.otcmarkets.com/about/otc-markets-history (all websites referenced in this opinion were last visited July 10, 2013).

6 Excerpt from Listing Application, Ex. J to CleanTech's Submission in Support of Appeal to NASDAQ Listing and Hearing Review Council, Docket NQ 5872C-11.

7 Affidavit of William W. Uchimoto (July 1, 2011) (hereinafter "Uchimoto Aff."). We have considered this affidavit, which is consistent in many respects with other documentary record evidence, for the truth of the factual representations it contains. *See, e.g., Jeffrey L. Gibson,* Exchange Act Release No. 57266, 2008 SEC LEXIS 236, at *22 (Feb. 4, 2008) (including affidavits among the categories of evidence that may be introduced to support a position), *petition denied,* 561 F.3d 548 (6th. Cir. 2009). In contrast, unsworn representations by counsel contained in briefs or memoranda are not evidence of the facts they purport to recount. *See Dennis Todd Lloyd Gordon,* Exchange Act Release No. 57655, 2008 SEC LEXIS 819, at *70 n.98 (Apr. 11, 2008) ("The assertions contained in Applicants' briefs are not evidence.").

8 Bill Alpert & Leslie P. Norton, *Beware this Chinese Export,* BARRON'S (Aug. 28, 2010), http://online.barrons.com/article/SB50001424052970204304404575449812943183940.html.

9 *Id.* The article also alluded to Wey's disciplinary history, which had been discussed in an earlier *Barron's* article. The specifics of Wey's disciplinary history are not relevant to our resolution of this matter, because NASDAQ did not base its delisting on the fact of Wey's

(continued...)

On September 1, prompted by the *Barron's* article, NASDAQ staff e-mailed CleanTech to request information about Wey and the services he had provided to the company. CleanTech responded the following day with an e-mail that described Wey as the owner and president of New York Global Group ("NYGG US"), which has a business relationship with New York Global Group China ("NYGG China").[10]

On October 15, CleanTech filed with the Commission a Form 8-K disclosing a financing transaction that closed on October 14 involving Strong Growth Capital Ltd., an entity affiliated with Wey (the "October Financing"). On October 18, NASDAQ staff, by e-mail, requested a conference call with CleanTech's counsel for the stated purpose of "ask[ing] a few questions regarding [CleanTech's] involvement with [Wey]."[11] On October 28, the staff sent CleanTech an e-mail requesting, among other things, "[a]ll documents, including e-mails and attachments, relating to all loans and/or similar arrangements to or from Benjamin Wey, NYGG [US], NYGG China, and/or affiliated persons and/or entities."[12] The request did not include any instruction to update responses on an ongoing basis.

The company gave the staff responsive documents other than e-mails on November 4. CleanTech proposed that Wey "personally appear before [the staff] to answer questions directly in lieu of producing email documents."[13] The staff agreed to meet with Wey, and did so on November 5.[14]

After talking with Wey, the staff still had questions about him and NYGG US. In a conference call on November 16, the staff asked CleanTech to describe the services that NYGG US and NYGG China "[had] performed, [were] currently performing, or [were] anticipated to

---

(...continued)
involvement (or that of his affiliates) with CleanTech, but rather on its finding that CleanTech deliberately failed to provide information about that involvement.

[10] The record contains references to "New York Global Group China," "New York Global Group Asia," and "New York Global Group China / Asia." We understand these references to refer to a single entity. To avoid confusion, we use the term "NYGG China" to refer to this entity.

[11] E-mail from Michael Wolf, NASDAQ OMX, to James M. Connolly (Oct. 18, 2010, 3:28 p.m.). The record does not show whether the conference call took place.

[12] E-mail from Michael Wolf, NASDAQ OMX, to William W. Uchimoto (Oct. 28, 2010, 11:19 a.m.).

[13] Uchimoto Aff. ¶10.

[14] NASDAQ introduced no evidence as to whether it understood that the meeting was to take the place of e-mail production, or whether it expected CleanTech to produce the requested e-mails notwithstanding the meeting.

perform" for CleanTech.[15] CleanTech responded by e-mail dated November 17.[16] There is no indication that CleanTech was asked to update its response on an ongoing basis.

The staff also orally asked CleanTech to provide e-mails on three occasions after the November 5 meeting with Wey. On November 8, the staff requested CleanTech's e-mails; the exact terms of this request are not in the record.[17] CleanTech provided those e-mails it considered non-privileged on November 12.[18] On November 22, the staff asked CleanTech to produce e-mails of the company's corporate counsel, the Newman Law Firm ("Corporate Counsel"). On November 24, after CleanTech's chief executive officer agreed to waive the attorney-client privilege, CleanTech responded, stating that it was providing the documents in response to the staff's November 22 oral request for "all retained e-mail communications of the Company's U.S. legal and disclosure counsel, Robert Newman, Esquire of the Newman Law Firm Pllc that [are] between, cop[y] or mention[] [NYGG China] or [NYGG US], including [NYGG US's] President, Benjamin Wey."[19] The record does not show that the staff told CleanTech that it had an ongoing obligation to update its response.[20]

One week later, on December 1, the staff orally requested e-mails from CleanTech's Listing Counsel.[21] In a conference call on December 2, the staff informed Listing Counsel that "'if every requested [Listing Counsel] email was not produced, [CleanTech's] listing review would not continue and the application would be denied.'"[22] Once again, CleanTech's CEO agreed to waive the attorney-client privilege, and Listing Counsel sent 182 pages comprising 262

---

[15] Uchimoto Aff. ¶ 13. CleanTech's e-mail response to the call summarized the request in almost identical language.

[16] CleanTech's response listed twelve types of services, including "[i]ntroductions of potential institutional investors and bridge lenders" and "provision of short term loan for working capital through [NYGG China] affiliate." E-mail from William W. Uchimoto, Stevens & Lee, P.C., to Traynham E. Mitchell Jr. (Nov. 17, 2010, 11:03 a.m.).

[17] The Uchimoto affidavit states only, "On November 8, 2010, Mr. Sundick called me to request the Company's emails." Uchimoto Aff. ¶ 12.

[18] The record is unclear as to whether CleanTech told the staff that it was withholding documents it viewed as privileged when it produced e-mails on November 12.

[19] Letter from William W. Uchimoto, Stevens & Lee, to NASDAQ OMX Listing Qualifications, Attn: Traynham E. Mitchell Jr., Chief Counsel, Listing Investigations (Nov. 24, 2010).

[20] In his affidavit, Uchimoto stated that he "was not aware of any NASDAQ staff request to me or any other Company representative to provide any updates as to previously submitted responsive documents." Uchimoto Aff. ¶ 21.

[21] The exact terms of this request are not in the record.

[22] Uchimoto Aff. ¶ 15 (purporting to quote Michael Emen, Senior Vice President, Listing Qualifications, NASDAQ).

e-mails, dated between August 2 and December 3, 2010, to the staff on December 3.[23] The record does not establish that the staff told CleanTech that it had an ongoing obligation to update its response.

By December 6, NASDAQ staff had received the e-mails sent on December 3, and a conference call between Listing Counsel and the staff to review those e-mails was scheduled for December 7. During the December 7 call, there was some additional discussion of Wey, but by the end of the call, the staff had shifted focus and had begun asking questions about CleanTech's contract with Toshiba, one of its suppliers. At the end of the call, Uchimoto had the impression that "the NASDAQ staff appeared comfortable with Mr. Wey and his consulting firm's role with the Company throughout the entire listing process."[24] The record does not show that there were any outstanding requests for information about Wey when the call concluded.[25]

C. NASDAQ staff approved CleanTech's application, after which CleanTech disclosed new financing arrangements.

On December 10, 2010, the staff sent CleanTech a letter stating that it had approved its application. The listing approval letter noted that the approval was based on information provided to the staff by the company or filed by the company with the Commission, and it instructed CleanTech to notify the staff promptly of any material change to such information.

Less than a week later, on December 16, CleanTech filed a Form 8-K disclosing the December Financing. The Form 8-K described the December Financing as involving "a closing of US $20,000,000 in a combination of equity and debt offerings through accredited institutional investors."[26] NASDAQ staff thereupon contacted CleanTech and obtained the e-mails at issue.[27]

---

[23] The Uchimoto affidavit states, "All requested emails in existence at that time were produced, whether privileged or not." Uchimoto Aff. ¶ 16.

[24] *Id.* ¶ 18.

[25] In recounting the facts of this matter in the delisting letter, the staff wrote: "Staff discussed [certain e-mails that CleanTech had not initially produced because they were also sent or copied to counsel] at length with the Company's outside counsel on December 7th, and the Company thereafter provided additional documents pursuant to this discussion." Letter from Gary N. Sundick, Vice President, Listing Qualifications, The NASDAQ Stock Market, LLC, to Bei Lu, Chairman & Chief Executive Officer, CleanTech Innovations, Inc., at 2 (Jan. 13, 2011). The record does not show whether these "additional documents" related to Wey. Moreover, we are unaware of any evidence (as opposed to filings by the parties) showing that CleanTech provided documents to the staff between December 3 and 16, 2010, when CleanTech filed its Form 8-K. *See supra* note 7 (distinguishing between affidavits, which may serve as evidence, and assertions made in briefs, which are not evidence).

[26] http://www.sec.gov/Archives/edgar/data/1382219/000114420410066849/v205629_8k.htm (Dec. 16, 2010).

[27] The record does not show the terms of the request that resulted in this production.

D. NASDAQ delisted CleanTech's stock.

On January 13, 2011, NASDAQ staff informed CleanTech by letter that, "[b]ased on [its] review of public documents and information provided by the Company," the staff believed that the continued listing of CleanTech's securities on NASDAQ was no longer warranted.[28] The staff found that CleanTech "failed to provide Staff with material information in violation of . . . the applicable Listing Rules."[29] The staff based its conclusion "on Nasdaq's broad discretionary authority contained in Listing Rule 5101 to deny continued inclusion of securities in order to maintain the quality of, and the public's confidence in, Nasdaq and the failure of the Company to comply with Listing Rules 5205(e) and 5250(a)(1),"[30] which provide that a company may be denied initial or continued listing if "any communication to Nasdaq contains a material misrepresentation or omits material information necessary to make the communication to Nasdaq not misleading."[31]

The delisting letter characterized the December Financing as "two material financing transactions," an equity portion and a debt portion, and found that

> neither of these material transactions was disclosed to Nasdaq prior to the filing of the Form 8-K on December 16th, despite the fact [that the] Staff had previously requested any such information with regard to Mr. Wey and Mr. Li or their affiliated entities; the [Company had a] general obligation to update Staff throughout the listing process concerning any material information; and the [listing application contained a specific question] concerning any bridge financings and private placements by the Company. . . . Substantial e-mail traffic was provided to Staff showing that these transactions were developed throughout the very period that Staff was considering whether to approve the Company's application. A number of these emails were copied to Mr. Wey and were required to have been produced to Staff by the clear terms of Staff's requests and discussions with Company counsel.[32]

The staff concluded that CleanTech's failure to inform NASDAQ of the December Financing "displays a blatant disregard for the integrity of the listing process and Nasdaq's Listing Rules," and that CleanTech's actions in "not only proceeding with the [December Financing], but also [hiding it] from Nasdaq . . . raise the risk that the company will continue to

---

28 Sundick letter, *supra* note 25, at 1.

29 *Id.* The delisting letter also alluded to a violation of CleanTech's obligations under its listing application, but as discussed below, NASDAQ did not base its decision on this ground, so we do not consider it.

30 *Id.* (footnote omitted).

31 *Id.* at 1 n.2.

32 *Id.* at 3-4.

act in a manner inconsistent with its obligations under the Nasdaq Listing Rules and the federal securities laws."[33] The staff therefore concluded that CleanTech's actions raised significant public interest concerns and that the delisting of the company's securities from NASDAQ was warranted.

E. NASDAQ reviewed the delisting decision.

CleanTech appealed the delisting decision, requesting a hearing before a NASDAQ Listing Qualifications Panel. On February 28, 2011, the hearing panel found that "the Company's failure to provide prior notice to Nasdaq of the [December Financing] displays an unacceptable disregard for the Company's obligations as a listing applicant and for staff's stated concerns regarding the association with Mr. Wey," and it determined to delist CleanTech's shares.[34] The hearing panel made few factual findings, stating that the underlying facts "are largely uncontroverted."[35]

CleanTech immediately asked the NASDAQ Listing and Hearing Review Council to review the hearing panel's decision. An acknowledgement letter, dated March 4, confirmed receipt of CleanTech's request for review, asked the staff to provide the Review Council with an updated qualifications sheet and any additional information that the staff believed would assist the Review Council, and informed CleanTech that it was allowed to submit any additional information that it wanted the Review Council to consider. In response to the acknowledgment letter, the staff submitted an updated qualifications summary sheet and a list of record documents. CleanTech submitted a brief and nineteen exhibits, including copies of record documents as well as newly prepared letters from NYGG US, Listing Counsel, and Corporate Counsel.

On May 19, the Review Council remanded the matter to the hearing panel because it found that the record lacked sufficient fact and detail on two issues critical to the staff's determination to delist CleanTech:

> "1. Did the Company intentionally withhold information from Staff concerning Mr. Wey and his affiliates, and/or the December Financing[?]
>
> 2. At what point did the Company become aware that listing approval was imminent? "[36]

---

[33] *Id.* at 4-6.

[34] Letter from Amy Horton, Chief Counsel, NASDAQ Office of General Counsel, Hearings, to A. David Strandberg III, Donohoe Advisory Associates LLC, at 3 (Feb. 28, 2011) (unnumbered).

[35] *Id.* at 2.

[36] *CleanTech Innovations, Inc.*, No. NQ 5872C (NASDAQ Listing and Hearing Review Council May 19, 2011).

But one week later, on May 26, the Review Council's remand decision was stayed based on a determination that CleanTech made an ex parte communication by not providing the staff with a copy of its submission and in so doing violated NASDAQ Rule 5835(a)(1).[37] The record was reopened to allow the staff to respond to the issues raised by CleanTech, and both CleanTech and the staff were directed to address the factual issues noted in the remand decision so that the Review Council would be able to deliberate on a complete record in its reconsideration of its decision. The parties filed additional briefs and evidence. The staff submitted as evidence selected e-mails and correspondence from the period August to December 2010 and a business card for Ming Li, identified as "Senior Managing Director" and "Chief China Representative" for NYGG US. CleanTech submitted, among other things, the Uchimoto affidavit, in which Uchimoto disavowed any knowledge of an ongoing obligation to update responses to staff information requests.

The Review Council affirmed the decision of the hearing panel on July 22. In so doing, it found that CleanTech's "repeated failure to provide information requested by Staff is likely sufficient by itself to warrant delisting . . ."[38] But rather than basing its decision solely on that ground, the Review Council also considered, and agreed with, the staff's contention that CleanTech's failure to disclose information about the December Financing was intentional. It found that "[b]ecause delisting is warranted on this basis," *i.e.*, CleanTech's intentional failure to disclose, it "need not address whether the Company also violated the duty imposed by the listing application, which requests information on financings and requires the applicant to 'notify NASDAQ promptly of any material changes' to its application."[39]

On November 23, 2011, CleanTech was notified that the Review Council's decision had become the final action of NASDAQ when the NASDAQ Board of Directors declined to call it for review.[40] This appeal followed.

---

[37] *See* NASDAQ Rule 5835(a)(1) (prohibiting ex parte communications relevant to the merits of a proceeding). CleanTech strongly disputed the characterization of its submission as an ex parte communication, and in its brief to the Commission, CleanTech further argues that it is unclear whether the determination that it was an ex parte communication was made in accordance with NASDAQ's rules. Our disposition of this matter makes it unnecessary to address these issues.

[38] *CleanTech Innovations, Inc.*, *supra* note 4, at 5.

[39] *Id.* at 5 n.12.

[40] NASDAQ represented in its brief to the Commission that, on December 9, 2011, CleanTech requested that the Board of Directors reconsider its determination not to review the Review Council's decision, to which NASDAQ responded by letter dated December 12, 2011, informing CleanTech that NASDAQ rules did not provide for the Board of Directors to call a decision for review after it had already declined once to do so.

III.

Our review is governed by § 19(f) of the Securities Exchange Act of 1934, which provides that we must dismiss CleanTech's appeal if we determine that the specific grounds on which the delisting is based exist in fact, that the delisting is in accordance with the applicable NASDAQ rules, and that those rules are consistent with, and were applied in a manner consistent with, the purposes of the Exchange Act.[41] NASDAQ has broad discretion in determining whether to permit a security's initial or continued listing on the Exchange,[42] and we are not free to substitute our discretion for NASDAQ's.[43] But in this proceeding, the record does not show that the specific grounds on which NASDAQ based its delisting decision exist in fact, and the considerable discretion afforded to NASDAQ therefore does not permit its delisting decision.[44]

NASDAQ based its delisting determination on its finding that "the record evidence warrants the conclusion that, when the Company failed to produce documents [regarding the December Financing] to Staff, it did so intentionally."[45] The Review Council identified four bases for its conclusion that CleanTech's withholding of information was intentional:

> (1) the Company was aware that Staff was closely examining its relationship and dealings with Mr. Wey and that Staff had requested all documents on the issue; (2) the Company knew that Staff would likely view the December Financing as a subject for further examination, as indeed it did; (3) the Company failed to provide information on the December Financing even as it was producing other

---

[41] 15 U.S.C. § 78s(f); *cf. Fog Cutter Capital Grp., Inc.*, Exchange Act Release No. 52993, 58 SEC 1049, 2005 SEC LEXIS 3280, at *13-14 (Dec. 21, 2005) (applying § 19(f) standard to NASD delisting decision), *petition denied*, 474 F.3d 822 (D.C. Cir. 2007). CleanTech has not alleged, and the record does not establish, that NASDAQ's action has created "any burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]" such that the Commission is required by § 19(f) to set aside NASDAQ's action.

[42] *See* NASDAQ Listing Rule 5101 (providing that NASDAQ "has broad discretionary authority over the initial and continued listing of securities in Nasdaq in order to maintain the quality of and public confidence in its market, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest").

[43] *Cf. Tassaway, Inc.*, Exchange Act Release No. 11291, 1975 SEC LEXIS 2057, at *7 (Mar. 13, 1975) (stating that Commission may not substitute its discretion for NASD's in determining whether security should be removed from automated quotation system).

[44] NASDAQ's arguments in support of the grounds on which it based its delisting decision are not supported by facts established by the record, but only by assertions made in its briefs. As noted above, *see supra* note 7, unsworn representations by counsel contained in briefs or memoranda are not evidence of the facts they purport to recount, and we have declined to base findings on such representations. *Gordon*, 2008 SEC LEXIS 819, at *70 n.98.

[45] *CleanTech Innovations, Inc.*, *supra* note 4, at 6.

documents regarding Mr. Wey; and (4) the Company had previously failed to provide all requested information.[46]

We address these bases in turn.

A. Although the record evidence establishes that CleanTech knew that the staff was interested in its relationship to and dealings with Wey, it does not support a finding that the staff had requested the documents related to the December Financing that are at issue in this proceeding.

The record shows that CleanTech was aware that NASDAQ staff was closely examining its relationship and dealings with Wey and that the staff had requested many documents related to that subject. But NASDAQ's statement that the staff had requested "all documents on the issue" of CleanTech's relationship and dealings with Wey—and thus, presumably, the documents related to the December Financing—is overly broad and is not supported by the record. The documents in question are the e-mails dated between November 30 and December 10, 2010 that were not produced until after CleanTech filed the Form 8-K disclosing the December Financing.[47] CleanTech cannot have intentionally withheld those documents while the staff was considering the listing application unless the staff made a request that encompassed them. But because the earliest of the documents at issue did not exist until November 30, CleanTech can be found to have intentionally failed to produce those documents only if the staff requested them on or after November 30 or a request made before November 30 included a requirement to provide updated responses that covered those documents.[48] The record evidence supports neither finding.

1. There is no evidence that pre-November 30 requests covered the documents related to the December Financing.

We find in the record no instruction to update that would have required CleanTech to provide the contested e-mails. Although Bei Lu certified, when she filed the application on July 14, 2010, that she would "notify NASDAQ promptly of any material changes to the information provided in the application," [49] NASDAQ did not base its decision on a violation of that duty; it explicitly declined to address "whether [CleanTech] also violated the duty imposed by the listing

---

[46] *Id.*

[47] NASDAQ did not base its decision on a finding that CleanTech's failure to notify NASDAQ of the consummated December Financing between December 13 and December 16 violated the listing rules.

[48] As noted above, NASDAQ explicitly stated that it was not addressing whether CleanTech "violated the duty imposed by the listing application, which requests information on financings and requires the applicant to 'notify NASDAQ promptly of any material changes' to its application." *CleanTech Innovations, Inc.*, *supra* note 4, at 5 n.12.

[49] Excerpt from Listing Application, *supra* note 6.

application, which requests information on financings and requires the applicant to 'notify NASDAQ promptly of any material changes' to its application."[50]

The October 28, 2010 e-mail to CleanTech from the staff contains a comprehensive request for "all documents, including e-mails and attachments, related to Benjamin Wey (a/k/a/ Wei), Ming Li, New York Global Group, NYGG China, and/or any other associated/affiliated persons and/or entities," and "all documents, including e-mails and attachments, relating to all loans and/or similar arrangements to or from Benjamin Wey, NYGG [US], NYGG China, and/or affiliated persons and/or entities."[51] But the e-mail contains no language that imposed an ongoing duty to update information provided in response, and NASDAQ points to nothing else in the record or in the NASDAQ Listing Rules that would impose an ongoing obligation to update responses. Moreover, Uchimoto stated in his affidavit that he "was not aware of any NASDAQ staff request to me or any other Company representative to provide any updates as to previously submitted responsive documents."[52]

If the staff did not ask for updates of information submitted in response to its requests, it was not unreasonable for CleanTech to interpret those requests as terminating once it submitted responsive information.[53] Nor is it, on the record before us, unreasonable for CleanTech to have believed that its answers to repeated staff questions about Wey had assuaged the staff's concerns on that subject.

2. There is no evidence that post-November 30 requests covered the documents related to the December Financing.

The record shows that there was only one request for documents made on or after November 30. That was the December 1 oral request for e-mails from CleanTech's Listing Counsel. After CleanTech's CEO waived the attorney-client privilege, Listing Counsel produced responsive documents on December 3. The record does not purport to quote the request

---

[50] *CleanTech Innovations, Inc.*, *supra* note 4, at 5 n.12. The only other instance in the record where we have found that NASDAQ instructed CleanTech that it should update its responses was in the December 10 listing approval letter, in which the staff instructed CleanTech to notify the staff promptly of any material change to the information provided to the staff by the company or filed by the company with the Commission. But a failure to produce documents while NASDAQ was considering the listing application cannot be based on a duty imposed only at the time the application was granted.

[51] E-mail from Wolf to Uchimoto, *supra* note 12.

[52] Uchimoto Aff. ¶ 21.

[53] Moreover, because both CleanTech's application and the letter notifying CleanTech of the listing approval imposed an obligation to update information submitted, CleanTech reasonably could have concluded that the staff's decision not to include such language in other contexts was intentional. It was therefore not unreasonable for CleanTech to assume that absent such language, there was no continuing obligation to update its response once it had responded fully to a request.

verbatim, but if we understand "e-mails from CleanTech's Listing Counsel" to mean that the request was for e-mails to or from Listing Counsel, or on which Listing Counsel was copied, then that request would not have encompassed any of the e-mails that NASDAQ found to have been intentionally withheld, because none of those e-mails fit into that category. It was not Listing Counsel, but Corporate Counsel, who was involved in the December Financing. As far as we can tell, Listing Counsel did not send or receive any of the 190 e-mails at issue, nor was it copied on any of those e-mails.[54] Thus, the record does not establish that CleanTech's failure to produce any of the contested e-mails in response to the December 1 request constituted intentional withholding of requested documents.[55]

Thus, given the language of the staff's requests, CleanTech's awareness that the staff had been highly interested in its relationship to and dealings with Wey at some points while its application was under consideration does not establish that CleanTech intentionally withheld information about the December Financing in late November and early December.[56]

---

[54] Not all of the senders or recipients of the e-mails are identified in the record, but NASDAQ does not contend that Listing Counsel was among them.

[55] The Uchimoto affidavit provides the following explanation, the accuracy of which NASDAQ does not contest:

> [Stevens & Lee, PC], as Listing Counsel, was not counsel to nor involved with the then proposed financing transaction that is the subject of this proceeding. In this regard, [James Connolly, an attorney at Stevens & Lee who assisted Uchimoto in the CleanTech listing engagement] and I were not copied on any of the emails regarding this transaction and, therefore, the production of all 182 pages, comprising all of S&L's emails in existence on December 3, 2010, to NASDAQ did not include any mention of this transaction. Because the submission of the Newman Law Firm (corporate counsel) emails requested by the NASDAQ staff had been sent on November 24, 2010, and the financing transaction related emails did not start until November 30, 2010, they did not appear in the November 24 production since none of them existed on November 24.

Uchimoto Aff. ¶ 19.

[56] Nothing in this opinion should be construed to suggest that applicants may engage in a game of semantics with NASDAQ staff, whereby applicants scrutinize every staff request for loopholes so as to avoid providing information that the staff clearly indicated it wanted. On the other hand, the fact that many of the document requests in this matter were made orally limits our ability to discern exactly what those requests encompassed. Our review must be based on the record before us, and we cannot rely on unsworn representations to fill evidentiary gaps.

B. Awareness on CleanTech's part that the staff would be interested in the December Financing would not, without more, lead to the conclusion that CleanTech intentionally failed to provide the staff with the information in question while its listing application was pending.

Even if CleanTech knew that the staff would be interested in the December Financing, the record does not show that such knowledge demonstrates that CleanTech intentionally failed to provide NASDAQ with any of the contested e-mails before December 10, when the listing application was granted. The application expressly required CleanTech to provide information only about consummated financings, and CleanTech filed the 8-K after the December Financing was consummated. CleanTech had filed a Form 8-K after the October Financing, with no apparent objection from NASDAQ. In any event, NASDAQ did not base its decision on the violation of the duty to update imposed by the listing application.[57] In the November 16 call, the staff asked for a narrative that would include "anticipated future services" to be provided by NYGG US and NYGG China,[58] but the record does not show that CleanTech anticipated the December Financing on November 17, when it responded to that request. Moreover, Uchimoto stated in his affidavit:

> I did not understand the November 16 Request to be a duty imposed by the NASDAQ staff to continuously update submitted responses, nor could such request reasonably be viewed as such. I understood the meaning of the request for a written statement including "all services anticipated to be provided in the future" to mean ***any expected future services which were then known.***[59]

It appears that CleanTech complied with this understanding of the request, and nothing in the record shows this understanding to have been unreasonable. NASDAQ's second finding thus does not support the conclusion that CleanTech was intentionally withholding information about the December Financing.

C. Although CleanTech produced certain documents in early December in response to a staff request, there is no evident reason that CleanTech should have considered the documents in question to have been encompassed by that request.

As discussed above, all of the contested e-mails postdate the staff's request for Corporate Counsel's e-mails and CleanTech's response, and the record does not establish that there was any direction to update. Although CleanTech provided e-mails from Listing Counsel on December 3, after some of the e-mails regarding the December Financing had been written, Listing Counsel

---

57 *See supra* note 48.

58 *See supra* note 15 and accompanying text (discussing wording of November 16 request).

59 Uchimoto Aff. ¶ 21 (emphasis in original).

neither wrote nor received the e-mails about the December Financing, so there is no evident reason that CleanTech should have considered those e-mails encompassed by the request.

D. The record does not substantiate NASDAQ's assertions regarding CleanTech's alleged pattern of withholding documents.

The Review Council found that

> After the Company's initial production on November 12, and despite the Company's assurance that it "ha[d] been responsive to all requests made," Staff discovered that the Company had not produced e-mails, including non-privileged e-mails, that were sent or copied to the Company's counsel. After Staff repeatedly pressed the Company on this and subsequent omissions, the Company produced additional documents on three separate occasions—November 24, December 3, and December 7—all while repeatedly assuring Staff that all responsive documents had been produced. Not only was this representation inaccurate because the Company had not produced documents bearing on the December [F]inancing, the Company's repeated pattern of withholding documents itself warrants an inference that the withholding was intentional.[60]

There is insufficient record evidence about the staff's requests and the company's responses to support all of these findings. For example, it is not clear what record evidence the Review Council was relying on in making the finding that the company "repeatedly assur[ed] Staff that all responsive documents had been produced."[61] The November 17 e-mail providing a narrative response about services provided and to be provided by Wey contains the statement, "Based upon the information provided in this correspondence, we believe we have been responsive to the requests made by your Department," which supports the quoted finding to a limited extent.[62] But this is one e-mail, which cannot alone constitute repeated assurances. And the e-mail was sent before any of the e-mails about the December Financing were written. In its brief to the Commission, NASDAQ states that on December 7, the staff "was assured by the company that all responsive e-mails had been produced,"[63] but NASDAQ cites only to a memorandum submitted to the hearing panel by the staff, and assertions in such memoranda are not evidence of the underlying facts.[64] Moreover, because for the reasons set out above there is

---

[60] *CleanTech Innovations, Inc.*, *supra* note 4, at 7. As noted above, *see supra* note 25, the record does not show what, if any, documents were produced on December 7.

[61] *Id.*

[62] E-mail from Uchimoto, to Mitchell, *supra* note 16. This may have been the language to which the Review Council was alluding when it referred to "the Company's assurance that it 'ha[d] been responsive to all requests made.'" *CleanTech Innovations, Inc.*, *supra* note 4, at 7. But in the November 17 e-mail, CleanTech did not use the phrase "all requests," so the company's representation is less sweeping than the Review Council's language would indicate.

[63] NASDAQ Br. in Opp'n at 4.

[64] *See supra* note 7.

no record evidence of an outstanding request (including a request to update) that would have encompassed the contested e-mails, the record does not show that such a statement made on December 7 would have been inaccurate.

Additionally, although the Review Council states that the staff "repeatedly pressed the Company on this and subsequent omissions,"[65] it is unclear from the record what "subsequent omissions" the Review Council had in mind. Although the staff made a number of requests for information, it is impossible to tell from the record whether that was because CleanTech did not give the staff everything when it first asked, or whether documents provided by CleanTech suggested new avenues of inquiry to the staff, or whether there was a different reason altogether for the inquiries. Some of the "omissions" appear to have been due to CleanTech's assertion of the attorney-client privilege, which does not on its face suggest that CleanTech was being obdurate, and once the staff made clear that the application would be denied unless CleanTech produced the documents it asserted were privileged, CleanTech expeditiously obtained its CEO's consent and produced the requested documents.

IV.

For the reasons discussed above, we conclude that the record does not show that the grounds on which NASDAQ relied in delisting CleanTech exist in fact. [66] The record may give a distorted

---

[65] *CleanTech Innovations, Inc.*, *supra* note 4, at 7.

[66] Both parties seek to introduce new evidence on appeal. In its brief on appeal, NASDAQ asked us to consider several articles published in January 2012 that, NASDAQ alleges, report that the FBI raided both Wey's home and his office, apparently in early 2012. NASDAQ cited the articles on the theory that it "was entitled at least to consider any relevant information regarding Wey before deciding whether to list CleanTech's securities." NASDAQ Br. in Opp. at 18 (emphasis in original). In a later motion, NASDAQ asked the Commission to allow the submission of a Form 12b-25 filed by CleanTech on May 15, 2012 and to take note that CleanTech did not timely file the underlying Form 10-Q, which, NASDAQ asserts, was due on May 15, 2012. NASDAQ contends that the Form 12b-25 and the Company's failure to file its Form 10-Q demonstrate non-compliance with NASDAQ listing standards and the Commission's filing requirements, further supporting the conclusion that listing of the Company's securities on NASDAQ is unwarranted. NASDAQ asserts that, although CleanTech's failure to timely file its Form 10-Q "was not a basis for NASDAQ's decision to delist [CleanTech], this additional failure is a basis to deny relisting the Company under the Commission's de novo review." NASDAQ's Mot. for Leave to Adduce Add'l Evidence at 3 n.1 (May 24, 2012). CleanTech opposes the motion, but asks that if the Commission allows the Form 12b-25 into evidence, the Commission should also allow CleanTech's Form 10-Q, filed on June 25, 2012, into evidence, "to complete the record." CleanTech's Mot. for Leave to Adduce Add'l Evidence at 1 (July 2, 2012).

Rule of Practice 452 permits the introduction of new evidence on review if the party seeking to adduce the evidence shows that it is material and there were reasonable grounds for failure to adduce such evidence previously. 17 C.F.R. § 201.452. The question in this proceeding is whether the grounds on which NASDAQ based its delisting decision exist in fact. As NASDAQ concedes, CleanTech's failure to file its Form 10-Q in May 2012 was not a basis for the delisting

(continued...)

picture: much of the communication about document production between the staff and the company was oral, and there may not be detailed written records of those conversations. But when the Review Council originally decided that the record was insufficient to enable it to determine whether CleanTech intentionally withheld information and allowed the parties to submit additional evidence, CleanTech submitted the Uchimoto affidavit, providing evidence from someone who was involved in those conversations. The staff did not provide similar evidence. If there were requests that clearly encompassed the contested e-mails, or directions to update that would have required their production, we cannot discern this from the record. We therefore set aside NASDAQ's delisting decision.

An appropriate order will issue.[67]

By the Commission (Chair WHITE and Commissioners WALTER, AGUILAR, PAREDES and GALLAGHER).

Elizabeth M. Murphy
Secretary

(...continued)
decision–indeed, it could not have been, because the alleged untimely filing occurred months after CleanTech was notified in November 2011 that the delisting decision had become final. (The January 2012 "FBI raids" discussed in the articles NASDAQ seeks to admit similarly postdate the delisting decision, as does CleanTech's filing of its Form 10-Q in June 2012.) Thus, none of the proposed evidence is material, and it therefore does not satisfy the requirements of Rule 452. We therefore deny the motions to adduce new evidence.

[67] We have considered all the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein. Because the issues have been thoroughly briefed and can be adequately determined on the basis of the record filed by the parties, Applicants' request for oral argument is denied. Rule of Practice 451, 17 C.F.R. § 201.451.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69968 / July 11, 2013
Admin. Proc. File No. 3-14640

In the Matter of the Application of

CLEANTECH INNOVATIONS, INC.
c/o Paula D. Shaffner
Joshua R. Dutill
Stradley, Ronon, Stevens & Young, LLP
2600 One Commerce Square
Philadelphia, PA 19103

For Review of Action Taken by
The NASDAQ Stock Market, LLC

ORDER SETTING ASIDE DELISTING DECISION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the delisting action taken by The NASDAQ Stock Market, LLC against CleanTech Innovations, Inc. is hereby set aside.

By the Commission.

Elizabeth M. Murphy
Secretary

Release No. 37559 (S.E.C. Release No.), Release No. 34-37559, 62 S.E.C. Docket 1516, 1996 WL 457250

S.E.C. Release No.
Securities Exchange Act of 1934

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF THE APPLICATION OF DOMESTIC SECURITIES, INC.
160 SUMMIT AVENUE
MONTVALE, NJ 07645
FOR REVIEW OF DENIAL OF ACCESS OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Admin. Proc. File No. 3-8702
August 13, 1996

OPINION OF THE COMMISSION

*1 REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DENIAL OF ACCESS TO SERVICES
Request to Amend Restrictive Agreement
Where registered securities association denied request by member to have restrictive agreement modified to permit market making by the member in unlimited number of securities without articulating basis for decision, held, action set aside.

APPEARANCES:
Bill T. Singer, of Singer, Bienenstock, Zamansky, Ogele & Selengut, LLP.
Norman Sue, Jr., for the National Association of Securities Dealers, Inc.
Appeal filed: May 19, 1995

Briefing completed: August 14, 1995

I.

Domestic Securities, Inc. ("Domestic" or "the firm"), a member of the National Association of Securities Dealers, Inc. ("NASD" or "Association"), has applied for review of a decision by the Association's National Business Conduct Committee ("the NBCC") dated May 4, 1995, in which the NBCC denied Domestic's request for modification of the terms of its restrictive agreement to permit the firm to expand the number of securities in which it was authorized to make a market from 50 to an unlimited number. Our findings are based on an independent review of the record.

II.

Domestic is a broker-dealer that has been in existence since 1984, first as a member of the New York Stock Exchange, Inc., then as an associate member of the American Stock Exchange, Inc. In June 1993, after its decision to concentrate its trading activities in market making for over-the-counter securities, Domestic applied for membership in the NASD. After the requisite pre-membership interview with the staff for District No. 10 provided for by the NASD's By-Laws, Domestic's membership application was granted effective May 5, 1994. [1]

Although initially Domestic sought approval to make markets in an unlimited number of securities, the NASD conditioned its approval of Domestic's application on the firm entering into a restrictive agreement limiting to 50 the number of securities in which Domestic may make markets. The NASD sought this limitation out of a concern that Domestic's two principals, Harvey Houtkin and Mark Shefts, would not be able adequately to supervise Domestic in the making of additional markets

simultaneously with fulfilling their supervisory responsibilities for another NASD member firm, All-Tech Investment Group, Inc. ("All-Tech").[2] Another provision of the restrictive agreement prohibited Domestic from seeking any amendment to the agreement for one year.

In July 1994, Domestic sought to have the 50-security limitation lifted because of what it characterized as a dramatic and unforeseen change in circumstances. After changes in NASD rules affecting All-Tech's business, All-Tech had suffered a serious decline in its operations, from approximately 1,000 to 1,500 trades a day with approximately 60 customers, to approximately 200 trades a day with six customers.[3] Thus, Domestic reasoned to the NASD that the concern expressed by the NASD with Houtkin's and Shefts's ability to supervise two firms no longer had an adequate basis. At the same time, the reversal of fortunes for All-Tech increased the financial importance for Houtkin and Shefts of Domestic's making markets in more securities than the 50 allowed by the restrictive agreement.

*2 The District denied Domestic's request by letter dated July 20, 1994, on the basis of its staff recommendation that no modification to the restrictive agreement should be permitted within a year of May 5, 1994. Domestic contested the decision and sought a hearing. Hearings were held before a District Business Conduct Committee ("DBCC") on September 18, 1994, November 21, 1994, and January 12, 1995, before the DBCC issued an opinion denying Domestic's request on February 17, 1995.

At the September hearing, the staff expressed concern with the recent date of Domestic's NASD membership, and uncertainty as to whether Domestic had adequate numbers of experienced traders, supervisory procedures, and capital for the requested business expansion. Domestic argued that, while its membership in the NASD was new, the firm itself dated from 1984; that it was run by and staffed with adequate trading personnel; that it had made, and would continue to make, every adjustment in its supervisory procedures requested by the NASD staff; and that its capital was adequate. At the panel's suggestion, the hearing was adjourned for the purpose of giving the staff and Domestic an opportunity to negotiate a compromise between the 50-security limit and Domestic's request for authority to make a market in an unlimited number of securities. A new hearing was scheduled for November 21, in the event that the parties could not reach a negotiated agreement.[4]

On November 18, though an agreement had not been reached, the NASD staff requested a postponement of the November 21 hearing date, arguing that a partial analysis of Domestic's trading activity gave cause for concern, and more time was needed to conclude the analysis. The request was denied and, at the hearing, the staff described the trading information on which its analysis had focussed. In the period covered by the analysis, a substantial majority of Domestic's trading was with a firm called HMS Securities, Inc. ("HMS"). HMS was formerly owned by Wanshef, Inc. ("Wanshef"), a corporation owned by Houtkin and Shefts that also owns Domestic. HMS is currently owned by an employee of All-Tech.

The NASD staff's analysis showed that Domestic would sell short certain securities positions to HMS, which would then allocate the purchased securities to customers who predominantly were related to Houtkin and Shefts. Those customers' securities would be sold through SOES, usually on the same day as the purchase, and Domestic's short position would be covered later in the day by sales to it by Houtkin and Shefts family members, although not always the same members who had made the original purchases.

The staff suggested that this activity might involve violations of SOES rules, which at that time prohibited short-selling and required that multiple SOES transactions made as the result of a "single investment decision" be aggregated for the purpose of determining compliance with the SOES order size limitation rule.[5] The staff conceded, however, that its analysis was inconclusive. The hearing was adjourned again after the staff agreed to increase to 500 the number of securities in which Domestic could make a market, contingent on Domestic providing adequate documentation of the qualifications of its traders, of its supervisory procedures, and of the sufficiency of its capital.

*3 Protracted negotiations between the NASD staff and Domestic ensued, but no agreement resulted. Consequently, yet another hearing was scheduled before the panel on January 12, 1995. At this hearing, the sole ground for the staff's opposition was a "heightened concern" over the trading activity discussed above, based on further, although still not complete, analysis and development of the facts. [6]

The DBCC decision denied Domestic any relief from the provisions of its restrictive agreement. Because the staff had raised no objections to Domestic's qualifications under Part 1, Section (1)(c)(1)-(5) of Schedule C, the DBCC limited the scope of its inquiry to the requirement in Section (1)(c)(6) that consideration be given to ". . . other factors relevant to the scope and operation of [the firm's] business."

The DBCC noted the concerns raised by the staff at the hearings concerning the pattern of trading activity involving Domestic and HMS and their customers. In addition to the matters discussed above, the DBCC identified as problematic the facts that: many of the HMS customer accounts under review were joint accounts between Houtkin or Shefts and a family member or business entity; Domestic and HMS were located in adjoining suites; Wanshef, owned by Houtkin and Shefts, maintained two accounts at HMS, one of which was used to finance other HMS customers' day trading; Domestic had a customer account at HMS; and the firms used the same clearing broker.

The DBCC concluded:

> Whether or not there was an actual violation of the SOES rules . . . we leave to the [NASD]'s disciplinary process. However, we find that the trading activity set forth in the record . . . gives at least the appearance of an attempt to circumvent [SOES rules]. . . . It is our opinion that serious questions have been raised . . . not only about what seems to be [Domestic's] role in giving the appearance of participating in a pattern of trading which may have been inconsistent with the SOES rules. . . but also as to the overall transactions and interrelationships between Domestic, HMS, Wanshef, Inc., Houtkin, Shefts and the other related accounts at HMS. . . . [W]e are concerned that in actuality Houtkin and Shefts may have more control over the activities of HMS than its shareholders may have. (Footnote omitted; emphasis in original.)

Based on these concerns, [7] the DBCC denied Domestic's request to have its restrictive agreement amended. [8]

On appeal, the NBCC reviewed the history of the case and concluded:

> The controversy herein . . . centers on whether the trading activity and relationships described by NASD staff between Domestic and HMS, which facts were never disputed by Domestic and which we accept for purpose of this proceeding, constitute sufficient grounds for denial of Domestic's request to expand its market making activities. We are not prepared to state without qualification that staff concerns as to possible regulatory violations, or the fact of an open investigation by regulatory authorities, without more, cannot in any circumstances justify the denial of requests for amendment of restriction agreements. Moreover, we recognize the genuine concern of the DBCC that the facts identified raised serious concern that NASD rules may have been violated. Nevertheless, based on our independent review of the record, we believe that the current restrictions should be modified.

*4 The NBCC modified the restrictive agreement to permit Domestic to increase the number of securities in which it makes a market from 50 to 500, subject to a requirement that the applicant maintain 135% of minimum required net capital.

The sole reason the NASD gave for not granting Domestic's request to make markets in an unlimited number of securities was that "an unlimited number cannot be justified on the basis of this record." The reason to grant an expansion from 50 to 500 was based on the NASD's conclusion that "applicants have made a sufficient showing to justify an expansion of the number of its markets" and its observation that "as of November 21, 1994, both the staff and the applicant were favorably inclined to compromise their differences in order to . . . permit the applicant to increase the number of stocks in which it makes a market from 50 to 500" subject to the requirements enumerated above. This appeal followed.

III.

The NBCC was correct in rejecting the reasoning and decision of the DBCC. For the reasons discussed below, however, we cannot sustain the decision to grant Domestic only a partial modification of the 50-security limitation.

Information concerning regulatory violations by a firm may under some circumstances be the basis for denying requests to amend restrictive agreements.[9] However, the basis for the restriction at issue here is not clear. Without a connection to a regulatory purpose, such a broad-based limitation on Domestic's ability to function as a market maker in the wholesale dealer market appears to impose a burden on competition "not necessary or appropriate in furtherance of the purposes" of the Securities Exchange Act of 1934 ("the Act").

The NBCC's decision to grant Domestic authority to expand its number of markets to 500, rather than the unlimited authority sought by Domestic, also is not sustainable for a different reason. Section 19(f) of the Act requires us, in reviewing a limitation on access to services, to find that the specific grounds on which such limitation is based exist in fact, and that the limitation "is in accordance with [NASD rules], and that such rules . . . were applied in a manner consistent with the purposes of" the Act. The NBCC's decision does not state the specific grounds on which its limitation is based, and therefore we are unable to determine whether the NASD's rules were applied appropriately.[10]

The NBCC's decision does not state how, or in what degree, the NASD concluded that Domestic failed to meet the criteria in Part 1 of Schedule C.[11] Moreover, our own review of the record does not reveal the basis for the NASD's decision. The NASD staff specifically conceded that none of the first five factors of Part 1, Section (1)(c) of Schedule C were an issue in opposing Domestic's request. The staff's views, while not binding on the NASD, evidence lengthy analysis and on-site examinations by the staff that are uncontradicted by anything in the record.

*5 Further evidence in the record supports the staff's conclusions concerning the first five factors. Domestic, although new to the NASD, has been in existence since 1984. It has 12 traders with a wide variety and depth of experience.[12] It has undertaken to employ as many traders as are necessary to accommodate its increase in business.[13] The firm has given adequate assurances that it is able to maintain sufficient net capital.[14] Its supervisory and compliance procedures have been substantially revised in consultation with the NASD staff. In testimony undisputed by the staff (who conducted on-site examinations), Domestic has asserted that its equipment is "state-of-the-art," and that the spreads it has been quoting in the securities which it has authority to trade have been among the narrowest in the industry. The disciplinary history of Domestic's control affiliates (reported in the firm's application for membership), although evidencing various SOES rules violations, does not indicate any propensity not to comply with the duties incumbent on a market maker.

Given these facts, together with the abbreviated nature of the NASD's analysis, we are unable to discern the path by which the NASD arrived at its conclusion to limit to 500 the number of securities in which Domestic can make markets. We cannot

make the findings that the Act requires. Accordingly, we set aside the NASD's action limiting the number of securities in which Domestic can make markets.

An appropriate order will issue. [15]

By the Commission (Chairman LEVITT and Commissioners WALLMAN, JOHNSON, and HUNT).
Jonathan G. Katz
Secretary

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

*6 SECURITIES EXCHANGE ACT OF 1934

Rel. No. 37559 / August 13, 1996

Admin. Proc. File No. 3-8702

In the Matter of the Application of DOMESTIC SECURITIES, INC.

160 Summit Avenue

Montvale, NJ 07645

For Review of Denial of Access by the

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

ORDER SETTING ASIDE ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the action of the National Association of Securities Dealers, Inc. in restricting the number of securities in which Domestic Securities, Inc. can make a market, be, and it hereby is, set aside.

By the Commission.

Jonathan G. Katz

Secretary

Footnotes

1 Schedule C, Part 1, Section (1)(c) to the By-Laws provides that the pre-membership interview shall review, among other things,
(1) the nature, adequacy, source and permanence of applicant's capital and its arrangements for additional capital should a business need arise;
(2) the applicant's proposed recordkeeping system;

(3) the applicant's proposed internal procedures, including compliance procedures;

(4) the applicant's familiarity with applicable NASD rules and federal securities laws;

(5) the applicant's capability to properly conduct the type of business intended in view of the: A. number, experience and qualifications of the persons to be associated with it at the time of its admission to membership; B. its planned facilities; C. arrangements, if any, with banks, clearing corporations and others, to assist it in the conduct of its securities business; D. supervisory personnel, methods and procedures; and

(6) other factors relevant to the scope and operation of its business.

2 Early in the hearing process, the District 10 Staff suggested that the reason for the 50-security limitation was because Domestic had requested it in the business plan submitted to the staff on January 5, 1994. This suggestion is contradicted by the existence in the record of a business plan submitted October 28, 1993, in which no such restriction is included. Later statements by staff in the testimony also support the findings in the text above.

3 All-Tech is engaged primarily in retail trading for customers using the NASD's Small Order Execution System ("SOES"). NASD Rule changes for SOES which came into effect in January 1994 affected the profitability of All-Tech's customers' trading strategy on SOES, precipitating the decline in its business.

4 Domestic made clear that its request for unlimited market-making authorization was unchanged, but that it was willing to compromise on some lesser number for the sake of resolving the situation by settlement.

5 The short-selling rule ceased to be effective in January 1995. The rule concerning aggregation of transactions is still in effect.

6 The staff stated that it was not opposing Domestic's request on the basis of: (1) the firm's traders or their qualifications, (2) the adequacy of the firm's supervisory procedures, (3) the adequacy of the firm's capital, or any of the first five of the six factors enumerated in Part 1, Section (1)(c) of Schedule C.

7 The DBCC added: "[t]his could very well be the type of activity the staff was apprehensive about and which gave rise to the one year period in the Agreement during which the staff wanted to review the Firm's operations." This supposition, however, is contradicted by the record. The staff was emphatic in its assertion that it was unaware of the trading activity between the two firms until shortly before the November 21, 1994 hearing, arguing that the recent nature of the discovery justified its request for a postponement of the hearing.

8 Domestic appealed the DBCC's decision to the Commission during the pendency of the appeal to the NBCC. Domestic argued that the basis for Commission jurisdiction would be the futility of exhaustion of administrative remedies before the NASD. The NBCC issued its opinion prior to our acting on Domestic's earlier appeal, which was subsequently withdrawn.

9 We take no position with respect to the NASD staff's characterization of these facts.

10 The NBCC's decision does not discuss the standards for determining to place restrictions on the number of securities in which a new member may make markets. Therefore, among other things, we have no basis for determining the relative fairness of the NASD's action with respect to Domestic.

11 The NASD argues on appeal that Domestic is not "aggrieved" by the NBCC's decision, because Domestic can reapply at a later time for additional modification of the restrictions on its market-making authorization. However, Domestic claims that it is aggrieved by the present limitation on its business, and that the NASD's invitation to Domestic to return is meaningless unless the NASD articulates what Domestic must do to achieve success on any future request for modification.

12 For example, Houtkin and Shefts, in managing an earlier incarnation of Domestic, Domestic Arbitrage Group, made markets in over 400 securities. Between them, they have over 40 years of experience as traders. Another of their traders has over 20 years of experience.

13 As of September 1994, no trader was responsible for more than seven securities. Domestic has represented that it would apportion securities to traders based on trading activity levels in each security.

14 The record indicates that the firm maintains approximately $800,000 in capital.

15 All of the contentions advanced by the parties have been considered. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Release No. 37559 (S.E.C. Release No.), Release No. 34-37559, 62 S.E.C. Docket 1516, 1996 WL 457250

End of Document

Release No. 39800 (S.E.C. Release No.), Release No. 34-39800, 66 S.E.C. Docket 1920, 1998 WL 133847

Securities and Exchange Commission (S.E.C.)
Securities Exchange Act of 1934

IN THE MATTER OF THE APPLICATION OF EAGLE SUPPLY GROUP, INC.
122 EAST 42ND STREET
SUITE 1116
NEW YORK, NEW YORK 10168
FOR REVIEW OF ACTION TAKEN BY THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Admin. Proc. File No. 3-9313
March 25, 1998

OPINION OF THE COMMISSION

*1 REGISTERED SECURITIES ASSOCIATION -- DENIAL OF NASDAQ SMALLCAP MARKET LISTING
Control Persons' Prior Civil and Criminal Actions

Registered securities association, in denying an issuer's request that its securities be included in the association's automatic quotation system, failed to explain why twenty-five- and twenty-seven-year-old securities law violations by two control persons indicate a risk of future misconduct. Held, remanded for a more definitive and complete statement of the reasoning for its decision.

APPEARANCES:
Richard H. Rowe, of Proskauer Rose LLP, for Eagle Supply Group, Inc.
Robert E. Aber, Sara Nelson Bloom, and Arnold P. Golub, for the Nasdaq Stock Market, Inc.
Appeal filed: May 22, 1997

Last brief filed: August 28, 1997

I.

Eagle Supply Group, Inc. ("Eagle" or the "Company") has applied for review of a decision of the National Association of Securities Dealers, Inc. ("NASD") denying its application to include the Company's securities on the Nasdaq SmallCap Market. The NASD identified as the basis for denial the fact that two of Eagle's control persons were found, in criminal and civil actions, to have violated the securities laws twenty-five and twenty-seven years ago. The NASD found that these prior violations created a risk of future misconduct and that denial of listing was, therefore, merited. [1] We base our findings on an independent review of the record.

II.

The two Eagle control persons referred to above are Douglas P. Fields, chairman of the board of directors and chief executive officer of the Company and Frederick M. Friedman, the executive vice president, treasurer, secretary, and a director of the Company. Since the early 1970s, Fields and Friedman have held the same positions with TDA Industries, Inc. ("TDA") that they hold with the Company.

Fields and Friedman's securities law violations occurred in the early 1970s. In 1971, Fields and Friedman engaged in "illicit schemes and misrepresentations designed to artificially inflate the price of TDA stock prior to a public offering of that company's stock." [2] In addition, in 1971 and 1973, Fields and Friedman were involved in the payment of sham

finder's fees disguised as legitimate business transactions in connection with company acquisitions by TDA and one of its subsidiaries. A prospectus relating to a public offering of TDA stock in November 1971 and proxy materials distributed in December 1971 were false and misleading because they failed to disclose the 1971 transactions.

In a 1976 action brought by this Commission based on the conduct described above, Fields, Friedman, and TDA were enjoined from violating certain of the registration, reporting, proxy, and anti-fraud provisions of the federal securities laws. [3] In a 1979 criminal action based on the same conduct, Fields and Friedman were convicted of conspiracy, securities fraud, making a false statement concerning finder's fees paid in connection with company acquisitions by TDA and a subsidiary of TDA, and the preparation and filing of an offering document and proxy statements that failed to disclose these transactions. [4] In 1980, Friedman was convicted on two counts of mail fraud and one count of wire fraud in connection with the 1973 finder's fee. [5]

*2 Following their convictions and the expiration of the two-year prohibition on their acting as directors of TDA, Fields and Friedman resumed their positions with TDA and currently continue to hold these positions. TDA is a holding company which operates four business enterprises, including a roofing supply distributor and three real estate investment companies. Fields and Friedman currently advise the roofing supply distributor as to potential roofing company acquisitions and are compensated through finder's fees.

Eagle was incorporated on May 1, 1996, primarily to raise capital and to acquire and operate privately-held companies engaged in the wholesale distribution of roofing supplies. On August 12, 1996 the Company filed a Form S-1 Registration Statement ("Registration Statement") with this Commission in connection with an initial public offering of its common stock and warrants. [6] According to the Registration Statement, upon the conclusion of the initial public offering, TDA will own approximately 54% of the issued and outstanding common stock of the Company. Fields and Friedman are principal stockholders of TDA and therefore will own, through TDA, a controlling interest in the Company. [7] Fields and Friedman will identify potential acquisitions for the Company and receive finder's fees in return for their services.

In November 1996, the Company applied to the NASD for inclusion of its securities in the Nasdaq SmallCap Market. The NASD staff denied the Company's application based on the disciplinary histories of Fields and Friedman and on other issues. [8] The Company appealed the decision to the Nasdaq Listing Qualifications Panel ("Qualifications Panel"). During the pendency of the Company's application, all of the issues that were the basis of the NASD's initial denial other than the disciplinary history of Fields and Friedman were resolved. The Qualifications Panel, however, also denied the Company's request for listing on the Nasdaq SmallCap Market.

The Qualifications Panel was particularly concerned by its belief that Fields and Friedman had received a kick-back twenty-five years ago and concurred with the NASD staff's concern that there were "similarities between the activities from which the civil and criminal penalties resulted and the activities that Messrs. Fields and Friedman . . . will be engaged in on behalf of the Company." At the hearing before the Qualifications Panel, Company counsel testified that in the more than twenty-five years since the misconduct occurred "there has not been any suggestion of any wrongdoing on a civil or criminal level against" Fields and Friedman. The Qualifications Panel noted that "the passage of time" may be considered a mitigating factor. The Qualifications Panel concluded, however, that the serious nature of the violations and Fields' and Friedman's "direct ties" to the Company merited denial of listing.

The Company requested that the Nasdaq Listing and Hearing Review Committee ("Review Committee") review the Qualifications Panel's decision. During the review process the Company notified the Review Committee that the Qualifications Panel had incorrectly stated that the Commission had alleged that both Fields and Friedman received a kick-back in connection with TDA's acquisition of another company. The Company noted that the Commission alleged that only Friedman received such a kick-back.

*3 The Review Committee affirmed the Qualifications Panel's decision to deny listing based on the "serious disciplinary histories" of Fields and Friedman. Thus, the basis for the NASD's refusal to accept the Company for listing on the Nasdaq SmallCap Market is the disciplinary histories of Fields and Friedman. The Review Committee concurred with the Qualifications Panel's conclusion that since the "SEC complaint focused on the receipt of a kick-back by Messrs. Fields and Friedman," there existed "this same potential with respect to activities that they will be engaged in on behalf of the Company going forward." The Review Committee did not explain how, or even whether, it factored into its decision to concur with the Panel the Company's assertion that only Friedman received a kick-back in connection with TDA's acquisition of another company and what significance, if any, this information might have. The Review Committee also did not explain why it believed that securities law violations that occurred twenty-five and twenty-seven years ago would create the potential for similar misconduct in the future given the Company's assertion that Fields and Friedman have had an unblemished record since that time.

III.

In order to sustain NASD action of this nature, we must find that such action is in accordance with applicable NASD rules and that these rules are and were applied in a manner consistent with the purposes of the securities laws. In addition, the specific grounds for the denial of inclusion must exist in fact. [9] The applicable NASD rule here is Rule 4300. [10]

In reviewing applications for listing, the NASD "will form a reasonable belief as to whether certain persons connected with an issuer may be predisposed to engage in further violative conduct" since "the NASD believes that the history of prior violative conduct raises concerns regarding the continuing potential for conduct in connection with the operation of the company or the market for its securities that would be considered fraudulent and manipulative, contrary to just and equitable principles of trade, or otherwise raise investor protection concerns." [11] Thus, the NASD may consider past securities law violations in assessing whether the association of certain persons with a company raises concerns about its listing. Nevertheless, the NASD must articulate a basis for concluding that individuals who have engaged in past misconduct may be predisposed to engage in future violations of the securities laws or otherwise present a risk to the integrity of the Nasdaq Stock Market. [12] The NASD's decision and the record here do not reveal the basis for its conclusion.

At the hearing before the Qualifications Panel, Company counsel stated that, in the lengthy period following the securities law violations by Fields and Friedman, "there has not been any suggestion of any wrongdoing on a civil or criminal level against [Fields and Friedman]." The NASD does not respond to this contention, and the record does not reflect any facts to the contrary. The NASD simply notes that the securities law violations committed by Fields and Friedman were serious, and that Fields and Friedman currently hold the same positions with the Company that they held at the time of the violations. However, Fields and Friedman have held these positions for over twenty years, [13] during which time the Company asserts that there has been no suggestion of any further misconduct. The NASD does not describe in detail its concerns about the misconduct of Fields and Friedman and we are unable to ascertain the extent to which the criminal record of Fields and Friedman was reviewed or considered by the NASD. Absent further explanation of the NASD's conclusion that these historic violations are indicative of the potential for future misconduct, we cannot evaluate the NASD's decision. Given the circumstances, we think it is appropriate to remand this review proceeding for further consideration.

*4 The decision as to whether or not to list a particular security in Nasdaq "should not depend solely on meeting quantitative criteria, but should also entail an element of judgment given the expectation of investors and the imprimatur of listing on a particular market." [14] We have said that "[t]o the extent that discretion enters into the matter . . . the discretion in question is the NASD's, not ours." [15] We do not intend to substitute our judgment for that of the NASD. Rather, we are directing the NASD on remand to provide a sufficient basis for its decision to enable us to make the

requisite determination as to whether the NASD's action was in accordance with applicable NASD rules and that such rules were applied in a manner consistent with the purposes of the securities laws. [16]

IV.

We find that the Review Committee has set forth insufficient reasoning for its denial of Eagle's application for inclusion of its securities in the Nasdaq SmallCap Market. Accordingly, this review proceeding is remanded to the NASD for further consideration and for an explanation of the basis for its finding that there exists a potential for future misconduct by Fields and Friedman. Its explanation should be supported by a description of the factors which led it to conclude that the securities law violations of Fields and Friedman have a likelihood of repetition. [17] In making the decision to remand, we express no view concerning the outcome.

An appropriate order will issue. [18]

By the Commission (Chairman LEVITT and Commissioners JOHNSON, HUNT AND UNGER); Commissioner CAREY not participating.
Jonathan G. Katz
Secretary

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

*5 SECURITIES EXCHANGE ACT OF 1934

Rel. No. 39800 / March 25, 1998

Admin. Proc. File No. 3-9313

In the Matter of the Application of EAGLE SUPPLY GROUP, INC.

122 East 42nd Street

Suite 1116

New York, New York 10168

For Review of Action Taken by the NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

ORDER DISMISSING REVIEW PROCEEDING

On the basis of the Commission's opinion issued this day, it is

ORDERED that this proceeding be, and it hereby is, remanded to the National Association of Securities Dealers, Inc., for further action in accordance with such opinion.

By the Commission.

Jonathan G. Katz

Secretary

Footnotes

1 The NASD invoked its authority under NASD Marketplace Rules 4300 and 4330. Rule4300 provides that the NASD exercises "broad discretionary authority" over initial inclusion in the Nasdaq SmallCap Market. Rule 4330 provides that the NASD may "deny inclusion or apply additional or more stringent criteria for the initial . . . inclusion of particular securities" if the NASD "deems it necessary to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, or to protect investors and the public interest."

2 United States v. Fields, No. 76 Crim. 1022, 1977 LEXIS 15588 (S.D.N.Y. Jun. 3, 1977).

3 See SEC v. TDA Industries, Inc., No. 75 Civil 4519, 1976 SEC LEXIS 1835 (S.D.N.Y. Apr. 23, 1976) (In addition, Fields and Friedman were removed as directors of TDA and were prohibited from voting any securities of TDA for a two-year period).

4 See United States v. Friedman, No. 76 Crim. 1022, 1979 SEC LEXIS 326 (S.D.N.Y. Nov. 14, 1979) (Fields was sentenced to six months imprisonment on each of five counts, to run concurrently, and a $50,000 fine, and Friedman was sentenced to three months imprisonment on each of two counts, to run concurrently, and a $25,000 fine).

5 See United States v. Friedman, No. 76 Crim. 1022, 1980 SEC LEXIS 2117 (S.D.N.Y. Feb. 7, 1980) (Friedman was sentenced to one month imprisonment on each of three counts, to run concurrently, and a $3,000 fine).

6 An amendment to the Registration Statement was filed on October 15, 1996 and this Commission sent comments concerning the amendment to the Company on October 29, 1996. The Company has not responded to those comments and the Registration Statement has not yet been declared effective, withdrawn, or abandoned.

7 Fields is the chairman of the board of directors, president, and the chief executive officer of TDA, and Friedman is the executive vice president, chief financial officer, treasurer, and a director of TDA.

8 The NASD staff gave the following reasons for denying the application:
(1) the regulatory history of Douglas P. Fields, Frederick M. Friedman and TDA Industries, Inc. coupled with their significant control and influence over the operations of the Company presents a public interest concern to future Nasdaq Investors, (2) certain June and July 1996 Private Placements appear to be inconsistent with just and equitable principles of trade, and (3) the legal entity applying to be listed on Nasdaq does not meet the income [and net tangible asset] requirements . . . .

9 Section 19(f) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78s(f).

10 This provision was adopted in 1994 as an amendment to Part II, Section 3(a) of Schedule D to the NASD's By-Laws and subsequently became a part of Rule 4300.

11 See Exchange Act Rel. No. 34151 (June 3, 1994), 56 SEC Docket 2654, 2655.

12 Eagle argues that the NASD has effectively established a rule, without formal promulgation in accordance with the requirements of Section 19(b) of the Exchange Act, that prevents an entity's securities from being listed if an officer or director engaged in prior criminal or civil violations of the federal securities laws. We disagree. As noted, the NASD has broad discretion in these matters. This discretion necessarily involves a fact-specific inquiry in determining whether to list particular securities.

13 Twenty years have elapsed since the expiration of the two-year prohibition on Fields and Friedman acting as directors of TDA.

14 See Exchange Act Rel. No. 34151 (June 3, 1994), 56 SEC Docket 2654, 2656.

15 Tassaway, Inc., 45 S.E.C. 706, 710 (1975).

16 We also note that in order to affirm NASD action of this nature, we must find that the specific grounds for the denial of inclusion exist in fact. Exchange Act Section 19(f), 15 U.S.C. § 78s(f). The Review Committee appears to have relied on an inaccurate version of certain facts. The Review Committee stated in its decision that it concurred "with the Panel's concerns regarding the potential for similar misconduct going forward." In reaching this conclusion, the Qualifications Panel specifically relied on its belief that both Fields and Friedman had received a kick-back. The Review Committee in its decision notes that the Company alerted the Review Committee to this inaccuracy by stating that in the Commission complaint only Friedman was the focus of allegations involving kick-backs in connection with TDA's acquisition of another company. However, the Review Committee does not respond to this, or address the impact, if any, of this information on the Review Committee's reasoning. The NASD may address this point on reconsideration.

17 The NASD explanation may also be supported by any additional fact-finding that it deems necessary.

18 All of the arguments advanced by the parties have been considered. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Release No. 39800 (S.E.C. Release No.), Release No. 34-39800, 66 S.E.C. Docket 1920, 1998 WL 133847

End of Document

KeyCite Yellow Flag - Negative Treatment
Declined to Extend by Uni-World Capital L.P. v. Preferred Fragrance, Inc., S.D.N.Y., August 8, 2014

660 F.3d 569
United States Court of Appeals,
Second Circuit.

John J. FIERO and Fiero Brothers, Inc., Plaintiffs–Counter–Defendants–Appellants–Cross–Appellees,
v.
FINANCIAL INDUSTRY REGULATORY AUTHORITY, INC., Defendant–Counterclaimant–Appellee–Cross–Appellant.

Docket Nos. 09–1556–cv(L), 09–1863–cv(XAP).
|
Argued: April 6, 2010.
|
Decided: Oct. 5, 2011.

Synopsis

Background: Member securities brokerage firm brought action against Financial Industry Regulatory Authority (FINRA), seeking declaration, based on dismissal of FINRA's state-court breach of contract claims, 10 N.Y.3d 12, 853 N.Y.S.2d 267, 882 N.E.2d 879, that FINRA could not recover financial penalties that it had imposed on firm following disciplinary proceeding. FINRA counterclaimed for breach of contract, seeking to collect penalties. The United States District Court for the Southern District of New York, Victor Marrero, J., 606 F.Supp.2d 500, dismissed plaintiff's claim and entered judgment for defendant. Plaintiff appealed.

Holdings: The Court of Appeals, Winter, Circuit Judge, held that:

[1] Congress did not intend to empower FINRA to bring judicial actions to enforce its disciplinary fines and

[2] rule implemented under "house–keeping" procedure that served only as notice of new policy by FINRA to enforce collection of disciplinary fines through judicial proceedings did not constitute authorization for such conduct.

Reversed and remanded.

Procedural Posture(s): On Appeal; Motion to Dismiss.

West Headnotes (7)

[1] **Federal Courts**
Questions of Law in General

Review of a district court's legal conclusions, including the interpretation of a federal statute, is de novo.

1 Cases that cite this headnote

[2] **Federal Courts**
Pleadings and Motions

For federal question jurisdiction to arise, the claim as stated in the complaint must arise under the Constitution or laws of the United States. 28 U.S.C.A. § 1331.

Cases that cite this headnote

[3] **Federal Courts**
Securities regulation

A federal court has federal question jurisdiction to determine whether the Financial Industry Regulatory Authority (FINRA) has authority to collect fines through judicial proceedings that were levied pursuant to the Exchange Act. Securities Exchange Act of 1934, § 27, 15 U.S.C.A. § 78aa; 28 U.S.C.A. § 1331.

10 Cases that cite this headnote

[4] **Securities Regulation**
Proceedings and review

Congress did not intend to empower Financial Industry Regulatory Authority (FINRA) to bring judicial actions to enforce its disciplinary fines, since, among other things, there were no explicit provisions in statutes to authorize securities self-regulatory organizations (SROs) to seek judicial enforcement of variety of sanctions they could impose, Congress only provided that FINRA's sanctions were appealable by aggrieved party to Securities and Exchange Commission (SEC) and thereafter to United States Courts of

Appeals, and common law proceeding would have undermined exclusive jurisdiction that Congress gave to federal courts to enforce Exchange Act. Securities Exchange Act of 1934, § 15A(b)(7), 15 U.S.C.A. § 78*o*–3(b)(7).

14 Cases that cite this headnote

|5| **Securities Regulation**
⇐ Proceedings and review

Rule implemented under "house–keeping" procedure that served only as notice of new policy by securities self-regulatory organization (SRO) to enforce collection of disciplinary fines through judicial proceedings did not constitute authorization for such conduct, since SRO previously did not have such power, rule was substantive in that it affected rights of barred and suspended members to stay out of industry and not pay fines imposed on them in prior disciplinary proceedings, and it had not been properly promulgated under required notice and comment procedures established by Exchange Act. Securities Exchange Act of 1934, § 19(b), 15 U.S.C.A. § 78s(b).

7 Cases that cite this headnote

|6| **Administrative Law and Procedure**
⇐ Legislative rules; substantive rules

A substantive rule, or legislative one as it is sometimes called, creates a new law, right, or duties, in what amounts to a legislative act.

Cases that cite this headnote

|7| **Administrative Law and Procedure**
⇐ Construction, operation, and effect in general

The particular label placed upon an order by an agency is not necessarily conclusive, for it is the substance of what the agency has purported to do and has done which is decisive.

Cases that cite this headnote

Attorneys and Law Firms

*571 Brian D. Graifman, Gusrae, Kaplan, Bruno & Nusbaum, PLLC, New York, N.Y., for Plaintiffs–Counter–Defendants–Appellants–Cross–Appellees.

Terri L. Reicher, Financial Industry Regulatory Authority, Inc., Washington, D.C., for Defendant–Counterclaimant–Appellee–Cross–Appellant.

Before: JACOBS, Chief Judge, WINTER, and JOHN M. WALKER. JR., Circuit Judges.

Opinion

WINTER, Circuit Judge:

John J. Fiero ("Fiero") and Fiero Brothers, Inc. ("Fiero Brothers") (together, "Fieros") appeal from Judge Marrero's dismissal of their complaint, which sought a declaratory judgment that, *inter alia*, the Financial Industry Regulatory Authority, Inc. ("FINRA") lacks the authority to bring court actions to collect disciplinary fines it has imposed. We hold that FINRA lacks such authority. We therefore reverse the dismissal of the complaint and vacate the money judgment on FINRA's counterclaim.

BACKGROUND

a) *FINRA's Role*

FINRA is a "self-regulatory organization" ("SRO") as a national securities association registered with the SEC pursuant to the Maloney Act of 1938, 15 U.S.C. § 78*o*–3, *et seq.* *See* *Desiderio v. Nat'l Ass'n of Sec. Dealers, Inc.*, 191 F.3d 198, 201 (2d Cir.1999). FINRA is the successor to the National Association of Securities Dealers ("NASD"). [1] It "is responsible for conducting investigations and commencing disciplinary proceedings against [FINRA] member firms and their associated member representatives relating to compliance with the federal securities laws and regulations." *D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 157 (2d Cir.2002) (quoting *Datek Sec. Corp. v. Nat'l Ass'n of Sec. Dealers, Inc.*, 875 F.Supp. 230, 232 (S.D.N.Y.1995) (internal quotation marks omitted)). As a practical matter, all securities firms dealing with the public must be members of FINRA. *See* *Sacks v. SEC*, 648 F.3d 945, 948 (9th Cir.2011) (citing 72 Fed.Reg. 42,169, 42.170

(Aug. 1, 2007); 15 U.S.C. §§ 78c(a) 26, 78s(b)) (noting that FINRA is "responsible for regulatory oversight of all securities firms that do business with the public"); *see also* note 1, *supra.* FINRA's disciplinary proceedings are governed by the FINRA Code of Procedure ("FINRA COP").[2] The FINRA COP has been approved *572 by the SEC, as required by Section 19 of the Securities Exchange Act of 1934. 15 U.S.C. § 78s(b) (describing the required procedure for approval of proposed SRO rule changes).

FINRA has the power to initiate a disciplinary proceeding against any FINRA member or associated person for violating any FINRA rule, SEC regulation, or statutory provision. *Id.* § 78s(h)(3). To issue a complaint, FINRA's Department of Enforcement or Department of Market Regulation must obtain authorization from the FINRA Regulation Board or FINRA Board. FINRA COP § 9211. After a complaint is filed, a hearing panel conducts a hearing and issues a decision. *Id.* § 9231. Final decisions of the hearing panel may be appealed to the FINRA National Adjudicatory Council ("NAC"), which can affirm, modify, or reverse the hearing panel's decision. *Id.* §§ 9311, 9349(a), 9268–9269. NAC decisions may then be appealed to the SEC, pursuant to 15 U.S.C. § 78s(d), and from the SEC to the United States Court of Appeals, pursuant to 15 U.S.C. § 78y. 15 U.S.C. §§ 78s(d), 78y(a); *see also* *Mister Discount Stockbrokers v. SEC.* 768 F.2d 875, 876 (7th Cir.1985).

b) *The Disciplinary Action Against the Fieros*

Fiero Brothers, a New York corporation, was a FINRA member firm and broker-dealer registered with the SEC. John J. Fiero was the sole registered representative of Fiero Brothers. As such, the Fieros were subject to the regulations and discipline of NASD.

On February 6, 1998, NASD's Department of Enforcement initiated disciplinary proceedings against the Fieros, the merits of which are not pertinent to this appeal. On December 6, 2000, an NASD hearing panel held that the Fieros had violated Section 10(b) of the Exchange Act, Rule 10b–5, and FINRA Conduct Rules 2110, 2120, and 3370. The hearing panel expelled Fiero Brothers, barred Fiero from associating with any FINRA-member firm in any capacity, and fined the Fieros $1,000,000 plus costs, jointly and severally.

On appeal, the NAC affirmed the hearing panel's decision in its entirety. John Fiero, Nat'l Adjudicatory Council No. CAF980002, 2002 WL 31476976, at *34 (Oct. 28, 2002). The Fieros did not appeal the NAC's decision to the SEC.

c) *State Court Proceedings*

After the Fieros refused to pay the fine, FINRA commenced an action on December 22, 2003, in New York Supreme Court. *Fin. Indus. Regulatory Auth., Inc. v. Fiero,* 10 N.Y.3d 12, 853 N.Y.S.2d 267, 882 N.E.2d 879, 880–81 (2008). On September 12, 2005, the Supreme Court concluded that "NASD's claim [was] firmly based on ordinary principles of contract law" because the Fieros had "expressly agreed to comply with all NASD rules, including the imposition of fines and sanctions" when they voluntarily executed the NASD registration forms. *Nat'l Ass'n of Sec. Dealers, Inc. v. Fiero,* 2005 N.Y. Slip Op. 30161(U), at 2, 2005 WL 6012105 (Sept. 12, 2005). The Supreme Court further stated that "New York state courts have long recognized the right of a private membership organization to impose fines on its members, when authorized to do so by statute, charter or by-laws," and that "NASD is not 'just a private club,' but a self-regulatory organization, federally-mandated under ... the Exchange Act to discipline its members and enforce the federal securities laws as well as its own SEC-approved rules." *Id.* at 4–5. On May 11, 2006, the Supreme Court awarded the NASD a judgment of $1,329,724.54. *573 *Nat'l Ass'n of Sec. Dealers, Inc. v. Fiero,* 2006 N.Y. Slip Op. 30302(U), 2006 WL 5251396 (May 11, 2006).

The First Department of the New York Appellate Division affirmed the Supreme Court's decision. *Nat'l Ass'n of Sec. Dealers, Inc. v. Fiero,* 33 A.D.3d 547, 827 N.Y.S.2d 4, 5 (1st Dep't 2006). The New York Court of Appeals granted the Fieros leave to appeal, and on February 7, 2008, reversed on the ground that the state courts lacked subject matter jurisdiction. *Fiero,* 853 N.Y.S.2d 267, 882 N.E.2d at 881–82. The court explained that the FINRA complaint constituted an action to enforce a liability or duty created under the Exchange Act, and therefore, fell within the exclusive jurisdiction of the federal courts pursuant to 15 U.S.C. § 78aa. *Id.,* 853 N.Y.S.2d 267, 882 N.E.2d at 882.

d) *Federal Court Proceedings*

On February 8, 2008, the day after the New York Court of Appeals issued its ruling, the Fieros filed the instant action seeking a declaratory judgment that, *inter alia,* FINRA has no authority to collect fines through judicial proceedings.[3] FINRA thereafter filed a counterclaim, seeking to enforce the

fine under a breach of contract theory. Both parties moved to dismiss the complaint and counterclaim, respectively.

On March 30, 2009, the district court granted FINRA's motion to dismiss the Fieros' claim, denied the Fieros' motion to dismiss FINRA's counterclaim, and instructed the clerk to enter judgment in favor of FINRA. [4]

DISCUSSION

[1] [2] [3] We review a district court's grant of a motion to dismiss *de novo*. *Chase Grp. Alliance v. City of N.Y. Dep't of Fin.*, 620 F.3d 146, 150 (2d Cir.2010). Our review of a district court's legal conclusions, including the interpretation of a federal statute, is also *de novo*. *United States v. Fuller*, 627 F.3d 499, 503 (2d Cir.2010). [5]

*574 The Fieros argue that while the Exchange Act and FINRA's rules and bylaws authorize FINRA to impose sanctions on its members, it has no authority to bring judicial actions to collect monetary sanctions. FINRA argues that it has this authority under the Exchange Act and from a FINRA rule submitted to, and not disapproved by, the SEC in 1990 ("1990 Rule Change"). *See* Notice of Filing and Immediate Effectiveness of Proposed Rule Change by NASD Relating to the Collection of Fines and Costs in Disciplinary Proceedings, Exchange Act SEC Release No. 28227, 46 S.E.C. Docket 1049 (July 18, 1990) (hereinafter "SEC Notice of 1990 Rule Change"). We discuss each argument *seriatim*.

a) *FINRA's Authority Under the Exchange Act*

The first question is whether the Exchange Act provides FINRA with the necessary authority. We hold that it does not.

[4] Under Section 15A(b) of the Exchange Act, SRO's have a statutory authority and obligation to "appropriately discipline[ ]" their members for violation of any provision of the Exchange Act, the rules or regulations promulgated thereunder, or their own rules, "by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction." 15 U.S.C. § 78*o*–3(b)(7). However, there is no express statutory authority for SRO's to bring judicial actions to enforce the collection of fines. [6]

In the present context the omission is not insignificant. The core issue, of course, is congressional intent, *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568, 99 S.Ct. 2479, 61 L.Ed.2d 82 (1979), and, in the discussion that follows, we explain why we believe that Congress did not intend to empower FINRA to bring judicial actions to enforce its fines.

The statutory scheme carefully particularizes an array of available remedies, including permissible actions in the federal courts. These include, of course, a variety of actions by private parties for damages. 15 U.S.C. §§ 77k–77*l*, 78i(f), 78t(b); *see Redington*, 442 U.S. at 571–72, 99 S.Ct. 2479 (discussing generally private rights of action in the Securities Exchange Act).

Also, Section 21(d) of the Exchange Act provides express statutory authority for the SEC to seek judicial enforcement of penalties. *See* 15 U.S.C. § 78u(d). More specifically, the SEC "may in its discretion bring an action" to enjoin any person who "is engaged or is about to engage in acts or practices constituting a violation" of, *inter alia*, any provision of the Exchange Act, the rules or regulations thereunder, or the rules of a national securities exchange or registered securities association of which such person is a member from such practices. *Id.* § 78u(d)(1). Moreover, *575 the SEC has explicit authority to seek monetary penalties for violations of the Exchange Act, the rules and regulations promulgated thereunder, or for the violation of a cease and desist order. *Id.* § 78u(d)(3)(A). Under Section 21(e) of the Exchange Act, the SEC may also seek "writs of mandamus, injunctions, and orders" from the federal courts commanding any person to comply with, *inter alia*, "the provisions of [the Exchange Act], the rules, regulations, and orders thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or person associated with a member...." *Id.* § 78u(e). Under Section 21(f), however, the SEC is prohibited from bringing "any action pursuant to subsection (d) or (e) of this section against any person for violation of, or to command compliance with, the rules of a self-regulatory organization ... unless it appears to the Commission that (1) such self-regulatory organization ... is unable or unwilling to take appropriate action against such person in the public interest and for the protection of investors, or (2) such action is otherwise necessary or appropriate in the public interest or for the protection of investors." *Id.* § 78u(f). [7]

Therefore, when Congress passed the Exchange Act, and to this date, Sarbanes–Oxley Act of 2002, § 3(b), (amending 15 U.S.C. § 78u); Dodd–Frank Wall Street Reform Act, Pub.L. No. 111–203, § 929P, 124 Stat. 1376, 1862–63 (2010) (amending 15 U.S.C. § 78u), it was well aware of how to grant an agency access to the courts to seek judicial enforcement of specific sanctions, including monetary penalties. 15 U.S.C. § 78u(d)(3)(A); *see, e.g., SEC v. Rosenthal,* 426 Fed.Appx. 1 (2d Cir.2011); *SEC v. Tx. Gulf Sulphur Co.,* 446 F.2d 1301, 1307 (2d Cir.1971).

In contrast, there are no explicit provisions in the statute authorizing SRO's to seek judicial enforcement of the variety of sanctions they can impose. This is significant evidence that Congress did not intend to authorize FINRA to seek judicial enforcement to collect its disciplinary fines. *Redington,* 442 U.S. at 571–72, 99 S.Ct. 2479 (not implying a private right of action where elsewhere in the Exchange Act Congress demonstrated the ability and explicit intent to create private rights of action).

We need not rely upon negative implications alone, however, because there are statutory provisions that weigh heavily against FINRA's claim of enforcement powers through court actions alleging breach of contract. First, FINRA's sanctions are appealable by an aggrieved party to the SEC and thereafter to the United States Courts of Appeals. Had Congress intended judicial enforcement, it would surely have provided for some specific relief other than leaving SRO's to common-law proceedings in state courts or in federal district courts under diversity jurisdiction.[8] Second, where FINRA enforces ***576** statutory or administrative rules, or enforces its own rules promulgated pursuant to statutory or administrative authority, it is exercising the powers granted to it under the Exchange Act. Indeed, FINRA's powers in that regard are subject to divestment by the SEC under Section 19(g)(2) of that Act. However, Congress gave the federal courts exclusive jurisdiction to enforce the Exchange Act, 15 U.S.C. § 78aa, and FINRA's breach of contract theory undermines that provision. FINRA contract enforcement actions may bristle with Exchange Act legal issues because the most serious fines levied by FINRA will be for member violations of the Act. For example, the Fieros were charged with a violation of Section 10(b) of that Act. State court enforcement of FINRA fines might well, therefore, entail interpretation of the Exchange Act notwithstanding the exclusive jurisdiction of the federal courts.

One might argue that an inference of congressional intent to authorize such legal actions by FINRA can be drawn from the seemingly inexplicable nature of a gap in the FINRA enforcement scheme: fines may be levied but not collected. However, the gap does not support an inference of inadvertent omission because significant underenforcement of the securities laws and FINRA rules is hardly the inevitable result of FINRA's inability to bring fine-enforcement actions. FINRA fines are already enforced by a draconian sanction not involving court action. One cannot deal in securities with the public without being a member of FINRA. When a member fails to pay a fine levied by FINRA, FINRA can revoke the member's registration, resulting in exclusion from the industry. Moreover, where a fine is based on a violation of the Exchange Act, the violator will also face a panoply of private and SEC remedies. *See, e.g.,* 15 U.S.C. §§ 77k–77*l*, 78i, 78j(b).

Finally, our conclusion is amply supported by NASD's longstanding practices. It has always relied exclusively upon its powers to revoke the registration of or deny reentry into the industry to punish members who do not comply with sanctions. U.S. Gen. Accounting Office, SEC and CFTC: Most Fines Collected, But Improvements Needed in the Use of Treasury's Collection Service 11 (2001). So far as we can tell, it was not until 1990 that the NASD sought to enforce fines or any other sanction through judicial actions in its own right. NASD (or any other SRO) may never even have claimed to have the power to do so until 1990. In that year, as discussed *infra,* NASD proposed a rule and successfully asked the SEC not to disapprove it. The rule notified the public of a new NASD policy of bringing court actions in its name to collect fines. NASD, Notice to Members 90–21, *available at* http://www.finra. org/Industry/Regulation/Notices/Pre–1996/. This rule, and its effect, are discussed in the next subsection. And, even after the change in policy in 1990—the effect of which turns in part on the question of statutory authority—the action against the Fieros is said to be the first case brought under that policy. Appellant's Br. at 10.

Such a longstanding practice supports an inference that NASD believed that it lacked judicial enforcement power. As the Supreme Court has stated,

> Authority actually granted by Congress of course cannot evaporate through lack of administrative exercise. But just as established practice may shed light on the extent of power conveyed by general statutory language, so the want of assertion of power by those who presumably *577 would be alert to exercise it, is equally significant in determining whether such power was actually conferred.

Fed. Trade Comm'n v. Bunte Bros., 312 U.S. 349, 352, 61 S.Ct. 580, 85 L.Ed. 881 (1941); *see also Bankamerica Corp. v. United States*, 462 U.S. 122, 131, 103 S.Ct. 2266, 76 L.Ed.2d 456 (1983) (finding that "the Government's failure for over 60 years to exercise the power it now claims ... strongly suggests that it did not read the statute as granting such power").

Moreover, NASD's longstanding reliance upon these other substantial enforcement methods was known to Congress, and Congress left that reliance unaltered. This lack of action further indicates that FINRA is not authorized to enforce the collection of its fines through the courts. *See* *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 381–82, 102 S.Ct. 1825, 72 L.Ed.2d 182 (1982) (noting that "an implied cause of action under the [Commodities Exchange Act] was a part of the 'contemporary legal context' in which Congress legislated," and that "[i]n that context, the fact that a comprehensive reexamination and significant amendment of the [Commodities Exchange Act] left intact the statutory provisions under which the federal courts had implied a cause of action is itself evidence that Congress affirmatively intended to preserve that remedy" (internal citations omitted)). The situation here is different from *Merrill Lynch* in that a failure to bring actions, rather than the bringing of actions, was involved, but the principle of congressional acquiescence is the same.

In sum, the issue is one of legislative intent, and we conclude that the heavy weight of evidence suggests that Congress did not intend to empower FINRA to bring court proceedings to enforce its fines.

b) *FINRA's Authority Under the 1990 Rule*

[5] On April 10, 1990, and as amended on June 20, 1990, FINRA filed a rule with the SEC pursuant to Section 19(b)(1) of the Exchange Act. Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the Collection of Fines and Costs in Disciplinary Proceedings, Exchange Act Release No. 28227, 46 SEC Docket 1049 (July 18, 1990), 1990 WL 320480. The proposal provided notification that the NASD "intends to pursue other available means for the collection of fines and costs imposed ... in disciplinary decisions" on or after July 1, 1990. *Id.* at *1. The NASD advised that should "its own internal efforts for the collection of fines ... fail," it may refer a matter "to external collection agencies and in appropriate situations, ... seek to reduce such fines to a judgment." *Id.* at *1 n. 2. Along with its SEC filing, the NASD issued a notice to its members in April 1990, informing them of its new policy and outlining how the policy would be implemented. *See* NASD, Notice to Members 90–21, *available at* http:// www.finra.org/Industry/Regulation/Notices/Pre–1996/. The notice became effective on July 1, 1990. *Id.* (noting that the "NASD will not pursue the collection of fines and costs assessed in cases concluded prior to July 1, 1990").

In October 1999, NASD sent a second notice to its members notifying them that it would "pursue the collection of any fine in sales practice cases, even if an individual is barred, if ... there has been widespread, significant, and identifiable customer harm; or the respondent has retained substantial ill-gotten gains."[9] *578 NASD, Notice to Members 99–86, *available at* http://www.finra.org/Industry/Regulation/Notices/1999/p004067.

FINRA claims that the 1990 Rule Change constitutes authority for judicial enforcement of its fines. This claim is something of an exaggeration. The 1990 Rule Change does not even purport to be newly granted authorization from the SEC to FINRA to bring such judicial actions. Rather, it appears to assume a pre-existing power and to serve only as a notice of a new policy under that power.

Having found no such pre-existing power, we may nevertheless assume for purposes of analysis that the 1990 Rule Change, if properly obtained, constitutes such authorization.[10] However, for FINRA to have obtained authority under the 1990 Rule Change to enforce

the collection of its disciplinary fines through judicial proceedings, the rule must have been properly promulgated under the procedures established by the Exchange Act. It was not.

Section 19(b) of the Exchange Act establishes the mechanism by which SRO's can change their governing rules. *See* 15 U.S.C. § 78s(b). To initiate the process, an SRO must file any proposed rule change with the SEC, "accompanied by a concise general statement of the basis and purpose of such proposed rule change." *Id.* § 78s(b)(1).[11] The SEC is then required to publish notice of the proposed rule change and give interested individuals an opportunity to comment prior to either approving or disapproving the rule. *Id.*

[6] Under this system, established by Congress in 1975, all new substantive rules and modification of existing rules for SRO's must go through a notice and comment period and obtain SEC approval before becoming effective. Securities Acts Amendments of 1975, Pub.L. No. 94–29, 89 Stat. 97 (codified as amended at 15 U.S.C. §§ 78a to 80b–4 (1975)); *Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1130 (9th Cir.2005). A substantive rule—or legislative one, as it is sometimes called in this Circuit—creates "new law, right, or duties, in what amounts to a legislative act." *N.Y. State Elec. & Gas Corp. v. Saranac Power Partners, L.P.*, 267 F.3d 128, 131 (2d Cir.2001) (citations and internal quotation mark omitted) (defining substantive rule in the context of the Administrative Procedure Act).

Congress also included an exception to the comment and notice requirement of § 19(b)(1) for " 'House–Keeping' rules and other rules which do not substantially affect the public interest or the protection of investors." 121 Cong. Rec. 700–183 (1975) (comments of Sen. Harrison Williams); *see also Saranac Power Partners*, 267 F.3d at 131 (defining interpretive rules as those which "do not create rights, but merely clarify an existing statute or regulation" (citations and internal quotation marks omitted)); *Grunwald*, 400 F.3d at 1130 n. 11. Such proposed rule changes take immediate effect upon filing with the SEC. 15 U.S.C. § 78s(b)(3)(A). In particular, the rule change becomes effective on filing with the SEC if the SRO designates the proposed rule as:

> *579 (i) constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization, (ii) establishing or changing a due, fee, or other charge imposed by the self-regulatory organization on any person, whether or not the person is a member of the self-regulatory organization, or (iii) concerned solely with the administration of the self-regulatory organization or other matters which the Commission [may specify].

Id.

In proposing the 1990 Rule Change, the NASD designated it as such a "House–Keeping" rule, "one constituting a stated policy with respect to the enforcement of an existing rule of the NASD under § 19(b)(3)(A)(i) of the [Exchange] Act." *See* Self–Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the Collection of Fines and Costs in Disciplinary Proceedings, Exchange Act Release No. 28227, 46 SEC Docket 1049 at *1, 1990 WL 320480. Thus, the rule was to become effective upon the SEC's receipt of the filing. 15 U.S.C. § 78s(b)(3)(A).

[7] We, however, are not bound by the NASD's characterization as to whether the 1990 Rule Change affected the substantive rights of members. *Brodsky v. U.S. Nuclear Regulatory Comm'n*, 578 F.3d 175, 182 (2d Cir.2009) (" 'The particular label placed upon [an order] by [an agency] is not necessarily conclusive, for it is the substance of what the [agency] has purported to do and has done which is decisive.' " (quoting *Columbia Broad. Sys., Inc. v. United States*, 316 U.S. 407, 416, 62 S.Ct. 1194, 86 L.Ed. 1563 (1942))).

Prior to the 1990 Rule Change, as discussed, there was no existing SEC rule or statute that authorized the NASD to initiate judicial proceedings to enforce the collection of its disciplinary fines. Furthermore, the NASD had a longstanding practice of not seeking to enforce collection through judicial actions. Indeed, even subsequent to the 1990 Rule Change, NASD did not rely on it to ask courts to enter judgments based on its disciplinary fines. For example, in 1998, it sought the SEC's assistance in obtaining court orders to direct violators owing NASD fines to pay these amounts. *See* U.S. Gen. Accounting Office, SEC and CFTC: Most

Fines Collected, But Improvements Needed in the Use of Treasury's Collection Service 11 (2001). In response, the SEC agreed to seek court orders under Exchange Act § 21(e)(1) to enforce the NASD's disciplinary fines, but only for cases that it affirmed on appeal and that met other specific requirements. *Id.*

This background and the various statutory provisions discussed above demonstrate that the 1990 Rule Change was not simply a stated policy change under 15 U.S.C. § 78s(b)(3)(A) that could bypass the required notice and comment period of Section 19(b). Rather, it was a new substantive rule that affected the rights of barred and suspended members to stay out of the industry and not pay the fines imposed on them in prior disciplinary proceedings. As a result, the NASD was required to file the new substantive rule with the SEC under 15 U.S.C. § 78s(b)(1) for publication of a notice and comment period. Because the NASD improperly designated the 1990 Rule Change, it was never properly promulgated and cannot authorize FINRA to judicially enforce the collection of its disciplinary fines.

CONCLUSION

For the foregoing reasons, we reverse the judgment dismissing the appellants' *580 declaratory judgment complaint and vacate the judgment entered in favor of the appellee.

All Citations

660 F.3d 569, Fed. Sec. L. Rep. P 96,557

Footnotes

1 FINRA is a non-profit Delaware corporation that was formed in July 2007, when the National Association of Securities Dealers, Inc. ("NASD") consolidated with the regulatory arm of the New York Stock Exchange. *See Standard Inv. Chartered, Inc. v. Nat'l Ass'n of Sec. Dealers, Inc.*, 637 F.3d 112, 114 (2d Cir.2011). As a result of this consolidation, FINRA is the sole SRO providing member firm regulation for securities firms that conduct business with the public in the United States. *Fin. Indus. Regulatory Auth., Inc. v. Fiero*, 853 N.Y.S.2d 267, 882 N.E.2d 879, 880 n. * (N.Y.2008). Much of the facts and background in this case occurred prior to July 2007, so we will refer to the appellee as the NASD where appropriate. The distinction is, however, irrelevant to the merits and our disposition of the case.

2 The entire FINRA COP is contained in the FINRA Manual available at http://finra.complinet.com.

3 Even prior to the Court of Appeals' ruling, the Fieros had brought an action in the Southern District, which has been voluntarily dismissed without prejudice pursuant to Fed.R.Civ.P. 41(a).

4 However, the court's order did not specify the amount of the judgment. On April 2, 2009, the district court issued a more detailed decision and order, setting forth its findings, reasoning, and conclusions as to the earlier judgment, but similar to its earlier order, this decision did not specifically direct entry of a judgment for a specific amount of money. *Fiero v. Fin. Indus. Regulatory Auth., Inc.*, 606 F.Supp.2d 500 (S.D.N.Y.2009). The Fieros and FINRA both timely filed their notices of appeal on April 14, 2009 and April 29, 2009, respectively.
On April 17, 2009, the district court requested a limited remand to correct the omission of the judgment amount. On July 15, 2009, we granted the district court's request, and, thereafter the district court directed the clerk to enter a judgment in favor of FINRA in the amount of $1,010,809.25 with costs and interest. Both parties made timely requests to reinstate the appeals, which we granted on August 12, 2009.

5 Although both parties had agreed that federal jurisdiction existed, the district court *sua sponte* decided that it lacked federal question jurisdiction under 28 U.S.C. § 1331, but had diversity jurisdiction under 28 U.S.C. § 1332. *Fiero*, 606 F.Supp.2d at 509. We disagree with the district court's conclusion that it lacked federal question jurisdiction.
For jurisdiction to arise under Section 1331, "the claim as stated in the complaint" must "arise[ ] under the Constitution or laws of the United States." *S. New England Tel. Co. v. Global NAPs Inc.*, 624 F.3d 123, 132 (2d Cir.2010) (quoting *Carlson v. Principal Fin. Grp.*, 320 F.3d 301, 306 (2d Cir.2003) (internal quotation mark omitted)). The Fieros seek a declaratory judgment under 28 U.S.C. § 2201, "that FINRA has no authority to obtain a money judgment based on" a disciplinary fine imposed pursuant to FINRA's powers under the Exchange Act. *See* Compl. ¶¶ 1, 16, and 30. On its face, the complaint states a claim under the Exchange Act. We have federal question jurisdiction to determine whether FINRA has authority to collect through judicial proceedings fines levied pursuant to the Exchange Act. *See Franchise*

Tax Bd. v. Constr. Laborers Vacation Trust, 463 U.S. 1, 19 n. 19, 103 S.Ct. 2841, 77 L.Ed.2d 420 (1983) (explaining that federal question jurisdiction exists over a declaratory judgment action if, *inter alia,* the defendant could have brought a coercive claim under federal law against the plaintiff); *see also* *Carlson,* 320 F.3d at 307 (holding that the district court has subject matter jurisdiction because it "is clear that the complaint, on its face, seeks relief under ERISA").

6 It is worth noting that the power granted to SRO's by Section 15A of the Exchange Act to discipline their members applies to all SRO's, and not just FINRA.

7 The SEC takes the position that it has the authority to bring an action in a federal district court to enforce any order it issues that affirms sanctions, including fines, imposed by FINRA. *See* Delegation of Authority to the Office of the General Counsel, SEC Release No. 42,488, 71 S.E.C. Docket 1910 (March 2, 2000); 15 U.S.C. § 78u(e)(1). Although several other Courts of Appeals have affirmed the SEC's authority to enforce FINRA-imposed sanctions pursuant to Section 21(e), *see, e.g.,* *SEC v. Mohn,* 465 F.3d 647, 651–52 (6th Cir.2006); *SEC v. McCarthy,* 322 F.3d 650, 655 (9th Cir.2003); *SEC v. Vittor,* 323 F.3d 930 (11th Cir.2003); and *Lang v. French,* 154 F.3d 217, 222 (5th Cir.1998), this issue is not before us on this appeal.

8 One court has even held that NASD is not an "aggrieved person" in a Court of Appeals review proceeding, and that NASD was thus unable to bring a petition for review of an SEC decision vacating an NASD disciplinary decision. *Nat'l Ass'n of Sec. Dealers, Inc. v. SEC,* 431 F.3d 803, 809–10 (D.C.Cir.2005).

9 This second notice to members was issued after the NASD enforcement action against the Fieros was initiated, but before the Fieros chose not to pursue an appeal to the SEC.

10 We of course intimate no opinion on the validity of a properly promulgated rule authorizing fine collection through judicial proceedings.

11 Congress's intention in adopting § 19(b)(1) was to impose on SRO's "the same standards of policy justification that the Administrative Procedure Act imposes on the SEC." S. REP. No. 94–75 (1975), *reprinted in* 1975 U.S.C.C.A.N. 179, 208, 1975 WL 12347, at *29.

KeyCite Yellow Flag - Negative Treatment
Distinguished by Billing v. Credit Suisse First Boston Ltd., 2nd Cir.(N.Y.), September 28, 2005

313 F.3d 796
United States Court of Appeals,
Second Circuit.

Alan FRIEDMAN, Sybil Meisel, Steven Langsom, Trustees u/w/o Benjamin Meisel and Sybil Meisel, on behalf of themselves and all others similarly situated, Plaintiffs–Appellants,

v.

SALOMON/SMITH BARNEY, INC., Goldman Sachs, Merrill Lynch & Co., Inc., Credit Suisse First Boston, Corp., Morgan Stanley Dean Witter, Painewebber Inc., Natwest Securities, Deutsche Bank Alex Brown, Inc., Coburn & Meredith, Inc., Shamrock Partners Ltd., Prudential Securities Inc., Raymond James & Associates, Inc., Donaldson Lufkin & Jenrette, Legg Mason Wood Walker, Inc., Nations Banc Montgomery Securities, LLC, Lazard Freres & Co., LLC, and Morgan Keegan & Co., Defendants–Appellees.

Docket No. 01–7207.
|
Argued: Dec. 11, 2001.
|
Decided: Dec. 20, 2002.

Synopsis
Retail investors brought class action alleging that underwriters and brokerage firms participated in price-fixing scheme by restricting their re-sale of stock for a period after initial public offering. The United States District Court for the Southern District of New York, Naomi Reice Buchwald, J., 2000 WL 1804719, dismissed complaint on ground that defendants' action enjoyed implied immunity from antitrust laws. Investors appealed. The Court of Appeals, Pooler, Circuit Judge, held that implied immunity barred claim.

Affirmed.

Procedural Posture(s): On Appeal; Motion to Dismiss.

West Headnotes (3)

[1] **Antitrust and Trade Regulation**
Antitrust Exemptions and Defenses

Generally, courts should not abrogate antitrust laws through implied immunity.

5 Cases that cite this headnote

[2] **Antitrust and Trade Regulation**
Investment

Antitrust and Trade Regulation
Regulatory Agencies; Regulated Industries

Implied immunity from antitrust claim exists where allowing parallel antitrust proceeding and Securities and Exchange Commission (SEC) proceeding would subject defendants to conflicting mandates; source of conflict may, but need not, involve affirmative SEC action, and conflict can exist where SEC has jurisdiction over challenged activity and deliberately has chosen not to regulate it.

5 Cases that cite this headnote

[3] **Antitrust and Trade Regulation**
Regulatory Agencies; Regulated Industries

Underwriters and brokerage firms were entitled to implied immunity from retail investors' claim that they participated in price-fixing scheme by restricting their re-sale of stock for a period after initial public offering; Securities and Exchange Commission (SEC) had exclusive jurisdiction over price stabilization, and had studied price stabilization and flipping repeatedly yet made administrative judgment not to regulate the practice despite its anti-competitive aspects. Securities Exchange Act of 1934, § 9(a)(6), 15 U.S.C.A. § 78i(a)(6).

5 Cases that cite this headnote

Attorneys and Law Firms

*797 Roger Kirby, Kirby McInerney & Squire LLP (Alice McInerney, Randall K. Berger, W. Mark Booker, on the brief) New York, NY, for Plaintiffs–Appellants.

Robert F. Wise. Jr., Davis Polk & Wardwell (John J. Clarke, Jr., Kevin Wallace, on the brief) New York, NY, for Defendants–Appellees.

Jay N. Fastow, Weil, Gotshal & Manges LLP (Adam P. Strochak, on the brief), New York, NY, for amicus curiae New York Stock Exchange, Inc.

David M. Becker, General Counsel, Securities and Exchange Commission (Meyer Eisenberg, Deputy General Counsel, Mark Pennington, Assistant General Counsel, on the brief) Washington, DC, for amicus curiae Securities and Exchange Commission.

Before OAKES and POOLER, Circuit Judges. *

Opinion

POOLER, Circuit Judge.

Plaintiffs Alan Friedman, et al., appeal from the December 11, 2000, judgment of the United States District Court for the Southern District of New York (Naomi Reice Buchwald, *Judge*) dismissing their class action complaint pursuant to Fed.R.Civ.P. 12(b)(6). Plaintiffs alleged that defendants participated in a price-fixing scheme concerning the sale of securities in violation of federal antitrust laws. The district court correctly held, however, that defendants' action enjoys implied immunity from antitrust laws because the antitrust laws conflict with securities regulatory provisions.

BACKGROUND

Plaintiffs are a class of retail investors who bought stock in public offerings. Plaintiffs are buyers. Defendants are underwriters and brokerage firms that manage public offerings through which they distribute shares of stock. Defendants are sellers. According to plaintiffs, defendants do not permit plaintiffs to re-sell their public offering stock during a prescribed "retail restricted period" of between 30 and 90 days after the initial offering distribution. First Am. Compl. at ¶¶ 2.b, 3. This retail restricted period occurs in the "aftermarket," which concerns any sales after the initial distribution. The re-sale of stock shortly after purchasing it in a public offering is known as "flipping." Generally, flipping causes stock prices to fluctuate—usually downward —and aftermarket sales restrictions are a form of price stabilization. According to plaintiffs, stock that institutional investors purchased from the same public offerings is not subject to aftermarket sales restrictions. *Id.* at ¶ 4. Plaintiffs also claim that defendants do not disclose the restrictions in an offering's registration statement or prospectus. *Id.* at ¶ 2.b.

Plaintiffs allege a conspiracy beginning in approximately 1990 among defendants to impose the restrictions on retail investors. According to plaintiffs, defendants *798 discourage flipping but do not strictly forbid the practice. Instead, defendants enforce the retail restricted period by denying stock allocations in future public offerings to retail investors who previously flipped stock. Defendants also enforce the retail restricted period by denying or restricting stock allocations or commissions to brokers whose retail customers engage in flipping. First Am. Compl. at ¶¶ 60, 63. Defendants monitor stock sales and flipping on a customer-by-customer basis through the Depository Trust Co., "a clearing house for the settlement of securities traded on all major exchanges and the NASDAQ system." *Id.* at ¶ 8.

Plaintiffs contend that defendants' practice artificially drives up the price of stock in the aftermarket by restricting the supply of shares. Plaintiffs also contend that the practice causes them to pay inflated prices for shares during the initial distribution of public offering stock. According to plaintiffs, institutional investors benefit from defendants' practice because they can re-sell their shares at a higher price in the aftermarket. First Am. Compl. at ¶ 4. Defendants also benefit from the scheme by, among other things, receiving more business and even kickbacks from institutional investors. Plaintiffs also note that defendants benefit from the artificially high prices because they do not have to spend as much of their own capital to support the price of public offering shares, and defendants attract future business based on the stock price performance of current public offerings. *Id.* at ¶ 11.e.

Plaintiffs filed a class action lawsuit in federal court on August 21, 1998, alleging a violation of Section 1 of the Sherman Act, [1] 15 U.S.C. § 1. Plaintiffs also alleged a cause of action under New York law for breach of fiduciary duty. Plaintiffs filed an amended complaint on March 10, 1999, and defendants moved to dismiss it pursuant to Rule 12(b)(6). After hearing oral argument, the district court granted defendants' motion in a Memorandum and Order in December

2000. *Friedman v. Salomon/Smith Barney, Inc.*, 2000 WL 1804719 (S.D.N.Y. Dec.8, 2000) ("*Friedman I*"). In addition to dismissing plaintiffs' federal claim on the merits, the district court dismissed their state law claim by declining to exercise supplemental jurisdiction over it. *Id.* at *12. Plaintiffs moved for reconsideration, and the district court denied the motion in a January 2001 Memorandum and Order. *Friedman v. Salomon/Smith Barney, Inc.*, 2001 WL 64774 (S.D.N.Y. Jan.23, 2001) ("*Friedman II*"). Plaintiffs now appeal. Our review is *de novo*. *Sheppard v. Beerman*, 18 F.3d 147, 150 (2d Cir.1994).

DISCUSSION

Both parties agree that the only issue on appeal is whether defendants' conduct is immune from antitrust enforcement based on the regulatory authority and actions of the Securities and Exchange Commission ("SEC"), principally under Section 9(a)(6) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78i(a)(6).[1] The relevant legal doctrine is known as implied immunity. The parties also agree *799 that the SEC has not regulated price stabilization in the aftermarket, but they draw opposite inferences from this circumstance.

According to plaintiffs, defendants' conduct does not benefit from the shield of implied immunity because the SEC's failure to regulate the manipulation of stock prices in the aftermarket is not the product of its consideration of antitrust or competitive concerns, and the SEC never has implied or held that defendants' conduct was permissible. Plaintiffs also argue that because defendants' conduct is anti-competitive, applying antitrust laws would reinforce the purpose of the Exchange Act rather than subject defendants to conflicting directives of securities and antitrust laws. Defendants and *amici* contend that the SEC has exercised its statutory authority in permitting —through the deliberate absence of regulation—defendants' conduct, so punishing that same conduct under antitrust principles would create an impermissible conflict.

I. Implied immunity

[1] The doctrine of implied immunity rests on three Supreme Court cases: *Silver v. New York Stock Exch.*, 373 U.S. 341, 83 S.Ct. 1246, 10 L.Ed.2d 389 (1963), *Gordon v. New York Stock Exch., Inc.*, 422 U.S. 659, 95 S.Ct. 2598, 45 L.Ed.2d 463 (1975), and *United States v. National Ass'n of Sec. Dealers, Inc.*, 422 U.S. 694, 95 S.Ct. 2427, 45 L.Ed.2d 486 (1975) ("*NASD*"). Generally, courts should not abrogate antitrust laws through implied immunity, also known as implied repeal or revocation, "casually" because "repeal by implication is not favored." *Finnegan v. Campeau Corp.*, 915 F.2d 824, 828 (2d Cir.1990) (quotation marks and citation omitted). Implied immunity will exist "[o]nly where there is a plain repugnancy between the antitrust and regulatory provisions." *Id.* (quotation marks and citation omitted). "[R]epeal of antitrust jurisdiction cannot be implied simply when the antitrust laws and a regulatory scheme overlap." *Strobl v. New York Mercantile Exch.*, 768 F.2d 22, 27 (2d Cir.1985). Importantly, the "plain repugnancy," or conflict, between antitrust and securities laws extends to potential as well as actual conflicts. *Id.*

As the district court below recognized, implied immunity analysis requires a fairly fact-specific inquiry into the nature and extent of regulatory action that allegedly conflicts with antitrust law. *See Friedman I*, 2000 WL 1804719, at *4–5 (listing relevant factors to implied immunity analysis). In their arguments on appeal, the parties largely compare the case at bar to the facts of prior cases, making a brief review of those cases helpful here.

In *Finnegan*, we found implied immunity where a direct conflict existed between antitrust law, which would prohibit joint takeover bidders, and the Williams Act, 15 U.S.C. §§ 78m(d)-(e) & 78n(d)-(f), which allowed competing bidders to make joint bids as long as they complied with SEC disclosure regulations. *Finnegan*, 915 F.2d at 829–31. In light of the direct conflict, implied immunity was necessary for the "proper functioning of the securities laws." *Id.* at 831. In *Finnegan*, we held that "[w]e cannot presume that Congress has allowed competing bidders to make a joint bid under the Williams Act and the SEC's regulations and taken that right away by authorizing suit against such joint bidders under the antitrust laws." *Id.* at 830.

In *Strobl*, we found that no implied immunity existed where both the Sherman Act and Commodity Exchange Act forbid price manipulation, although the Sherman Act called for greater damages. *Strobl*, 768 F.2d at 27–28. Key to that decision *800 was the absence of conflict or repugnancy between the legal schemes and the fact that "[t]here is no

built-in balance in the regulatory scheme of the [Commodity Exchange] Act that permits a little price manipulation in order to further some other statutory goal." *Id.* at 28. Thus, both sets of laws had the same goal and considered the same factors to reach that goal. Note that the Exchange Act, which governs our decision here, differs from the Commodity Exchange Act because the former allows "a little price manipulation" to further goals such as efficiently raising capital through new issues. *See* 15 U.S.C. § 78i(a)(6); *see also* S.Rep. No. 34–792S.Rep. No. 34–792, at 8–9, 17 (1934), SEC Release No. 34–2446, at 10–11 (March 18, 1940).

In *NASD,* the Supreme Court found implied immunity where the Investment Company Act of 1940, 15 U.S.C. § 80a–22(f), gave the SEC power to authorize sales and distribution restrictions on the transfer of mutual fund shares in secondary markets even though the same restrictions were anti-competitive under the antitrust laws. *NASD,* 422 U.S. at 729–30, 95 S.Ct. 2427. The facts in *NASD* are analogous to the case at bar because the statute in *NASD* "authorizes funds to impose transferability or negotiability restrictions, subject to [SEC] disapproval." *Id.* at 726, 95 S.Ct. 2427. Here, Section 9(a)(6) of the Exchange Act authorizes price stabilization mechanisms subject to SEC disapproval. 15 U.S.C. § 78i(a)(6). The Supreme Court found that "[t]here can be no reconciliation of [the SEC's] authority under Section 22(f) to permit these and similar restrictive agreements with the Sherman Act's declaration that they are illegal per se," even though the SEC had not specifically approved the restrictive agreements. *Id.* at 729–30, 95 S.Ct. 2427.

In *Gordon,* the Supreme Court found implied immunity where the SEC under Section 19(b) of the Exchange Act, 15 U.S.C. § 78s(b), had jurisdiction to establish a system of fixed commission rates on the New York Stock Exchange. *Gordon,* 422 U.S. at 691, 95 S.Ct. 2598. The Court did not concern itself with the "wisdom of fixed rates" but considered only Congress' intent that the SEC and not antitrust laws address the issue. *Id.* at 688, 95 S.Ct. 2598. Again, the Court focused on conflict, holding that "different standards are likely to result because the sole aim of antitrust legislation is to protect competition, whereas the SEC must consider, in addition, the economic health of the investors, the exchanges, and the securities industry." *Id.* at 689, 95 S.Ct. 2598.

In contrast to *Gordon* and *NASD,* in the earlier case *Silver* the Supreme Court found no implied immunity because applying antitrust principles to New York Stock Exchange rules that lay outside the SEC's jurisdiction created no conflict. *Silver,* 373 U.S. at 358, 83 S.Ct. 1246. Because the Exchange Act at that time did not give the SEC power to "review particular instances of enforcement of exchange rules," *id.* at 357, 83 S.Ct. 1246, applying the antitrust laws to effect that review did not affect the function of the Exchange Act, particularly because nothing in the SEC regulatory scheme at the time performed the "antitrust function" of considering injuries to competition. *Id.* at 358–59, 83 S.Ct. 1246. The Court noted that if the SEC had jurisdiction over review of exchange rules "a different case as to antitrust exemption would be presented." *Id.* at 360, 83 S.Ct. 1246. After *Silver* was decided, Congress amended the Exchange Act to require the SEC to take competition, among other things, into account in rulemaking and when reviewing rules of exchanges. *See* 15 U.S.C. §§ 78c(f), 78w(a)(2).

[2] Thus, implied immunity exists where allowing an antitrust lawsuit to proceed ***801** would conflict with Congress's implicit determination that the SEC should regulate the alleged anti-competitive conduct. In other words, implied immunity exists where allowing parallel proceedings on antitrust and SEC tracks would subject defendants to conflicting mandates. The source of the conflict may, but need not, involve affirmative SEC action. Conflict also can exist where the SEC has jurisdiction over the challenged activity and deliberately has chosen not to regulate it. *Strobl,* 768 F.2d at 27.

II. Application of legal standard

[3] In a thorough and comprehensive opinion, the district court found that implied immunity existed here because (1) the SEC has exclusive jurisdiction over price stabilization pursuant to Section 9(a)(6), which allows stabilization practices not specifically prohibited by the SEC; (2) Congress was aware of stabilization practices when it passed the Exchange Act and created the SEC in 1934; (3) the SEC actively studied and regulated stabilization practices over the last 60 years and consistently made a "studied assessment that the benefits of price stabilization to the capital markets outweigh the admitted anti-competitive aspects of stabilizing manipulation;" and (4) there is a clear conflict between plaintiff's reading of antitrust laws and SEC regulation under

Section 9(a)(6). *Friedman I*, 2000 WL 1804719, at *11–12; *Friedman II*, 2001 WL 64774, at *1. These holdings rest on proper interpretation of Section 9(a)(6) and analysis of the history of SEC regulation of price stabilization practices.

We examine briefly the SEC's regulation of price stabilization in both the distribution and aftermarket phases of public offerings. As noted previously, at the time Congress passed the Exchange Act, it declined to prohibit pegging, fixing or stabilizing practices outright and instead gave the SEC authority to regulate them. In 1940, the SEC issued its first policy statement about the practices, did not prohibit stabilization during distribution, and adopted regulations in an attempt to balance the interests of individual investors and "protection of the nation's credit and banking structure and the health of its capital markets." SEC Release No. 34–2446, at 10, 14. The SEC acknowledged that stabilization, "broadly defined as the buying of a security for the limited purpose of preventing or retarding a decline in its open market price in order to facilitate its distribution to the public," was a longstanding market practice with some "vicious and unsocial aspects" requiring additional monitoring in light of the new regulations. *Id.* at 3, 14. The SEC also pointed out that stabilization tended to combat the serious problem of flipping. *Id.* at 5.

In 1955 and 1963, the SEC revisited the stabilization issue and modified existing regulations but did not prohibit the practice. *See* SEC Release No. 34–5194 (July 5, 1955); H.R. Doc. No. 95, Pt. 1 (1963). In its 1963 report to Congress, the SEC pointed out that various firms combated flipping by depriving salespeople of their commissions "if resales by customers occur within 30 days of the effective date," by identifying "customers who sold stock in the immediate aftermarket" and declining to give these customers "allotments of subsequent oversubscribed issues," and telling customers "not to sell for varying periods, usually 30 or 60 days." H.R. Doc. No. 95, Pt. 1, at 525–26. The SEC nonetheless declined to regulate or prohibit the practices.

More recently, the SEC in 1994 undertook a comprehensive review of its trading practice rules and posed several questions dealing specifically with flipping in the aftermarket ***802** and whether a need existed to regulate the practice. SEC Release Nos. 33–7057, 34–33924, at 1316–17 (April 19, 1994). The SEC rule that resulted from this inquiry did *not* regulate price stabilization in the aftermarket. *See* 17 C.F.R. § 242.104 ("Regulation M"). In its release describing its new regulation, the SEC noted that stabilization in the aftermarket to combat flipping was "not uncommon and may act to support the price of the offered security in the aftermarket." SEC Release Nos. 33–7282, 34–37094, at 1740 (April 11, 1996). The commenters were "divided" over whether to regulate stabilization in the aftermarket, and the SEC chose instead to gather information, monitor aftermarket practices and "assess[ ] whether further regulation is warranted." *Id.*

Defendants argue that this history demonstrates that the SEC studied price stabilization and flipping repeatedly yet made the administrative judgment not to regulate the practices of which plaintiffs complain. Plaintiffs dispute the import of this history. First, plaintiffs argue that price stabilization in the aftermarket is a recent phenomenon beginning in the 1990s, so there is no way that Congress in 1934 or the SEC until just recently could have studied the issue. Thus, plaintiffs contend, the history we recounted above is essentially meaningless. We disagree. Plaintiffs rely on an artificial distinction between price stabilization in the aftermarket and price stabilization during distributions. There is no question that underwriters and brokers consistently employed some form of price stabilization to deter flipping. The practice pre-dated the Exchange Act and the SEC. As technology has evolved and distributions have taken shorter and shorter periods of time, the problem of flipping—and its "solution" of price stabilization—simply has spilled into the aftermarket as well as the distribution period. The SEC explicitly recognized this trend in its 1994 release, when it stated that " 'stabilization' of the market in connection with offerings may have shifted from the sales period to the aftermarket period." SEC Release Nos. 33–7057, 34–33924, at 1316. The SEC still declined to regulate price stabilization in the aftermarket when it adopted Regulation M, and we find this decision to be both deliberate and significant. Plaintiffs cannot contend that this latest action concerned only distributions and not the aftermarket.

Second, plaintiffs claim that no conflict exists here because application of antitrust laws would reinforce the Exchange Act's hostility to price manipulation. Plaintiffs argue that the SEC has not considered the antitrust implications of price stabilization. However, the agency must consider the competitive effects of its regulations. *See* 15 U.S.C. §§ 78c(f), 78w(a)(2). Contrary to plaintiffs' contention, this case is unlike *Strobl*, where both the securities and antitrust laws imposed a categorical prohibition on price manipulation, *Strobl*, 768 F.2d at 28, because here Section 9(a)(6) requires the SEC to consider other factors such as

the public interest and protection of investors in addition to market competition. The SEC has considered these factors in deciding not to regulate price stabilization in the aftermarket. Moreover, because Section 9(a)(6) permits some forms of price stabilization, it conflicts with the antitrust laws' blanket prohibition of the practices. The SEC also indicated in its 1940 release that its power to regulate stabilizing under the Exchange Act was broad and exclusive and that anti-competitive practices were lawful in the absence of SEC regulation. SEC Release No. 34–2446, at 12–14. The agency was aware of the antitrust implications of stabilization practices and the potential for direct conflict.

*803 Third, plaintiffs argue repeatedly that the SEC has specifically declined to regulate the aftermarket and the absence of this regulation means that courts can enforce the antitrust laws against defendants without the danger of a conflict. Plaintiffs also contend that the possibility of future SEC aftermarket regulation is insufficient to sustain a finding of implied immunity. Plaintiffs' argument rests on a misinterpretation of Section 9(a)(6), which the district court addressed in its order denying plaintiffs' motion for reconsideration. On that motion and on appeal, plaintiffs argue that the district court misread the "plain words" of Section 9(a)(6) and "turned [the section] on its head by an interpretation directly opposite its plain meaning." It is plaintiffs that have given an opposite meaning to Section 9(a)(6).

The statute clearly provides that price stabilization in contravention of SEC regulations is unlawful. [1] 15 U.S.C. § 78i(a)(6). As the district court correctly found, the statute allows price stabilization practices that the SEC does not prohibit. *Friedman II*, 2001 WL 64774, at *1. Plaintiffs reach the opposite conclusion—that the statute prohibits all price stabilization practices that the SEC does not specifically allow—because only this interpretation permits plaintiffs to construe the SEC's failure to regulate the aftermarket as leaving a space for antitrust laws to fill. Plaintiffs' misinterpretation of Section 9(a)(6) is the core of their position on appeal because all of their arguments against implied immunity flow from this view of the statute. But once the correct interpretation of Section 9(a)(6) is in place—the interpretation that the district court and defendants espouse—a finding of implied immunity is the direct consequence. We therefore affirm the district court's ruling that implied immunity bars plaintiffs' challenge to price stabilization practices in the aftermarket.

CONCLUSION

For the forgoing reasons, we affirm the judgment below in its entirety. Because we hold that implied immunity bars plaintiffs' claim, we do not reach defendants' alternative argument that the complaint alleges no antitrust injury because plaintiffs bought their shares at the same price as institutional investors and are free to sell them in the aftermarket.

All Citations

313 F.3d 796, Fed. Sec. L. Rep. P 92,242, 2002-2 Trade Cases P 73,908

Footnotes

* Judge Wilfred Feinberg recused himself from consideration of this matter after oral argument took place and did not participate in this decision. Because the remaining two panel members agree on the disposition of this appeal, they act in accordance with 2d Cir. R. 0.14.

1 The statute states: "It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange ... [t]o effect either alone or with one or more other persons any series of transactions for the purchase and/or sale of any security registered on a national securities exchange for the purpose of pegging, fixing, or stabilizing the price of such security in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78i(a)(6).

End of Document

39 F.3d 1451
United States Court of Appeals,
Tenth Circuit.

GENERAL BOND & SHARE CO., Petitioner,
v.
SECURITIES AND EXCHANGE COMMISSION, Respondent.

No. 93–9545.
|
Oct. 27, 1994.

Synopsis
Broker-dealer member of National Association of Securities Dealers (NASD) petitioned for review of disciplinary action taken against it by Securities and Exchange Commission (SEC). The Court of Appeals, Wesley E. Brown, District Judge, sitting by designation, held that: (1) NASD's interpretation of article of its Rules of Fair Practice as prohibiting member firms from accepting issuer-paid compensation for making a market in a security was a "rule change," which had to be submitted to SEC for approval; (2) firm violated NASD Rule by continuing to accept issuer-paid compensation after informing NASD that it would cease this practice; (3) SEC's determination that firm had burden of production did not constitute informal rule making; and (4) firm was obligated to comply fully with NASD's information request.

Affirmed in part, vacated in part and remanded.

West Headnotes (5)

[1] **Securities Regulation**
⇐ Dealers' associations

National Association of Securities Dealer's (NASD) interpretation of article of its Rules of Fair Practice as prohibiting member firms from accepting issuer-paid compensation for making a market in a security was a "rule change," which, even before Securities Acts amendments of 1975, had to be submitted to Securities and Exchange Commission (SEC) for approval prior to enforcement of that interpretation. Securities Exchange Act of 1934, § 19(b)(1), as amended, 15 U.S.C.A. § 78s(b)(1); § 15A(j), as amended, 15 U.S.C.(1970 Ed.) § 78 *o*–3(j).

1 Cases that cite this headnote

[2] **Securities Regulation**
⇐ Dealers' associations

Under Securities and Exchange Commission (SEC) regulations, application of National Association of Securities Dealers (NASD) Rule of Fair Practice to particular facts of case would not be considered "rule change" which would have to be submitted to SEC for approval prior to enforcement, where it is reasonably and fairly implied by an existing rule. Securities Exchange Act of 1934, § 19(b)(1), as amended, 15 U.S.C.A. § 78s(b)(1); § 15A(j), as amended, 15 U.S.C. (1970 Ed.) § 78*o*–3(j).

3 Cases that cite this headnote

[3] **Securities Regulation**
⇐ Dealers' associations

Although National Association of Securities Dealers (NASD) rules in effect at the time did not prohibit member firm from accepting issuer-paid compensation for making market in a security, firm violated NASD Rules of Fair Practice by continuing to accept issuer-paid compensation after informing NASD that it would cease this practice, and this conduct fully supported sanctions of cost, censure and expulsion, and fine of $20,000.

3 Cases that cite this headnote

[4] **Securities Regulation**
⇐ Broker-dealers and associates, registration and regulation

Securities and Exchange Commission's (SEC) determination that broker-dealer had burden of production under rule requiring broker-dealer submitting a quotation to maintain in its files certain information concerning the issuer did

not constitute informal rule making, but was an existing interpretation of requirements implied in existing rule. 17 C.F.R. § 240.15c2–11.

Cases that cite this headnote

[5] **Securities Regulation**
Dealers' associations

Once National Association of Securities Dealers (NASD) required information from member firm in course of its investigation of firm, firm was obligated to comply fully with the request, notwithstanding its opinion that requested documents were "neither material nor necessary for the charge."

Cases that cite this headnote

Attorneys and Law Firms

*1452 John Henry Schlie of Cross, Schlie & Heckenback, P.C., Englewood, CO., for petitioner.

Randall W. Quinn, Sr. Litigation Counsel, S.E.C., Washington, DC (Simon M. Lorne, Gen. Counsel, Eric Summergrad, Principal Asst. Gen. Counsel, and Angel Yang, Attorney, with him on the briefs) for respondent.

Before BRORBY and McWILLIAMS, Circuit Judges, and BROWN,* District Judge.

Opinion

WESLEY E. BROWN, District Judge.

Petitioner General Bond & Share Company ("General Bond") seeks review of disciplinary *1453 action taken against it by the Securities and Exchange Commission (hereinafter "the Commission" or "SEC"). The Commission found that General Bond violated several Rules of Fair Practice of the National Association of Securities Dealers, Inc. ("NASD"), of which General Bond was a member. Specifically, the Commission determined that General Bond, through its president Samuel C. Pandolfo, acted improperly in accepting compensation from approximately forty-five issuers of securities in exchange for publicly listing General Bond as a wholesale dealer for the securities, that it failed to maintain current information in its files as required by Commission rules, and that it failed to respond fully to requests for information made by NASD in the course of its investigation of General Bond.[1] General Bond now asks this court to vacate the sanctions imposed by SEC.

I.

Regulatory Background. The NASD is registered with SEC as a securities association pursuant to Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. § 78*o*–3. As such, the NASD is responsible for self-regulation of its members, subject to oversight by SEC. *Id.* NASD is required to adopt rules regulating the conduct of its members and to enforce those rules through disciplinary proceedings. *Id.* Under NASD procedures, the NASD Market Surveillance Committee ("MSC") brings disciplinary actions concerning member violations. Any final action taken by the MSC is subject to review by the NASD's National Business Conduct Committee ("NBCC"), which may affirm, reverse or modify the action taken by the MSC.

Disciplinary action taken by the NASD is subject to review by SEC. 15 U.S.C. § 78s(d)(2). In such cases, SEC conducts a *de novo* review of the record and makes its own finding as to whether the conduct in question violated the NASD rule charged. 15 U.S.C. § 78s(e)(1). *See also Sorrell v. SEC,* 679 F.2d 1323, 1326 n. 2 (9th Cir.1982). The SEC may also modify or cancel the sanctions imposed if it finds them to be excessive or oppressive. 15 U.S.C. § 78s(e)(2).

A person aggrieved by a final order of SEC in such a case may obtain review of the order in the appropriate U.S. Court of Appeals. § 78y(a)(1). A court reviewing the order must uphold the factual findings of SEC if they are supported by substantial evidence. § 78y(a)(4).

II.

Facts. The following facts, which were adopted by SEC, are supported by substantial evidence in the record. *See* § 78y(a)(4). General Bond, located in Denver, Colorado, has been an NASD member since 1961. At all times relevant to this case, General Bond was a one-man broker/dealer owned and operated by its president, Samuel C. Pandolfo. General Bond was a wholesale trader which dealt only with "Pink Sheet" securities. It had no retail customers.

The "Pink Sheets" are published on a daily basis by the National Quotation Bureau, Inc. They contain broker-dealer submitted "bid" and "ask" prices for, or indications of interest in, specified securities. During the periods December, 1988 to July, 1990 and November, 1990 to January, 1991, General Bond received a total of $25,750 from about forty-five issuers in return for General Bond entering its name in the pink sheets as a "market maker" for the securities. A "market maker" includes any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular and continuous basis. *See* 15 U.S.C. § 78c(a)(38). General Bond normally charged a negotiable fee for an individual listing, ranging between $250 and $1,000. The amount negotiated depended, according to Mr. Pandolfo, upon "supply and demand."

General Bond commanded these fees for at least ten years; in 1989 and 1990 about 25% of the firm's revenues consisted of such issuer-paid ***1454** compensation. Pandolfo testified that the firm could not have stayed in business during 1989 and 1990 without these payments. He acknowledged that General Bond did not list issues based on expectations or promises of order flow and that potential trading activity was unimportant to him. If trading interest surfaced, General Bond would continue the listing; if not, the listing would be pulled. Sixteen of the issues identified in the complaint were listed by General Bond for periods of less than thirty days.

The NASD contacted Mr. Pandolfo in September of 1990 concerning applications he had filed to have General Bond listed in the pink sheets as a market maker for two stocks. At that time, the NASD staff advised Pandolfo that NASD member firms were prohibited from accepting issuer-paid compensation for making a market in a security. NASD staff also furnished Pandolfo with a NASD Notice to Members, issued in February 1975, which set forth NASD's position on the matter of issuer-paid compensation. Thereafter, Pandolfo agreed to refund $500 he had received from an issuer and to accept no further issuer-paid compensation. Despite these representations, Pandolfo did not refund the money and General Bond continued its practice of accepting compensation for entering the pink sheets.

In mid-March 1991, NASD staff requested that Pandolfo furnish documentation concerning issuer-paid compensation the firm received between July, 1990 and the date of the request. Pandolfo furnished documentation for the period December, 1990 through March of 1991, but did not provide the pre-December 1990 documentation requested.

III.

The disciplinary action against General Bond was initiated by the filing of two separate complaints which were consolidated for purposes of the hearings before NASD and SEC. The first complaint alleged that General Bond violated Article III, Section 1 of the NASD Rules of Fair Practice, by accepting payments totaling $23,250 from issuers in return for listing itself as a market maker for the securities in the pink sheets during the period December, 1988 to July, 1990. Article III, Section 1 states: "A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." The complaint further alleged a violation of Section 15(c) of the 1934 Act and Rule 15c2–11 promulgated thereunder, which requires a broker-dealer who has submitted a quotation or an indication of interest in a security to maintain current information on the issuer. The second complaint alleged a violation of Article III, Section I by virtue of General Bond's receipt of $2,500 in return for listing itself as a market maker for securities between November, 1990 and January, 1991, and by virtue of the fact that Mr. Pandolfo was notified that NASD considered such payments improper and represented to NASD that he would cease accepting such compensation but continued to accept payments. The second complaint also alleged that General Bond failed to produce documents requested by NASD in the course of its investigation and that such failure was a violation of Article III, Section 1 and Article IV, Section 5 of the Rules of Fair Practice. Following a hearing and decision before the NASD Market Surveillance Committee, NASD's National Business Conduct Committee determined on appeal that General Bond had engaged in the conduct alleged and found such conduct to be violations of NASD Rules of Fair Practice. NASD imposed sanctions consisting of fines, costs, and expulsion from membership in the association.

General Bond then sought a hearing before SEC. After that hearing, the Commission determined that General Bond's practice of accepting compensation for listing General Bond in the pink sheets as a market maker violated Article III, Section 1 of NASD's Rules of Fair Practice. The Commission noted that the typical market maker is compensated by trading for its own account and that, in deciding whether to list a stock in the pink sheets, the typical market maker is

concerned with factors that affect the stock's liquidity and the security's intrinsic value. In contrast, General Bond's primary motivation in listing stocks was the payment that it received to list the security. According to *1455 the findings of the Commission, market participants view a pink sheet listing as an indicia of some measure of liquidity in the market and of the listing broker-dealer's interest in buying or selling the security. Market participants, the Commission found, had no way to know that General Bond was indifferent to the market factors likely to affect trading profits. The Commission concluded that General Bond's practice of accepting compensation "compromised the integrity of the market and misled market participants." The Commission further found that General Bond violated Article III, Section I by telling NASD that it would cease accepting issuer-paid compensation and then continuing to command such fees. The SEC adopted NASD's finding that Mr. Pandolfo "deceived the staff by claiming that he had ceased accepting such listing fees, while continuing business as usual." The Commission also held that General Bond violated Rule 15c2–11 by failing to maintain reasonably current information in its files on two issuers. Finally, SEC concluded that General Bond's failure to produce documents requested by NASD was not excusable and was a violation of the Rules of Fair Practice.

The SEC approved the sanctions levied by NASD with one exception. A majority of the Commission determined that an "additional remedial fine" of $14,250 imposed by NASD was not appropriate. Otherwise, the Commission upheld the NASD's imposition of censure and expulsion from the association as well as a total fine of $45,750 for the violations committed by General Bond.

IV.

1. *Article III, Section 1—Acceptance of Compensation by a Market Maker.* We first examine two related arguments asserted by General Bond. These arguments concern the Commission's determination that General Bond violated Article III, Section 1 of NASD Rules of Fair Practice by accepting compensation for listing General Bond in the "Pink Sheets" as a market maker for the securities. The first argument asserts that Article III, Section 1 of NASD rules, standing alone, is unconstitutionally vague. The second argument pertains to whether NASD was required by statute to submit its "interpretation" that the acceptance of such compensation was a violation of Article III, Section 1, to SEC prior to enforcing it. As is set forth herein, we find General Bond's second argument to be persuasive. We need not decide, therefore, whether the NASD rule standing alone is unconstitutionally vague.

a. *Vagueness.* General Bond first argues that the provisions of the rule requiring members to "observe high standards of commercial honor and just and equitable principles of trade" failed to provide fair warning to General Bond that its acceptance of compensation from issuers of securities would be considered a violation of the rule. *Citing Rose v. Locke,* 423 U.S. 48, 50, 96 S.Ct. 243, 244, 46 L.Ed.2d 185 (1975) (The Due Process Clause of the Fifth Amendment requires that sufficient warning be given so that individuals may conduct themselves so as to avoid that which is forbidden.) In its response, SEC does not challenge the applicability of the Due Process Clause to the disciplinary proceeding below, nor does it dispute the assertion that due process requires that NASD rules give fair warning of what conduct is prohibited before NASD members may be disciplined for engaging in such conduct. *See Handley Investment Co. v. S.E.C.,* 354 F.2d 64, 66 (10th Cir.1965). Moreover, SEC's brief does not assert that the provisions of Article III, Section 1 standing alone were sufficient to give adequate notice. The SEC maintains, however, that the requirements of due process were satisfied because General Bond had specific notice that its conduct violated NASD rules. In support of this assertion, SEC cites two documents: a 1973 publicly available "No–Action Letter" and a 1975 NASD "Notice to Members." These two documents are described below.

In *Monroe Securities, Inc.,* SEC No–Action Letter (Pub. Avail. June 4, 1973), SEC responded to a question from a broker as to whether he could charge an issuer a service charge for expenses incurred in entering quotations and making a market for the issuer's securities. The SEC's response included the following comments:

> It is generally understood that broker-dealers have wide freedom to commence or *1456 terminate making an over-the-counter market. The pricing of a stock or making of a market at any given time should involve a combination of factors, including the firm's current inventory position, its attitude toward the market, and any market being made in competition. In view of the common understanding of a market maker's role and economic motivations, an arrangement whereby a broker-dealer charges an issuer a fee for making a market in its stock may conflict with the antifraud provisions of the federal securities laws.

> * * * Your attention is also directed to Section 17(b) of the Securities Act which makes it unlawful for any person for consideration to be received from an issuer to publish, give publicity to or circulate, any notice, circular, advertisement, or communication which, though not an offering for sale, describes such security without fully disclosing the compensation arrangement with the issuer.

Id. After discussing other aspects of the broker's proposal to charge fees, SEC concluded: "In our view your proposal raises serious questions under the federal securities laws; any attempt to implement such a plan would appear to be inadvisable."

On February 20, 1975, NASD issued Notice to Members 75–16, which echoed the matters set forth in the 1973 SEC No–Action Letter. The Notice stated in part:

> Recently, questions have arisen with respect to the propriety of an issuer paying a member to make a market in its securities and whether it would be permissible under applicable securities laws for a member to charge an issuer for out of pocket expenses incurred in the course of making a market in an issuer's securities. An additional question concerns the acceptance by a member of unsolicited payments from an issuer in whose securities the member makes a market.
>
> In connection with the above, the Association wishes to advise members that ramifications of these and several other related questions are currently being reviewed. As part of this review, the Association staff has recently met with the Securities and Exchange Commission staff to discuss, in general terms, the applicability of the federal securities laws to these practices and whether there were areas where some measure of liberalization could be achieved. For the reasons discussed below, both members and issuers are cautioned that it appears such payments may be prohibited under existing laws and are advised to consult with their counsel prior to taking any action in this regard.
>
> By way of background to the above, it is important to note that members generally have considerable latitude and freedom to make or terminate market making activities in over-the-counter securities. The decision to make a market in a given security and the question of "price" are generally dependent on a number of factors including, among others, supply and demand, the firm's attitude toward the market, its current inventory position and exposure to risk and competition. The additional factor of payments by an issuer to a market maker would probably be viewed as a conflict of interest since it would undoubtedly influence, to some degree, a firm's decision to make a market and thereafter, perhaps, the prices it would quote. Hence, what might appear to be independent trading activity may well be illusory. In view of these and other factors, any arrangement whereby a member charges an issuer a fee for making a market or accepts an unsolicited payment from an issuer whose securities the member makes a market in raises serious questions under the anti-fraud provisions of the federal securities laws. In addition, the payment by an issuer to a market maker to facilitate market making activities may also violate Section 5 of the Securities Act of 1933.
>
> Members should also be aware that in addition to the above mentioned concerns, Section 17(b) of the Securities Act of 1933 explicitly makes it unlawful for any person receiving consideration, directly or indirectly from an issuer, to publish or circulate any material which describes such issuer's securities without fully disclosing the receipt of such consideration, whether *1457 past or prospective, and the amount thereof. In addition, such conduct may violate the provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 promulgated thereunder.

The SEC contends that these documents provided sufficient notice that the conduct engaged in by General Bond was a violation of NASD rules. Additionally, the SEC points out that prior to five of the transactions in question, NASD staff members informed General Bond orally and in writing of NASD's view that acceptance of compensation of General Bond was prohibited by NASD rules.

b. *Invalid Rule Change.* General Bond's second argument is that the finding that its acceptance of compensation violated Article III, Section 1, constituted a "rule change" which was required by statute to be submitted by NASD to the SEC for approval prior to taking effect. General Bond relies upon 15 U.S.C. § 78s(b)(1), which provides:

> Each self-regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory

> organization (hereinafter in this subsection collectively referred to as a "proposed rule change") accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

Article III, Section 1 of NASD rules was submitted to and approved by SEC. It is undisputed, however, that NASD did not file Notice to Members 75–16 with SEC prior to the disciplinary action against General Bond, nor did NASD file any other document with SEC indicating that a market maker's acceptance of compensation in exchange for listing a security in the pink sheets was conduct prohibited by Article III, Section 1.

The SEC contends that NASD was not required to submit Notice to Members 75–16 to the Commission for approval as a proposed rule or a rule change. The SEC points out that the Notice was issued on February 20, 1975. At that time, the Maloney Act required self-regulatory organizations to file "any changes in or additions to the rules of the association" with the Commission, but the statute did not provide any guidance on what constituted a "rule change." *See former* 15 U.S.C. § 78*o*–3(j) (1970). Subsequently, SEC notes, the Securities Acts Amendments of 1975 defined the "rules of an association" to include the constitution, articles of incorporation, bylaws, and rules of an association, together with "*such of the stated policies, practices, and interpretations of such ... association ... 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 of such ... association....*" § 78c(a)(27) (emphasis added). After this amendment was added to the statute, SEC adopted Rule 19b–4 (17 C.F.R. § 240.19b–4), which provided that a stated policy, practice, or interpretation of a self-regulatory organization shall be deemed a rule change unless: 1) it is reasonably and fairly implied by an existing rule of the organization, or 2) it is concerned solely with administration of the organization and is not a stated policy, practice or interpretation ***1458** with respect to the meaning or enforcement of an existing rule of the organization. *See id.* The SEC concedes that NASD Notice to Members 75–16 (which SEC describes as a "statement of policy") would have to be submitted to the Commission for approval were it to be proposed today. But, SEC contends "nothing in the statute, which requires approval of proposed rules or rule changes, requires the submission of rules that were in existence prior to the adoption of the amendments." Resp.Br. at 22. [2]

[1] c. *Discussion.* After carefully considering the arguments of both parties, we must agree with General Bond that NASD's interpretation of Article III, Section 1 concerning acceptance of compensation was a "rule change" and was required by statute to be submitted to SEC for approval prior to enforcement of that interpretation. Because no such interpretation was filed with SEC prior to the disciplinary proceeding below, we conclude that the enforcement of the rule against General Bond was contrary to 15 U.S.C. § 78s(b)(1) and is therefore invalid. *See Id.* ("No proposed rule change shall take effect unless approved by the Commission...."). We believe that such a view is the only result consistent with the statutory responsibility of SEC—both before and after the Securities Acts Amendments of 1975—to oversee the rule-making activities of a registered national securities association.

We do not quarrel with SEC's assertion that nothing in the 1975 Securities Acts Amendments required submission to SEC of NASD rules "that were in existence prior to adoption of the amendments." Nor can it be denied that the 1975 Amendments, unlike former § 78*o*–3(j), specifically indicated that NASD interpretations and policy statements could be considered rules changes. From these facts, SEC apparently concludes that under the Maloney Act, as it existed prior to the Securities Acts Amendments of 1975, the issuance of an NASD interpretation or policy statement such as Notice to Members 75–16, although it established a new standard of conduct, was not considered a "rule change" and did not have to be submitted to SEC for approval. We disagree with this premise as applied in this case.

The Maloney Act of 1938 established extensive guidelines for the formation and oversight of "self-regulatory organizations" such as NASD. The Act supplemented SEC's regulation of over-the-counter markets by providing a system of cooperative self-regulation through voluntary associations of brokers and dealers. In order to become registered as a national securities association under the Maloney Act, an association such as NASD was required to adopt extensive rules to ensure that the purposes of the Act were carried out. *See* former 15 U.S.C. § 78*o* –3 (1970). Those rules had to include a provision stating that the association's members would be disciplined for any violation of its rules and had to provide for a fair and orderly procedure with respect to the disciplining of members. *Id.* § 78*o* –3(b)(10) & (11).

The Securities Exchange Commission was given extensive oversight responsibilities for such associations, including the responsibility of determining whether the association's rules as initially filed met the requirements of the Maloney Act. In order to become a registered association, the association had to file with SEC "[c]opies of its constitution, charter, or articles of incorporation or association, with all amendments thereto, and of its existing bylaws, and of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this chapter collectively referred to as the 'rules of the association.' " *Id.* § 78*o* –3(a)(2). Pursuant to former § 78*o* –3(j), any subsequent changes in or additions to the rules of the ***1459** association were required to be filed with the Commission to become effective:

> (j) Filing changes or additions to association rules and current information.
>
> Every registered securities association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, copies of any changes in or additions to the rules of the association, and such other information ... as the Commission may require.... Any change in or addition to the rules of a registered securities association shall take effect upon the thirtieth day after the filing of a copy thereof with the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of subsections (b) and (d) of this subsection.

The Maloney Act additionally authorized SEC to request changes in NASD rules and gave SEC authority to order such changes if such a request were not complied with. *See former* § 78*o* –3(k)(2). *See also* *United States v. National Association of Securities Dealers*, 422 U.S. 694, 733, 95 S.Ct. 2427, 2449, 45 L.Ed.2d 486 (1975).

If, as SEC contends, NASD Notice to Members 75–16 established that acceptance of issuer-paid compensation by a market maker was a violation of Article III, Section 1, we find that such a determination was a "change in or addition to the rules" of NASD. Although SEC apparently had no regulations defining "rule change" at the time Notice to Members 75–16 was issued, the establishment of a new standard of conduct such as this must be considered a "rule change" under any common sense definition of that term. *Cf.* *United States v. National Association of Securities Dealers*, 422 U.S. 694, 733, 95 S.Ct. 2427, 2449, 45 L.Ed.2d 486 (1975) ("[W]e see no meaningful distinction between the [NASD's] rules and the manner in which it construes and implements them. Each is equally a subject of SEC oversight.") More specifically, we conclude that the establishment of such a new standard was within the definition of "rule change" contemplated by Congress when it enacted former § 78*o* –3(j). As such, the change had to be filed with SEC under the provisions of former § 78*o* –3(j) prior to becoming a valid rule of the association.

[2] We note that SEC was faced with a somewhat similar issue *In the Matter of The Rules of the National Association of Securities Dealers, Inc.*, Securities Exchange Act Rel. No. 3623 (Nov. 25, 1944), 1944 SEC LEXIS 114. In that case, objections were filed with SEC concerning a policy issued by NASD Board of Governors. The policy concerned an interpretation of Article III, Section 1 relating to price spreads and commissions charged by NASD members. Members objecting to the Board's interpretation of the rule argued that it constituted a rule change that had to be submitted to SEC under § 78*o* –3(j). In its decision, SEC indicated that the resolution of this issue turned on whether the purported interpretation " 'does no more than express what must be clearly implied in the rule itself,' or whether it has the effect of adding some duty or standard not otherwise contained in the rules." 1944 SEC LEXIS 114, *16. Because the interpretation

of the rule in that case was simply an application of a standard of conduct already expressed in another NASD rule, the Commission found that the Board's interpretation of Article III, Section 1 did not establish a new standard. *Id.* at *18.[3] By contrast, in this case SEC has not cited any ***1460** previously established NASD rule (aside from its reliance on Notice to Members 75–16) that prohibited acceptance of issuer-paid compensation by a market maker under circumstances similar to those presented. Nor can we conclude that this type of conduct was so inherently deceptive that a ban against it was "clearly implied" by a provision requiring members to observe "high standards of commercial honor and just and equitable principles of trade."[4] The NASD, of course, is to be commended for taking the view that any conduct with the potential for deception or that involves a conflict of interest should be prohibited under its rules. When a prohibition sets a new standard of conduct for its members, however, the NASD is required by statute to submit such a change to SEC prior to enforcing it. In sum, we find that the enforcement of Article III, Section I against General Bond in this case for its acceptance of compensation represented a change in NASD rules that was invalid under 15 U.S.C. § 78s(b)(1).

[3] 2. *Article III, Section 1—General Bond's Deceit of NASD Staff.* The SEC also determined that General Bond violated Article III, Section 1 when it continued to accept issuer-paid compensation after informing NASD that it would cease this practice. The SEC found that Mr. Pandolfo "deceived the staff by claiming that he had ceased accepting such listing fees, while continuing business as usual." Pet.App. at 5. General Bond argues that under the circumstances it was not bound to cease accepting compensation because the NASD incorrectly determined that acceptance of payments was prohibited by NASD rules. This argument ignores the fact that Mr. Pandolfo's deception of NASD staff formed the basis of this portion of SEC's ruling. Although we have determined that NASD rules in effect at the time did not prohibit the acceptance of these payments, our ruling does not absolve General Bond of culpability for making misrepresentations to NASD.

Under Article IV, Section 5 of NASD Rules, General Bond had an obligation to provide the information sought by NASD. General Bond attempts to cast Mr. Pandolfo's conduct as the product of a good faith dispute concerning the scope of an NASD rule and intimates that Pandolfo may have decided to continue accepting payments on advice from counsel. It is clear to us from SEC's opinion, however, that the Commission determined that Mr. Pandolfo intentionally deceived NASD staff concerning his practice of accepting compensation. This determination is supported by substantial evidence in the record. Moreover, we find that any reasonable person would know that such intentional deception of NASD while it is engaged in an investigation violates the prohibition against conduct contrary to high standards of commercial honor and just and equitable principles of trade. Consequently, we do not disturb the Commission's ruling that General Bond's deception of NASD staff violated Article III, Section 1.

3. *Rule 15c2–11—Failure to Maintain Reasonably Current Financial Information.* ***1461** Rule 15c2–11 (17 C.F.R. § 240.15c2–11) requires a broker-dealer submitting a quotation to maintain in its files certain information concerning the issuer that is "reasonably current" in relation to the day the quotation is submitted. The SEC found that General Bond violated Rule 15c2–11 by failing to maintain in its records reasonably current information with respect to two issuers. In so ruling, SEC stated that "[t]he broker-dealer has the burden of production under the Rule because the broker-dealer is in a better position than NASD or other authority to know the condition of a company whose stock it intends to list, and to obtain the requisite up-to-date financial information about the issuer." Pet.App. at 9. The SEC concluded that General Bond failed to show that information in its files was reasonably current.

[4] General Bond now contends that SEC's determination that it had the "burden of production" on this issue constituted informal rule making. As such, General Bond argues, the rule should not have been applied retroactively. We agree with SEC, however, that SEC's determination did not constitute rule making, but was an interpretation of the requirements implied in an existing rule. The SEC's opinion indicates that when information in the broker's file falls outside of the regulatory presumption of what is "reasonably current," the broker bears the burden of producing documentation showing that the information in its files is nevertheless reasonably current. Although Rule 15c2–11 says nothing explicit about the burden of production, we find that SEC's interpretation is fairly implied by the rule's express requirements, which place an affirmative duty on the broker to maintain reasonably current information. *See* 17 C.F.R. § 240.15c2–11 ("[I]t shall be unlawful for any broker or dealer to publish any quotation for a security or ... to submit any quotation for publication ... unless such broker or dealer has in its records the documents and information required by this paragraph....").

[5] 4. *Article IV, Section 5—Failure to Produce Materials Requested by NASD.* The SEC determined that General Bond violated Article IV, Section 5 of NASD Rules of Fair Practice by failing to produce information requested by NASD in the course of its investigation. General Bond concedes that it never produced the information but argues that it was not obligated to because the documents requested were "neither material nor necessary for the charge."

General Bond's argument borders on the frivolous. As SEC succinctly stated: "NASD member firms may not ignore NASD inquiries; nor may they take it upon themselves to determine whether information requested is material to an NASD investigation of their conduct. Once the NASD requested the documentation, the firm was obligated to comply fully with the request." Pet.App. at 9. The SEC's finding of a violation of Article IV, Section 5 is fully supported by the evidence.

5. *Sanctions.* General Bond's final argument is that the sanctions affirmed by SEC were excessive and constituted an abuse of discretion. General Bond contends that, because Mr. Pandolfo is now deceased, the sanctions imposed "impact no one except Mr. Pandolfo's estate and the heirs thereunder." Pet.Br. at 41.

General Bond is the petitioner in this case, not Mr. Pandolfo or his heirs. Our review is limited to determining whether the Commission abused its discretion in connection with the sanctions imposed upon General Bond for its violations of NASD Rules. *See C.E. Carlson, Inc. v. SEC,* 859 F.2d 1429, 1438 (10th Cir.1988).

As is evidenced by the opinion of the National Business Conduct Committee, the sanctions affirmed by SEC consisted of censure and an assessment of costs of $1,114, expulsion of General Bond from membership, a fine of $25,750 "representing the ill-gotten gains attributable to the listing fees charged by [General Bond]," and a fine of $20,000 "representing the monetary sanction attributable to [General Bond's] failures to respond."

With the exception of the fine of $25,750, we affirm the sanctions imposed by SEC. Regardless of whether Mr. Pandolfo's practice of accepting compensation was prohibited by a valid NASD rule, his deception of ***1462** NASD staff investigating his conduct and his failure to comply with NASD requests for various documents represent an egregious departure from the ethical standards of conduct established by NASD. This conduct fully supports the sanctions of costs, censure and expulsion, and the fine of $20,000 for General Bond's failure to respond to NASD requests.

The fine of $25,750 imposed below, which was said to represent General Bond's "ill-gotten gains," was based at least in part on General Bond's acceptance of compensation for listings in the pink sheets. Inasmuch as we have determined that Article III, Section 1 did not prohibit such conduct at the time General Bond engaged in it, we find it necessary to vacate that portion of the fine imposed. No sanction should be imposed for that alleged violation. The record does not disclose, however, whether this $25,750 was also based in part on any of the other violations committed by General Bond or whether the imposition of such a fine is necessary to adequately remedy these other violations. Accordingly, we remand the case to SEC for a reconsideration of whether this portion of the fine is appropriate.

The order of the Commission is affirmed in part and vacated in part. The case is remanded to SEC for reconsideration of a portion of the sanctions imposed upon Petitioner.

All Citations

39 F.3d 1451, Fed. Sec. L. Rep. P 98,517

Footnotes

* The Honorable Wesley E. Brown, United States District Senior Judge for the District of Kansas, sitting by designation.

1 The NASD also took disciplinary action against Mr. Pandolfo individually. Mr. Pandolfo died after an application for review of those sanctions had been filed with the SEC. The Commission subsequently dismissed the disciplinary action against Mr. Pandolfo.

2 Additionally, the SEC asserts that, following the 1975 Amendments, the Commission initially adopted a provision in Rule 19b–4 that would have required self-regulatory organizations to file with the Commission rules in effect prior to the 1975 Amendments. The SEC contends that the Commission subsequently concluded, however, that the provision would provide little assistance and would impose a great burden, and therefore the Commission determined that it would not require compliance with the provision. According to the SEC, the provision was removed from the rule in 1980. In sum,

the SEC contends, "the statute and the rules thereunder do not require pre–1975 Amendment rules to be submitted to the Commission for approval." Resp.Br. at 23.

3 It appears that in most prior cases questions concerning a lack of notice or the validity of a rule change have been avoided because the broker is typically charged with a violation of Article III, Section 1 in conjunction with a violation of another NASD Rule. *See e.g., Todd & Company v. SEC*, 557 F.2d 1008, 1011 (3rd Cir.1977). *See also Carl F. Campbell*, Securities Exchange Act Release No. 12793 (Sept. 13, 1976), 10 SEC Docket 459 ("We need only observe that terms such as 'high standards of commercial honor' and 'just and equitable principles of trade' refer, among other things, to standards of business conduct codified in the rules of the securities industry's self-regulatory bodies.")

4 We do not question NASD's or SEC's view that the type of conduct engaged in by General Bond may reasonably be considered deceptive to market participants. We do find, however, that reasonable persons could disagree as to whether a standard requiring "high standards of commercial honor" necessarily prohibited this type of conduct. NASD itself suggested as much in Notice to Members 75–16, when it indicated to its members that it was discussing "the applicability of the federal securities laws to these practices *and whether there were areas where some measure of liberalization could be achieved*." (emphasis added).

Our ruling should not be taken to mean that every disciplinary action taken by the NASD or SEC will be considered a "rule change" unless an interpretation has been previously submitted to the SEC showing that identical conduct has been held to violate an NASD rule. Under SEC regulations, application of a Rule of Fair Practice to the particular facts of a case would not be considered a rule change where it is reasonably and fairly implied by an existing rule.

Moreover, we recognize that the securities laws and SEC Rules appropriately contain broad prohibitions against manipulative, deceptive or fraudulent practices. *See e.g.*, Rule 10b–5 (17 C.F.R. § 240.10b–5). General Bond's activities, however, were not alleged to have violated any of these provisions or any of the regulations governing market making activities. Thus, we are not called upon to determine whether it is fairly implied in Article III, Section 1, that any conduct which violates the anti-fraud provisions of the securities laws is conduct inconsistent with "high standards of commercial honor and just and equitable principles of trade."

End of Document

1987 SEC LEXIS 1879;

In the Matter of the Applications of WILLIAM J. HIGGINS, Werner, Kennedy & French, 220 East 42nd Street, New York, New York and MICHAEL D. ROBBINS, Booth TT-2, 11 Wall Street, New York, New York; For Review of Action Taken by the NEW YORK STOCK EXCHANGE, INC.

Admin. Proc. File No. 3-6609

Securities and Exchange Commission

SECURITIES EXCHANGE ACT OF 1934, Release No. 34-24429

May 6, 1987

48 S.E.C. 713

SEC Decisions, Orders & Releases

Reporter
1987 SEC LEXIS 1879; *; 48 S.E.C. 713 **;

Core Terms

floor, non-members, telephone, exchange floor, stated policy, unwritten, telephone communication, install, attorney's fees, off-floor, staff, direct communication, proposed rule, trading floor, no rule, membership, notice, transaction of business, existing rule, electronic, customer, negotiate, booth, securities exchange

Counsel:

APPEARANCES:

Russell E. Brooks, of Milbank Tweed, Hadley and McCloy, for the New York Stock Exchange, Inc.

John T. Buckley, of Werner, Kennedy & French for William Higgins.

Michael Robbins, pro se

Action

[*1]

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE - DENIAL OF ACCESS

Where requests by two members of the New York Stock Exchange for permission to install telephones to permit them to communicate from the exchange floor with non-members located off-floor were denied by the exchange, held, since exchange has no rule prohibiting requested communication facilities, exchange denials of those requests set aside and exchange ordered to permit applicants to install the requested telephone links.

Text

[713]** I. Introduction and Summary

On February 7, 1986, we instituted proceedings pursuant to Section 19(d) of the Securities Exchange Act of 1934 ("Act") [1] to review an alleged denial of access to services by the New York Stock Exchange, Inc. ("NYSE" or "Exchange") against two members of the Exchange, William Higgins and Michael Robbins ("Applicants"). [2] Applicants had requested the NYSE's permission to install telephones which would permit them to have direct telephone access to their non-member **[**714]** **[*2]** customers from the NYSE trading floor. [3] These requests were denied by the NYSE which cited in support of its action the NYSE's "alleged" policy against direct telephone communications between a member on the floor and a non-member off the floor. [4] Applicants subsequently asked us to review the NYSE's decisions. [5] We instituted review proceedings to determine whether the NYSE's actions denying Applicants' requests were consistent with the requirements of the Act. [6]
[*3]

The principal issue in this proceeding is whether the NYSE has a rule, or policy enforceable as a rule, which prohibits members from installing telephone links to communicate, from the floor of the Exchange, with non-members located off the floor.

Applicant Higgins argues that the NYSE has no rule prohibiting communication between members on the Exchange floor and non-members located off the floor and that, accordingly, the NYSE's denial of his request should be set aside. [7] Higgins also argues that, even if we conclude that the NYSE does have a rule prohibiting such telephone access, we should set the rule aside, pursuant to Section 19(f) of the Act, because it imposes burdens on competition not necessary or appropriate in furtherance of the purposes of the Act. Applicant Robbins filed three letters with the Commission in support of his application in which he provides arguments which are substantially similar to those advanced by Higgins. [8]
[*4]

The NYSE asserts that it has a longstanding rule, or policy enforceable as a rule, prohibiting such communication links and **[**715]** urges dismissal of this proceeding under Section 19(f). The Exchange makes three main

---

[1] *15 U.S.C. § 78s(b).*

[2] Securities Exchange Act Release No. 22877 (February 7, 1986). While the applications of Higgins and Robbins were submitted to the Commission separately, we determined to consider them together because of the similarity of the issues presented.

[3] Specifically, Higgins requested permission to use a portable telephone in the conduct of his business on the Exchange floor. Robbins requested permission to install a regular outside telephone line in his booth on the Exchange floor. See Exhibit 9, letter from William Higgins to Richard D'Angelo, Director, Trading and Market Section, (hereafter "Director"), NYSE, dated June 20, 1984; Exhibit 37, letter from Michael Robbins to Richard D'Angelo, Director, NYSE, dated April 10, 1985.

[4] See Exhibit 10, letter from Richard D'Angelo, Director, NYSE, to William Higgins, dated June 27, 1984; Exhibit 38, letter from Richard D'Angelo, Director, NYSE, to Michael Robbins, dated April 12, 1985.

[5] See letter from John T. Buckley, Counsel for Higgins, to John Wheeler, Secretary, Commission, dated April 9, 1985; letter from Michael Robbins, to Shirley E. Hollis, Acting Secretary, Commission, dated May 22, 1985.

[6] See note 2, supra.

[7] See Brief for Applicant Higgins, received April 14, 1986, and Reply Memorandum for Applicant Higgins, dated May 16, 1986 (hereafter "Higgins' Briefs").

In a motion submitted on April 14, 1986, counsel for Higgins objected to the inclusion of certain portions of the record submitted by the NYSE and sought permission to make corrections to, and have certain supplemental materials included in, the record. On April 18, 1986, the NYSE submitted a brief which agreed that the corrections submitted by Higgins should be included in the record and also agreed that Higgins' notice of appeal should be included as a part of the record. The NYSE objected, however, to Higgins' requested exclusion of certain items from the record of the NYSE's proceedings and also objected to Higgins' request that an affidavit, dated April 11, 1986, be included as part of the record.

Rule 19d-3(e) under the Act allows the Commission, by its own motion, to direct that the record under review be supplemented with such additional evidence as it may deem relevant. We have concluded that the corrections to the record and the additional

arguments in support of this position. [9] First, the NYSE argues that the telephone access requested by Applicants would constitute the transaction of business on the floor by a non-member which is prohibited by NYSE rules. Second, the Exchange argues that, even if we should conclude that its rules do not expressly prohibit members from installing the requested telephone links, its policy denying such access, although unwritten, qualifies as a rule under the Act as a "stated policy, practice or interpretation" that is reasonably and fairly implied by existing NYSE rules. Finally, the NYSE asserts that because the Exchange's telephone access policy predates the Securities Acts Amendments of 1975 ("1975 Amendments") [10] and we did not object to the NYSE's telephone access policy during our review of all Exchange rules under Section 31(b) of the 1975 Amendments, [11] we may not now conclude that this rule does not exist. [12]

[*5]

For the reasons set forth below, we conclude that the NYSE has no rule, or policy enforceable as a rule, denying members the right to have direct telephone communication from the Exchange floor with non-members located off the floor. In brief, we find that the provisions of the NYSE Constitution and rules cited as the basis for the Exchange's alleged rule, viewed either separately or in combination, do not constitute a rule prohibiting such telephone communication between members and non-members.

We also disagree with the NYSE's assertion that its unwritten telephone access policy constitutes a "stated policy, practice or interpretation" and, thus, qualifies as a rule under the Act. As discussed below, a stated policy, practice, or interpretation must be in writing and must be submitted to the Commission for its review pursuant to Section 19(b) of the Act. [13] The NYSE's telephone access policy does not meet either of these requirements.

Finally, we reject the **[*6]** NYSE's argument that the absence of an objection to the NYSE's alleged unwritten rule during the review of the Exchange's written rules undertaken by the Commission pursuant **[**716]** to Section 31(b) of the 1975 Amendments, prevents us from now concluding that the NYSE does not have such a rule. [14]

Based on the above, as discussed in more detail below, we are issuing an order, pursuant to Section 19(f) of the Act, setting aside the NYSE's denials of Applicants' requests and ordering the NYSE to permit Applicants to install

---

materials to supplement the record requested by Higgins are relevant to this proceeding and, accordingly, direct that they be included in the record under review. We have also determined that those portions of the record that Higgins has requested be excluded from the record under review are relevant to this proceeding and, accordingly, deny Higgins' motion that they be excluded from the record.

[8] See letters from Michael D. Robbins to John Wheeler, Secretary, Commission, dated March 21, 1986, April 5, 1986, and May 24, 1986.

[9] See Memorandum of the New York Stock Exchange, Inc., In Opposition to Applications by Willaim Higgins and Michael Robbins, dated May 5, 1986 (hereafter "NYSE Brief").

[10] Pub. L. No. 94-29, *89 Stat. 97* (June 4, 1975).

[11] Section 31(b) of the 1975 Amendments directed the Commission to review all self-regulatory organization ("SRO") rules to determine if any were not in accordance with the Act.

[12] In its brief to the Commission the NYSE also requested, pursuant to Rule 19d-3(f), oral argument of these application's before the Commission. The Commission issued an order, dated August 12, 1986, denying this request.

As discussed in more detail below, we also note that the NYSE disagrees with Applicants' claim that, in any case, the "rule" cannot be enforced against them because it imposes a burden on competition not necessary or appropriate in furtherance of the Act.

[13] As discussed in detail below, we reject the NYSE's contention that its policy does not have to be filed pursuant to Section 19(b) because it falls within the exception for filing a policy under Rule 19b-4(c)(1).

[14] As discussed in more detail below, in view of these conclusions we need not resolve the parties' conflicting claims regarding whether the NYSE's "policy" or "rule" against member telephone access to non-members imposes an unnecessary or inappropriate burden on competition.

the direct telephone links to the Exchange floor which they requested. Our findings are based on an independent review of the record.

II. Background

By letter, dated June 20, 1984, William J. Higgins informed Richard D'Angelo, Director of the NYSE's Trading and Market Section, [15] that he had purchased a portable telephone which he intended to use in conducting his business on the floor **[*7]** of the Exchange. On June 27, 1984, Mr. Higgins was notified that the use of a portable telephone on the NYSE trading floor was inconsistent with Exchange policy and that its use would not be permitted. [16] Subsequently, Mr. Higgins appealed this denial to the NYSE Board of Directors [17] which referred the matter for consideration by the Board's Committee for Review. [18] After receiving arguments from Mr. Higgins and the NYSE's Operations and Administration Group, the Committee for Review recommended to the NYSE Board that they establish a committee to conduct an in-depth review of the Exchange's policy concerning non-member telephone access and that final action on Mr. Higgins' appeal be deferred pending the report of that Committee. [19] The NYSE Board accepted the Committee on Review's recommendation [20] and established the Committee on Telephone Access.

[*8]

On March 7, 1985, the Committee on Telephone Access issued its report, stating that non-member access to on-floor brokers is not a service provided by the NYSE and recommending denial of Mr. Higgins' request. [21] The NYSE's Board of Directors then voted to deny **[**717]** Mr. Higgins' appeal. [22] On April 9, 1985, the Commission's Office of the Secretary received a letter from John T. Buckley, counsel for Mr. Higgins, stating that to preserve Mr. Higgins' appeal rights, he was filing for Commission review of the NYSE Board's decision. [23]

[*9]

Following the NYSE Board's action in the Higgins case, Michael D. Robbins filed an application with the Director of Floor Services of the NYSE to install a telephone link-up in his floor booth to enable him to communicate with

---

[15] Exhibit 9, letter from William Higgins to Richard D'Angelo, Director, NYSE, dated June 20, 1984.

[16] Exhibit 10, letter from Richard D'Angelo, Director, NYSE, to William Higgins, dated June 27, 1984.

[17] Exhibit 11, letter from William Higgins to James E. Buck, Secretary, NYSE, dated July 6, 1984.

[18] Exhibit 12, letter from Kenneth S. Corson, Counsel for NYSE, to William Higgins, dated July 17, 1984.

[19] Exhibit 22, Report of the Committee for Review at 5-6, dated September 5, 1984.

[20] Exhibit 23, minutes of the Board of Directors of the New York Stock Exchange, dated September 6, 1984.

Subsequently, John T. Buckley, counsel for William Higgins contacted the Commission staff regarding the NYSE's denial of Mr. Higgins' request. See letter from Buckley to Michael Cavalier, Branch Chief, Division of Market Regulation, dated October 9, 1984. Writing on behalf of Mr. Higgins, Buckley contended that the decision of the NYSE Board of Directors to defer action on Mr. Higgins' request pending the report of the Committee on Telephone Access was causing an undue delay in the resolution of the matter and requested the Commission to act immediately to review the action of the NYSE. The Commission staff contacted the NYSE and was informed that the Committee on Telephone Access intended to expedite its review of the matter. See letter from Henry Poole, General Counsel, NYSE, to Michael Cavalier, dated October 26, 1984.

[21] Exhibit 33, Report of the Committee on Telephone Access, dated March 1, 1985 ("1985 Report").

[22] Exhibit 34, minutes of the NYSE Board of Directors Executive Session, dated March 7, 1985; Exhibit 35, letter from James E. Buck, Secretary, NYSE, to John T. Buckley, counsel for Higgins, dated March 12, 1985.

As we noted in the order instituting review proceedings in this matter, note 2, supra, after the NYSE Board of Directors denied Higgins' request, the Commission staff contacted the NYSE to inquire whether, in light of the Board's decision, the NYSE planned to file: (1) a notice of final action pursuant to Section 19(d)(1) of the Act regarding Higgins' appeal, or (2) a proposed rule change pursuant to Section 19(b)(2) of the Act to codify the policies adopted in the 1985 Report. The NYSE indicated that it did not intend to pursue either course of action. The NYSE stated that it did not intend to file a notice of final action regarding Higgins' request because it did not deem its action regarding Higgins to constitute a prohibition of access to Exchange services.

non-members located off the Exchange floor. [24] His request was denied by the NYSE's Floor Operations Committee citing the Exchange's policy against such communication links. [25] The denial was upheld by the NYSE Board on May 2, 1985. [26] On May 23, 1985, the Commission's Office of the Secretary received Robbins' application for review. [27] The Commission, on February 7, 1986, ordered that review proceedings be instituted pursuant to Section 19(d) of the Act on the NYSE's denial of the Higgins' and Robbins' applications. [28]

[*10]

III. Discussion

A. Reviewability of the NYSE's Actions Under the Act

Under Section 19(d)(2) of the Act, the Commission can review actions of the NYSE that prohibit or limit any person in respect to access to services offered by the Exchange or a member thereof. [29] In **[**718]** its Brief, the NYSE argues that Higgins' and Robbins' applications are not reviewable under Section 19(d) because its actions are not a denial of access to its own services or services of a member. The NYSE contends that its actions are not a denial of access to services of a member because Applicants seek to offer services which, as NYSE members, they have no right to offer. The NYSE states that only it has the right to grant access to the floor, and it does so through the vehicle of membership. The NYSE believes that there is no distinction between the Exchange's authority to deny requests that non-members be permitted to be physically present on the floor and their authority to deny Applicants' requests to permit them to communicate from the Exchange floor with non-members located off the floor.

[*11]

The NYSE further argues that there has been no denial of access to Exchange services because it has never offered as a service direct telephone access by non-members to the Exchange floor and, in fact, consistently has prohibited such connections. In this regard, the NYSE also states that because the Exchange is an organization of limited membership which offers access to its facilities only to members, access to non-members cannot be a service the NYSE would offer. [30]

The NYSE also indicated that it did not intend to file a proposed rule change with the Commission codifying the Committee's Report. The Exchange stated that the provisions of the NYSE Constitution and rules, as well as NYSE policy statements in their 1985 Report and a December 1976 report by the NYSE's Committee on Access entitled Achieving Greater Access to the NYSE, provide, by their terms, only for members' access to services, thereby excluding non-members by implication.

[23] Letter from John T. Buckley, counsel for Higgins, to John Wheeler, Secretary, Commission, dated April 9, 1985.

[24] Exhibit 37, letter from Michael Robbins to Richard D'Angelo, Director, NYSE, dated April 10, 1985.

[25] Exhibit 38, letter from Richard D'Angelo, Director, NYSE, to Michael Robbins, dated April 12, 1986.

[26] Exhibit 41, Minutes of the NYSE Board of Directors, dated May 2, 1985; Exhibit 40, letter from James E. Buck, Secretary, NYSE, to Michael Robbins, dated May 2, 1985.

[27] Letter from Michael Robbins to Shirley E. Hollis, Acting Secretary, Commission, dated May 22, 1985.

[28] See note 2, supra.

[29] Under Section 19(d)(1) a SRO taking final action to limit or prohibit access to services offered by the SRO or its members must promptly file notice of its actions with the Commission. As noted in our order instituting these proceedings (see note 2, supra), the NYSE declined to file a notice of final action in connection with the Exchange's denial of Mr. Higgins' appeal under Section 19(d)(1).

Nevertheless, under Section 19(d)(2), the Commission may review any action with respect to which an SRO is required by Section 19(d)(1) to file notice with the Commission. Accordingly, we made an initial determination that the NYSE's actions constituted a limitation of access to exchange or member services. We noted, however, that we would make a final determination on this issue after the parties had had an opportunity to address these issues in their submissions.

[30] Applicants argue that the NYSE has no rule, or policy enforceable as a rule, prohibiting members from communicating from the Exchange floor with non-members located off-floor. In the absence of such a rule, Applicants' argue that the Exchange has no authority to prohibit an Exchange member from offering such a service to his customers.

We cannot agree that there has been no denial or limitation of access to services. The operation of a trading floor and access to that floor is the principal service offered by a national securities exchange to its members, and by its members to investors. Thus, in a 1978 order approving the establishment of limited electronic access and physical presence memberships on **[*12]** the NYSE, [31] we stated that, in the absence of a rule prohibiting non-member telephone access to the trading floor, such access constitutes a service which could be offered by members to non-members. [32] Accordingly, in our view, the denial of a member's request to be permitted to communicate from the Exchange floor with non-members located off-floor would constitute a prohibition **[**719]** of, or limitation on, access to services of a member subject to our review under Sections 19(d) and 19(f) of the Act. [33]

[*13]

B. Statutory Standard Governing Commission Review

The scope of our review of the NYSE's actions in this matter is controlled by Section 19(f) of the Act, [34] which governs Commission review of an action by an SRO that limits access to services of the SRO or of any member of the SRO. Under this provision, if we find that the grounds on which the NYSE's actions were based exist in fact, that the actions were effected in accordance with the rules of the Exchange, that the rules are, and were applied in a manner, consistent with the Act, and that the actions do not impose "any burden on competition not necessary or appropriate in furtherance of the purposes of the Act," then we must dismiss these proceedings. If, however, the NYSE's actions fail to meet any of these standards, we must set them aside and grant Applicants' requests for on-floor telephone access to off-floor non-member customers. [35]

[*14]

C. Findings

(1) Whether an NYSE "rule" prohibits members from communicating from the floor with non-members?

---

[31] Securities Exchange Act Release No. 14535, March 7, 1978, ***43 FR 10659*** ("1978 Release").

[32] ***Id. at 10660.*** In the 1978 Release the Commission stated:

Absent Commission approval of [a rule or an interpretation of existing NYSE rules prohibiting members from having direct communications from the Exchange floor to non-members located off-floor] , however, nonmembers who wish to forego the opportunity to became electronic access annual members . . . may continue to pursue the alternative of negotiating with an NYSE floor member for direct communication links to that member on the floor. " (footnote omitted)

The Commission also noted:

Absent a rule setting forth an exchange's self-regulatory authority to govern the right of its members to provide direct communications access to their non-member customers, or an effective interpretation of existing rules to that end, denial of such access would be beyond the bounds of the exchange's authority and could thereby constitute an unreasonable restraint of trade. Moreover, under Section 19(d) of the Act, any such action would be reviewable by the Commission upon its own motion or upon the motion of an aggrieved person.

See 1978 Release, note 8.

[33] We note that as a practical matter, the NYSE has in fact precluded such access in that, but for the NYSE's refusal to approve such applications, the Applicants would have been able to arrange such telecommunication facilities. It would be a strained reading of the Act to conclude that because the telephone company offers a service, i.e., telephone lines, that the NYSE has not precluded access to a service it offers by precluding its members from entering into otherwise lawful business relationships.

[34] *15 U.S.C. § 78s(f).*

[35] In the order instituting these proceedings, we noted that the NYSE's refusal to file a rule proposal under Section 19(b)(2) of the Act expressly addressing this matter has denied us the opportunity to review those concerns which led the Exchange to establish its telephone access policy, and evaluate, with the benefit of public comment, the important issues involved in the access issue.

We have reviewed carefully the provisions of the NYSE Constitution and NYSE Rules cited as the basis for the Exchange's alleged rule prohibiting direct telephone links by members on the floor to non-members. [36] Applicant Higgins has argued that the NYSE has no rule, or policy enforceable as a rule, prohibiting members' telephone access from the Exchange floor with non-members located off the floor. We conclude that neither the provisions cited by the NYSE, governing the transaction of business on the floor and providing the NYSE with administrative control over the use and availability of Exchange services, nor any other provisions of the Exchange Constitution and rules, viewed either separately or in combination, constitute a rule prohibiting telephone communication between NYSE members on the Exchange floor and non-members located off the floor.

[720]** We do not agree with the NYSE's contention that the cited provisions, such as NYSE Rules 54 and 36, **[*15]** [37] reasonably can be construed as constituting a blanket prohibition against communication links between members on the trading floor and non-members. For example, under Rule 54 only Exchange members are allowed to transact business on the floor. In our order approving amendments clarifying Rule 54, we specifically stated our understanding of the scope of the rule, as confirmed by the NYSE, that Rule 54 "would have no application to members on the NYSE floor effecting transactions with persons located elsewhere." [38] Clearly, under this interpretation, Rule 54 would have no application in the instant case. Similarly, Rule 36, by its own terms, applies only to requests for telephone or electronic links between a member or member organization and the floor of the Exchange. [39] Thus, it does not apply in the instant case where Applicant's have requested a telephone connection to permit them to communicate from the Exchange floor to non-member customers located off the floor.

[*16]

We also disagree with the NYSE's contention that Applicant's requests for telephone access to non-member customers necessarily would enable such non-members to bypass their broker on the floor and deal directly with specialists and negotiate directly with the other side of a trade. Such activity is very different than the placement of an order for execution by telephone with a member of an exchange. Any negotiation by a non-member with the other side of a trade would be transacting business on the floor of the exchange and is plainly prohibited under NYSE Rule 54. Nothing in Higgins' or Robbins' requests indicate that they seek to either change or circumvent this prohibition.

---

[36] See NYSE Rules 36, 37 and 54; NYSE Constitution Article I, Section 2(a), and Article III, Section 5 and Section 6.

[37] NYSE Rules 36 and 54 provide in pertinent part:

Rule 36. No member or member organization shall establish or maintain any telephonic or electronic communication between his or its office and the Exchange without the approval of the Exchange. The Exchange may to the extent not inconsistent with the [Act] deny, limit or revoke such approval whenever it determines, in accordance with the procedures set forth in Rule 475, that such communication is inconsistent with the public interest, the protection of investors or just and equitable principles of trade.

Rule 54. Only members shall be permitted to make or accept bids and offers, consumate transactions or otherwise transact business on the Floor in any security admitted to dealings on the Exchange, ...

Nothing in this rule to the contrary shall be construed to prohibit a commitment or obligation to trade received on the Floor through ITS, or any other Application of the System, from being accepted or rejected on the Floor.

[38] Securities Exchange Act Release No. 14076, October 20, 1977, ***42 FR 56823.***

In this regard, we note that the Rule 54 prohibition has never been construed to prevent members on the floor, who are seatholders, from communicating with non-seatholder employees of member firms off-the-floor. Indeed, seatholders on the Exchange floor are constantly communicating with non-member employees of member firms located off-the-floor through phones in floor booths. Although these non-member employees are prohibited under NYSE Rule 54 from transacting business on the Exchange floor, the NYSE has never viewed such telephone communications as resulting in the transaction of business by a non-member on the floor in violation of Rule 54.

[39] See September 16, 1976 letter from the Division of Market Regulation discussed p. 29, infra.

The provisions of the NYSE Constitution (Article I, Section 2(a), [40] **[**721]** Article III Sections 5 and 6) [41] cited by the Exchange help to define the purposes of the Exchange and provide the NYSE's Board of Directors with the authority to regulate access to the Exchange floor and facilities. These are enabling and empowering provisions, and do not by themselves constitute an Exchange rule, or policy, which prohibits telephone communications between members on the Exchange floor and non-members off the floor. **[*17]**
[*18]

In addition, we do not agree with the NYSE's suggestion that these provisions provide the NYSE's Board of Directors with the administrative discretion to establish and implement a policy which creates a blanket prohibition against telephone communication between members on the Exchange floor and non-members located off the floor. In particular, the plain language of Article III, Section 6 does not set forth a policy or rule that prohibits members from communicating with non-members off the floor. In this regard, we note that where the NYSE has sought to regulate member communications on the floor it has done so through rules promulgated by the Board rather than by relying solely on its authority under Article III, Section 6. Indeed, the NYSE's Brief acknowledges that Rule 36, dealing with communications between member organizations and the floor, is promulgated pursuant to the Board's authority under Article III, Section 6. [42] Accordingly, it appears that the NYSE has never regarded Article III, Section 6 as a sufficient basis for establishing a broad based restriction on member communications from the floor. Moreover, any such comprehensive rule or policy plainly would have **[*19]** to be submitted for Commission review under the requirements of Section 19(b) of the Act and Rule 19b-4. [43]

---

[40] Article I, Section 2(a) of the NYSE Constitution includes among the objects and purposes of the Exchange," to furnish exchange rooms for the convenient transaction of their business by its members; to furnish other facilities for its members, allied members, member firms and member corporations; . . . ."

[41] Article III, Sections 5 and 6 of the NYSE Constitution provide in pertinent part:

Sec. 5. The Board of Directors may, by the affirmative vote of a majority of Directors then in office, adopt, amend or repeal such rules as it may deem necessary or proper, including rules with respect to . . . (b) the access of members to and the conduct of members upon the Floor of the Exchange and their use of Floor facilities, . . . (n) the location and use on the Floor of the Exchange of such facilities as may be approved by the Board of Directors to permit members to send orders from the Floor to other markets and receive orders on the floor from other markets for the purchase or sale of securities traded on the Exchange.

Sec. 6. [The Board of Directors] shall have the power to approve or disapprove of any connection or means of communication with the Floor and may require the discontinuance of any such connection or means of communication . . . .

[42] See, NYSE Brief at 17. Separately, we have, as noted above, specifically rejected the NYSE's claim that Rule 36 would prohibit member communications from the floor with non-members and fail to find any other rule where the NYSE has used its authority to promulgate a standard governing on-floor member communications with non-members off the floor.

[43] In the 1978 Release (see note 31, supra) the Commission approved two new membership categories on the NYSE, electronic access membership and physical presence membership. In its discussion of NYSE restrictions on non-member communications access to the floor, the Commission stated that it believed that the NYSE had no rule or stated policy which prohibited direct communication links between members on the floor and non-members.

[T]he Commission notes that no existing NYSE rule or stated policy requires membership as a prerequisite to the establishment of direct communications links to any particular NYSE member on the floor. Thus, under existing NYSE rules, as amended by the instant proposal, electronic access membership should not be viewed as the exclusive means by which non-members may obtain direct communications access to the NYSE floor.

While we noted that the NYSE could in the future, submit a proposed rule under Section 19(b)(2) of the Act to limit communications access to the floor to members, we reserved judgment whether a proposal by the NYSE to amend its existing rules or adopt new rules to permit only members to have direct communications access to members on the floor would be consistent with the Act. We noted that absent our approval of such a rule or interpretation of existing rules concerning non-member access to the trading floor, "non-members who wish to forego the opportunity to become electronic access annual members may continue to pursue the alternative of negotiating with an NYSE floor member for direct communication links to that member on the floor. "

In reaction to the 1978 Release, the NYSE sent a letter strongly disagreeing with the Commission's conclusions and raising substantially the same arguments in defense of the Exchange's policy that have been raised in the current proceeding. (Exhibit

[722]** **[*20]** (2) Whether the NYSE has an unwritten policy that is valid as a rule under the Act prohibiting members on the floor from communicating with non-members?

We find unpersuasive the NYSE's argument that, even if we conclude that the NYSE has no written rule prohibiting such telephone access, the NYSE's policy on this question, although unwritten, constitutes a "stated policy, practice or interpretation" and qualifies as a rule under Section 3(a)(27) of the Act. Applicant Higgins argues that the NYSE's policy prohibiting members on the Exchange floor from communicating with non-members located off-floor cannot be reasonably implied from the Exchange Constitution or rules and, therefore, is not enforceable under the Act.

The term "rules of an exchange" is defined in Section 3(a)(27) of the Act as including "such of the stated policies, practices, and interpretations of such exchange, . . . 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 of such exchange, ..." In turn, Rule 19b-4(b) defines the phrase "stated policy, practice or interpretation" to mean:

(1) any material aspect **[*21]** of the operation of the facilities of the [exchange] (2) any statement made generally available to the membership of, to all participants in, or to persons having or seeking access (including, in the case of national securities exchange . . ., through a member) to facilities of, the [exchange] ("specified persons"), that establishes or changes any standard, limit, or guideline with respect to (i) the rights, obligations, or privileges of specified persons or, in the case of [an exchange], persons associated with specified persons, or (ii) the meaning, administration, or enforcement of an existing rule. [44]

We have has long interpreted the phrase "stated policy, practice or interpretation" to require **[*22]** a written statement of the particular policy, practice or interpretation. The specific question of whether an unwritten Exchange policy could constitute a rule under the Act was addressed by **[**723]** us in 1977. [45] At that time we declined to treat a proposed recission of an unwritten NYSE policy prohibiting members and member organizations from engaging in direct communications between the trading floor of the Exchange and the trading floor of another exchange as a proposed rule change under Rule 19b-4. In our order, we noted that the NYSE's "policy" was not included in the published rules of the Exchange which were reviewed by the Commission in the course of our review of exchange rules under Section 31(b) of the 1975 Amendments. We also observed that this policy was not included in "the stated (that is to say published) policies, practices, or interpretations by the NYSE, ..." We stated that the "policy" did not appear to have been enacted after adoption of the 1975 Amendments because it had not been submitted for the Commission's review pursuant to the requirements of Section 19(b) of the Act. On this basis, we concluded that the policy in question was not currently a rule of the **[*23]** NYSE. We further stated that, "since the policy was never published by the NYSE as a stated policy, practice or interpretation, it does not have any binding effect on NYSE members or other persons."

The situation described in the Commission's 1977 order is virtually identical to the circumstances in the instant case. There is no indication that the unwritten NYSE policy or rule was ever included in the rules of the Exchange reviewed by the Commission under Section 31(b). [46] Further, the NYSE has not alleged that this "policy" was included in the stated, that is to say published, rules of the NYSE. [47]

4, letter from James E. Buck, Secretary, NYSE, to George A. Fitzsimmons, Secretary, Commission, dated May 1, 1978.) The Commission responded with a letter to James E. Buck, Secretary, NYSE reaffirming the views expressed in the Commission's 1978 release. (Exhibit 5, letter from George A. Fitzsimmons, Secretary, Commission, to James E. Buck, Secretary, NYSE, dated August 31, 1978.)

[44] We note that Rule 19b-4(b) defines situations when a stated policy, practice or interpretation is deemed a rule of the exchange for purposes of filing the policy as a rule change under Section 19(b) with the Commission for its review. As discussed in more detail below, Section 19(b)(4)(c) of the Act is the only provision that indicates when a stated policy, practice or interpretation of the SRO is not deemed a proposed rule change that needs to be filed with the Commission.

[45] Securities Exchange Act Release No. 13594, June 3, 1977, *42 FR 29986;* See also note 53, infra, and accompanying text.

[46] The scope of the Commission's review under Section 31(b) is discussed at p. 28, infra.

Moreover, even if we were to conclude, arguendo, that a "stated policy" under Section 3(a)(27) of the Act or Rule 19b-4 did not need to be written or published to be a rule under the Act, the policy must be filed with the Commission for review under Section **[*24]** 19(b) of the Act. [48] No such filing has ever been submitted for the policy in question. [49]

The only exception to the filing requirement for a "stated policy" under Rule 19b-4 potentially applicable to the NYSE policy in question is the exception in paragraph (c)(1) for policies which are reasonably and fairly implied by an existing rule of the SRO. The NYSE argues that this exception applies to the Exchange's telephone access policy.

We discussed the "reasonably and fairly implied" exception in our 1980 order amending Rule 19b-4 and adding paragraph (c). [50]

[724]** The limits of the "reasonably and fairly implied" exception will have to be determined on a case-by-case basis. It is clear, however, that a stated policy, practice or interpretation that prescribes extensive and specific limitations on particular types of transactions or conduct that are not apparent from the face of the existing rule is not "reasonably and fairly implied" by the rule. Moreover, the fact that a **[*25]** [SRO] for purposes of its internal operations characterizes a stated policy, practice, or interpretation as reasonably and fairly implied does not mean the statement is reasonably and fairly implied for purposes of Rule 19b-4. (footnotes omitted)
It is evident from this statement that a stated policy imposing a broad prohibition on members' telephone access to non-members from the Exchange floor would have to be apparent from the face of existing NYSE rules to fall within the reasonably and fairly implied category.

As discussed above, however, we have concluded that the provisions of the Constitution and the rules cited by the Exchange do not constitute a rule or rules prohibiting telephone communication between members on the floor of the Exchange and non-members. [51] Nor is such a policy apparent from the face of those provisions. Indeed, from the face of those provisions, a reasonable person would assume that the issue of telephone access to non-members has not been addressed at all by the NYSE. Accordingly, we do not agree with the NYSE that this prohibition can be reasonably and fairly **[*26]** implied by the provisions of the NYSE Constitution and rules cited by the Exchange in support of this policy.

(3) Whether the Commission's review of the NYSE actions under Section 19(f) is limited by prior Commission actions under Sections 31(b) and 19(b)

a. Section 31(b) Review

The NYSE contends that the Exchange's rule, or policy, denying members the right to communicate by telephone from the Exchange floor with non-members located off-floor predates the 1975 Amendments and was reviewed by the Commission for compliance with the Act, along with other NYSE rules, during the Commission's Section 31(b) review. The NYSE argues that because the Commission did not indicate an objection to this policy, a policy which they contend the Commission necessarily had notice of and acquiesed to, the Commission may not now conclude that the "rule" does not exist.

Applicant Higgins contends that the NYSE's alleged unwritten "rule" was not reviewed by the Commission in the course of our review of exchange rules conducted under Section 31(b) of the 1975 Amendments. Accordingly,

---

[47] See 1978 Release (note 31, supra); Commission's order instituting this review proceeding (note 2, supra).

[48] See discussion at pp. 20-21, supra.

[49] The NYSE also has provided no evidence that either the Commission or its staff was aware of this oral "policy" prior to the Securities Acts Amendments of 1975.

[50] Securities Exchange Act Release No. 17258, October 30, 1980, *45 FR 73906, 73913.*

[51] See discussion pp. 15-21, supra.

Higgins argues that the Commission did not approve the Exchange's "rule" **[*27]** by the absence of an objection to it during the Commission's Section 31(b) review.

[725]** As discussed above, [52] we have concluded that the Exchange has no rule, or policy enforceable as a rule, denying members the right to communicate by telephone from the Exchange floor with non-members located off-floor. Accordingly, there was no NYSE rule, written or unwritten, which could have been reviewed by the Commission during the course of our review of NYSE rules under Section 31(b).

As stated earlier, in our view, the NYSE never followed the proper statutory procedure to make the telephone access policy a valid rule which could be reviewed under Section 31(b). In our December 1, 1976, release, "rules" which were the subject of the Commission's review under Section 31(b) were defined as rules which had either been submitted to the Commission for review under Section 19(b)(4) of the Act, or the former Rule 17a-8 under the Act, or, where the rules of the exchange antedated those provisions, rules which were reflected in official publications of exchange rules. [53] Under this definition it is clear that the NYSE's alleged unwritten policy or rule prohibiting members **[*28]** telephone access from the floor of the Exchange to non-members located off the floor was never reviewed by the Commission during the course of the review of exchange rules under Section 31(b). [54]

The NYSE contends that the Commission was aware of the existence of the NYSE policy denying members on the floor of the exchange telephone access to non-members located off the floor and acquiesced to this policy during the 31(b) review period. In support of this, the NYSE claims that in September 1976 the Commission "ruled" on an application by an NYSE member who had requested that an unrestricted telephone be installed in his booth on the floor. [55] In fact the alleged ruling was not an order or opinion by the Commission or its staff, rather, **[*29]** it was a letter from the Commission staff declining to issue an advisory opinion on the member's application because the member indicated that no action had been taken by the NYSE to deny his request for telephone access from the floor. [56]

We note that the staff's letter stated that NYSE Rule 36, cited by the member as a possible basis for the NYSE's anticipated denial of his request, would not provide an adequate basis for denying a request for a telephone connection between members on the floor and non-members because the rule applies only to requests between a member **[**726]** on the floor and the member's office. [57] The staff's letter also stated that the question of whether there was a basis for denying such connections had not been raised with the Commission and that any such restriction would have to be justified as necessary or appropriate in furtherance of the purposes of the Act. Subsequently, the Commission staff on two separate occasions suggested to the NYSE that if the Exchange desired to effect a policy imposing such restrictions, it would have to file the policy as a proposed rule change under Section 19(b) of the Act. [58] Thus, it is **[*30]** apparent that the Commission never acknowledged that such a policy existed.

b. Section 19(b)

---

[52] See pp. 15-26, supra.

[53] Securities Exchange Act Release No. 13027, December 1, 1976, *41 FR 53557 n.3.*

[54] It also should be noted that the NYSE does not assert in its Brief that the Exchange ever notified the Commission or its staff during the 31(b) review process of the existence of NYSE's alleged telephone access rule or that it filed with the Commission information identifying the NYSE's unwritten telephone access rule as an Exchange rule currently in effect.

[55] See note 39 supra.

[56] Id.

[57] Discussed, supra, at p. 18.

[58] See 1978 Release, discussed p. 13, supra; note 32, supra.

The Exchange also contends, in connection with its argument that the Commission has implicitly approved or acquiesced to the NYSE's policy denying non-member telephone access to the floor, that in several recent orders the Commission has approved rule changes by the NYSE and the American Stock Exchange, Inc. ("Amex") which confirmed rules or policies by those exchanges which denied members on the floor telephone access to non-members. We do not agree with the NYSE's interpretation of those orders.

Among the orders cited by the Exchange is the Commission's approval of changes proposed to NYSE Rules 303, 36 and to Article III, Section 6 of the NYSE Constitution, [59] that established criteria upon which the Exchange may base the denial, limitation, or revocation of approval of telephone links between the offices of members or member firms and the Exchange floor. The NYSE contends this order evidences Commission acquiescence to the NYSE's telephone access policy. We have concluded, however, **[*31]** that those rules, viewed either individually or in combination, do not prohibit members on the floor from having telephone access to non-members located off the exchange floor. [60] In addition, nothing in the Commission's order approving those rule changes supports the NYSE's contention that the Commission either was aware of or agreed with an interpretation of those rules by the NYSE which would deny members on the Exchange floor the right to install telephone communications links which would enable them to communicate with non-members located off the floor of the Exchange.

The NYSE also notes that in the course of the review of exchange rules under Section 31(b), the Commission expressed reservations on **[**727]** rules "prohibiting members from transacting business with non-members while on the floor of the exchange" citing, among other rules, NYSE Rule 54. [61] The NYSE argues that the Commission's subsequent approval of **[*32]** amendments to that rule and the lack of a statement by the Commission requiring that non-members be allowed to communicate with the Exchange floor indicates Commission acquiescence to the NYSE's interpretation of Rule 54 prohibiting members on the floor of the Exchange from communicating with non-members located off-floor.

As we have previously stated, however, Rule 54 applies only to transactions by non-members effected on the floor of the Exchange. It does not address the right of a member on the floor of the Exchange to communicate by telephone with a non-member off the floor. [62] As we stated in our order approving amendments to Rule 54, the rule "would have no application to members on the NYSE floor effecting transactions with persons located elsewhere." This evidenced the Commission's understanding of the rule, an understanding that, as the Commission noted in its order, had been confirmed by the NYSE and which formed part of the basis for the Commission's approval of the rule as amended.

The NYSE also asserts that the Commission's approval of a proposed rule change by Amex which permitted Amex to modify their wire **[*33]** access policy to allow the installation of direct telephone wires linking persons on the floor of the Chicago Board of Trade ("CBT") with member booths on the Amex floor, for the purpose of entering orders in the Amex Major Market Index option and the Amex Market Value Index option, [63] demonstrates that the Commission implicitly had ratified an Amex policy, similar to the NYSE's, of denying members on the floor telephone access to non-members. We disagree.

The Amex filing arose in the context of extensive negotiations between Amex and the CBT on a variety of issues associated with the introduction on the CBT of futures on two indexes on which Amex traded options. These included reciprocal agreements by the two markets for reduced transaction fees for each other's members as well as the cross-access agreements. Under these circumstances, it was essential from a negotiation perspective that

---

[59] Securities Exchange Act Release No. 16611, February 27, 1980, *45 FR 14733*.

[60] Rules 303 and 36 only provide guidelines for member access to the floor while Article III, Section 6, simply gives the Board power to regulate such access. See pp. 18 to 21, supra.

[61] See note 38, supra.

[62] See pp. 16-18, supra.

[63] Securities Exchange Act Release No. 21145, July 13, 1984, ***49 FR 29501.***

each exchange codify these agreements in rule filings with their respective regulators, regardless of what their rules provided generally. It was also appropriate, from a legal perspective, that this specific application **[*34]** of Amex rules be embodied in a proposed rule change. Thus, the Commission's order approving this rule change did not discuss the non-member **[**728]** telephone access issue generally nor deny such access. The order only determined that, under the terms of the proposed rule, the Amex would permit CBT traders access to the Amex floor. Although the published notice of the Amex proposal refers to an Amex "policy" of limiting floor access to members, neither the notice nor the approval order addressed whether the Amex could either prohibit non-member telephone access or must permit such access under its existing rules. [64] Moreover, no action by the Amex denying members on the floor the right to have direct telephone communications with non-members has been appealed to the Commission for review under Section 19(d) or (f) of the Act. Thus, the Commission has not been afforded an opportunity to determine whether the Amex has such a policy and whether it would be consistent with the requirements of the Act. [65]

[*35]

Moreover, as a general matter, both the NYSE's arguments regarding Section 31(b) and Section 19(b) essentially seek to establish, based on collateral proceedings, an implied Commission approval of what is at best an unwritten "policy" of the NYSE to limit telephone access by investors to NYSE broker-dealers. Absent clear and convincing evidence that such implied ratification was part of the Commission's decisional process, we do not believe that such an implied ratification is appropriate for a "policy" with such obvious competitive implications. [66] Indeed, to uphold such an argument of implied ratification would substantially undermine the purposes of Section 19(b) of the Act which envisions that SRO rules would be published for public comment and scrutiny before they take effect. [67]

[*36]

IV. Burden on Competition

In view of our determination that the NYSE does not have a rule prohibiting members from establishing telephone links that would enable them to communicate from the floor of the Exchange with **[**729]** non-members located off the floor, we do not need to address Higgins' contention that the NYSE's action, even if based on a proper procedural rule, would impose a burden on competition not necessary or appropriate in furtherance of the Act. [68]

V. Attorneys' Fees

---

[64] It is true that the Amex filing contained a statement that "presently Exchange policy prohibits non-member access to our trading floor through direct telephone lines to members booths. " However, in light of the fact that the Amex filing was appropriate and consistent with the Act, the Commission's failure to address an assertion unrelated to the Amex's proposal provides no evidence of Commission acquiescence regarding Amex's position.

[65] Moreover, such a rule regarding the Amex obviously does not address whether the NYSE had such a policy.

[66] Cf., e.g., *U.S. v. Philadelphia National Bank, 374 U.S. 321, 350-351 (1963); Pan American World Airways, Inc. v. United States, 371 U.S. 296 (1963); California v. Federal Power Commission, 369 U.S. 482 (1962)* ("Repeals of the anti-trust laws by implication from a regulatory statute are strongly disfavored and have only been found in cases of plain repuguancy between the antitrust and regulatory provisions."); *Douglas v. Seacoast Products, Inc., 431 U.S. 265, 272 (1977); New York State Department of Social Services v. Dublino, 413 U.S. 405 (1973)* (Preemption of state law by federal legislation "will be found only if that was the clear and manifest purpose of Congress.").

[67] Because we do not believe the NYSE's unwritten policy against non-member telephone access provides grounds for establishing a rule exists, we do not believe it is necessary to address NYSE's argument that to make a change to such policy the Commission must institute proceedings under Section 19(c) of the Act. Rather, we have concluded, consistent with the 1978 Release, (supra, note 31), that the NYSE's current rules do not prohibit non-member telephone access to a member on the floor, and accordingly that the NYSE Board's denial of Applicants' requests is a limitation on access to Exchange member services.

[68] As noted above, Section 19(f) requires the Commission to set aside a denial, bar, limitation, or prohibition on access by a SRO if it finds that such action imposes a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

Applicant Higgins has requested that the Commission award him attorneys' fees in this proceeding. The reasons cited for this request are the six year delay since Higgins requested telephone access from the Exchange floor and alleged bad faith by the NYSE in denying Higgins permission to install a telephone and in the NYSE's continuing insistence that it had a valid rule prohibiting such telephone communication by members on the floor of **[*37]** the Exchange to non-members located off-floor throughout the period that this question was under review by the Exchange and the Commission. Higgins argues that the Commission's power to award attorneys' fees in this matter is implicitly contained in Section 19 of the Act, which provides the Commission with broad powers to review the actions of SROs, and Section 28(a) of the Act, which he alleges provides the Commission with equitable powers to grant relief in such cases. The NYSE argues that there is no statutory provision authorizing an award of attorneys' fees in a proceeding under Section 19(d) of the Act and that, therefore, the Commission has no authority to award such fees.

We conclude that we have no authority to award attorneys' fees in this proceeding. Applicant Higgins concedes in his Brief that the Commission has no express statutory authority under Section 19 of the Act to award attorneys' fees. He asks, instead, that the Commission view the requested award of attorneys' fees as analogous to other disciplinary remedies that the Commission is authorized to employ. In our view, it is clear under current case law that in the absence of express statutory language, a **[*38]** regulatory agency does not have the authority to require the losing party in an administrative proceeding to pay the attorneys' fees of the prevailing party. [69]

Applicant Higgins also contends that the Commission has equitable powers to grant relief under Section 28(a) of the Act and asks the Commission to utilize this power to award him attorneys' fees in this proceeding. We do not agree that Section 28(a) of the Act provides us with equitable powers to grant attorneys' fees. As noted above, the Commission has no express statutory authority to award attorneys' **[**730]** fees in a proceeding under Section 19 of the Act. Accordingly, we deny Higgins' request for attorneys' fees.

VI. Conclusion

For the reasons discussed above, we conclude that the NYSE has no rule, or policy enforceable as a rule, which prohibits members on the floor of the Exchange from establishing telephone communication links with non-members located off the floor. Under Section 19(f) we must set aside any SRO action that imposes a limitation on access when the action is not taken **[*39]** pursuant to a rule of the SRO. Accordingly, because the NYSE has no rule prohibiting members on the floor from having telephone access to off-floor non-members and the denial of Applicants' requests is a limitation of access to services that can be offered by the exchange and its members to its member's customers, we believe the action of the NYSE should be set aside. An appropriate order will issue setting aside the NYSE's actions concerning the Applicants. [70]

By the Commission (Chairman SHAD, and Commissioners COX, PETERS and GRUNDFEST); Commissioner FLEISCHMAN not participating.

Load Date: 2018-09-27

SEC Decisions, Orders & Releases

End of Document

[69] See *Alyeska Pipeline Service Co. v. Wilderness Society, 421 U.S. 240 (1975); F.D. Rich Co. v. United States, 417 U.S. 116 (1974).*

[70] We have considered all of the other arguments made by the parties. Their arguments are rejected or sustained to the extent they are inconsistent or in accord with the views expressed in this opinion.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No.66549 / March 9, 2012

Admin. Proc. File No. 3-14544

In the Matter of the Application of

JAMES LEE GOLDBERG
c/o Simon S. Kogan, Esq.
Attorney at Law
27 Weaver Street
Staten Island, NY 10312

For Review of Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF ASSOCIATION ACTION DENYING WAIVER OF EXAMINATION REQUIREMENTS

Registered securities association denied the request by a member firm, on behalf of a registered general securities representative seeking registration as an investment banking representative, that the applicable qualification examination be waived and that the representative be permitted to obtain that license without qualifying by examination. *Held*, review proceeding *dismissed*.

APPEARANCES:

Simon S. Kogan, for James Lee Goldberg.

Marc Menchel, *Jennifer C. Brooks*, and *Michael J. Garawski*, for Financial Industry Regulatory Authority, Inc.

Appeal filed: September 6, 2011
Last brief received: December 21, 2011

I.

James Lee Goldberg, a registered representative associated with Katalyst Securities, LLC ("Katalyst"), a FINRA member firm, seeks review of a FINRA action. FINRA denied a request by Katalyst, on Goldberg's behalf, for a waiver of the qualification examination required by NASD Membership and Registration Rules 1031(c) and 1032(i), for a Series 79 (investment banking representative) securities license.[1] We base our findings on an independent review of the record.

II.

In December 1985, Goldberg passed the Series 7 (general securities representative) examination. Since then, Goldberg has served as a registered general securities representative with seven different member firms and has also worked periodically as a self-employed consultant, in both investment related and non-investment related capacities.[2] As detailed below, Goldberg's Series 7 license had lapsed by late 2007. In January 2011, Goldberg joined Katalyst. He became a Katalyst general securities representative on March 3, 2011, after FINRA granted him a waiver of the Series 7 examination requirement. Goldberg has never taken the Series 79 qualification examination.

A. Goldberg's Prior Associations with Westor Capital Group, Inc.

1. First Association: October 2007 – July 2008

In October 2007, Goldberg was hired by Westor Capital Group, Inc. ("Westor"), then a FINRA member firm. On October 31, 2007, Westor filed a Uniform Application for Securities Industry Registration or Transfer ("Form U4") seeking to register Goldberg as a Series 7 general securities representative.[3] FINRA did not approve Goldberg's registration with Westor because

---

[1] FINRA was formed on July 26, 2007, as a result of the merger of the member firm regulatory functions of the National Association of Securities Dealers, Inc. ("NASD") and NYSE Regulation, Inc. ("NYSE"). Securities Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522. FINRA has since begun consolidating NASD and NYSE rules as new FINRA rules; however, many NASD rules, including NASD Membership Rules 1031, remain in effect. Exchange Act Rel. No. 58643 (Sept. 25, 2008), 73 Fed. Reg. 57,174 (Oct. 1, 2008).

[2] In addition to our consideration of the record in this case, we take official notice of the various filings and general information regarding Goldberg in the Central Registration Depository ("CRD"), an electronic database maintained by FINRA and *available at* https://crd.finra.org. 17 C.F.R. § 201.323.

[3] Goldberg's previous registration with FINRA had terminated in June 2006.

Goldberg had failed to complete a required continuing education course.[4] On April 28, 2008, because Goldberg failed to timely complete the course, FINRA's Central Registration Depository ("CRD") system automatically changed his registration status to "purged."[5]

Two days later, Westor filed an amended Form U4. This action gave Goldberg an additional 120 days to renew his registration by taking the continuing education course. Goldberg completed the course on May 12, 2008. By this time, however, FINRA had suspended Westor's membership for the firm's failure to file an annual report for 2007 and thus Goldberg's registration was not approved. On July 8, 2008, Westor terminated Goldberg's association with the firm by filing a Uniform Termination Notice for Securities Industry Registration ("Form U5"). The Form U5 explained that Goldberg's resignation was "voluntary" because Westor was "unable to facilitate deals at this time." Goldberg's Form U4 represents that, for a period thereafter, he was self-employed as a "consultant."

2. Second Association: June 2009 – April 2010

In June 2009, Goldberg rejoined Westor. However, he learned shortly thereafter that his previous registration with FINRA had been purged and that he was no longer licensed.

On April 20, 2010, Westor filed a Form U4 seeking to register Goldberg as a Series 7 "general securities representative." FINRA granted Goldberg a waiver of the Series 7 examination requirement in August 2010, conditioned on Goldberg's completion of a continuing education course within ninety days; however, Goldberg did not complete the required course during the time provided. In subsequent correspondence with FINRA, Goldberg stated that he was unable to take the course because Westor "owed FINRA $2,000 for prior registration and fees . . . [and it] was unwilling to pay the outstanding balance . . . [which] left my waiver in limbo."[6]

On November 15, 2010, FINRA withdrew its conditional waiver of the Series 7 examination requirement and Goldberg's Series 7 registration with Westor was never approved. On January 25, 2011, Westor filed a Form U5 terminating Goldberg's association. The Form U5 stated the reason for the termination was "voluntary" but also stated, without explanation, that

---

[4] Goldberg states on appeal that he "was duly registered with [Westor] until 2008." This is not accurate. Despite numerous attempts commencing in 2007, Goldberg was never registered with Westor.

[5] *See* FINRA, *Web CRD Firm User's Manual* at p. 5-32, *available at* http://finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsuppportdocs/p005317.pdf.

[6] The record does not clarify the basis for the connection between the purported amount owed by Westor to FINRA and Goldberg's failure to take the continuing education course.

the termination date for Goldberg's association was April 23, 2010, three days after Westor filed a Form U4 on Goldberg's behalf.[7]

3. The November 2009 – May 2010 "Opt-In" Period for the Series 79 Exam

During Goldberg's second association with Westor, FINRA adopted amendments to NASD Rule 1032 requiring "individuals whose activities are limited to investment banking . . . to pass [a] new Limited Representative – Investment Banking Qualification Examination (Series 79 Exam)."[8] As part of the new requirement, FINRA offered a six-month transitional "opt-in" period, between November 2, 2009 and May 3, 2010, in which "[i]nvestment bankers who hold the Series 7 registration . . . may opt in to the Investment Banking Representative registration, provided that, as of the date they opt in, such individuals are engaged in investment banking activities."[9] To opt in, the individual's member firm was required to "submit an amended Form U4 to request the Limited Representative—Investment Banking registration."[10] Individuals who qualified for the "opt-in" relief were exempt from taking the Series 79 examination. After the opt-in period, any person who sought to engage in investment banking activities would be required "to pass the Series 79 Exam or obtain a waiver" from FINRA.

Westor did not file an amended Form U4 seeking an Investment Banking Representative registration on Goldberg's behalf during the Series 79 opt-in period. In February 2010, Goldberg's counsel sent a letter to FINRA in connection with the reinstatement of Goldberg's Series 7 registration. That letter did not indicate that Goldberg intended to obtain a Series 79 securities license.

B. Goldberg Joins Katalyst

1. Katalyst Requests Waiver of the Series 7 and 79 Exams

In February 2011, Katalyst filed a Form U4 seeking to register Goldberg as a general securities representative and as an investment banking representative. Katalyst also requested waiver of the Series 7 and 79 examination requirements on Goldberg's behalf. FINRA granted Katalyst's Series 7 waiver request on February 17, 2011, conditioned on Goldberg taking a required continuing education course. Goldberg completed the required course and FINRA approved his Series 7 registration on March 3, 2011.

---

[7] This April 2010 termination date is also reflected in Goldberg's employment history in CRD.

[8] FINRA Notice to Members 09-41, at *1 (July 2009).

[9] *Id.* at *3.

[10] *Id.* at *6.

On February 22, 2011, FINRA's Department of Testing and Continuing Education (the "Department") requested additional information regarding Katalyst's waiver request for the Series 79 qualification examination. The Department asked for a description of what Goldberg's duties would be at Katalyst, an explanation of "why [Westor] did not opt-in [Goldberg] to the [Investment Banking] position" previously, and a "detailed description" of Goldberg's investment banking experience.

On March 8, 2011, Katalyst responded that Goldberg would be involved in "the private placement of securities" and "various corporate restructurings and M&A activities." Katalyst also included a statement by Goldberg that he believed that Westor did not opt him into the Series 79 because of "the firm's financial problems."

With respect to his past investment banking experience, Goldberg represented that over the preceding five years he had "assisted several companies requiring investment banking services." Goldberg stated that he provided "business and financial planning strategies[,] introductions to potential financing candidates[,] discussions with legal and accounting specialists[,] and offering solutions to management and stakeholder's goals and expectations during the entire process." According to Goldberg, he also worked "alongside" the ex-treasurer of PepsiCo, with whom he "assisted companies with deal structure, contract negotiations, corporate and securities compliance issues, exit strategies, buy-sell arrangements, merger and acquisitions, among other services on an as needed basis."

2. FINRA's Determination

On March 29, 2011, the Department denied Katalyst's Series 79 examination waiver request. The Department stated that, after "carefully considering the material [Katalyst] presented" on Goldberg's behalf, "neither [Katalyst's] representations . . . nor the official registration record, provide a basis for waiving the required qualification examination." On April 15, 2011, Goldberg appealed that decision to the Waiver Subcommittee of FINRA's National Adjudicatory Council ("Waiver Subcommittee"), asserting that the Series 79 examination requirement should be waived "for the same reasons that his Series 7 exam was waived." In this connection, Goldberg referred the Waiver Subcommittee to an e-mail from FINRA staff regarding the expiration of his Series 7 license, three letters of recommendation from individuals with whom Goldberg previously worked, and a statement from a compliance official from STG Secure Trading Group, Inc. ("STG"), indicating that Goldberg had no "outstanding issues" with that firm as of May 22, 2006.[11]

---

[11] These letters describe Goldberg's investment banking experience by saying that Goldberg was "a prime mover in . . . efforts to raise investment capital for clients, in areas such as identifying potential investors, conducting pre-money business evaluations and analysis of comparables, developing investor exit strategies, and negotiating financing terms"; "particularly helpful in assisting with the preparation of business plans, identifying potential investors,

(continued...)

On August 2, 2011, the Waiver Subcommittee affirmed the Department's denial of the waiver request. The Waiver Subcommittee found that Goldberg's waiver request did not present the "exceptional case" that would justify "accept[ing] other standards as evidence of [his] qualification for registration" in lieu of passing the Series 79 examination. According to the Waiver Subcommittee, Katalyst "present[ed] limited evidence concerning Goldberg's experience with the wide variety of tasks that the Series 79 examination qualifies one to perform." In addition, the Waiver Subcommittee found insufficient evidence supporting Goldberg's claim that a waiver was warranted because of an alleged filing error by Westor for failing to opt him into the Series 79 category during his association with the firm. Goldberg appealed the Waiver Subcommittee's decision.

III.

We review FINRA denial of a request for waiver of an examination requirement pursuant to Section 19(f) of the Securities Exchange Act.[12] In accordance with that section, we must dismiss an application for review of a denial of a waiver request if we find that: (1) the specific grounds upon which FINRA based its denial "exist in fact"; (2) the action is in accordance with FINRA rules; (3) FINRA applied its rules in a manner consistent with the purposes of the Exchange Act; and (4) the action does not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[13]

A. Specific Grounds for Denying Waiver Exist in Fact

NASD Membership and Registration Rules 1031 and 1032(i) require associated persons seeking to engage in investment banking activities to pass the Series 79 qualification examination. FINRA designed the Series 79 examination to "provide a more targeted assessment of the competency of investing banking personnel to perform their unique job

---

[11] (...continued)
preparing investor presentations, structuring deals, and negotiating financing agreements"; and "essential in establishing relationships and structure in every aspect of Investment Banking."

[12] 15 U.S.C. § 78s(f); *see Gina M. Guzzone*, 57 S.E.C. 592, 596 (2004) (explaining that a "denial of a waiver . . . , in effect, constitutes a bar . . . from associating" with a FINRA member firm).

[13] *Fog Cutter Capital Group v. SEC*, 474 F.3d 822, 825 (D.C. Cir. 2007). Goldberg mistakenly states that we review this proceeding pursuant to Section 19(e) of the Exchange Act. He also argues that the Act "requires FINRA to evaluate if its determinations impose a burden on competition" and that FINRA improperly failed to make this evaluation. The Act requires the Commission, not FINRA, to make this determination.

functions and, as a result, provide investors better protection."[14] In accordance with NASD Membership and Registration Rule 1070(d), FINRA may "in exceptional cases and where good cause is shown" waive an examination requirement and accept "other standards as evidence of an applicant's qualifications for registration."

FINRA "examines the merits of any waiver request based on its Waiver Guidelines,"[15] a non-exhaustive list of factors "to assist member firms in recognizing situations where a basis may exist for requesting a waiver."[16] Goldberg based his Series 79 examination waiver request on two factors in the Waiver Guidelines: (1) an alleged filing error caused by Westor's failure to "opt" him into the Series 79 category during the opt-in period, and (2) Goldberg's experience in the securities industry. We find that specific grounds for the Waiver Subcommittee's denial of Goldberg's waiver request existed in fact.

1. The Waiver Guideline applicable to a filing error provides that FINRA may grant a waiver to an individual who has been functioning in good faith in the securities industry and believes himself to be properly registered, but whose application forms had been incorrectly filed and are therefore not reflected in the CRD. The Waiver Guideline requires that the "firm(s) involved document the nature of the filing error" as well as evidence showing the individual's "good faith" belief, notwithstanding the filing error, that he or she was appropriately registered.

The record amply supports the Waiver Subcommittee's conclusion that Westor's failure was a result of a "purposeful" financial decision by the firm, rather than an inadvertent filing mistake, as contemplated by the Waiver Guideline.[17] Goldberg presented no evidence that, during the opt-in period for the Series 79 license, he believed in good faith that he was properly registered as a Series 79 licensee.[18] To the contrary, the February 2010 letter from Goldberg's attorney admits that Goldberg knew since at least June 2009 that he lacked even a Series 7

---

[14] Series 79 Exam Adopting Release, 74 Fed. Reg. at 39,985.

[15] *Michael Stegawski*, Exchange Act Rel. No. 59326 (Jan. 30, 2009), 95 SEC Docket 13819, 13823 (citing NASD Notice to Members 04-59 (Aug. 2004)).

[16] FINRA, Qualification Examination Waiver Guidelines, *available at* http://www.finra.org/RegistrationQualifications/BrokerGuidanceResponsibility/Qualifications/p010600 (last visited January 26, 2012).

[17] Waiver Guidelines, *supra* note 16 (noting that, "[i]n a typical case, a member firm files an incomplete application that is eventually purged from the CRD system. After two years, the CRD system will reschedule the appropriate qualification examination if the individual re-submits an application for registration. This normally occurs when the individual attempts to transfer to another firm.").

[18] *Jon G. Symon*, 54 S.E.C. 102, 108 (1999) (finding applicant failed to provide sufficient evidence supporting his claim of a registration error).

license, the prerequisite for seeking an exemption from the Series 79 examination during the "opt-in" period. Moreover, Westor did not file a Series 79 opt-in application on behalf of Goldberg, much less claim that any error had been made in connection with such an application, as required by the Waiver Guideline. Goldberg essentially conceded that he knew Westor never submitted such an application when he admitted that he believed the main reason Westor failed to seek an exemption during the "opt-in" period was due to Westor's "financial problems" at the time.

Goldberg further argues that he was "deprived of the opportunity to opt in to the Series 79 registration because of a registration error involving his Series 7 license." Even if a filing error with respect to one licensing application could be the basis for a waiver of another, different license, Goldberg has not established any such error with respect to his Series 7 application. The lapse in his Series 7 registration was due initially to his failure to complete a continuing education course. This does not constitute a "filing error," but rather a failure to meet his continuing education obligations as required by FINRA Rule 1250.[19] Rule 1250 prescribes the frequency with which registered persons must take continuing education courses, and that, during any period of non-compliance with the continuing education requirements a registered person must cease to perform any duties as a registered person. Since Goldberg was required to be aware of his continuing education obligations, it is unclear how he could have been eligible for a "filing error" waiver based on a good faith belief that he was properly registered, at least until he completed his continuing education course in May of 2008.[20]

When Goldberg eventually took the course, his Series 7 registration was not approved because Westor's membership had been suspended for failure to file its 2007 annual report. This does not constitute a "filing error" in connection with Goldberg's Series 7 application, but a filing failure in connection with Westor's annual report.

Goldberg blames his failure to take his required continuing education course during his second association with Westor on Westor's failure to pay outstanding fees owing to FINRA. However, Westor's failure to pay fees is not a "filing error" with respect to Goldberg's registration. Moreover, the record is clear that Goldberg was aware of his unregistered status throughout his second association with Westor, and therefore could not have in good faith

---

[19] Former NASD Rule 1120.

[20] Registered persons such as Goldberg are required to be familiar with all applicable FINRA rules. *Ryan Henry*, Exchange Act Rel. No. 53957 (June 8, 2006), 88 SEC Docket 587, 592 n.13. Goldberg blames FINRA for not notifying him of his Series 7 continuing education deficiency during his association with Westor. We have long held that"[a]pplicants 'cannot shift their burden of compliance to [FINRA].'" *CMG Institutional Trading, LLC*, Exchange Act Rel. No. 59325 (Jan. 30, 2009), 95 SEC Docket 13802, 13813 n.33 (quoting *Hans N. Beerbaum*, Exchange Act Rel. No. 55731 (May 9, 2007), 90 SEC Docket 1863, 1871 n.22).

believed himself to be properly registered and therefore eligible for a "filing error" waiver for his Series 7 registration.

Goldberg asserts that but for "the SNAFU with respect to his Series 7 registration . . . Goldberg would have opted in to the [Series] 79" category. This assertion is not supported by the record. Westor did not seek an "opt-in" for Goldberg at any time. Moreover, the February 2010 letter sent by Goldberg's counsel to FINRA during the Series 79 opt-in period made no reference to any intention of Goldberg to register as an investment banking representative. Even if Goldberg had sought to take advantage of the opt-in period, he was not eligible because his Series 7 registration had lapsed.[21]

2. There is also ample support for the Waiver Subcommittee's denial of Goldberg's waiver request based on his purported investment banking experience. The Waiver Guidelines provide six factors that FINRA considers in determining whether to grant a waiver request based on applicant's industry experience.[22] Goldberg based his waiver request on four of those factors: (1) the length and quality of his experience; (2) the specific registration he requested and type of business he would conduct; (3) his previous registration history; and (4) the nature of any regulatory matters as disclosed on his application for registration.

In assessing his investment banking credentials, the Waiver Subcommittee considered Goldberg's more than eleven years as a registered general securities representative (although that experience was not consecutive), his current registration in that capacity, and the various letters submitted by individuals with whom he has worked. The Waiver Subcommittee, however, determined that Goldberg's experience did not present "an exceptional case," finding that Goldberg's description of his investment banking experience was "only in general terms," that "he has no direct experience in investment banking as a registered representative," and that Katalyst presented "limited evidence concerning Goldberg's experience with the wide variety of tasks that the Series 79 examination qualifies one to perform."

We agree with FINRA's assessment. Goldberg has not demonstrated, under NASD Rule 1070, that his industry experience presents an "exceptional case" to waive the Series 79 examination requirement. Passing the Series 79 examination qualifies an investment banking representative to advise on or facilitate debt or equity offerings through a private placement or public offering or to advise or facilitate mergers or acquisitions, tender offers, financial

---

[21] We are unclear about the basis for Goldberg's assertion on appeal that "[d]uring the past few years, believing that he was properly registered at both STG and [Westor], Mr. Goldberg was actively engaged in investment banking activities," at least with respect to Goldberg's tenure at Westor. The lapse of his Series 7 registration during the entire opt-in period, of which he was admittedly aware, required him to cease all duties as a registered person during the lapse. CRD shows that his registration with STG ended in June 2006, well before the events at issue.

[22] Waiver Guidelines, *supra* note 16.

restructurings, asset sales, divestitures or other corporate reorganizations or business combination transactions.[23] Goldberg's waiver request, however, consisted of a four-line, unspecified list of "investment banking services" with which he "assisted" for "several companies," without any indication of the level or breadth of his involvement, or the specific services in which he was involved.

Moreover, although Goldberg's waiver request represented that, "for the past five years, [he] actively provided investment banking on wide variety of matters," FINRA found that "he has no direct experience in investment banking as a registered representative and gained -- at best -- only 15 months of investment banking experience at Westor . . . ." Goldberg offered little explanation of his past associations or his consulting practice to provide a basis to determine whether they compare with being an investment banking representative associated with a regulated broker-dealer. The letters of recommendation submitted on Goldberg's behalf were also vague, giving little indication of the kinds of investment banking services Goldberg provided.[24]

B. Waiver Denial Was in Accordance with FINRA Rules

FINRA conducted its review of Katalyst's waiver request on behalf of Goldberg in accordance with its rules. An applicant may request an exemption from FINRA's examination requirements pursuant to the procedures set forth in the 9600 Series of NASD's Code of Procedure. In addition, the Waiver Guidelines provide guidance to member firms regarding the proper procedures for submitting examination waiver requests on behalf of individual applicant.[25]

On February 16, 2011, Katalyst filed a Form U4 requesting a Series 79 waiver on Goldberg's behalf. On March 29, 2011, the Department rendered a written decision, in accordance with NASD Procedural Rule 9620, denying the request. On April 15, 2011, and in accordance with NASD Procedural Rule 9630, Goldberg filed a timely written appeal of the

---

[23] NASD Membership and Registration Rule 1032(i). The Series 79 examination covers four main topics (in order of concentration): (1) collection, analysis, and evaluation of data (75 questions); (2) underwriting/new financing transactions, types of offerings and registration of securities (43 questions); (3) mergers and acquisitions, tender offers and financial restructuring transactions (34 questions); and (4) general securities industry regulations (23 questions). Series 79 Exam Adopting Release, 74 Fed. Reg. at 39,985.

[24] We disagree with Goldberg's assertion that his lack of recent disciplinary history is indicative of his specific qualification to serve as an investment banking professional. *See Symon*, 54 S.E.C. at 108 (denying waiver request despite applicant's "thirty-one years of experience in the securities industry, unblemished record," and investment management experience).

[25] Waiver Guidelines, *supra* note 16.

Department's decision to the Waiver Subcommittee. The Waiver Subcommittee gave Goldberg an opportunity to provide an explanation for the basis of his appeal. On May 16, 2011, Goldberg submitted a brief in support of his appeal to the Waiver Subcommittee. On August 2, 2011, the Waiver Subcommittee issued a written decision "setting forth its findings and conclusions" denying the waiver request, in accordance with NASD Procedural Rule 9630(e).[26]

Goldberg argues that the Department's denial of his waiver request was arbitrary and capricious for failing to provide a basis for the denial. The Department's decision, however, is not before us in this appeal. The Waiver Subcommittee considered the Department's decision *de novo*,[27] and its decision is the one before us on appeal.[28]

C. FINRA Applied Its Rules Consistently with Exchange Act's Purposes

We also find that FINRA applied its rules in a manner consistent with the purposes of the Exchange Act. Exchange Act Section 15(b)(7) authorizes the Commission to regulate persons associated with broker-dealers by establishing qualification standards.[29] Among these standards is Exchange Act Rule 15b7-1, which requires associated persons to "pass[] any required examinations" established by the rules of the self-regulatory organizations.[30] In adopting that rule, we stated that "[self-regulatory organization] qualification of associated persons of broker-dealers is of substantial importance in promoting compliance with the substantive requirements of the federal securities laws," that we "rely principally on the [self-regulatory organizations] in the formulation and administration of qualification standards, subject to [our] review and oversight," and that requiring compliance with such standards advances "investor protection."[31]

Goldberg has failed to show that he currently possesses the requisite skills necessary to competently perform the functions of an investment banking professional. Thus, we agree with the Waiver Subcommittee's conclusion that "it is important for Goldberg to familiarize himself

---

[26] *See Stegawski*, 95 SEC Docket at 13828 n.27 (explaining that FINRA created the Waiver Subcommittee as a means of providing expedited review of appeals of waiver requests).

[27] FINRA Rule 9630(e)(2).

[28] *Cf. Harry Friedman*, Exchange Act Rel. No. 64486 (May 13, 2011), *101* SEC Docket *41227* (holding that in disciplinary cases, NAC decisions, not Hearing Panel decisions, are subject to Commission review). *Accord Philippe N. Keyes*, Exchange Act Rel. No. 54723 (Nov. 8, 2006), 89 SEC Docket 792, 800 n.17.

[29] 15 U.S.C. § 78*o*(b)(7).

[30] 17 C.F.R. § 240.15b7-1.

[31] *Requirement of Broker-Dealers to Comply with SRO Qualification Standards*, Exchange Act Rel. No. 32261 (May 4, 1993), 54 SEC Docket 39, 40.

with the relevant rules through the [Series 79] examination process." The Series 79 examination, as part of FINRA's qualification examination program, is specifically designed "to measure the degree to which each candidate possesses the knowledge, skills and abilities needed to perform the major functions of an entry-level investment banker."[32] We find that requiring Goldberg to pass the Series 79 examination is fully consistent with the purposes of the Exchange Act by helping ensure that he possesses the minimum standards of competency and awareness of his responsibilities as an investment banking professional before engaging in his firm's investment banking activities,[33] which in turn "provide[s] investors better protection."[34]

D. FINRA Action Did Not Impose an Undue Burden on Competition

We also reject Goldberg's claim that FINRA's denial of his waiver request imposed an undue burden on competition that is not necessary or appropriate in furtherance of the Exchange Act. We have previously held that denying a waiver request does not impose an undue burden on competition because "[a]ll other similarly situated applicants are required to take the applicable examinations before being issued licenses."[35] Goldberg contends that the denial of his waiver "imposed a burden on competition" because any concerns about "the depth and breadth of his investment banking knowledge can be easily alleviated by conditioning his waiver on [his] completion of appropriate continuing education modules." However, we agree with the Waiver Subcommittee's determination that Goldberg has not demonstrated the requisite level of experience to qualify for a waiver. Goldberg must pass the Series 79 examination before acting as an investment banking representative. Any burden on Goldberg, individually, or his firm, Katalyst, for him in the short term to take and pass the required examination is outweighed by

---

[32] FINRA, *Investment Banking Representative Qualification Examination (Test Series 79) Content Outline* (2010), at 2, *available at* http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/industry/p119446.pdf.

[33] *Stegawski*, 95 SEC Docket at 13828 (finding that requiring applicant "to retake the qualification examination for the Series 7 license" after over four years away since his last Series 7 terminated "is fully consistent with the Exchange Act's statutory goal of ensuring the requisite levels of knowledge and competency of associated persons"); *see also Report of the Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. Pt. I, 54 (1963) ("The way should be left open for newcomers to enter the securities business, as with any other business, but the public interest demands that newcomers meet minimum standards of competency and show an awareness of their responsibilities before being allowed to approach the public as brokers, dealers, or underwriters.").

[34] Series 79 Exam Adopting Release, 74 Fed. Reg. at 39,985.

[35] *Symon*, 54 S.E.C. at 110.

the public interest in ensuring that he is competent to serve as an investment banking representative.[36]

We therefore find that FINRA properly denied Goldberg's request for waiver of the Series 79 examination requirement. Based on the foregoing, we dismiss Goldberg's appeal.

An appropriate order will issue.[37]

By the Commission (Chairman SCHAPIRO and Commissioners WALTER, AGUILAR, PAREDES and GALLAGHER).

Elizabeth M. Murphy
Secretary

---

[36] *Exchange Servs., Inc. v. SEC*, 797 F.2d 188, 191 (4th Cir. 1986) (stating that "any burden on competition created by the overly comprehensive exam is outweighed by the necessity for the public interest protection").

Goldberg claims that, "[h]istorically, FINRA has implemented . . . and enforced [its] rules in a manner design[ed] to burden competition at the expense of smaller broker dealers and their representatives," referencing issues confronting FINRA's predecessor nearly 20 years ago in connection with its then-existing automated system for executing small orders. Without further elaboration, Goldberg concludes "[t]here can be no question that denying Mr. Goldberg the requested waiver under the guise of protecting the public, FINRA is reducing Katalyst's ability to compete in the Investment Banking marketplace." The connection between the referenced issues and the instant case is not clear, and the claim concerning any impact on Katalyst's competitive posture is not substantiated. For the reasons stated in the text, we reject Goldberg's claim that FINRA's action is anti-competitive.

[37] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 66549 / March 9, 2012

Admin. Proc. File No. 3-14544

In the Matter of the Application of

JAMES LEE GOLDBERG
c/o Simon S. Kogan, Esq.
Attorney at Law
27 Weaver Street
Staten Island, NY 10312

For Review of Action Taken by

FINRA

ORDER DISMISSING REVIEW PROCEEDING

On the basis of the Commission's opinion issued this day, it is

ORDERED that the application for review filed by James Lee Goldberg, be, and it hereby is, dismissed.

By the Commission.

Elizabeth M. Murphy
Secretary

Release No. 39343 (S.E.C. Release No.), Release No. 34-39343, 65 S.E.C. Docket 2055, 1997 WL 722029

Securities and Exchange Commission (S.E.C.)
Securities Exchange Act of 1934

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF THE APPLICATION OF JJFN SERVICES, INC.
100 QUENTIN ROOSEVELT BOULEVARD
SUITE 202
GARDEN CITY, NEW YORK 11530
FOR REVIEW OF ACTION TAKEN BY THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Administrative Proceeding File No. 3-9229
November 21, 1997

OPINION OF THE COMMISSION

*1 REGISTERED SECURITIES ASSOCIATION -- DENIAL OF NASDAQ SMALLCAP MARKET LISTING
Control Person's Felony Tax Conviction

Registered securities association acted consistently with its rules and the purposes of the federal securities laws in denying an issuer's request that its securities be included in the association's automatic quotation system, because the issuer's controlling shareholder, paid consultant, and promoter has been convicted of felony tax law violations. Held, review proceeding is dismissed.

APPEARANCES:
Richard M. Asche, of Litman, Asche & Gioiella, LLP, for JJFN Services, Inc.
Robert E. Aber, Sara Nelson Bloom, and Arnold P. Golub, for the Nasdaq Stock Market, Inc.
Appeal filed: January 21, 1997

Last brief filed: May 6, 1997

I.

JJFN Services, Inc. ("JJFN" or the "Company") appeals the decision of the National Association of Securities Dealers, Inc. ("NASD") denying its application to include the Company's securities on the Nasdaq SmallCap Market. The NASD denied JJFN's application based on the 1992 felony tax conviction of David Miller, the Company's controlling shareholder, promoter, and paid consultant. [1] We base our findings on an independent review of the record.

II.

JJFN, a Delaware corporation, was organized in late 1995. Its primary business is the purchase of model homes from real estate developers and the subsequent leaseback of such homes to the developers from whom they were purchased. According to the Forms 10-K and 10-Q filed with us by the Company, David Miller is a "key person" who has been engaged as a "financial consultant" to the Company since its inception, and may be deemed the Company's "promoter." Miller has a consulting contract with JJFN under which he is paid $180,000 per year for his services. By comparison, the annual salary of JJFN's highest-paid employee, the Company's president and chief executive officer, is $120,000. As specified in its consulting contract with Miller, JJFN has reserved the right to purchase a "key man" insurance policy on Miller's life, naming itself as the beneficiary. As of June 30, 1996, Miller and members of his family owned or controlled more than half of the 15.96 million JJFN shares then-outstanding.

In April 1992, Miller pleaded guilty to three felony tax fraud charges, [2] admitting that in 1983, 1984, and 1985 he filed, and conspired with others to file, false federal tax returns on behalf of a company of which he was the president and chief executive officer. Miller was sentenced in October 1992 to 20 months in prison, fined $40,000, and assessed the costs of his incarceration. [3] He entered federal prison in December 1992, was paroled in December 1993, and was released from custody in May 1994. In November 1995, Miller paid the $40,000 fine, as well as $18,054 in incarceration costs.

*2 Three months later, on February 1, 1996, JJFN applied to the NASD for inclusion of its securities in the Nasdaq SmallCap Market. In the ensuing months, Nasdaq staff contacted JJFN to request additional information about the application and about Miller's conviction.

By letter dated July 22, 1996, Nasdaq staff denied JJFN's application based on David Miller's association with the Company. The staff asserted that, given Miller's "regulatory history" and the "potential influence and control he may exercise over the Company . . . it would be to the detriment of the investing public" to list JJFN's shares on the Nasdaq SmallCap Market.

JJFN appealed the staff's decision to the Nasdaq Listing Qualifications Panel ("Qualifications Panel"). After a hearing at which Miller and certain officers of JJFN testified, the Qualifications Panel, by letter dated August 22, 1996, found that Miller's "involvement in [JJFN] both as a shareholder and as a consultant is substantial." The panel determined that Miller's felony tax fraud convictions "related to his role as the officer of a company." The panel further explained that it was affirming the staff's denial of JJFN's application "in order to preserve and strengthen the quality of and public confidence in the market, and in order to protect prospective investors and the public interest."

In late August 1996, JJFN appealed the Qualifications Panel's decision to the Nasdaq Listing and Hearing Review Committee ("Review Committee"). In early September, while that appeal was pending, Miller offered to place in an irrevocable voting trust all JJFN shares held by him and members of his family, and the Company offered to terminate Miller's consulting contract. One week later, Miller offered in addition to sell to an independent third party all JJFN shares "personally owned by him." [4]

By letter dated December 20, 1996, the Review Committee affirmed the Qualifications Panel's decision to deny inclusion of JJFN's securities in the Nasdaq SmallCap Market. Although the Review Committee noted Miller's offers to terminate his consulting contract with JJFN, to sell his JJFN shares, and to place the shares held by his family in a voting trust, it found that Miller "appear[s] to play an essential role in [JJFN]" and that JJFN is "dependent on [Miller's] expertise." The Review Committee voiced its concern that Miller's "past violative conduct might indicate a propensity to engage in conduct detrimental of [sic] public investors."

III.

JJFN seeks reversal of the NASD's action and an order directing the NASD to include JJFN's securities in the Nasdaq SmallCap Market. We will uphold the NASD's decision to deny JJFN's request for inclusion if we find "that the specific grounds on which such denial . . . is based exist in fact, that such denial . . . is in accordance with [NASD rules], and that such [NASD] rules are, and were applied in a manner, consistent with the purposes of" the Securities Exchange Act of 1934 ("Exchange Act"), unless we find that the NASD's "denial imposes any burden on competition not necessary or appropriate in furtherance of the purposes" of the Exchange Act. [5]

*3 A. JJFN contends that there is no basis in fact for the NASD's conclusion that Miller might have a "propensity to engage in conduct detrimental of [sic] public investors." We disagree. Notwithstanding JJFN's assertion that the NASD's "concern with Mr. Miller appears to be more cosmetic than real," Miller's conviction for tax fraud legitimately may be

considered by the NASD to be evidence of a propensity for future conduct violative of securities laws or regulations. Both the tax and the securities regulatory schemes depend on the honor, candor, and integrity of regulated persons to report accurately to the regulatory authority the information sought by such authority. [6]

JJFN also challenges the NASD's conclusion that Miller plays an "essential role" in the Company. The record supports the NASD's conclusion that Miller is "essential" to the Company and that the Company is dependent on his expertise. As noted, Miller has a generous consulting contract with JJFN, controls the Company, and is a key person and the promoter of JJFN. In addition, JJFN's president and its general counsel both testified that Miller "invented" JJFN and the idea of the sale-leaseback of model homes, that Miller is responsible for designing and structuring all of the complex financial transactions into which JJFN has entered, and that Miller negotiated and closed all of the Company's deals to date. [7] In the words of JJFN's general counsel, "[i]t's clear that Miller is important to the Company. Very important to the Company."

JJFN also contends that the NASD failed to consider Miller's offer to "divest himself and his family of all stock in JJFN" and otherwise to remove himself from involvement with the Company. As an initial matter, JJFN overstates Miller's offer. Miller offered to end his consulting contract with JJFN, to place in an irrevocable voting trust all shares of JJFN owned by members of his family, and to sell those shares "personally owned by him," but not to dispose of the much larger block of shares beneficially owned or otherwise controlled by him and members of his family.

While the Review Committee explained in detail Miller's offer to disengage from JJFN, it nevertheless stated that Miller "appear[s] to play an essential role in [JJFN]" and that JJFN is "dependent on [Miller's] expertise." That the Review Committee discounted Miller's offer is understandable, given that the record establishes that Miller is crucial to JJFN and that neither Miller nor the Company has suggested that another JJFN employee or consultant can undertake Miller's responsibilities, or has proposed a plan for the Company's continued viability without Miller.

B. JJFN argues that the NASD's denial of JJFN's application was not in accordance with NASD rules. Specifically, the Company claims that the NASD exceeded its authority and "abused its discretion" in denying JJFN's application for inclusion of its securities in Nasdaq on the basis of Miller's felony tax fraud conviction. The NASD's authority to deny an application for inclusion, however, is necessarily broad, and, in our view, the NASD properly exercised its investor protection responsibilities in denying JJFN's application. [8] As we have stated previously, investors are entitled to assume that the securities in the system meet the system's standards, [9] and that "the risk associated with investing in Nasdaq is market risk rather than the risk that the promoter or other persons exercising substantial influence over the issuer is acting in an illegal manner." [10]

***4** JJFN also asserts that the NASD's denial of JJFN's application constitutes the "de facto promulgation" of a new rule barring absolutely the inclusion in Nasdaq of issuers that have control persons or key personnel who have been convicted of a felony. We disagree. "The inclusion of a security for trading in Nasdaq . . . should not depend solely on meeting quantitative criteria, but should also entail an element of judgment given the expectations of investors and the imprimatur of listing on a particular market." [11] The denial at issue here is a reasoned decision made on consideration of all of the facts and circumstances presented, and does not reflect a blanket rule.

C. JJFN does not contend that the rules pursuant to which the NASD denied its application for inclusion are inconsistent with the purposes of the Exchange Act, nor is there support in this record for such a proposition. [12] Rather, JJFN appears to claim that the NASD did not apply its rules in a manner consistent with the Exchange Act.

JJFN asserts that the NASD's denial of JJFN's application is arbitrary because it is allegedly inconsistent with prior NASD listing decisions. JJFN also asserts that NASD has approved other applications for inclusion in Nasdaq subject to the creation of a voting trust similar to that offered by Miller for the JJFN shares that he and his family hold. Each

application for inclusion in Nasdaq, however, must be considered in light of all of the facts and circumstances presented, and should not be determined by comparison with the actions taken in other proceedings. [13]

JJFN also claims that the Nasdaq staff, in its review of the application, expressed concern with JJFN's debt-to-equity ratio and impliedly promised that, should Miller and certain of his family convert $1.75 million in loans to the Company into common stock, JJFN's application would be approved. JJFN states that Miller and his family converted the debt to common stock in reliance on this statement by the staff, and assertedly were injured when the NASD failed to list the stock. The record, however, does not support that the Nasdaq staff made such representations to JJFN. Moreover, our authority to order the NASD to include an issuer's securities is governed by Exchange Act Section 19(f), not by a theory of promissory estoppel or quasi-contract. [14] Lastly, the actions or representations of the Nasdaq staff with respect to JJFN's application do not bind the NASD and cannot be the basis for requiring the inclusion of JJFN's securities on Nasdaq. [15]

D. Finally, we do not find that the NASD's denial imposes an unnecessary or inappropriate burden on competition. This argument is not advanced by JJFN, and the record does not support such a finding. [16]

IV.

We find that a factual basis exists to deny JJFN's application for inclusion of its securities in the Nasdaq SmallCap Market; that the NASD acted with respect to JJFN in accordance with its rules; that the NASD's rules are, and were applied in a manner, consistent with the purposes of the securities laws; and we do not find that the NASD's denial of JJFN's application for inclusion imposes an unnecessary or inappropriate burden on competition. Accordingly, this review proceeding shall be dismissed.

*5 An appropriate order will issue. [17]

By the Commission (Chairman LEVITT, Commissioners JOHNSON, HUNT, CAREY, and UNGER)
Jonathan G. Katz
Secretary

*6 SECURITIES EXCHANGE ACT OF 1934

Rel. No. 39343 / November 21, 1997

Admin. Proc. File No. 3-9229

In the Matter of the Application of JJFN Services, Inc.

100 Quentin Roosevelt Boulevard

Suite 202

Garden City, New York 11530

For Review of Action Taken by the NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

ORDER DISMISSING REVIEW PROCEEDING

On the basis of the Commission's opinion issued this day, it is

ORDERED that the application for review filed by JJFN Services, Inc. be, and it hereby is, dismissed.

By the Commission.

Jonathan G. Katz

Secretary

Footnotes

1 The NASD invoked its authority under NASD Marketplace Rules 4300 and 4330. Rule 4300 provides that, with respect to initial inclusion in the Nasdaq SmallCap Market, the NASD

[M]ay deny initial inclusion [in the Nasdaq Smallcap Market] or apply additional or more stringent criteria for the initial . . . inclusion of particular securities . . . based on any event, condition, or circumstance which exists or occurs that makes initial . . . inclusion of the securities in Nasdaq inadvisable or unwarranted in the opinion of [the NASD], even though the securities meet all enumerated criteria for initial . . . inclusion in [the Nasdaq Smallcap Market].

Rule 4330 provides in turn that the NASD may "deny inclusion or apply additional or more stringent criteria for the initial . . . inclusion of particular securities" if the NASD "deems it necessary to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, or to protect investors and the public interest."

2 Miller pleaded guilty to violations of 26 U.S.C. § 7206(1) ("Fraud and false statements -- Declaration under penalty of perjury"), 26 U.S.C. § 7206(2) ("Fraud and false statements -- Aid or assistance"), and 18 U.S.C. § 371 ("Conspiracy to commit offense [against] or to defraud the United States").

3 Miller also was assessed and has paid costs of $50 for each of the three felony counts.

4 It appears from the record that Miller owns personally 1.46 million shares (about nine percent of JJFN's issued stock), but controls with members of his family nearly 9.7 million additional shares.

5 Section 19(f) of the Exchange Act, 15 U.S.C. § 78s(f).

6 JJFN also asserts that Miller's conviction is not relevant because it is "remote in time." While the conduct on which the conviction was based occurred more than ten years ago, Miller admitted to a pattern of conduct violative of the tax laws that persisted for three years. In addition, the conviction itself and Miller's resulting prison term are relatively recent.

The Company further argues that Miller's conviction must be viewed in light of his entire career, which "has been unmarked by any escutcheon except his tax conviction." Contrary to this assertion, however, this Commission twice has brought enforcement actions against Miller or entities with which he is associated. In 1970, we ordered the temporary suspension of trading in a company of which Miller was the chief financial officer out of concern that information that the company had filed with us about its financial condition might not be accurate. Exchange Act Rel. No. 8944 (July 28, 1970). 1970 WL 9786 (S.E.C.). In 1973, we obtained a permanent injunction by consent against Miller and a company of which he was the president. The district court's order required the filing with us of, among other reports, three years of delinquent Forms 10-K and enjoined future violations of Exchange Act § 13(a) and the rules and regulations thereunder. S.E.C. v. Met Sports Centers, Inc., and David Miller, Civil Action No. 192-73 (D.D.C. Apr. 24, 1973) (order entering final judgment of permanent injunction). Neither action is a stated basis for the NASD's decision to deny JJFN a Nasdaq listing, and, accordingly, we have not considered these prior actions in our decision here, except in evaluating the Company's contention described above.

7 As the Company's general counsel testified before the Qualifications Panel, "[Miller] is a designer. He invented the program, he structured it. He puts the right people in place, he gets people who are loyal and productive to do what needs to be done, and then he designs the next product." The Company's president and CEO testified that "[w]hat [Miller] brings to the Company is not only a huge contact base in the financial community, but he can structure complex financial transactions that I've never had any exposure to."

8 See supra n.1 (discussing the NASD's authority to deny an application for inclusion in Nasdaq). It is important that the NASD have this broad authority, given that "[s]ecurities listed for trading or included in Nasdaq often qualify for margin loans and are exempt from many of the state blue sky laws" and from our Penny Stock Sales Practice and Disclosure Rules

(Rules 3a51-1, 15g-1 to 15g-6, 15g-8 and 15g-9 under the Exchange Act). Exchange Act Rel. No. 34151 (June 3, 1994), 56 SEC Docket 2654, 2656-57.

9 Tassaway, Inc., 45 S.E.C. 706, 709 (1975).

10 Exchange Act Rel. No. 34151, 56 SEC Docket at 2656.

11 Id.

12 This Commission approved the predecessor to NASD Marketplace Rule 4300, finding that the rule is "consistent with the requirements of the [Exchange Act] and the rules and regulations thereunder applicable to the NASD." Id.

13 DHB Capital Group, Inc., Exchange Act Rel. No. 37069 (April 5, 1996), 61 SEC Docket 2049, 2056. See also J.V. Ace & Co., Inc., and Joseph V. Ace, 50 S.E.C. 461, 467 (1990).
We have not reviewed the NASD decisions to which JJFN refers; our reference to them here does not indicate our endorsement or disapproval of those decisions.

14 See supra n.5 and accompanying text.

15 Cf. Peter T. Higgins, 51 S.E.C. 865, 868 n.10 (1993) (holding that erroneous advice from NASD staff does not alter respondent's obligation to pay arbitration award).

16 We also note that a public market already is made in JJFN shares -- the Company currently is listed on the NASD's OTC Bulletin Board.

17 All of the arguments advanced by the parties have been considered. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Release No. 39343 (S.E.C. Release No.), Release No. 34-39343, 65 S.E.C. Docket 2055, 1997 WL 722029

End of Document

Release No. 41285 (S.E.C. Release No.), Release No. 34-41285,
69 S.E.C. Docket 1250, 69 S.E.C. Docket 1253, 1999 WL 212709

Securities and Exchange Commission (S.E.C.)
Securities Exchange Act of 1934

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

IN THE MATTER OF THE APPLICATION OF JON G. SYMON J.G. SYMON & COMPANIES
101 West 11th Street, Suite 1200
Kansas City, Missouri 64105
FOR REVIEW OF ACTION TAKEN BY THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Administrative Proceeding File No. 3-9609
April 14, 1999
Appeal Filed: May 22, 1998
Last Brief Received: October 7, 1998

*1 APPEARANCES:
Jon G. Symon, pro se.
Alden S. Adkins and Gary L. Goldsholle, for NASD Regulation, Inc.

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION--REVIEW OF ASSOCIATION ACTION DENYING WAIVER OF EXAMINATION REQUIREMENTS

Registered securities association denied the request of a former registered securities principal, whose registrations as a general securities principal and a financial and operations principal had lapsed, to resume those licenses without requalifying by examination. Held, appeal proceedings dismissed.

I.

Jon G. Symon, a former registered representative with D. E. Frey & Company, Inc. ("D. E. Frey"), a member of the National Association of Securities Dealers, Inc. ("NASD"), seeks review of an April 1, 1998 ruling by the NASD's National Adjudicatory Council ("NAC"). The NASD denied Symon a waiver from the requirement in the NASD's Membership and Registration Rule 1021(c)[1] that he pass the appropriate qualification examinations for the principal capacities in which he sought to become associated. We base our findings on an independent review of the record.

II.

Symon is the president and owner of Braveheart, L.L.C. ("Braveheart"), a broker-dealer that applied for NASD membership in July 1997. In Braveheart's application, Symon proposed that he would act as Braveheart's general securities principal ("principal") and as a limited principal--financial and operations ("FINOP"). Although Symon had been previously registered both as a principal and a FINOP while associated with another member firm, CKS Securities, Inc., those registrations terminated in August 1994. Pursuant to NASD Membership and Registration Rule 1021(c), Symon had two years from the date of termination to reinstate his principal and FINOP registrations without being required to retake the Series 24 and 27 examinations. Symon was associated with D. E. Frey from November 1994 to July 1995. Frey applied to have Symon's registration as a general securities representative transferred, but did not seek to transfer his principal or FINOP registrations. During August

1996, the applicable two-year period for the reinstatement of Symon's registrations as a principal and FINOP expired without their reactivation. The NASD "terminated" Braveheart's application after determining that Symon lacked the registrations of a principal or FINOP and finding that Braveheart did not have any other qualified principals.

Absent a waiver, Symon could reinstate his principal and FINOP registrations only by re-taking the Series 24 and 27 license examinations. On September 25, 1997, Symon requested a waiver of re-examination pursuant to NASD Rule 1070(e),[2] contending that D. E. Frey failed to transfer his principal and FINOP registrations from his previous firm. Attached to his request was a letter from Kathryn Dominick, Co-Director of Compliance at D. E. Frey, stating:

> *2 It is now our understanding that Mr. Symon also held the Series 24 and 27 licenses at his prior firm and D. E. Frey & Company would have transferred all such licenses but for our inadvertence. Therefore, Mr. Symon should have had these licenses in effect while at D. E. Frey & Company. Therefore, we respectfully request that his Series 24 and 27 licenses be reinstated.

The NASD Regulation staff contacted Dominick requesting that the firm state whether Symon in fact had functioned as a principal and as a FINOP at D. E. Frey. Dominick declined to provide this representation, and on October 21, 1997, NASD Regulation staff issued Symon a letter denying his request for an examination waiver.[3]

In a second letter to Symon, dated November 13, 1997, the staff noted that Dominick's letter conflicted with the "registration documents" that Symon had executed indicating that his duties with D. E. Frey would require a registration only as a representative, not as a principal. The staff, however, offered to reconsider the matter if Symon could provide a letter from a D. E. Frey principal attesting that Symon was associated with the firm in a capacity requiring the principal and FINOP registrations. The staff also required that D. E. Frey specify Symon's principal duties at D. E. Frey and the period during which Symon performed those duties.

Symon refused to make any additional submissions in support of his waiver request. Instead, he contended that Dominick's letter made clear that D. E. Frey's inadvertence had prevented the transfer of his licenses, and that this contention provided a sufficient basis to grant the exemption. On November 18, 1997, Symon appealed the NASD Regulation staff's decision to the NAC.

In response to a new inquiry from the staff about Symon's duties at D. E. Frey, Dominick stated that "Mr. Symon was not assigned any supervisory functions during his affiliation with D. E. Frey & Company, Inc." Dominick also stated that Symon "was never responsible for the preparation of D. E. Frey & Company, Inc.'s financial records or financial reporting requirements."

Before the NAC, Dominick also submitted, among other things, a new account form submitted by Symon and signed by Symon's supervisor, commission processing forms also signed by Symon's supervisor, and organizational charts showing that Symon was a registered representative and did not hold a supervisory position. Symon provided no additional information to support his request for an examination waiver. Symon instead argued that Dominick's original letter demonstrated that the lapse in his registrations was caused by D. E. Frey's inadvertence and, thus, his waiver request should be granted.[4] Symon, however, stated: "that "D. E. Frey & Co., Inc. fully believed that [I] acted in the capacity of a General Principal, if not a FINOP."

Based upon its review of the record, the NAC denied Symon's request for an examination waiver. Symon now seeks review of the NAC's denial of his waiver request.

III.

*3 As a threshold matter, the NASD questions whether we have jurisdiction over the appeal. Our authority to review NASD actions is governed by the Securities Exchange Act of 1934.[5] Exchange Act Section 19(d)(1) authorizes Commission review of an action of a self-regulatory organization ("SRO"), including the NASD, that imposes a final disciplinary action on a person associated with a member; denies membership to any applicant; prohibits or limits access to services offered by the organization or any of its members to any person; or bars any person from associating with a member.[6]

Denial of Symon's request for a waiver of the Series 24 and 27 qualifying examinations is clearly not a final disciplinary action nor a prohibition or limitation of access to services.[7] The NASD did not find Symon engaged in any violation or impose a sanction, nor did the NASD deny him access to services.

We also reject Symon's argument that the denial of his waiver request constitutes a denial of Braveheart's membership. The denial of Symon's request for an examination waiver and the denial of membership to Braveheart occurred in two separate proceedings. Braveheart did not appeal from the denial of its membership. Moreover, although the NASD noted that Symon was not qualified to be a principal or a FINOP at Braveheart, the NASD ultimately terminated Braveheart's application because Braveheart could not demonstrate that any qualified principal or FINOP was associated with the firm.

We find, however, that the NASD's action constituted a bar against Symon from associating as a principal with any NASD member. In Frank R. Rubba, we reviewed the NASD's denial of an applicant's request for waiver from taking the registered representative examination and concluded that the NASD's action effectively barred Rubba from associating with any NASD member until he requalified for registration by taking the Series 7 examination.[8] We find here that the NASD's denial has effectively barred Symon from associating with any NASD member in a supervisory capacity until he satisfies the principal and FINOP examination requirements.

We do not find persuasive the NASD's argument that Symon is not barred because he can still associate with an NASD member as a registered representative. Allowing association in another capacity does not diminish the fact that Symon has been denied association as a FINOP or a principal. The language of Section 19(d)(1) is not limited to a bar in all capacities from association with a member.[9] Section 19(d)(1) requires as a predicate to our review that the self-regulatory organizations impose a bar from association. We believe that this language encompasses a bar from association in specific capacities. We, therefore, determine that we have the jurisdiction to review the NASD's denial of an examination waiver to Symon.[10]

IV.

Pursuant to Section 19(f) of the Exchange Act, we review the NASD's action to determine whether: 1) the specific grounds on which the bar is based exist in fact; 2) the bar is in accordance with the rules of the NASD; and 3) the rules of the NASD are and were applied in a manner consistent with the purposes of the Act. If we do not make any of those findings, or if we find that the NASD's action imposes a burden on competition not necessary or appropriate in furtherance of the purposes of the Act, we must set aside the NASD's action and require the NASD to allow Symon to become associated.[11]

*4 NASD Membership and Registration Rule 1070(e) provides that the NASD may "in exceptional cases and where good cause is shown" waive the applicable examination requirements. The NASD has stated that it grants relief from the re-examination requirements to individuals where a firm, acting in good faith, has failed to file the appropriate application forms. The NASD considers this relief to be a correction of its records, rather than a waiver.

Symon again asserts to us that he qualifies for a waiver because D. E. Frey erroneously failed to transfer his registrations as a principal and FINOP when he was engaged in supervisory acts while at D. E. Frey that required him to hold those licenses. Symon continues to rely upon Dominick's initial letter requesting reinstatement of Symon's principal and FINOP registrations because the firm had inadvertently failed to request transfer of those registrations.

We find unpersuasive both Symon's assertions and the evidence upon which he relies. Under NASD Membership and Registration Rule 1021(a), a member firm is not permitted to maintain a principal registration for a person not functioning as a principal or where the sole purpose is to avoid examination requirements. While Dominick's initial letter stated that Symon's principal and FINOP registrations should have been transferred, D. E. Frey subsequently admitted to the NASD that Symon held no supervisory duties while he was associated with the firm. D. E. Frey, moreover, submitted records, including documents signed by Symon and employee organizational charts, demonstrating that Symon held no positions and performed no duties requiring those licenses. While Symon claims that D. E. Frey is not being candid about his duties, Symon never adduced evidence demonstrating his association with D. E. Frey in a capacity requiring principal and FINOP registrations.

Symon also contends that the NASD overlooked other evidence which, combined with D. E. Frey's alleged failures, entitled him to either a full or a conditional waiver. Symon points to his thirty-one years of experience in the securities industry, his unblemished disciplinary history, his responsibilities in the area of investment management, and his current age of 63 as other evidence of his qualification for registration as a principal and FINOP without examinations.

The NASD previously has stated that it grants two types of waivers. [12] The first type is an unconditional waiver where a registration category is granted without any further requirements. The NASD sometimes grants such waivers to individuals with substantial securities experience who have also qualified as Chartered Financial Analysts after completing a program focusing on the industry practice and regulation of research analysts and investment managers. The NASD will also occasionally grant unconditional waivers to persons with extensive experience in securities regulation with a state or federal agency or a self-regulatory organization or to major public figures whose registrations have been terminated for more than two years and who are returning to the private sector. [13]

*5 The NASD Regulation staff may consider certain factors in deciding whether an unconditional waiver should be granted. Those factors include: 1) length and quality of experience; 2) age and physical condition; 3) registration requested and type of business the person will engage in; 4) previous registration history; 5) absence of disciplinary actions; and 6) other qualification examinations that are suitable substitutes for the normal industry qualification requirements. [14] However, NASD Membership and Registration Rule 1070(e) makes clear that "[a]dvanced age, physical infirmity or experience in fields ancillary to the investment banking or securities business will not individually of themselves constitute sufficient grounds to waive a[n] ... [e]xamination." [15] The NASD rarely grants unconditional waivers.

The second type of waiver, which is more common, is a conditional waiver. A conditional waiver is based upon a person demonstrating substantial investment-related experience before becoming associated with a member firm. [16] Usually such persons were previously registered in the securities business but have been working for many years in securities-related fields without association with a broker-dealer. In many cases, these individuals are coming to a member firm in a management capacity. It is common for the NASD in such circumstances to waive the representative examination and require a principal examination. In cases where an individual with significant securities-related experience joins a member as a representative, the NASD may waive the representative examination but require the person to attend a continuing education session before the registration becomes effective. [17]

Symon's situation does not fall under any of the circumstances in which the NASD normally considers granting unconditional waivers. He is neither a Chartered Financial Analyst, nor an individual returning to the private sector after years of public service to the securities industry.

Symon further would not be aided by a conditional waiver. He is attempting to become associated with his company Braveheart in a management capacity. While he might be eligible for a conditional waiver that would exempt him from the requirement that he take the representative examination, he is not seeking such relief. Under the NASD's practice, he would still be required to take the principal examinations for which he seeks a waiver. [18]

V.

For the reasons discussed above, we find that the NASD's registration and waiver rules are and were applied by the NASD in a manner consistent with the purposes of the Act. We also do not believe that, by requiring Symon to comply with the examination requirements, the NASD has subjected him to an unfair competitive advantage. All other similarly situated applicants are required to take the applicable examinations before being issued licenses. [19] We note also that the NASD has substantially revised the majority of its rules. We believe that requiring Symon to take an examination on these new rules is fully consistent with the purposes of the Act and will ensure that he maintains the requisite levels of knowledge and competence.

*6 Accordingly, on the basis of the foregoing, we shall dismiss this appeal.

An appropriate order will issue. [20]

By the Commission
Jonathan G. Katz
Secretary

ORDER DISMISSING APPLICATION FOR REVIEW OF DENIAL OF WAIVER OF EXAMINATION BY REGISTERED SECURITIES ASSOCIATION

*7 On the basis of the Commission's opinion issued this day, it is

ORDERED that Jon G. Symon's petition for review of the denial by the National Association of Securities Dealers, Inc. of a waiver of the requirement that Symon of take the Series 24 and 27 registration examinations be, and it hereby is, dismissed.

By the Commission.
Jonathan G. Katz
Secretary

Footnotes

1 Rule 1021(c) provides that:
[a]ny person whose ... most recent registration as a principal has been terminated for a period of two or more years immediately preceding the date of receipt by the Association of a new application shall be required to pass [the applicable] Qualification Examination....
NASD Membership and Registration Rule 1021(c).

2 NASD Membership and Registration Rule 1070(e) states that:
the Association may, in exceptional cases and where good cause is shown, waive the applicable Qualification Examination and accept other standards as evidence of an applicant's qualifications for registration.

3 NASD Regulation staff inadvertently dated its decision May 29, 1997, well before Symon's request. After Symon brought the error to the staff's attention, the staff reissued its decision with the correct date, October 21, 1997. We conclude Symon was not prejudiced by this error.

4 Symon also attempted to rebut the NASD Regulation staff's assertion that he had not functioned as a principal since 1994 by asserting that he continued to operate as a FINOP and a Principal for Great Midwest Securities Corporation ("Great Midwest") until March 14, 1995. NASD Regulation staff determined that Symon's registration as a principal and FINOP at Great Midwest was never "completed." Symon does not claim on appeal that he had effective registrations at Great Midwest. Even if those registrations had been effective, they lapsed more than two years before his application to become Braveheart's principal and FINOP.

5 15 U.S.C. § 78a *et seq.* (1997).

6 15 U.S.C. § 78s(d)(1)(1997).

7 Frank R. Rubba, Securities Exchange Act Rel. No. 34-40238, 67 SEC Docket 1775, 1777 (July 21, 1998).

8 67 SEC Docket at 1777, citing Exchange Services, Inc., 48 S.E.C. 210. 214 (1985). In Exchange Services, Inc., we concluded that the NASD's denial of applicant's request for examination waivers on behalf of its order takers constituted an effective bar from associating with a member.

9 See 15 U.S.C. § 78s(d)(1)(1997).

10 We take no position on whether, as a general question, the determinations of self-regulatory organizations relating to requests for a waiver or an exemption from an NASD rule are reviewable.

11 15 U.S.C. § 78s(f)(1997).

12 See Memorandum dated April 10, 1997 from Frank J. McAuliffe, vice-president of NASD Regulation, Inc., to Debra Bollinger, Chairperson of North American Securities Administrators Association. The standards for such waivers are discussed above.

13 See id.

14 Id.

15 Id.

16 Id.

17 Id.

18 Id.

19 See Exchange Services, Inc., 48 S.E.C. at 214.

20 All of the contentions advanced by the parties have been considered. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Release No. 41285 (S.E.C. Release No.), Release No. 34-41285, 69 S.E.C. Docket 1250, 69 S.E.C. Docket 1253, 1999 WL 212709

End of Document

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 51236 / February 22, 2005

Admin. Proc. File No. 3-11437

In the Matter of the Application of

HARRY M. RICHARDSON
c/o Charles R. Mills, Esq.
Kirkpatrick & Lockhart LLP
1800 Massachusetts Avenue, N.W.
Suite 200
Washington, DC 20036-1221

For Review of Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DENIAL OF APPLICATION TO ASSOCIATE

Registered securities association denied member's application to permit employment of individual subject to a statutory disqualification. Held, review proceeding is remanded.

APPEARANCES:

Charles R. Mills, Kathryn A. Sellig, and *Jon A. Stanley*, of Kirkpatrick & Lockhart LLP, for Harry M. Richardson.

Marc Menchel, Alan B. Lawhead, Deborah F. McIlroy, Leavy Mathews III, and *Jennifer C. Brooks* for NASD.

Appeal filed: March 18, 2004
Last brief received: June 29, 2004

I.

Harry M. Richardson ("Richardson") appeals from a denial by NASD of a member firm's application to continue as a member with Richardson as an associated person. The application was necessary because Richardson is subject to two statutory disqualifications: an injunction and a bar order imposed by the Commission with a right to reapply after three years. We base our determinations on an independent review of the record.

II.

On March 4, 1999, Richardson settled a civil action filed against him by the Commission by consenting to the entry of an injunction against future violations of Section 17(a) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; Section 15B(c)(1) of the Securities Exchange Act of 1934,[1] and Municipal Securities Rulemaking Board ("MSRB") Rules G-17 and G-19.[2] Richardson also settled a related administrative proceeding without admitting or denying the Commission's allegations that he "in connection with two 'pool' municipal bond offerings made material misrepresentations and omissions pertaining to the size of the pools and the intended use of the bond proceeds, and advised the pools to purchase unsuitable securities."[3] The Commission

further alleged that Richardson "in connection with three land development municipal bond offerings made material misrepresentations and omissions pertaining to the value of the land, developer, and capitalization of the project."[4] Pursuant to the settlement, Richardson consented to being barred from association with any broker, dealer, investment adviser, investment company or municipal securities dealer, with a right to reapply for association after three years.[5]

In April 2003, more than three years after the entry of the Commission's bar order, Emmett A. Larkin Company, Inc. ("Emmett Larkin" or "the Firm"), applied to NASD to allow the Firm to continue in NASD membership with Richardson as an employee. After obtaining an agreement from Emmett Larkin for special supervisory conditions for Richardson, NASD's Department of Member Regulation recommended that the application be approved. After a hearing, NASD's National Adjudicatory Council ("NAC") in February 2004 denied the Firm's application. The NAC based its decision solely on the municipal bond misconduct underlying both Richardson's injunction and the Commission's bar order, finding that misconduct to be so serious that readmitting Richardson would not be in the public interest or consistent with investor protection.

The NASD decision acknowledged the tension between the denial and Commission precedent in *Paul Edward Van Dusen*.[6] NASD characterized the holding of *Van Dusen* as requiring, in cases where the Commission has settled an administrative proceeding involving the same misconduct that underlies a permanent injunction and has imposed a bar with the right to reapply after a specified time, that "NASD may not consider the underlying misconduct in a subsequent application by the barred person to re-enter the securities industry at the expiration of the limited bar." NASD decided to deny the Firm's application on the basis of the underlying misconduct, however, since it

> strongly believe[s] that this guidance in *Van Dusen* fails to take into account properly the separate analysis in which NASD is charged with engaging when an applicant seeks readmission. It conflates two separate processes - the one in which someone is barred from the industry and given the ability after a period of time to reapply, and the separate process by which NASD is charged with the duty to evaluate whether an applicant can be permitted to function in a particular registered capacity consistent with the public interest and investor protection.

This appeal followed.

III.

Our review of NASD's denial of the Firm's application is governed by standards set forth in Section 19(f) of the Exchange Act.[7] We must dismiss Richardson's appeal if we find that the specific grounds on which NASD based its action exist in fact, that the denial is in accordance with NASD rules, and that those rules were applied in a manner consistent with the purposes of .the Exchange Act, unless we determine that NASD's action imposes an unnecessary burden on competition.[8]

The grounds on which NASD based its decision, Richardson's statutory disqualifications resulting from the injunction and the Commission bar order, exist in fact.[9] Moreover, the record gives no indication that the proceeding was not in compliance with NASD rules.[10] Whether NASD's application of its rules in reviewing applications involving certain statutorily disqualified persons was consistent with the purposes of the Exchange Act can be determined by applying the principles set forth in *Van Dusen* and our subsequent decision in *Arthur H. Ross*.[11]

Underlying much of NASD's argument is its characterization of *Van Dusen* as setting forth a rigid "exclusionary rule" that precludes NASD from considering all relevant factors in reviewing applications like the one at issue here. To the contrary, *Van Dusen* and *Ross* encourage analysis that looks at all relevant factors, including, among others, misconduct in which a statutorily disqualified person may have engaged since the misconduct that gave rise to the statutory disqualification, the nature and disciplinary history of a prospective employer, and the proposed supervisory structure to which the statutorily disqualified person would be subject.[12]

Van Dusen and *Ross* do not preclude consideration of the misconduct that led to the statutory disqualification and the bar with a right to reapply.

Rather, these cases require that the misconduct be considered in an appropriate context and given appropriate weight. For example, the misconduct could be considered as forming a part of a pattern, or in evaluating how well the employer firm's proposed scheme of supervision was designed to prevent the type of conduct that had resulted in the bar order.[13] Quite simply, *Van Dusen* and *Ross* instruct that an SRO ordinarily may not deny reentry based solely on the underlying misconduct that led to the statutory disqualification and the conditional bar; something more is needed.[14]

Thus, *Van Dusen* and *Ross* recognize that the misconduct underlying a statutory disqualification may play a role in the consideration of an application like the one at issue here.[15] Requiring that NASD generally consider new information leaves ~~ample~~ room for NASD to consider a wide range of appropriate factors.[16] *Van Dusen* and *Ross* neither force nor preclude any particular outcome.[17]

Specifically, *Van Dusen* involved an NASD denial of association to a person subject to two statutory disqualifications, an injunction and a Commission bar from association with a broker-dealer in a supervisory capacity, with a right to apply after 18 months.[18] We set aside NASD's denial because it was premised on NASD's finding that the underlying misconduct that had led to *Van Dusen*'s statutory disqualification was sufficiently egregious that *Van Dusen*'s association would not be consistent with the public interest.[19] We determined that the denial of the application on that basis was inconsistent with the purposes of the Exchange Act and unfair. We were careful to make clear, however, that such applications should not be granted automatically simply because the passage of time had made application possible; instead, a variety of relevant factors should be considered.[20]

Ross involved a person subject to statutory disqualification based on a Commission order that barred him from associating in any proprietary or supervisory capacity, with the right to apply after three and one-half years.[21] NASD denied *Ross*'s application to perform supervisory functions and become a principal in the firm that employed him. Although the record contained new information that perhaps reflected adversely on *Ross*'s ability to function in his proposed employment in a manner consistent with the public interest, it appeared that "NASD also gave substantial weight to matters related to the Commission Order," and we could not determine the degree to which NASD's action was based upon the behavior that resulted in the bar order rather than the new information.[22] Because we could not conclude that NASD's decision was consistent with the purposes of the Exchange Act, we remanded the proceeding. We stated that "our expressed policy in cases of this type . . . requires that the NASD generally confine its analysis to new information," but explained that the misconduct that led to a statutory disqualification could play a legitimate role in that analysis in appropriate circumstances.[23]

NASD does not attempt to distinguish Richardson's case from *Van Dusen* and *Ross*. It argues, instead, that *Van Dusen* (and implicitly *Ross*) should be overturned. NASD argues that the Commission "committed two fundamental errors" in deciding *Van Dusen*. First, NASD argues, the Commission "misread the relevant statutory provision when it imported the requirement [found in Section 19(e)(2) of the Exchange Act, 15 U.S.C. § 78s(e)(2)] that sanctions in [self-regulatory organization or "SRO"] disciplinary actions should not be excessive into its review of the application of a statutorily disqualified individual [under Exchange Act Section 19(f), 15 U.S.C. § 78s(f)]." Second, it argues, the Commission "incorrectly relied on its 1975 policy regarding disqualified individuals who apply directly to the Commission for readmission into the securities industry" because NASD has never adopted such a policy and should be allowed to follow its own policy, "which includes analyzing the seriousness of the misconduct that relates to a permanent injunction."

NASD misreads *Van Dusen* by arguing that *Van Dusen* erroneously applies a standard applicable to our review of sanctions imposed in disciplinary proceedings to the review of denials of applications to continue NASD membership despite the employment of a statutorily disqualified person. In *Van Dusen*, we discussed the remedial purpose behind disciplinary actions, but we did so in the context of explaining that, in determining a sanction in a disciplinary action, we engage in an analysis that determines the public interest by weighing the alleged misconduct and the need to avoid visiting unnecessarily harsh consequences on wrongdoers.[24] The reference to

disciplinary actions does not suggest that the same analysis used in disciplinary actions should be used in considering applications to associate. To the contrary, the reference acknowledges that an analysis of public interest requirements based solely on the underlying misconduct has already been performed and that an application to associate after the time determined to be in the public interest has expired requires a different analysis.

NASD correctly states that the policy quoted by the Commission in *Van Dusen* -- "When hereafter the Commission specifies a date after which [an] application [for re-entry] may be made, the Commission upon a proper showing will generally act favorably upon the application" -- originally appeared in a release that dealt with applications for association that were directed to the Commission itself, not an SRO.[25] By relying on that policy in *Van Dusen*, however, we clearly indicated our view that it also was relevant in SRO consideration of applications to associate.[26] As explained above, *Ross* expanded on *Van Dusen* by suggesting ways in which consideration of the underlying misconduct might appropriately be part of an SRO's process.

NASD also argues that *Van Dusen* was incorrectly decided because it inappropriately articulated a substantive fairness requirement. NASD contends that the purposes of the Exchange Act do not encompass such a requirement, but only basic procedural guarantees.[27] We disagree. Congress clearly intended that the substantive fairness of NASD deliberations subject to the Commission's review; one of the goals of the 1975 Amendments was to strengthen the Commission's oversight of SROs.[28] The Commission has an obligation to ensure "that [self-regulatory power] is used effectively to fulfill the responsibilities assigned to the self-regulatory agencies, and that it is not used in a manner inimical to the public interest or unfair to private interests."[29] Among the Commission's responsibilities in reviewing SRO actions under Section 19(f) is to determine whether the rules of the SRO have been applied "in a discriminatory or unfair manner," i.e., whether the action is substantively fair.[30]

We also reject NASD's argument that *Van Dusen* and *Ross* are inconsistent with the anti-fraud purpose of the Exchange Act and with NASD's duty to protect investors from unreasonable risk by ensuring high ethical standards in the securities industry.[31] *Van Dusen* and *Ross* are not inconsistent with NASD's duty to critically scrutinize applications involving statutorily disqualified persons with a view to protecting investors. Rather, they articulate an analytic framework within which to consider such applications.

NASD's arguments ignore the impact that allowing the conduct underlying a statutory disqualification to provide the sole basis for denial of applications like the one at issue here would have on the Commission's own anti-fraud and investor protection efforts. If persons contemplating settlements with the Commission know that SROs, through denial of reentry applications, may, in effect, routinely extend those persons' bar from the securities industry beyond the period after which the settlement would allow them to reapply, based solely on the misconduct leading to the settlement, the incentive to settle would diminish markedly. Thus, allowing NASD to ignore *Van Dusen* and *Ross* would undermine our ability to settle cases in pursuance of our anti-fraud and investor protection goals.[32]

NASD argues that *Van Dusen* and *Ross*, in providing guidance on which factors NASD should examine in statutory disqualification hearings, allow disqualified individuals to craft their applications "to take advantage of *Van Dusen*." We believe it is entirely appropriate for statutorily disqualified persons to look to our decisions in *Van Dusen* and *Ross* and to understand that, before an application to associate will be approved, they will need to demonstrate, among other things, a clean disciplinary history subsequent to the statutorily disqualifying event, and that they would be well-advised to choose to associate with a firm with a good disciplinary record and an appropriate supervisory structure. Moreover, since *Van Dusen* and *Ross* do not purport to provide exhaustive lists of factors, applicants must still formulate their applications as their specific circumstances require.

IV.

We hold that *Van Dusen* and *Ross* remain the appropriate standards by which NASD should evaluate Richardson's application.[33] NASD did not conduct its evaluation of Richardson's application consistently with those precedents, instead focusing exclusively on the municipal bond misconduct

underlying the Commission bar order against Richardson. Therefore we are unable to determine whether the denial of Richardson's application is consistent with the purposes of the Exchange Act, and accordingly we remand for further consideration not inconsistent with this opinion.

An appropriate order will issue.[34]

By the Commission (Chairman DONALDSON and Commissioners GLASSMAN, GOLDSCHMID, ATKINS, and CAMPOS).

Jonathan G. Katz
Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 51236 / February 22, 2005

Admin. Proc. File No. 3-11437

In the Matter of the Application of

HARRY M. RICHARDSON
c/o Charles R. Mills, Esq.
Kirkpatrick & Lockhart LLP
1800 Massachusetts Avenue, N.W.
Suite 200
Washington, DC 20036-1221

For Review of Action Taken by

NASD

ORDER REMANDING APPEAL FROM REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the review proceeding of the application by Emmett A. Larkin Company, Inc. to employ Harry M. Richardson as a general securities representative is hereby remanded to NASD for further consideration.

By the Commission.

Jonathan G. Katz
Secretary

Endnotes

[1] 15 U.S.C. § 77q(a); 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5; 15 U.S.C. § 78o-4(c)(1).

[2] *SEC v. First Cal. Capital Mkts. Group, Inc.*, C 97-02761 CRB (N.D. Cal., Apr. 5, 1999). The settlement also required Richardson and his employer to disgorge $600,000, and Richardson to pay a $40,000 civil penalty.

[3] *H. Michael Richardson*, Securities Exchange Act Rel. No. 41448 (May 25, 1999), 69 SEC Docket 2622 (order instituting proceedings, making findings and imposing remedial sanctions).

[4] *Id.* The Commission also alleged that sale of the municipal bonds violated MSRB Rules G-17 and G-19. *Id.*

[5] *Id.*

[6] 47 S.E.C. 668 (1981).

[7] 15 U.S.C. § 78s(f).

[8] *Id.* Richardson does not claim, and the record does not support a finding, that NASD's action has imposed an unnecessary burden on competition.

[9] Richardson's argument that the events that were the basis for the bar order are "not a legally cognizable basis in fact to deny" his readmission, and therefore no grounds for the denial exist in fact, has no merit. The statutory disqualifications do exist in fact. Moreover, as discussed in more detail *infra*, Richardson's suggestion that the events underlying the injunction and bar order are "not legally cognizable" as a basis for denying his application overstates the breadth of our holding in *Van Dusen.*

[10] Although Richardson has not raised the issue, we note that the record does not indicate whether the Hearing Panel or the Statutory Disqualification Committee ever submitted written recommendations as required by NASD Procedural Rule 9524(a)(10), or whether they were considered by the NAC, as required by Rule 9524(b)(1). *See Reuben D. Peters*, Exchange Act Rel. No. 49819 (June 7, 2004), 82 SEC Docket 3959, 3966 n.15.

Richardson argues that, because NASD "intentionally act[ed] in derogation of . . . controlling Commission precedent," *i.e., Van Dusen*, its denial of the Firm's application "cannot be deemed to be in accordance with NASD rules." Richardson does not specifically identify any NASD rule that has been violated, and this argument therefore appears to be an assertion that the denial was not consistent with the purposes of the Exchange Act. *See infra*.

[11] *Arthur H. Ross*, 50 S.E.C. 1082 (1992). NASD made no reference to Ross in its decision denying the Firm's application.

[12] *Van Dusen*, 47 S.E.C. at 671-72 (identifying several factors for consideration, but stating that list represented "only some of the matters that must be carefully weighed and considered." *Id.* at 671. NASD's argument that Commission precedent prevents it from considering all relevant factors is ironic, given that in this case it based its decision on a single factor -- the misconduct underlying the statutory disqualification.

[13] *Ross*, 50 S.E.C. at 1085 n.10.

[14] As we emphasized in *Van Dusen*, our objective in imposing sanctions pursuant to Exchange Act Section 15 is to "'afford investors protection without visiting upon the wrongdoers adverse consequences not required in achieving the statutory objectives.'" 47 S.E.C. at 671 (quoting *Commonwealth Sec. Corp.*, 44 S.E.C. 100, 101-02 (1969)). In determining that Richardson should be subject to a bar with a right to apply for association in three years, we considered at that time how much protection the public interest requires, based on the nature and seriousness of the misconduct underlying the bar, and weighed the need for that protection against the importance of avoiding adverse consequences to Richardson that are not necessary to protect the public interest. *See H. Michael Richardson*, Exchange Act Rel. No. 41448 (May 25, 1999), 69 SEC Docket 2622, 2623-24 (noting Commission determination "that it is appropriate and in the public interest to accept Richardson's Offer of Settlement," which included the provision of a right to reapply in three years).

Where an initial public interest determination was made by an entity other than the Commission, different considerations may apply. *See Ross*, 50 S.E.C. at 1085 & n.13 (NYSE settlement not binding on NASD); *see also Stephen R. Flaks*, 46 S.E.C. 891, 894 n.6 (1977) (upholding NASD denial of application to associate, even though Commission had granted approval, because denial was based on independent ground of separate NASD bar, rather than on Commission bar).

[15] In rare circumstances, the underlying conduct that led to the statutory disqualification may be sufficiently egregious, in light of the environment at the time of the application to associate, to warrant denial of the application. That is not the case here, however.

[16] *See M.J. Coen*, 47 S.E.C. 558, 563-64 (1981) ("In cases of this sort, which are based on a prior statutory disqualification, Congress has granted the Association broad discretion."). *See also Halpert & Co.*, 50 S.E.C. 420, 422 (1990) ("Particularly in matters involving a firm's employment of persons subject to a statutory disqualification, it is appropriate to recognize the NASD's evaluation of appropriate business standards for its members."). Moreover, we note that NASD has broad discretion in imposing conditions on the employment relationship of a statutorily disqualified

person to the employing firm. *See, e.g. Scott E. Wiard*, Exchange Act Rel. No. 50393 (Sept. 16, 2004), 83 SEC Docket 2752, 2754.

[17] NASD cites *Robert B. Graham, Sr.*, 51 S.E.C. 449, 454 (1993) to support its argument that the Commission has no power to veto a decision by the NASD to disallow the association of a statutorily disqualified person. The Commission was evenly divided on the issues raised in *Graham*, so the language on which NASD relies does not represent the position of the Commission. 51 S.E.C. at 456. In any event, since *Ross* and *Van Dusen* do not dictate the outcome of NASD proceedings, they do not purport to create veto power in the Commission. We note, however, that, as discussed above, Section 19(f) contemplates that the Commission, under prescribed conditions, will set aside an NASD determination to deny access to a statutorily disqualified person.

[18] *Van Dusen*, 47 S.E.C. at 669.

[19] *Id.* at 670-71.

[20] *Id.* at 671-72.

[21] *Ross*, 50 S.E.C. at 1083.

[22] *Id.* at 1084-85.

[23] *Id.*

[24] 47 S.E.C. at 670-71.

[25] *Applications for Relief from Disqualification*, Exchange Act Rel. No. 11267 (Feb. 26, 1975), 6 SEC Docket 346, *quoted in Van Dusen*, 47 S.E.C. at 671.

[26] NASD contends that its by-laws, not the policy set forth in *Van Dusen*, provide the applicable standard for NASD review of applications that would allow the association of statutorily disqualified persons. Congress has made clear, however, that NASD's regulatory authority is subject to Commission oversight. *See* S. Rep. No. 94-75, 23 (cautioning against fallacious impression that industry and government fulfill same function in regulatory framework, enjoy same order of authority, or deserve same degree of deference and noting that SROs "exercise authority subject to SEC oversight" and "have no authority to regulate independently of the SEC's control"). To the extent that NASD by-laws might allow consideration of Richardson's underlying misconduct beyond that permitted under Commission precedent, Commission precedent controls. We note, however, that NASD has not specifically identified anything in its by-laws that is inconsistent with *Van Dusen* or *Ross*.

[27] In the alternative, NASD argues that any substantive fairness requirement was satisfied in Richardson's case because evidence of the misconduct that underlies the statutory disqualification is admissible under the Federal Rules of Evidence. *See* Fed. R. E. 403 (allowing exclusion of evidence if probative value is substantially outweighed by danger of unfair prejudice). NASD proceedings are not governed by the Federal Rules of Evidence. Moreover, *Van Dusen* and *Ross* do not preclude consideration of the underlying misconduct. They merely provide a context in which it may be considered.

[28] "In the new regulatory environment created by this bill, self-regulation would be continued, but the SEC would be expected to play a much larger role than it has in the past to ensure that there is no gap between self-regulatory performance and regulatory need." S. Rep. No. 94-75, 2.

[29] S. Rep. No. 94-75, 23.

[30] *Id.* at 132.

[31] *See United States v. O'Hagan*, 521 U.S. 642, 658 (1997) (primary objective of Exchange Act was "to insure honest securities markets and thereby promote investor confidence."); *Citadel Sec. Corp.*, Exchange Act Rel. No. 49666 (May 7, 2004), 82 SEC Docket 3249, 3255 ("[I]n order to ensure the protection of investors, NASD may demand a high level of integrity from securities professionals.").

[32] Although the decision to settle an administrative proceeding is a complex function of multiple factors, the right to reapply for association is often an important aspect of a settlement. Settlement terms should be administered in accordance with the fair expectations of the settling parties.

[33] On July 12, 2004, an order was issued, pursuant to delegated authority, denying a motion filed by NASD requesting oral argument in connection with this matter. Pursuant to Rule of Practice 430(a), NASD has requested our review of that order.

Rule of Practice 451 provides that we will consider appeals (other than those from initial decisions by a Commission hearing officer) on the basis of the papers filed by the parties without oral argument unless we determine that the presentation of facts and legal arguments in the briefs and record and the decisional process would be significantly aided by oral argument. NASD contends that oral argument is necessary because the important policy issues at stake warrant careful consideration that necessarily will be aided by oral argument.

We do not believe that NASD has shown that oral argument will significantly aid our decision-making process. The parties have thoroughly briefed the factual and legal issues in this proceeding, and their contentions are presented before us in a manner that have permitted us to fully evaluate and determine the matters at issue. Accordingly, the request of NASD for oral argument is denied.

[34] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

http://www.sec.gov/litigation/opinions/34-51236.htm

KeyCite Yellow Flag - Negative Treatment
Overruling Recognized by In re Drexel Burnham Lambert Group, Inc., Bankr.S.D.N.Y., December 14, 1990

83 S.Ct. 1246
Supreme Court of the United States

Harold J. SILVER, doing business as Municipal Securities Company, et al., Petitioners,
v.
NEW YORK STOCK EXCHANGE.

No. 150.
|
Argued Feb. 25 and 26, 1963.
|
Decided May 20, 1963.

Synopsis

Action by corporate broker-dealer in municipal bonds in over-the-counter market and by executrix of sole proprietor of another broker-dealer against the stock exchange for injunctive relief and treble damages for violation of Sherman Act arising from exchange's withdrawal of private wire connections between broker-dealers and exchange members. The United States District Court for the Southern District of New York, 196 F.Supp. 209, granted summary judgment adverse to exchange, and exchange appealed. The Court of Appeals, Second Circuit, 302 F.2d 714, reversed judgment, and broker-dealer and executrix brought error. The Supreme Court, Mr. Justice Goldberg, held that stock exchange violated Sherman Act and, therefore, was liable under Clayton Act for withdrawing the private wire connections without notice or opportunty for hearing.

Judgment reversed, and cause remanded with directions.

Mr. Justice Stewart and Mr. Justice Harlan dissented.

West Headnotes (22)

[1] **Antitrust and Trade Regulation**
Antitrust Law and Trade and Professional Associations

Removal of private wire connections between broker-dealer in over-the-counter security market and exchange members by collective action of exchange and its members will constitute a per se violation of Sherman Act in absence of other federal regulation. Sherman Anti-Trust Act, § 1, 15 U.S.C.A. § 1.

59 Cases that cite this headnote

[2] **Antitrust and Trade Regulation**
Antitrust Law and Trade and Professional Associations

Fact that consensus underlying collective action was arrived at when stock exchange members bound themselves to comply with exchange's directives upon being admitted to membership, rather than when specific issue of qualifications of broker-dealers in municipal bonds in over-the-counter market to have private wire connections with exchange members arose, did not diminish collective nature of action for purposes of determining whether Sherman Act had been violated. Sherman Anti-Trust Act, §§ 1, 2, 15 U.S.C.A. §§ 1, 2.

9 Cases that cite this headnote

[3] **Antitrust and Trade Regulation**
Antitrust Law and Trade and Professional Associations

Fact that valuable private wire connection service which connected broker-dealers in over-the-counter security market with stock exchange members, which was germane to broker-dealers' business, and which was important to their effective competition with others was withheld from them by collective action on part of stock exchange and its members was enough to create Sherman Act violation. Sherman Anti-Trust Act, §§ 1, 2, 15 U.S.C.A. §§ 1, 2.

46 Cases that cite this headnote

[4] **Exchanges**
Regulation by Exchanges of Members' Dealings with Nonmembers

Stock exchange's statutory duty of self-regulation includes regulation of exchange members' doing of business with nonmembers in over-the-counter market and, in particular, regulation of private wire connections between members and nonmembers. Securities Exchange Act of 1934, § 6(b, d), 15 U.S.C.A. § 78f(b, d).

2 Cases that cite this headnote

[5] **Antitrust and Trade Regulation**
Regulatory agencies; regulated industries
Exchanges
Statutory provisions
Exchanges
Regulation by Exchanges of Members' Dealings with Nonmembers

Scheme of antitrust laws and scheme of Securities Exchange Act of 1934 relating to stock exchange's duty of self-regulation of members doing business with nonmembers in over-the-counter market are to be reconciled with one another, rather than construed so that one scheme is completely ousted. Sherman Anti-Trust Act, §§ 1, 2, 15 U.S.C.A. §§ 1, 2; Clayton Act, §§ 4, 14, 15 U.S.C.A. §§ 15, 26; Securities Exchange Act of 1934, § 6(b, d), 15 U.S.C.A. § 78f(b, d).

49 Cases that cite this headnote

[6] **Statutes**
Implied Repeal

Repeals by implication are not favored.

23 Cases that cite this headnote

[7] **Antitrust and Trade Regulation**
Constitutional and Statutory Provisions

Implied repealer of anti-trust laws by Securities Exchange Act provision creating a duty of exchange self-regulation would exist only if necessary to make Securities Exchange Act work and then only to minimum extent necessary. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.; Sherman Anti-Trust Act, §§ 1, 2; 15 U.S.C.A. §§ 1, 2; Clayton Act, §§ 4, 14, 15 U.S.C.A. §§ 15, 26.

73 Cases that cite this headnote

[8] **Exchanges**
Constitution, by-laws, and rules

Securities Exchange Act provision giving Securities and Exchange Commission power to request exchanges to make changes in their rules gives Commission implied power to disapprove any rules adopted by an exchange but does not give Commission jurisdiction to review particular instances of enforcement of exchange rules. Sherman Anti-Trust Act, § 1, 15 U.S.C.A. § 1.

3 Cases that cite this headnote

[9] **Antitrust and Trade Regulation**
Conditions precedent
Antitrust and Trade Regulation
Injunction

Corporate broker-dealers in over-the-counter security market could resort directly to court without first seeking relief before Securities and Exchange Commission for alleged Sherman Act violation arising from exchange's withdrawal of private wire connections between broker-dealers and exchange members. Securities Exchange Act of 1934, §§ 6(a) (4), 19(d), 15 U.S.C.A. §§ 78f(a) (4), 78s(b).

6 Cases that cite this headnote

[10] **Antitrust and Trade Regulation**
Regulatory agencies; regulated industries
Exchanges
Regulation by Exchanges of Members' Dealings with Nonmembers

Question of antitrust exemption applicable to stock exchange's statutory duty of self-regulation does not involve any problem of conflict or co-

extensiveness of coverage with regulatory power of the Securities and Exchange Commission. Sherman Anti-Trust Act, §§ 1, 2, 15 U.S.C.A. §§ 1, 2; Clayton Act, §§ 4, 14, 15 U.S.C.A. §§ 15, 26; Securities Exchange Act of 1934, §§ 6(a) (4), 19(b), 15 U.S.C.A. §§ 78f(a) (4), 78s(b).

4 Cases that cite this headnote

[11] **Exchanges**
Proceedings

Some form of review of stock exchange self-policing under Securities Exchange Act is not incompatible with fulfillment of aims of Act, whether by administrative agency or by courts. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

3 Cases that cite this headnote

[12] **Antitrust and Trade Regulation**
Purpose of Antitrust Regulation

Antitrust and Trade Regulation
Investment

Antitrust laws serve, among other things, to protect competitive freedom, i.e., freedom of individual business units to compete unhindered by group action of others, and, therefore, antitrust laws are peculiarly appropriate as a check upon anticompetitive acts of stock exchanges which conflict with their duty to keep their operations and those of their members honest and viable. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.; Clayton Act, §§ 4, 14, 15 U.S.C.A. §§ 15, 26.

13 Cases that cite this headnote

[13] **Antitrust and Trade Regulation**
Regulatory agencies; regulated industries

Under aegis of rule of reason, traditional antitrust concepts are flexible enough to permit stock exchange sufficient breathing space within which to carry out mandate of Securities Exchange Act relating to exchange's self-regulation of exchange members. Securities Exchange Act of 1934, § 6(b, d), 15 U.S.C.A. § 78f(b, d).

11 Cases that cite this headnote

[14] **Antitrust and Trade Regulation**
Regulatory agencies; regulated industries

Statutory scheme of Securities Exchange Act of 1934 does not totally exempt from antitrust laws stock exchange's self-regulation of exchange members' business with nonmembers, but particular instances of exchange self-regulation which fall within scope and purposes of Securities Exchange Act may be regarded as justified in answer to assertion of an antitrust claim. Sherman Anti-Trust Act, §§ 1, 2, 15 U.S.C.A. §§ 1, 2; Clayton Act, §§ 4, 14, 15 U.S.C.A. §§ 15, 26; Securities Exchange Act of 1934, § 6(b, d), 15 U.S.C.A. § 78f(b, d).

23 Cases that cite this headnote

[15] **Antitrust and Trade Regulation**
Regulatory agencies; regulated industries

Stock exchange self-regulation is justified as an exemption from antitrust charges only to extent necessary to protect achievement of aims of Securities Exchange Act, and no justification can be offered for self-regulation conducted without provision for some method of telling protesting nonmember why an exchange rule is being invoked to harm him and of allowing him to reply in explanation of his position. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

36 Cases that cite this headnote

[16] **Antitrust and Trade Regulation**
Regulatory agencies; regulated industries

Securities Exchange Act of 1934 affords no justification for anti-competitive collective action taken by stock exchange members in regard to nonmembers without according fair

procedures. Sherman Anti-Trust Act, §§ 1, 2, 15 U.S.C.A. §§ 1, 2; Clayton Act, §§ 4, 14, 15 U.S.C.A. §§ 15, 26; Securities Exchange Act of 1934, § 6(b, d), 15 U.S.C.A. § 78f(b, d).

8 Cases that cite this headnote

[17] **Exchanges**
Proceedings

Congress in effecting a scheme of stock exchange self-regulation designed to insure fair dealing cannot be thought to have sanctioned and protected self-regulative activity which is carried out in a fundamentally unfair manner. Securities Exchange Act of 1934, § 6(b, d), 15 U.S.C.A. § 78f(b, d).

5 Cases that cite this headnote

[18] **Antitrust and Trade Regulation**
Regulatory agencies; regulated industries

Exchanges
Regulation by Exchanges of Members' Dealings with Nonmembers

Stock exchange exceeded scope of its authority under Securities Exchange Act to engage in self-regulation in withdrawing private wire connections between broker-dealers in municipal bonds in over-the-counter market and exchange members without affording broker-dealers notice and a hearing, and, therefore, act did not justify the withdrawal which otherwise constituted a Sherman Act violation. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.; Sherman Anti-Trust Act, §§ 1, 2, 15 U.S.C.A. §§ 1, 2.

23 Cases that cite this headnote

[19] **Alternative Dispute Resolution**
Relations Between Customer-Investors and Broker-Dealers

Antitrust and Trade Regulation
Regulatory agencies; regulated industries

Securities and Exchange Commission has power to direct stock exchange to adopt general rule providing for hearing and attendant procedures as to nonmembers of exchange, but any rule adopted would, to be consonant with antitrust laws, have to provide as a minimum the procedural safeguards which those laws made imperative. Securities Exchange Act of 1934, § 19(b), 15 U.S.C.A. § 78s(b); Sherman Anti-Trust Act, §§ 1, 2; 15 U.S.C.A. §§ 1, 2; Clayton Act, §§ 4, 14, 15 U.S.C.A. §§ 15, 26.

18 Cases that cite this headnote

[20] **Exchanges**
Proceedings

Congress in effecting scheme of self-regulation designed to insure fair dealing in regard to stock exchanges could not be thought to have sanctioned and protected an exchange self-regulative activity when carried out in a fundamentally unfair manner. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

4 Cases that cite this headnote

[21] **Antitrust and Trade Regulation**
Antitrust Law and Trade and Professional Associations

Stock exchange violated Sherman Act and, therefore, was liable under Clayton Act to corporate dealers in municipal bonds in over-the-counter market for having withdrawn broker-dealers' private wire connections between broker-dealers and exchange members without notice or opportunity for hearing. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.; Sherman Anti-Trust Act, § 1, 15 U.S.C.A. § 1; Clayton Act, §§ 4, 16, 15 U.S.C.A. §§ 15, 26.

1 Cases that cite this headnote

[22] **Associations**
Actions by or Against Associations

Private association's failure to afford procedural safeguards may result in imposition of damage liability without inquiry into whether association's action lacked substantive basis.

1 Cases that cite this headnote

Attorneys and Law Firms

**1249 *342 David I. Shapiro, Washington, D.C., for petitioners.

A. Donald MacKinnon, New York City, for respondent. Archibald Cox, Sol. Gen., for the United States, as amicus curiae, by special leave of Court.

Opinion

Mr. Justice GOLDBERG delivered the opinion of the Court.

We deal here today with the question, of great importance to the public and the financial community, of whether and to what extent the federal antitrust laws apply to securities exchanges regulated by the Securities Exchange Act of 1934. More particularly, the question *343 is whether the New York Stock Exchange is to be held liable to a nonmember broker-dealer under the antitrust laws or regarded as impliedly immune therefrom when, pursuant to rules the Exchange has adopted under the Securities Exchange Act of 1934, it orders a number of its members to remove private direct telephone wire connections previously in operation between their offices and those of the nonmember, without giving the nonmember notice, assigning him any reason for the action, or affording him an opportunity to be heard.

I.

The facts material to resolution of this question are not in dispute. Harold J. Silver, who died during the pendency of this action, entered the securities business in Dallas, Texas, in 1955, by establishing the predecessor of petitioner Municipal Securities (Municipal) to deal primarily in municipal bonds. The business of Municipal having increased steadily, Silver, in June 1958, established petitioner Municipal Securities, Inc. (Municipal, **1250 Inc.), to trade in corporate over-the-counter securities. Both firms are registered broker-dealers and members of the National Association of Securities Dealers, Inc. (NASD); neither is a member of the respondent Exchange.

Instantaneous communication with firms in the mainstream of the securities business is of great significance to a broker-dealer not a member of the Exchange, and Silver took steps to see that this was established for his firms. Municipal obtained direct private telephone wire connections with the municipal bond departments of a number of securities firms (three of which were members of the Exchange) and banks, and Municipal, Inc., arranged for private wires to the corporate securities trading departments of 10 member firms of the Exchange, as well as to the trading desks of a number of nonmember firms.

*344 Pursuant to the requirements of the Exchange's rules, all but one of the member firms which had granted private wires to Municipal, Inc., applied to the Exchange for approval of the connections. [1] During the summer of 1958 the Exchange granted 'temporary approval' for these, as well as for a direct teletype connection to a member firm in New York City and for stock ticker service to be furnished to petitioners directly from the floor of the Exchange.

On February 12, 1959, without prior notice to Silver, his firms, or anyone connected with them, the Exchange's Department of Member Firms decided to disapprove the private wire and related applications. Notice was sent to the member firms involved, instructing them to discontinue the wires, a directive with which compliance was required by the Exchange's Constitution and rules. These firms in turn notified Silver that the private wires would have to be discontinued, and the Exchange advised him directly of the discontinuance of the stock ticker service. The wires and ticker were all removed by the beginning of March. By telephone calls, letters, and a personal trip to New York, Silver sought an explanation from the Exchange of the reason for its decision, but was repeatedly told it was the policy of the Exchange not to disclose the reasons for such action. [2]

Petitioners contend that their volume of business dropped substantially thereafter and that their profits fell, due to a combination of forces all stemming from the *345 removal of the private wires—their consequent inability to obtain quotations quickly, the inconvenience to other traders in calling petitioners, and the stigma attaching to the disapproval. As a result of this change in fortunes, petitioners contend, Municipal, Inc., soon ceased functioning as an operating business organization, and Municipal has remained in business only on a greatly diminished scale.

The present litigation was commenced by Silver as proprietor of Municipal and by Municipal, Inc., against the Exchange in April 1959, in the Southern District of New York.[3] Three causes of action were asserted. The first, seeking an injunction and treble damages,[4] alleged that the Exchange had, in violation of **1251 ss 1 and 2 of the Sherman Act, conspired with its member firms to deprive petitioners of their private wire connections and stock ticker service. The second alleged that the Exchange had tortiously induced its member firms to breach their contracts for wire connections with petitioners, and the third asserted that the Exchange's action constituted a tort of intentional and wrongful harm inflicted without reasonable cause.

Petitioners moved for summary judgment on the antitrust claim, and for an accompanying permanent injunction against the Exchange's coercion of its members into refusing to provide private wire connections and against the Exchange's refusal to reinstate the stock ticker service. The district judge, after considering the respective affidavits of the parties, granted summary judgment and a permanent injunction as to the private wire connections, 196 F.Supp. 209, holding that the antitrust *346 laws applied to the Exchange, and that its directive and the ensuing compliance by its members constituted a collective refusal to continue the wires and was a per se violation of s 1 of the Sherman Act. The judge so held on the basis that, although the Exchange had the power to regulate the conduct of its members in dealing with listed securities, its members' relations with nonmembers with regard to over-the-counter securities were not sufficiently germane to the fulfillment of its duties of self-regulation under the Securities Exchange Act to warrant its being excused from having to answer for restraints of trade such as occurred here by removal of the private wires. He left the issues of treble damages and costs to a later trial. With reference to the stock ticker service, the judge held that there were triable issues of fact as to whether the Exchange's action could be considered to have been the concerted action of its members and as to whether, if the Exchange was to be regarded as having acted by itself, any violation of s 2 of the Sherman Act had occurred. He therefore denied summary judgment as to that aspect of petitioners' claims.

On the Exchange's appeal from the grant of partial summary judgment the United States Court of Appeals for the Second Circuit reversed over the dissent of one judge. 302 F.2d 714. The court held that the Securities Exchange Act 'gives the Commission and the Exchange disciplinary powers over members of the Exchange with respect to their transactions in over-the-counter securities, and that the policy of the statute requires that the Exchange exercise these powers fully.' Id., at 720. This meant that 'the action of the Exchange in bringing about the cancellation of the private wire connections * * * was within the general scope of the authority of the Exchange as defined by the 1934 Act,' id., at 716, and dictated a conclusion that '(t)he Exchange is exempt from the restrictions of the Sherman Act because it is exercising a *347 power which it is required to exercise by the Securities Exchange Act,' id., at 721. The court, however, did not exclude the possibility that the Exchange might be liable on some other theory, and remanded the case for consideration of petitioners' second and third causes of action.

This Court granted certiorari. 371 U.S. 808, 83 S.Ct. 26, 9 L.Ed.2d 53. What is before us is only so much of the first cause of action as relates to the collective refusal to continue the private wire connections, since petitioners did not attempt to appeal from the denial of summary judgment as to the portion relating to the discontinuance of the stock ticker service. Summary judgment was never sought as to the second and third causes of action, hence those are also not in issue at the present time.

II.

The fundamental issue confronting us is whether the Securities Exchange Act has created a duty of exchange self-regulation so pervasive as to constitute an **1252 implied repealer of our antitrust laws, thereby exempting the Exchange from liability in this and similar cases.

A.

[1] [2] [3] It is plain, to begin with, that removal of the wires by collective action of the Exchange and its members would, had it occurred in a context free from other federal regulation, constitute a per se violation of s 1 of the Sherman Act. The concerted action of the Exchange and its members here was, in simple terms, a group boycott depriving petitioners of a valuable business service which they needed in order to compete effectively as broker-dealers in the over-the-counter securities market. Fashion Originators' Guild of America v. Federal Trade Comm., 312 U.S. 457, 61 S.Ct. 703, 85 L.Ed. 949; Associated

Press v. United States, 326 U.S. 1, 65 S.Ct. 1416, 89 L.Ed. 2013;[fn] Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 79 S.Ct. 705, 3 L.Ed.2d 741;[fn] *348 Radiant Burners, Inc. v. Peoples Gas Light & Coke Co., 364 U.S. 656, 81 S.Ct. 365, 5 L.Ed.2d 358. Unlike listed securities, there is no central trading place for securities traded over the counter. The market is established by traders in the numerous firms all over the country through a process of constant communication to one another of the latest offers to buy and sell. The private wire connection, which allows communication to occur with a flip of a switch, is an essential part of this process. Without the instantaneously available market information provided by private wire connections, an over-the-counter dealer is hampered substantially in his crucial endeavor—to buy, whether it be for customers or on his own account, at the lowest quoted price and sell at the highest quoted price. Without membership in the network of simultaneous communication, the over-the-counter dealer loses a significant volume of trading with other members of the network which would come to him as a result of his easy accessibility. These important business advantages were taken away from petitioners by the group action of the Exchange and its members. Such 'concerted refusals by traders to deal with other traders * * * have long been held to be in the forbidden category,' [fn] Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S., at 212, 79 S.Ct., at 709 of restraints which 'because of their inherent nature or effect * * * injuriously restrained trade,' [fn] United States v. American Tobacco Co., 221 U.S. 106, 179, 31 S.Ct. 632, 55 L.Ed. 663.[5] Hence, absent any justification derived from the policy of another statute *349 or otherwise, the Exchange acted in violation of the Sherman Act. In this case, however, the presence of another statutory scheme, that of the Securities Exchange Act of 1934, means that such a conclusion is only the beginning, not the end, of inquiry.

B.

The difficult problem here arises from the need to reconcile pursuit of theantitrust **1253 aim of eliminating restraints on competition with the effective operation of a public policy contemplating that securities exchanges will engage in self-regulation which may well have anti-competitive effects in general and in specific applications.

The need for statutory regulation of securities exchanges and the nature of the duty of self-regulation imposed by the Securities Exchange Act are properly understood in the context of a consideration of both the economic role played by exchanges and the historical setting of the Act. Stock exchanges perform an important function in the economic life of this country. They serve, first of all, as an indispensable mechanism through which corporate securities can be bought and sold. To corporate enterprise such a market mechanism is a fundamental element in facilitating the successful marshaling of large aggregations of funds that would otherwise be extremely difficult of access. To the public the exchanges are an investment channel which promises ready convertibility of stock holdings into cash. The importance *350 of these functions in dollar terms is vast—in 1962 the New York Stock Exchange, by far the largest of the 14 exchanges which are registered with the Securities and Exchange Commission, had $47.4 billion of transactions in stocks, rights, and warrants (a figure which represented 86% of the total dollar volume on registered exchanges). Report of the Special Study of Securities Markets (1963), c. IB, p. 6.[6] Moreover, because trading on the exchanges, in addition to establishing the price level of listed securities, affects securities prices in general, and because such transactions are often regarded as an indicator of our national economic health, the significance of the exchanges in our economy cannot be measured only in terms of the dollar volume of trading. Recognition of the importance of the exchanges' role led the House Committee on Interstate and Foreign Commerce to declare in its report preceding the enactment of the Securities Exchange Act of 1934 that 'The great exchanges of this country upon which millions of dollars of securities are sold are affected with a public interest in the same degree as any other great utility.' H.R.Rep. No. 1383, 73d Cong., 2d Sess. 15 (1934).

The exchanges are by their nature bodies with a limited number of members, each of which plays a certain role in the carrying out of an exchange's activities. The limited-entry feature of exchanges led historically to their being *351 treated by the courts as private clubs, Belton v. Hatch, 109 N.Y. 593, 17 N.E. 225 (1888), and to their being given great latitude by the courts in disciplining errant members, see Westwood and Howard, Self-Government in the Securities Business, 17 Law and Contemp. Prob. 518—525 (1952). As exchanges became a more and more important element in our Nation's economic and financial system, however, the private-club analogy became increasingly inapposite and the ungoverned self-regulation became more and more obviously

inadequate, with acceleratingly grave consequences. This impotency ultimately led to the enactment of the 1934 Act. The House **1254 Committee Report summed up the long-developing problem in discussing the general purposes of the bill:

'The fundamental fact behind the necessity for this bill is that the leaders of private business, whether because of inertia, pressure of vested interests, lack of organization, or otherwise, have not since the war been able to act to protect themselves by compelling a continuous and orderly program of change in methods and standards of doing business to match the degree to which the economic system has itself been constantly changing * * *. The repetition in the summer of 1933 of the blindness and abuses of 1929 has convinced a patient public that enlightened self-interest in private leadership is not sufficiently powerful to effect the necessary changes alone—that private leadership seeking to make changes must be given Government help and protection.' H.R.Rep. No. 1383, supra, at 3.

It was, therefore, the combination of the enormous growth in the power and impact of exchanges in our economy, and their inability and unwillingness to curb abuses which had increasingly grave implications because of this growth, that moved Congress to enact the Securities Exchange Act *352 of 1934. S.Rep. No. 792, 73d Cong., 2d Sess. 2—5 (1934); H.R.Rep. No. 1383, supra, at 2—5.

The pattern of governmental entry, however, was by no means one of total displacement of the exchanges' traditional process of self-regulation. The intention was rather, as Mr. Justice Douglas said, while Chairman of the S.E.C., one of 'letting the exchanges take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used.' Douglas, Democracy and Finance (Allen ed. 1940), 82. Thus the Senate Committee Report stressed that 'the initiative and responsibility for promulgating regulations pertaining to the administration of their ordinary affairs remain with the exchanges themselves. It is only where they fail adequately to provide protection to investors that the Commission is authorized to step in and compel them to do so.' S.Rep. No. 792, supra, at 13. The House Committee Report added the hope that the bill would give the exchanges sufficient power to reform themselves without intervention by the Commission. H.R.Rep. No. 1383, supra, at 15. See also 2 Loss, Securities Regulation (2d ed. 1961), 1175—1178, 1180—1182.

Thus arose the federally mandated duty of self-policing by exchanges. Instead of giving the Commission the power to curb specific instances of abuse, the Act placed in the exchanges a duty to register with the Commission, s 5, 15 U.S.C. s 78e, and decreed that registration could not be granted unless the exchange submitted copies of its rules, s 6(a)(3), 15 U.S.C. s 78f(a)(3), and unless such rules were 'just and adequate to insure fair dealing and to protect investors,' s 6(d), 15 U.S.C. s 78f(d). The general dimensions of the duty of self-regulation are suggested by s 19(b) of the Act, 15 U.S.C. s 78s(b), which gives the Commission power to order changes in exchange *353 rules respecting a number of subjects, which are set forth in the margin.[7]

[4] One aspect of the statutorily imposed duty of self-regulation is the obligation **1255 to formulate rules governing the conduct of exchange members. The Act specifically requires that registration cannot be granted 'unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade * * *,' s 6(b), 15 U.S.C. s 78f(b). In addition, the general requirement of s 6(d) that an exchange's rules be 'just and adequate to insure fair dealing and to protect investors' has obvious relevance to the area of rules regulating the conduct of an exchange's members.

The s 6(b) and s 6(d) duties taken together have the broadest implications in relation to the present problem, for members inevitably trade on the over-the-counter market in addition to dealing in listed securities,[8] and *354 such trading inexorably brings contact and dealings with nonmember firms which deal in or specialize in over-the-counter securities. It is no accident that the Exchange's Constitution and rules are permeated with instances of regulation of members' relationships with nonmembers including nonmember broker-dealers.[9] A member's purchase of unlisted securities for itself or on behalf of its customer from a boiler-shop operation[10] creates an obvious *355 danger of loss to the principal in the transaction, and sale of securities to a nonmember insufficiently capitalized to **1256 protect customers' rights creates similar risks. In addition to the potential financial injury to the investing public and Exchange members that is inherent in these

transactions as well as in dealings with nonmembers who are unreliable for any other reason, all such intercourse carries with it the gravest danger of engendering in the public a loss of confidence in the Exchange and its members, a kind of damage which can significantly impair fulfillment of the Exchange's function in our economy. Rules which regulate Exchange members' doing of business with nonmembers in the over-the-counter market are therefore very much pertinent to the aims of self-regulation under the 1934 Act. Transactions with nonmembers under the circumstances mentioned can only be described as 'inconsistent with just and equitable principles of trade,' and rules regulating such dealing are indeed 'just and adequate to insure fair dealing and to protect investors.'

The Exchange's constitutional provision and rules relating to private wire connections [11] are unquestionably part *356 of this fulfillment of the s 6(b) and s 6(d) duties, for such wires between members and nonmembers facilitate trading in and exchange of information about unlisted securities, and such contact with an unreliable nonmember not only may further his business undesirably, but may injure the member or the member's customer on whose behalf the contract is made and ultimately imperil the future status of the Exchange by sapping public confidence. In light of the important role of exchanges in our economy and the 1934 Act's design of giving the exchanges a major part in curbing abuses by obligating them to regulate themselves, it appears conclusively—contrary to the District Court's conclusion—that the rules applied in the present case are germane to performance of the duty, implied by s 6(b) and s 6(d), to have rules governing members' transactions and relationships with nonmembers. The Exchange's enforcement of such rules inevitably affects the nonmember involved, often (as here) far more seriously than it affects the members in question. The sweeping of the nonmembers into the **1257 currents of the Exchange's process of self-regulation is therefore unavoidable; the case cannot be disposed of by holding as the *357 district judge did that the substantive act of regulation engaged in here was outside the boundaries of the public policy established by the Securities Exchange Act of 1934.

C.

[5] But, it does not follow that the case can be disposed of, as the Court of Appeals did, by holding that since the Exchange has a general power to adopt rules governing its members' relations with nonmembers, particular applications of such rules are therefore outside the purview of the antitrust laws. Contrary to the conclusions reached by the courts below, the proper approach to this case, in our view, is an analysis which reconciles the operation of both statutory schemes with one another rather than holding one completely ousted.

[6] [7] The Securities Exchange Act contains no express exemption from the antitrust laws or, for that matter, from any other statute. This means that any repealer of the antitrust laws must be discerned as a matter of implication, and '(i)t is a cardinal principle of construction that repeals by implication are not favored.' United States v. Borden Co., 308 U.S. 188, 198, 60 S.Ct. 182, 188, 84 L.Ed. 181; see Georgia v. Pennsylvania R. Co., 324 U.S. 439, 456—457, 65 S.Ct. 716, 725—726, 89 L.Ed. 1051; California v. Federal Power Comm., 369 U.S. 482, 485, 82 S.Ct. 901, 903, 8 L.Ed.2d 54. Repeal is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary. This is the guiding principle to reconciliation of the two statutory schemes.

[8] [9] [10] Although the Act gives to the Securities and Exchange Commission the power to request exchanges to make changes in their rules, s 19(b), 15 U.S.C. s 78s(b), and impliedly, therefore, to disapprove any rules adopted by an exchange, see also s 6(a)(4), 15 U.S.C. s 78f(a)(4), it does not give the Commission jurisdiction to review particular instances of enforcement of exchange rules. See 2 Loss, op. cit., supra, at 1178; Westwood and *358 Howard, supra, 17 Law & Contemp. Prob., at 525. This aspect of the statute, for one thing, obviates any need to consider whether petitioners were required to resort to the Commission for relief before coming into court. Compare Georgia v. Pennsylvania R. Co., 324 U.S., at 455, 65 S.Ct. at 725. Moreover, the Commission's lack of jurisdiction over particular applications of exchange rules means that the question of antitrust exemption does not involve any problem of conflict or coextensiveness of coverage with the agency's regulatory power. See Georgia v. Pennsylvania R. Co., supra; United States v. Radio Corp. of America, 358 U.S. 334, 79 S.Ct. 457, 3 L.Ed.2d 354; California v. Federal Power Comm., supra; Pan American World Airways, Inc. v. United States, 371 U.S. 296, 83 S.Ct. 476, 9 L.Ed.2d 325. [12] The issue is only that of the extent to which the character and objectives of the duty of exchange self-regulation contemplated by the Securities Exchange Act

are incompatible with the maintenance of an antitrust action. Compare [12] Maryland & Virginia Milk Producers Ass'n v. United States, 362 U.S. 458, 80 S.Ct. 847, 4 L.Ed.2d 880.

**1258 [11] [12] The absence of Commission jurisdiction, besides defining the limits of the inquiry, contributes to its solution. There is nothing built into the regulatory scheme which performs the antitrust function of insuring that an exchange will not in some cases apply its rules so as to do injury to competition which cannot be justified as furthering legitimate self-regulative ends. By providing *359 no agency check on exchange behavior in particular cases, Congress left the regulatory scheme subject to 'the influences of * * * (improper collective action) over which the Commission has no authority but which if proven to exist can only hinder the Commission in the tasks with which it is confronted,' [13] Georgia v. Pennsylvania R. Co., 324 U.S., at 460, 65 S.Ct. at 727; See United States v. Borden Co., 308 U.S., at 200, 60 S.Ct. at 189; [14] Maryland & Virginia Milk Producers Ass'n v. United States, 362 U.S., at 465—466, 80 S.Ct. at 852—853. Enforcement of exchange rules, particularly those of the New York Stock Exchange with its immense economic power, may well, in given cases, result in competitive injury to an issuer, a nonmember broker-dealer, or another when the imposition of such injury is not within the scope of the great purposes of the Securities Exchange Act. Such unjustified self-regulatory activity can only diminish public respect for and confidence in the integrity and efficacy of the exchange mechanism. Some form of review of exchange self-policing, whether by administrative agency or by the courts, is therefore not at all incompatible with the fulfillment of the aims of the Securities Exchange Act. Only this year S. E. C. Chairman Cary observed that 'some government oversight is warranted, indeed necessary, to insure that action in the name of self-regulation is neither discriminatory nor capricious.' Cary, Self-Regulation in the Securities Industry, 49 A.B.A.J. 244, 246 (1963). [13] Since the antitrust laws serve, among other things, to protect competitive freedom, i.e., the freedom of individual business units to compete unhindered by the *360 group action of others, it follows that the antitrust laws are peculiarly appropriate as a check upon anticompetitive acts of exchanges which conflict with their duty to keep their operations and those of their members honest and viable. Applicability of the antitrust laws, therefore, rests on the need for vindication of their positive aim of insuring competitive freedom. Denial of their applicability would defeat the congressional policy reflected in the antitrust laws without serving the policy of the Securities Exchange Act. Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented. See note 12, supra.

[13] [14] Yet it is only frank to acknowledge that the absence of power in the Commission to review particular exchange exercises of self-regulation does create problems for the Exchange. The entire public policy of self-regulation, beginning with the idea that the Exchange may set up barriers to membership, contemplates that the Exchange will engage in restraints of trade which might well be unreasonable absent sanction by the Securities Exchange Act. Without the oversight of the Commission to elaborate from time to time on the propriety of various acts of self-regulation, the Exchange is left without guidance and without warning as to what regulative action would be viewed as excessive by an antitrust court possessing power to proceed **1259 based upon the considerations enumerated in the preceding paragraphs. But, under the aegis of the rule of reason, traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act. See [15] United States v. Terminal R. Ass'n of St. Louis, 224 U.S. 383, 394—395, 32 S.Ct. 507, 509—510, 56 L.Ed. 810; [16] Board of Trade of City of Chicago v. United States, 246 U.S. 231, 238, 38 S.Ct. 242, 243, 62 L.Ed. 683. Although, as we have seen, the statutory scheme of that Act is not sufficiently pervasive to create a total exemption *361 from the antitrust laws, compare Hale and Hale, Competition or Control VI: Application of Antitrust Laws to Regulated Industries, 111 U. of Pa.L.Rev. 46, 48, 57—59 (1962), it is also true that particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust Claim.

III.

The final question here is, therefore, whether the act of self-regulation in this case was so justified. The answer to that question is that it was not, because the collective refusal to continue the private wires occurred under totally unjustifiable circumstances. Notwithstanding their prompt and repeated requests, petitioners were not informed of the charges underlying the decision to invoke the Exchange rules

and were not afforded an appropriate opportunity to explain or refute the charges against them.

[15] Given the principle that exchange self-regulation is to be regarded as justified in response to antitrust charges only to the extent necessary to protect the achievement of the aims of the Securities Exchange Act, it is clear that no justification can be offered for self-regulation conducted without provision for some method of telling a protesting non-member why a rule is being invoked so as to harm him and allowing him to reply in explanation of his position. No policy reflected in the Securities Exchange Act is, to begin with, served by denial of notice and an opportunity for hearing. Indeed, the aims of the statutory scheme of self-policing—to protect investors and promote fair dealing —are defeated when an exchange exercises its tremendous economic power without explaining its basis for acting, for the absence of an obligation to give some form of notice and, if timely requested, a hearing creates a great danger of perpetration of injury that will damage public confidence in the exchanges. The requirement *362 of such a hearing will, by contrast, help in effectuating antitrust policies by discouraging anticompetitive applications of exchange rules which are not justifiable as within the scope of the purposes of the Securities Exchange Act. In addition to the general impetus to refrain from making unsupportable accusations that is present when it is required that the basis of charges be laid bare, the explanation or rebuttal offered by the nonmember will in many instances dissipate the force of the ex parte information upon which an exchange proposes to act. The duty to explain and afford an opportunity to answer will, therefore, be of extremely beneficial effect in keeping exchange action from straying into areas wholly foreign to the purposes of the Securities Exchange Act. And, given the possibility of antitrust liability for anti-competitive acts of self-regulation which fall too far outside the scope of the Exchange Act, the utilization of a notice and hearing procedure with its inherent check upon unauthorized exchange action will diminish rather than enlarge the likelihood that such liability will be incurred and hence will not interfere with the Exchange's ability to engage efficaciously in legitimate substantive self-regulation.[14] Provision of such a hearing will, **1260 moreover, contribute *363 to the effective functioning of the antitrust court, which would be severely impeded in providing the review of exchange action which we deem essential if the exchange could obscure rather than illuminate the circumstances under which it has acted. Hence the affording of procedural safeguards not only will substantively encourage the lessening of anticompetitive behavior outlawed by the Sherman Act but will allow the antitrust court to perform its function effectively.[15]

*364 [16] [17] [18] [19] [20] [21] [22] Our decision today recognizes that the action here taken by the Exchange would clearly be in violation of the Sherman Act unless justified by reference to the purposes of the Securities Exchange Act, and holds that that statute affords no justification for anti-competitive collective action taken without according fair procedures.[16] Congress in effecting a scheme of self-regulation designed to insure fair dealing cannot be thought to have sanctioned and protected self-regulative activity when **1261 carried out in a fundamentally unfair manner.[17] The point is not that the antitrust laws impose the requirement of *365 notice and a hearing here, but rather that, in acting without according petitioners these safeguards in response to their request, the Exchange has plainly exceeded the scope of its authority under the Securities Exchange Act to engage in self-regulation and therefore has not even reached that threshold of justification under that statute for what would otherwise be an antitrust violation. Since it is perfectly clear that the Exchange can offer no justification under the Securities Exchange Act for its collective action in denying petitioners the private wire connections without notice and an opportunity for hearing, and that the Exchange has therefore violated s 1 of the Sherman Act, 15 U.S.C. s 1, and is thus liable to petitioners under ss 4 and 16 of the Clayton Act, 15 U.S.C. ss 15, 26, there is no occasion for us to pass upon the sufficiency of the reasons which the Exchange later assigned for its action.[18] Thus there is also no need for *366 us to define further whether the interposing **1262 of a substantive justification in an antitrust suit brought to challenge a particular enforcement of the rules on its merits is to be governed by a standard of arbitrariness, good faith, reasonableness, or some other measure. It will be time enough to deal with that problem if and when the occasion arises. Experience teaches, however, that the affording of procedural safeguards, which by their nature serve to illuminate the underlying facts, in itself often operates to prevent erroneous decisions on the merits from occurring. There is no reason to believe that the experience of the Exchange will be different from that of other institutions, both public and private. The benefits which a guarantee of procedural safeguards brings about are, moreover, of particular importance here. It requires but little appreciation of the extent of the Exchange's economic power and of what happened in this country during

the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail as to every aspect of the Exchange's activities. What is basically at issue here is whether the type of partnership between government and private enterprise that marks the design of the Securities Exchange Act of 1934 can operate effectively to insure the maintenance of such standards in the long run. *367 We have today provided not a brake upon the private partner executing the public policy of self-regulation but a balance wheel to insure that it can perform this necessary activity in a setting compatible with the objectives of both the antitrust laws and the Securities Exchange Act.

The judgment is reversed and remanded for further proceedings consistent with this opinion.

It is so ordered.

Judgment reversed and the case is remanded with directions.

Mr. Justice CLARK concurs in the result on the grounds stated in the opinion of the District Court, 196 F.Supp. 209, and the dissenting opinion in the Court of Appeals, 302 F.2d 714.

Mr. Justice STEWART, whom Mr. Justice HARLAN joins, dissenting.

The Court says that the fundamental question in this case is 'whether and to what extent the federal antitrust laws apply to securities exchanges regulated by the Securities Exchange Act of 1934.' I agree that this is the issue presented, but with all respect it seems to me that the answer which the Court has given is both unsatisfactory and incomplete.

The Court begins by pointing out, correctly, that removal of the petitioners' wire connections by collective action of the Exchange and its members would constitute a violation of the Sherman Act, had it occurred in an ordinary commercial context.[1] The Court then reviews at length the purpose, scope, and structure of the Securities Exchange Act and holds, again correctly I think, that the *368 substantive act of regulation engaged in here was inside 'the boundaries of the public policy' established by the Exchange Act. The Court next reminds us, correctly, that the Exchange Act contains no express exemption from the antitrust **1263 laws, and that a stock exchange or its members might in some cases 'apply its rules so as to do injury to competition which cannot be justified as furthering legitimate self-regulative ends.'

So far, so good. The Court has fairly and thoroughly stated the competing considerations bearing upon the basic problem involved in this case. But then—in the last five pages of the Court's opinion—the nature of the problem seems suddenly to change. The case becomes one involving due process concepts of notice, confrontation, and hearing.

It may be that a hearing should be accorded a member or nonmember of an exchange, injured by the invocation of an exchange rule, in all cases. On the other hand, in view of the sophisticated, subtle, and highly technical nature of the problem of what are 'just and equitable principles of trade,' or because of the fragile and mercurial ingredients of public confidence in the securities markets, there might be cases in which the public interest would demand that at least preliminary disciplinary action be taken with swift effectiveness. These broad policy questions were, quite properly, neither briefed nor argued in the present case. They are questions well within the power of Congress and of the Securities and Exchange Commission to canvass and to resolve.[2] But they *369 are questions, I respectfully submit, which have only the most tangential bearing upon the issues now before us.

The Court says that because of the failure to accord 'procedural safeguards' to the petitioners, the respondent Exchange is ipso facto liable to them under the antitrust laws. This means **1264 that a bucket-shop operator who had been engaged in swindling the public could collect treble damages from a stock exchange which had denied him *370 its wire connections without first according him notice and a hearing. For, as I understand the Court's opinion, the exchange would not be allowed to prove in this hypothetical antitrust case that the plaintiff was such a swindler, even though proof of that fact to an absolute certainty were available. This result seems to me completely to frustrate the purpose and policy of the Securities Exchange Act, and to bear no relevance to the purpose and policy of the antitrust laws. Even assuming that Congress agreed with the Court's notions of the appropriate procedures under the Exchange Act, I cannot believe that Congress would have provided an antitrust forum and private treble damage liability to enforce them.

Whether there has been a violation of the antitrust laws depends not at all upon whether or not the defendants' conduct was arbitrary. As this Court has said, 'the reasonableness of the methods pursued by the combination to accomplish

its unlawful object is no more material than would be the reasonableness of the prices fixed by unlawful combination.' Fashion Originators' Guild of America v. Federal Trade Comm., 312 U.S. 457, 468, 61 S.Ct. 703, 708, 85 L.Ed. 949.[3] Yet the Court today says that because the Exchange did not accord the petitioners what the Court considers 'fair procedures' under the Exchange Act, the Exchange has therefore violated s 1 of the Sherman Act.

I think the Court errs in using the antitrust laws to serve ends they were never intended to serve—to enforce the Court's concept of fair procedures under a totally unrelated statute. I should have thought that the aftermath of Duplex Printing Press Co. v. Deering[4] *371 would have provided a sufficient lesson as to the unwisdom of such a broad and basically irrelevant use of the antitrust laws.

The purpose of the self-regulation provisions of the Securities Exchange Act was to delegate governmental power to working institution which would undertake, at their own initiative, to enforce compliance with ethical as well as legal standards in a complex and changing industry. This self-initiating process of regulation can work effectively only if the process itself is allowed to operate free from a constant threat of antitrust penalties. To achieve this end, I believe it must be held that the Securities Exchange Act removes antitrust liability for any action taken in good faith to effectuate an exchange's statutory duty of self-regulation. The inquiry in each case should be whether the conduct complained of was for this purpose. If it was, that should be the end of the matter so far as the antitrust laws are concerned—unless, of course, some antitrust violation other than the mere concerted action of an exchange and its members is alleged.[5]

**1265 I would vacate the judgment of the Court of Appeals and remand the case to the District Court for further proceedings consistent with the views expressed in this dissenting opinion.

All Citations

373 U.S. 341, 83 S.Ct. 1246, 10 L.Ed.2d 389

Footnotes

1 Exchange approval was never sought for Municipal's private wires to the municipal bond departments of member firms.

2 Ultimately, during the pretrial stages of this litigation, the Exchange disclosed most of the reasons for its action, and these are summarized and discussed in the opinions of both the District Court, 196 F.Supp. 209, 216—217, 225—227, and the Court of Appeals, 302 F.2d 714, 716. In view, however, of the disposition we make of the case hereafter, there is no need to set forth these reasons in detail in this opinion.

3 Silver died while the case was pending in the Court of Appeals, and his widow, Evelyn B. Silver, as executrix of his estate, was substituted for him.

4 These forms of relief are provided by ss 4 and 16 of the Clayton Act, 15 U.S.C. ss 15, 26.

5 The fact that the consensus underlying the collective action was arrived at when the members bound themselves to comply with Exchange directives upon being admitted to membership rather than when the specific issue of Silver's qualifications arose does not diminish the collective nature of the action. A blanket subscription to possible future restraints does not excuse the restraints when they occur. Associated Press v. United States, 326 U.S. 1, 65 S.Ct. 1416, 89 L.Ed. 2013. Nor does any excuse derive from the fact that the collective refusal to deal was only with reference to the private wires, the member firms remaining willing to deal with petitioners for the purchase and sale of securities. See Bigelow v. RKO Radio Pictures, Inc., 327 U.S. 251, 66 S.Ct. 574, 90 L.Ed. 652; United States v. Paramount Pictures, Inc., 334 U.S. 131, 167, 68 S.Ct. 915, 934, 92 L.Ed. 1260. A valuable service germane to petitioners' business and important to their effective competition with others was withheld from them by collective action. That is enough to create a violation of the Sherman Act. United States v. Terminal R. Ass'n of St. Louis, 224 U.S. 383, 32 S.Ct. 507, 56 L.Ed. 810;United States v. First National Pictures, Inc., 282 U.S. 44, 51 S.Ct. 45, 75 L.Ed. 151; Associated Press v. United States, supra; cf. Anderson v. United States, 171 U.S. 604, 618—619, 19 S.Ct. 50, 55, 43 L.Ed. 300.

6 The report cited in the text is the recently issued first segment of a study which the Commission was directed to make by a 1961 amendment to the Securities Exchange Act, s 19(d), 15 U.S.C. (Supp. III) s 78s(d). Another set of figures reported

by the Special Study illustrates the great importance of corporate securities as a form of private property. As of the end of 1961, individuals had net financial savings of about $900,000,000,000, of which direct holdings of corporate securities amounted to more than half. In addition, life insurance companies and private pension funds held about $93,000,000,000 in corporate securities, and personal trust funds held another $57,000,000,000. Special Study, c. IB, pp. 2—3.

7 'The Commission is * * * authorized * * * to alter or supplement the rules of * * * (an) exchange * * * in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (5) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters.'

8 Member firms of the New York Stock Exchange accounted for over half of the total dollar volume of over-the-counter business in fiscal 1961, Special Study, op. cit., supra, c. IB, pp. 17—18, and trading in over-the-counter stocks constituted 21.6% of the estimated gross income of member firms of the Exchange for the same period, id., c. I, Table I—12.

9 Of most significance in this connection is Art. XIV, s 17, of the Exchange's Constitution, which permits it to order a member to sever any business connection which might cause the interest or good repute of the Exchange to suffer, and Rules 331—335, which provide various specific regulations governing members' relations with nonmember corporations and associations (including broker-dealers) in which they have an ownership interest or with which they are otherwise connected. Equally important are Rule 403, prohibiting transaction of business with a bucket shop, and Rule 435, prohibiting participation in any manipulative operation. The subject of commissions to be collected from nonmembers is regulated by Article XV of the Constitution and by numerous rules. Arbitration involving nonmembers is dealt with by Art. VIII, ss 1 and 6, of the Constitution. Various other rules prohibit the joint use of an office with a nonmember unless the Exchange approves (Rule 344), the giving of compensation or gratuities to the employees of nonmembers without their employer's consent (Rule 350), and the paying of certain expenses of nonmembers (Rule 369). Rule 418 permits the Exchange to engage in a 'surprise' audit of any member who does business with nonmembers. And [11] Art. III, s 6, of the Constitution and Rules 355 through 358 deal with private wire connections and related installations, see note 11, infra.

10 In deposition, the assistant director of the Exchange's Department of Member Firms described a boiler shop as 'usually a physically small operation which employs high pressure telephone salesmanship to oversell to the public by quantity, and in many cases by quality.' He said that this kind of firm, as well as bucket shops, inadequately capitalized firms, and firms which might misrepresent or withhold material facts from customers, was among those which the Exchange seeks to prevent from having the use of its facilities.

11 [11] Article III, s 6, of the Constitution, which is entitled 'Supervision Over Members, Allied Members, Member Firms and Member Corporations,' provides, among other things, that the Exchange 'shall have power to approve or disapprove any application for ticker service to any non-member, or for wire, wireless, or other connection between any office of any member of the Exchange, member firm or member corporation and any non-member, and may require the discontinuance of any such service or connection.' Rule 355 provides, '(a) No member or member organization shall establish or maintain any wire connection, private radio, television or wireless system between his or its offices and the office of any non-member, or permit any private radio or television system between his or its offices, without prior consent of the Exchange. (b) Every non-member will be required to execute a private wire contract in form prescribed by the Exchange to be filed with it, unless a contract is already on file with the Exchange. (c) Notification regarding a private means of communication with a non-member and the signed contract when necessary shall be submitted to the Department of Member Firms. This notification, by a member or allied member, may be in form supplied by the Exchange or in letter form, and shall include the essential facts concerning the non-member and the means of communication. (d) Each member or member organization shall submit annually to the Department of Member Firms a list of all non-members with whom private means of communication are maintained. (e) The Exchange may require at any time that any means of communication be discontinued.' Rule 356, insofar as relevant, provides, 'The Exchange may require at any time the discontinuance of any means of communication whatsoever which has a terminus in the office of a member or member organization.'

12 Were there Commission jurisdiction and ensuing judicial review for scrutiny of a particular exchange ruling, as there is under the 1938 Maloney Act amendments to the Exchange Act to examine disciplinary action by a registered securities association (i.e., by the NASD), ss 15A(g), 15A(h), 25(a), 15 U.S.C. ss 78o—3(g), 78o—3(h), 78y(a); see R. H. Johnson & Co. v. Securities & Exchange Comm., 198 F.2d 690 (C.A.2d Cir.1952), cert. denied, 344 U.S. 855, 73 S.Ct. 94, 97 L.Ed. 664, a different case would arise concerning exemption from the operation of laws designed to prevent anticompetitive activity, an issue we do not decide today.

13 Although the recently issued first segment of the Report of the Special Study of Securities Markets is more critical of situations in the over-the-counter market and with reference to exchanges other than the respondent, it does point out that improper selling practices have occurred among member firms of respondent, c. IIIB, pp. 178—179, 183—184, and suggests the need for new Commission rules to govern selling practices of securities dealers, id., p. 186.

14 The Exchange argues that total disclosure of the reasons for its action and of the sources of its information will subject it and its informants to a risk of being sued for defamation in many instances. This risk, however, is properly met by the flexibility inherent in the law of defamation in the concept of the conditional or qualified privilege. 1 Harper and James, The Law of Torts (1956), ss 5.21, 5.25, 5.26, especially s 5.26, at 442, n. 3. In addition, even if a particular communication of information to the Exchange should fall outside the scope of such a privilege, the Exchange can protect itself and its informant from expansion of damage liability by confining the hearing, unless otherwise requested by the aggrieved nonmember, to the parties to the dispute and the necessary witnesses, so as to limit the area of dissemination of the defamatory matter. See 1 Harper and James, op. cit., supra, s 5.30, at 469. Similarly, any concern that our holding exposes the Exchange to excessive liability for past enforcement of its rules accomplished without a hearing ignores the presumable applicability of familiar principles of waiver, laches, and estoppel to bar relief to a nonmember who failed to make timely and appropriate protest to the Exchange.

15 The affording of procedural safeguards will not burden the New York Stock Exchange; notice and hearing are already guaranteed by its Constitution, Art. XIV, s 14, to any member accused of violating its rules. The existence of these guarantees goes far toward dispelling fears that provision of a hearing to nonmembers would interfere significantly with the need for timely Exchange action, for it can surely be assumed that prompt action is as much required to deal with member wrongdoing as with that of a nonmember. We have no doubt, moreover, that provision of a hearing to a protesting nonmember can, when circumstances require, be accomplished expeditiously enough to prevent injury to investors. Indeed, if the basis for invocation of an Exchange rule is also a violation of the Securities Act of 1933, the Securities Exchange Act of 1934, or the Commission's rules and regulations under either statute, the Commission can come to the aid of the Exchange by obtaining a preliminary or permanent injunction or restraining order against such practice in the appropriate United States District Court. Securities Act of 1933, s 20(b), 15 U.S.C. s 77t(b); Securities Exchange Act of 1934, s 21(e), 15 U.S.C. s 78u(e). It is significant, however, that the Commission's power to obtain restraint of particular violation is confined to traditional judicial channels with the safeguards implied thereby, and that when the Commission, pursuant to the powers conferred on it by Congress in the Maloney Act of 1938, wishes to resort to the more drastic sanction of suspending or revoking the membership in the NASD of a wrongdoing over-the-counter dealer, it may only do so 'after appropriate notice and opportunity for hearing * * *.' s 15A(l), 15 U.S.C. s 78o—3(l).

16 It may be assumed that the Securities and Exchange Commission would have had the power, under s 19(b) of the Exchange Act, 15 U.S.C. s 78s(b), pp. 1254—1255, 1257 & note 7, supra, to direct the Exchange to adopt a general rule providing a hearing and attendant procedures to nonmembers. However, any rule that might be adopted by the Commission would, to be consonant with the antitrust laws, have to provide as a minimum the procedural safeguards which those laws make imperative in cases like this. Absent Commission adoption of a rule requiring fair procedure, and in light of both the utility of such a rule as an antitrust matter and its compatibility with securities-regulation principles, see p. 1259, supra, no incompatibility with the Commission's power inheres in announcement by an antitrust court of the rule. Compare Colorado Anti-Discrimination Comm. v. Continental Air Lines, Inc., 372 U.S. 714, 723—724, 83 S.Ct. 1022, 1026—1027.

17 The basic nature of the rights which we hold to be required under the antitrust laws in the circumstances of today's decision is indicated by the fact that public agencies, labor unions, clubs, and other associations have, under various legal principles, all been required to afford notice, a hearing, and an opportunity to answer charges to one who is about to be denied a valuable right. Goldsmith v. United States Board of Tax Appeals, 270 U.S. 117, 46 S.Ct. 215, 70 L.Ed. 494; Russell v. Duke of Norfolk, (1949) 1 All E.R. 109 (C.A.); Fellman, Constitutional Rights of Association, in The Supreme Court Review, 1961 (Kurland ed.), 74, 104, 112—113; Developments in the Law—Judicial Control of Actions

of Private Associations, 76 Harv.L.Rev. 983, 1026—1037 (1963); see authorities cited note 18, infra; cf. Vitarelli v. Seaton, 359 U.S. 535, 79 S.Ct. 968, 3 L.Ed.2d 1012; Cafeteria & Restaurant Workers Union, Local 473, AFL—CIO v. McElroy, 367 U.S. 886, 894—895, 81 S.Ct. 1743, 1748, 6 L.Ed.2d 1230; Willner v. Committee on Character and Fitness, 373 U.S. 96, 83 S.Ct. 1175.

18 The principle that a private association's failure to afford procedural safeguards may result in the imposition of damage liability without inquiry into whether the association's action lacked substantive basis is reflected in many state-court decisions, resting on various theories of liability. Cason v. Glass Bottle Blowers Ass'n, 37 Cal.2d 134, 231 P.2d 6, 21 A.L.R.2d 1387 (1951); Lahiff v. Saint Joseph's Total Abstinence & Benevolent Soc., 76 Conn. 648, 57 A. 692,65 L.R.A. 92 (1904); Malmsted v. Minneapolis Aerie, 111 Minn. 119, 126 N.W. 486 (1910); Johnson v. International of United Brotherhood of Carpenters, 52 Nev. 400, 288 P. 170 (1930); 54 Nev. 332, 16 P.2d 658,18 P.2d 448 (1932); Brooks v. Engar, 259 App.Div. 333,19 N.Y.S.2d 114 (1st Dept.), appeal dismissed, 284 N.Y. 767, 31 N.E.2d 514 (1940); Blek v. Wilson, 145 Misc. 373, 259 N.Y.S. 443 (Sup.Ct.1932), modified and aff'd, 237 App.Div. 712, 262 N.Y.S. 416 (1st Dept.), rev'd on other grounds, 262 N.Y. 253, 186 N.E. 692 (1933); Glauber v. Patof, 183 Misc. 400, 47 N.Y.S.2d 762 (Sup.Ct.1944), aff'd mem., 269 App.Div. 687, 54 N.Y.S.2d 384 (1st Dept.), modified per curiam on other grounds, 294 N.Y. 583, 63 N.E.2d 181 (1945); O'Brien v. Papas, 49 N.Y.S.2d 521 (Sup.Ct.1944); Taxicab Drivers' Local Union No. 889 v. Pittman, 322 P.2d 159 (Okl.1957); International Printing Pressmen & Assistants' Union of North America v. Smith, 145 Tex. 399, 198 S.W.2d 729 (1946); Leo v. Local Union No. 612 of International Union of Operating Engineers, 26 Wash.2d 498, 174 P.2d 523, 168 A.L.R. 1440 (1946) (alternative holding). See also Developments in the Law, supra, 76 Harv.L.Rev., at 1087—1095; Note, Procedural 'Due Process' in Union Disciplinary Proceedings, 57 Yale L.J. 1302 (1948). The precedents cited undoubtedly rest on a recognition that the according of fair procedures is of fundamental significance, that serious and irreversible economic injury may result from their denial in a context like that of the present case, and that a substantive inquiry after the fact cannot possibly succeed in accurately ascertaining retrospectively what the outcome would have been had the procedural safeguards been afforded in the first instance. The conditioning of relief for the procedural breach on a finding that a concomitant substantive breach occurred might well, therefore, result in an ultimate wrongful denial of recovery to a party in the position of petitioners here.

1 See, e.g., Radiant Burners, Inc. v. Peoples Gas Light & Coke Co., 364 U.S. 656, 81 S.Ct. 365, 5 L.Ed.2d 358; Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 79 S.Ct. 705, 3 L.Ed.2d 741; Fashion Originators' Guild America v. Federal Trade Comm., 312 U.S. 457, 61 S.Ct. 703, 85 L.Ed. 949. It may be assumed, I think, that almost every exercise of an exchange's statutory duty of self-regulation would involve an actual or threatened concerted refusal to deal—a 'group boycott.'

2 See ante, p. 1260, note 16. Contrary to the Court's suggestion, there has not been a total absence of agency or legislative attention to the problems of the Exchange's disciplinary machinery. In s 19(c) of the 1934 Act, Congress expressly ordered the Securities and Exchange Commission to study the exchanges' procedures for disciplining members and to report back on the need for further legislation. The Commission reported the following year, giving a detailed account of existing procedures and making specific recommendations for reform. H.R.Doc. No. 85, 74th Cong., 1st Sess. (Jan. 25, 1935). It advised against legislation, however, suggesting that the exchanges themselves be given the opportunity to adopt the recommendations voluntarily. The agency also undertook to continue its surveillance of such procedures and to report to Congress 'such further recommendations as it may deem advisable in regard to exchange government.' Id., at 17. In its 1935 Annual Report, the Commission stated that the respondent Exchange, as well as many others, had voluntarily complied. 1 S.E.C.Ann.Rep. 20 (1935). The process of surveillance has continued. In 1938, a general overhaul of the respondent Exchange's constitution was effected by informal Commission action. See 2 Loss, Securities Regulation, 1179—1182. In 1941, the Commission's proposals for statutory amendments included a specific request to extend s 19(b) rule-making authority over rules governing discipline of members. Report of the Securities and Exchange Commission on Proposals for Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934, House Committee Print, Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess. 40 (Aug. 7, 1941). The proposal was not acted upon. Exchange disciplinary procedures were again examined in recent congressional hearings concerning the operation of the stock market. The absence of review by the Commission in individual cases was noted,

but representatives of the respondent Exchange also testified that all such actions are reported informally to the agency. A detailed account of the Exchange's present procedures was included in the record. Hearings before a Subcommittee of the House Committee on Interstate and Foreign Commerce on H.J.Res. 438, 87th Cong., 1st Sess. 107—113. These recent hearings have led to an exhaustive study of current stock market conditions, and completion of the resulting report by the Commission is imminent. See Securities Exchange Act of 1934, s 19(d), added by 75 Stat. 465, as amended, 76 Stat. 247, 15 U.S.C. (Supp. IV) s 78s(d); S.E.C., Report of Special Study of Securities Markets (Apr. 3, 1963).

3 The Court pointed out that 'An elaborate system of trial and appellate tribunals exists, for the determination of whether a given garment is in fact a copy of a Guild member's design.' 312 U.S., at 462—463, 61 S.Ct. at 706. See also Klor's, Inc. v. Broadway-Hale Stores, Inc., 359 U.S. 207, 212, 79 S.Ct. 705, 709, 3 L.Ed.2d 741.

4 254 U.S. 443, 41 S.Ct. 172, 65 L.Ed. 349. See Apex Hosiery Co. v. Leader, 310 U.S. 469, 60 S.Ct. 982, 84 L.Ed. 1311; United States v. Hutcheson, 312 U.S. 219, 61 S.Ct. 463, 85 L.Ed. 788.

5 For example, an exchange would be liable under the antitrust laws if it conspired with outsiders, or if it attempted to use its power to monopolize. United States v. Borden Co., 308 U.S. 188, 60 S.Ct. 182, 84 L.Ed. 181; Maryland & Virginia Milk Producers Ass'n v. United States, 362 U.S. 458, 80 S.Ct. 847, 4 L.Ed.2d 880; Allen Bradley Co. v. Local Union No. 3, IBEW, 325 U.S. 797, 65 S.Ct. 1533, 89 L.Ed. 1939. Furthermore, individual members of an exchange would be liable if it were shown that they had conspired to use the exchange's machinery for the purpose of suppressing competition. Cf. Georgia v. Pennsylvania R. Co., 324 U.S. 439, 65 S.Ct. 716, 89 L.Ed. 1051; United States v. Pacific & Artic Ry. & Nav. Co., 228 U.S. 87, 33 S.Ct. 443, 57 L.Ed. 742. Application of the antitrust laws to such conduct would rest on the presence of an independent violation, not, as the present case does, simply upon concerted activity by the exchange and its members.

Release No. 18284 (S.E.C. Release No.), Release No. 34-18284,
24 S.E.C. Docket 94, 47 S.E.C. Docket 668, 1981 WL 315505

S.E.C. Release No.
Securities Exchange Act of 1934

SECURITIES AND EXCHANGE COMMISSION (S.E.C.)

In the Matter of the Application of
PAUL EDWARD VAN DUSEN
2471 N. W. 63rd Avenue
Fort Lauderdale, Florida
For Review of the Denial of a Member's Continuance Application by the
NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Admin. Proc. File No. 3-5946
November 24, 1981

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DENIAL OF MEMBERSHIP CONTINUANCE APPLICATION

*1 Where registered securities association denied member's application to employ individual as a registered principal on the basis of an injunction and a Commission bar based on the same misconduct, and the bar order provided that, after 18 months, individual could apply to become associated with a broker-dealer in a supervisory capacity, held, association's action set aside and association directed to permit individual's association as a principal, since specified time had expired, and exclusionary action was not based on any new adverse circumstance.

APPEARANCES:
Sidney T. Bernstein, of Bernstein, Bernstein, Feinman & Rush, for Paul Edward Van Dusen.
David P. Doherty and Adele Geffen, for the Commission's Division of Enforcement.
Andrew McR. Barnes, Peter J. Chepucavage and Mary S. Head, for the National Association of Securities Dealers, Inc.

I.

Paul Edward Van Dusen appeals from the denial by the National Association of Securities Dealers, Inc. ('NASD') of a broker-dealer firm's request to remain an NASD member with Van Dusen as a registered principal acting as sales manager.[1] The request was necessary because Van Dusen is subject to two 'statutory disqualifications,' a bar imposed by this Commission and an injunction.[2] Our Division of Enforcement filed briefs in support of Van Dusen's application. Our findings are based on an independent review of the record.

II.

From about November 1974 to August 1977, Van Dusen was executive vice president of Winters & Co., Inc., a registered broker-dealer, and of its wholly-owned subsidiary, Winters Government Securities Corporation ('WGSC'). In August 1977, this Commission brought an injunctive action against Winters & Co., WGSC, their president, vice presidents, and several salesmen,

charging fraud in connection with the purchase, offer and sale of government securities during the period August 1976 to August 1977.[3]

In July 1978, without admitting or denying the allegations of this Commission's complaint, Van Dusen consented to the entry of an injunction against violations of the antifraud provisions of the securities acts.[4] He also consented, without admitting or denying those allegations, to a 40-day suspension from association with any broker-dealer, investment adviser, or investment company, and to a bar from any such association in a supervisory capacity, with the right to apply to this Commission after 18 months for reassociation in that capacity.[5]

III.

*2 While our complaint in the injunctive action charged Van Dusen with responsibility for overseeing the activities of WGSC's salesmen and traders, it also alleged that another respondent, a Mr. B, vice president and sales manager of Winters & Co. and WGSC, 'was responsible for the day to day supervision of salesmen.'

At the hearings before the NASD, Van Dusen testified that, beginning in June of 1976, he left the day-to-day supervision of WGSC's salesmen to Mr. B, and concentrated on the development of an asset management service for commercial banks, which was to be offered through an investment adviser subsidiary. He stated that, during the period covered by our complaint, he was probably out of the office more than he was present and that his fault lay in failing to monitor the activities of Mr. B. Van Dusen testified:

> 'I . . . assumed [Mr. B] had the knowledge, and trusted . . . that he would take care of everything. And, frankly, I did not mind the store in that area.'

Van Dusen further testified that he had entered the securities business in January 1970 as a salesman with another firm, and served as a branch office sales manager for about a year before leaving that firm in 1974. He then joined Winters & Co. and acted as sales manager until June 1976. Except for his 40-day suspension, he has been employed since July 1978 as a salesman by the firm that now wishes to promote him to sales manager. The record does not reflect any misconduct by Van Dusen other than that described above, nor does his present employer have any disciplinary history. The employer's president plans to continue his close supervision of Van Dusen if Van Dusen is approved as a supervisor.

The NASD approved the continued employment of Van Dusen as a salesman by his present employer. In doing so, it stated, among other things, that it was satisfied that the employer's 'strict procedures' were 'such as to prevent as much as possible a recurrence of [violative] activity in the future.' The Association further noted Van Dusen's statements that 'many of the problems [at Winters] occurred during a very short period when he was out of the office and at a time when he had transferred the day to day supervision of his salesmen to a newly hired sales manager.' And it took into account the fact that Van Dusen's present employer and its president had no disciplinary history. However, in light of this Commission's prior actions against Van Dusen, it concluded that approval of his employment as a supervisor was not justified.

IV.

The standards which govern our review of Van Dusen's appeal are contained in Section 19(f) of the Securities Exchange Act, as amended in 1975. In order to sustain the NASD's action, we must find that the grounds on which the NASD based that action exist, that the action was in accordance with NASD rules, and that 'such rules are, and were applied in a manner, consistent with the purposes of [the Act].' In the present instance, we are unable to conclude that the NASD applied its rules in a manner consistent with the Act's purposes.

*3 In judging the NASD's action, we must determine whether or not the Association's application of its rules was 'unfair.' [6] And, in making that determination we must bear in mind the purpose of disciplinary actions under the Exchange Act. Whether taken by this Commission or the NASD, the purpose of all such actions is remedial, not penal. They are not designed to punish, but to protect the public interest against further risk of harm. As we stated many years ago:

'The sanctions authorized by Section 15 of Exchange Act are part of a comprehensive regulatory scheme to protect the public interest in maintaining the integrity of the securities markets. Their imposition serves to deter both the particular respondents as well as others in the securities industry from committing violations of the securities laws. We have been cognizant of the importance of exercising the discretionary power reposed in us in this area in a manner that will afford investors protection without visiting upon the wrongdoers adverse consequences not required in achieving the statutory objectives.' [7] (Emphasis supplied. Footnotes omitted.)

Prior to accepting Van Dusen's offer of settlement in 1978, we carefully weighed the requirements of the public interest in the light of his alleged misconduct. And we concluded that it was appropriate to allow him, after 18 months, to apply for permission to become associated with a broker-dealer in a supervisory capacity. In 1975, we announced our policy with respect to such applications as follows:

'When hereafter the Commission specifies a date after which [an] application [for re-entry] may be made, the Commission upon a proper showing will generally act favorably upon the application . . .' [8]

This did not and does not mean that re-entry is to be granted automatically when an application is made after the period specified in an offer of settlement has expired. Such factors as other misconduct in which the applicant may have engaged, the nature and disciplinary history of a prospective employer, and the supervision to be accorded the applicant, are only some of the matters that must be carefully weighed and considered. Here, however, the NASD's exclusionary action was not based on any new circumstance or any defect in the showing that Van Dusen made, but merely on the 1978 injunction and bar.

We conclude that, in the absence of new information reflecting adversely on Van Dusen's ability to function in his proposed employment in a manner consonant with the public interest, it is inconsistent with the remedial purposes of the Exchange Act and unfair to exclude him any longer from the position he seeks. We shall accordingly set aside the NASD's action, and require it to permit Van Dusen to become associated with the applicant firm as a registered principal. [9]

An appropriate order will issue.

By the Commission (Chairman SHAD and Commissioners LOOMIS, EVANS, THOMAS and LONGSTRETH).
George A. Fitzsimmons, Secretary

Footnotes

1 See Article I, Section 13 of the NASD's By-Laws. NASD Manual ¶1113, p. 1067.

2 Section 15A(g)(2) of the Securities Exchange Act gives and NASD authority to bar any person who is subject to a 'statutory disqualification' from becoming associated with any of its members. As defined in Section 3(a)(39) of the Act, such a person includes anyone who has been barred by this Commission from association with any broker or dealer, and anyone who has been enjoined from continuing any conduct or practice in connection with the purchase or sale of any security.

3 S.E.C. v. Winters Government Securities Corporation, et al., Civil Action No. 77-6345 (S.D. Fla.). Litigation Release No. 8067 (August 15, 1977), 12 SEC Docket 1560.

4 Litigation Release No. 8484 (August 2. 1978), 15 SEC Docket 536.

5 Paul E. Van Dusen, Securities Exchange Act Release No. 15022 (August 2. 1978), 15 SEC Docket 493.

6 See S. Rep. No. 94-75, 94th Cong., 1st Sess. 132 (1975).

7 Commonwealth Securities Corporation, 44 S.E.C. 100, 101-102 (1969).

8 Applications for Relief from Disqualification, Securities Exchange Act Release No. 11267 (February 26, 1975), 6 SEC Docket 346.

9 Under Section 15(b)(6) of the Exchange Act, no person subject to a Commission bar may become associated with a broker-dealer 'without the consent of the Commission.' Thus, in addition to applying to the NASD for permission to work in the position at issue in these proceedings, Van Dusen made a direct application to this Commission for permission to work in that capacity. We have determined to grant his application.

Release No. 18284 (S.E.C. Release No.), Release No. 34-18284,
24 S.E.C. Docket 94, 47 S.E.C. Docket 668, 1981 WL 315505

End of Document

SUSPENSION AND EXPULSION OF EXCHANGE MEMBERS

§ 240.19a3–1 [Reserved]

§ 240.19b–3 [Reserved]

§ 240.19b–4 Filings with respect to proposed rule changes by self-regulatory organizations.

(a) Filings with respect to proposed rule changes by a self-regulatory organization shall be made on Form 19b–4.

(b) The term *stated policy, practice, or interpretation* means:

(1) Any material aspect of the operation of the facilities of the self-regulatory organization; or

(2) Any statement made generally available to the membership of, to all participants in, or to persons having or seeking access (including, in the case of national securities exchanges or registered securities associations, through a member) to facilities of, the self-regulatory organization ("specified persons"), or to a group or category of specified persons, that establishes or changes any standard, limit, or guideline with respect to:

(i) The rights, obligations, or privileges of specified persons or, in the case of national securities exchanges or registered securities associations, persons associated with specified persons; or

(ii) The meaning, administration, or enforcement of an existing rule.

(c) A stated policy, practice, or interpretation of the self-regulatory organization shall be deemed to be a proposed rule change unless (1) it is reasonably and fairly implied by an existing rule of the self-regulatory organization or (2) it is concerned solely with the administration of the self-regulatory organization and is not a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization.

(d) Regardless of whether it is made generally available, an interpretation of an existing rule of the self-regulatory organization shall be deemed to be a proposed rule change if (1) it is approved or ratified by the governing body of the self-regulatory organization and (2) it is not reasonably and fairly implied by that rule.

(e) A proposed rule change may take effect upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act, 15 U.S.C. 78s(b)(3)(A), if properly designated by the self-regulatory organization as:

(1) Constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule;

(2) Establishing or changing a due, fee, or other charge;

(3) Concerned solely with the administration of the self-regulatory organization;

(4) Effecting a change in an existing service of a registered clearing agency that:

(i) Does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible; and

(ii) Does not significantly affect the respective rights or obligations of the clearing agency or persons using the service;

(5) Effecting a change in an existing order-entry or trading system of a self-regulatory organization that:

(i) Does not significantly affect the protection of investors or the public interest;

(ii) Does not impose any significant burden on competition; and

(iii) Does not have the effect of limiting the access to or availability of the system; or

(6) Effecting a change that:

(i) Does not significantly affect the protection of investors or the public interest;

(ii) Does not impose any significant burden on competition; and

(iii) By its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

(f) After instituting a proceeding to determine whether a proposed rule change should be disapproved, the Commission will afford the self-regulatory organization and interested persons an opportunity to submit additional written data, views, and arguments and may afford, in the discretion of the Commission, an opportunity to make oral presentations.

(g) Notice of orders issued pursuant to section 19(b) of the Act will be given by prompt publication thereof, together with a statement of written reasons therefor.

(h) Self-regulatory organizations shall retain at their principal place of business a file, available to interested persons for public inspection and copying, of all filings made pursuant to this section and all correspondence and other communications reduced to writing (including comment letters) to and from such self-regulatory organization concerning any such filing, whether such correspondence and communications are received or prepared before or after the filing of the proposed rule change.

[45 FR 73914, Nov. 7, 1980, as amended at 59 FR 66701, Dec. 28, 1994]

§240.19c-1 Governing certain off-board agency transactions by members of national securities exchanges.

The rules of each national securities exchange shall provide as follows:

No rule, stated policy, or practice of this exchange shall prohibit or condition, or be construed to prohibit or condition or otherwise limit, directly or indirectly, the ability of any member acting as agent to effect any transaction otherwise than on this exchange with another person (except when such member also is acting as agent for such other person in such transaction), in any equity security listed on this exchange or to which unlisted trading privileges on this exchange have been extended.

(Secs. 2, 3, 6, 11, 17, 19, 23, Pub. L. 78-291, 48 Stat. 881, 882, 885, 891, 897, 898, 901, as amended by secs. 2, 3, 6, 14, 16, 18, Pub. L. 94-29, 89 Stat. 97, 104, 110, 137, 146, 155 (15 U.S.C. 78b, 78c, 78f, 78k, 78q, 78s, 78w, as amended by Pub. L. 94-29 (June 4, 1975)); sec. 7 Pub. L. 94-29, 89 Stat. 111 (15 U.S.C. 78k-1))

[43 FR 1328, Jan. 9, 1978]

§240.19c-3 Governing off-board trading by members of national securities exchanges.

The rules of each national securities exchange shall provide as follows:

(a) No rule, stated policy or practice of this exchange shall prohibit or condition, or be construed to prohibit, condition or otherwise limit, directly or indirectly, the ability of any member to effect any transaction otherwise than on this exchange in any reported security listed and registered on this exchange or as to which unlisted trading privileges on this exchange have been extended (other than a put option or call option issued by the Options Clearing Corporation) which is not a covered security.

(b) For purposes of this rule,

(1) The term *Act* shall mean the Securities Exchange Act of 1934, as amended.

(2) The term *exchange* shall mean a national securities exchange registered as such with the Securities and Exchange Commission pursuant to section 6 of the Act.

(3) The term *covered security* shall mean (i) Any equity security or class of equity securities which

(A) Was listed and registered on an exchange on April 26, 1979, and

(B) Remains listed and registered on at least one exchange continuously thereafter;

(ii) Any equity security or class of equity securities which

(A) Was traded on one or more exchanges on April 26, 1979, pursuant to unlisted trading privileges permitted by section 12(f)(1)(A) of the Act, and

(B) Remains traded on any such exchange pursuant to such unlisted trading privileges continuously thereafter; and

(iii) Any equity security or class of equity securities which

(A) Is issued in connection with a statutory merger, consolidation or similar plan or reorganization (including a reincorporation or change of

15 U.S.C.
United States Code, 2010 Edition
Title 15 - COMMERCE AND TRADE
CHAPTER 2B - SECURITIES EXCHANGES
Sec. 78c - Definitions and application
From the U.S. Government Publishing Office, www.gpo.gov

§78c. Definitions and application

(a) Definitions

When used in this chapter, unless the context otherwise requires—

(1) The term "exchange" means any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.

(2) 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.

(3)(A) The term "member" when used with respect to a national securities exchange means (i) any natural person permitted to effect transactions on the floor of the exchange without the services of another person acting as broker, (ii) any registered broker or dealer with which such a natural person is associated, (iii) any registered broker or dealer permitted to designate as a representative such a natural person, and (iv) any other registered broker or dealer which agrees to be regulated by such exchange and with respect to which the exchange undertakes to enforce compliance with the provisions of this chapter, the rules and regulations thereunder, and its own rules. For purposes of sections 78f(b)(1), 78f(b)(4), 78f(b)(6), 78f(b)(7), 78f(d), 78q(d), 78s(d), 78s(e), 78s(g), 78s(h), and 78u of this title, the term "member" when used with respect to a national securities exchange also means, to the extent of the rules of the exchange specified by the Commission, any person required by the Commission to comply with such rules pursuant to section 78f(f) of this title.

(B) The term "member" when used with respect to a registered securities association means any broker or dealer who agrees to be regulated by such association and with respect to whom the association undertakes to enforce compliance with the provisions of this chapter, the rules and regulations thereunder, and its own rules.

(4) BROKER.—

(A) IN GENERAL.—The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others.

(B) EXCEPTION FOR CERTAIN BANK ACTIVITIES.—A bank shall not be considered to be a broker because the bank engages in any one or more of the following activities under the conditions described:

(i) THIRD PARTY BROKERAGE ARRANGEMENTS.—The bank enters into a contractual or other written arrangement with a broker or dealer registered under this chapter under which the broker or dealer offers brokerage services on or off the premises of the bank if—

(I) such broker or dealer is clearly identified as the person performing the brokerage services;

(II) the broker or dealer performs brokerage services in an area that is clearly marked and, to the extent practicable, physically separate from the routine deposit-taking activities of the bank;

(III) any materials used by the bank to advertise or promote generally the availability of brokerage services under the arrangement clearly indicate that the brokerage services are being provided by the broker or dealer and not by the bank;

(IV) any materials used by the bank to advertise or promote generally the availability of brokerage services under the arrangement are in compliance with the Federal securities laws before distribution;

(V) bank employees (other than associated persons of a broker or dealer who are qualified pursuant to the rules of a self-regulatory organization) perform only clerical or ministerial functions in connection with brokerage transactions including scheduling appointments with the associated persons of a broker or dealer, except that bank employees may forward customer funds or securities and may describe in general terms the types of investment vehicles available from the bank and the broker or dealer under the arrangement;

(VI) bank employees do not receive incentive compensation for any brokerage transaction unless such employees are associated persons of a broker or dealer and are qualified pursuant to the rules of a self-regulatory organization, except that the bank employees may receive compensation for the referral of any customer if the compensation

is a nominal one-time cash fee of a fixed dollar amount and the payment of the fee is not contingent on whether the referral results in a transaction;

(VII) such services are provided by the broker or dealer on a basis in which all customers that receive any services are fully disclosed to the broker or dealer;

(VIII) the bank does not carry a securities account of the customer except as permitted under clause (ii) or (viii) of this subparagraph; and

(IX) the bank, broker, or dealer informs each customer that the brokerage services are provided by the broker or dealer and not by the bank and that the securities are not deposits or other obligations of the bank, are not guaranteed by the bank, and are not insured by the Federal Deposit Insurance Corporation.

(ii) TRUST ACTIVITIES.—The bank effects transactions in a trustee capacity, or effects transactions in a fiduciary capacity in its trust department or other department that is regularly examined by bank examiners for compliance with fiduciary principles and standards, and—

(I) is chiefly compensated for such transactions, consistent with fiduciary principles and standards, on the basis of an administration or annual fee (payable on a monthly, quarterly, or other basis), a percentage of assets under management, or a flat or capped per order processing fee equal to not more than the cost incurred by the bank in connection with executing securities transactions for trustee and fiduciary customers, or any combination of such fees; and

(II) does not publicly solicit brokerage business, other than by advertising that it effects transactions in securities in conjunction with advertising its other trust activities.

(iii) PERMISSIBLE SECURITIES TRANSACTIONS.—The bank effects transactions in—

(I) commercial paper, bankers acceptances, or commercial bills;

(II) exempted securities;

(III) qualified Canadian government obligations as defined in section 24 of title 12, in conformity with section 78*o*–5 of this title and the rules and regulations thereunder, or obligations of the North American Development Bank; or

(IV) any standardized, credit enhanced debt security issued by a foreign government pursuant to the March 1989 plan of then Secretary of the Treasury Brady, used by such foreign government to retire outstanding commercial bank loans.

(iv) CERTAIN STOCK PURCHASE PLANS.—

(I) EMPLOYEE BENEFIT PLANS.—The bank effects transactions, as part of its transfer agency activities, in the securities of an issuer as part of any pension, retirement, profit-sharing, bonus, thrift, savings, incentive, or other similar benefit plan for the employees of that issuer or its affiliates (as defined in section 1841 of title 12), if the bank does not solicit transactions or provide investment advice with respect to the purchase or sale of securities in connection with the plan.

(II) DIVIDEND REINVESTMENT PLANS.—The bank effects transactions, as part of its transfer agency activities, in the securities of an issuer as part of that issuer's dividend reinvestment plan, if—

(aa) the bank does not solicit transactions or provide investment advice with respect to the purchase or sale of securities in connection with the plan; and

(bb) the bank does not net shareholders' buy and sell orders, other than for programs for odd-lot holders or plans registered with the Commission.

(III) ISSUER PLANS.—The bank effects transactions, as part of its transfer agency activities, in the securities of an issuer as part of a plan or program for the purchase or sale of that issuer's shares, if—

(aa) the bank does not solicit transactions or provide investment advice with respect to the purchase or sale of securities in connection with the plan or program; and

(bb) the bank does not net shareholders' buy and sell orders, other than for programs for odd-lot holders or plans registered with the Commission.

(IV) PERMISSIBLE DELIVERY OF MATERIALS.—The exception to being considered a broker for a bank engaged in activities described in subclauses (I), (II), and (III) will not be affected by delivery of written or electronic plan materials by a bank to employees of the issuer, shareholders of the issuer, or members of affinity groups of the issuer, so long as such materials are—

(aa) comparable in scope or nature to that permitted by the Commission as of November 12, 1999; or

(bb) otherwise permitted by the Commission.

(v) SWEEP ACCOUNTS.—The bank effects transactions as part of a program for the investment or reinvestment of deposit funds into any no-load, open-end management investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a–1 et seq.] that holds itself out as a money market fund.

(vi) AFFILIATE TRANSACTIONS.—The bank effects transactions for the account of any affiliate of the bank (as defined in section 1841 of title 12) other than—

(I) a registered broker or dealer; or

(II) an affiliate that is engaged in merchant banking, as described in section 1843(k)(4)(H) of title 12.

(vii) PRIVATE SECURITIES OFFERINGS.—The bank—

(I) effects sales as part of a primary offering of securities not involving a public offering, pursuant to section 3(b), 4(2), or 4(5) of the Securities Act of 1933 [15 U.S.C. 77c(b), 77d(2), 77d(5)] or the rules and regulations issued thereunder;

(II) at any time after the date that is 1 year after November 12, 1999, is not affiliated with a broker or dealer that has been registered for more than 1 year in accordance with this chapter, and engages in dealing, market making, or underwriting activities, other than with respect to exempted securities; and

(III) if the bank is not affiliated with a broker or dealer, does not effect any primary offering described in subclause (I) the aggregate amount of which exceeds 25 percent of the capital of the bank, except that the limitation of this subclause shall not apply with respect to any sale of government securities or municipal securities.

(viii) SAFEKEEPING AND CUSTODY ACTIVITIES.—

(I) IN GENERAL.—The bank, as part of customary banking activities—

(aa) provides safekeeping or custody services with respect to securities, including the exercise of warrants and other rights on behalf of customers;

(bb) facilitates the transfer of funds or securities, as a custodian or a clearing agency, in connection with the clearance and settlement of its customers' transactions in securities;

(cc) effects securities lending or borrowing transactions with or on behalf of customers as part of services provided to customers pursuant to division (aa) or (bb) or invests cash collateral pledged in connection with such transactions;

(dd) holds securities pledged by a customer to another person or securities subject to purchase or resale agreements involving a customer, or facilitates the pledging or transfer of such securities by book entry or as otherwise provided under applicable law, if the bank maintains records separately identifying the securities and the customer; or

(ee) serves as a custodian or provider of other related administrative services to any individual retirement account, pension, retirement, profit sharing, bonus, thrift savings, incentive, or other similar benefit plan.

(II) EXCEPTION FOR CARRYING BROKER ACTIVITIES.—The exception to being considered a broker for a bank engaged in activities described in subclause (I) shall not apply if the bank, in connection with such activities, acts in the United States as a carrying broker (as such term, and different formulations thereof, are used in section 78*o*(c)(3) of this title and the rules and regulations thereunder) for any broker or dealer, unless such carrying broker activities are engaged in with respect to government securities (as defined in paragraph (42) of this subsection).

(ix) IDENTIFIED BANKING PRODUCTS.—The bank effects transactions in identified banking products as defined in section 206 of the Gramm-Leach-Bliley Act.

(x) MUNICIPAL SECURITIES.—The bank effects transactions in municipal securities.

(xi) DE MINIMIS EXCEPTION.—The bank effects, other than in transactions referred to in clauses (i) through (x), not more than 500 transactions in securities in any calendar year, and such transactions are not effected by an employee of the bank who is also an employee of a broker or dealer.

(C) EXECUTION BY BROKER OR DEALER.—The exception to being considered a broker for a bank engaged in activities described in clauses (ii), (iv), and (viii) of subparagraph (B) shall not apply if the activities described in such provisions result in the trade in the United States of any security that is a publicly traded security in the United States, unless—

(i) the bank directs such trade to a registered broker or dealer for execution;

(ii) the trade is a cross trade or other substantially similar trade of a security that—

(I) is made by the bank or between the bank and an affiliated fiduciary; and

(II) is not in contravention of fiduciary principles established under applicable Federal or State law; or

(iii) the trade is conducted in some other manner permitted under rules, regulations, or orders as the Commission may prescribe or issue.

(D) FIDUCIARY CAPACITY.—For purposes of subparagraph (B)(ii), the term "fiduciary capacity" means—

(i) in the capacity as trustee, executor, administrator, registrar of stocks and bonds, transfer agent, guardian, assignee, receiver, or custodian under a uniform gift to minor act, or as an investment adviser if the bank receives a fee for its investment advice;

(ii) in any capacity in which the bank possesses investment discretion on behalf of another; or

(iii) in any other similar capacity.

(E) EXCEPTION FOR ENTITIES SUBJECT TO SECTION 78*o*(e).[1] —The term "broker" does not include a bank that—

(i) was, on the day before November 12, 1999, subject to section 78*o*(e) [1] of this title; and

(ii) is subject to such restrictions and requirements as the Commission considers appropriate.

(F) JOINT RULEMAKING REQUIRED.—The Commission and the Board of Governors of the Federal Reserve System shall jointly adopt a single set of rules or regulations to implement the exceptions in subparagraph (B).

(5) DEALER.—

(A) IN GENERAL.—The term "dealer" means any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise.

(B) EXCEPTION FOR PERSON NOT ENGAGED IN THE BUSINESS OF DEALING.—The term "dealer" does not include a person that buys or sells securities for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business.

(C) EXCEPTION FOR CERTAIN BANK ACTIVITIES.—A bank shall not be considered to be a dealer because the bank engages in any of the following activities under the conditions described:

(i) PERMISSIBLE SECURITIES TRANSACTIONS.—The bank buys or sells—

(I) commercial paper, bankers acceptances, or commercial bills;

(II) exempted securities;

(III) qualified Canadian government obligations as defined in section 24 of title 12, in conformity with section 78*o*–5 of this title and the rules and regulations thereunder, or obligations of the North American Development Bank; or

(IV) any standardized, credit enhanced debt security issued by a foreign government pursuant to the March 1989 plan of then Secretary of the Treasury Brady, used by such foreign government to retire outstanding commercial bank loans.

(ii) INVESTMENT, TRUSTEE, AND FIDUCIARY TRANSACTIONS.—The bank buys or sells securities for investment purposes—

(I) for the bank; or

(II) for accounts for which the bank acts as a trustee or fiduciary.

(iii) ASSET-BACKED TRANSACTIONS.—The bank engages in the issuance or sale to qualified investors, through a grantor trust or other separate entity, of securities backed by or representing an interest in notes, drafts, acceptances, loans, leases, receivables, other obligations (other than securities of which the bank is not the issuer), or pools of any such obligations predominantly originated by—

(I) the bank;

(II) an affiliate of any such bank other than a broker or dealer; or

(III) a syndicate of banks of which the bank is a member, if the obligations or pool of obligations consists of mortgage obligations or consumer-related receivables.

(iv) IDENTIFIED BANKING PRODUCTS.—The bank buys or sells identified banking products, as defined in section 206 of the Gramm-Leach-Bliley Act.

(6) The term "bank" means (A) a banking institution organized under the laws of the United States or a Federal savings association, as defined in section 1462(5) of title 12, (B) a member bank of the Federal Reserve System, (C) any other banking institution or savings association, as defined in section 1462(4) of title 12, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency pursuant to section 92a of title 12, and which is supervised and examined by State or Federal authority having supervision over banks or savings associations, and which is not operated for the purpose of evading the provisions of this chapter, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

(7) The term "director" means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated.

(8) The term "issuer" means any person who issues or proposes to issue any security; except that with respect to certificates of deposit for securities, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or of the fixed, restricted management, or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; and except that with respect to equipment-trust certificates or like securities, the term "issuer" means the person by whom the equipment or property is, or is to be, used.

(9) The term "person" means a natural person, company, government, or political subdivision, agency, or instrumentality of a government.

(10) The term "security" means any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription,

transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

(11) The term "equity security" means any stock or similar security; or any security future on any such security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Commission shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security.

(12)(A) The term "exempted security" or "exempted securities" includes—

(i) government securities, as defined in paragraph (42) of this subsection;

(ii) municipal securities, as defined in paragraph (29) of this subsection;

(iii) any interest or participation in any common trust fund or similar fund that is excluded from the definition of the term "investment company" under section 3(c)(3) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(3)];

(iv) any interest or participation in a single trust fund, or a collective trust fund maintained by a bank, or any security arising out of a contract issued by an insurance company, which interest, participation, or security is issued in connection with a qualified plan as defined in subparagraph (C) of this paragraph;

(v) any security issued by or any interest or participation in any pooled income fund, collective trust fund, collective investment fund, or similar fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(10)(B)];

(vi) solely for purposes of sections 78*l*, 78m, 78n, and 78p of this title, any security issued by or any interest or participation in any church plan, company, or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(14)]; and

(vii) such other securities (which may include, among others, unregistered securities, the market in which is predominantly intrastate) as the Commission may, by such rules and regulations as it deems consistent with the public interest and the protection of investors, either unconditionally or upon specified terms and conditions or for stated periods, exempt from the operation of any one or more provisions of this chapter which by their terms do not apply to an "exempted security" or to "exempted securities".

(B)(i) Notwithstanding subparagraph (A)(i) of this paragraph, government securities shall not be deemed to be "exempted securities" for the purposes of section 78q–1 of this title.

(ii) Notwithstanding subparagraph (A)(ii) of this paragraph, municipal securities shall not be deemed to be "exempted securities" for the purposes of sections 78*o* and 78q–1 of this title.

(C) For purposes of subparagraph (A)(iv) of this paragraph, the term "qualified plan" means (i) a stock bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of title 26, (ii) an annuity plan which meets the requirements for the deduction of the employer's contribution under section 404(a)(2) of title 26, (iii) a governmental plan as defined in section 414(d) of title 26 which has been established by an employer for the exclusive benefit of its employees or their beneficiaries for the purpose of distributing to such employees or their beneficiaries the corpus and income of the funds accumulated under such plan, if under such plan it is impossible, prior to the satisfaction of all liabilities with respect to such employees and their beneficiaries, for any part of the corpus or income to be used for, or diverted to, purposes other than the exclusive benefit of such employees or their beneficiaries, or (iv) a church plan, company, or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(14)], other than any plan described in clause (i), (ii), or (iii) of this subparagraph which (I) covers employees some or all of whom are employees within the meaning of section 401(c) of title 26, or (II) is a plan funded by an annuity contract described in section 403(b) of title 26.

(13) The terms "buy" and "purchase" each include any contract to buy, purchase, or otherwise acquire. For security futures products, such term includes any contract, agreement, or transaction for future delivery.

(14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of. For security futures products, such term includes any contract, agreement, or transaction for future delivery.

(15) The term "Commission" means the Securities and Exchange Commission established by section 78d of this title.

(16) The term "State" means any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States.

(17) The term "interstate commerce" means trade, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and

any place or ship outside thereof. The term also includes intrastate use of (A) any facility of a national securities exchange or of a telephone or other interstate means of communication, or (B) any other interstate instrumentality.

(18) The term "person associated with a broker or dealer" or "associated person of a broker or dealer" means any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of section 78*o*(b) of this title (other than paragraph (6) thereof).

(19) The terms "investment company", "affiliated person", "insurance company", "separate account", and "company" have the same meanings as in the Investment Company Act of 1940 [15 U.S.C. 80a–1 et seq.].

(20) The terms "investment adviser" and "underwriter" have the same meanings as in the Investment Advisers Act of 1940 [15 U.S.C. 80b–1 et seq.].

(21) The term "person associated with a member" or "associated person of a member" when used with respect to a member of a national securities exchange or registered securities association means any partner, officer, director, or branch manager of such member (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such member, or any employee of such member.

(22)(A) The term "securities information processor" means any person engaged in the business of (i) collecting, processing, or preparing for distribution or publication, or assisting, participating in, or coordinating the distribution or publication of, information with respect to transactions in or quotations for any security (other than an exempted security) or (ii) distributing or publishing (whether by means of a ticker tape, a communications network, a terminal display device, or otherwise) on a current and continuing basis, information with respect to such transactions or quotations. The term "securities information processor" does not include any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation, any self-regulatory organizations, any bank, broker, dealer, building and loan, savings and loan, or homestead association, or cooperative bank, if such bank, broker, dealer, association, or cooperative bank would be deemed to be a securities information processor solely by reason of functions performed by such institutions as part of customary banking, brokerage, dealing, association, or cooperative bank activities, or any common carrier, as defined in section 153 of title 47, subject to the jurisdiction of the Federal Communications Commission or a State commission, as defined in section 153 of title 47, unless the Commission determines that such carrier is engaged in the business of collecting, processing, or preparing for distribution or publication, information with respect to transactions in or quotations for any security.

(B) The term "exclusive processor" means any securities information processor or self-regulatory organization which, directly or indirectly, engages on an exclusive basis on behalf of any national securities exchange or registered securities association, or any national securities exchange or registered securities association which engages on an exclusive basis on its own behalf, in collecting, processing, or preparing for distribution or publication any information with respect to (i) transactions or quotations on or effected or made by means of any facility of such exchange or (ii) quotations distributed or published by means of any electronic system operated or controlled by such association.

(23)(A) The term "clearing agency" means any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities. Such term also means any person, such as a securities depository, who (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates.

(B) The term "clearing agency" does not include (i) any Federal Reserve bank, Federal home loan bank, or Federal land bank; (ii) any national securities exchange or registered securities association solely by reason of its providing facilities for comparison of data respecting the terms of settlement of securities transactions effected on such exchange or by means of any electronic system operated or controlled by such association; (iii) any bank, broker, dealer, building and loan, savings and loan, or homestead association, or cooperative bank if such bank, broker, dealer, association, or cooperative bank would be deemed to be a clearing agency solely by reason of functions performed by such institution as part of customary banking, brokerage, dealing, association, or cooperative banking activities, or solely by reason of acting on behalf of a clearing agency or a participant therein in connection with the furnishing by the clearing agency of services to its participants or the use of services of the clearing agency by its participants, unless the Commission, by rule, otherwise provides as necessary or appropriate to assure the prompt and accurate clearance and settlement of securities transactions or to prevent evasion of this chapter; (iv) any life insurance company, its registered separate accounts, or a subsidiary of such insurance company solely by reason of functions commonly performed by such entities in connection with variable annuity contracts or variable life policies issued by such insurance company or its

separate accounts; (v) any registered open-end investment company or unit investment trust solely by reason of functions commonly performed by it in connection with shares in such registered open-end investment company or unit investment trust, or (vi) any person solely by reason of its performing functions described in paragraph (25)(E) of this subsection.

(24) The term "participant" when used with respect to a clearing agency means any person who uses a clearing agency to clear or settle securities transactions or to transfer, pledge, lend, or hypothecate securities. Such term does not include a person whose only use of a clearing agency is (A) through another person who is a participant or (B) as a pledgee of securities.

(25) The term "transfer agent" means any person who engages on behalf of an issuer of securities or on behalf of itself as an issuer of securities in (A) countersigning such securities upon issuance; (B) monitoring the issuance of such securities with a view to preventing unauthorized issuance, a function commonly performed by a person called a registrar; (C) registering the transfer of such securities; (D) exchanging or converting such securities; or (E) transferring record ownership of securities by bookkeeping entry without physical issuance of securities certificates. The term "transfer agent" does not include any insurance company or separate account which performs such functions solely with respect to variable annuity contracts or variable life policies which it issues or any registered clearing agency which performs such functions solely with respect to options contracts which it issues.

(26) The term "self-regulatory organization" means any national securities exchange, registered securities association, or registered clearing agency, or (solely for purposes of sections 78s(b), 78s(c), and 78w(b) ⊥ of this title) the Municipal Securities Rulemaking Board established by section 78*o*–4 of this title.

(27) The term "rules of an exchange", "rules of an association", or "rules of a clearing agency" means the constitution, articles of incorporation, bylaws, and rules, or instruments corresponding to the foregoing, of an exchange, association of brokers and dealers, or clearing agency, respectively, and such of the stated policies, practices, and interpretations of such exchange, association, or clearing agency 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 of such exchange, association, or clearing agency.

(28) The term "rules of a self-regulatory organization" means the rules of an exchange which is a national securities exchange, the rules of an association of brokers and dealers which is a registered securities association, the rules of a clearing agency which is a registered clearing agency, or the rules of the Municipal Securities Rulemaking Board.

(29) The term "municipal securities" means securities which are direct obligations of, or obligations guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States, or any security which is an industrial development bond (as defined in section 103(c)(2) ⊥ of title 26) the interest on which is excludable from gross income under section 103(a)(1) ⊥ of title 26 if, by reason of the application of paragraph (4) or (6) of section 103(c) ⊥ of title 26 (determined as if paragraphs (4)(A), (5), and (7) were not included in such section 103(c)), ⊥ paragraph (1) of such section 103(c) ⊥ does not apply to such security.

(30) The term "municipal securities dealer" means any person (including a separately identifiable department or division of a bank) engaged in the business of buying and selling municipal securities for his own account, through a broker or otherwise, but does not include—

(A) any person insofar as he buys or sells such securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business; or

(B) a bank, unless the bank is engaged in the business of buying and selling municipal securities for its own account other than in a fiduciary capacity, through a broker or otherwise: *Provided, however*, That if the bank is engaged in such business through a separately identifiable department or division (as defined by the Municipal Securities Rulemaking Board in accordance with section 78*o*–4(b)(2)(H) of this title), the department or division and not the bank itself shall be deemed to be the municipal securities dealer.

(31) The term "municipal securities broker" means a broker engaged in the business of effecting transactions in municipal securities for the account of others.

(32) The term "person associated with a municipal securities dealer" when used with respect to a municipal securities dealer which is a bank or a division or department of a bank means any person directly engaged in the management, direction, supervision, or performance of any of the municipal securities dealer's activities with respect to municipal securities, and any person directly or indirectly controlling such activities or controlled by the municipal securities dealer in connection with such activities.

(33) The term "municipal securities investment portfolio" means all municipal securities held for investment and not for sale as part of a regular business by a municipal securities dealer or by a person, directly or indirectly, controlling, controlled by, or under common control with a municipal securities dealer.

(34) The term "appropriate regulatory agency" means—

(A) When used with respect to a municipal securities dealer:

(i) the Comptroller of the Currency, in the case of a national bank, or a subsidiary or a department or division of any such bank;

(ii) the Board of Governors of the Federal Reserve System, in the case of a State member bank of the Federal Reserve System, a subsidiary or a department or division thereof, a bank

holding company, a subsidiary of a bank holding company which is a bank other than a bank specified in clause (i), (iii), or (iv) of this subparagraph, or a subsidiary or a department or division of such subsidiary;

(iii) the Federal Deposit Insurance Corporation, in the case of a bank insured by the Federal Deposit Insurance Corporation (other than a member of the Federal Reserve System), or a subsidiary or department or division thereof;

(iv) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))), the deposits of which are insured by the Federal Deposit Insurance Corporation, a subsidiary or a department or division of any such savings association, or a savings and loan holding company; and

(v) the Commission in the case of all other municipal securities dealers.

(B) When used with respect to a clearing agency or transfer agent:

(i) the Comptroller of the Currency, in the case of a national bank, or a subsidiary of any such bank;

(ii) the Board of Governors of the Federal Reserve System, in the case of a State member bank of the Federal Reserve System, a subsidiary thereof, a bank holding company, or a subsidiary of a bank holding company which is a bank other than a bank specified in clause (i), (iii), or (iv) of this subparagraph;

(iii) the Federal Deposit Insurance Corporation, in the case of a bank insured by the Federal Deposit Insurance Corporation (other than a member of the Federal Reserve System), or a subsidiary thereof;

(iv) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))), the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary of any such savings association, or a savings and loan holding company; and

(v) the Commission in the case of all other clearing agencies and transfer agents.

(C) When used with respect to a participant or applicant to become a participant in a clearing agency or a person requesting or having access to services offered by a clearing agency:

(i) The Comptroller of the Currency, in the case of a national bank when the appropriate regulatory agency for such clearing agency is not the Commission;

(ii) the Board of Governors of the Federal Reserve System in the case of a State member bank of the Federal Reserve System, a bank holding company, or a subsidiary of a bank holding company, or a subsidiary of a bank holding company which is a bank other than a bank specified in clause (i), (iii), or (iv) of this subparagraph when the appropriate regulatory agency for such clearing agency is not the Commission;

(iii) the Federal Deposit Insurance Corporation, in the case of a bank insured by the Federal Deposit Insurance Corporation (other than a member of the Federal Reserve System) when the appropriate regulatory agency for such clearing agency is not the Commission;

(iv) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))), the deposits of which are insured by the Federal Deposit Insurance Corporation, a savings and loan holding company, or a subsidiary of a savings and loan holding company when the appropriate regulatory agency for such clearing agency is not the Commission; and

(v) the Commission in all other cases.

(D) When used with respect to an institutional investment manager which is a bank the deposits of which are insured in accordance with the Federal Deposit Insurance Act [12 U.S.C. 1811 et seq.]:

(i) the Comptroller of the Currency, in the case of a national bank;

(ii) the Board of Governors of the Federal Reserve System, in the case of any other member bank of the Federal Reserve System;

(iii) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation; and

(iv) the Federal Deposit Insurance Corporation, in the case of any other insured bank.

(E) When used with respect to a national securities exchange or registered securities association, member thereof, person associated with a member thereof, applicant to become a member thereof or to become associated with a member thereof, or person requesting or having access to services offered by such exchange or association or member thereof, or the Municipal Securities Rulemaking Board, the Commission.

(F) When used with respect to a person exercising investment discretion with respect to an account;

(i) the Comptroller of the Currency, in the case of a national bank;

(ii) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))), the deposits of which are insured by the Federal Deposit Insurance Corporation; and

(iii) the Board of Governors of the Federal Reserve System in the case of any other member bank of the Federal Reserve System;

(iv) the Federal Deposit Insurance Corporation, in the case of any other bank the deposits of which are insured in accordance with the Federal Deposit Insurance Act [12 U.S.C. 1811 et seq.]; and

(v) the Commission in the case of all other such persons.

(G) When used with respect to a government securities broker or government securities dealer, or person associated with a government securities broker or government securities dealer:

(i) the Comptroller of the Currency, in the case of a national bank or a Federal branch or Federal agency of a foreign bank (as such terms are used in the International Banking Act of 1978 [12 U.S.C. 3101 et seq.]);

(ii) the Board of Governors of the Federal Reserve System, in the case of a State member bank of the Federal Reserve System, a foreign bank, an uninsured State branch or State agency of a foreign bank, a commercial lending company owned or controlled by a foreign bank (as such terms are used in the International Banking Act of 1978), or a corporation organized or having an agreement with the Board of Governors of the Federal Reserve System pursuant to section 25 or section 25A of the Federal Reserve Act [12 U.S.C. 601 et seq., 611 et seq.];

(iii) the Federal Deposit Insurance Corporation, in the case of a bank insured by the Federal Deposit Insurance Corporation (other than a member of the Federal Reserve System or a Federal savings bank) or an insured State branch of a foreign bank (as such terms are used in the International Banking Act of 1978);

(iv) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act [12 U.S.C. 1813(b)]) the deposits of which are insured by the Federal Deposit Insurance Corporation; [2]

(v) the Commission, in the case of all other government securities brokers and government securities dealers.

(H) When used with respect to an institution described in subparagraph (D), (F), or (G) of section 1841(c)(2), or held under section 1843(f) of title 12—

(i) the Comptroller of the Currency, in the case of a national bank;

(ii) the Board of Governors of the Federal Reserve System, in the case of a State member bank of the Federal Reserve System or any corporation chartered under section 25A of the Federal Reserve Act [12 U.S.C. 611 et seq.];

(iii) the Federal Deposit Insurance Corporation, in the case of any other bank the deposits of which are insured in accordance with the Federal Deposit Insurance Act [12 U.S.C. 1811 et seq.]; or

(iv) the Commission in the case of all other such institutions.

As used in this paragraph, the terms "bank holding company" and "subsidiary of a bank holding company" have the meanings given them in section 1841 of title 12, and the term "District of Columbia savings and loan association" means any association subject to examination and supervision by the Office of Thrift Supervision under section 1466a of title 12. As used in this paragraph, the term "savings and loan holding company" has the same meaning as in section 1467a(a) of title 12.

(35) A person exercises "investment discretion" with respect to an account if, directly or indirectly, such person (A) is authorized to determine what securities or other property shall be purchased or sold by or for the account, (B) makes decisions as to what securities or other property shall be purchased or sold by or for the account even though some other person may have responsibility for such investment decisions, or (C) otherwise exercises such influence with respect to the purchase and sale of securities or other property by or for the account as the Commission, by rule, determines, in the public interest or for the protection of investors, should be subject to the operation of the provisions of this chapter and the rules and regulations thereunder.

(36) A class of persons or markets is subject to "equal regulation" if no member of the class has a competitive advantage over any other member thereof resulting from a disparity in their regulation under this chapter which the Commission determines is unfair and not necessary or appropriate in furtherance of the purposes of this chapter.

(37) The term "records" means accounts, correspondence, memorandums, tapes, discs, papers, books, and other documents or transcribed information of any type, whether expressed in ordinary or machine language.

(38) The term "market maker" means any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis.

(39) A person is subject to a "statutory disqualification" with respect to membership or participation in, or association with a member of, a self-regulatory organization, if such person—

(A) has been and is expelled or suspended from membership or participation in, or barred or suspended from being associated with a member of, any self-regulatory organization, foreign equivalent of a self-regulatory organization, foreign or international securities exchange, contract market designated pursuant to section 5 of the Commodity Exchange Act (7 U.S.C. 7), or any substantially equivalent foreign statute or regulation, or futures association registered under section 17 of such Act (7 U.S.C. 21), or any substantially equivalent foreign statute or

regulation, or has been and is denied trading privileges on any such contract market or foreign equivalent;

(B) is subject to—

(i) an order of the Commission, other appropriate regulatory agency, or foreign financial regulatory authority—

(I) denying, suspending for a period not exceeding 12 months, or revoking his registration as a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer or limiting his activities as a foreign person performing a function substantially equivalent to any of the above; or

(II) barring or suspending for a period not exceeding 12 months his being associated with a broker, dealer, municipal securities dealer, government securities broker, government securities dealer, or foreign person performing a function substantially equivalent to any of the above;

(ii) an order of the Commodity Futures Trading Commission denying, suspending, or revoking his registration under the Commodity Exchange Act (7 U.S.C. 1 et seq.); or

(iii) an order by a foreign financial regulatory authority denying, suspending, or revoking the person's authority to engage in transactions in contracts of sale of a commodity for future delivery or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent thereof;

(C) by his conduct while associated with a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer, or while associated with an entity or person required to be registered under the Commodity Exchange Act, has been found to be a cause of any effective suspension, expulsion, or order of the character described in subparagraph (A) or (B) of this paragraph, and in entering such a suspension, expulsion, or order, the Commission, an appropriate regulatory agency, or any such self-regulatory organization shall have jurisdiction to find whether or not any person was a cause thereof;

(D) by his conduct while associated with any broker, dealer, municipal securities dealer, government securities broker, government securities dealer, or any other entity engaged in transactions in securities, or while associated with an entity engaged in transactions in contracts of sale of a commodity for future delivery or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent thereof, has been found to be a cause of any effective suspension, expulsion, or order by a foreign or international securities exchange or foreign financial regulatory authority empowered by a foreign government to administer or enforce its laws relating to financial transactions as described in subparagraph (A) or (B) of this paragraph;

(E) has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person described by subparagraph (A), (B), (C), or (D) of this paragraph; or

(F) has committed or omitted any act, or is subject to an order or finding, enumerated in subparagraph (D), (E), (H), or (G) of paragraph (4) of section 78*o*(b) of this title, has been convicted of any offense specified in subparagraph (B) of such paragraph (4) or any other felony within ten years of the date of the filing of an application for membership or participation in, or to become associated with a member of, such self-regulatory organization, is enjoined from any action, conduct, or practice specified in subparagraph (C) of such paragraph (4), has willfully made or caused to be made in any application for membership or participation in, or to become associated with a member of, a self-regulatory organization, report required to be filed with a self-regulatory organization, or proceeding before a self-regulatory organization, any statement which was at the time, and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application, report, or proceeding any material fact which is required to be stated therein.

(40) The term "financial responsibility rules" means the rules and regulations of the Commission or the rules and regulations prescribed by any self-regulatory organization relating to financial responsibility and related practices which are designated by the Commission, by rule or regulation, to be financial responsibility rules.

(41) The term "mortgage related security" means a security that is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization, and either:

(A) represents ownership of one or more promissory notes or certificates of interest or participation in such notes (including any rights designed to assure servicing of, or the receipt or timeliness of receipt by the holders of such notes, certificates, or participations of amounts payable under, such notes, certificates, or participations), which notes:

(i) are directly secured by a first lien on a single parcel of real estate, including stock allocated to a dwelling unit in a residential cooperative housing corporation, upon which is located a dwelling or mixed residential and commercial structure, on a residential manufactured home as defined in section 5402(6) of title 42, whether such manufactured home is considered real or personal property under the laws of the State in which it is to be located, or on one or more parcels of real estate upon which is located one or more commercial structures; and

(ii) were originated by a savings and loan association, savings bank, commercial bank, credit union, insurance company, or similar institution which is supervised and examined by a Federal or State authority, or by a mortgagee approved by the Secretary of Housing and Urban Development pursuant to sections 1709 and 1715b of title 12, or, where such notes involve a lien on the manufactured home, by any such institution or by any financial institution approved for insurance by the Secretary of Housing and Urban Development pursuant to section 1703 of title 12; or

(B) is secured by one or more promissory notes or certificates of interest or participations in such notes (with or without recourse to the issuer thereof) and, by its terms, provides for payments of principal in relation to payments, or reasonable projections of payments, on notes meeting the requirements of subparagraphs (A)(i) and (ii) or certificates of interest or participations in promissory notes meeting such requirements.

For the purpose of this paragraph, the term "promissory note", when used in connection with a manufactured home, shall also include a loan, advance, or credit sale as evidence [3] by a retail installment sales contract or other instrument.

(42) The term "government securities" means—

(A) securities which are direct obligations of, or obligations guaranteed as to principal or interest by, the United States;

(B) securities which are issued or guaranteed by the Tennessee Valley Authority or by corporations in which the United States has a direct or indirect interest and which are designated by the Secretary of the Treasury for exemption as necessary or appropriate in the public interest or for the protection of investors;

(C) securities issued or guaranteed as to principal or interest by any corporation the securities of which are designated, by statute specifically naming such corporation, to constitute exempt securities within the meaning of the laws administered by the Commission;

(D) for purposes of sections 78*o*–5 and 78q–1 of this title, any put, call, straddle, option, or privilege on a security described in subparagraph (A), (B), or (C) other than a put, call, straddle, option, or privilege—

(i) that is traded on one or more national securities exchanges; or

(ii) for which quotations are disseminated through an automated quotation system operated by a registered securities association; or

(E) for purposes of sections 78*o*, 78*o*–5, and 78q–1 of this title as applied to a bank, a qualified Canadian government obligation as defined in section 24 of title 12.

(43) The term "government securities broker" means any person regularly engaged in the business of effecting transactions in government securities for the account of others, but does not include—

(A) any corporation the securities of which are government securities under subparagraph (B) or (C) of paragraph (42) of this subsection; or

(B) any person registered with the Commodity Futures Trading Commission, any contract market designated by the Commodity Futures Trading Commission, such contract market's affiliated clearing organization, or any floor trader on such contract market, solely because such person effects transactions in government securities that the Commission, after consultation with the Commodity Futures Trading Commission, has determined by rule or order to be incidental to such person's futures-related business.

(44) The term "government securities dealer" means any person engaged in the business of buying and selling government securities for his own account, through a broker or otherwise, but does not include—

(A) any person insofar as he buys or sells such securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business;

(B) any corporation the securities of which are government securities under subparagraph (B) or (C) of paragraph (42) of this subsection;

(C) any bank, unless the bank is engaged in the business of buying and selling government securities for its own account other than in a fiduciary capacity, through a broker or otherwise; or

(D) any person registered with the Commodity Futures Trading Commission, any contract market designated by the Commodity Futures Trading Commission, such contract market's affiliated clearing organization, or any floor trader on such contract market, solely because such person effects transactions in government securities that the Commission, after consultation with the Commodity Futures Trading Commission, has determined by rule or order to be incidental to such person's futures-related business.

(45) The term "person associated with a government securities broker or government securities dealer" means any partner, officer, director, or branch manager of such government securities broker or government securities dealer (or any person occupying a similar status or performing similar functions), and any other employee of such government securities broker or government securities dealer who is engaged in the management, direction, supervision, or performance of any activities relating to government securities, and any person directly or indirectly controlling,

controlled by, or under common control with such government securities broker or government securities dealer.

(46) The term "financial institution" means—

(A) a bank (as defined in paragraph (6) of this subsection);

(B) a foreign bank (as such term is used in the International Banking Act of 1978); and

(C) a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act [12 U.S.C. 1813(b)]) the deposits of which are insured by the Federal Deposit Insurance Corporation.

(47) The term "securities laws" means the Securities Act of 1933 (15 U.S.C. 77a et seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), the Sarbanes-Oxley Act of 2002 [15 U.S.C. 7201 et seq.], the Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.), the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.), the Investment Advisers Act of 1940 (15 U.S.C. 80b et seq.) [15 U.S.C. 80b–1 et seq.], and the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.).

(48) The term "registered broker or dealer" means a broker or dealer registered or required to register pursuant to section 78*o* or 78*o*–4 of this title, except that in paragraph (3) of this subsection and sections 78*f* and 78*o*–3 of this title the term means such a broker or dealer and a government securities broker or government securities dealer registered or required to register pursuant to section 78*o*–5(a)(1)(A) of this title.

(49) The term "person associated with a transfer agent" and "associated person of a transfer agent" mean any person (except an employee whose functions are solely clerical or ministerial) directly engaged in the management, direction, supervision, or performance of any of the transfer agent's activities with respect to transfer agent functions, and any person directly or indirectly controlling such activities or controlled by the transfer agent in connection with such activities.

(50) The term "foreign securities authority" means any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters.

(51)(A) The term "penny stock" means any equity security other than a security that is—

(i) registered or approved for registration and traded on a national securities exchange that meets such criteria as the Commission shall prescribe by rule or regulation for purposes of this paragraph;

(ii) authorized for quotation on an automated quotation system sponsored by a registered securities association, if such system (I) was established and in operation before January 1, 1990, and (II) meets such criteria as the Commission shall prescribe by rule or regulation for purposes of this paragraph;

(iii) issued by an investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a–1 et seq.];

(iv) excluded, on the basis of exceeding a minimum price, net tangible assets of the issuer, or other relevant criteria, from the definition of such term by rule or regulation which the Commission shall prescribe for purposes of this paragraph; or

(v) exempted, in whole or in part, conditionally or unconditionally, from the definition of such term by rule, regulation, or order prescribed by the Commission.

(B) The Commission may, by rule, regulation, or order, designate any equity security or class of equity securities described in clause (i) or (ii) of subparagraph (A) as within the meaning of the term "penny stock" if such security or class of securities is traded other than on a national securities exchange or through an automated quotation system described in clause (ii) of subparagraph (A).

(C) In exercising its authority under this paragraph to prescribe rules, regulations, and orders, the Commission shall determine that such rule, regulation, or order is consistent with the public interest and the protection of investors.

(52) The term "foreign financial regulatory authority" means any (A) foreign securities authority, (B) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts of sale of a commodity for future delivery, or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent, or other financial activities, or (C) membership organization a function of which is to regulate participation of its members in activities listed above.

(53)(A) The term "small business related security" means a security that is rated in 1 of the 4 highest rating categories by at least 1 nationally recognized statistical rating organization, and either—

(i) represents an interest in 1 or more promissory notes or leases of personal property evidencing the obligation of a small business concern and originated by an insured depository institution, insured credit union, insurance company, or similar institution which is supervised and examined by a Federal or State authority, or a finance company or leasing company; or

(ii) is secured by an interest in 1 or more promissory notes or leases of personal property (with or without recourse to the issuer or lessee) and provides for payments of principal in relation to payments, or reasonable projections of payments, on notes or leases described in clause (i).

(B) For purposes of this paragraph—

(i) an "interest in a promissory note or a lease of personal property" includes ownership rights, certificates of interest or participation in such notes or leases, and rights designed to assure servicing of such notes or leases, or the receipt or timely receipt of amounts payable under such notes or leases;

(ii) the term "small business concern" means a business that meets the criteria for a small business concern established by the Small Business Administration under section 632(a) of this title;

(iii) the term "insured depository institution" has the same meaning as in section 3 of the Federal Deposit Insurance Act [12 U.S.C. 1813]; and

(iv) the term "insured credit union" has the same meaning as in section 1752 of title 12.

(54) QUALIFIED INVESTOR.—

(A) DEFINITION.—Except as provided in subparagraph (B), for purposes of this chapter, the term "qualified investor" means—

(i) any investment company registered with the Commission under section 8 of the Investment Company Act of 1940 [15 U.S.C. 80a–8];

(ii) any issuer eligible for an exclusion from the definition of investment company pursuant to section 3(c)(7) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(7)];

(iii) any bank (as defined in paragraph (6) of this subsection), savings association (as defined in section 3(b) of the Federal Deposit Insurance Act [12 U.S.C. 1813(b)]), broker, dealer, insurance company (as defined in section 2(a)(13) of the Securities Act of 1933 [15 U.S.C. 77b(a)(13)]), or business development company (as defined in section 2(a)(48) of the Investment Company Act of 1940 [15 U.S.C. 80a–2(a)(48)]);

(iv) any small business investment company licensed by the United States Small Business Administration under section 301(c) [15 U.S.C. 681(c)] or (d) [1] of the Small Business Investment Act of 1958;

(v) any State sponsored employee benefit plan, or any other employee benefit plan, within the meaning of the Employee Retirement Income Security Act of 1974 [29 U.S.C. 1001 et seq.], other than an individual retirement account, if the investment decisions are made by a plan fiduciary, as defined in section 3(21) of that Act [29 U.S.C. 1002(21)], which is either a bank, savings and loan association, insurance company, or registered investment adviser;

(vi) any trust whose purchases of securities are directed by a person described in clauses (i) through (v) of this subparagraph;

(vii) any market intermediary exempt under section 3(c)(2) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(2)];

(viii) any associated person of a broker or dealer other than a natural person;

(ix) any foreign bank (as defined in section 1(b)(7) of the International Banking Act of 1978 [12 U.S.C. 3101(7)]);

(x) the government of any foreign country;

(xi) any corporation, company, or partnership that owns and invests on a discretionary basis, not less than $25,000,000 in investments;

(xii) any natural person who owns and invests on a discretionary basis, not less than $25,000,000 in investments;

(xiii) any government or political subdivision, agency, or instrumentality of a government who owns and invests on a discretionary basis not less than $50,000,000 in investments; or

(xiv) any multinational or supranational entity or any agency or instrumentality thereof.

(B) ALTERED THRESHOLDS FOR ASSET-BACKED SECURITIES AND LOAN PARTICIPATIONS.—For purposes of subsection (a)(5)(C)(iii) of this section and section 206(a)(5) of the Gramm-Leach-Bliley Act, the term "qualified investor" has the meaning given such term by subparagraph (A) of this paragraph except that clauses (xi) and (xii) shall be applied by substituting "$10,000,000" for "$25,000,000".

(C) ADDITIONAL AUTHORITY.—The Commission may, by rule or order, define a "qualified investor" as any other person, taking into consideration such factors as the financial sophistication of the person, net worth, and knowledge and experience in financial matters.

(55)(A) The term "security future" means a contract of sale for future delivery of a single security or of a narrow-based security index, including any interest therein or based on the value thereof, except an exempted security under paragraph (12) of this subsection as in effect on January 11, 1983 (other than any municipal security as defined in paragraph (29) of this subsection as in effect on January 11, 1983). The term "security future" does not include any agreement, contract, or transaction excluded from the Commodity Exchange Act [7 U.S.C. 1 et seq.] under section 2(c), 2(d), 2(f), or 2(g) of the Commodity Exchange Act [7 U.S.C. 2(c), (d), (f), (g)] (as in effect on December 21, 2000) or sections 27 to 27f of title 7.

(B) The term "narrow-based security index" means an index—

(i) that has 9 or fewer component securities;

(ii) in which a component security comprises more than 30 percent of the index's weighting;

(iii) in which the five highest weighted component securities in the aggregate comprise more than 60 percent of the index's weighting; or

(iv) in which the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting have an aggregate dollar value of average daily trading volume of less than $50,000,000 (or in the case of an index with 15 or more component securities,

$30,000,000), except that if there are two or more securities with equal weighting that could be included in the calculation of the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting, such securities shall be ranked from lowest to highest dollar value of average daily trading volume and shall be included in the calculation based on their ranking starting with the lowest ranked security.

(C) Notwithstanding subparagraph (B), an index is not a narrow-based security index if—
(i)(I) it has at least nine component securities;
(II) no component security comprises more than 30 percent of the index's weighting; and
(III) each component security is—
(aa) registered pursuant to section 78*l* of this title;
(bb) one of 750 securities with the largest market capitalization; and
(cc) one of 675 securities with the largest dollar value of average daily trading volume;

(ii) a board of trade was designated as a contract market by the Commodity Futures Trading Commission with respect to a contract of sale for future delivery on the index, before December 21, 2000;
(iii)(I) a contract of sale for future delivery on the index traded on a designated contract market or registered derivatives transaction execution facility for at least 30 days as a contract of sale for future delivery on an index that was not a narrow-based security index; and
(II) it has been a narrow-based security index for no more than 45 business days over 3 consecutive calendar months;
(iv) a contract of sale for future delivery on the index is traded on or subject to the rules of a foreign board of trade and meets such requirements as are jointly established by rule or regulation by the Commission and the Commodity Futures Trading Commission;
(v) no more than 18 months have passed since December 21, 2000, and—
(I) it is traded on or subject to the rules of a foreign board of trade;
(II) the offer and sale in the United States of a contract of sale for future delivery on the index was authorized before December 21, 2000; and
(III) the conditions of such authorization continue to be met; or

(vi) a contract of sale for future delivery on the index is traded on or subject to the rules of a board of trade and meets such requirements as are jointly established by rule, regulation, or order by the Commission and the Commodity Futures Trading Commission.

(D) Within 1 year after December 21, 2000, the Commission and the Commodity Futures Trading Commission jointly shall adopt rules or regulations that set forth the requirements under clause (iv) of subparagraph (C).
(E) An index that is a narrow-based security index solely because it was a narrow-based security index for more than 45 business days over 3 consecutive calendar months pursuant to clause (iii) of subparagraph (C) shall not be a narrow-based security index for the 3 following calendar months.
(F) For purposes of subparagraphs (B) and (C) of this paragraph—
(i) the dollar value of average daily trading volume and the market capitalization shall be calculated as of the preceding 6 full calendar months; and
(ii) the Commission and the Commodity Futures Trading Commission shall, by rule or regulation, jointly specify the method to be used to determine market capitalization and dollar value of average daily trading volume.

(56) The term "security futures product" means a security future or any put, call, straddle, option, or privilege on any security future.
(57)(A) The term "margin", when used with respect to a security futures product, means the amount, type, and form of collateral required to secure any extension or maintenance of credit, or the amount, type, and form of collateral required as a performance bond related to the purchase, sale, or carrying of a security futures product.
(B) The terms "margin level" and "level of margin", when used with respect to a security futures product, mean the amount of margin required to secure any extension or maintenance of credit, or the amount of margin required as a performance bond related to the purchase, sale, or carrying of a security futures product.
(C) The terms "higher margin level" and "higher level of margin", when used with respect to a security futures product, mean a margin level established by a national securities exchange registered pursuant to section 78f(g) of this title that is higher than the minimum amount established and in effect pursuant to section 78g(c)(2)(B) of this title.
(58) AUDIT COMMITTEE.—The term "audit committee" means—
(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and
(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

(59) REGISTERED PUBLIC ACCOUNTING FIRM.—The term "registered public accounting firm" has the same meaning as in section 2 of the Sarbanes-Oxley Act of 2002 [15 U.S.C. 7201].

(60) CREDIT RATING.—The term "credit rating" means an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.

(61) CREDIT RATING AGENCY.—The term "credit rating agency" means any person—

(A) engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;

(B) employing either a quantitative or qualitative model, or both, to determine credit ratings; and

(C) receiving fees from either issuers, investors, or other market participants, or a combination thereof.

(62) NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION.—The term "nationally recognized statistical rating organization" means a credit rating agency that—

(A) issues credit ratings certified by qualified institutional buyers, in accordance with section 78*o*–7(a)(1)(B)(ix) of this title, with respect to—

(i) financial institutions, brokers, or dealers;

(ii) insurance companies;

(iii) corporate issuers;

(iv) issuers of asset-backed securities (as that term is defined in section 1101(c) of part 229 of title 17, Code of Federal Regulations, as in effect on September 29, 2006);

(v) issuers of government securities, municipal securities, or securities issued by a foreign government; or

(vi) a combination of one or more categories of obligors described in any of clauses (i) through (v); and

(B) is registered under section 78*o*–7 of this title.

(63) PERSON ASSOCIATED WITH A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION.—The term "person associated with" a nationally recognized statistical rating organization means any partner, officer, director, or branch manager of a nationally recognized statistical rating organization (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with a nationally recognized statistical rating organization, or any employee of a nationally recognized statistical rating organization.

(64) QUALIFIED INSTITUTIONAL BUYER.—The term "qualified institutional buyer" has the meaning given such term in section 230.144A(a) of title 17, Code of Federal Regulations, or any successor thereto.

(77) [4] ASSET-BACKED SECURITY.—The term "asset-backed security"—

(A) means a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including—

(i) a collateralized mortgage obligation;

(ii) a collateralized debt obligation;

(iii) a collateralized bond obligation;

(iv) a collateralized debt obligation of asset-backed securities;

(v) a collateralized debt obligation of collateralized debt obligations; and

(vi) a security that the Commission, by rule, determines to be an asset-backed security for purposes of this section; and

(B) does not include a security issued by a finance subsidiary held by the parent company or a company controlled by the parent company, if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company.

(b) Power to define technical, trade, accounting, and other terms

The Commission and the Board of Governors of the Federal Reserve System, as to matters within their respective jurisdictions, shall have power by rules and regulations to define technical, trade, accounting, and other terms used in this chapter, consistently with the provisions and purposes of this chapter.

(c) Application to governmental departments or agencies

No provision of this chapter shall apply to, or be deemed to include, any executive department or independent establishment of the United States, or any lending agency which is wholly owned, directly or indirectly, by the United States, or any officer, agent, or employee of any such department, establishment, or agency, acting in the course of his official duty as such, unless such provision makes specific reference to such department, establishment, or agency.

(d) Issuers of municipal securities

No issuer of municipal securities or officer or employee thereof acting in the course of his official duties as such shall be deemed to be a "broker", "dealer", or "municipal securities dealer" solely by reason of buying, selling, or effecting transactions in the issuer's securities.

(e) Charitable organizations

(1) Exemption

Notwithstanding any other provision of this chapter, but subject to paragraph (2) of this subsection, a charitable organization, as defined in section 3(c)(10)(D) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(10)(D)], or any trustee, director, officer, employee, or volunteer of such a charitable organization acting within the scope of such person's employment or duties with such organization, shall not be deemed to be a "broker", "dealer", "municipal securities broker", "municipal securities dealer", "government securities broker", or "government securities dealer" for purposes of this chapter solely because such organization or person buys, holds, sells, or trades in securities for its own account in its capacity as trustee or administrator of, or otherwise on behalf of or for the account of—

(A) such a charitable organization;

(B) a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(10)(B)]; or

(C) a trust or other donative instrument described in section 3(c)(10)(B) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(10)(B)], or the settlors (or potential settlors) or beneficiaries of any such trust or other instrument.

(2) Limitation on compensation

The exemption provided under paragraph (1) shall not be available to any charitable organization, or any trustee, director, officer, employee, or volunteer of such a charitable organization, unless each person who, on or after 90 days after December 8, 1995, solicits donations on behalf of such charitable organization from any donor to a fund that is excluded from the definition of an investment company under section 3(c)(10)(B) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(10)(B)], is either a volunteer or is engaged in the overall fund raising activities of a charitable organization and receives no commission or other special compensation based on the number or the value of donations collected for the fund.

(f) Consideration of promotion of efficiency, competition, and capital formation

Whenever pursuant to this chapter the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

(g) Church plans

No church plan described in section 414(e) of title 26, no person or entity eligible to establish and maintain such a plan under title 26, no company or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(14)], and no trustee, director, officer or employee of or volunteer for such plan, company, account, person, or entity, acting within the scope of that person's employment or activities with respect to such plan, shall be deemed to be a "broker", "dealer", "municipal securities broker", "municipal securities dealer", "government securities broker", "government securities dealer", "clearing agency", or "transfer agent" for purposes of this chapter—

(1) solely because such plan, company, person, or entity buys, holds, sells, trades in, or transfers securities or acts as an intermediary in making payments in connection with transactions in securities for its own account in its capacity as trustee or administrator of, or otherwise on behalf of, or for the account of, any church plan, company, or account that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(14)]; and

(2) if no such person or entity receives a commission or other transaction-related sales compensation in connection with any activities conducted in reliance on the exemption provided by this subsection.

(June 6, 1934, ch. 404, title I, §3, 48 Stat. 882; Aug. 23, 1935, ch. 614, §203(a), 49 Stat. 704; Proc. No. 2695, eff. July 4, 1946, 11 F.R. 7517, 60 Stat. 1352; Pub. L. 86–70, §12(b), June 25, 1959, 73 Stat. 143; Pub. L. 86–624, §7(b), July 12, 1960, 74 Stat. 412; Pub. L. 88–467, §2, Aug. 20, 1964, 78 Stat. 565; Pub. L. 91–373, title IV, §401(b), Aug. 10, 1970, 84 Stat. 718; Pub. L. 91–547, §28(a), (b), Dec. 14, 1970, 84 Stat. 1435; Pub. L. 91–567, §6(b), Dec. 22, 1970, 84 Stat. 1499; Pub. L. 94–29, §3, June 4, 1975, 89 Stat. 97; Pub. L. 95–283, §16, May 21, 1978, 92 Stat. 274; Pub. L. 96–477, title VII, §702, Oct. 21, 1980, 94 Stat. 2295; Pub. L. 97–303, §2, Oct. 13, 1982, 96 Stat. 1409; Pub. L. 98–376, §6(a), Aug. 10, 1984, 98 Stat. 1265; Pub. L. 98–440, title I, §101, Oct. 3, 1984, 98 Stat. 1689; Pub. L. 99–514, §2, Oct. 22, 1986, 100 Stat. 2095; Pub. L. 99–571, title I, §102(a)–(d), Oct. 28, 1986, 100 Stat. 3214–3216; Pub. L. 100–181, title III, §§301–306, Dec. 4, 1987, 101 Stat. 1253, 1254; Pub. L. 100–704, §6(a), Nov. 19, 1988, 102 Stat. 4681; Pub. L. 101–73, title VII, §744(u)(1), Aug. 9, 1989, 103 Stat. 441; Pub. L. 101–429, title V, §503, Oct. 15, 1990, 104 Stat. 952; Pub. L. 101–550, title II, §§203(b), 204, Nov. 15, 1990, 104 Stat. 2717, 2718; Pub. L. 103–202, title I, §§106(b)(2)(A), 109(a), Dec. 17, 1993, 107 Stat. 2350, 2352; Pub. L. 103–325, title II, §202, title III, §347(a), Sept. 23, 1994, 108 Stat. 2198, 2241; Pub. L. 104–62, §4(a), (b), Dec. 8, 1995, 109 Stat. 684; Pub. L. 104–290, title I, §106(b), title V, §508(c), Oct. 11, 1996, 110 Stat. 3424, 3447; Pub. L. 105–353, title III, §301(b)(1)–(4), Nov. 3, 1998, 112 Stat. 3235, 3236; Pub. L. 106–102, title II, §§201, 202, 207, 208, 221(b), 231(b)(1), Nov. 12, 1999, 113 Stat. 1385, 1390, 1394, 1395, 1401, 1406; Pub. L. 106–554, §1(a)(5) [title II, §201], Dec. 21, 2000, 114 Stat. 2763, 2763A–413; Pub. L. 107–204, §2(b), title II, §205(a), title VI, §604(c)(1)(A), July 30, 2002, 116 Stat. 749, 773, 796; Pub. L. 108–359, §1(c)(1), Oct. 25, 2004, 118 Stat. 1666; Pub. L. 108–386, §8(f)(1)–(3), Oct. 30, 2004,

118 Stat. 2232; Pub. L. 108–447, div. H, title V, §520(1), Dec. 8, 2004, 118 Stat. 3267; Pub. L. 109–291, §3(a), Sept. 29, 2006, 120 Stat. 1328; Pub. L. 109–351, title I, §101(a)(1), title IV, §401(a)(1), (2), Oct. 13, 2006, 120 Stat. 1968, 1971, 1972; Pub. L. 111–203, title III, §376(1), title VII, §761(a), title IX, §§932(b), 939(e), 941(a), 944(b), 985(b)(2), 986(a)(1), July 21, 2010, 124 Stat. 1566, 1754, 1883, 1886, 1890, 1898, 1933, 1935.)

AMENDMENT OF SUBSECTION (A)

Pub. L. 111–203, title VII, §§761(a), 774, July 21, 2010, 124 Stat. 1754, 1802, provided that, effective on the later of 360 days after July 21, 2010, or, to the extent a provision of subtitle B (§§761–774) of title VII of Pub. L. 111–203 requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of subtitle B, subsection (a) of this section is amended as follows:

(1) in paragraph (5)(A), (B), by inserting "(not including security-based swaps, other than security-based swaps with or for persons that are not eligible contract participants)" after "securities" each place that term appears;

(2) in paragraph (10), by inserting "security-based swap," after "security future,";

(3) in paragraph (13), by adding at the end the following: "For security-based swaps, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require.";

(4) in paragraph (14), by adding at the end the following: "For security-based swaps, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require.";

(5) in paragraph (39)—

(A) in subparagraph (B)(i)—

(i) in subclause (I), by striking "or government securities dealer" and inserting "government securities dealer, security-based swap dealer, or major security-based swap participant"; and

(ii) in subclause (II), by inserting "security-based swap dealer, major security-based swap participant," after "government securities dealer,";

(B) in subparagraph (C), by striking "or government securities dealer" and inserting "government securities dealer, security-based swap dealer, or major security-based swap participant"; and

(C) in subparagraph (D), by inserting "security-based swap dealer, major security-based swap participant," after "government securities dealer,"; and

(6) by adding at the end the following:

(65) ELIGIBLE CONTRACT PARTICIPANT.—The term "eligible contract participant" has the same meaning as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

(66) MAJOR SWAP PARTICIPANT.—The term "major swap participant" has the same meaning as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

(67) MAJOR SECURITY-BASED SWAP PARTICIPANT.—

(A) IN GENERAL.—The term "major security-based swap participant" means any person—

(i) who is not a security-based swap dealer; and

(ii)(I) who maintains a substantial position in security-based swaps for any of the major security-based swap categories, as such categories are determined by the Commission, excluding both positions held for hedging or mitigating commercial risk and positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;

(II) whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or

(III) that is a financial entity that—

(aa) is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and

(bb) maintains a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission.

(B) DEFINITION OF SUBSTANTIAL POSITION.—For purposes of subparagraph (A), the Commission shall define, by rule or regulation, the term "substantial position" at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. In setting the definition under this subparagraph, the Commission shall consider the person's relative position in uncleared as opposed to cleared security-based swaps and may take into consideration the value and quality of collateral held against counterparty exposures.

(C) SCOPE OF DESIGNATION.—For purposes of subparagraph (A), a person may be designated as a major security-based swap participant for 1 or more categories of security-based swaps without being classified as a major security-based swap participant for all classes of security-based swaps.

(68) SECURITY-BASED SWAP.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term "security-based swap" means any agreement, contract, or transaction that—

(i) is a swap, as that term is defined under section 1a of the Commodity Exchange Act (without regard to paragraph (47)(B)(x) of such section); and

(ii) is based on—

(I) an index that is a narrow-based security index, including any interest therein or on the value thereof;

(II) a single security or loan, including any interest therein or on the value thereof; or

(III) the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer.

(B) RULE OF CONSTRUCTION REGARDING MASTER AGREEMENTS.—The term "security-based swap" shall be construed to include a master agreement that provides for an agreement, contract, or transaction that is a security-based swap pursuant to subparagraph (A), together with all supplements to any such master agreement, without regard to whether the master agreement contains an agreement, contract, or transaction that is not a security-based swap pursuant to subparagraph (A), except that the master agreement shall be considered to be a security-based swap only with respect to each agreement, contract, or transaction under the master agreement that is a security-based swap pursuant to subparagraph (A).

(C) EXCLUSIONS.—The term "security-based swap" does not include any agreement, contract, or transaction that meets the definition of a security-based swap only because such agreement, contract, or transaction references, is based upon, or settles through the transfer, delivery, or receipt of an exempted security under paragraph (12), as in effect on January 11, 1983 (other than any municipal security as defined in paragraph (29) as in effect on January 11, 1983), unless such agreement, contract, or transaction is of the character of, or is commonly known in the trade as, a put, call, or other option.

(D) MIXED SWAP.—The term "security-based swap" includes any agreement, contract, or transaction that is as described in subparagraph (A) and also is based on the value of 1 or more interest or other rates, currencies, commodities, instruments of indebtedness, indices, quantitative measures, other financial or economic interest or property of any kind (other than a single security or a narrow-based security index), or the occurrence, non-occurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence (other than an event described in subparagraph (A)(ii)(III)).

(E) RULE OF CONSTRUCTION REGARDING USE OF THE TERM INDEX.—The term "index" means an index or group of securities, including any interest therein or based on the value thereof.

(69) SWAP.—The term "swap" has the same meaning as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

(70) PERSON ASSOCIATED WITH A SECURITY-BASED SWAP DEALER OR MAJOR SECURITY-BASED SWAP PARTICIPANT.—

(A) IN GENERAL.—The term "person associated with a security-based swap dealer or major security-based swap participant" or "associated person of a security-based swap dealer or major security-based swap participant" means—

(i) any partner, officer, director, or branch manager of such security-based swap dealer or major security-based swap participant (or any person occupying a similar status or performing similar functions);

(ii) any person directly or indirectly controlling, controlled by, or under common control with such security-based swap dealer or major security-based swap participant; or

(iii) any employee of such security-based swap dealer or major security-based swap participant.

(B) EXCLUSION.—Other than for purposes of section 78o–10(l)(2) of this title, the term "person associated with a security-based swap dealer or major security-based swap participant" or "associated person of a security-based swap dealer or major security-based swap participant" does not include any person associated with a security-based swap dealer or major security-based swap participant whose functions are solely clerical or ministerial.

(71) SECURITY-BASED SWAP DEALER.—

(A) IN GENERAL.—The term "security-based swap dealer" means any person who—

(i) holds themself out as a dealer in security-based swaps;

(ii) makes a market in security-based swaps;

(iii) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or

(iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps.

(B) DESIGNATION BY TYPE OR CLASS.—A person may be designated as a security-based swap dealer for a single type or single class or category of security-based swap or activities and

considered not to be a security-based swap dealer for other types, classes, or categories of security-based swaps or activities.

(C) EXCEPTION.—The term "security-based swap dealer" does not include a person that enters into security-based swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.

(D) DE MINIMIS EXCEPTION.—The Commission shall exempt from designation as a security-based swap dealer an entity that engages in a de minimis quantity of security-based swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of any determination to exempt.

(72) APPROPRIATE FEDERAL BANKING AGENCY.—The term "appropriate Federal banking agency" has the same meaning as in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).

(73) BOARD.—The term "Board" means the Board of Governors of the Federal Reserve System.

(74) PRUDENTIAL REGULATOR.—The term "prudential regulator" has the same meaning as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

(75) SECURITY-BASED SWAP DATA REPOSITORY.—The term "security-based swap data repository" means any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security-based swaps.

(76) SWAP DEALER.—The term "swap dealer" has the same meaning as in section 1a of the Commodity Exchange Act (7 U.S.C. 1a).

(77) SECURITY-BASED SWAP EXECUTION FACILITY.—The term "security-based swap execution facility" means a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—

(A) facilitates the execution of security-based swaps between persons; and

(B) is not a national securities exchange.

(78) SECURITY-BASED SWAP AGREEMENT.—

(A) IN GENERAL.—For purposes of sections 78i, 78j, 78p, 78t, and 78u–1 of this title, and section 17 of the Securities Act of 1933 (15 U.S.C. 77q), the term "security-based swap agreement" means a swap agreement as defined in section 206A of the Gramm-Leach-Bliley Act (15 U.S.C. 78c note) of which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.

(B) EXCLUSIONS.—The term "security-based swap agreement" does not include any security-based swap.

AMENDMENT OF SUBSECTION (A)(34)

Pub. L. 111–203, title III, §§351, 376(1), July 21, 2010, 124 Stat. 1546, 1566, provided that, effective on the transfer date, subsection (a)(34) of this section is amended as follows:

(1) in subparagraph (A)—

(A) in clause (i), by striking "or a subsidiary or a department or division of any such bank" and inserting "a subsidiary or a department or division of any such bank, a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(2))), the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary or department or division of any such Federal savings association";

(B) in clause (ii), by striking "or a subsidiary or a department or division of such subsidiary" and inserting "a subsidiary or a department or division of such subsidiary, or a savings and loan holding company";

(C) in clause (iii), by striking "or a subsidiary or department or division thereof;" and inserting "a subsidiary or department or division of any such bank, a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3))), the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary or a department or division of any such State savings association; and"; and

(D) by striking clause (iv) and redesignating clause (v) as clause (iv);

(2) in subparagraph (B)—

(A) in clause (i), by striking "or a subsidiary of any such bank" and inserting "a subsidiary of any such bank, a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(2))), the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary of any such Federal savings association";

(B) in clause (ii), by striking "or a subsidiary of a bank holding company which is a bank other than a bank specified in clause (i), (iii), or (iv) of this subparagraph" and inserting "a subsidiary of a bank holding company that is a bank other than a bank specified in clause (i) or (iii) of this subparagraph, or a savings and loan holding company";

(C) in clause (iii), by striking "or a subsidiary thereof;" and inserting "a subsidiary of any such bank, a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3))), the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary of any such State savings association; and"; and

(D) by striking clause (iv) and redesignating clause (v) as clause (iv);

(3) in subparagraph (C)—

(A) in clause (i), by striking "bank" and inserting "bank or a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(2))), the deposits of which are insured by the Federal Deposit Insurance Corporation";

(B) in clause (ii), by striking "or a subsidiary of a bank holding company which is a bank other than a bank specified in clause (i), (iii), or (iv) of this subparagraph" and inserting "a subsidiary of a bank holding company that is a bank other than a bank specified in clause (i) or (iii) of this subparagraph, or a savings and loan holding company";

(C) in clause (iii), by striking "System)" and inserting, "System) or a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3))), the deposits of which are insured by the Federal Deposit Insurance Corporation; and"; and

(D) by striking clause (iv) and redesignating clause (v) as clause (iv);

(4) in subparagraph (D)—

(A) in clause (i), by inserting after "bank" the following: "or a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(2))), the deposits of which are insured by the Federal Deposit Insurance Corporation";

(B) in clause (ii), by adding "and" at the end;

(C) by striking clause (iii) and redesignating clause (iv) as clause (iii); and

(D) in clause (iii), as so redesignated, by inserting after "bank" the following: "or a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3))), the deposits of which are insured by the Federal Deposit Insurance Corporation";

(5) in subparagraph (F)—

(A) in clause (i), by inserting after "bank" the following: "or a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(2))), the deposits of which are insured by the Federal Deposit Insurance Corporation";

(B) by striking clause (ii) and redesignating clauses (iii), (iv), and (v) as clauses (ii), (iii), and (iv), respectively; and

(C) in clause (iii), as so redesignated, by inserting before the semicolon the following: "or a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(3))), the deposits of which are insured by the Federal Deposit Insurance Corporation";

(6) in subparagraph (G)—

(A) in clause (i), by inserting after "national bank" the following: ", a Federal savings association (as defined in section 3(b)(2) of the Federal Deposit Insurance Act), the deposits of which are insured by the Federal Deposit Insurance Corporation,";

(B) in clause (iii), by inserting after "bank)" the following: ", a State savings association (as defined in section 3(b)(3) of the Federal Deposit Insurance Act), the deposits of which are insured by the Federal Deposit Insurance Corporation," and by adding "and" at the end; and

(C) by striking clause (iv) and redesignating clause (v) as clause (iv); and

(7) in the undesignated matter following subparagraph (H), by striking ", and the term 'District of Columbia savings and loan association' means any association subject to examination and supervision by the Office of Thrift Supervision under section 1466a of title 12".

See Effective Date of 2010 Amendment note below.

AMENDMENT OF SUBSECTION (a)(41)

Pub. L. 111–203, title IX, §939(e)(1), (g), July 21, 2010, 124 Stat. 1886, 1887, provided that, effective 2 years after July 21, 2010, subsection (a)(41) of this section is amended by striking "is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization" and inserting "meets standards of credit-worthiness as established by the Commission".

AMENDMENT OF SUBSECTION (a)(53)(A)

Pub. L. 111–203, title IX, §939(e)(2), (g), July 21, 2010, 124 Stat. 1886, 1887, provided that, effective 2 years after July 21, 2010, subsection (a)(53)(A) of this section is amended by striking "is rated in 1 of the 4 highest rating categories by at least 1 nationally recognized statistical rating organization" and inserting "meets standards of credit-worthiness as established by the Commission".

REFERENCES IN TEXT

This chapter, referred to in subsecs. (a), (b), (c), (e)(1), (f), and (g), was in the original "this title". See References in Text note set out under section 78a of this title.

The Investment Company Act of 1940, referred to in subsec. (a)(4)(B)(v), (19), (47), (51)(A)(iii), is title I of act Aug. 20, 1940, ch. 686, 54 Stat. 789, which is classified generally to subchapter I (§80a–1 et seq.) of chapter 2D of this title. For complete classification of this Act to the Code, see section 80a–51 of this title and Tables.

This chapter, referred to in subsec. (a)(4)(B)(vii)(II), was in the original "this Act". See References in Text note set out under section 78a of this title.

Section 206 of the Gramm-Leach-Bliley Act, referred to in subsec. (a)(4)(B)(ix), (5)(C)(iv), (54)(B), is section 206 of Pub. L. 106–102, which is set out as a note below.

Subsec. (e) of section 78*o* of this title, referred to in subsec. (a)(4)(E), was redesignated (f) by Pub. L. 111–203, title IX, §929X(c)(1), July 21, 2010, 124 Stat. 1870.

The Investment Advisers Act of 1940, referred to in subsec. (a)(20), (47), is title II of act Aug. 20, 1940, ch. 686, 54 Stat. 847, which is classified generally to subchapter II (§80b–1 et seq.) of chapter 2D of this title. For complete classification of this Act to the Code, see section 80b–20 of this title and Tables.

Section 78w(b) of this title, referred to in subsec. (a)(26), was omitted from the Code.

Section 103 of title 26, referred to in subsec. (a)(29), which related to interest on certain governmental obligations, was amended generally by Pub. L. 99–514, title XIII, §1301(a), Oct. 22, 1986, 100 Stat. 2602, and, as so amended, relates to interest on State and local bonds. Section 103(b)(2) (formerly section 103(c)(2)), which prior to the general amendment defined industrial development bond, relates to the applicability of the interest exclusion to arbitrage bonds.

The Federal Deposit Insurance Act, referred to in subsec. (a)(34)(D), (F)(iv), (H)(iii), is act Sept. 21, 1950, ch. 967, §2, 64 Stat. 873, which is classified generally to chapter 16 (§1811 et seq.) of Title 12, Banks and Banking. For complete classification of this Act to the Code, see Short Title note set out under section 1811 of Title 12 and Tables.

The International Banking Act of 1978, referred to in subsec. (a)(34)(G)(i) to (iii), (46)(B), is Pub. L. 95–369, Sept. 17, 1978, 92 Stat. 607, which enacted chapter 32 (§3101 et seq.) and sections 347d and 611a of Title 12, Banks and Banking, amended sections 72, 378, 614, 615, 618, 619, 1813, 1815, 1817, 1818, 1820, 1821, 1822, 1823, 1828, 1829b, 1831b, and 1841 of Title 12, and enacted provisions set out as notes under sections 247, 611a, and 3101 of Title 12 and formerly set out as notes under sections 36, 247, and 601 of Title 12. For complete classification of this Act to the Code, see Short Title note set out under section 3101 of Title 12 and Tables.

Section 25 of the Federal Reserve Act, referred to in subsec. (a)(34)(G)(ii), is classified to subchapter I (§601 et seq.) of chapter 6 of Title 12, Banks and Banking. Section 25A of the Federal Reserve Act, referred to in subsec. (a)(34)(G)(ii), (H)(ii), is classified to subchapter II (§611 et seq.) of chapter 6 of Title 12.

The Commodity Exchange Act, referred to in subsec. (a)(39)(B)(ii), (C), (55)(A), is act Sept. 21, 1922, ch. 369, 42 Stat. 998, which is classified generally to chapter 1 (§1 et seq.) of Title 7, Agriculture. For complete classification of this Act to the Code, see section 1 of Title 7 and Tables.

The Securities Act of 1933, referred to in subsec. (a)(47), is act May 27, 1933, ch. 38, title I, 48 Stat. 74, which is classified generally to subchapter I (§77a et seq.) of chapter 2A of this title. For complete classification of this Act to the Code, see section 77a of this title and Tables.

The Securities Exchange Act of 1934, referred to in subsec. (a)(47), is act June 6, 1934, ch. 404, 48 Stat. 881, which is classified generally to this chapter (§78a et seq.). For complete classification of this Act to the Code, see section 78a of this title and Tables.

The Sarbanes-Oxley Act of 2002, referred to in subsec. (a)(47), is Pub. L. 107–204, July 30, 2002, 116 Stat. 745. Section 2 of the Act enacted section 7201 of this title and amended this section. For complete classification of this Act to the Code, see Short Title note set out under section 7201 of this title and Tables.

The Trust Indenture Act of 1939, referred to in subsec. (a)(47), is title III of act May 27, 1933, ch. 38, as added Aug. 3, 1939, ch. 411, 53 Stat. 1149, which is classified generally to subchapter III (§77aaa et seq.) of chapter 2A of this title. For complete classification of this Act to the Code, see section 77aaa of this title and Tables.

The Securities Investor Protection Act of 1970, referred to in subsec. (a)(47), is Pub. L. 91–598, Dec. 30, 1970, 84 Stat. 1636, which is classified generally to chapter 2B–1 (§78aaa et seq.) of this title. For complete classification of this Act to the Code, see section 78aaa of this title and Tables.

Section 301(d) of the Small Business Investment Act of 1958, referred to in subsec. (a)(54)(A)(iv), was classified to section 681(d) of this title and was repealed by Pub. L. 104–208, div. D, title II, §208(b)(3)(A), Sept. 30, 1996, 110 Stat. 3009–742.

The Employee Retirement Income Security Act of 1974, referred to in subsec. (a)(54)(A)(v), is Pub. L. 93–406, Sept. 2, 1974, 88 Stat. 832, which is classified principally to chapter 18 (§1001 et seq.) of Title 29, Labor. For complete classification of this Act to the Code, see Short Title note set out under section 1001 of Title 29 and Tables.

Codification

Words "Philippine Islands" deleted from definition of term "State" in subsec. (a)(16) under authority of Proc. No. 2695, which granted independence to the Philippine Islands. Proc. No. 2695 was issued pursuant to section 1394 of Title 22, Foreign Relations and Intercourse, and is set out as a note under that section.

Amendments

2010—Subsec. (a)(4)(B)(vii)(I). Pub. L. 111–203, §944(b), substituted "4(5)" for "4(6)".

Subsec. (a)(47). Pub. L. 111–203, §986(a)(1), struck out "the Public Utility Holding Company Act of 1935," before "the Trust Indenture Act of 1939".

Subsec. (a)(55)(A). Pub. L. 111–203, §985(b)(2)(A), made technical amendment to reference in original act which appears in text as reference to paragraph (12) of this subsection.

Subsec. (a)(62). Pub. L. 111–203, §932(b), redesignated subpars. (B) and (C) as (A) and (B), respectively, and struck out former subpar. (A) which read as follows: "has been in business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration under section 78*o*–7 of this title;".

Subsec. (a)(77). Pub. L. 111–203, §941(a), added par. (77).

Subsec. (g). Pub. L. 111–203, §985(b)(2)(B), substituted "account, person" for "account person" in introductory provisions.

2006—Subsec. (a)(4)(F). Pub. L. 109–351, §101(a)(1), added subpar. (F).

Subsec. (a)(6)(A). Pub. L. 109–351, §401(a)(1)(A), inserted "or a Federal savings association, as defined in section 1462(5) of title 12" after "a banking institution organized under the laws of the United States".

Subsec. (a)(6)(C). Pub. L. 109–351, §401(a)(1)(B), inserted "or savings association, as defined in section 1462(4) of title 12" after "other banking institution" and "or savings associations" after "having supervision over banks".

Subsec. (a)(34). Pub. L. 109–351, §401(a)(2)(G), inserted at end of concluding provisions "As used in this paragraph, the term 'savings and loan holding company' has the same meaning as in section 1467a(a) of title 12."

Subsec. (a)(34)(A)(ii). Pub. L. 109–351, §401(a)(2)(A)(i), substituted "clause (i), (iii), or (iv)" for "clause (i) or (iii)".

Subsec. (a)(34)(A)(iv), (v). Pub. L. 109–351, §401(a)(2)(A)(ii)–(iv), added cl. (iv) and redesignated former cl. (iv) as (v).

Subsec. (a)(34)(B)(ii). Pub. L. 109–351, §401(a)(2)(B)(i), substituted "clause (i), (iii), or (iv)" for "clause (i) or (iii)".

Subsec. (a)(34)(B)(iv), (v). Pub. L. 109–351, §401(a)(2)(B)(ii)–(iv), added cl. (iv) and redesignated former cl. (iv) as (v).

Subsec. (a)(34)(C)(ii). Pub. L. 109–351, §401(a)(2)(C)(i), substituted "clause (i), (iii), or (iv)" for "clause (i) or (iii)".

Subsec. (a)(34)(C)(iv), (v). Pub. L. 109–351, §401(a)(2)(C)(ii)–(iv), added cl. (iv) and redesignated former cl. (iv) as (v).

Subsec. (a)(34)(D)(iii), (iv). Pub. L. 109–351, §401(a)(2)(D), added cl. (iii) and redesignated former cl. (iii) as (iv).

Subsec. (a)(34)(F)(ii) to (v). Pub. L. 109–351, §401(a)(2)(E), added cl. (ii) and redesignated former cls. (ii) to (iv) as (iii) to (v), respectively.

Subsec. (a)(34)(H). Pub. L. 109–351, §401(a)(2)(F), moved subpar. (H) and inserted it immediately after subpar. (G).

Subsec. (a)(60) to (64). Pub. L. 109–291 added pars. (60) to (64).

2004—Subsec. (a)(12)(C)(iv). Pub. L. 108–359 added cl. (iv).

Subsec. (a)(34)(A)(i), (B)(i), (C)(i), (D)(i), (F)(i). Pub. L. 108–386, §8(f)(1), struck out "or a bank operating under the Code of Law for the District of Columbia" after "national bank".

Subsec. (a)(34)(G)(i). Pub. L. 108–386, §8(f)(2), struck out ", a bank in the District of Columbia examined by the Comptroller of the Currency," after "national bank".

Subsec. (a)(34)(H)(i). Pub. L. 108–386, §8(f)(3), struck out "or a bank in the District of Columbia examined by the Comptroller of the Currency" after "national bank".

Subsec. (a)(42)(B). Pub. L. 108–447 inserted "by the Tennessee Valley Authority or" after "issued or guaranteed".

2002—Subsec. (a)(39)(F). Pub. L. 107–204, §604(c)(1)(A), inserted ", or is subject to an order or finding," before "enumerated" and substituted "(H), or (G)" for "or (G)".

Subsec. (a)(47). Pub. L. 107–204, §2(b), inserted "the Sarbanes-Oxley Act of 2002," before "the Public Utility Holding Company Act of 1935".

Subsec. (a)(58), (59). Pub. L. 107–204, §205(a), added pars. (58) and (59).

2000—Subsec. (a)(10). Pub. L. 106–554, §1(a)(5) [title II, §201(1)], inserted "security future," after "treasury stock,".

Subsec. (a)(11). Pub. L. 106–554, §1(a)(5) [title II, §201(2)], added par. (11) and struck out former par. (11) which read as follows: "The term 'equity security' means any stock or similar security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Commission shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security."

Subsec. (a)(13), (14). Pub. L. 106–554, §1(a)(5) [title II, §201(3), (4)], inserted at end "For security futures products, such term includes any contract, agreement, or transaction for future delivery."

Subsec. (a)(55) to (57). Pub. L. 106–554, §1(a)(5) [title II, §201(5)], added pars. (55) to (57).

1999—Subsec. (a)(4). Pub. L. 106–102, §201, inserted heading and amended text of par. (4) generally. Prior to amendment, text read as follows: "The term 'broker' means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank."

Subsec. (a)(5). Pub. L. 106–102, §202, inserted heading and amended text of par. (5) generally. Prior to amendment, text read as follows: "The term 'dealer' means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business."

Subsec. (a)(12)(A)(iii). Pub. L. 106–102, §221(b), amended cl. (iii) generally. Prior to amendment, cl. (iii) read as follows: "any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian;".

Subsec. (a)(34)(H). Pub. L. 106–102, §231(b)(1), added subpar. (H) at end of par. (34).

Subsec. (a)(42)(E). Pub. L. 106–102, §208, added subpar. (E).

Subsec. (a)(54). Pub. L. 106–102, §207, added par. (54).

1998—Subsec. (a)(10). Pub. L. 105–353, §301(b)(1), substituted "deposit for" for "deposit, for".

Subsec. (a)(12)(A)(vi). Pub. L. 105–353, §301(b)(2), realigned margins.

Subsec. (a)(22)(A). Pub. L. 105–353, §301(b)(3), substituted "section 153" for "section 153(h)" and for "section 153(t)".

Subsec. (a)(39)(B)(i). Pub. L. 105–353, §301(b)(4), substituted "of the Commission" for "to the Commission" in introductory provisions.

1996—Subsec. (a)(12)(A)(vi), (vii). Pub. L. 104–290, §508(c)(1), added cl. (vi) and redesignated former cl. (vi) as (vii).

Subsecs. (f), (g). Pub. L. 104–290, §§106(b), 508(c)(2), added subsecs. (f) and (g), respectively.

1995—Subsec. (a)(12)(A)(iv) to (vi). Pub. L. 104–62, §4(a), struck out "and" at end of cl. (iv), added cl. (v), and redesignated former cl. (v) as (vi).

Subsec. (e). Pub. L. 104–62, §4(b), added subsec. (e).

1994—Subsec. (a)(41)(A)(i). Pub. L. 103–325, §347(a), substituted "on a residential" for "or on a residential" and inserted before semicolon ", or on one or more parcels of real estate upon which is located one or more commercial structures".

Subsec. (a)(53). Pub. L. 103–325, §202, added par. (53).

1993—Subsec. (a)(12)(B)(ii). Pub. L. 103–202, §106(b)(2)(A), substituted "sections 78*o* and 78q–1" for "sections 78*o*, 78*o*–3 (other than subsection (g)(3)), and 78q–1".

Subsec. (a)(34)(G)(ii) to (iv). Pub. L. 103–202, §109(a)(1), amended cls. (ii) to (iv) generally. Prior to amendment, cls. (ii) to (iv) read as follows:

"(ii) the Board of Governors of the Federal Reserve System, in the case of a State member bank of the Federal Reserve System, a foreign bank, a State branch or a State agency of a foreign bank, or a commercial lending company owned or controlled by a foreign bank (as such terms are used in the International Banking Act of 1978);

"(iii) the Federal Deposit Insurance Corporation, in the case of a bank insured by the Federal Deposit Insurance Corporation (other than a member of the Federal Reserve System or a Federal savings bank);

"(iv) the Director of the Office of Thrift Supervision, in the case of a savings association the deposits of which are insured by the Federal Deposit Insurance Corporation;".

Subsec. (a)(46). Pub. L. 103–202, §109(a)(2), amended par. (46) generally. Prior to amendment, par. (46) read as follows: "The term 'financial institution' means (A) a bank (as such term is defined in paragraph (6) of this subsection), (B) a foreign bank, and (C) an insured institution (as such term is defined in section 1724 of title 12)."

Subsec. (a)(52). Pub. L. 103–202, §109(a)(3), redesignated par. (51) defining "foreign financial regulatory authority" as (52).

1990—Subsec. (a)(39)(A). Pub. L. 101–550, §203(b)(1), inserted "foreign equivalent of a self-regulatory organization, foreign or international securities exchange," after "self-regulatory organization,", "or any substantially equivalent foreign statute or regulation," after "(7 U.S.C. 7)," and "(7 U.S.C. 21),", and "or foreign equivalent" after "contract market".

Subsec. (a)(39)(B). Pub. L. 101–550, §203(b)(2), added subpar. (B) and struck out former subpar. (B) which read as follows: "is subject to an order of the Commission or other appropriate regulatory agency denying, suspending for a period not exceeding twelve months, or revoking his registration as a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer, or barring or suspending for a period not exceeding 12 months his being associated with a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer, or is subject to an order of the Commodity Futures Trading Commission denying, suspending, or revoking his registration under the Commodity Exchange Act (7 U.S.C. 1 et seq.);".

Subsec. (a)(39)(D). Pub. L. 101–550, §203(b)(4), added subpar. (D). Former subpar. (D) redesignated (E).

Subsec. (a)(39)(E). Pub. L. 101–550, §203(b)(3), (5), redesignated subpar. (D) as (E) and substituted "(A), (B), (C), or (D)" for "(A), (B), or (C)". Former subpar. (E) redesignated (F).

Subsec. (a)(39)(F). Pub. L. 101–550, §203(b)(3), (6), redesignated subpar. (E) as (F), substituted "(D), (E), or (G)" for "(D) or (E)", and inserted "or any other felony" before "within ten years".

Subsec. (a)(51). Pub. L. 101–550, §204, added par. (51) defining "foreign financial regulatory authority".

Pub. L. 101–429 added par. (51) defining "penny stock".

1989—Subsec. (a)(34). Pub. L. 101–73, §744(u)(1)(B), substituted "Office of Thrift Supervision" for "Federal Home Loan Bank Board" in concluding provisions.

Subsec. (a)(34)(G)(iv) to (vi). Pub. L. 101–73, §744(u)(1)(A), added cl. (iv), redesignated cl. (vi) as (v), and struck out former cls. (iv) and (v) which read as follows:

"(iv) the Federal Home Loan Bank Board, in the case of a Federal savings and loan association, Federal savings bank, or District of Columbia savings and loan association;

"(v) the Federal Savings and Loan Insurance Corporation, in the case of an institution insured by the Federal Savings and Loan Insurance Corporation (other than a Federal savings and loan association, Federal savings bank, or District of Columbia savings and loan association);".

1988—Subsec. (a)(50). Pub. L. 100–704 added par. (50).

1987—Subsec. (a)(6)(C). Pub. L. 100–181, §301, substituted "under the authority of the Comptroller of the Currency pursuant to section 92a of title 12" for "under section 11(k) of the Federal Reserve Act, as amended".

Subsec. (a)(16). Pub. L. 100–181, §302, struck out reference to Canal Zone.

Subsec. (a)(22)(B). Pub. L. 100–181, §303, substituted "association, or any" and "own behalf, in" for "association or any" and "own behalf in", respectively.

Subsec. (a)(34)(C)(ii). Pub. L. 100–181, §304, substituted "State" for "state".

Subsec. (a)(39)(B). Pub. L. 100–181, §305, substituted "months, or revoking" for "months, revoking" and "barring or suspending for a period not exceeding 12 months his" for "barring his".

Subsec. (a)(47). Pub. L. 100–181, §306(1), added par. (47).

Subsec. (a)(49). Pub. L. 100–181, §306(2), added par. (49).

1986—Subsec. (a)(12). Pub. L. 99–571, §102(a), in amending par. (12) generally, expanded definition of "exempted security" or "exempted securities" to include government securities as defined in par. (42) of this subsection, provided that such securities not be deemed exempt for purposes of section 78q–1 of this title, substituted section 78*o*–3(g)(3) of this title for section 78*o*–3(b)(6), (11), and (g)(2) of this title in provision relating to municipal securities as not being "exempted securities" and defined "qualified plan" to mean qualified stock bonus, pension, or profit-sharing plan, qualified annuity plan, or governmental plan.

Pub. L. 99–514 substituted "Internal Revenue Code of 1986" for "Internal Revenue Code of 1954", which for purposes of codification was translated as "title 26" thus requiring no change in text.

Subsec. (a)(29). Pub. L. 99–514 substituted "Internal Revenue Code of 1986" for "Internal Revenue Code of 1954", which for purposes of codification was translated as "title 26" thus requiring no change in text.

Subsec. (a)(34). Pub. L. 99–571, §102(b)(2), inserted ", and the term 'District of Columbia savings and loan association' means any association subject to examination and supervision by the Federal Home Loan Bank Board under section 1466a of title 12" in concluding provisions.

Subsec. (a)(34)(G). Pub. L. 99–571, §102(b)(1), added subpar. (G).

Subsec. (a)(39)(B). Pub. L. 99–571, §102(c)(1)(A), which directed insertion of "or other appropriate regulatory agency" after "Commission" was executed by making the insertion after "Commission" the first place appearing as the probable intent of Congress.

Pub. L. 99–571, §102(c)(1)(B), substituted "municipal securities dealer, government securities broker, or government securities dealer" for "or municipal securities dealer" in two places.

Subsec. (a)(39)(C). Pub. L. 99–571, §102(c)(2), substituted "municipal securities dealer, government securities broker, or government securities dealer" for "or municipal securities dealer" and inserted ", an appropriate regulatory agency," after "the Commission".

Subsec. (a)(42) to (46), (48). Pub. L. 99–571, §102(d), added pars. (42) to (46) and (48).

1984—Subsec. (a)(39)(A). Pub. L. 98–376, §6(a)(1), inserted ", contract market designated pursuant to section 5 of the Commodity Exchange Act (7 U.S.C. 7), or futures association registered under section 17 of such Act (7 U.S.C. 21), or has been and is denied trading privileges on any such contract market".

Subsec. (a)(39)(B). Pub. L. 98–376, §6(a)(2), inserted ", or is subject to an order of the Commodity Futures Trading Commission denying, suspending, or revoking his registration under the Commodity Exchange Act (7 U.S.C. 1 et seq.)".

Subsec. (a)(39)(C). Pub. L. 98–376, §6(a)(3), inserted "or while associated with an entity or person required to be registered under the Commodity Exchange Act,".

Subsec. (a)(41). Pub. L. 98–440 added par. (41).

1982—Subsec. (a)(10). Pub. L. 97–303 inserted "any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency," after "for a security,".

1980—Subsec. (a)(12). Pub. L. 96–477 included within definition of "exempted security" interests or participation in single trust funds, provided that qualifying interests, participation, or securities could be issued in connection with certain governmental plans as defined in section 414(d) of title 26, substituted provisions relating to securities arising out of contracts issued by insurance companies for provisions relating to separate accounts maintained by insurance companies, and excluded from definition of "exempted security" any plans described in cls. (A), (B), or (C) of par. (12) which were funded by annuity contracts described in section 403(b) of title 26.

1978—Subsec. (a)(40). Pub. L. 95–283 added par. (40).

1975—Subsec. (a)(3). Pub. L. 94–29, §3(1), redefined term "member" to recognize the elimination of fixed commission rates in the case of exchanges, inserted definition of term when used in the case of registered securities associations, expanded definition of term when used with respect to an exchange to include any natural person permitted to effect transactions on the floor of an exchange without the services of another person acting as broker, any registered broker or dealer with which such natural person is associated, any registered broker or dealer permitted to designate a natural person as its representative on the floor of an exchange, and any other registered broker or dealer which agrees to be regulated by an exchange and with respect to whom the exchange has undertaken to enforce compliance with its rules, this chapter, and the rules and regulations thereunder, introduced the concept of including among members any person required to comply with the rules of an exchange to the extent specified by the Commission in accordance with section 78f(f) of this title, and expanded definition of term when used with respect to a registered securities association to include any broker or dealer who has agreed to be regulated and with respect to whom the association undertakes to enforce compliance with its own rules, this chapter, and the rules and regulations thereunder.

Subsec. (a)(9). Pub. L. 94–29, §3(2), substituted "a natural person, company, government, or political subdivision, agency, or instrumentality of a government" for "an individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization".

Subsec. (a)(12). Pub. L. 94–29, §3(3), brought brokers and dealers engaged exclusively in municipal securities business within the registration provisions of this chapter by transferring the existing description of municipal securities to subsec. (a)(29) and by inserting in its place provisions revoking the exempt status of municipal securities for purposes of sections 78o, 78o–3 (except subsections (b)(6), (b)(11), and (g)(2) thereof) and 78q–1 of this title.

Subsec. (a)(17). Pub. L. 94–29, §3(4), expanded definition of "interstate commerce" to establish that the intrastate use of any facility of an exchange, any telephones or other interstate means of communication, or any other interstate instrumentality constitutes a use of the jurisdictional means for purposes of this chapter.

Subsec. (a)(18). Pub. L. 94–29, §3(4), expanded definition to include persons under common control with the broker or dealer and struck out references to the classification of the persons, including employees, controlled by a broker or a dealer.

Subsec. (a)(19). Pub. L. 94–29, §3(4), substituted " 'separate account', and 'company' " for "and 'separate account'."

Subsec. (a)(21). Pub. L. 94–29, §3(5), broadened definition of term "person associated with a member" to encompass a person associated with a broker or dealer which is a member of an exchange by restating directly the definition of a "person associated with a broker or dealer" in subsec. (a)(18).

Subsec. (a)(22) to (39). Pub. L. 94–29, §3(6), added pars. (22) to (39).

Subsec. (b). Pub. L. 94–29, §3(7), substituted "accounting, and other terms used in this chapter, consistently with the provisions and purposes of this chapter" for "and accounting terms used in this chapter insofar as such definitions are not inconsistent with the provisions of this chapter".

Subsec. (d). Pub. L. 94–29, §3(8), added subsec. (d).

1970—Subsec. (a)(12). Pub. L. 91–567 inserted provisions which brought within definition of "exempted security" any security which is an industrial development bond the interest on which is excludable from gross income under section 103(a)(1) of title 26 if, by reason of the application of section 103(c)(4) or (6) of title 26, section 103(c)(1) does not apply to such security. Such amendment was also made by Pub. L. 91–373.

Pub. L. 91–547, §28(a), struck out reference to industrial development bonds the interest on which is excludable from gross income under section 103(a)(1) of title 26; and included as exempted securities interests or participations in common trust funds maintained by a bank for collective investment of assets held by it in a fiduciary capacity; interests or participations in bank collective trust funds maintained for funding of employees' stock-bonus, pension, or profit-sharing plans; interests or participations in separate accounts maintained by insurance companies for funding certain stock-bonus, pension, or profit-sharing plans which meet the requirements for qualification under section 401 of title 26; and such other securities as the Commission by rules and regulations deems necessary in the public interest.

Pub. L. 91–373 inserted provisions which brought within definition of "exempted security" any security which is an industrial development bond the interest on which is excludable from gross income under section 103(a)(1) of title 26 if, by reason of the application of section 103(c)(4) or (6) of title 26, section 103(c)(1) does not apply to such security. Such amendment was also made by Pub. L. 91–567.

Subsec. (a)(19). Pub. L. 91–547, §28(b), provided for term "separate account" the same meaning as in the Investment Company Act of 1940.

1964—Subsec. (a)(18) to (21). Pub. L. 88–467 added pars. (18) to (21).

1960—Subsec. (a)(16). Pub. L. 86–624 struck out reference to Hawaii.

1959—Subsec. (a)(16). Pub. L. 86–70 struck out reference to Alaska.

CHANGE OF NAME

Act Aug. 23, 1935, substituted "Board of Governors of the Federal Reserve System" for "Federal Reserve Board".

EFFECTIVE DATE OF 2010 AMENDMENT

Amendment by sections 932(b), 941(a), 944(b), 985(b)(2), and 986(a)(1) of Pub. L. 111–203 effective 1 day after July 21, 2010, except as otherwise provided, see section 4 of Pub. L. 111–203, set out as an Effective Date note under section 5301 Title 12, Banks and Banking.

Amendment by section 376(1) of Pub. L. 111–203 effective on the transfer date, see section 351 of Pub. L. 111–203, set out as a note under section 906 of Title 2, The Congress.

Amendment by section 761(a) of Pub. L. 111–203 effective on the later of 360 days after July 21, 2010, or, to the extent a provision of subtitle B (§§761–774) of title VII of Pub. L. 111–203 requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of subtitle B, see section 774 of Pub. L. 111–203, set out as a note under section 77b of this title.

Amendment by section 939(e) of Pub. L. 111–203 effective 2 years after July 21, 2010, see section 939(g) of Pub. L. 111–203, set out as a note under section 24a of Title 12, Banks and Banking.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108–386 effective Oct. 30, 2004, and, except as otherwise provided, applicable with respect to fiscal year 2005 and each succeeding fiscal year, see sections 8(i) and 9 of Pub. L. 108–386, set out as notes under section 321 of Title 12, Banks and Banking.

EFFECTIVE DATE OF 1999 AMENDMENT

Amendment by sections 201, 202, 207, and 208 of Pub. L. 106–102 effective at the end of the 18-month period beginning on Nov. 12, 1999, see section 209 of Pub. L. 106–102, set out as a note under section 1828 of Title 12, Banks and Banking.

Amendment by section 221(b) of Pub. L. 106–102 effective 18 months after Nov. 12, 1999, see section 225 of Pub. L. 106–102, set out as a note under section 77c of this title.

EFFECTIVE DATE OF 1995 AMENDMENT

Amendment by Pub. L. 104–62 applicable as defense to any claim in administrative and judicial actions pending on or commenced after Dec. 8, 1995, that any person, security, interest, or participation of type described in Pub. L. 104–62 is subject to the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, the Investment Advisers Act of 1940, or any State statute or regulation preempted as provided in section 80a–3a of this title, except as specifically provided in such statutes, see section 7 of Pub. L. 104–62, set out as a note under section 77c of this title.

EFFECTIVE DATE OF 1994 AMENDMENT

Amendment by section 347(a) of Pub. L. 103–325 effective upon date of promulgation of final regulations under section 347(c) of Pub. L. 103–325, see section 347(d) of Pub. L. 103–325, set out as an Effective Date of 1994 Amendment note under section 24 of Title 12, Banks and Banking.

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by Pub. L. 101–429 effective 12 months after Oct. 15, 1990, with provision to commence rulemaking proceedings to implement such amendment note later than 180 days after Oct. 15, 1990, and with provisions relating to civil penalties and accounting and disgorgement, see section 1(c)(2), (3)(A), (C) of Pub. L. 101–429, set out in a note under section 77g of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100–704, except for amendment by section 6, not applicable to actions occurring before Nov. 19, 1988, see section 9 of Pub. L. 100–704, set out as a note under section 78*o* of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99–571 effective 270 days after Oct. 28, 1986, see section 401 of Pub. L. 99–571, set out as an Effective Date note under section 78*o*–5 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 7 of Pub. L. 98–376 provided that: "The amendments made by this Act [amending this section and sections 78*o*, 78t, 78u, and 78ff of this title] shall become effective immediately upon enactment of this Act [Aug. 10, 1984]."

EFFECTIVE DATE OF 1975 AMENDMENT

Amendment by Pub. L. 94–29 effective June 4, 1975, except for amendment of subsec. (a)(12) by Pub. L. 94–29 to be effective 180 days after June 4, 1975, with provisions of subsec. (a)(3), as amended by Pub. L. 94–29, or rules or regulations thereunder, not to apply in a way so as to deprive any person of membership in any national securities exchange (or its successor) of which such person was, on June 4, 1975, a member or a member firm as defined in the constitution of such exchange, or so as to deny membership in any such exchange (or its successor) to any natural person who is or becomes associated with such member or member firm, see section 31(a) of Pub. L. 94–29, set out as a note under section 78b of this title.

EFFECTIVE DATE OF 1970 AMENDMENTS

For effective date of amendment by Pub. L. 91–567, see section 6(d) of Pub. L. 91–567, set out as a note under section 77c of this title.

Amendment by Pub. L. 91–547 effective Dec. 14, 1970, see section 30 of Pub L. 91–547, set out as a note under section 80a–52 of this title.

For effective date of amendment by Pub. L. 91–373, see section 401(c) of Pub. L. 91–373, set out as a note under section 77c of this title.

Effective Date of 1964 Amendment

Section 13 of Pub. L. 88–467 provided that: "The amendments made by this Act shall take effect as follows:

"(1) The effective date of section 12(g)(1) of the Securities Exchange Act of 1934, as added by section 3(c) of this Act [section 78*l*(g)(1) of this title], shall be July 1, 1964.

"(2) The effective date of the amendments to sections 12(b) and 15(a) of the Securities Exchange Act of 1934 [sections 78*l*(b) and 78*o*(a) of this title], contained in sections 3(a) and 6(a), respectively, of this Act shall be July 1, 1964.

"(3) All other amendments contained in this Act [amending this section and sections 77d, 78*l*, 78m, 78n, 78*o*, 78*o*–3, 78p, 78t, 78w, and 78ff of this title] shall take effect on the date of its enactment [Aug. 20, 1964]."

Regulations

Pub. L. 109–351, title I, §101(a)(2)–(c), Oct. 13, 2006, 120 Stat. 1968, provided that:

"(2) Timing.—Not later than 180 days after the date of the enactment of this Act [Oct. 13, 2006], the Securities and Exchange Commission (in this section [enacting this note and amending 15 U.S.C. 78c] referred to as the 'Commission') and the Board of Governors of the Federal Reserve System (hereafter in this section referred to as the 'Board') shall jointly issue a proposed single set of rules or regulations to define the term 'broker' in accordance with section 3(a)(4) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(4)], as amended by this subsection.

"(3) Rulemaking supersedes previous rulemaking.—A final single set of rules or regulations jointly adopted in accordance with this section shall supersede any other proposed or final rule issued by the Commission on or after the date of enactment of section 201 of the Gramm-Leach-Bliley Act [Nov. 12, 1999] with regard to the exceptions to the definition of a broker under section 3(a)(4)(B) of the Securities Exchange Act of 1934. No such other rule, whether or not issued in final form, shall have any force or effect on or after that date of enactment.

"(b) Consultation.—Prior to jointly adopting the single set of final rules or regulations required by this section, the Commission and the Board shall consult with and seek the concurrence of the Federal banking agencies concerning the content of such rulemaking in implementing section 3(a)(4)(B) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(4)(B)], as amended by this section and section 201 of the Gramm-Leach-Bliley Act [Pub. L. 106–102].

"(c) Definition.—For purposes of this section, the term 'Federal banking agencies' means the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation."

Construction of 1993 Amendment

Amendment by Pub. L. 103–202 not to be construed to govern initial issuance of any public debt obligation or to grant any authority to (or extend any authority of) the Securities and Exchange Commission, any appropriate regulatory agency, or a self-regulatory organization to prescribe any procedure, term, or condition of such initial issuance, to promulgate any rule or regulation governing such initial issuance, or to otherwise regulate in any manner such initial issuance, see section 111 of Pub. L. 103–202, set out as a note under section 78*o*–5 of this title.

Transfer of Functions

For transfer of functions of Securities and Exchange Commission, with certain exceptions, to Chairman of such Commission, see Reorg. Plan No. 10 of 1950, §§1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out under section 78d of this title.

State Opt Out

Section 347(e) of Pub. L. 103–325 provided that: "Notwithstanding the amendments made by this section [amending this section and section 24 of Title 12, Banks and Banking], a note that is directly secured by a first lien on one or more parcels of real estate upon which is located one or more commercial structures shall not be considered to be a mortgage related security under section 3(a)(41) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(41)] in any State that, prior to the expiration of 7 years after the date of enactment of this Act [Sept. 23, 1994], enacts a statute that specifically refers to this section and either prohibits or provides for a more limited authority to purchase, hold, or invest in such securities by any person, trust, corporation, partnership, association, business trust, or business entity or class thereof than is provided by the amendments made by this subsection. The enactment by any State of any statute of the type described in the preceding sentence shall not affect the validity of any contractual commitment to purchase, hold, or invest that was made prior thereto, and shall not require the sale or other disposition of any securities acquired prior thereto."

Definitions

Pub. L. 106–554, §1(a)(5) [title III, §301(b)], Dec. 21, 2000, 114 Stat. 2763, 2763A–451, provided that: "As used in the amendment made by subsection (a) [enacting sections 206A to 206C of Pub. L. 106—102, set out below], the term 'security' has the same meaning as in section 2(a)(1) of the Securities Act of 1933 [15 U.S.C. 77b(a)(1)] or section 3(a)(10) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(10)]."

Pub. L. 106–102, title II, §206, Nov. 12, 1999, 113 Stat. 1393, as amended by Pub. L. 111–203, title VII, §742(b), July 21, 2010, 124 Stat. 1733, provided that:

"(a) Definition of Identified Banking Product.—Except as provided in subsection (e) [sic], for purposes of paragraphs (4) and (5) of section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4), (5)), the term 'identified banking product' means—

"(1) a deposit account, savings account, certificate of deposit, or other deposit instrument issued by a bank;

"(2) a banker's acceptance;

"(3) a letter of credit issued or loan made by a bank;

"(4) a debit account at a bank arising from a credit card or similar arrangement;

"(5) a participation in a loan which the bank or an affiliate of the bank (other than a broker or dealer) funds, participates in, or owns that is sold—

"(A) to qualified investors; or

"(B) to other persons that—

"(i) have the opportunity to review and assess any material information, including information regarding the borrower's creditworthiness; and

"(ii) based on such factors as financial sophistication, net worth, and knowledge and experience in financial matters, have the capability to evaluate the information available, as determined under generally applicable banking standards or guidelines; or

"(6) any swap agreement, including credit and equity swaps, except that an equity swap that is sold directly to any person other than a qualified investor (as defined in section 3(a)(54) of the Securities Act of 1934 [15 U.S.C. 78c(a)(54)]) shall not be treated as an identified banking product.

"(b) DEFINITION OF SWAP AGREEMENT.—For purposes of subsection (a)(6), the term 'swap agreement' means any individually negotiated contract, agreement, warrant, note, or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities, securities, currencies, interest or other rates, indices, or other assets, but does not include any other identified banking product, as defined in paragraphs (1) through (5) of subsection (a).

"(c) CLASSIFICATION LIMITED.—Classification of a particular product as an identified banking product pursuant to this section shall not be construed as finding or implying that such product is or is not a security for any purpose under the securities laws, or is or is not an account, agreement, contract, or transaction for any purpose under the Commodity Exchange Act [7 U.S.C. 1 et seq.].

"(d) INCORPORATED DEFINITIONS.—For purposes of this section, the terms 'bank' and 'qualified investor' have the same meanings as given in section 3(a) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)], as amended by this Act."

Pub. L. 106–102, title II, §§206A—206C, as added by Pub. L. 106–554, §1(a)(5) [title III, §301(a)], Dec. 21, 2000, 114 Stat. 2763, 2763A–449, and amended by Pub. L. 111–203, title VII, §762(a), (b), July 21, 2010, 124 Stat. 1759, provided that:

"SEC. 206A. SWAP AGREEMENT.

"(a) IN GENERAL.—Except as provided in subsection (b), as used in this section, the term 'swap agreement' means any agreement, contract, or transaction between eligible contract participants (as defined in section 1a(12) of the Commodity Exchange Act [7 U.S.C. 1a(12)] as in effect on the date of the enactment of this section [Dec. 21, 2000]), other than a person that is an eligible contract participant under section 1a(12)(C) of the Commodity Exchange Act, the material terms of which (other than price and quantity) are subject to individual negotiation, and that—

"(1) is a put, call, cap, floor, collar, or similar option of any kind for the purchase or sale of, or based on the value of, one or more interest or other rates, currencies, commodities, indices, quantitative measures, or other financial or economic interests or property of any kind;

"(2) provides for any purchase, sale, payment or delivery (other than a dividend on an equity security) that is dependent on the occurrence, non-occurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence;

"(3) provides on an executory basis for the exchange, on a fixed or contingent basis, of one or more payments based on the value or level of one or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred, including any such agreement, contract, or transaction commonly known as an interest rate swap, including a rate floor, rate cap, rate collar, cross-currency rate swap, basis swap, currency swap, equity index swap, equity swap, debt index swap, debt swap, credit spread, credit default swap, credit swap, weather swap, or commodity swap;

"(4) provides for the purchase or sale, on a fixed or contingent basis, of any commodity, currency, instrument, interest, right, service, good, article, or property of any kind; or

"(5) is any combination or permutation of, or option on, any agreement, contract, or transaction described in any of paragraphs (1) through (4).

"(b) EXCLUSIONS.—The term 'swap agreement' does not include—

"(1) any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof;

"(2) any put, call, straddle, option, or privilege entered into on a national securities exchange registered pursuant to section 6(a) of the Securities Exchange Act of 1934 [15 U.S.C. 78f(a)] relating to foreign currency;

"(3) any agreement, contract, or transaction providing for the purchase or sale of one or more securities on a fixed basis;

"(4) any agreement, contract, or transaction providing for the purchase or sale of one or more securities on a contingent basis, unless such agreement, contract, or transaction predicates such purchase or sale on the occurrence of a bona fide contingency that might reasonably be expected to affect or be affected by the creditworthiness of a party other than a party to the agreement, contract, or transaction;

"(5) any note, bond, or evidence of indebtedness that is a security as defined in section 2(a)(1) of the Securities Act of 1933 [15 U.S.C. 77b(a)(1)] or section 3(a)(10) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(10)]; or

"(6) any agreement, contract, or transaction that is—

"(A) based on a security; and

"(B) entered into directly or through an underwriter (as defined in section 2(a) of the Securities Act of 1933 [15 U.S.C. 77b(a)]) by the issuer of such security for the purposes of raising capital, unless such agreement, contract, or transaction is entered into to manage a risk associated with capital raising.

"(c) RULE OF CONSTRUCTION REGARDING MASTER AGREEMENTS.—As used in this section, the term 'swap agreement' shall be construed to include a master agreement that provides for an agreement, contract, or transaction that is a swap agreement pursuant to subsections (a) and (b), together with all supplements to any such master agreement, without regard to whether the master agreement contains an agreement, contract, or transaction that is not a swap agreement pursuant to subsections (a) and (b), except that the master agreement shall be considered to be a swap agreement only with respect to each agreement, contract, or transaction under the master agreement that is a swap agreement pursuant to subsections (a) and (b).

"SEC. 206B. SECURITY-BASED SWAP AGREEMENT.

"As used in this section, the term 'security-based swap agreement' means a swap agreement (as defined in section 206A) of which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.

"SEC. 206C. NON-SECURITY-BASED SWAP AGREEMENT.

"As used in this section, the term 'non-security-based swap agreement' means any swap agreement (as defined in section 206A) that is not a security-based swap agreement (as defined in section 206B)."

[Pub. L. 111–203, title VII, §§762(a), (b), 774, July 21, 2010, 124 Stat. 1759, 1802, provided that, effective on the later of 360 days after July 21, 2010, or, to the extent a provision of subtitle B (§§761–774) of title VII of Pub. L. 111–203 requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of subtitle B, Pub. L. 106–102, §§206A–206C, set out above, is amended: (1) in section 206A(a) in the material preceding paragraph (1), by striking "Except as" and all that follows through "that—" and inserting the following: "Except as provided in subsection (b), as used in this section, the term 'swap agreement' means any agreement, contract, or transaction that—"; and (2) by repealing sections 206B and 206C.]

[1] *See References in Text note below.*

[2] *So in original. Probably should be followed by "and".*

[3] *So in original. Probably should be "evidenced".*

[4] *So in original. See Amendment of Subsection (a) note below.*

15 U.S.C.
United States Code, 2009 Edition
Title 15 - COMMERCE AND TRADE
CHAPTER 2B - SECURITIES EXCHANGES
Sec. 78f - National securities exchanges
From the U.S. Government Publishing Office, www.gpo.gov

§78f. National securities exchanges

(a) Registration; application

An exchange may be registered as a national securities exchange under the terms and conditions hereinafter provided in this section and in accordance with the provisions of section 78s(a) of this title, by filing with the Commission an application for registration in such form as the Commission, by rule, may prescribe containing the rules of the exchange and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) Determination by Commission requisite to registration of applicant as a national securities exchange

An exchange shall not be registered as a national securities exchange unless the Commission determines that—

(1) Such exchange is so organized and has the capacity to be able to carry out the purposes of this chapter and to comply, and (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) to enforce compliance by its members and persons associated with its members, with the provisions of this chapter, the rules and regulations thereunder, and the rules of the exchange.

(2) Subject to the provisions of subsection (c) of this section, the rules of the exchange provide that any registered broker or dealer or natural person associated with a registered broker or dealer may become a member of such exchange and any person may become associated with a member thereof.

(3) The rules of the exchange assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer.

(4) The rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

(5) The rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange.

(6) The rules of the exchange provide that (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) its members and persons associated with its members shall be appropriately disciplined for violation of the provisions of this chapter, the rules or regulations thereunder, or the rules of the exchange, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

(7) The rules of the exchange are in accordance with the provisions of subsection (d) of this section, and in general, provide a fair procedure for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming associated with a member thereof, and the prohibition or limitation by the exchange of any person with respect to access to services offered by the exchange or a member thereof.

(8) The rules of the exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

(9) The rules of the exchange prohibit the listing of any security issued in a limited partnership rollup transaction (as such term is defined in paragraphs (4) and (5) of section 78n(h) of this title), unless such transaction was conducted in accordance with procedures designed to protect the rights of limited partners, including—

(A) the right of dissenting limited partners to one of the following:

(i) an appraisal and compensation;

(ii) retention of a security under substantially the same terms and conditions as the original issue;

(iii) approval of the limited partnership rollup transaction by not less than 75 percent of the outstanding securities of each of the participating limited partnerships;

(iv) the use of a committee of limited partners that is independent, as determined in accordance with rules prescribed by the exchange, of the general partner or sponsor, that has been approved by a majority of the outstanding units of each of the participating limited

partnerships, and that has such authority as is necessary to protect the interest of limited partners, including the authority to hire independent advisors, to negotiate with the general partner or sponsor on behalf of the limited partners, and to make a recommendation to the limited partners with respect to the proposed transaction; or

(v) other comparable rights that are prescribed by rule by the exchange and that are designed to protect dissenting limited partners;

(B) the right not to have their voting power unfairly reduced or abridged;

(C) the right not to bear an unfair portion of the costs of a proposed limited partnership rollup transaction that is rejected; and

(D) restrictions on the conversion of contingent interests or fees into non-contingent interests or fees and restrictions on the receipt of a non-contingent equity interest in exchange for fees for services which have not yet been provided.

As used in this paragraph, the term "dissenting limited partner" means a person who, on the date on which soliciting material is mailed to investors, is a holder of a beneficial interest in a limited partnership that is the subject of a limited partnership rollup transaction, and who casts a vote against the transaction and complies with procedures established by the exchange, except that for purposes of an exchange or tender offer, such person shall file an objection in writing under the rules of the exchange during the period during which the offer is outstanding.

(c) Denial of membership in national exchanges; denial of association with member; conditions; limitation of membership

(1) A national securities exchange shall deny membership to (A) any person, other than a natural person, which is not a registered broker or dealer or (B) any natural person who is not, or is not associated with, a registered broker or dealer.

(2) A national securities exchange may, and in cases in which the Commission, by order, directs as necessary or appropriate in the public interest or for the protection of investors shall, deny membership to any registered broker or dealer or natural person associated with a registered broker or dealer, and bar from becoming associated with a member any person, who is subject to a statutory disqualification. A national securities exchange shall file notice with the Commission not less than thirty days prior to admitting any person to membership or permitting any person to become associated with a member, if the exchange knew, or in the exercise of reasonable care should have known, that such person was subject to a statutory disqualification. The notice shall be in such form and contain such information as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(3)(A) A national securities exchange may deny membership to, or condition the membership of, a registered broker or dealer if (i) such broker or dealer does not meet such standards of financial responsibility or operational capability or such broker or dealer or any natural person associated with such broker or dealer does not meet such standards of training, experience, and competence as are prescribed by the rules of the exchange or (ii) such broker or dealer or person associated with such broker or dealer has engaged and there is a reasonable likelihood he may again engage in acts or practices inconsistent with just and equitable principles of trade. A national securities exchange may examine and verify the qualifications of an applicant to become a member and the natural persons associated with such an applicant in accordance with procedures established by the rules of the exchange.

(B) A national securities exchange may bar a natural person from becoming a member or associated with a member, or condition the membership of a natural person or association of a natural person with a member, if such natural person (i) does not meet such standards of training, experience, and competence as are prescribed by the rules of the exchange or (ii) has engaged and there is a reasonable likelihood he may again engage in acts or practices inconsistent with just and equitable principles of trade. A national securities exchange may examine and verify the qualifications of an applicant to become a person associated with a member in accordance with procedures established by the rules of the exchange and require any person associated with a member, or any class of such persons, to be registered with the exchange in accordance with procedures so established.

(C) A national securities exchange may bar any person from becoming associated with a member if such person does not agree (i) to supply the exchange with such information with respect to its relationship and dealings with the member as may be specified in the rules of the exchange and (ii) to permit the examination of its books and records to verify the accuracy of any information so supplied.

(4) A national securities exchange may limit (A) the number of members of the exchange and (B) the number of members and designated representatives of members permitted to effect transactions on the floor of the exchange without the services of another person acting as broker: *Provided, however*, That no national securities exchange shall have the authority to decrease the number of memberships in such exchange, or the number of members and designated representatives of members permitted to effect transactions on the floor of such exchange without the services of another person acting as broker, below such number in effect on May 1, 1975, or the date such exchange was registered with the Commission, whichever is later: *And provided further*, That the Commission, in accordance with the provisions of section 78s(c) of this title, may amend the rules of any national securities exchange to increase (but not to decrease) or to remove any limitation on the number of memberships in such exchange or the number of members or designated representatives

of members permitted to effect transactions on the floor of the exchange without the services of another person acting as broker, if the Commission finds that such limitation imposes a burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

(d) Discipline of national securities exchange members and persons associated with members; summary proceedings

(1) In any proceeding by a national securities exchange to determine whether a member or person associated with a member should be disciplined (other than a summary proceeding pursuant to paragraph (3) of this subsection), the exchange shall bring specific charges, notify such member or person of, and give him an opportunity to defend against, such charges, and keep a record. A determination by the exchange to impose a disciplinary sanction shall be supported by a statement setting forth—

(A) any act or practice in which such member or person associated with a member has been found to have engaged, or which such member or person has been found to have omitted;

(B) the specific provision of this chapter, the rules or regulations thereunder, or the rules of the exchange which any such act or practice, or omission to act, is deemed to violate; and

(C) the sanction imposed and the reasons therefor.

(2) In any proceeding by a national securities exchange to determine whether a person shall be denied membership, barred from becoming associated with a member, or prohibited or limited with respect to access to services offered by the exchange or a member thereof (other than a summary proceeding pursuant to paragraph (3) of this subsection), the exchange shall notify such person of, and give him an opportunity to be heard upon, the specific grounds for denial, bar, or prohibition or limitation under consideration and keep a record. A determination by the exchange to deny membership, bar a person from becoming associated with a member, or prohibit or limit a person with respect to access to services offered by the exchange or a member thereof shall be supported by a statement setting forth the specific grounds on which the denial, bar, or prohibition or limitation is based.

(3) A national securities exchange may summarily (A) suspend a member or person associated with a member who has been and is expelled or suspended from any self-regulatory organization or barred or suspended from being associated with a member of any self-regulatory organization, (B) suspend a member who is in such financial or operating difficulty that the exchange determines and so notifies the Commission that the member cannot be permitted to continue to do business as a member with safety to investors, creditors, other members, or the exchange, or (C) limit or prohibit any person with respect to access to services offered by the exchange if subparagraph (A) or (B) of this paragraph is applicable to such person or, in the case of a person who is not a member, if the exchange determines that such person does not meet the qualification requirements or other prerequisites for such access and such person cannot be permitted to continue to have such access with safety to investors, creditors, members, or the exchange. Any person aggrieved by any such summary action shall be promptly afforded an opportunity for a hearing by the exchange in accordance with the provisions of paragraph (1) or (2) of this subsection. The Commission, by order, may stay any such summary action on its own motion or upon application by any person aggrieved thereby, if the Commission determines summarily or after notice and opportunity for hearing (which hearing may consist solely of the submission of affidavits or presentation of oral arguments) that such stay is consistent with the public interest and the protection of investors.

(e) Commissions, allowances, discounts, and other fees

(1) On and after June 4, 1975, no national securities exchange may impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members: *Provided, however*, That until May 1, 1976, the preceding provisions of this paragraph shall not prohibit any such exchange from imposing or fixing any schedule of commissions, allowances, discounts, or other fees to be charged by its members for acting as broker on the floor of the exchange or as odd-lot dealer: *And provided further*, That the Commission, in accordance with the provisions of section 78s(b) of this title as modified by the provisions of paragraph (3) of this subsection, may—

(A) permit a national securities exchange, by rule, to impose a reasonable schedule or fix reasonable rates of commissions, allowances, discounts, or other fees to be charged by its members for effecting transactions on such exchange prior to November 1, 1976, if the Commission finds that such schedule or fixed rates of commissions, allowances, discounts, or other fees are in the public interest; and

(B) permit a national securities exchange, by rule, to impose a schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members for effecting transactions on such exchange after November 1, 1976, if the Commission finds that such schedule or fixed rates of commissions, allowances, discounts, or other fees (i) are reasonable in relation to the costs of providing the service for which such fees are charged (and the Commission publishes the standards employed in adjudging reasonableness) and (ii) do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter, taking into consideration the competitive effects of permitting such schedule or fixed rates weighed against the competitive effects of other lawful actions which the Commission is authorized to take under this chapter.

(2) Notwithstanding the provisions of section 78s(c) of this title, the Commission, by rule, may abrogate any exchange rule which imposes a schedule or fixes rates of commissions, allowances,

discounts, or other fees, if the Commission determines that such schedule or fixed rates are no longer reasonable, in the public interest, or necessary to accomplish the purposes of this chapter.

(3)(A) Before approving or disapproving any proposed rule change submitted by a national securities exchange which would impose a schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members for effecting transactions on such exchange, the Commission shall afford interested persons (i) an opportunity for oral presentation of data, views, and arguments and (ii) with respect to any such rule concerning transactions effected after November 1, 1976, if the Commission determines there are disputed issues of material fact, to present such rebuttal submissions and to conduct (or have conducted under subparagraph (B) of this paragraph) such cross-examination as the Commission determines to be appropriate and required for full disclosure and proper resolution of such disputed issues of material fact.

(B) The Commission shall prescribe rules and make rulings concerning any proceeding in accordance with subparagraph (A) of this paragraph designed to avoid unnecessary costs or delay. Such rules or rulings may (i) impose reasonable time limits on each interested person's oral presentations, and (ii) require any cross-examination to which a person may be entitled under subparagraph (A) of this paragraph to be conducted by the Commission on behalf of that person in such manner as the Commission determines to be appropriate and required for full disclosure and proper resolution of disputed issues of material fact.

(C)(i) If any class of persons, the members of which are entitled to conduct (or have conducted) cross-examination under subparagraphs (A) and (B) of this paragraph and which have, in the view of the Commission, the same or similar interests in the proceeding, cannot agree upon a single representative of such interests for purposes of cross-examination, the Commission may make rules and rulings specifying the manner in which such interests shall be represented and such cross-examination conducted.

(ii) No member of any class of persons with respect to which the Commission has specified the manner in which its interests shall be represented pursuant to clause (i) of this subparagraph shall be denied, pursuant to such clause (i), the opportunity to conduct (or have conducted) cross-examination as to issues affecting his particular interests if he satisfies the Commission that he has made a reasonable and good faith effort to reach agreement upon group representation and there are substantial and relevant issues which would not be presented adequately by group representation.

(D) A transcript shall be kept of any oral presentation and cross-examination.

(E) In addition to the bases specified in section 78y(a) of this title, a reviewing Court may set aside an order of the Commission under section 78s(b) of this title approving an exchange rule imposing a schedule or fixing rates of commissions, allowances, discounts, or other fees, if the Court finds—

(1) a Commission determination under subparagraph (A) of this paragraph that an interested person is not entitled to conduct cross-examination or make rebuttal submissions, or

(2) a Commission rule or ruling under subparagraph (B) of this paragraph limiting the petitioner's cross-examination or rebuttal submissions,

has precluded full disclosure and proper resolution of disputed issues of material fact which were necessary for fair determination by the Commission.

(f) Compliance of non-members with exchange rules

The Commission, by rule or order, as it deems necessary or appropriate in the public interest and for the protection of investors, to maintain fair and orderly markets, or to assure equal regulation, may require—

(1) any person not a member or a designated representative of a member of a national securities exchange effecting transactions on such exchange without the services of another person acting as a broker, or

(2) any broker or dealer not a member of a national securities exchange effecting transactions on such exchange on a regular basis,

to comply with such rules of such exchange as the Commission may specify.

(g) Notice registration of security futures product exchanges

(1) Registration required

An exchange that lists or trades security futures products may register as a national securities exchange solely for the purposes of trading security futures products if—

(A) the exchange is a board of trade, as that term is defined by the Commodity Exchange Act (7 U.S.C. 1a(2)) [7 U.S.C. 1 et seq.], that—

(i) has been designated a contract market by the Commodity Futures Trading Commission and such designation is not suspended by order of the Commodity Futures Trading Commission; or

(ii) is registered as a derivative transaction execution facility under section 5a of the Commodity Exchange Act [7 U.S.C. 7a] and such registration is not suspended by the Commodity Futures Trading Commission; and

(B) such exchange does not serve as a market place for transactions in securities other than—

(i) security futures products; or

(ii) futures on exempted securities or groups or indexes of securities or options thereon that have been authorized under section 2(a)(1)(C) of the Commodity Exchange Act [7 U.S.C. 2(a)(1)(C)].

(2) Registration by notice filing

(A) Form and content

An exchange required to register only because such exchange lists or trades security futures products may register for purposes of this section by filing with the Commission a written notice in such form as the Commission, by rule, may prescribe containing the rules of the exchange and such other information and documents concerning such exchange, comparable to the information and documents required for national securities exchanges under subsection (a) of this section, as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. If such exchange has filed documents with the Commodity Futures Trading Commission, to the extent that such documents contain information satisfying the Commission's informational requirements, copies of such documents may be filed with the Commission in lieu of the required written notice.

(B) Immediate effectiveness

Such registration shall be effective contemporaneously with the submission of notice, in written or electronic form, to the Commission, except that such registration shall not be effective if such registration would be subject to suspension or revocation.

(C) Termination

Such registration shall be terminated immediately if any of the conditions for registration set forth in this subsection are no longer satisfied.

(3) Public availability

The Commission shall promptly publish in the Federal Register an acknowledgment of receipt of all notices the Commission receives under this subsection and shall make all such notices available to the public.

(4) Exemption of exchanges from specified provisions

(A) Transaction exemptions

An exchange that is registered under paragraph (1) of this subsection shall be exempt from, and shall not be required to enforce compliance by its members with, and its members shall not, solely with respect to those transactions effected on such exchange in security futures products, be required to comply with, the following provisions of this chapter and the rules thereunder:

(i) Subsections (b)(2), (b)(3), (b)(4), (b)(7), (b)(9), (c), (d), and (e) of this section.

(ii) Section 78h of this title.

(iii) Section 78k of this title.

(iv) Subsections (d), (f), and (k) of section 78q of this title.

(v) Subsections (a), (f), and (h) of section 78s of this title.

(B) Rule change exemptions

An exchange that registered under paragraph (1) of this subsection shall also be exempt from submitting proposed rule changes pursuant to section 78s(b) of this title, except that—

(i) such exchange shall file proposed rule changes related to higher margin levels, fraud or manipulation, recordkeeping, reporting, listing standards, or decimal pricing for security futures products, sales practices for security futures products for persons who effect transactions in security futures products, or rules effectuating such exchange's obligation to enforce the securities laws pursuant to section 78s(b)(7) of this title;

(ii) such exchange shall file pursuant to sections 78s(b)(1) and 78s(b)(2) of this title proposed rule changes related to margin, except for changes resulting in higher margin levels; and

(iii) such exchange shall file pursuant to section 78s(b)(1) of this title proposed rule changes that have been abrogated by the Commission pursuant to section 78s(b)(7)(C) of this title.

(5) Trading in security futures products

(A) In general

Subject to subparagraph (B), it shall be unlawful for any person to execute or trade a security futures product until the later of—

(i) 1 year after December 21, 2000; or

(ii) such date that a futures association registered under section 17 of the Commodity Exchange Act [7 U.S.C. 21] has met the requirements set forth in section 78*o*–3(k)(2) of this title.

(B) Principal-to-principal transactions

Notwithstanding subparagraph (A), a person may execute or trade a security futures product transaction if—

(i) the transaction is entered into—

(I) on a principal-to-principal basis between parties trading for their own accounts or as described in section 1a(12)(B)(ii) of the Commodity Exchange Act [7 U.S.C. 1a(12)(B)(ii)]; and

(II) only between eligible contract participants (as defined in subparagraphs (A), (B)(ii), and (C) of such section 1a(12) [7 U.S.C. 1a(12)(A), (B)(ii), (C)]) at the time at which the persons enter into the agreement, contract, or transaction; and

(ii) the transaction is entered into on or after the later of—

(I) 8 months after December 21, 2000; or

(II) such date that a futures association registered under section 17 of the Commodity Exchange Act [7 U.S.C. 21] has met the requirements set forth in section 78*o*–3(k)(2) of this title.

(h) Trading in security futures products

(1) Trading on exchange or association required

It shall be unlawful for any person to effect transactions in security futures products that are not listed on a national securities exchange or a national securities association registered pursuant to section 78*o*–3(a) of this title.

(2) Listing standards required

Except as otherwise provided in paragraph (7), a national securities exchange or a national securities association registered pursuant to section 78*o*–3(a) of this title may trade only security futures products that (A) conform with listing standards that such exchange or association files with the Commission under section 78s(b) of this title and (B) meet the criteria specified in section 2(a)(1)(D)(i) of the Commodity Exchange Act [7 U.S.C. 2(a)(1)(D)(i)].

(3) Requirements for listing standards and conditions for trading

Such listing standards shall—

(A) except as otherwise provided in a rule, regulation, or order issued pursuant to paragraph (4), require that any security underlying the security future, including each component security of a narrow-based security index, be registered pursuant to section 78*l* of this title;

(B) require that if the security futures product is not cash settled, the market on which the security futures product is traded have arrangements in place with a registered clearing agency for the payment and delivery of the securities underlying the security futures product;

(C) be no less restrictive than comparable listing standards for options traded on a national securities exchange or national securities association registered pursuant to section 78*o*–3(a) of this title;

(D) except as otherwise provided in a rule, regulation, or order issued pursuant to paragraph (4), require that the security future be based upon common stock and such other equity securities as the Commission and the Commodity Futures Trading Commission jointly determine appropriate;

(E) require that the security futures product is cleared by a clearing agency that has in place provisions for linked and coordinated clearing with other clearing agencies that clear security futures products, which permits the security futures product to be purchased on one market and offset on another market that trades such product;

(F) require that only a broker or dealer subject to suitability rules comparable to those of a national securities association registered pursuant to section 78*o*–3(a) of this title effect transactions in the security futures product;

(G) require that the security futures product be subject to the prohibition against dual trading in section 4j of the Commodity Exchange Act (7 U.S.C. 6j) and the rules and regulations thereunder or the provisions of section 78k(a) of this title and the rules and regulations thereunder, except to the extent otherwise permitted under this chapter and the rules and regulations thereunder;

(H) require that trading in the security futures product not be readily susceptible to manipulation of the price of such security futures product, nor to causing or being used in the manipulation of the price of any underlying security, option on such security, or option on a group or index including such securities;

(I) require that procedures be in place for coordinated surveillance among the market on which the security futures product is traded, any market on which any security underlying the security futures product is traded, and other markets on which any related security is traded to detect manipulation and insider trading;

(J) require that the market on which the security futures product is traded has in place audit trails necessary or appropriate to facilitate the coordinated surveillance required in subparagraph (I);

(K) require that the market on which the security futures product is traded has in place procedures to coordinate trading halts between such market and any market on which any security underlying the security futures product is traded and other markets on which any related security is traded; and

(L) require that the margin requirements for a security futures product comply with the regulations prescribed pursuant to section 78g(c)(2)(B) of this title, except that nothing in this subparagraph shall be construed to prevent a national securities exchange or national securities association from requiring higher margin levels for a security futures product when it deems such action to be necessary or appropriate.

(4) Authority to modify certain listing standard requirements

(A) Authority to modify

The Commission and the Commodity Futures Trading Commission, by rule, regulation, or order, may jointly modify the listing standard requirements specified in subparagraph (A) or (D) of paragraph (3) to the extent such modification fosters the development of fair and orderly

markets in security futures products, is necessary or appropriate in the public interest, and is consistent with the protection of investors.

(B) Authority to grant exemptions

The Commission and the Commodity Futures Trading Commission, by order, may jointly exempt any person from compliance with the listing standard requirement specified in subparagraph (E) of paragraph (3) to the extent such exemption fosters the development of fair and orderly markets in security futures products, is necessary or appropriate in the public interest, and is consistent with the protection of investors.

(5) Requirements for other persons trading security future products

It shall be unlawful for any person (other than a national securities exchange or a national securities association registered pursuant to section 78*o*–3(a) of this title) to constitute, maintain, or provide a marketplace or facilities for bringing together purchasers and sellers of security future products or to otherwise perform with respect to security future products the functions commonly performed by a stock exchange as that term is generally understood, unless a national securities association registered pursuant to section 78*o*–3(a) of this title or a national securities exchange of which such person is a member—

(A) has in place procedures for coordinated surveillance among such person, the market trading the securities underlying the security future products, and other markets trading related securities to detect manipulation and insider trading;

(B) has rules to require audit trails necessary or appropriate to facilitate the coordinated surveillance required in subparagraph (A); and

(C) has rules to require such person to coordinate trading halts with markets trading the securities underlying the security future products and other markets trading related securities.

(6) Deferral of options on security futures trading

No person shall offer to enter into, enter into, or confirm the execution of any put, call, straddle, option, or privilege on a security future, except that, after 3 years after December 21, 2000, the Commission and the Commodity Futures Trading Commission may by order jointly determine to permit trading of puts, calls, straddles, options, or privileges on any security future authorized to be traded under the provisions of this chapter and the Commodity Exchange Act [7 U.S.C. 1 et seq.].

(7) Deferral of linked and coordinated clearing

(A) Notwithstanding paragraph (2), until the compliance date, a national securities exchange or national securities association registered pursuant to section 78*o*–3(a) of this title may trade a security futures product that does not—

(i) conform with any listing standard promulgated to meet the requirement specified in subparagraph (E) of paragraph (3); or

(ii) meet the criterion specified in section 2(a)(1)(D)(i)(IV) of the Commodity Exchange Act [7 U.S.C. 2(a)(1)(D)(i)(IV)].

(B) The Commission and the Commodity Futures Trading Commission shall jointly publish in the Federal Register a notice of the compliance date no later than 165 days before the compliance date.

(C) For purposes of this paragraph, the term "compliance date" means the later of—

(i) 180 days after the end of the first full calendar month period in which the average aggregate comparable share volume for all security futures products based on single equity securities traded on all national securities exchanges, any national securities associations registered pursuant to section 78*o*–3(a) of this title, and all other persons equals or exceeds 10 percent of the average aggregate comparable share volume of options on single equity securities traded on all national securities exchanges and any national securities associations registered pursuant to section 78*o*–3(a) of this title; or

(ii) 2 years after the date on which trading in any security futures product commences under this chapter.

(i) Rules to avoid duplicative regulation of dual registrants

Consistent with this chapter, each national securities exchange registered pursuant to subsection (a) of this section shall issue such rules as are necessary to avoid duplicative or conflicting rules applicable to any broker or dealer registered with the Commission pursuant to section 78*o*(b) of this title (except paragraph (11) thereof), that is also registered with the Commodity Futures Trading Commission pursuant to section 4f(a) of the Commodity Exchange Act [7 U.S.C. 6f(a)] (except paragraph (2) thereof), with respect to the application of—

(1) rules of such national securities exchange of the type specified in section 78*o*(c)(3)(B) of this title involving security futures products; and

(2) similar rules of national securities exchanges registered pursuant to subsection (g) of this section and national securities associations registered pursuant to section 78*o*–3(k) of this title involving security futures products.

(j) Procedures and rules for security future products

A national securities exchange registered pursuant to subsection (a) of this section shall implement the procedures specified in subsection (h)(5)(A) of this section and adopt the rules specified in subparagraphs (B) and (C) of subsection (h)(5) of this section not later than 8 months after the date of receipt of a request from an alternative trading system for such implementation and rules.

(k) Rules relating to security futures products traded on foreign boards of trade

(1) To the extent necessary or appropriate in the public interest, to promote fair competition, and consistent with the promotion of market efficiency, innovation, and expansion of investment opportunities, the protection of investors, and the maintenance of fair and orderly markets, the Commission and the Commodity Futures Trading Commission shall jointly issue such rules, regulations, or orders as are necessary and appropriate to permit the offer and sale of a security futures product traded on or subject to the rules of a foreign board of trade to United States persons.

(2) The rules, regulations, or orders adopted under paragraph (1) shall take into account, as appropriate, the nature and size of the markets that the securities underlying the security futures product reflect.

(June 6, 1934, ch. 404, title I, §6, 48 Stat. 885; Pub. L. 94–29, §4, June 4, 1975, 89 Stat. 104; Pub. L. 100–181, title III, §§309–312, Dec. 4, 1987, 101 Stat. 1255; Pub. L. 103–202, title III, §303(b), Dec. 17, 1993, 107 Stat. 2365; Pub. L. 106–554, §1(a)(5) [title II, §§202(a), 206(a), (i), (k)(2), (*l*)], Dec. 21, 2000, 114 Stat. 2763, 2763A–416, 2763A–426, 2763A–433, 2763A–434.)

REFERENCES IN TEXT

This chapter, referred to in subsecs. (b) to (e), (g)(4)(A), (h)(3)(G), (7)(C)(ii), and (i), was in the original "this title". This chapter, referred to in subsec. (h)(6), was in the original "this Act". See References in Text note set out under section 78a of this title.

The Commodity Exchange Act, referred to in subsecs. (g)(1)(A) and (h)(6), is act Sept. 21, 1922, ch. 369, 42 Stat. 998, as amended, which is classified generally to chapter 1 (§1 et seq.) of Title 7, Agriculture. For complete classification of this Act to the Code, see section 1 of Title 7 and Tables.

AMENDMENTS

2000—Subsec. (g). Pub. L. 106–554, §1(a)(5) [title II, §202(a)], added subsec. (g).

Subsec. (h). Pub. L. 106–554, §1(a)(5) [title II, §206(a)], added subsec. (h).

Subsec. (i). Pub. L. 106–554, §1(a)(5) [title II, §206(i)], added subsec. (i).

Subsec. (j). Pub. L. 106–554, §1(a)(5) [title II, §206(k)(2)], added subsec. (j).

Subsec. (k). Pub. L. 106–554, §1(a)(5) [title II, §206(*l*)], added subsec. (k).

1993—Subsec. (b)(9). Pub. L. 103–202 added par. (9).

1987—Subsec. (c)(2). Pub. L. 100–181, §309, substituted "protection of investors shall" for "protection shall".

Subsec. (c)(3)(A). Pub. L. 100–181, §310, substituted "associated" for "association".

Subsec. (c)(4). Pub. L. 100–181, §311, substituted "may limit (A)" for "may (A) limit".

Subsec. (e)(1). Pub. L. 100–181, §312(1), substituted "paragraph (3) of this subsection" for "paragraph (4) of this section".

Subsec. (e)(3), (4). Pub. L. 100–181, §312(2), (3), redesignated par. (4) as (3) and, in subpar. (E), substituted "fixing" for "fixes" in introductory provisions, "subparagraph (A) of this paragraph" for "paragraph (4)(A) of this subsection" in cl. (1), and "subparagraph (B) of this paragraph" for "paragraph (4)(B) of this subsection" in cl. (2), and struck out former par. (3) which read as follows: "Until December 31, 1976, the Commission, on a regular basis, shall file with the Speaker of the House and the President of the Senate information concerning the effect on the public interest, protection of investors, and maintenance of fair and orderly markets of the absence of any schedule or fixed rates of commissions, allowances, discounts, or other fees to be charged by members of any national securities exchange for effecting transactions on such exchange."

1975—Pub. L. 94–29 restructured the entire section and, in addition, authorized the Commission to require an exchange to file such documents and information as it deems necessary or appropriate in the public interest or for the protection of investors and to prescribe the form and substance of an exchange's application for registration, expanded to eight the number of explicit statutory requirements that must be satisfied before an exchange may be registered as a national securities exchange, set forth the authority of a national securities exchange to admit or deny persons membership or association with members, prescribed exchange procedures for instituting disciplinary actions, denying membership, and summarily suspending members or persons associated with members, specified the authority of national securities exchanges to impose schedules or fix rates of commissions, allowances, discounts, or other fees to be charged by its members for transacting business on the exchange, and empowered the Commission to regulate any broker or dealer who effects transactions on an exchange on a regular basis but who is not a member of that exchange and any person who effects transactions on an exchange without the services of another person acting as broker.

EFFECTIVE DATE OF 1993 AMENDMENT

Section 304 of title III of Pub. L. 103–202 provided that:

"(a) EFFECTIVE DATE.—

"(1) IN GENERAL.—The amendments made by section 303 [amending this section and section 78*o*–3 of this title] shall become effective 12 months after the date of enactment of this Act [Dec. 17, 1993].

"(2) RULEMAKING AUTHORITY.—Notwithstanding paragraph (1), the authority of the Securities and Exchange Commission, a registered securities association, and a national securities exchange to commence rulemaking proceedings for the purpose of issuing rules pursuant to the amendments made by section 303 is effective on the date of enactment of this Act.

"(3) REVIEW OF FILINGS PRIOR TO EFFECTIVE DATE.—Prior to the effective date of regulations promulgated pursuant to this title [amending this section and sections 78n and 78*o*–3 of this title and enacting provisions set out as notes under sections 78a and 78n of this title], the Securities and Exchange Commission shall continue to review and declare effective registration statements and amendments thereto relating to limited partnership rollup transactions in accordance with applicable regulations then in effect.

"(b) EFFECT ON EXISTING AUTHORITY.—The amendments made by this title [amending this section and sections 78n and 78*o*–3 of this title] shall not limit the authority of the Securities and Exchange Commission, a registered securities association, or a national securities exchange under any provision of the Securities Exchange Act of 1934 [15 U.S.C. 78a et seq.], or preclude the Commission or such association or exchange

from imposing, under any other such provision, a remedy or procedure required to be imposed under such amendments."

Effective Date of 1975 Amendment

Amendment by Pub. L. 94–29 effective June 4, 1975, except for amendment of subsecs. (a) through (d) by Pub. L. 94–29 to be effective 180 days after June 4, 1975, with provisions of subsecs. (b)(2) and (c)(6), as amended by Pub. L. 94–29, or rules or regulations thereunder, not to apply in a way so as to deprive any person of membership in any national securities exchange (or its successor) of which such person was, on June 4, 1975, a member or a member firm as defined in the constitution of such exchange, or so as to deny membership in any such exchange (or its successor) to a natural person who is or becomes associated with such member or member firm, see section 31(a) of Pub. L. 94–29, set out as a note under section 78b of this title.

Transfer of Functions

For transfer of functions of Securities and Exchange Commission, with certain exceptions, to Chairman of such Commission, see Reorg. Plan No. 10 of 1950, §§1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out under section 78d of this title.

Changes in Organization and Rules of National Securities Exchanges and Registered Securities Associations

Section 31(b) of Pub. L. 94–29 provided that: "If it appears to the Commission at any time within one year of the effective date of any amendment made by this Act [see Short Title of 1975 Amendment note under section 78a of this title] to the Securities Exchange Act of 1934 that the organization or rules of any national securities exchange or registered securities association registered with the Commission on the date of enactment of this Act [June 4, 1975] do not comply with such Act as amended, the Commission shall so notify such exchange or association in writing, specifying the respects in which the exchange or association is not in compliance with such Act. On and after the one hundred eightieth day following the date of receipt of such notice by a national securities exchange or registered securities association, the Commission, without regard to the provisions of section 19(h) of the Securities Exchange Act of 1934 [section 78s(h) of this title], as amended by this Act, is authorized by order, to suspend the registration of any such exchange or association or impose limitations on the activities, functions, and operations of any such exchange or association, if the Commission finds, after notice and opportunity for hearing, that the organization or rules of such exchange or association do not comply with such Act. Any such suspension or limitation shall continue in effect until the Commission, by order, declares that such exchange or association is in compliance with such requirements."

15 U.S.C.
United States Code, 2011 Edition
Title 15 - COMMERCE AND TRADE
CHAPTER 2B - SECURITIES EXCHANGES
Sec. 78s - Registration, responsibilities, and oversight of self-regulatory organizations
From the U.S. Government Publishing Office, www.gpo.gov

§78s. Registration, responsibilities, and oversight of self-regulatory organizations

(a) Registration procedures; notice of filing; other regulatory agencies

(1) The Commission shall, upon the filing of an application for registration as a national securities exchange, registered securities association, or registered clearing agency, pursuant to section 78f, 78*o*–3, or 78q–1 of this title, respectively, publish notice of such filing and afford interested persons an opportunity to submit written data, views, and arguments concerning such application. Within ninety days of the date of publication of such notice (or within such longer period as to which the applicant consents), the Commission shall—

(A) by order grant such registration, or

(B) institute proceedings to determine whether registration should be denied. Such proceedings shall include notice of the grounds for denial under consideration and opportunity for hearing and shall be concluded within one hundred eighty days of the date of a publication of notice of the filing of the application for registration. At the conclusion of such proceedings the Commission, by order, shall grant or deny such registration. The Commission may extend the time for conclusion of such proceedings for up to ninety days if it finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the applicant consents.

The Commission shall grant such registration if it finds that the requirements of this chapter and the rules and regulations thereunder with respect to the applicant are satisfied. The Commission shall deny such registration if it does not make such finding.

(2) With respect to an application for registration filed by a clearing agency for which the Commission is not the appropriate regulatory agency—

(A) The Commission shall not grant registration prior to the sixtieth day after the date of publication of notice of the filing of such application unless the appropriate regulatory agency for such clearing agency has notified the Commission of such appropriate regulatory agency's determination that such clearing agency is so organized and has the capacity to be able to safeguard securities and funds in its custody or control or for which it is responsible and that the rules of such clearing agency are designed to assure the safeguarding of such securities and funds.

(B) The Commission shall institute proceedings in accordance with paragraph (1)(B) of this subsection to determine whether registration should be denied if the appropriate regulatory agency for such clearing agency notifies the Commission within sixty days of the date of publication of notice of the filing of such application of such appropriate regulatory agency's (i) determination that such clearing agency may not be so organized or have the capacity to be able to safeguard securities or funds in its custody or control or for which it is responsible or that the rules of such clearing agency may not be designed to assure the safeguarding of such securities and funds and (ii) reasons for such determination.

(C) The Commission shall deny registration if the appropriate regulatory agency for such clearing agency notifies the Commission prior to the conclusion of proceedings instituted in accordance with paragraph (1)(B) of this subsection of such appropriate regulatory agency's (i) determination that such clearing agency is not so organized or does not have the capacity to be able to safeguard securities or funds in its custody or control or for which it is responsible or that the rules of such clearing agency are not designed to assure the safeguarding of such securities or funds and (ii) reasons for such determination.

(3) A self-regulatory organization may, upon such terms and conditions as the Commission, by rule, deems necessary or appropriate in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission. If the Commission finds that any self-regulatory organization is no longer in existence or has ceased to do business in the capacity specified in its application for registration, the Commission, by order, shall cancel its registration. Upon the withdrawal of a national securities association from registration or the cancellation, suspension, or revocation of the registration of a national securities association, the registration of any association affiliated therewith shall automatically terminate.

(b) Proposed rule changes; notice; proceedings

(1) Each self-regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization (hereinafter in this subsection collectively referred to as a "proposed rule change") accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, as soon as practicable after the date of the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect

unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.

(2) APPROVAL PROCESS.—

(A) APPROVAL PROCESS ESTABLISHED.—

(i) IN GENERAL.—Except as provided in clause (ii), not later than 45 days after the date of publication of a proposed rule change under paragraph (1), the Commission shall—

(I) by order, approve or disapprove the proposed rule change; or

(II) institute proceedings under subparagraph (B) to determine whether the proposed rule change should be disapproved.

(ii) EXTENSION OF TIME PERIOD.—The Commission may extend the period established under clause (i) by not more than an additional 45 days, if—

(I) the Commission determines that a longer period is appropriate and publishes the reasons for such determination; or

(II) the self-regulatory organization that filed the proposed rule change consents to the longer period.

(B) PROCEEDINGS.—

(i) NOTICE AND HEARING.—If the Commission does not approve or disapprove a proposed rule change under subparagraph (A), the Commission shall provide to the self-regulatory organization that filed the proposed rule change—

(I) notice of the grounds for disapproval under consideration; and

(II) opportunity for hearing, to be concluded not later than 180 days after the date of publication of notice of the filing of the proposed rule change.

(ii) ORDER OF APPROVAL OR DISAPPROVAL.—

(I) IN GENERAL.—Except as provided in subclause (II), not later than 180 days after the date of publication under paragraph (1), the Commission shall issue an order approving or disapproving the proposed rule change.

(II) EXTENSION OF TIME PERIOD.—The Commission may extend the period for issuance under clause (I) by not more than 60 days, if—

(aa) the Commission determines that a longer period is appropriate and publishes the reasons for such determination; or

(bb) the self-regulatory organization that filed the proposed rule change consents to the longer period.

(C) STANDARDS FOR APPROVAL AND DISAPPROVAL.—

(i) APPROVAL.—The Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this chapter and the rules and regulations issued under this chapter that are applicable to such organization.

(ii) DISAPPROVAL.—The Commission shall disapprove a proposed rule change of a self-regulatory organization if it does not make a finding described in clause (i).

(iii) TIME FOR APPROVAL.—The Commission may not approve a proposed rule change earlier than 30 days after the date of publication under paragraph (1), unless the Commission finds good cause for so doing and publishes the reason for the finding.

(D) RESULT OF FAILURE TO INSTITUTE OR CONCLUDE PROCEEDINGS.—A proposed rule change shall be deemed to have been approved by the Commission, if—

(i) the Commission does not approve or disapprove the proposed rule change or begin proceedings under subparagraph (B) within the period described in subparagraph (A); or

(ii) the Commission does not issue an order approving or disapproving the proposed rule change under subparagraph (B) within the period described in subparagraph (B)(ii).

(E) PUBLICATION DATE BASED ON FEDERAL REGISTER PUBLISHING.—For purposes of this paragraph, if, after filing a proposed rule change with the Commission pursuant to paragraph (1), a self-regulatory organization publishes a notice of the filing of such proposed rule change, together with the substantive terms of such proposed rule change, on a publicly accessible website, the Commission shall thereafter send the notice to the Federal Register for publication thereof under paragraph (1) within 15 days of the date on which such website publication is made. If the Commission fails to send the notice for publication thereof within such 15 day period, then the date of publication shall be deemed to be the date on which such website publication was made.

(F) RULEMAKING.—

(i) IN GENERAL.—Not later than 180 days after July 21, 2010, after consultation with other regulatory agencies, the Commission shall promulgate rules setting forth the procedural requirements of the proceedings required under this paragraph.

(ii) NOTICE AND COMMENT NOT REQUIRED.—The rules promulgated by the Commission under clause (i) are not required to include republication of proposed rule changes or solicitation of public comment.

(3)(A) Notwithstanding the provisions of paragraph (2) of this subsection, a proposed rule change shall take effect upon filing with the Commission if designated by the self-regulatory organization as

(i) constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization, (ii) establishing or changing a due, fee, or other charge imposed by the self-regulatory organization on any person, whether or not the person is a member of the self-regulatory organization, or (iii) concerned solely with the administration of the self-regulatory organization or other matters which the Commission, by rule, consistent with the public interest and the purposes of this subsection, may specify as without the provisions of such paragraph (2).

(B) Notwithstanding any other provision of this subsection, a proposed rule change may be put into effect summarily if it appears to the Commission that such action is necessary for the protection of investors, the maintenance of fair and orderly markets, or the safeguarding of securities or funds. Any proposed rule change so put into effect shall be filed promptly thereafter in accordance with the provisions of paragraph (1) of this subsection.

(C) Any proposed rule change of a self-regulatory organization which has taken effect pursuant to subparagraph (A) or (B) of this paragraph may be enforced by such organization to the extent it is not inconsistent with the provisions of this chapter, the rules and regulations thereunder, and applicable Federal and State law. At any time within the 60-day period beginning on the date of filing of such a proposed rule change in accordance with the provisions of paragraph (1), the Commission summarily may temporarily suspend the change in the rules of the self-regulatory organization made thereby, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter. If the Commission takes such action, the Commission shall institute proceedings under paragraph (2)(B) to determine whether the proposed rule should be approved or disapproved. Commission action pursuant to this subparagraph shall not affect the validity or force of the rule change during the period it was in effect and shall not be reviewable under section 78y of this title nor deemed to be "final agency action" for purposes of section 704 of title 5.

(4) With respect to a proposed rule change filed by a registered clearing agency for which the Commission is not the appropriate regulatory agency—

(A) The Commission shall not approve any such proposed rule change prior to the thirtieth day after the date of publication of notice of the filing whereof unless the appropriate regulatory agency for such clearing agency has notified the Commission of such appropriate regulatory agency's determination that the proposed rule change is consistent with the safeguarding of securities and funds in the custody or control of such clearing agency or for which it is responsible.

(B) The Commission shall institute proceedings in accordance with paragraph (2)(B) of this subsection to determine whether any such proposed rule change should be disapproved, if the appropriate regulatory agency for such clearing agency notifies the Commission within thirty days of the date of publication of notice of the filing of the proposed rule change of such appropriate regulatory agency's (i) determination that the proposed rule change may be inconsistent with the safeguarding of securities or funds in the custody or control of such clearing agency or for which it is responsible and (ii) reasons for such determination.

(C) The Commission shall disapprove any such proposed rule change if the appropriate regulatory agency for such clearing agency notifies the Commission prior to the conclusion of proceedings instituted in accordance with paragraph (2)(B) of this subsection of such appropriate regulatory agency's (i) determination that the proposed rule change is inconsistent with the safeguarding of securities or funds in the custody or control of such clearing agency or for which it is responsible and (ii) reasons for such determination.

(D)(i) The Commission shall order the temporary suspension of any change in the rules of a clearing agency made by a proposed rule change that has taken effect under paragraph (3), if the appropriate regulatory agency for the clearing agency notifies the Commission not later than 30 days after the date on which the proposed rule change was filed of—

(I) the determination by the appropriate regulatory agency that the rules of such clearing agency, as so changed, may be inconsistent with the safeguarding of securities or funds in the custody or control of such clearing agency or for which it is responsible; and

(II) the reasons for the determination described in subclause (I).

(ii) If the Commission takes action under clause (i), the Commission shall institute proceedings under paragraph (2)(B) to determine if the proposed rule change should be approved or disapproved.

(5) The Commission shall consult with and consider the views of the Secretary of the Treasury prior to approving a proposed rule filed by a registered securities association that primarily concerns conduct related to transactions in government securities, except where the Commission determines that an emergency exists requiring expeditious or summary action and publishes its reasons therefor. If the Secretary of the Treasury comments in writing to the Commission on a proposed rule that has been published for comment, the Commission shall respond in writing to such written comment before approving the proposed rule. If the Secretary of the Treasury determines, and notifies the Commission, that such rule, if implemented, would, or as applied does (i) adversely affect the liquidity or efficiency of the market for government securities; or (ii) impose any burden on competition not necessary or appropriate in furtherance of the purposes of this section, the Commission shall, prior to adopting the proposed rule, find that such rule is necessary and appropriate in furtherance of the purposes of this section notwithstanding the Secretary's determination.

(6) In approving rules described in paragraph (5), the Commission shall consider the sufficiency and appropriateness of then existing laws and rules applicable to government securities brokers, government securities dealers, and persons associated with government securities brokers and government securities dealers.

(7) SECURITY FUTURES PRODUCT RULE CHANGES.—

(A) FILING REQUIRED.—A self-regulatory organization that is an exchange registered with the Commission pursuant to section 78f(g) of this title or that is a national securities association registered pursuant to section 78*o*–3(k) of this title shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule change or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization (hereinafter in this paragraph collectively referred to as a "proposed rule change") that relates to higher margin levels, fraud or manipulation, recordkeeping, reporting, listing standards, or decimal pricing for security futures products, sales practices for security futures products for persons who effect transactions in security futures products, or rules effectuating such self-regulatory organization's obligation to enforce the securities laws. Such proposed rule change shall be accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, upon the filing of any proposed rule change, promptly publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit data, views, and arguments concerning such proposed rule change.

(B) FILING WITH CFTC.—A proposed rule change filed with the Commission pursuant to subparagraph (A) shall be filed concurrently with the Commodity Futures Trading Commission. Such proposed rule change may take effect upon filing of a written certification with the Commodity Futures Trading Commission under section 7a–2(c) of title 7, upon a determination by the Commodity Futures Trading Commission that review of the proposed rule change is not necessary, or upon approval of the proposed rule change by the Commodity Futures Trading Commission.

(C) ABROGATION OF RULE CHANGES.—Any proposed rule change of a self-regulatory organization that has taken effect pursuant to subparagraph (B) may be enforced by such self-regulatory organization to the extent such rule is not inconsistent with the provisions of this chapter, the rules and regulations thereunder, and applicable Federal law. At any time within 60 days of the date of the filing of a written certification with the Commodity Futures Trading Commission under section 7a–2(c) of title 7, the date the Commodity Futures Trading Commission determines that review of such proposed rule change is not necessary, or the date the Commodity Futures Trading Commission approves such proposed rule change, the Commission, after consultation with the Commodity Futures Trading Commission, may summarily abrogate the proposed rule change and require that the proposed rule change be refiled in accordance with the provisions of paragraph (1), if it appears to the Commission that such proposed rule change unduly burdens competition or efficiency, conflicts with the securities laws, or is inconsistent with the public interest and the protection of investors. Commission action pursuant to the preceding sentence shall not affect the validity or force of the rule change during the period it was in effect and shall not be reviewable under section 78y of this title nor deemed to be a final agency action for purposes of section 704 of title 5.

(D) REVIEW OF RESUBMITTED ABROGATED RULES.—

(i) PROCEEDINGS.—Within 35 days of the date of publication of notice of the filing of a proposed rule change that is abrogated in accordance with subparagraph (C) and refiled in accordance with paragraph (1), or within such longer period as the Commission may designate up to 90 days after such date if the Commission finds such longer period to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents, the Commission shall—

(I) by order approve such proposed rule change; or

(II) after consultation with the Commodity Futures Trading Commission, institute proceedings to determine whether the proposed rule change should be disapproved. Proceedings under subclause (II) shall include notice of the grounds for disapproval under consideration and opportunity for hearing and be concluded within 180 days after the date of publication of notice of the filing of the proposed rule change. At the conclusion of such proceedings, the Commission, by order, shall approve or disapprove such proposed rule change. The Commission may extend the time for conclusion of such proceedings for up to 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding or for such longer period as to which the self-regulatory organization consents.

(ii) GROUNDS FOR APPROVAL.—The Commission shall approve a proposed rule change of a self-regulatory organization under this subparagraph if the Commission finds that such proposed rule change does not unduly burden competition or efficiency, does not conflict with the securities laws, and is not inconsistent with the public interest or the protection of investors. The Commission shall disapprove such a proposed rule change of a self-regulatory organization if it does not make such finding. The Commission shall not approve any proposed rule change prior to the 30th day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for so doing and publishes its reasons for so finding.

(8) DECIMAL PRICING.—Not later than 9 months after the date on which trading in any security futures product commences under this chapter, all self-regulatory organizations listing or trading

security futures products shall file proposed rule changes necessary to implement decimal pricing of security futures products. The Commission may not require such rules to contain equal minimum increments in such decimal pricing.

(9) CONSULTATION WITH CFTC.—

(A) CONSULTATION REQUIRED.—The Commission shall consult with and consider the views of the Commodity Futures Trading Commission prior to approving or disapproving a proposed rule change filed by a national securities association registered pursuant to section 78*o*–3(a) of this title or a national securities exchange subject to the provisions of subsection (a) of this section that primarily concerns conduct related to transactions in security futures products, except where the Commission determines that an emergency exists requiring expeditious or summary action and publishes its reasons therefor.

(B) RESPONSES TO CFTC COMMENTS AND FINDINGS.—If the Commodity Futures Trading Commission comments in writing to the Commission on a proposed rule that has been published for comment, the Commission shall respond in writing to such written comment before approving or disapproving the proposed rule. If the Commodity Futures Trading Commission determines, and notifies the Commission, that such rule, if implemented or as applied, would—

(i) adversely affect the liquidity or efficiency of the market for security futures products; or

(ii) impose any burden on competition not necessary or appropriate in furtherance of the purposes of this section,

the Commission shall, prior to approving or disapproving the proposed rule, find that such rule is necessary and appropriate in furtherance of the purposes of this section notwithstanding the Commodity Futures Trading Commission's determination.

(10) ┘ RULE OF CONSTRUCTION RELATING TO FILING DATE OF PROPOSED RULE CHANGES.—

(A) IN GENERAL.—For purposes of this subsection, the date of filing of a proposed rule change shall be deemed to be the date on which the Commission receives the proposed rule change.

(B) EXCEPTION.—A proposed rule change has not been received by the Commission for purposes of subparagraph (A) if, not later than 7 business days after the date of receipt by the Commission, the Commission notifies the self-regulatory organization that such proposed rule change does not comply with the rules of the Commission relating to the required form of a proposed rule change, except that if the Commission determines that the proposed rule change is unusually lengthy and is complex or raises novel regulatory issues, the Commission shall inform the self-regulatory organization of such determination not later than 7 business days after the date of receipt by the Commission and, for the purposes of subparagraph (A), a proposed rule change has not been received by the Commission, if, not later than 21 days after the date of receipt by the Commission, the Commission notifies the self-regulatory organization that such proposed rule change does not comply with the rules of the Commission relating to the required form of a proposed rule change.

(10) ┘ Notwithstanding paragraph (2), the time period within which the Commission is required by order to approve a proposed rule change or institute proceedings to determine whether the proposed rule change should be disapproved is stayed pending a determination by the Commission upon the request of the Commodity Futures Trading Commission or its Chairman that the Commission issue a determination as to whether a product that is the subject of such proposed rule change is a security pursuant to section 8306 of this title.

(c) Amendment by Commission of rules of self-regulatory organizations

The Commission, by rule, may abrogate, add to, and delete from (hereinafter in this subsection collectively referred to as "amend") the rules of a self-regulatory organization (other than a registered clearing agency) as the Commission deems necessary or appropriate to insure the fair administration of the self-regulatory organization, to conform its rules to requirements of this chapter and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this chapter, in the following manner:

(1) The Commission shall notify the self-regulatory organization and publish notice of the proposed rulemaking in the Federal Register. The notice shall include the text of the proposed amendment to the rules of the self-regulatory organization and a statement of the Commission's reasons, including any pertinent facts, for commencing such proposed rulemaking.

(2) The Commission shall give interested persons an opportunity for the oral presentation of data, views, and arguments, in addition to an opportunity to make written submissions. A transcript shall be kept of any oral presentation.

(3) A rule adopted pursuant to this subsection shall incorporate the text of the amendment to the rules of the self-regulatory organization and a statement of the Commission's basis for and purpose in so amending such rules. This statement shall include an identification of any facts on which the Commission considers its determination so to amend the rules of the self-regulatory agency to be based, including the reasons for the Commission's conclusions as to any of such facts which were disputed in the rulemaking.

(4)(A) Except as provided in paragraphs (1) through (3) of this subsection, rulemaking under this subsection shall be in accordance with the procedures specified in section 553 of title 5 for rulemaking not on the record.

(B) Nothing in this subsection shall be construed to impair or limit the Commission's power to make, or to modify or alter the procedures the Commission may follow in making, rules and regulations pursuant to any other authority under this chapter.

(C) Any amendment to the rules of a self-regulatory organization made by the Commission pursuant to this subsection shall be considered for all purposes of this chapter to be part of the rules of such self-regulatory organization and shall not be considered to be a rule of the Commission.

(5) With respect to rules described in subsection (b)(5) of this section, the Commission shall consult with and consider the views of the Secretary of the Treasury before abrogating, adding to, and deleting from such rules, except where the Commission determines that an emergency exists requiring expeditious or summary action and publishes its reasons therefor.

(d) Notice of disciplinary action taken by self-regulatory organization against a member or participant; review of action by appropriate regulatory agency; procedure

(1) If any self-regulatory organization imposes any final disciplinary sanction on any member thereof or participant therein, denies membership or participation to any applicant, or prohibits or limits any person in respect to access to services offered by such organization or member thereof or if any self-regulatory organization (other than a registered clearing agency) imposes any final disciplinary sanction on any person associated with a member or bars any person from becoming associated with a member, the self-regulatory organization shall promptly file notice thereof with the appropriate regulatory agency for the self-regulatory organization and (if other than the appropriate regulatory agency for the self-regulatory organization) the appropriate regulatory agency for such member, participant, applicant, or other person. The notice shall be in such form and contain such information as the appropriate regulatory agency for the self-regulatory organization, by rule, may prescribe as necessary or appropriate in furtherance of the purposes of this chapter.

(2) Any action with respect to which a self-regulatory organization is required by paragraph (1) of this subsection to file notice shall be subject to review by the appropriate regulatory agency for such member, participant, applicant, or other person, on its own motion, or upon application by any person aggrieved thereby filed within thirty days after the date such notice was filed with such appropriate regulatory agency and received by such aggrieved person, or within such longer period as such appropriate regulatory agency may determine. Application to such appropriate regulatory agency for review, or the institution of review by such appropriate regulatory agency on its own motion, shall not operate as a stay of such action unless such appropriate regulatory agency otherwise orders, summarily or after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of the submission of affidavits or presentation of oral arguments). Each appropriate regulatory agency shall establish for appropriate cases an expedited procedure for consideration and determination of the question of a stay.

(3) The provisions of this subsection shall apply to an exchange registered pursuant to section 78f(g) of this title or a national securities association registered pursuant to section 78o–3(k) of this title only to the extent that such exchange or association imposes any final disciplinary sanction for —

(A) a violation of the Federal securities laws or the rules and regulations thereunder; or

(B) a violation of a rule of such exchange or association, as to which a proposed change would be required to be filed under this section, except that, to the extent that the exchange or association rule violation relates to any account, agreement, contract, or transaction, this subsection shall apply only to the extent such violation involves a security futures product.

(e) Disposition of review; cancellation, reduction, or remission of sanction

(1) In any proceeding to review a final disciplinary sanction imposed by a self-regulatory organization on a member thereof or participant therein or a person associated with such a member, after notice and opportunity for hearing (which hearing may consist solely of consideration of the record before the self-regulatory organization and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the sanction)—

(A) if the appropriate regulatory agency for such member, participant, or person associated with a member finds that such member, participant, or person associated with a member has engaged in such acts or practices, or has omitted such acts, as the self-regulatory organization has found him to have engaged in or omitted, that such acts or practices, or omissions to act, are in violation of such provisions of this chapter, the rules or regulations thereunder, the rules of the self-regulatory organization, or, in the case of a registered securities association, the rules of the Municipal Securities Rulemaking Board as have been specified in the determination of the self-regulatory organization, and that such provisions are, and were applied in a manner, consistent with the purposes of this chapter, such appropriate regulatory agency, by order, shall so declare and, as appropriate, affirm the sanction imposed by the self-regulatory organization, modify the sanction in accordance with paragraph (2) of this subsection, or remand to the self-regulatory organization for further proceedings; or

(B) if such appropriate regulatory agency does not make any such finding it shall, by order, set aside the sanction imposed by the self-regulatory organization and, if appropriate, remand to the self-regulatory organization for further proceedings.

(2) If the appropriate regulatory agency for a member, participant, or person associated with a member, having due regard for the public interest and the protection of investors, finds after a proceeding in accordance with paragraph (1) of this subsection that a sanction imposed by a self-regulatory organization upon such member, participant, or person associated with a member imposes any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter or is excessive or oppressive, the appropriate regulatory agency may cancel, reduce, or require the remission of such sanction.

(f) Dismissal of review proceeding

In any proceeding to review the denial of membership or participation in a self-regulatory organization to any applicant, the barring of any person from becoming associated with a member of a self-regulatory organization, or the prohibition or limitation by a self-regulatory organization of any person with respect to access to services offered by the self-regulatory organization or any member thereof, if the appropriate regulatory agency for such applicant or person, after notice and opportunity for hearing (which hearing may consist solely of consideration of the record before the self-regulatory organization and opportunity for the presentation of supporting reasons to dismiss the proceeding or set aside the action of the self-regulatory organization) finds that the specific grounds on which such denial, bar, or prohibition or limitation is based exist in fact, that such denial, bar, or prohibition or limitation is in accordance with the rules of the self-regulatory organization, and that such rules are, and were applied in a manner, consistent with the purposes of this chapter, such appropriate regulatory agency, by order, shall dismiss the proceeding. If such appropriate regulatory agency does not make any such finding or if it finds that such denial, bar, or prohibition or limitation imposes any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter, such appropriate regulatory agency, by order, shall set aside the action of the self-regulatory organization and require it to admit such applicant to membership or participation, permit such person to become associated with a member, or grant such person access to services offered by the self-regulatory organization or member thereof.

(g) Compliance with rules and regulations

(1) Every self-regulatory organization shall comply with the provisions of this chapter, the rules and regulations thereunder, and its own rules, and (subject to the provisions of section 78q(d) of this title, paragraph (2) of this subsection, and the rules thereunder) absent reasonable justification or excuse enforce compliance—

(A) in the case of a national securities exchange, with such provisions by its members and persons associated with its members;

(B) in the case of a registered securities association, with such provisions and the provisions of the rules of the Municipal Securities Rulemaking Board by its members and persons associated with its members; and

(C) in the case of a registered clearing agency, with its own rules by its participants.

(2) The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this chapter, may relieve any self-regulatory organization of any responsibility under this chapter to enforce compliance with any specified provision of this chapter or the rules or regulations thereunder by any member of such organization or person associated with such a member, or any class of such members or persons associated with a member.

(h) Suspension or revocation of self-regulatory organization's registration; censure; other sanctions

(1) The appropriate regulatory agency for a self-regulatory organization is authorized, by order, if in its opinion such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter, to suspend for a period not exceeding twelve months or revoke the registration of such self-regulatory organization, or to censure or impose limitations upon the activities, functions, and operations of such self-regulatory organization, if such appropriate regulatory agency finds, on the record after notice and opportunity for hearing, that such self-regulatory organization has violated or is unable to comply with any provision of this chapter, the rules or regulations thereunder, or its own rules or without reasonable justification or excuse has failed to enforce compliance—

(A) in the case of a national securities exchange, with any such provision by a member thereof or a person associated with a member thereof;

(B) in the case of a registered securities association, with any such provision or any provision of the rules of the Municipal Securities Rulemaking Board by a member thereof or a person associated with a member thereof; or

(C) in the case of a registered clearing agency, with any provision of its own rules by a participant therein.

(2) The appropriate regulatory agency for a self-regulatory organization is authorized, by order, if in its opinion such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter, to suspend for a period not exceeding twelve months or expel from such self-regulatory organization any member thereof or participant therein, if such member or participant is subject to an order of the Commission pursuant to section 78*o*(b)(4) of this title or if such appropriate regulatory agency finds, on the record after notice and opportunity for hearing, that such member or participant has willfully violated or has effected any transaction for any other person who, such member or participant had reason to believe, was violating with respect to such transaction—

(A) in the case of a national securities exchange, any provision of the Securities Act of 1933 [15 U.S.C. 77a et seq.], the Investment Advisers Act of 1940 [15 U.S.C. 80b–1 et seq.], the Investment Company Act of 1940 [15 U.S.C. 80a–1 et seq.], this chapter, or the rules or regulations under any of such statutes;

(B) in the case of a registered securities association, any provision of the Securities Act of 1933, the Investment Advisers Act of 1940, the Investment Company Act of 1940, this chapter, the rules

or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board; or

(C) in the case of a registered clearing agency, any provision of the rules of the clearing agency.

(3) The appropriate regulatory agency for a national securities exchange or registered securities association is authorized, by order, if in its opinion such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter, to suspend for a period not exceeding twelve months or to bar any person from being associated with a member of such national securities exchange or registered securities association, if such person is subject to an order of the Commission pursuant to section 78*o*(b)(6) of this title or if such appropriate regulatory agency finds, on the record after notice and opportunity for hearing, that such person has willfully violated or has effected any transaction for any other person who, such person associated with a member had reason to believe, was violating with respect to such transaction—

(A) in the case of a national securities exchange, any provision of the Securities Act of 1933, the Investment Advisers Act of 1940, the Investment Company Act of 1940, this chapter, or the rules or regulations under any of such statutes; or

(B) in the case of a registered securities association, any provision of the Securities Act of 1933, the Investment Advisers Act of 1940, the Investment Company Act of 1940, this chapter, the rules or regulations under any of the statutes, or the rules of the Municipal Securities Rulemaking Board.

(4) The appropriate regulatory agency for a self-regulatory organization is authorized, by order, if in its opinion such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter, to remove from office or censure any person who is, or at the time of the alleged misconduct was, an officer or director of such self-regulatory organization, if such appropriate regulatory agency finds, on the record after notice and opportunity for hearing, that such person has willfully violated any provision of this chapter, the rules or regulations thereunder, or the rules of such self-regulatory organization, willfully abused his authority, or without reasonable justification or excuse has failed to enforce compliance—

(A) in the case of a national securities exchange, with any such provision by any member or person associated with a member;

(B) in the case of a registered securities association, with any such provision or any provision of the rules of the Municipal Securities Rulemaking Board by any member or person associated with a member; or

(C) in the case of a registered clearing agency, with any provision of the rules of the clearing agency by any participant.

(i) Appointment of trustee

If a proceeding under subsection (h)(1) of this section results in the suspension or revocation of the registration of a clearing agency, the appropriate regulatory agency for such clearing agency may, upon notice to such clearing agency, apply to any court of competent jurisdiction specified in section 78u(d) or 78aa of this title for the appointment of a trustee. In the event of such an application, the court may, to the extent it deems necessary or appropriate, take exclusive jurisdiction of such clearing agency and the records and assets thereof, wherever located; and the court shall appoint the appropriate regulatory agency for such clearing agency or a person designated by such appropriate regulatory agency as trustee with power to take possession and continue to operate or terminate the operations of such clearing agency in an orderly manner for the protection of participants and investors, subject to such terms and conditions as the court may prescribe.

(June 6, 1934, ch. 404, title I, §19, 48 Stat. 898; Pub. L. 87–196, Sept. 5, 1961, 75 Stat. 465; Pub. L. 87–561, July 27, 1962, 76 Stat. 247; Pub. L. 90–438, July 29, 1968, 82 Stat. 453; Pub. L. 91–94, Oct. 20, 1969, 83 Stat. 141; Pub. L. 91–410, Sept. 25, 1970, 84 Stat. 862; Pub. L. 94–29, §16, June 4, 1975, 89 Stat. 146; Pub. L. 103–202, title I, §106(c), Dec. 17, 1993, 107 Stat. 2350; Pub. L. 105–353, title III, §301(b)(11), Nov. 3, 1998, 112 Stat. 3236; Pub. L. 106–554, §1(a)(5) [title II, §202(b), (c)], Dec. 21, 2000, 114 Stat. 2763, 2763A–418, 2763A–421; Pub. L. 111–203, title VII, §717(c), title IX, §§916, 929F(e), July 21, 2010, 124 Stat. 1652, 1833, 1854.)

AMENDMENT OF SECTION

Unless otherwise provided, amendment by subtitle A (§§711–754) of title VII of Pub. L. 111–203 effective on the later of 360 days after July 21, 2010, or, to the extent a provision of subtitle A requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of subtitle A, see 2010 Amendment notes and Effective Date of 2010 Amendment note below.

REFERENCES IN TEXT

This chapter, referred to in subsecs. (a)(1), (b)(2)(C)(i), (3)(C), (7)(C), (8), (c), (d)(1), (e)(1)(A), (2), (f), (g), and (h), was in the original "this title". See References in Text note set out under section 78a of this title.

The Securities Act of 1933, referred to in subsec. (h), is act May 27, 1933, ch. 38, title I, 48 Stat. 74, as amended, which is classified generally to subchapter I (§77a et seq.) of chapter 2A of this title. For complete classification of this Act to the Code, see section 77a of this title and Tables.

The Investment Advisers Act of 1940, referred to in subsec. (h), is title II of act Aug. 22, 1940, ch. 686, 54 Stat. 847, as amended, which is classified generally to subchapter II (§80b–1 et seq.) of chapter 2D of this title. For complete classification of this Act to the Code, see section 80b–20 of this title and Tables.

The Investment Company Act of 1940, referred to in subsec. (h), is title I of act Aug. 22, 1940, ch. 686, 54 Stat. 789, as amended, which is classified generally to subchapter I (§80a–1 et seq.) of chapter 2D of this title. For complete classification of this Act to the Code, see section 80a–51 of this title and Tables.

AMENDMENTS

2010—Subsec. (b)(1). Pub. L. 111–203, §916(b)(2), substituted "as soon as practicable after the date of the filing" for "upon the filing".

Subsec. (b)(2). Pub. L. 111–203, §916(a), added par. (2) and struck out former par. (2) which related to approval of rule change or institution of proceedings regarding disapproval of such change within thirty-five days of publication of notice or within such longer period as the Commission may designate up to ninety days of such date.

Subsec. (b)(3)(A). Pub. L. 111–203, §916(c)(1), substituted "shall take effect" for "may take effect" and inserted "on any person, whether or not the person is a member of the self-regulatory organization" after "charge imposed by the self-regulatory organization".

Subsec. (b)(3)(C). Pub. L. 111–203, §916(c)(2), substituted second sentence for former second sentence which read as follows: "At any time within sixty days of the date of filing of such a proposed rule change in accordance with the provisions of paragraph (1) of this subsection, the Commission summarily may abrogate the change in the rules of the self-regulatory organization made thereby and require that the proposed rule change be refiled in accordance with the provisions of paragraph (1) of this subsection and reviewed in accordance with the provisions of paragraph (2) of this subsection, if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this chapter.", added third sentence, and substituted "this subparagraph" for "the preceding sentence" in last sentence.

Subsec. (b)(4)(D). Pub. L. 111–203, §916(d), amended subpar. (D) generally. Prior to amendment, subpar. (D) read as follows: "The Commission shall abrogate any change in the rules of such a clearing agency made by a proposed rule change which has taken effect pursuant to paragraph (3) of this subsection, require that the proposed rule change be refiled in accordance with the provisions of paragraph (1) of this subsection, and reviewed in accordance with the provisions of paragraph (2) of this subsection, if the appropriate regulatory agency for such clearing agency notifies the Commission within thirty days of the date of filing of such proposed rule change of such appropriate regulatory agency's (i) determination that the rules of such clearing agency as so changed may be inconsistent with the safeguarding of securities or funds in the custody or control of such clearing agency or for which it is responsible and (ii) reasons for such determination."

Subsec. (b)(10). Pub. L. 111–203, §916(b)(1), added par. (10) relating to rule of construction relating to filing date of proposed rule changes.

Pub. L. 111–203, §717(c), added par. (10) relating to stay pending determination whether product is a security pursuant to section 8306 of this title.

Subsec. (h)(4). Pub. L. 111–203, §929F(e), in introductory provisions, substituted "any person who is, or at the time of the alleged misconduct was, an officer or director" for "any officer or director" and "such person" for "such officer or director".

2000—Subsec. (b)(7). Pub. L. 106–554, §1(a)(5) [title II, §202(b)(1)], added par. (7).

Subsec. (b)(8). Pub. L. 106–554, §1(a)(5) [title II, §202(b)(2)], added par. (8).

Subsec. (b)(9). Pub. L. 106–554, §1(a)(5) [title II, §202(b)(3)], added par. (9).

Subsec. (d)(3). Pub. L. 106–554, §1(a)(5) [title II, §202(c)], added par. (3).

1998—Subsec. (c)(5). Pub. L. 105–353 realigned margins.

1993—Subsec. (b)(5), (6). Pub. L. 103–202, §106(c)(1), added pars. (5) and (6).

Subsec. (c)(5). Pub. L. 103–202, §106(c)(2), added par. (5).

1975—Pub. L. 94–29 amended section generally, substituting provisions covering the registration, responsibilities, and oversight of self-regulatory organizations by the Commission for provisions covering only the Commission's powers with respect to exchanges and securities, with a view to consolidating and expanding the Commission's oversight powers with respect to self-regulatory organizations, their members, participants, and officers, and with a view to giving the Commission identical powers over all self-regulatory organizations, including registered clearing agencies, and substantially strengthening the Commission's ability to assure that these organizations carry out their statutory responsibilities.

1970—Subsec. (e)(1). Pub. L. 91–410 substituted "December 31, 1970" for "September 1, 1970".

1969—Subsec. (e). Pub. L. 91–94 substituted "September 1, 1970" for "September 1, 1969" in par. (1), and "$945,000" for "$875,000" in par. (4).

1968—Subsec. (e). Pub. L. 90–438 added subsec. (e).

1962—Subsec. (d). Pub. L. 87–561 substituted "April 3, 1963" for "January 3, 1963" and "$950,000" for "$750,000".

1961—Subsec. (d). Pub. L. 87–196 added subsec. (d).

EFFECTIVE DATE OF 2010 AMENDMENT

Amendment by sections 916 and 929F(e) of Pub. L. 111–203 effective 1 day after July 21, 2010, except as otherwise provided, see section 4 of Pub. L. 111–203, set out as an Effective Date note under section 5301 of Title 12, Banks and Banking.

Amendment by section 717(c) of Pub. L. 111–203 effective on the later of 360 days after July 21, 2010, or, to the extent a provision of subtitle A (§§711–754) of title VII of Pub. L. 111–203 requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of subtitle A, see section 754 of Pub. L. 111–203, set out as a note under section 1a of Title 7, Agriculture.

EFFECTIVE DATE OF 1975 AMENDMENT

Amendment by Pub. L. 94–29 effective June 4, 1975, except for amendment of subsec. (g) by Pub. L. 94–29 which is effective 180 days after June 4, 1975, see section 31(a) of Pub. L. 94–29, set out as a note under section 78b of this title.

CONSTRUCTION OF 1993 AMENDMENT

Amendment by Pub. L. 103–202 not to be construed to govern initial issuance of any public debt obligation or to grant any authority to (or extend any authority of) the Securities and Exchange Commission, any appropriate regulatory agency, or a self-regulatory organization to prescribe any procedure, term, or condition of such initial issuance, to promulgate any rule or regulation governing such initial issuance, or to otherwise regulate in any manner such initial issuance, see section 111 of Pub. L. 103–202, set out as a note under section 78*o*–5 of this title.

TRANSFER OF FUNCTIONS

For transfer of functions of Securities and Exchange Commission, with certain exceptions, to Chairman of such Commission, see Reorg. Plan No. 10 of 1950, §§1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out under section 78d of this title.

REVIEW OF REGULATORY STRUCTURES AND PROCEDURES WITH RESPECT TO PENNY STOCKS; REPORT

Pub. L. 101–429, title V, §510, Oct. 15, 1990, 104 Stat. 957, directed Comptroller General, in consultation with Securities and Exchange Commission, to conduct a review of rules, procedures, facilities, and oversight and enforcement activities of self-regulatory organizations under Securities Exchange Act of 1934, with respect to penny stocks (within the meaning of 15 U.S.C. 78c(a)(51)), and, within one year after Oct. 15, 1990, to submit a report on the review including a statement of findings and such recommendations as the Comptroller General considered appropriate with respect to legislative or administrative changes.

[1] *So in original. Two pars. (10) have been enacted.*

15 U.S.C.
United States Code, 2011 Edition
Title 15 - COMMERCE AND TRADE
CHAPTER 2B - SECURITIES EXCHANGES
Sec. 78w - Rules, regulations, and orders; annual reports
From the U.S. Government Publishing Office, www.gpo.gov

§78w. Rules, regulations, and orders; annual reports

(a) Power to make rules and regulations; considerations; public disclosure

(1) The Commission, the Board of Governors of the Federal Reserve System, and the other agencies enumerated in section 78c(a)(34) of this title shall each have power to make such rules and regulations as may be necessary or appropriate to implement the provisions of this chapter for which they are responsible or for the execution of the functions vested in them by this chapter, and may for such purposes classify persons, securities, transactions, statements, applications, reports, and other matters within their respective jurisdictions, and prescribe greater, lesser, or different requirements for different classes thereof. No provision of this chapter imposing any liability shall apply to any act done or omitted in good faith in conformity with a rule, regulation, or order of the Commission, the Board of Governors of the Federal Reserve System, other agency enumerated in section 78c(a)(34) of this title, or any self-regulatory organization, notwithstanding that such rule, regulation, or order may thereafter be amended or rescinded or determined by judicial or other authority to be invalid for any reason.

(2) The Commission and the Secretary of the Treasury, in making rules and regulations pursuant to any provisions of this chapter, shall consider among other matters the impact any such rule or regulation would have on competition. The Commission and the Secretary of the Treasury shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of this chapter. The Commission and the Secretary of the Treasury shall include in the statement of basis and purpose incorporated in any rule or regulation adopted under this chapter, the reasons for the Commission's or the Secretary's determination that any burden on competition imposed by such rule or regulation is necessary or appropriate in furtherance of the purposes of this chapter.

(3) The Commission and the Secretary, in making rules and regulations pursuant to any provision of this chapter, considering any application for registration in accordance with section 78s(a) of this title, or reviewing any proposed rule change of a self-regulatory organization in accordance with section 78s(b) of this title, shall keep in a public file and make available for copying all written statements filed with the Commission and the Secretary and all written communications between the Commission or the Secretary and any person relating to the proposed rule, regulation, application, or proposed rule change: *Provided, however*, That the Commission and the Secretary shall not be required to keep in a public file or make available for copying any such statement or communication which it may withhold from the public in accordance with the provisions of section 552 of title 5.

(b) Annual report to Congress

(1) The Commission, the Board of Governors of the Federal Reserve System, and the other agencies enumerated in section 78c(a)(34) of this title shall each make an annual report to the Congress on its work for the preceding year, and shall include in each such report whatever information, data, and recommendations for further legislation it considers advisable with regard to matters within its respective jurisdiction under this chapter.

(2) The appropriate regulatory agency for a self-regulatory organization shall include in its annual report to the Congress for each fiscal year, a summary of its oversight activities under this chapter with respect to such self-regulatory organization, including a description of any examination conducted as part of such activities of any such organization, any material recommendation presented as part of such activities to such organization for changes in its organization or rules, and any action by such organization in response to any such recommendation.

(3) The appropriate regulatory agency for any class of municipal securities dealers shall include in its annual report to the Congress for each fiscal year a summary of its regulatory activities pursuant to this chapter with respect to such municipal securities dealers, including the nature of and reason for any sanction imposed pursuant to this chapter against any such municipal securities dealer.

(4) The Commission shall also include in its annual report to the Congress for each fiscal year—

(A) a summary of the Commission's oversight activities with respect to self-regulatory organizations for which it is not the appropriate regulatory agency, including a description of any examination of any such organization, any material recommendation presented to any such organization for changes in its organization or rules, and any action by any such organization in response to any such recommendations;

(B) a statement and analysis of the expenses and operations of each self-regulatory organization in connection with the performance of its responsibilities under this chapter, for which purpose data pertaining to such expenses and operations shall be made available by such organization to the Commission at its request;

(C) the steps the Commission has taken and the progress it has made toward ending the physical movement of the securities certificate in connection with the settlement of securities transactions, and its recommendations, if any, for legislation to eliminate the securities certificate;

(D) the number of requests for exemptions from provisions of this chapter received, the number granted, and the basis upon which any such exemption was granted;

(E) a summary of the Commission's regulatory activities with respect to municipal securities dealers for which it is not the appropriate regulatory agency, including the nature of, and reason for, any sanction imposed in proceedings against such municipal securities dealers;

(F) a statement of the time elapsed between the filing of reports pursuant to section 78m(f) of this title and the public availability of the information contained therein, the costs involved in the Commission's processing of such reports and tabulating such information, the manner in which the Commission uses such information, and the steps the Commission has taken and the progress it has made toward requiring such reports to be filed and such information to be made available to the public in machine language;

(G)information concerning (i) the effects its rules and regulations are having on the viability of small brokers and dealers; (ii) its attempts to reduce any unnecessary reporting burden on such brokers and dealers; and (iii) its efforts to help to assure the continued participation of small brokers and dealers in the United States securities markets;

(H) a statement detailing its administration of the Freedom of Information Act, section 552 of title 5, including a copy of the report filed pursuant to subsection (d) of such section; and

(I) the steps that have been taken and the progress that has been made in promoting the timely public dissemination and availability for analytical purposes (on a fair, reasonable, and nondiscriminatory basis) of information concerning government securities transactions and quotations, and its recommendations, if any, for legislation to assure timely dissemination of (i) information on transactions in regularly traded government securities sufficient to permit the determination of the prevailing market price for such securities, and (ii) reports of the highest published bids and lowest published offers for government securities (including the size at which persons are willing to trade with respect to such bids and offers).

(c) Procedure for adjudication

The Commission, by rule, shall prescribe the procedure applicable to every case pursuant to this chapter of adjudication (as defined in section 551 of title 5) not required to be determined on the record after notice and opportunity for hearing. Such rules shall, as a minimum, provide that prompt notice shall be given of any adverse action or final disposition and that such notice and the entry of any order shall be accompanied by a statement of written reasons.

(d) Cease-and-desist procedures

Within 1 year after October 15, 1990, the Commission shall establish regulations providing for the expeditious conduct of hearings and rendering of decisions under section 78u–3 of this title, section 77h–1 of this title, section 80a–9(f) of this title, and section 80b–3(k) of this title.

(June 6, 1934, ch. 404, title I, §23, 48 Stat. 901; Aug. 23, 1935, ch. 614, §203(a), 49 Stat. 704; May 27, 1936, ch. 462, §8, 49 Stat. 1379; Pub. L. 88–467, §10, Aug. 20, 1964, 78 Stat. 580; Pub. L. 94–29, §18, June 4, 1975, 89 Stat. 155; Pub. L. 99–571, title I, §102(j), Oct. 28, 1986, 100 Stat. 3220; Pub. L. 100–181, title III, §§324, 325, Dec. 4, 1987, 101 Stat. 1259; Pub. L. 101–429, title II, §204, Oct. 15, 1990, 104 Stat. 940; Pub. L. 103–202, title I, §107, Dec. 17, 1993, 107 Stat. 2351; Pub. L. 109–351, title IV, §401(a)(3), Oct. 13, 2006, 120 Stat. 1973; Pub. L. 111–203, title III, §376(4), July 21, 2010, 124 Stat. 1569.)

REFERENCES IN TEXT

This chapter, referred to in subsecs. (a) to (c), was in the original "this title". See References in Text note set out under section 78a of this title.

AMENDMENTS

2010—Subsec. (b)(1). Pub. L. 111–203 struck out ", other than the Office of Thrift Supervision," before "shall each make".

2006—Subsec. (b)(1). Pub. L. 109–351 inserted "other than the Office of Thrift Supervision," before "shall each".

1993—Subsec. (b)(4)(C) to (K). Pub. L. 103–202, §107, redesignated subpars. (E) to (G) and (I) to (K) as (C) to (E) and (F) to (H), respectively, added a new subpar. (I), and struck out former subpars. (C), (D), and (H). Prior to amendment, subpars. (C), (D), and (H) read as follows:

"(C) beginning in 1975 and ending in 1980, information, data, and recommendations with respect to the development of a national system for the prompt and accurate clearance and settlement of securities transactions, including a summary of the regulatory activities, operational capabilities, financial resources, and plans of self-regulatory organizations and registered transfer agents with respect thereto;

"(D) beginning in 1975 and ending in 1980, a description of the steps taken, and an evaluation of the progress made, toward the establishment of a national market system, and recommendations for further legislation it considers advisable with respect to such system;

"(H) beginning in 1975 and ending in 1980, a description of the effect the absence of any schedule or fixed rates of commissions, allowances, discounts, or other fees to be charged by members for effecting transactions on a national securities exchange is having on the maintenance of fair and orderly markets and the development of a national market system for securities;".

1990—Subsec. (d). Pub. L. 101–429 added subsec. (d).

1987—Subsec. (a)(1). Pub. L. 100–181, §324(1), inserted "or" before "any self-regulatory organization" in last sentence.

Subsec. (a)(3). Pub. L. 100–181, §324(2), inserted "shall" after "section 78s(b) of this title,".

Subsec. (b)(4)(F). Pub. L. 100–181, §325, substituted "the" for "The".

1986—Subsec. (a)(2). Pub. L. 99–571, §102(j)(1), (2), inserted "and the Secretary of the Treasury" in three places and "or the Secretary's" in one place.

Subsec. (a)(3). Pub. L. 99–571, §102(j)(3), (4), inserted "and the Secretary" in three places and "or the Secretary" in one place.

1975—Subsec. (a). Pub. L. 94–29 designated existing provisions as par. (1), inserted references to other agencies enumerated in section 78c(a)(34) of this title, regulations appropriate to implement the provisions of this chapter for which the agencies are responsible, the classification of persons, transactions, statements, applications, and reports, the prescribing of greater, lesser, or different requirements for different classifications, and the non-liability of self-regulatory organization, and added pars. (2) and (3).

Subsec. (b). Pub. L. 94–29 designated existing provisions as par. (1), substituted "The Commission, the Board of Governors of the Federal Reserve System, and the other agencies enumerated in section 78c(a)(34) of this title, shall each make an annual report to the Congress on its work for the preceding year, and shall include in each such report whatever information, data, and recommendations for further legislation it considers advisable with regard to matters within its respective jurisdiction under this chapter" for "The Commission and the Board of Governors of the Federal Reserve System, respectively, shall include in their annual reports to Congress such information, data, and recommendation for further legislation as they may deem advisable with regard to matters within their respective jurisdictions under this chapter. The Commission shall include in its annual reports to the Congress for the fiscal years ended on June 30 of 1965, 1966, and 1967 information, data, and recommendations specifically related to the operation of the amendments to this chapter made by the Securities Acts Amendments of 1964", and added pars. (2) to (4).

Subsec. (c). Pub. L. 94–29 added subsec. (c).

1964—Subsec. (b). Pub. L. 88–467 required the Commission in its annual reports to Congress for fiscal years ending June 30, 1965, 1966, and 1967, to furnish information, data, and recommendations specifically related to the operations of the amendments to the Securities Exchange Act of 1934 made by the Securities Act Amendments of 1964.

1936—Subsec. (a). Act May 27, 1936, inserted second sentence.

Change of Name

Section 203(a) of act Aug. 23, 1935, substituted "Board of Governors of the Federal Reserve System" for "Federal Reserve Board".

Effective Date of 2010 Amendment

Amendment by Pub. L. 111–203 effective on the transfer date, see section 351 of Pub. L. 111–203, set out as a note under section 906 of Title 2, The Congress.

Effective Date of 1990 Amendment

Amendment by Pub. L. 101–429 effective Oct. 15, 1990, with provisions relating to civil penalties and accounting and disgorgement, see section 1(c)(1), (2) of Pub. L. 101–429, set out in a note under section 77g of this title.

Effective Date of 1986 Amendment

Amendment by Pub. L. 99–571 effective 270 days after Oct. 28, 1986, see section 401 of Pub. L. 99–571, set out as an Effective Date note under section 78*o*–5 of this title.

Effective Date of 1975 Amendment

Amendment by Pub. L. 94–29 effective June 4, 1975, see section 31(a) of Pub. L. 94–29, set out as a note under section 78b of this title.

Effective Date of 1964 Amendment

Amendment by Pub. L. 88–467 effective Aug. 20, 1964, see section 13 of Pub. L. 88–467, set out as a note under section 78c of this title.

Construction of 1993 Amendment

Amendment by Pub. L. 103–202 not to be construed to govern initial issuance of any public debt obligation or to grant any authority to (or extend any authority of) the Securities and Exchange Commission, any appropriate regulatory agency, or a self-regulatory organization to prescribe any procedure, term, or condition of such initial issuance, to promulgate any rule or regulation governing such initial issuance, or to otherwise regulate in any manner such initial issuance, see section 111 of Pub. L. 103–202, set out as a note under section 78*o*–5 of this title.

Termination of Reporting Requirements

For termination, effective May 15, 2000, of provisions of law requiring submittal to Congress of any annual, semiannual, or other regular periodic report listed in House Document No. 103–7 (in which the 2nd item on page 143, the 18th item on page 167, the 7th item on page 172, and 18th item on page 190 identify a reporting provision which, as subsequently amended, is contained in subsec. (b) of this section), see section 3003 of Pub. L. 104–66, as amended, set out as a note under section 1113 of Title 31, Money and Finance.

Transfer of Functions

For transfer of functions of Securities and Exchange Commission, with certain exceptions, to Chairman of such Commission, see Reorg. Plan No. 10 of 1950, §§1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out under section 78d of this title.

21 U.S.C.
United States Code, 2011 Edition
Title 21 - FOOD AND DRUGS
CHAPTER 13 - DRUG ABUSE PREVENTION AND CONTROL
SUBCHAPTER I - CONTROL AND ENFORCEMENT
Part B - Authority To Control; Standards and Schedules
Sec. 812 - Schedules of controlled substances
From the U.S. Government Publishing Office, www.gpo.gov

§812. Schedules of controlled substances

(a) Establishment

There are established five schedules of controlled substances, to be known as schedules I, II, III, IV, and V. Such schedules shall initially consist of the substances listed in this section. The schedules established by this section shall be updated and republished on a semiannual basis during the two-year period beginning one year after October 27, 1970, and shall be updated and republished on an annual basis thereafter.

(b) Placement on schedules; findings required

Except where control is required by United States obligations under an international treaty, convention, or protocol, in effect on October 27, 1970, and except in the case of an immediate precursor, a drug or other substance may not be placed in any schedule unless the findings required for such schedule are made with respect to such drug or other substance. The findings required for each of the schedules are as follows:

(1) SCHEDULE I.—

(A) The drug or other substance has a high potential for abuse.

(B) The drug or other substance has no currently accepted medical use in treatment in the United States.

(C) There is a lack of accepted safety for use of the drug or other substance under medical supervision.

(2) SCHEDULE II.—

(A) The drug or other substance has a high potential for abuse.

(B) The drug or other substance has a currently accepted medical use in treatment in the United States or a currently accepted medical use with severe restrictions.

(C) Abuse of the drug or other substances may lead to severe psychological or physical dependence.

(3) SCHEDULE III.—

(A) The drug or other substance has a potential for abuse less than the drugs or other substances in schedules I and II.

(B) The drug or other substance has a currently accepted medical use in treatment in the United States.

(C) Abuse of the drug or other substance may lead to moderate or low physical dependence or high psychological dependence.

(4) SCHEDULE IV.—

(A) The drug or other substance has a low potential for abuse relative to the drugs or other substances in schedule III.

(B) The drug or other substance has a currently accepted medical use in treatment in the United States.

(C) Abuse of the drug or other substance may lead to limited physical dependence or psychological dependence relative to the drugs or other substances in schedule III.

(5) SCHEDULE V.—

(A) The drug or other substance has a low potential for abuse relative to the drugs or other substances in schedule IV.

(B) The drug or other substance has a currently accepted medical use in treatment in the United States.

(C) Abuse of the drug or other substance may lead to limited physical dependence or psychological dependence relative to the drugs or other substances in schedule IV.

(c) Initial schedules of controlled substances

Schedules I, II, III, IV, and V shall, unless and until amended [1] pursuant to section 811 of this title, consist of the following drugs or other substances, by whatever official name, common or usual name, chemical name, or brand name designated:

SCHEDULE I

(a) Unless specifically excepted or unless listed in another schedule, any of the following opiates, including their isomers, esters, ethers, salts, and salts of isomers, esters, and ethers, whenever the existence of such isomers, esters, ethers, and salts is possible within the specific chemical designation:

(1) Acetylmethadol.
(2) Allylprodine.
(3) Alphacetylmathadol.[2]
(4) Alphameprodine.
(5) Alphamethadol.
(6) Benzethidine.
(7) Betacetylmethadol.
(8) Betameprodine.
(9) Betamethadol.
(10) Betaprodine.
(11) Clonitazene.
(12) Dextromoramide.
(13) Dextrorphan.
(14) Diampromide.
(15) Diethylthiambutene.
(16) Dimenoxadol.
(17) Dimepheptanol.
(18) Dimethylthiambutene.
(19) Dioxaphetyl butyrate.
(20) Dipipanone.
(21) Ethylmethylthiambutene.
(22) Etonitazene.
(23) Etoxeridine.
(24) Furethidine.
(25) Hydroxypethidine.
(26) Ketobemidone.
(27) Levomoramide.
(28) Levophenacylmorphan.
(29) Morpheridine.
(30) Noracymethadol.
(31) Norlevorphanol.
(32) Normethadone.
(33) Norpipanone.
(34) Phenadoxone.
(35) Phenampromide.
(36) Phenomorphan.
(37) Phenoperidine.
(38) Piritramide.
(39) Propheptazine.
(40) Properidine.
(41) Racemoramide.
(42) Trimeperidine.

(b) Unless specifically excepted or unless listed in another schedule, any of the following opium derivatives, their salts, isomers, and salts of isomers whenever the existence of such salts, isomers, and salts of isomers is possible within the specific chemical designation:

(1) Acetorphine.
(2) Acetyldihydrocodeine.
(3) Benzylmorphine.
(4) Codeine methylbromide.
(5) Codeine-N-Oxide.
(6) Cyprenorphine.
(7) Desomorphine.
(8) Dihydromorphine.
(9) Etorphine.
(10) Heroin.
(11) Hydromorphinol.
(12) Methyldesorphine.
(13) Methylhydromorphine.
(14) Morphine methylbromide.
(15) Morphine methylsulfonate.
(16) Morphine-N-Oxide.
(17) Myrophine.
(18) Nicocodeine.
(19) Nicomorphine.
(20) Normorphine.
(21) Pholcodine.
(22) Thebacon.

(c) Unless specifically excepted or unless listed in another schedule, any material, compound, mixture, or preparation, which contains any quantity of the following hallucinogenic substances, or which contains any of their salts, isomers, and salts of isomers whenever the existence of such salts, isomers, and salts of isomers is possible within the specific chemical designation:

(1) 3,4-methylenedioxy amphetamine.
(2) 5-methoxy-3,4-methylenedioxy amphetamine.
(3) 3,4,5-trimethoxy amphetamine.
(4) Bufotenine.
(5) Diethyltryptamine.
(6) Dimethyltryptamine.
(7) 4-methyl-2,5-diamethoxyamphetamine.
(8) Ibogaine.
(9) Lysergic acid diethylamide.
(10) Marihuana.
(11) Mescaline.
(12) Peyote.
(13) N-ethyl-3-piperidyl benzilate.
(14) N-methyl-3-piperidyl benzilate.
(15) Psilocybin.
(16) Psilocyn.
(17) Tetrahydrocannabinols.

SCHEDULE II

(a) Unless specifically excepted or unless listed in another schedule, any of the following substances whether produced directly or indirectly by extraction from substances of vegetable origin, or independently by means of chemical synthesis, or by a combination of extraction and chemical synthesis:

(1) Opium and opiate, and any salt, compound, derivative, or preparation of opium or opiate.
(2) Any salt, compound, derivative, or preparation thereof which is chemically equivalent or identical with any of the substances referred to in clause (1), except that these substances shall not include the isoquinoline alkaloids of opium.
(3) Opium poppy and poppy straw.
(4) coca [3] leaves, except coca leaves and extracts of coca leaves from which cocaine, ecgonine, and derivatives of ecgonine or their salts have been removed; cocaine, its salts, optical and geometric isomers, and salts of isomers; ecgonine, its derivatives, their salts, isomers, and salts of isomers; or any compound, mixture, or preparation which contains any quantity of any of the substances referred to in this paragraph.

(b) Unless specifically excepted or unless listed in another schedule, any of the following opiates, including their isomers, esters, ethers, salts, and salts of isomers, esters and ethers, whenever the existence of such isomers, esters, ethers, and salts is possible within the specific chemical designation:

(1) Alphaprodine.
(2) Anileridine.
(3) Bezitramide.
(4) Dihydrocodeine.
(5) Diphenoxylate.
(6) Fentanyl.
(7) Isomethadone.
(8) Levomethorphan.
(9) Levorphanol.
(10) Metazocine.
(11) Methadone.
(12) Methadone-Intermediate, 4-cyano-2-dimethylamino-4,4-diphenyl butane.
(13) Moramide-Intermediate, 2-methyl-3-morpholino-1, 1-diphenylpropane-carboxylic acid.
(14) Pethidine.
(15) Pethidine-Intermediate-A, 4-cyano-1-methyl-4-phenylpiperidine.
(16) Pethidine-Intermediate-B, ethyl-4-phenylpiperidine-4-carboxylate.
(17) Pethidine-Intermediate-C, 1-methyl-4-phenylpiperidine-4-carboxylic acid.
(18) Phenazocine.
(19) Piminodine.
(20) Racemethorphan.
(21) Racemorphan.

(c) Unless specifically excepted or unless listed in another schedule, any injectable liquid which contains any quantity of methamphetamine, including its salts, isomers, and salts of isomers.

SCHEDULE III

(a) Unless specifically excepted or unless listed in another schedule, any material, compound, mixture, or preparation which contains any quantity of the following substances having a stimulant effect on the central nervous system:

(1) Amphetamine, its salts, optical isomers, and salts of its optical isomers.

(2) Phenmetrazine and its salts.

(3) Any substance (except an injectable liquid) which contains any quantity of methamphetamine, including its salts, isomers, and salts of isomers.

(4) Methylphenidate.

(b) Unless specifically excepted or unless listed in another schedule, any material, compound, mixture, or preparation which contains any quantity of the following substances having a depressant effect on the central nervous system:

(1) Any substance which contains any quantity of a derivative of barbituric acid, or any salt of a derivative of barbituric acid.

(2) Chorhexadol.

(3) Glutethimide.

(4) Lysergic acid.

(5) Lysergic acid amide.

(6) Methyprylon.

(7) Phencyclidine.

(8) Sulfondiethylmethane.

(9) Sulfonethylmethane.

(10) Sulfonmethane.

(c) Nalorphine.

(d) Unless specifically excepted or unless listed in another schedule, any material, compound, mixture, or preparation containing limited quantities of any of the following narcotic drugs, or any salts thereof:

(1) Not more than 1.8 grams of codeine per 100 milliliters or not more than 90 milligrams per dosage unit, with an equal or greater quantity of an isoquinoline alkaloid of opium.

(2) Not more than 1.8 grams of codeine per 100 milliliters or not more than 90 milligrams per dosage unit, with one or more active, non-narcotic ingredients in recognized therapeutic amounts.

(3) Not more than 300 milligrams of dihydrocodeinone per 100 milliliters or not more than 15 milligrams per dosage unit, with a fourfold or greater quantity of an isoquinoline alkaloid of opium.

(4) Not more than 300 milligrams of dihydrocodeinone per 100 milliliters or not more than 15 milligrams per dosage unit, with one or more active, nonnarcotic ingredients in recognized therapeutic amounts.

(5) Not more than 1.8 grams of dihydrocodeine per 100 milliliters or not more than 90 milligrams per dosage unit, with one or more active, nonnarcotic ingredients in recognized therapeutic amounts.

(6) Not more than 300 milligrams of ethylmorphine per 100 milliliters or not more than 15 milligrams per dosage unit, with one or more active, nonnarcotic ingredients in recognized therapeutic amounts.

(7) Not more than 500 milligrams of opium per 100 milliliters or per 100 grams, or not more than 25 milligrams per dosage unit, with one or more active, nonnarcotic ingredients in recognized therapeutic amounts.

(8) Not more than 50 milligrams of morphine per 100 milliliters or per 100 grams with one or more active, nonnarcotic ingredients in recognized therapeutic amounts.

(e) Anabolic steroids.

SCHEDULE IV

(1) Barbital.

(2) Chloral betaine.

(3) Chloral hydrate.

(4) Ethchlorvynol.

(5) Ethinamate.

(6) Methohexital.

(7) Meprobamate.

(8) Methylphenobarbital.

(9) Paraldehyde.

(10) Petrichloral.

(11) Phenobarbital.

SCHEDULE V

Any compound, mixture, or preparation containing any of the following limited quantities of narcotic drugs, which shall include one or more nonnarcotic active medicinal ingredients in sufficient proportion to confer upon the compound, mixture, or preparation valuable medicinal qualities other than those possessed by the narcotic drug alone:

(1) Not more than 200 milligrams of codeine per 100 milliliters or per 100 grams.

(2) Not more than 100 milligrams of dihydrocodeine per 100 milliliters or per 100 grams.

(3) Not more than 100 milligrams of ethylmorphine per 100 milliliters or per 100 grams.

(4) Not more than 2.5 milligrams of diphenoxylate and not less than 25 micrograms of atropine sulfate per dosage unit.

(5) Not more than 100 milligrams of opium per 100 milliliters or per 100 grams.

(Pub. L. 91–513, title II, §202, Oct. 27, 1970, 84 Stat. 1247; Pub. L. 95–633, title I, §103, Nov. 10, 1978, 92 Stat. 3772; Pub. L. 98–473, title II, §§507(c), 509(b), Oct. 12, 1984, 98 Stat. 2071, 2072; Pub. L. 99–570, title I, §1867, Oct. 27, 1986, 100 Stat. 3207–55; Pub. L. 99–646, §84, Nov. 10, 1986, 100 Stat. 3619; Pub. L. 101–647, title XIX, §1902(a), Nov. 29, 1990, 104 Stat. 4851.)

Amendments

1990—Subsec. (c). Pub. L. 101–647 added item (e) at end of schedule III.

1986—Subsec. (c). Pub. L. 99–646 amended schedule II(a)(4) generally. Prior to amendment, schedule II(a)(4) read as follows: "Coca leaves (except coca leaves and extracts of coca leaves from which cocaine, ecgonine, and derivatives of ecgonine or their salts have been removed); cocaine, its salts, optical and geometric isomers, and salts of isomers; and ecgonine, its derivatives, their salts, isomers, and salts of isomers."

Pub. L. 99–570 amended schedule II(a)(4) generally. Prior to amendment, schedule II(a)(4) read as follows: "Coca leaves and any salt, compound, derivative, or preparation of coca leaves (including cocaine and ecgonine and their salts, isomers, derivatives, and salts of isomers and derivatives), and any salt, compound, derivative, or preparation thereof which is chemically equivalent or identical with any of these substances, except that the substances shall not include decocainized coca leaves or extraction of coca leaves, which extractions do not contain cocaine or ecgonine."

1984—Subsec. (c). Pub. L. 98–473, §507(c), in schedule II(a)(4) added applicability to cocaine and ecgonine and their salts, isomers, etc.

Subsec. (d). Pub. L. 98–473, §509(b), struck out subsec. (d) which related to authority of Attorney General to except stimulants or depressants containing active medicinal ingredients.

1978—Subsec. (d)(3). Pub. L. 95–633 added cl. (3).

Effective Date of 1990 Amendment

Amendment by Pub. L. 101–647 effective 90 days after Nov. 29, 1990, see section 1902(d) of Pub. L. 101–647, set out as a note under section 802 of this title.

Effective Date of 1978 Amendment

Amendment by Pub. L. 95–633 effective on date the Convention on Psychotropic Substances enters into force in the United States [July 15, 1980], see section 112 of Pub. L. 95–633, set out as an Effective Date note under section 801a of this title.

Congressional Finding; Emergency Scheduling of GHB in Controlled Substances Act

Pub. L. 106–172, §§2, 3(a), Feb. 18, 2000, 114 Stat. 7, 8, provided that:

"SEC. 2. FINDINGS.

"Congress finds as follows:

"(1) Gamma hydroxybutyric acid (also called G, Liquid X, Liquid Ecstasy, Grievous Bodily Harm, Georgia Home Boy, Scoop) has become a significant and growing problem in law enforcement. At least 20 States have scheduled such drug in their drug laws and law enforcement officials have been experiencing an increased presence of the drug in driving under the influence, sexual assault, and overdose cases especially at night clubs and parties.

"(2) A behavioral depressant and a hypnotic, gamma hydroxybutyric acid ('GHB') is being used in conjunction with alcohol and other drugs with detrimental effects in an increasing number of cases. It is difficult to isolate the impact of such drug's ingestion since it is so typically taken with an ever-changing array of other drugs and especially alcohol which potentiates its impact.

"(3) GHB takes the same path as alcohol, processes via alcohol dehydrogenase, and its symptoms at high levels of intake and as impact builds are comparable to alcohol ingestion/intoxication. Thus, aggression and violence can be expected in some individuals who use such drug.

"(4) If taken for human consumption, common industrial chemicals such as gamma butyrolactone and 1.4-butanediol are swiftly converted by the body into GHB. Illicit use of these and other GHB analogues and precursor chemicals is a significant and growing law enforcement problem.

"(5) A human pharmaceutical formulation of gamma hydroxybutyric acid is being developed as a treatment for cataplexy, a serious and debilitating disease. Cataplexy, which causes sudden and total loss of muscle control, affects about 65 percent of the estimated 180,000 Americans with narcolepsy, a sleep disorder. People with cataplexy often are unable to work, drive a car, hold their children or live a normal life.

"(6) Abuse of illicit GHB is an imminent hazard to public safety that requires immediate regulatory action under the Controlled Substances Act (21 U.S.C. 801 et seq.).

"SEC. 3. EMERGENCY SCHEDULING OF GAMMA HYDROXYBUTYRIC ACID AND LISTING OF GAMMA BUTYROLACTONE AS LIST I CHEMICAL.

"(a) Emergency Scheduling of GHB.—

"(1) In general.—The Congress finds that the abuse of illicit gamma hydroxybutyric acid is an imminent hazard to the public safety. Accordingly, the Attorney General, notwithstanding sections 201(a), 201(b), 201(c), and 202 of the Controlled Substances Act [21 U.S.C. 811(a)–(c), 812], shall issue, not later

than 60 days after the date of the enactment of this Act [Feb. 18, 2000], a final order that schedules such drug (together with its salts, isomers, and salts of isomers) in the same schedule under section 202(c) of the Controlled Substances Act as would apply to a scheduling of a substance by the Attorney General under section 201(h)(1) of such Act (relating to imminent hazards to the public safety), except as follows:

"(A) For purposes of any requirements that relate to the physical security of registered manufacturers and registered distributors, the final order shall treat such drug, when the drug is manufactured, distributed, or possessed in accordance with an exemption under section 505(i) of the Federal Food, Drug, and Cosmetic Act [21 U.S.C. 355(i)] (whether the exemption involved is authorized before, on, or after the date of the enactment of this Act [Feb. 18, 2000]), as being in the same schedule as that recommended by the Secretary of Health and Human Services for the drug when the drug is the subject of an authorized investigational new drug application (relating to such section 505(i)). The recommendation referred to in the preceding sentence is contained in the first paragraph of the letter transmitted on May 19, 1999, by such Secretary (acting through the Assistant Secretary for Health) to the Attorney General (acting through the Deputy Administrator of the Drug Enforcement Administration), which letter was in response to the letter transmitted by the Attorney General (acting through such Deputy Administrator) on September 16, 1997. In publishing the final order in the Federal Register, the Attorney General shall publish a copy of the letter that was transmitted by the Secretary of Health and Human Services.

"(B) In the case of gamma hydroxybutyric acid that is contained in a drug product for which an application is approved under section 505 of the Federal Food, Drug, and Cosmetic Act [21 U.S.C. 355] (whether the application involved is approved before, on, or after the date of the enactment of this Act [Feb. 18, 2000]), the final order shall schedule such drug in the same schedule as that recommended by the Secretary of Health and Human Services for authorized formulations of the drug. The recommendation referred to in the preceding sentence is contained in the last sentence of the fourth paragraph of the letter referred to in subparagraph (A) with respect to May 19, 1999.

"(2) FAILURE TO ISSUE ORDER.—If the final order is not issued within the period specified in paragraph (1), gamma hydroxybutyric acid (together with its salts, isomers, and salts of isomers) is deemed to be scheduled under section 202(c) of the Controlled Substances Act [21 U.S.C. 812(c)] in accordance with the policies described in paragraph (1), as if the Attorney General had issued a final order in accordance with such paragraph."

PLACEMENT OF PIPRADROL AND SPA IN SCHEDULE IV TO CARRY OUT OBLIGATION UNDER CONVENTION ON PSYCHOTROPIC SUBSTANCES

Section 102(c) of Pub. L. 95–633 provided that: "For the purpose of carrying out the minimum United States obligations under paragraph 7 of article 2 of the Convention on Psychotropic Substances, signed at Vienna, Austria, on February 21, 1971, with respect to pipradrol and SPA (also known as (-)-1-dimethylamino-1,2-diphenylethane), the Attorney General shall by order, made without regard to sections 201 and 202 of the Controlled Substances Act [this section and section 811 of this title], place such drugs in schedule IV of such Act [see subsec. (c) of this section]."

Provision of section 102(c) of Pub. L. 95–633, set out above, effective on the date the Convention on Psychotropic Substances enters into force in the United States [July 15, 1980], see section 112 of Pub. L. 95–633, set out as an Effective Date note under section 801a of this title.

[1] *Revised schedules are published in the Code of Federal Regulations, Part 1308 of Title 21, Food and Drugs.*

[2] *So in original. Probably should be "Alphacetylmethadol."*

[3] *So in original. Probably should be capitalized.*

94TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
1st Session } { No. 94-123

SECURITIES REFORM ACT OF 1975

APRIL 7, 1975.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. STAGGERS, from the Committee on Interstate and Foreign Commerce, submitted the following

REPORT

together with

MINORITY VIEWS

[To accompany H.R. 4111]

The Committee on Interstate and Foreign Commerce, to whom was referred the bill (H.R. 4111) to amend the Securities Exchange Act of 1934 to remove barriers to competition, to foster the development of a national securities market system and a national clearance and settlement system, to make uniform the Securities and Exchange Commission's authority over securities industry regulatory organizations, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

That this Act may be cited as the "Securities Reform Act of 1975".

TITLE I—REGULATION OF EXCHANGES AND ASSOCIATIONS

SEC. 101. (a) Section 3(a)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(3)) is amended to read as follows:

"(3) The term 'member' when used with respect to a national securities exchange or national securities association means any person who agrees to be regulated by an exchange or association and with respect to whom the exchange or association undertakes to enforce compliance with its rules and with the provisions of this title, and any amendment thereto and any rule or regulation made or to be made thereunder."

(b) Section 3(a)(21) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(21)) is amended to read as follows:

"(21) The term 'person associated with a member' with respect to a member of a national securities exchange or national securities association means any partner, officer, director, or branch manager of such member (or any person

50-075—75——1

"(e) If by reason of the death, disqualification, or bona fide resignation of any director or directors, the requirements of the foregoing provisions of this section or of section 15(f)(1) in respect of directors shall not be met by a registered investment company, the operation of such provisions shall be suspended as to such registered company—

"(1) for a period of thirty days if the vacancy or vacancies may be filled by action of the board of directors;

"(2) for a period of sixty days if a vote of stockholders is required to fill the vacancy or vacancies; or

"(3) for such longer period as the Commission may prescribe, by rules and regulations upon its own motion or by order upon application, as not inconsistent with the protection of investors.".

(f) Section 9 thereof is amended by adding at the end thereof the following new subsection:

"(d) For the purposes of subsections (a) through (c) of this section, the term 'investment adviser' includes a corporate or other trustee performing the functions of an investment adviser.".

(g) Section 36 thereof is amended by adding at the end thereof the following new subsection:

"(c) For the purposes of subsections (a) and (b) of this section, the term 'investment adviser' includes a corporate or other trustee performing the functions of an investment adviser.".

(h) Section 15(d) of the Investment Company Act of 1940 (15 U.S.C. 80a–15(d)) is amended by striking 'paragraph (40) of section 2(a)' and inserting in lieu thereof 'paragraph (42) of section 2(a)'.".

TITLE V—DEVELOPMENT OF A NATIONAL SECURITIES MARKET SYSTEM

SEC. 501. The Securities Exchange Act of 1934 is amended by adding after section 20 (15 U.S.C. 78t) the following new section:

"NATIONAL SECURITIES MARKET SYSTEM

"SEC. 20A. (a) Congress finds and recognizes—

"(1) that our country's capital markets are an important national asset which must be preserved and strengthened;

"(2) that changing conditions and trading patterns have placed considerable strain on existing market mechanisms;

"(3) that in order to preserve and strengthen our capital markets, a national securities market system, should be established;

"(4) that it is in the national interest to assure the vitality and strength of the Nation's securities markets and to take all practicable steps to encourage a free and adequate flow of capital to the economy of the United States;

"(5) that a national system for the clearance and settlement of securities, wherever traded, should be established as part of the system; and

"(6) that a national regulatory body may be appropriate to govern and operate the system, subject to oversight and regulation by the Commission.

"(b) The Commission is directed, therefore, having due regard for the public interest, the protection of investors and the need to assure fair dealing in securities. and to preserve and foster competition among exchanges and between exchange markets and markets occurring otherwise than on an exchange, to take such steps as are within its power, including the power granted to it pursuant to this section and section 17 of this title, to establish a national market system for transactions in securities. Such a system shall include, as a minimum, a transactional reporting system for reporting transactions in securities qualified for trading within the national securities market system; a composite quotation system for reporting bid and offered quotations for all securities qualified for trading in the national securities market system; and rules or regulations designed to provide fair competition between competitors in the national securities market system.

"(c) No dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect, or induce, the purchase or sale for his own account of any security in contravention of such rules and regulations as the

Commission may prescribe as necessary or appropriate in the public interest and for the protection of investors, to assure the maintenance of a fair and orderly market in securities, or to remove impediments to and perfect the mechanism of a national market system. The Commission shall, under authority of this section, promulgate such rules and regulations applicable to any dealer in securities registered under section 12(b) of this title who, with respect to such securities, (a) regularly publishes bid and offer quotations through an interdealer quotation system, communications system or otherwise, (b) furnishes bid and offer quotations on request to others, including brokers and dealers, (c) holds himself out as being ready, willing, and able to effect transactions at quoted prices with others, including brokers and dealers, or (d) is otherwise acting as a specialist or market maker (as such term may be further defined by the Commission) in such securities on an exchange or otherwise than on an exchange, as may be necessary to assure that equal regulation of such dealers is obtained. For the purposes of this subsection the term 'equal regulation' means that degree of regulation as the Commission may determine to be necessary and appropriate to apply to such dealers in order to remove any unfair competitive advantage found to result from an unjustifiable disparity of regulation of such dealers by exchanges and associations of which they are members. If the Commission finds, after notice and opportunity for hearing on a record, that rules promulgated by the Commission pursuant to this title as applied to any broker or dealer, or class of brokers or dealers who effect transactions in securities registered under section 12(b) of this title, on a national securities exchange or otherwise than on a national securities exchange, are insufficient to assure the protection of investors and the maintenance of a fair and orderly market in such securities and that such investor protection and the maintenance of a fair and orderly market in such securities may not be assured through other lawful action under this title, it may, by order, prohibit such broker or dealer or such class thereof from effecting, or inducing, the purchase or sale of any such security on a national securities exchange or otherwise than on a national securities exchange. The Commission may, by such order, conditionally or unconditionally exempt any security or transaction, or class of securities or transactions, from the provisions of this section.

"(d) The Commission shall prescribe such rules and regulations as it deems necessary or appropriate in the public interest or for the protection of investors (1) to assure that all brokers and dealers and, subject to such limitations as the Commission may, by rule, impose as necessary or appropriate for the protection of investors and the maintenance of fair and orderly markets, all other persons, have access on reasonable and nondiscriminatory terms to quotations for, and reports of transactions in, securities; (2) to assure that any system utilized by any broker or dealer to transmit or direct orders for the purchase or sale of securities to a facility for execution operates in a manner consistent with the development and operation of a national market system; and (3) to provide for the fair and reasonable allocation among national securities exchanges, national securities associations, and brokers and dealers subject to paragraph (9) of section 15(b) of this title of the costs associated with the collection, processing, distribution, and publication of information with respect to quotations for, and transactions in, securities, and the development and operation of a national market system.

"(e) To facilitate the establishment and governance of a national market system, in accordance with this section, within one hundred eighty days after the effective date of the Securities Reform Act of 1975, or at such earlier date as the Commission may determine to be appropriate for the purposes of this title, the Commission shall appoint a National Market Board ('Board').

"(f)(1) In carrying out its responsibilities under subsection (e), the Commission shall appoint a Board of fifteen members, for a term specified by the Commission (but in no event to exceed five years), a majority of whom may, in the Commission's discretion, be persons active in the securities industry, the remainder of whom shall be representative of the public who, to the extent feasible, shall have knowledge of the Nation's capital markets.

"(2) Nothing in this subsection shall be construed to vest in any person any right to seek judicial review of the Commission's exercise of discretion in selecting members of the Board.

"(g)(1) The Board is authorized and directed to study and advise the Commission of the steps it finds appropriately should be taken, by the Commission,

the securities industry, the Congress, or otherwise, to facilitate the development of the system. For this purpose, the Board shall be given access by the Commission to any documents in the possession of the Commission, or obtainable by the Commission, if the disclosure of such document is deemed by the Commission (A) to be relevant to the functions of the Board and (B) not inconsistent with the public interest. For the purposes of performing the functions set forth in this paragraph, the Board shall assume the responsibilities of, and the documents prepared for or by, any advisory committee, in existence at the time of the establishment of the Board, appointed to advise the Commission on the implementation of the system.

"(2) The Board shall have, as a continuing responsibility, the obligation to furnish the Commission with its views on significant regulatory proposals of the Commission or any registered national securities exchange or association relating to the fairness, honesty, and efficiency of the markets for the trading in securities.

"(h)(1) The Board is authorized and directed to make a study of the need for the establishment of a national regulatory body (hereinafter referred to as the 'National Market Regulatory Board' or 'Regulatory Board') to administer the national market system, including the following:

"(A) the point in time at which such a Regulatory Board should be established;

"(B) the composition of such a Regulatory Board;

"(C) the manner in which such a Regulatory Board shall be brought into existence;

"(D) the scope of the authority of such a Regulatory Board;

"(E) the relationship of such a Regulatory Board to the Commission and to national securities exchanges and national securities associations registered with the Commission; and

"(F) the manner in which such a Regulatory Board should be funded.

"(2) The Board shall report to the Congress, on or before December 31, 1976, the results of its study, together with its recommendations, including such recommendations for legislation as it deems advisable.

"(3) In connection with the study authorized by this subsection, the Board shall consult with national securities exchanges; national securities associations; the likely classes of participants in a national market system, such as securities information processors, market makers, specialists, brokers and dealers; investors; the public; representatives of Government agencies and other interested persons.

"(i)(1) There is authorized to be appropriated $300,000 to the Commission for allocation to the Board for the purpose of enabling the Board to hire staff, rent office space, and generally to organize to carry out the functions set forth in this section.

(2) Such sums when appropriated for this purpose may be made available by the Commission to the Board beginning with the creation of the Board pursuant to the provisions of this section.

"(3) The Board, since it shall act as an advisory body, is authorized to appoint and fix the compensation of such officers, attorneys and other experts and employees as may be necessary for carrying out its functions under this section, without regard to the provision of any laws applicable to the employment and compensation of officers and employees of the United States.

"(4) The Board shall furnish to its members representing the public such funds, on a per diem basis, as it finds reasonably will permit such members to perform their functions under this section.

"(j)(1) The Commission is authorized and directed to make a study of the securities activities conducted by persons who are not brokers or dealers, who maintain accounts on behalf of public customers for buying and selling securities registered under section 12 of the Act to determine the extent of such business conducted by such persons, the desirability of greater uniformity of regulation of such accounts, the effects of such activities on the process of raising and allocating capital in interstate commerce, the effect on competition for such public accounts, and whether the exclusions from the definition of broker and dealer are necessary and appropriate for the protection of investors and to achieve the purposes of this title.

"(2) The Commission shall report to the Congress on or before December 31, 1976, the results of its study including such recommendations for legislation as it deems advisable."

SEC. 502. The Securities Exchange Act of 1934 is further amended by adding after section 20A the following new section:

"RESTRICTIONS ON MARKET SELECTION AND USE OF CLEARING AGENCIES AND DEPOSITORIES

"SEC. 20B. (a) On or after September 1, 1975, no national securities exchange or national securities association may, by rule or otherwise, limit or condition a member's ability to transact business on any other exchange or otherwise than on an exchange, except pursuant to a rule of such exchange or association which is approved as consistent with the purposes of this title and such member's agency obligation to its customer, and declared effective by the Commission by rule, after providing for appropriate notice and an opportunity for the oral presentation of views, data, and arguments by interested persons in addition to an opportunity to make written submissions to the Commission. The Commission shall approve, with or without modification, or disapprove any such rule proposed by an exchange or association within 90 days of the date of the filing of such proposed rule.

"(b) No national securities exchange registered under section 6 and no national securities association registered under section 15A shall by rule or otherwise limit or condition any of its members from participating in any clearing agency or securities depository registered under section 17A."

SEC. 503. Section 28 of the Securities Exchange Act of 1934 (15 U.S.C. 78bb) is further amended by adding at the end thereof the following new subsection:

"(d)(1) No person using the mails, or any means or instrumentality of interstate commerce, in the exercise of investment discretion with respect to an account shall be deemed to have acted unlawfully or to have breached a fiduciary duty under State or Federal law in effect on or enacted prior to the date of enactment of the Securities Reform Act of 1975 solely by reason of his having caused the account to pay a broker or dealer an amount of commission for effecting a securities transaction in excess of the amount of commission another broker or dealer would have charged for effecting that transaction, if such person determined in good faith that such amount of commission was reasonable in relation to the value of the brokerage and research services provided by such broker or dealer, viewed in terms of either that particular transaction or his overall responsibilities with respect to the accounts as to which he exercises investment discretion. This subsection is exclusive and plenary insofar as conduct is covered by the foregoing, unless otherwise expressly provided by contract: *Provided, however*, That nothing in this subsection shall be construed to impair or limit the power of the Commission under any other provision of this title.

"(2) A person exercising investment discretion with respect to an account shall make such disclosure of his policies and practices with respect to commissions that will be paid for effecting securities transactions, at such times and in such manner, as the appropriate regulatory agency, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

"(3) For purposes of this subsection a person provides brokerage and research services insofar as he—

"(A) furnishes advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities;

"(B) furnishes analyses and reports concerning securities, economic factors and trends, and the performance of accounts; or

"(C) effects securities transactions and performs functions incidental thereto (such as clearance, settlement, and custody) or required in connection therewith by rules of the Commission or a securities industry-regulatory organization of which such person is a member or person associated with a member or in which such person is a participant.".

PURPOSE OF THE LEGISLATION

It is a basic teaching of this nation's financial history that continued economic health fundamentally depends upon the maintenance of

investor confidence, the continuous availability of investment capital and efficient secondary trading markets in securities. Events of recent years have placed considerable stress on the ability of brokers and dealers to maintain a constant flow of debt and equity instruments available for public investment and serious questions have been raised whether the securities markets themselves are sufficiently resilient and flexible to meet the challenge of the changed economic circumstances of today. The Committee believes that the need to develop a modernized national system for effecting securities transactions is imperative, its importance unassailable.

Modern communication and data processing facilities now make possible the linking together of geographically separated trading markets on a national basis so as to provide greater investor protection and a strengthened mechanism for the efficient and effective allocation of investment capital. If our securities markets are to maintain their primacy and if this nation is to continue to play a central role in the international financial community, we must create a framework which permits the evolution of the marketplace free from unnecessary and artificial restraints on competition while at the same time focusing adequate authority in the Securities and Exchange Commission to modify and, in some cases, to give form to the evolving market structure so as to make certain that marketplace's responses to changing economic circumstances are consistent with the overall public interest. The creation of that framework is the fundamental purpose of this legislation.

To accomplish that end, briefly stated, this bill would (1) remove certain regulatory requirements which have been demonstrated to constitute unnecessary impediments to the development of the marketplace; (2) establish Congressionally defined goals premised upon competitive principles to guide the Securities and Exchange Commission in giving focus to and overseeing the development of a national system for effecting transactions in securities; (3) redefine and strengthen the regulatory authority of the Securities and Exchange Commission to provide greater assurance that the Commisison will be able to discharge its statutory responsibilities to protect investors and provide for fair dealing in securities transactions; and (4) clarify the scope of securities industry regulatory organization responsibilities to police the conduct and strengthen the professional standards of professional participants in our securities markets.

Background

This legislation finds its antecedents in the paperwork crisis of 1968–1970, when a veritable explosion in trading volume clogged an inadequate machinery for control and delivery of securities, resulting in what the Securities and Exchange Commission was moved to characterize as the "most prolonged and severe crisis in the securities industry in forty years".

The operational breakdown which followed brought our nation's securities market to its knees; despite sharp curtailments in trading hours, firms lost control of their records and many were forced into liquidation or were saved only through heroic measures. In the end,

Congress was required to step in and create, through the instrument of the Securities Investor Protection Act of 1970, a mechanism for safeguarding investors from loss in the event of brokerage house failures.

The Congress backed this guarantee against loss with $1 billion in U.S. Treasury credits. We did so with the resolve that we would take all necessary steps to insure that the crisis of 1968–70 would not be repeated and with the understanding that Congress would, in future years, exercise a closer and continuing scrutiny of the securities industry.

In furtherance of that objective, the Congress directed the Securities and Exchange Commission to compile a list of unsafe and unsound practices by brokers and dealers and to report to the Congress what corrective steps were to be taken under existing law and to submit recommendations for additional legislation, if needed. And, in parallel action, both the House and the Senate decided to conduct independent studies of the securities industry.

Legislative History

In the 92d Congress, this Committee's Subcommittee on Commerce and Finance conducted in-depth hearings to serve as a basis of its analysis of the securities industry. The printed hearings comprise 9 volumes of over 4,600 pages which record the testimony of 87 witnesses who appeared before the Subcommittee. This hearing record was augmented by numerous interviews conducted by members of the Committee and its staff in virtually every section of the country. Previous studies of the securities industry (and there have been many) were reviewed in the course of these proceedings and every effort was made to seek the advice of industry leaders and regulators and all segments of the investing public. On August 23, 1972, the Subcommittee submitted its final report to the Chairman of your Committee on Interstate and Foreign Commerce.[1] This report of 170 pages contained a series of conclusions coupled with specific legislative recommendations unanimously endorsed by the full membership of the Subcommittee.

In the beginning of the 93d Congress, a bill which constituted the legislative embodiment of the Subcommittee's recommendations, H.R. 5050, was introduced in the House. During the months of June through September, 1973, this Committee's Subcommittee on Commerce and Finance held 23 days of hearings on the introduced bill. Also under consideration was the bill, H.R. 340, which proposed to establish for the first time authorization limitations on the amounts to be appropriated to the Securities and Exchange Commission for the purpose of discharging its responsibilties under the securities laws. This latter proposal was ultimately integrated into H.R. 5050.

After numerous meetings in open session, the Subcommittee reported H.R. 5050 in revised form without dissent, one member being absent. The full Committee on Interstate and Foreign Commerce made further amendment to the bill and, after 5 meetings in open session, ordered the bill favorably reported to the House by voice

[1] Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, H. Rept. 92–1519, 92d Cong., 2d Sess. (1972).

vote with a Committee amendment in the nature of a substitute. The Clerk of the Committee was directed to record that of the members present and voting only one had registered a nay vote to the motion to favorably report the amended bill.

In the waning days of the last Congress, considerable opposition to H.R. 5050 was generated by the securities industry and the Rules Committee failed to pass a motion to grant the bill an open rule by a vote of 6 ayes, 6 nays, and 1 "present", thus preventing the House from considering the bill. This occurred notwithstanding the fact that the Senate had already enacted legislation substantially similar to H.R. 5050 and awaited only action by the House.

Since that time, the Securities and Exchange Commission has completed an administrative proceeding and ordered an abolition of fixed commission rates on securities exchanges effective May 1, 1975. That action, which would have been mandated by the provisions of H.R. 5050, had been the principal source of industry oppositions to the legislation. By moving administratively to accomplish the same result, the SEC has made moot the controversy which surrounded the commission rate issue and, therefore, much of the opposition to this legislation has dissipated. Indeed, because this legislation affords mechanisms which are necessary to assist the industry in making the transition from a fixed to a competitive rate environment, significant segments of the industry now wholeheartedly support enactment of this legislation.

At the beginning of this Congress, H.R. 4111 was introduced. The bill as introduced differed from H.R. 5050 in only two important respects. First, it eliminated Title I, which sought to remove or alter certain administrative controls which, over the years, the Executive Branch had imposed upon the Securities and Exchange Commission in the name of administrative efficiency. The Administration had strongly opposed these provisions and their deletion now permits the White House to wholly support the objectives of the bill. Second, this bill rewrote the provisions relating to the fiduciary obligations of money managers in choosing a broker after commission rates became unfixed. Subsituted for the provision which was contained in H.R. 5050 is an evolved method for dealing with this question which was developed in joint discussions with the Senate and the Treasury Department. It has attracted near unanimous support from the securities industry.

The full Committee on Interstate and Foreign Commerce determined to consider H.R. 4111 directly rather than referring it to Subcommittee for additional hearings, deciding that the extensive record developed during the 92nd and 93rd Congresses was more than sufficient. The Committee made certain amendments in H.R. 4111 as introduced and after three meetings in open session ordered the bill favorably reported to the House by voice vote with a Committee amendment in the nature of a substitute.

This legislation is the product of a most comprehensive and searching analysis of the securities industry. In a real sense, it follows and reflects the conclusions of a long line of studies of our capital markets beginning in the early 60's. Its roots can be found in the Special Study of the Securities Markets conducted by the Securities and Exchange

Commission and published in 1963.[2] Support for its provisions is reflected in the SEC study of the "Public Policy Implications of Investment Company Growth", submitted to the Congress in 1966 [3] and also in the multi-volume Institutional Investor Study submitted in 1971.[4] And many of its provisions can be traced to the specific recommendations of the Securities and Exchange Commission in its report to the Congress titled "Study of Unsafe and Unsound Practices of Brokers and Dealers" which was transmitted to the Congress in December 1971,[5] under the mandate of the Securities Investor Protection Act. Indeed, it is difficult to call to mind any other piece of legislation in recent years which has as firm a basis and record support for its recommendations than does this bill.

Discussion of Bill's Major Provisions

Elimination of barriers to competition

This Committee's Subcommittee on Commerce and Finance, in its Securities Industry Study Report, said:

> A review of the Subcommittee's record convinces us that in the securities industry undue emphasis has been placed on regulation instead of competition. We find that such emphasis has been unwarranted. The Subcommittee finds that in the economic areas affecting the securities industry, competition, rather than regulation, should be the guiding force. We have proposed, therefore, in other chapters of this report, to abolish the fixed minimum commission rate system; to open up membership on registered national securities exchanges to all registered broker-dealers who meet applicable capital and competency requirements; to prohibit boycotts such as New York Stock Exchange rule 394 and to provide for competition among market makers, including specialists. We find that at least in these areas competition, rather than regulation, should control. This still leaves for regulation those areas such as the supervising and imposing of standards of professional competence; the administration of fair and equitable principles of trade for the protection of investors; the regulation and discipline of members for fraudulent or manipulative practices; and the imposition of standards of financial responsibility and the policing of compliance with those standards.

The need to increase competition in economic areas has also been recognized by the Executive. In his October 8, 1974, Economic Message President Ford said, ". . . the Federal Government imposes too many hidden and too many inflationary costs on our economy" and recommended a joint effort "to identify and eliminate existing Federal rules

---

[2] Report of Special Study of Securities Markets of the Securities and Exchange Commission, H. Doc No. 95, 88th Cong., 1st Sess. (1963).

[3] Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth. H. Rept. No. 2337, 89th Cong., 2d Sess. (1966).

[4] Institutional Investor Study Report of the Securities and Exchange Commission, H. Doc. No. 92-64, 92d Cong., 1st Sess. (1971).

[5] Study of Unsafe and Unsound Practices of Brokers and Dealers, Report and Recommendation of Securities and Exchange Commission, H. Doc. No. 92-231, 92d Cong., 1st Sess. (1971).

and regulations that increase costs to the consumer, without any good reason, in today's economic climate." This recommendation mirrors sentiments expressed in the 1970 Presidential Economic Report where it was said:

> The American experience with regulation, despite notable achievement, has had its disappointing aspects. Regulation has too often resulted in protection of the status quo. Entry is often blocked, prices are kept from falling, and the industry becomes inflexible and insensitive to new techniques and opportunities for progress. There is no clear safeguard against these dangers, but more reliance on economic incentives and market mechanisms in regulated industries would be a step forward. * * *

The Committee feels that the provisions of the bill eliminating barriers to competition should well serve the investing public who, after all, are consumers of financial services. Thus the bill proposes to give life to the proposals contained in the Securities Industry Study Report.

Securities industry regulation and SEC oversight

In fashioning the Securities Exchange Act of 1934, Congress considered the question whether to continue in effect the system of regulation by which the industry voluntarily undertook to govern the conduct and professional standards of professional participants in the securities markets or to rely instead on direct regulation by governmental authority. Convinced that an attempt to regulate the industry directly through government on a wide scale would be "ineffective," the Congress chose to develop a unique pattern of regulation combining both industry and government responsibility. This pattern, which has remained substantially unchanged for 40 years, calls upon industry organizations—the exchanges and the NASD—to exercise delegated governmental power in order to enforce at their own initiative compliance by members of the industry with both the legal requirements laid down in the Securities Exchange Act and ethical standards which go beyond those requirements. The SEC is charged with supervising the exercise of this regulatory power in order to assure that it is used effectively to fulfill the responsibilities assigned to the regulatory organizations, and that it is not used in a manner inimical to the public interest or unfair to private interest. Moreover, in order to make certain that the Commission is able to fulfill its responsibilities to protect investors and assure fair dealing in securities, the SEC is granted authority to promulgate rules under the Securities Exchange Act which define permissible conduct of brokers and dealers and establish standards for trading in securities to insure the fairness and orderliness of the securities markets. The securities industry regulatory organizations, it should be emphasized, are intended to be subject to the SEC's control and have no governmentally derived authority to act independently of SEC oversight.

The regulatory roles of the exchanges and the NASD have been major elements of the regulatory scheme of the Securities Exchange Act since 1934 and 1938, respectively. Perhaps expectantly, the system has, on occasion, been found seriously deficient and it has not operated

as effectively or as fairly as the public interest would require. Nonetheless, in the last Congress, the Committee found that the system, on the whole, has worked and recommended that it be preserved and strengthened.

To guard against a recurrence of the lapses in regulatory responsibility which have occurred in the past, H.R. 4111 assigns to the SEC and directs the implementation of certain new authorities which augment its oversight powers and permit expeditious action. For example, H.R. 4111 proposes to permit the Commission to compel, through injunctive process in the courts, exchange and NASD members to adhere to the requirements of those organizations rules. This power is designed to permit the SEC to take independent action should a securities industry regulatory organization prove to be a reluctant enforcer of its regulatory standards. Such proved to be the case in the crisis period of 1968 through 1970 when some exchanges refused to compel strict adherence to financial responsibility requirements, which action in some cases permitted its member firms to continue in business in jeopardy to their customers.

H.R. 4111 also gives to the Commission certain oversight powers with respect to exchanges which are absent from the present statute but which have been a part of the regulatory pattern with respect to registered securities associations such as the NASD. Thus, the Commission will for the first time be in a position to disapprove changes in an exchange's body of rules. And the Commission may, upon its own motion, review disciplinary action taken by an exchange against one of its members as a means of assuring an observance of fair procedures and a coherent, and more uniform, imposition of sanctions for prohibited conduct.

In a number of important respects, this bill will redefine and clarify the regulatory responsibilities of the securities industry regulatory organizations. This redefinition is necessary to make certain that, in the changed economic and technological conditions of today, the regulatory pattern of the securities industry is responsive to and supportive of the basic goals underlying the Securities Exchange Act of 1934.

National securities market system

Over the past 40 years, the economic forces at work in our securities markets have placed considerable stress on the manner in which securities are traded and, in some cases, forced an alteration of basic market mechanisms. We have witnessed a dramatic increase in institutional participation in the markets and in competition for the investment dollar. Communication and data processing technologies have multiplied and made significant advances. Yet, the organized securities markets continue to operate by and large as they did when the Securities Exchange Act was adopted in 1934. Essentially the evolutionary process has been stunted and distorted by various rules and practices which, operating under the banner of regulatory need, have unnecessarily erected barriers to competition, insulated markets, and resulted in misallocations of capital, widespread inefficiencies, and potentially harmful fragmentation of trading markets.

There are, at present, thirteen registered national securities exchanges. Principal among these, of course, are the markets physically located in New York City, the New York Stock Exchange

and the American Stock Exchange. Respectively these two exchanges accounted for 71.4 percent and 17.5 percent of the total volume by shares traded in listed securities in calendar year 1972. National securities exchanges located outside of New York City, so called regional stock exchanges, and over-the-counter trading in listed securities, i.e. the so called third market, accounted for the remaining 11.1 percent of share volume. Significantly regional stock exchange share volume has shown a 16 percent increase over calendar year 1971 as compared to an increase of 6 percent for the New York Stock Exchange and 5 percent for the American Stock Exchange. Moreover, the third market in 1972 reported a volume in securities listed on the New York Stock Exchange of over 327 million shares, or roughly 7.3 percent of New York Stock Exchange volume. Five years previously, 1967, third market volume in New York Stock Exchange listed securities represented only 3.6 percent of the NYSE total. Thus, it can be seen that the regional stock exchanges and the third market have significantly increased their share of the market in recent years.

Critics of this development suggest that the markets are becoming dangerously fragmented. Others contend that the dilution of large market dominance is the result of healthy competitive forces which have done much to add to the liquidity and depth of the securities markets to the benefit of the investing public. The Committee shares the opinion that our markets will be strengthened by the infusion of marketmaker competition in listed securities with the concomitant increase in capital availability and diminution of risk which results from increased competition among specialists and marketmakers.

Nonetheless, market fragmentation becomes of increasing concern in the absence of mechanisms designed to assure that public investors are able to obtain the best price for securities regardless of the type or physical location of the market upon which his transaction may be executed. Investors must be assured that they are participants in a system which maximizes the opportunities for the most willing sellor to meet the most willing buyer. Today's market structure does not assure that opportunity. Largely this is the result of opposition to market integration by vested interests, monopoly control of essential mechanisms for the dissemination of market information, and the absence of effective control of market developments and operations by the Securities and Exchange Commission. This legislation seeks to overcome these impediments.

Provisions of this bill which mandate an end to fixed commission rate schedules and eliminate certain market advantages by prohibiting exchange members from effecting transactions for managed accounts will do much to eliminate artificial incentives for market distortion and fragmentation. Also, the Securities and Exchange Commission is to be equipped with plenary authority to break down unjustified barriers to access to markets and marketmakers, and to provide a focus for the development of complete market integration.

The bill does not attempt to give definition to a national market system. Nor is it either feasible or desireable for the Commission or any other agency of the government to predetermine and require a particular structure. Instead, the Commission is directed to act to modify the structure as it evolves through the ingenuity and response

of the marketplace to the extent that changes occur that are found inconsistent with the public interest. Nevertheless, this bill does define certain goals and principles to serve as a guide to the industry and to the Commission in this evolutionary process. These goals and principles have been articulated in publications of the SEC,[6] the Treasury Department,[7] the Justice Department[8] and the Congress.[9] Briefly stated, these embrace the principles of competition in which all buying and selling interests are able to participate and be represented. The objective is to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations of practices and services. Neither the markets themselves nor the broker-dealer participant in these markets should be forced into a single mold. Market centers should compete and evolve according to their own natural genius and all actions to compel uniformity must be measured and justified as necessary to accomplish the salient purposes of the Securities Exchange Act, assure the maintenance of fair and orderly markets and to provide price protection for the orders of investors.

National clearance and settlement system

Tied to the national market system will be a national clearance and settlement system to facilitate the paperwork attendant to transactions executed in the national market system. The national clearance and settlement system will eliminate the transcontinental shipment of money and securities and will allow stock brokers to perform the clearance and settlement function in their own region. This should insure that investors receive their money or evidences of ownership in a timely fashion, and should also produce significant cost savings to stock brokers, savings which the Committee expects to be passed on to the investor under the competitive commission rate system.

It should be made clear that the statutory charge to develop a unified system for the clearance and settlement of securities transactions does not carry with it the call—nor does it grant the authority—to eliminate competition among separate entities in the performance of these functions. Many of the innovations and improvements in clearance and settlement of the last several years have been the product of vigorous and healthy competition among different service entities. Often new market entrants have been responsible for the most significant advances. The Committee believes, therefore, that a national system, through fully integrated, must make full allowance for the continuance and future entry of separate service entities.

Abolition of fixed commission rates

In the last Congress the most controversial aspect of this legislation was the proposal to reverse the industry practice of charging fixed rates of commission for transactions on securities exchanges.

---

[6] Institutional Investor Study, above, note 4; Statement on the Future Structure of the Securities Markets (February 2, 1972); Policy Statement on the Structure of a Central Market System (March 29, 1973).

[7] Public Policy for American Capital Markets (February 7, 1974).

[8] Statement at SEC Hearings on the Structure, Operation and Regulation of the Securities Markets (December 1, 1971).

[9] Securities Industry Study, Report of the Subcommittee on Commerce and Finance, above, note 1; Securities Industry Study, Report of the Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, Comm. Print, 93d Cong., 1st Sess. (1973).

S. REP. 94-75, S. Rep. No. 75, 94TH Cong., 1ST Sess. 1975, 1975 U.S.C.C.A.N. 179, 1975 WL 12347 (Leg.Hist.)

**179 P.L. 94-29, SECURITIES ACTS AMENDMENTS OF 1975

Senate Report (Banking, Housing and Urban Affairs Committee) No. 94-75,
Apr. 14, 1975 (To accompany S. 249)

House Report (Interstate and Foreign Commerce Committee) No. 94-123,
Apr. 7, 1975 (To accompany H.R. 4111)

House Conference Report No. 94-229,
May 19, 1975 (To accompany S. 249)

Cong. Record Vol. 121 (1975)

DATES OF CONSIDERATION AND PASSAGE

Senate April 17, May 20, 1975

House April 24, May 22, 1975

The Senate bill was passed in lieu of the House bill. The Senate Report and the House Conference Report are set out.

(CONSULT NOTE FOLLOWING TEXT FOR INFORMATION ABOUT OMITTED MATERIAL. EACH COMMITTEE REPORT IS A SEPARATE DOCUMENT ON WESTLAW.)

SENATE REPORT NO. 94-75

Apr. 14, 1975

The Committee on Banking, Housing and Urban Affairs, to which was referred S. 249 (to amend the Securities Exchange Act of 1934, and for other purposes) having considered the same, reports favorably upon S. 249 as amended and recommends without objection that the bill do pass.

*1 INTRODUCTION

S. 249, the Securities Acts Amendments of 1975, consolidates five bills: S. 470, S. 2058, S. 2519, S. 2474, and S. 2234 considered during the 93d Congress. The first four of these bills passed the Senate and extensive hearings were held on the fifth.

The genesis of this legislation is the Securities Industry Study Report of the Subcommittee on Securities (S. Doc. No. 93-13, 93d Cong., 1st Sess. 1973). This report grew out of an extensive 18-month study. Its major recommendations, embodied in S. 249, point to a fundamental reform of the economic and regulatory structure of the securities markets and the securities industry.

**180 S. 249 was introduced by Senators Williams, Brooke, and Tower on January 17, 1975, and referred to the Committee on Banking. Housing and Urban Affairs. The Subcommittee on Securities held hearings on S. 249 on February 19, 20, and 21, 1975. On April 11, 1975, the Committee on Banking, Housing and Urban Affairs met in open executive session and ordered S. 249, as amended, to be report to the Senate.

A. NATIONAL MARKET SYSTEM AND SELF-REGULATORY ORGANIZATIONS

Fundamental changes have occurred over the past forty years in the manner in which securities are traded, the role played in the securities markets by institutional investors, the structure of the national and international economy, and the capabilities and availability of communications and data processing equipment. Yet, despite these changes, the Committee found that the organized securities markets continue to operate by and large as they did when the Securities Exchange Act of 1934 (the 'Exchange Act') was adopted. Rather than responding to changing investor needs and striving for more efficient ways to perform their essential functions, the principal stock exchanges and the majority of established securities firms appear to have resisted industry modernization and to have been unable or unwilling to respond promptly and effectively to radically altered economic

Securities processing costs are necessarily passed on to investors in the form of the commission rates they are charged. Investor participation in the market, particularly the participation of the small investor, is in part related to the costs of investing. The Committee is convinced that one of the most important steps that can be taken to assure that commission charges are reasonable and fair is to foster cost savings in *6 the processing end of the securities business. S. 249 is intended to do that.

Processing economies, the public interest in protecting investors against loss of securities and cash, the financial and operational responsibilities of broker-dealers, the need for greater public confidence in the market system, and the expectation that the markets of the future will be required to handle higher volume, all require a modernized national system for consummating securities transactions. The need for legislation is clear.

**185 *7 NATURE AND SCOPE OF LEGISLATION

I. A NATIONAL MARKET SYSTEM FOR SECURITIES

In its Securities Industry Study Report, the Subcommittee on Securities concluded that the present markets for securities in the United States could be substantially improved by the prompt development and implementation of a central or national market system. The Committee agrees with this judgment and believes that S. 249 will facilitate the development of such a new market system.

The bill does not define 'national market system' because the committee believes that the general concept is sufficiently clear from the words themselves. Furthermore, at this state of market development and technological innovation the Committee believes it is best to allow maximum flexibility in working out specific details. For these reasons, the Committee determined it essential that the Commission be granted broad, discretionary powers to oversee the development of a national market system and to implement its specific components in accordance with the findings and to carry out the objectives set forth in the bill.

The term 'national market system' as used in the bill would encompass all segments of the corporate securities markets including all types of common and preferred stocks, bonds, debentures, warrants and options. This is desirable because many of the goals of the national market system, e.g., availability of information with respect to price, volume, and quotations, and coordination of self-regulatory systems, and strengthening of Commission oversight, are nearly universal in scope and might not be fully realized within separate market systems.

This is not to say that it is the goal of the legislation to ignore or eliminate distinctions between exchange markets and over-the-counter markets or other inherent differences or variations in components of a national market system. Some present distinctions may tend to disappear in a national market system, but it is not the intention of the bill to force all markets for all securities into a single mold. Therefore, in implementing the bill's objectives, the SEC would have the power to classify markets, firms, and securities in any manner it deems necessary or appropriate in the public interest or for the protection of investors and to facilitate the development of subsystems within the national market system.

There are two paramount objectives in the development of a national market system. First, the maintenance of stable and orderly markets with maximum capacity for absorbing trading imbalances without undue price movements. And second, the centralization of all buying and selling interest so that each investor will have the opportunity for the best possible execution of his order, regardless of where in the system it originates.

In general terms, S. 249 is intended to clarify and enhance the authority of the SEC to take all necessary steps to bring such a national *8 market system into existence. The bill approaches the problem of encouraging the development and implementation of a national **186 market system from the point of view of preserving the competing markets for securities that have developed, breaking down all barriers to competition that do not serve a valid regulatory purpose, and encouraging maximum reliance on communication and data processing equipment consistent with justifiable costs. This approach is supported by the

SEC, as indicated in its Statement on the Future Structure of the Securities Markets (February 2, 1972) and its Policy Statement on the Structure of a Central Market System (March 29, 1973).

In 1936, this Committee pointed out that a major responsibility of the SEC in the administration of the securities laws is to 'create a fair field of competition.' This responsibility continues today. The bill would more clearly identify this responsibility and clarify and strengthen the SEC's authority to carry it out. The objective would be to enhance competition and to allow economic forces, interacting within a fair regulatory field, to arrive at appropriate variations in practices and services. It would obviously be contrary to this purpose to compel elimination of differences between types of markets or types of firms that might be competition-enhancing.

A. OBJECTIVES AND SEC AUTHORITY

Section 11A(a)(1) [1] of S. 249 sets forth the goals and objectives of a national market system for qualified securities. Subparagraphs (A), (B), (C), and (D) of that Section express the Committee's findings that the securities markets are an important national asset to be preserved and strengthened; that new data processing and communications systems create the opportunity for more efficient and effective markets; that it is in the public interest to assure (i) economically efficient mechanisms for the execution of transactions; (ii) fair competition among brokers and dealers, among markets and between exchange markets and over-the-counter markets; (iii) the availability of information with respect to quotations for, and transactions in, securities; (iv) an opportunity for investor orders to be executed without the participation of a dealer, so long as such opportunity would be consistent with an economically efficient mechanism for the execution of transactions; and (v) the practicability of brokers executing orders in the best market; and that the linking of all markets for qualified securities through communications and data processing facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers and investors, facilitate the off-setting of customers' orders, and contribute to best execution of such orders. Section 11A(a)(2) of S. 249 directs the Commission to facilitate the establishment of a national market system in accordance with the foregoing findings and objectives.

The Committee considered mandating certain minimum components of the national market system but rejected this approach. The nation's securities markets are in dynamic change and in some respects are delicate mechanisms; the sounder approach appeared to the Committee, therefore, to be to establish a statutory scheme clearly granting the Commission broad authority to oversee the implementation, **187 *9 operation, and regulation of the national market system and at the same time to charging it with the clear responsibility to assure that the system develops and operates in accordance with Congressionally determined goals and objectives. Section 11A(a) and 11A(c), taken together, would establish such an arrangement.

B. COMMUNICATION AMONG AND DISSEMINATION OF INFORMATION ABOUT SECURITIES MARKETS

In the securities markets, as in most other active markets, it is critical for those who trade to have access to accurate, up-to-the-second information as to the prices at which transactions in particular securities are taking place (i.e., last sale reports) and the prices at which other traders have expressed their willingness to buy or sell (i.e., quotations). For this reason, communications systems designed to provide automated dissemination of last sale and quotation information with respect to securities will form the heart of the national market system. The Committee has found, however, that there are significant questions as to the SEC's authority to regulate persons operating and administering such systems. As our trading markets shift from independent, self-contained units to a single integrated system, clear regulatory control over the communication links among markets becomes imperative. S. 249 would greatly expand the SEC's regulatory authority over the processors and distributors of market information. The goals of this pervasive regulatory authority would be to insure the availability of prompt and accurate trading information, to assure that these communications networks are not controlled or dominated by any particular market center, to guarantee fair access to such systems by all brokers, dealers and investors, and to prevent any competitive restriction on their operation not justified by the purposes of the exchange Act.

The SEC's authority to foster the implementation of a composite tape and composite quotation system has been questioned by the primary exchanges and certain vendors of market information. For example, after the SEC expressed its objections to the original composite tape plan filed by the exchanges and the NASD, the NYSE responded by stating:

. . . we are proceeding on the basis of our sincere desire to satisfactorily resolve the problems inherent in the creation of a consolidated tape, on a voluntary and cooperative basis, but the Exchange is not waiving-- and hereby expressly reserves-- its right to object to provisions of Rule 17a-15 (concerning the composite tape) and the Commission's assumption of authority in this area.

Arguments about the SEC's authority are not in the best interest of investors or the industry, for they can only result in substantial delays in implementing the communications systems necessary for the national market system. S. 249 is designed to make the SEC's authority over such systems and the operations of a national market system clear.

**188 Regulation of securities communication systems would be accomplished under S. 249 by adding a new section 11A to the Exchange Act. This section is intended to bring under the SEC'S direct jurisdiction *10 all organizations engaged in the business of collecting, processing, or publishing information relating to quotations for, indications of interest to purchase and sell, and transactions in securities.

Section 11A(b)(1) would prohibit any 'securities information processor,' as defined by section 3(a)(22), unless registered with the Commission or exempted from registration from making use of the mails or any means or instrumentality of interstate commerce to perform the functions of a securities information processor. Unless the Commission, by rule, provides otherwise, the only securities information processor's which would be required to register are those engaged on an exclusive basis (i.e., having a contractual monopoly) on behalf of an exchange or the NASD in collecting, processing, or preparing for distribution or publication of information with respect to transactions or quotations. Such persons are defined as 'exclusive processors.' In accordance with this provision, central processing facilities such as the Securities Industry Automation Corporation ('SIAC') would all be required to register with the SEC. Stock exchanges and the NASD would be exempt from registration, although their subsidiaries and affiliates would not be exempt. Moreover, to the extent a national securities exchange or registered securities association engages in the business of securities information processing other than through a subsidiary or other instrumentality registered as a securities information processor, the Commission's broad authority under the bill includes all powers necessary to ensure the regulation of the securities information processing activities of such exchanges and associations in the same manner and to the same extent as the Commission may regulate securities information processors registered and regulated under new Section 11A(b). Private vendors of marked information who are not exclusive processors within the meaning of section 3(a)(22)(B), such as Quotron and Ultronics, would initially be exempt from registration, but the SEC could remove the exemption upon a finding that registration was necessary or appropriate in the public interest or to facilitate the development of a national market system.

The bill would give the SEC administrative authority to regulate and oversee the activities of registered securities information processors. For example, the Commission would be authorized to censure or place limitations on the activities, functions, or operations of any registered securities information processor, or to suspend or revoke its registration, if the Commission determined that such processor had violated or was unable to comply with any provision of the exchange Act or the rules or regulations thereunder. (Section 11A(b)(6)). In addition, the Commission would be authorized to review and set aside any exclusionary action by a registered securities information processor. (Section 11A(b)(5)).

With respect to securities information processors generally and exchanges and the NASD insofar as they are performing processing functions, the bill would direct the Commission (1) to prevent the use, distribution, or publication of fraudulent, deceptive, or manipulative **189 information with respect to quotations for and transactions in qualified securities; (2) to assure the prompt, accurate, reliable, and fair collection, processing, distribution, and publication of information with respect to quotations for and transactions in such securities and *11 the fairness and usefulness of the form and content of such information; (3) to assure that all securities information processors may obtain access on fair and reasonable terms for purposes

of distribution and publication of such information with respect to quotations for and transactions in such securities as is collected, processed, or prepared for distribution or publication by any exclusive processor of such information acting in such capacity; (4) to assure that exchange members, brokers, dealers, securities information processors, and investors may obtain on terms which are not unreasonably discriminatory information with respect to quotations for and transactions in such securities published or distributed by any self-regulatory organization or securities information processor; (5) to assure that all exchange members, brokers, and dealers transmit and direct orders for the purchase or sale of qualified securities in a manner consistent with the establishment and operation of a national market system; and (6) to assure equal regulation of all markets for qualified securities and all exchange members, brokers, and dealers effecting transactions in such securities. (Section 11A(c)(1)).

Examples of the types of subjects as to which the SEC would have the authority to promulgate rules under these provisions include: the hours of operation of any type or quotation system, trading halts, what and how information is displayed and qualifications for the securities to be included on any tape or within any quotation system.

Despite the diversity of views with respect to the practical details of a national market system, all current proposals appear to assume that there will be an exclusive processor or service bureau to which the exchanges and the NASD will transmit data and which in turn will make transactions and quotation information available to vendors of such information. Under the composite tape 'plan' declared effective by the Commission, SIAC would serve as this exclusive processor. The Committee believes that if such a central facility is to be utilized, the importance of the manner of its regulation cannot be over-estimated. An exclusive processor of this sort will play a key role in determining how information about transactions in securities will reach the public. Its decisions as to who may report transactions through its facilities and in what manner will influence the extent and nature of competition among market facilities. And its decisions as to who may receive and disseminate the market information which it processes will structure the nature of the competition among vendors of market information.

The Committee believes that if economics and sound regulation dictate the establishment of an exclusive central processor for the composite tape or any other element of the national market system, provision must be made to insure that this central processor is not under the control or domination of any particular market center. Any exclusive processor is, in effect, a public utility, and thus it must function in a manner which is absolutely neutral with respect to all market centers, all market makers, and all private firms. Although the existence of a **190 monopolistic processing facility does not necessarily raise antitrust problems, serious antitrust questions would be posed if access to this facility and its services were not available on reasonable and nondiscriminatory terms to all in the trade or if its charges were not reasonable. Therefore, in order to foster efficient market development and *12 operation and to provide a first line of defense against anti-competitive practices. Sections 11A(b) and (c)(1) would grant the SEC broad powers over any exclusive processor and impose on that agency a responsibility to assure the processor's neutrality and the reasonableness of its charges in practice as well as in concept.

S. 249 would give the SEC broad authority not only to oversee the general development of a national market system but also to insure that the ancillary programs of the self-regulatory organizations and their affiliates are consistent with the best interests of the securities industry and the investing public. (See Sections 6(a), 15A(a), 19(b), 11A(c)(1), and 23(a)(1).) This is not to suggest that under S. 249 the SEC would have either the responsibility or the power to operate as an 'economic czar' for the development of a national market system. Quite the contrary, for a fundamental premise of the bill is that the initiative for the development of the facilities of a national market system must come from private interests and will depend upon the vigor of competition within the securities industry as broadly defined. Although the SEC's basic role would be to remove burdens on competition which would unjustifiably hinder the market's natural economic evolution and to assure that there is a fair field of competition consistent with investor protection, in situations in which natural competitive forces cannot, for whatever reason, be relied upon, the SEC must assume a special oversight and regulatory role. An exclusive processor for a national market system would create such a situation and so would self-regulatory projects which are not economically self-sufficient, which enjoy an effective monopoly, or which are merchandised to members on a basis other than cost and quality of services. The bill would give the SEC broad authority over and significant responsibility for the development and operation of such facilities, subject of course to any ultimate judicial reconciliation of the policies of the Exchange Act with those of the antitrust laws.

C. ELIMINATION OF UNNECESSARY REGULATORY RESTRICTIONS

In the Committee's view the fundamental goals of a national market system include (1) providing an investor or his broker with the ability to be able to determine, at any given time, where a particular transaction can be effected at the most favorable price and (2) creating an incentive for multiple market makers to deal in depth on a continuous basis. In other words, in the national market system, investors should be able to obtain the best execution of their orders and be assured that because of open competition among market makers the total market for each security is as liquid and orderly as the characteristics of that security warrant.

To achieve the objectives of a national market system, the private sector, under the supervision of the SEC, will be called upon to develop and operate sophisticated communication and data processing facilities. But the substantial investment that these facilities will require **191 would be wasted if brokers were prevented by restrictive rules and practices from using them to search out the best price for their customers or if dealers were prevented or hindered by unnecessary or inappropriate regulatory requirements or limitations from engaging in market making activities. The Committee therefore believes that the first order or priority in creating a national market system is to *13 break down the unnecessary regulatory restrictions which now impede contact between brokers and market makers and which restrain competition among markets and market makers.

As the Subcommittee on Securities concluded in its Securities Industry Study, the ability of individual firms as well as the various exchange and over-the-counter markets to compete with one another will be a critical element in the successful functioning of the national market system. Unfortunately, because of excessive and unnecessary regulatory restraints, competition in the securities industry has not been as vigorous and as effective in advancing the public interest as it could be. The Committee concluded, however, that rather than amending the Exchange Act to eliminate particular, enumerated barriers to competition, the most effective way to foster competition would be to charge the Commission with an explicit obligation to eliminate all present and future competitive restraints that cannot be justified by the purposes of the Exchange Act. Following this pattern, various sections of S. 249 would direct the Commission to remove existing burdens on competition and to refrain from imposing, or permitting to be imposed, any new regulatory burden on competition 'not necessary or appropriate in furtherance of the purposes' of the Exchange Act.

This explicit obligation to balance, against other regulatory criteria and considerations, the competitive implications of self-regulatory and Commission action should not be viewed as requiring the Commission to justify that such actions be the least anti-competitive manner of achieving a regulatory objective. Rather, the Commission's obligation is to weigh competitive impact in reaching regulatory conclusions. The manner in which it does so is to be subjected to judicial scrutiny upon review in the same fashion as are other Commission determinations, with no less deference to the Commission's expertise than is the case in other matters subject to its jurisdiction.

Thus, Sections 6(b)(8), 19(b) and 19(c) of the Exchange Act would obligate the Commission to review existing and proposed rules of the self-regulatory organizations and to abrogate any present rule, or to disapprove any proposed rule, having the effect of a competitive restraint it finds to be neither necessary nor appropriate in furtherance of a legitimate regulatory objective. Section 19(e) would empower the Commission to review disciplinary actions of the self-regulatory organizations and to set any such action aside if it finds such action imposes an undue burden on competition. Similarly, Section 19(f) would authorize the Commission to review quasi-adjudicatory actions of such organizations and would require it to set aside any such action which the Commission finds imposes a burden on competition determined by the Commission to be neither necessary nor appropriate in furtherance of the purposes of the Exchange Act. Further, Section 23(a) would require the Commission to evaluate its own regulatory **192 proposals in light of the fundamental national economic policy of furthering competition and would prohibit it from promulgating any rule which the Commission determines will impose a burden on competition not necessary or appropriate to achieve the purposes of the Exchange Act. Under all of these Sections, the Commission's responsibility would be to balance the perceived anti-competitive effects of the regulatory policy or decision at issue against the purposes *14 of the Exchange Act that would be advanced thereby and the costs of doing so. Competition would not thereby become paramount

to the great purposes of the Exchange Act, but the need for and effectiveness of regulatory actions in achieving those purposes would have to be weighed against any detrimental impact on competition.

S. 249 is designed to force the Commission to focus with particularity on the competitive implications of each regulatory requirement. For example, in promulgating its own rules under Section 23(a) and in reviewing proposed self-regulatory rules under Section 19(c), the Commission would be required to make specific findings as to the justification for any limitation on, or restraint of, competition that would be involved. On review, such findings, to the extent they are based upon evidentiary facts, would be subject to a searching and careful inquiry by the Court of Appeals to determine whether they are supported by substantial evidence.

Section 11 of S. 249 would eliminate present Section 15A(n) of the Exchange Act. This Section, while not expressly referring to the anti-trust laws, includes such laws in providing that, in the event of conflict of any other law with any provision of the Exchange Act relating to registered securities associations, the latter shall prevail. In light of the anomalous absence of a similar provision with respect to national securities exchanges and the prevailing case law interpreting the Section (e.g., Harwell v. Growth Programs) the Committee decided to delete the provision as superfluous and unnecessary.

The deletion of Section 15A(n) is not intended to change existing law with respect to the relationship between antitrust and securities laws-- nor is any other provision of S. 249 intended to change that relationship.

D. REGULATION OF MARKET MAKERS

A healthy, highly competitive system of market makers is essential to an efficient national market system. Investigations by the Committee have adequately demonstrated that in our increasingly complex and institutional markets a single specialist, regardless of the regulation and exhortation to which he is subject, cannot provide adequate liquidity and continuity to the market for a security. To assure that our markets are able to serve the needs of both individual and institutional investors, the Committee believes many types of market makers are necessary and that encouragement should be given to all dealers to make simultaneous competing markets within the new national system.

One of the fundamental purposes underlying the national market system contemplated by S. 249 is to enhance the competitive structure of the securities markets in order to foster the risk-taking function of market makers and thereby to provide free market incentives to **193 active participation in the flow of orders. The competitive structure and incentives to participation thus provided should supplement, and ultimately may be able to replace, most affirmative requirements to deal imposed by regulation.

It can be expected that competition will not obviate the need for all regulation of market makers, however. Despite the finding of the SEC's Institutional Investor Study that 'all types of market makers (in listed securities, i.e., NYSE specialists, block positioning firms, regional exchange specialists and third market makers) normally *15 tend to behave in a stabilizing manner and thus reduce the size of the price fluctuations that would otherwise occur,' the Committee found that regulatory authority may be needed to back up the competitive pressure to make tight and continuous markets.

In this regard, Section 11(b) of the Exchange Act already vests the Commission with broad power over exchange specialists. S. 249 deletes the existing negative obligation on specialist trading (i.e., the requirement that, if a specialist is permitted to act as dealer, he must limit his dealings 'so far as practicable to those reasonably necessary to permit him to maintain a fair and orderly market') and broadens the CommissionS rule making authority. Under this expanded provision the Commission may adopt rules as necessary not only for the public interest and for the protection of investors, but also for the maintenance of fair and orderly markets and the removal of impediments to and perfection of the mechanism of a national market system. The amendments to Section 11(b) also make clear that the Commission may limit the activity of a specialist to that of a broker or dealer. This grant of authority should ensure that the Commission will have the power to protect public customers from the conflicts inherent in such combination of functions or otherwise to establish effective regulation consistent with the purposes of the Exchange Act.

In addition to that authority, S. 249 supplements the Commission's powers to regulate market making by the addition of new Section 15(c)(5). This provision is intended to grant the Commission broad and flexible authority over dealers and makers by permitting the Commission to impose standards with respect to dealing as necessary or appropriate in the public interest and for the protection of investors, to maintain fair and orderly markets or to remove impediments to and perfect the mechanism of a national market system. The Commission is also empowered to prohibit a dealer from acting as a broker in the same security.

The SEC has generally chosen to rely on the exchanges for the formulation and enforcement of specialist regulations, and under the bill the SEC would have the same flexibility with respect to the regulation of other market makers-- for example, by delegating to the NASD primary regulatory responsibility for non-exchange market makers. With respect to all market makers, however, the SEC would continue to have direct authority and could regulate their activities without any intermediation of the self-regulatory organizations.

Regulation of market makers, including specialists, and other dealers pursuant to Section 11(b) and Section 15(c)(5) must be carried out with a view to Sections 11A(a)(1)(C)(ii) and 11A(c)(1)(F), **194 which establish fair competition among such persons as a goal of the Exchange Act and empower the Commission to assure 'equal regulation' of all dealers effecting transactions in qualified securities.

The subject of equal regulation has been a matter of considerable controversy within the securities industry. In the Committee's view equal regulation is appropriate only if the phrase is understood to mean that persons enjoying similar privileges, performing similar functions, and having the potential for similar market impact are treated equally. For example, the purpose of integrating all market makers into a single system is not to make them all do business in *16 the same way, but rather to enable public investors to take full advantage of the distinctive contributions that each group can make. The slogan 'equal regulation,' therefore, is not a meaningful guide to regulatory action unless similarly situated in terms of the purpose of the regulation are first identified.

Accordingly, the term 'equal regulation' must be read in the context of its definition in Section 3(a)(36). A class of persons is subject to equal regulation if no member of the class has an 'unfair competitive advantage' over another member thereof resulting from a disparity in regulation not justified by any of the purposes of the Exchange Act. This definition, when combined with the Commission will is power to classify in Section 23(a)(1), as amended, is intended to insure that the Commission regulate comparably those market makers and specialists enjoying the same opportunities, having the same market power, and subject to the same conflicts of interest.

If it should appear to the Commission that any disparity in regulation which permits an unfair competitive advantage is not justified by any of the purposes of the Act the Commission, in the exercise of its discretion, is authorized to modify such regulation. It should be noted, however, that this section is not intended to create a new standard for any right of action by any person to challenge the Commission's determination to exercise, or not to exercise, its authority under this provision; rather, it is intended to provide a guide for Commission action.

E. AUCTION TRADING PRINCIPLES

The Committee found that public investors could enjoy two important benefits when trading in an ideal auction-type market for securities as opposed to a purely dealer market: (1) Their limited price orders would have to be satisfied before any transaction could be effected at the same price, by a specialist or other market maker for his dealer account, or by the customer's broker for the latter's proprietary account, or by any participant in that market at a price less favorable to the other party; and (2) Their market orders could be executed against another public limit or market order at a better price than that currently being quoted by any dealer for his own account.

The Committee recognizes that many securities do not have the characteristics-- e.g., trading volume, price, and number of stockholders-- which would justify auction-type trading. Within a national market system, securities should trade in the manner

most appropriate to their characteristics, consistent with the public interest. However, with respect to securities which are suitable for auction trading, the **195 Committee believes that every effort should be made to design the national market system in such a way that public investors in these securities receive the benefits and protections associated with auction-type trading.

The investor benefits of auction trading would result from the placing of public orders ahead of dealers' orders in determining the sequence in which the orders entering the market are executed. Currently, for example, if a stock exchange member holds a customer's market or executable limited price order he may not initiate a transaction for his own account on the same side of the market until his customer's order has been executed. In other words, a member is required *17 to yield priority to his customers' orders. Similarly, a member trading on the floor of an exchange is not entitled to parity with or precedence over orders originating off the floor of an exchange. The effect of this latter requirement is to guarantee that public orders (or members' orders originated from off-the-floor), placed with a specialist are executed ahead of the specialist's own bid (or offer) at that price as well as ahead of the bid (or offer) of any other member trading on the floor.

These sequencing requirements protect public investors against prearranged trades that do not secure the best execution available and against the payment of a spread to a dealer. However, because the market for most listed securities is fragmented, i.e., conducted on several exchanges as well as in the third market, the value of this protection is considerably less than it might appear. For example, a limited price order is presently 'protected' as to price priority on the exchange on which it is held but it is not protected in any way respect to trading on another exchange or in the third market. As a consequence, a limit order for a listed security held in only one of several markets for that security need not be executed before a transaction is effected at the same price or at a price less favorable to the other party in another market. In the Committee's view this is the basic problem caused by the fragmentation of the securities markets; the lack of a mechanism by which all buying and selling interested in a given security can be centralized and thus assure public investors best execution. Until such centralization is accomplished, the protections and benefits of the auction market will remain limited.

As envisaged in S. 249, the national market system has as a fundamental goal the elimination of fragmented markets for securities suitable for auction trading. The implementation of a composite transaction tape and a composite quotation system will do much to achieve this result, and Section 11A(c)(1) will foster the development of these facilities. However, a composite tape and composite quotation system will not by themselves provide appropriate protection for limit orders held in one market against transactions completed in other markets at prices somewhat above or below the prevailing market price. Nor will such facilities guarantee that orders of public investors receive priority over orders of specialists, floor traders, or market makers and other dealers regardless of the market in which they are entered. Therefore, the Committee believes that to eliminate market fragmentation and thus to achieve a true national market system, a set of trading rules and procedures must be adopted which will tie the individual market centers together.

**196 In its Policy Statement on the Structure of a Central Market System, the SEC proposed that all trading in the national market system for listed securities be subject to two basic rules. First, public limit orders, wherever entered or held in the system, must be satisfied before any transaction in the same security is effected anywhere at a less favorable price to the other party. Thus, any public order in the system would be 'protected' against a transaction being effected at an inferior price without prior satisfaction of that order. Second, public orders would have price priority over the bids or offers of specialists and other market makers. This would mean that a dealer operating in the system could not trade for his own account unless he *18 is willing to buy at a higher price or sell at a lower price than any available public bid or offer. According to the Commission:

. . . adoption of these (two) rules would take the best features of the auction-agency market that exchanges now provide and expand them into principles to govern the functioning of the entire central market system (for securities with suitable trading characteristics).

The Committee is satisfied that S. 249 grants the Commission complete and effective authority to implement a system for the satisfaction of public limit orders. The bill would give the SEC broad authority to prescribe rules requiring all broker-dealers trading for their own account in such securities to yield in the execution of their transactions to public orders. Sections 11(a)(2)

and 11(b) would provide the SEC with this authority over members of exchanges. Section 15(c)(5) would provide the SEC with this authority with respect to other dealers. The SEC would also be given similar regulatory control over transactions effected by persons with access to exchange markets on terms comparable to those enjoyed by members. (Section 6(f).

In order to assure priority for public orders, a mechanism must be established by which specialists and other market makers can be made aware of all such orders within the national market system. The bill would not mandate the form of such a mechanism nor would it prescribe the precise terms of any rules with respect to auction-type protections. The Commission would be free to provide appropriate exemptions or to adopt an entirely different approach to the achievement of auction-type protections than the approach outlined in the Commission's Policy Statement. The bill would, however, remove all questions concerning the SEC's authority over trading practices and market integration and establish a clear Congressional policy supporting the preservation and extension of the protections associated with auction-type trading for appropriate securities under appropriate circumstances.

F. TRADING OF UNLISTED SECURITIES

Originally, securities markets commenced trading in particular securities when it was in the economic self-interest of the participants to do so. The exchanges began their operations in this way, and the over-the-counter ('OTC ') market continues to operate in this manner: trading a security when there is adequate investor and dealer interest, without concern for the actions or wishes of the issuer. At the present **197 time, nearly all stocks traded on the NYSE and Amex are 'listed' there, i.e., the issuer has executed a contractual agreement with the exchange in accordance with which the issuer assumes certain duties, and the exchange undertakes to provide a fair and orderly market for the securities. The regional stock exchanges also trade 'listed' securities, but by and large they continue to be markets for securities which are not listed on those exchanges.

Since the passage of the Exchange Act, the SEC has encouraged the development of competitive markets for securities listed on the NYSE. In large part, this has been done by facilitating the trading of these securities on the regional exchanges pursuant to what is called 'unlisted trading privileges.' Under applicable law, if a security is listed *19 on one exchange, any other exchange may initiate trading in that security merely by obtaining the SEC's permission, which has generally been granted as a matter of course. The issuer's consent is not required before the SEC may extend such trading privileges to another exchange, although the issuer is entitled to petition the SEC for termination of such privileges.

Prior to 1964, an exchange was permitted, subject to prior SEC approval, to commence trading in a security not listed on any exchange. However, because of the disparity in disclosure requirements applicable to listed and unlisted securities, the SEC only rarely permitted an exchange to trade securities not listed anywhere. When the Exchange Act was amended in 1964, the entire procedure for exchange trading of unlisted securities was dropped.

However, the 1964 amendments also provided for the extension of the basic periodic reporting and disclosure requirements of the Exchange Act to virtually all publicly traded companies. As a result, there has been increased competition between the primary exchanges, on the one hand, and the OTC market, on the other, to encourage or dissuade, as the case may be, issuers from listing. Subsequent to 1964, a substantial number of large companies which had previously remained in the OTC market primarily to avoid the disclosure requirements of the Exchange listed their securities on one or more exchanges. At the same time, the improvement in the OTC market as a result of the introduction of the NASDAQ automated quotation system has been used successfully by the NASD to persuade a number of issuers whose securities are eligible for listing to remain in the OTC market.

The Committee believes that in the context of a national market system, there is little or no justification for an issuer to deprive securities holders of the advantages of exchange trading. The protections inherent in exchange-type trading should be afforded to investors in all securities with suitable characteristics and should not be dependent upon the decision of corporate management to 'list.'

S. 249 would extend auction-type protections to unlisted securities by permitting exchanges, subject to SEC approval, to commence trading in any unlisted security. Under Sections 12(f)(1) and (2), no exchange would be required to trade securities on this basis, and in choosing to trade unlisted securities, exchanges would be free to set higher criteria for these securities than they do for securities which are formally 'listed.' However, these provisions would preclude corporate management from initially controlling or limiting an exchange's attempt to trade its securities. Management, of course, would retain the **198 right under present Section 12(f)(4) to petition the SEC to suspend unlisted trading privileges if the SEC finds this 'necessary or appropriate in the public interest or for the protection of investors.'

Before any exchange would be permitted to commence trading in an unlisted security, the SEC would be required under Section 12(f)(2) to weigh carefully the potential impact of such trading on the existing OTC market for the security. At present, when an OTC stock is admitted to trading on an exchange, existing patterns of dealing are disrupted because of the restrictions against exchange member brokers effecting transactions off an exchange with non-members in listed securities traded on the exchange and because of the restrictions against member dealers who have made or would make competitive markets in such security, effecting transactions off an exchange with *20 members or non-members. No extension of unlisted trading privileges should be permitted if it would have a similar impact. The Committee views unlisted trading as appropriate to a national market system in which all market makers and brokers are permitted to deal freely with one another without unnecessary regulatory constraints, such as the NYSE's Rule 394(b). Until substantial progress has been made toward the development of such a national market system, the ability of an exchange to commence unlisted trading in an OTC security might well decrease rather than increase competition. This result would be directly contrary to the Committee's intention, and therefore Section 12(f)(2) directs the SEC to consider carefully the progress that has been made toward the development of a national market system.

The Committee believes the approach to unlisted trading in S. 249 would be an important step toward a national market system in which investors obtain the benefits and protections of both the 'auction' and 'dealer' systems to the extent each is appropriate under the circumstances to any particular security.

G. THIRD MARKET TRADING

The securities markets in this country are undergoing rapid and fundamental changes. In recognition of this phenomenon, the bill articulates the goals of the national market system and the scope of SEC authority over that system in broad general terms. The Committee's intent has been to assure that the SEC will have sufficient regulatory flexibility to provide effective investor protection in circumstance which may not now be anticipated.

The NYSE and other industry groups, however, have expressed concern that certain proposed changes in the markets will have serious adverse consequences with which the SEC may not be prepared to deal. Accordingly, they have proposed that the bill require that all trading in listed securities must take place on national securities exchanges after fixed commission rates have been eliminated. The principal argument offered in support of this proposal was that the advent of competitive commission rates will eliminate the most important incentive to exchange membership. They contend that as firms drop their memberships, the strength of the exchange markets will be sapped, and there will be a fundamental shift away from auction-type markets with their alleged greater investor protections toward dealer-oriented markets. The way to prevent this result, so the argument was made, **199 is to prohibit anyone from trading in listed securities otherwise than on a stock exchange, i.e., to eliminate trading in the third market.

The Committee has carefully evaluated all arguments that have been presented in support of abolishing the third market and found them unpersuasive. The advent of competitive commission rates will unquestionably result in altered economic and regulatory conditions in the securities industry. It appears to the Committee, however, that on balance the changes will be beneficial and will contribute to a stronger industry and more efficient markets. Furthermore, the Committee found that the dealers operating in the third market provide valuable competition to the specialists operating on the exchanges and that this competition enhances the total market making capacity for listed securities. Therefore, the Committee believes it would be

unsound to prohibit third market trading under any circumstances unless the present *21 competition between third market dealers and specialists could be preserved within the context of an exchange market.

These views are shared by the SEC, the Department of the Treasury, and the Department of Justice. However, the Committee realizes that it is impossible for anyone to predict with absolute certainty and the results of instituting competitive commission rates in the securities industry. As the SEC stated to the Committee, ' . . . the NYSE's serious reservations about the implications of these changes (makes it) obvious that reasonable men can differ concerning such predictions.'

In light of the possibility that the fears expressed by the NYSE and others may be realized, the Committee believes that the SEC should be vested with flexible and effective power to deal with any serious disruptions in the operation of the markets for listed securities caused by trading in the third market. Section 11A(c)(3) embodies this proposition and would serve two purposes: First, it would direct the SEC to take all steps within its existing powers and those provided by the bill to correct any adverse affect on the fairness or orderliness of the markets for listed securities caused by third market trading. Second, the provision would authorize the SEC, after making carefully prescribed factual findings, to confine trading in listed securities to national securities exchanges.

The SEC would not be able to take any action under Section 11A(c)(3) until it had held a hearing and provided an opportunity for interested persons to make oral presentations. During the course of such a hearing and in its rulemaking under the section generally, the SEC would have complete discretion as to how much consideration it will give to conditions arising after the elimination of fixed commission rates. However, by virtue of Section 11A(c)(3)(C), the SEC could not, under any circumstances, adopt a rule abolishing third market trading until public commission rates had become fully competitive. In other words, before exercising its authority to confine listed trading to the exchanges, the SEC would be required to have had at least the opportunity to consider the actual impact of competitive rates on the operations of the markets for such securities.

Before promulgating any rule pursuant to Section 11A(c)(3), the SEC would be required to make two basic findings. Section 11A(c)(3)(A) would require the SEC to demonstrate that any such rule was necessary or appropriate to restore or maintain 'the fairness and orderliness' of the markets for listed securities. Section 23(a) would **200 require the SEC to articulate with particularity why any burden imposed on competition by any such rule was necessary or appropriate 'in furtherance of the purposes' of the Exchange Act.In connection with a rule which would prohibit trading in the third market, section 11A(c)(3)(A) would require the SEC to make two additional findings. First, the SEC would be required to find that no rule of any exchange (other than an exchange rule fairly and reasonably prescribing the sequence of execution of orders or adopted pursuant to a Commission rule adopted under the Exchange Act) unreasonably impaired the ability of any dealer to solicit or effect transactions for his own account. And second, the SEC would be required to find that no exchange rule whatsoever unreasonably restricted competition among dealers generally or between any class of dealers and registered specialists. The SEC's findings on all of these matters, as in all rule-making under the bill, would be subject to direct review in the Court *22 of Appeals and the factual foundations for the findings would be required to be supported by substantial evidence.

The establishment of a national market system should end all concern over the possibly inimical consequences of the third market to the fairness and orderliness of the markets for listed securities. Once trading in listed securities is centralized and subject to uniform trading principles, the distinction between trading on an exchange and trading off an exchange will lose much of its significance. Section 11A(c)(3)(C), therefore, provides that any rule banning trading in the third market would automatically lapse upon a determination by the SEC that a national market system had been achieved. In order to insure that this determination is not unduly delayed and to create an incentive for the rapid achievement of such a system, section 11A(c)(3)(C) further provides that any such rule must lapse no later than April 30, 1978, regardless of whether a national market system has been established. If the SEC promulgates a rule before April 30, 1978, it may extend it beyond that date for one year periods upon publishing its reasons for so doing and notifying the Congress not less than 60 days before the extension becomes effective.

II. SELF-REGULATION AND SEC OVERSIGHT

116TH CONGRESS
1ST SESSION

S. 597

To amend the Controlled Substances Act to provide for a new rule regarding the application of the Act to marihuana, and for other purposes.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 28, 2019

Mr. BOOKER (for himself, Mr. WYDEN, Mr. MERKLEY, Ms. WARREN, Ms. HARRIS, Mrs. GILLIBRAND, Mr. SANDERS, and Mr. BENNET) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To amend the Controlled Substances Act to provide for a new rule regarding the application of the Act to marihuana, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Marijuana Justice Act of 2019".

SEC. 2. DE-SCHEDULING MARIHUANA.

(a) MARIHUANA REMOVED FROM SCHEDULE OF CONTROLLED SUBSTANCES.—Subsection (c) of schedule

I of section 202(c) of the Controlled Substances Act (21 U.S.C. 812) is amended—

(1) by striking "marihuana"; and

(2) by striking "tetrahydrocannabinols".

(b) REMOVAL OF PROHIBITION ON IMPORT AND EXPORT.—Section 1010(b) of the Controlled Substances Import and Export Act (21 U.S.C. 960) is amended—

(1) in paragraph (1)—

(A) in subparagraph (F), by inserting "or" after the semicolon;

(B) by striking subparagraph (G); and

(C) by redesignating subparagraph (H) as subparagraph (G);

(2) in paragraph (2)—

(A) in subparagraph (F), by inserting "or" after the semicolon;

(B) by striking subparagraph (G); and

(C) by redesignating subparagraph (H) as subparagraph (G);

(3) in paragraph (3), by striking "paragraphs (1), (2), and (4)" and inserting "paragraphs (1) and (2)";

(4) by striking paragraph (4); and

(5) by redesignating paragraphs (5), (6), and (7) as paragraphs (4), (5), and (6), respectively.

(c) CONFORMING AMENDMENTS TO CONTROLLED SUBSTANCES ACT.—The Controlled Substances Act (21 U.S.C. 801 et seq.) is amended—

(1) in section 102(44) (21 U.S.C. 802(44)), by striking "marihuana,";

(2) in section 401(b) (21 U.S.C. 841(b))—

(A) in paragraph (1)—

(i) in subparagraph (A)—

(I) in clause (vi), by inserting "or" after the semicolon;

(II) by striking (vii); and

(III) by redesignating clause (viii) as clause (vii);

(ii) in subparagraph (B)—

(I) by striking clause (vii); and

(II) by redesignating clause (viii) as clause (vii);

(iii) in subparagraph (C), in the first sentence, by striking "subparagraphs (A), (B), and (D)" and inserting "subparagraphs (A) and (B)";

(iv) by striking subparagraph (D);

(v) by redesignating subparagraph (E) as subparagraph (D); and

(vi) in subparagraph (D)(i), as so redesignated, by striking "subparagraphs (C) and (D)" and inserting "subparagraph (C)";

(B) by striking paragraph (4); and

(C) by redesignating paragraphs (5), (6), and (7) as paragraphs (4), (5), and (6), respectively;

(3) in section 402(c)(2)(B) (21 U.S.C. 842(c)(2)(B)), by striking ", marihuana,";

(4) in section 403(d)(1) (21 U.S.C. 843(d)(1)), by striking ", marihuana,";

(5) in section 418(a) (21 U.S.C. 859(a)), by striking the last sentence;

(6) in section 419(a) (21 U.S.C. 860(a)), by striking the last sentence;

(7) in section 422(d) (21 U.S.C. 863(d))—

(A) in the matter preceding paragraph (1), by striking "marijuana,"; and

(B) in paragraph (5), by striking ", such as a marihuana cigarette,"; and

(8) in section 516(d) (21 U.S.C. 886(d)), by striking "section 401(b)(6)" each place the term appears and inserting "section 401(b)(5)".

(d) OTHER CONFORMING AMENDMENTS.—

(1) NATIONAL FOREST SYSTEM DRUG CONTROL ACT OF 1986.—The National Forest System Drug Control Act of 1986 (16 U.S.C. 559b et seq.) is amended—

(A) in section 15002(a) (16 U.S.C. 559b(a)) by striking "marijuana and other";

(B) in section 15003(2) (16 U.S.C. 559c(2)) by striking "marijuana and other"; and

(C) in section 15004(2) (16 U.S.C. 559d(2)) by striking "marijuana and other".

(2) INTERCEPTION OF COMMUNICATIONS.—Section 2516 of title 18, United States Code, is amended—

(A) in subsection (1)(e), by striking "marihuana,"; and

(B) in subsection (2) by striking "marihuana,".

SEC. 3. INELIGIBILITY FOR CERTAIN FUNDS.

(a) DEFINITIONS.—In this section—

(1) the term "covered State" means a State that has not enacted a statute legalizing marijuana in the State;

(2) the term "disproportionate arrest rate" means—

(A) the percentage of minority individuals arrested for a marijuana related offense in a State is higher than the percentage of the non-minority individual population of the State, as determined by the most recent census data; or

(B) the percentage of low-income individuals arrested for a marijuana offense in a State is higher than the percentage of the population of the State that are not low-income individuals, as determined by the most recent census data;

(3) the term "disproportionate incarceration rate" means the percentage of minority individuals incarcerated for a marijuana related offense in a State is higher than the percentage of the non-minority individual population of the State, as determined by the most recent census data;

(4) the term "low-income individual" means and individual whose taxable income (as defined in section 63 of the Internal Revenue Code of 1986) is equal to or below the maximum dollar amount for the 15 percent rate bracket applicable to the individual under section 1 of the Internal Revenue Code of 1986;

(5) the term "marijuana" has the meaning given the term "marihuana" in section 102 of the Controlled Substances Act (21 U.S.C. 802); and

(6) the term "minority individual" means an individual who is a member of a racial or ethnic minority group.

(b) INELIGIBILITY FOR CERTAIN FUNDS.—

(1) IN GENERAL.—For any fiscal year beginning after the date of enactment of this Act in which the Attorney General, acting through the Director of the Bureau of Justice Assistance, determines that a covered State has a disproportionate arrest rate or a disproportionate incarceration rate for marijuana offenses, the covered State—

(A) shall not be eligible to receive any Federal funds for the construction or staffing of a prison or jail; and

(B) shall be subject to not more than a 10-percent reduction of the funds that would otherwise be allocated for that fiscal year to the covered State under subpart 1 of part E of title I of the Omnibus Crime Control and Safe Streets Act of 1968 (34 U.S.C. 10151 et seq.), whether characterized as the Edward Byrne Memorial State and Local Law Enforcement

Assistance Programs, the Local Government Law Enforcement Block Grants Program, the Edward Byrne Memorial Justice Assistance Grant Program, or otherwise.

(2) FUNDS FOR CERTAIN PROGRAMMING.—For purposes of paragraph (1)(A), Federal funds for the construction or staffing of a prison or jail shall not include Federal funds used by a prison or jail to carry out recidivism reduction programming or drug addiction treatment.

(3) REALLOCATION.—Any amounts not awarded to a covered State because of a determination under paragraph (1) shall be deposited in the Community Reinvestment Fund established under section 4.

(c) EXPUNGEMENT OF MARIJUANA OFFENSE CONVICTIONS.—Each Federal court shall issue an order expunging each conviction for a marijuana use or possession offense entered by the court before the date of enactment of this Act.

(d) SENTENCING REVIEW.—

(1) IN GENERAL.—For any individual who was sentenced to a term of imprisonment for a Federal criminal offense involving marijuana before the date of enactment of this Act and is still serving such

term of imprisonment, the court that imposed the sentence, shall, on motion of the individual, the Director of the Bureau of Prisons, the attorney for the Government, or the court, conduct a sentencing hearing.

(2) POTENTIAL REDUCED RESENTENCING.—After a sentencing hearing under paragraph (1), a court may impose a sentence on the individual as if this Act, and the amendments made by this Act, were in effect at the time the offense was committed.

(e) RIGHT OF ACTION.—

(1) IN GENERAL.—An individual who is aggrieved by a disproportionate arrest rate or a disproportionate incarceration rate of a State may bring a civil action in an appropriate district court of the United States.

(2) RELIEF.—In a civil action brought under this subsection in which the plaintiff prevails, the court shall—

(A) grant all necessary equitable and legal relief, including declaratory relief; and

(B) issue an order requiring the Attorney General, acting through the Director of the Bureau of Justice Assistance, to—

(i) declare the State to be ineligible to receive any Federal funds for the construction or staffing of a prison or jail in accordance with subsection (b)(1)(A); and

(ii) reduce grant funding of the State in accordance with subsection (b)(1)(B).

SEC. 4. COMMUNITY REINVESTMENT FUND.

(a) ESTABLISHMENT.—There is established in the Treasury of the United States a fund, to be known as the "Community Reinvestment Fund" (referred to in this section as the "Fund").

(b) DEPOSITS.—The Fund shall consist of—

(1) any amounts not awarded to a covered State because of a determination under section 3(b)(1); and

(2) any amounts otherwise appropriated to the Fund.

(c) USE OF FUND AMOUNTS.—Amounts in the Fund shall be available to the Secretary of Housing and Urban Development to establish a grant program to reinvest in communities most affected by the war on drugs, which shall include providing grants to impacted communities for programs such as—

(1) job training;

(2) reentry services;

(3) expenses related to the expungement of convictions;

(4) public libraries;

(5) community centers;

(6) programs and opportunities dedicated to youth;

(7) the special purpose fund discussed below; and

(8) health education programs.

(d) AVAILABILITY OF FUND AMOUNTS.—Amounts in the Fund shall be available without fiscal year limitation.

(e) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated to the Fund $500,000,000 for each of fiscal years 2020 through 2042.

O

116TH CONGRESS
1ST SESSION

S. 1028

To amend the Controlled Substances Act to provide for a new rule regarding the application of the Act to marihuana, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 4, 2019

Ms. WARREN (for herself, Mr. GARDNER, Mr. BENNET, Ms. CORTEZ MASTO, Mr. CRAMER, Ms. KLOBUCHAR, Ms. MURKOWSKI, Mr. PAUL, Mr. SULLIVAN, and Mr. WYDEN) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

---

A BILL

To amend the Controlled Substances Act to provide for a new rule regarding the application of the Act to marihuana, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Strengthening the Tenth Amendment Through Entrusting States Act" or the "STATES Act".

SEC. 2. RULE REGARDING APPLICATION TO MARIHUANA.

Part G of the Controlled Substances Act (21 U.S.C. 801 et seq.) is amended by adding at the end the following:

"RULE REGARDING APPLICATION TO MARIHUANA

"SEC. 710. (a) Notwithstanding any other provision of law, the provisions of this title as applied to marihuana, other than the provisions described in subsection (c) and other than as provided in subsection (d), shall not apply to any person acting in compliance with State law relating to the manufacture, production, possession, distribution, dispensation, administration, or delivery of marihuana.

"(b) Notwithstanding any other provision of law, the provisions of this title related to marihuana, other than the provisions described in subsection (c) and other than as provided in subsection (d), shall not apply to any person acting in compliance with the law of a Federally recognized Indian tribe within its jurisdiction in Indian Country, as defined in section 1151 of title 18, United States Code, related to the manufacture, production, possession, distribution, dispensation, administration, or delivery of marihuana so long as such jurisdiction is located within a State that permits, respectively, manufacture, production, possession, distribution, dispensation, administration, or delivery of marihuana.

"(c) The provisions described in this subsection are—

"(1) section 401(a)(1), with respect to a violation of section 409 or 418;

"(2) section 409;

"(3) section 417; and

"(4) section 418.

"(d) Subsection (a) shall not apply to any person who—

"(1) violates the Controlled Substances Act with respect to any other controlled substance;

"(2) notwithstanding compliance with State or tribal law, knowingly or intentionally manufactures, produces, possesses, distributes, dispenses, administers, or delivers any other marihuana in violation of the laws of the State or tribe in which such manufacture, production, possession, distribution, dispensation, administration, or delivery occurs; or

"(3) employs or hires any person under 18 years of age to manufacture, produce, distribute, dispense, administer, or deliver marihuana.".

SEC. 3. TRANSPORTATION SAFETY OFFENSES.

Section 409 of the Controlled Substances Act (21 U.S.C. 849) is amended—

(1) in subsection (b), in the matter preceding paragraph (1)—

(A) by striking "A person" and inserting "Except as provided in subsection (d), a person"; and

(B) by striking "subsection (b)" and inserting "subsection (c)";

(2) in subsection (c), in the matter preceding paragraph (1)—

(A) by striking "A person" and inserting "Except as provided in subsection (d), a person"; and

(B) by striking "subsection (a)" and inserting "subsection (b)"; and

(3) by adding at the end the following:

"(d) EXCEPTION.—Subsections (b) and (c) shall not apply to any person who possesses, or possesses with intent to distribute marihuana in compliance with section 710.".

SEC. 4. DISTRIBUTION TO PERSONS UNDER AGE 21.

Section 418 of the Controlled Substances Act (21 U.S.C. 859) is amended—

(1) in subsection (a), in the first sentence, by inserting "and subsection (c) of this section" after "section 419";

(2) in subsection (b), in the first sentence, by inserting "and subsection (c) of this section" after "section 419"; and

(3) by adding at the end the following:

"(c) Subsections (a) and (b) shall not apply to any person at least 18 years of age who distributes medicinal marihuana to a person under 21 years of age in compliance with section 710.".

SEC. 5. COMPTROLLER GENERAL STUDY ON EFFECTS OF MARIHUANA LEGALIZATION ON TRAFFIC SAFETY.

(a) IN GENERAL.—The Comptroller General of the United States shall conduct a study on the effects of marihuana legalization on traffic safety.

(b) INCLUSIONS.—The study conducted under subsection (a) shall include a detailed assessment of—

(1) traffic crashes, fatalities, and injuries in States that have legalized marihuana use, including whether States are able to accurately evaluate marihuana impairment in those incidents;

(2) actions taken by the States referred to in paragraph (1) to address marihuana-impaired driving, including any challenges faced in addressing marihuana-impaired driving;

(3) testing standards used by the States referred to in paragraph (1) to evaluate marihuana impairment in traffic crashes, fatalities, and injuries, including any scientific methods used to determine impairment and analyze data; and

(4) Federal initiatives aiming to assist States that have legalized marihuana with traffic safety, including recommendations for policies and programs to be carried out by the National Highway Traffic Safety Administration.

(c) REPORT.—Not later than 1 year after the date of enactment of this Act, the Comptroller General of the United States shall submit to the appropriate committees of Congress a report on the results of the study conducted under subsection (a).

SEC. 6. RULE OF CONSTRUCTION.

(a) IN GENERAL.—Conduct in compliance with this Act and the amendments made by this Act—

(1) shall not be unlawful;

(2) shall not constitute trafficking in a controlled substance under section 401 of the Controlled Substances Act (21 U.S.C. 841) or any other provision of law; and

(3) shall not constitute the basis for forfeiture of property under section 511 of the Controlled Sub-

stances Act (21 U.S.C. 881) or section 981 of title 18, United States Code.

(b) PROCEEDS.—The proceeds from any transaction in compliance with this Act and the amendments made by this Act shall not be deemed to be the proceeds of an unlawful transaction under section 1956 or 1957 of title 18, United States Code, or any other provision of law.

O

Section 1 The Listing Process

101.00 Introduction

101.00 Introduction

A listing on the New York Stock Exchange is internationally recognized as signifying that a publicly owned corporation has achieved maturity and front-rank status in its industry—in terms of assets, earnings, and shareholder interest and acceptance. Indeed, the Exchange's listing standards are designed to assure that every domestic or non-U.S. company whose shares are admitted to trading in the Exchange's market merit that recognition.

The Exchange welcomes inquiries from corporate officials who wish to explore the advantages of listing with Exchange representatives. Discussions can be held at company headquarters, at the Exchange or over the telephone.

Prospective applicants for listing are invited to take advantage of the Exchange's free confidential review process to learn whether or not the company is eligible for listing and what additional conditions, if any, might first have to be satisfied. A company requesting such a review incurs no obligation whatever.

A company that has qualified for listing can normally expect its shares to be admitted to trading within four to six weeks after filing its original listing application. (See Section 7 of this Manual for details concerning listing applications.)

The Exchange has broad discretion regarding the listing of a company. The Exchange is committed to list only those companies that are suited for auction market trading and that have attained the status of being eligible for trading on the Exchange. Thus, the Exchange may deny listing or apply additional or more stringent criteria based on any event, condition, or circumstance that makes the listing of the company inadvisable or unwarranted in the opinion of the Exchange. Such determination can be made even if the company meets the standards set forth below.

104.00 Confidential Review of Eligibility

104.00 Confidential Review of Eligibility

The Exchange will undertake a free confidential review of the eligibility for listing of any company that requests such a review and provides the documents listed in Section 104.01 (for domestic companies) or Section 104.02 (for non-U.S. companies). A company may submit an original listing application only after it has been cleared to do so by the Exchange after completion of a free confidential eligibility review. (See Section 702.00 for a description of the original listing application process for an issuer which does not at the time of application have any other class of securities listed on the Exchange.)

Amended: August 15, 2013 (NYSE-2013-33).

104.01 Domestic Companies

The following is a general outline of the information needed for the purpose of conducting a confidential eligibility review:

1. Copy of the charter and by-laws.
2. Specimens of bonds or stock certificates, if any.
3. The annual reports to shareholders for the last five years. (Two copies of the latest year.)
4. The latest available prospectus covering an offering under the Securities Act of 1933 (where available) and latest Form 10-K filed with the SEC.
5. The proxy statement for the most recent annual meeting.
6. Supplementary data to assist the Exchange in determining the character of the share distribution and the number of publicly-held shares.
   (a) Identification of 10 largest holders of record, including beneficial owners (if known) of holdings of record nominees.
   (b) List of holdings of 1,000 shares or more in the names of Exchange member organizations.
   (c) NASDAQ or other registered securities exchanges' volume and price range during each of the last two years.
   (d) Summary, by principal groups, of stock owned or controlled by:
      (1) Directors or officers and their immediate families.
      (2) Other concentrated holdings of 10 % or more.
   (e) Shares held under investment letters (Securities Act of 1933) and not reported elsewhere under Item 5(d).
   (f) Estimate of number of non-officer employees owning stock and the total shares held.
   (g) Company shares held in profit-sharing, savings, pension, or other similar funds or trusts established for benefit of officers, employees, etc. Indicate basis on which employees' participation is allocated or vested circumstances under which employees may receive company shares, and provision for 'pass through' of voting rights to employees or other methods of voting shares.

The form of listing application and information regarding supporting documents required in connection with the listing of domestic companies are available on the Exchange's website or from the Exchange upon request.

Amended: August 15, 2013 (NYSE-2013-33).

104.02 Non-U.S. Companies

The following is a general outline of the information needed for the purpose of conducting a confidential eligibility review:

1. Copy of the charter and by-laws or equivalent constitutional documents (translated into English).
2. Specimens of certificates traded or to be traded in the U.S. market, if any. Also, a copy of any depository agreement, if applicable.

3. The annual reports to shareholders for the last five years. (Two copies of the latest year.) If no English version is available, provide translation for last three years' reports.

4. The latest available prospectus covering an offering under the Securities Act of 1933 and latest annual SEC filing, if any. Where no SEC documents are available, provide a copy of the most recent document utilized in connection with an offering of securities to the public or existing shareholders as well as any filings made with any regulatory authority.

5. The proxy statement or equivalent material made available to shareholders for the most recent annual (general) meeting (translated into English).

6. Supplementary data to assist the Exchange in determining the character of the share distribution and the number of publicly-held shares. This information should be provided for both U.S. and worldwide holdings.

   (a) Names of the 10 largest holders.

   (b) Exchange member organizations holding 1,000 or more shares or other units.

   (c) A list of the stock exchanges or other markets upon which the company's securities are currently traded as well as the price range and volume of those securities over the past five years.

   (d) Stock owned or known to be controlled by:

      (1) Directors, officers and their immediate families.

      (2) Other holdings of 10% or more.

   (e) Any type of restriction (and the details thereof) relating to shares of the company.

   (f) Estimate of non-officer employee ownership.

   (g) Company shares held in profit sharing, savings, pension, or similar plans for benefit of the company's employees.

7. If the company has any partially-owned subsidiaries, detail ownership (public or private) of the remainder (as well as any director or officer ownership therein).

8. A list of the company's principal bankers and a statement of the holdings of the applicant's stock by any one of these bankers which is in excess of 5%.

9. The identity of any regulatory agency which regulates the company or any portion of its operations. Describe the extent and impact of such regulation on taxation, accounting, foreign exchange control, etc.

10. Identification of the company's directors and principal officers by name, title and principal occupation.

11. Total number of employees and general status of labor relations.

12. A description of pending material litigation and opinion as to potential impact upon the company as operations.

The form of listing application and information regarding supporting documents required in connection with the listing of non-U.S. companies are available on the Exchange's website or from the Exchange upon request.

Amended: August 15, 2013 (NYSE-2013-33).

702.00 Original Listing Application for Securities of an Issuer Which Does Not at the Time of Application Have any Other Securities Listed on the Exchange

702.00 Original Listing Application for Securities of an Issuer Which Does Not at the Time of Application Have any Other Securities Listed on the Exchange

If a company wishes to list a class of securities (including common equity securities) but does not at the time of application have any other class of securities listed on the Exchange, the company must first seek a free confidential review of listing eligibility as set forth in Section 104.00. If, upon completion of this free confidential review, the Exchange determines that a company is eligible for listing, the Exchange will notify that company in writing (the "clearance letter") that it has been cleared to submit an original listing application. A clearance letter is valid for nine months from its date of issuance. If a company does not list within that nine month period and wishes to list thereafter, the Exchange will perform another confidential listing eligibility review as a condition to the issuance of a new clearance letter.

After receiving a clearance letter, a company choosing to list must file an original listing application. The original listing application and other required supporting documents can be found at nyx.com. A company should submit drafts of the original listing application and other required documents as far in advance as possible of the time it seeks Exchange authorization of its application. In the case of documents which by their nature cannot be completed until close to the listing date, the Exchange will authorize an application upon the condition that a company submits the supporting documents as soon as available, but, in any event, before the listing date. Prior to the listing date, the company's securities will be allocated to a Designated Market Maker pursuant to the Exchange's Allocation Policy. The company's Exchange representative will provide a copy of the Allocation Policy to the company.

Section 902.03 hereof requires certain categories of listing applicants to pay an Initial Application Fee as a prior condition to receipt of eligibility clearance. Promptly after making a determination that a company is eligible to list but subject to payment of the Initial Application Fee, the Exchange shall inform such company in writing that it is entitled to receive a clearance letter upon payment of the applicable Initial Application Fee. Applicants that are not subject to the Initial Application Fee will not receive any similar notification, but rather will receive a clearance letter promptly after the Exchange has made an eligibility determination.

In addition to applying to the Exchange, prior to the listing date, a company must, prior to the listing date, register its securities with the SEC under the Securities Exchange Act of 1934 ("Exchange Act") (unless the securities are exempt from that registration requirement). When the Exchange approves securities for listing and receives a company's Exchange Act registration statement, it will certify such approval to the SEC. (See Section 702.01 (Registration under the Securities Exchange Act of 1934).)

Adopted: August 15, 2013 (NYSE-2013-33).

702.01 Registration under the Securities Exchange Act of 1934

Before securities may be admitted to trading on the Exchange, they must be authorized for listing by the Exchange and, in addition, must be registered under the Securities Exchange Act of 1934.

Registration under the Securities Exchange Act of 1934 requires filing with both the Exchange and the SEC of a registration statement conforming to the rules of the SEC and certification by the Exchange to the SEC that it has received what purports to be a registration statement and has approved the particular securities for listing and registration.

Registration becomes effective automatically 30 days after receipt by the SEC of the Exchange's certification, but may become effective within a shorter period, by order of the SEC, upon request made by the company to the SEC. The Exchange will concur in the company's request for acceleration.

Registration of banks is effected in a similar manner through the filing of registration statements with the appropriate Federal banking agency.

For complete information as to those procedures and requirements, reference is made to the General Rules and Regulations under the Securities Exchange Act of 1934 as issued by the SEC under Section 12(b).

Amended: August 15, 2013 (NYSE-2013-33).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65709; File No. SR-NYSE-2011-38)

November 8, 2011

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice and Order Granting Accelerated Approval to Proposed Rule Change, as Modified by Amendment No. 2, Amending Sections 102.01 and 103.01 of the Exchange's Listed Company Manual Adopting Additional Listing Requirements for Companies Applying to List After Consummation of a "Reverse Merger" With a Shell Company

I. Introduction

On July 22, 2011, New York Stock Exchange LLC ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change adopting additional listing requirements for a company that has become an Act reporting company by combining with a public shell, whether through a reverse merger, exchange offer, or otherwise (a "Reverse Merger"). The proposed rule change was published for comment in the Federal Register on August 10, 2011.[3] On September 21, 2011, the Commission extended the time period in which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether the proposed rule change should be disapproved to November 8, 2011.[4] The Commission received one comment letter on the proposal.[5] NYSE filed Amendment No. 1 to the proposed rule change on November 4, 2011,

---

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 65034 (August 4, 2011), 76 FR 49513 ("Notice").

4 See Securities Exchange Act Release No. 65368 (September 21, 2011), 76 FR 59756 (September 27, 2011).

5 See Letter to Elizabeth M. Murphy, Secretary, Commission, from James Davidson, Hermes Equity Ownership Services Limited dated August 31, 2011 ("Hermes Letter").

which was later withdrawn.[6] NYSE filed Amendment No. 2 to the proposed rule change on November 8, 2011.[7] This order approves the proposed rule change, as modified by Amendment No. 2, on an accelerated basis.

II. Description of the Original Proposal

The Exchange proposes to adopt more stringent listing requirements for companies that become public through a Reverse Merger, to address significant regulatory concerns including accounting fraud allegations that have arisen with respect to Reverse Merger companies. In its filing, the Exchange noted that the Commission has taken direct action against Reverse Merger companies. In addition, the Exchange noted that the Commission has suspended trading in, and

---

In addition, the Commission received five comment letters on a substantially similar proposal by Nasdaq. (See Securities Exchange Act Release No. 64633 (June 8, 2011), 76 FR 34781 (June 14, 2011) (SR-NASDAQ-2011-073)). The comment letters received on the Nasdaq filing are: Letter from David Feldman, Partner, Richardson and Patel LLP dated August 20, 2011 ("Feldman Letter"); Letter to Elizabeth M. Murphy, Secretary, Commission, from WestPark Capital, Inc. dated September 2, 2011 ("WestPark Letter"); Letter to Elizabeth M. Murphy, Secretary, Commission, from Locke Lord LLP dated October 17, 2011 ("Locke Lord Letter"); Letter to Elizabeth M. Murphy, Secretary, Commission, from James N. Baxter, Chairman and General Counsel, New York Global Group dated October 17, 2011 ("New York Global Group Letter"); and Letter to Elizabeth M. Murphy, Secretary, Commission, from David A. Donohoe, Jr., Donohoe Advisory Associates LLC dated October 18, 2011 ("Donohoe Letter"). One of the comment letters submitted on the Nasdaq filing specifically referenced this proposal by NYSE. However, the Commission believes all of the filings submitted on the Nasdaq filing are applicable to this filing. Since the comment letters received on the Nasdaq filing either specifically reference the NYSE filing, or discuss issues directly related to this filing, the Commission has included them in its discussions of this filing.

6 Amendment No. 1, dated November 4, 2011, was withdrawn on November 8, 2011.

7 See Amendment No. 2, dated November 8, 2011. Amendment No. 2 replaces Amendment No. 1 in its entirety. In Amendment No. 2, NYSE made several changes to the proposed rule change. The changes proposed by NYSE include: (i) amending the proposed price requirement to make is applicable for a sustained period of time, but in no event for less than 30 of the most recent 60 trading days; (ii) added a new exception from certain requirements contained in the rule for companies that conducted their reverse merger a substantial length of time before applying to list; and (iii) other additional changes to clarify the rule and harmonize it with a similar proposal by Nasdaq.

revoked the securities registration of, a number of Reverse Merger companies.[8] The Exchange also stated that the Commission recently brought an enforcement proceeding against an audit firm relating to its work for Reverse Merger companies[9] and issued a bulletin on the risks of investing in Reverse Merger companies, noting potential market and regulatory risks related to investing in such companies.[10]

In response to the concerns noted above, the Exchange proposed to adopt additional listing requirements for Reverse Merger companies.[11] Specifically, NYSE proposed to prohibit a Reverse Merger company from applying to list until the combined entity has traded in the U.S. over-the-counter market, on another national securities exchange, or on a regulated foreign exchange, for at least one year following the filing of all required information about the Reverse Merger transaction, including audited financial statements, with the Commission. The Reverse Merger company would also be required to timely file with the Commission all required reports since the consummation of the Reverse Merger, including the filing of at least one annual report containing audited financial statements for a full fiscal year commencing on a date after the date

---

8 See Letter from Mary L. Schapiro to Hon. Patrick T. McHenry, dated April 27, 2011 ("Schapiro Letter"), at pages 3-4.

9 See Schapiro Letter at page 4.

10 See "Investor Bulletin: Reverse Mergers" 2011-123.

11 In addition to the specific additional listing requirements contained in the proposal, the Exchange included language in the proposed rule that states that the Exchange may "in its discretion impose more stringent requirements than those set forth above if the Exchange believes it is warranted in the case of a particular Reverse Merger Company based on, among other things, an inactive trading market in the Reverse Merger Company's securities, the existence of a low number of publicly held shares that are not subject to transfer restrictions, if the Reverse Merger Company has not had a Securities Act registration statement or other filing subjected to a comprehensive review by the Commission, or if the Reverse Merger Company has disclosed that it has material weaknesses in its internal controls which have been identified by management and/or the Reverse Merger Company's independent auditor and has not yet implemented an appropriate corrective action plan."

of filing with the Commission of all required information about the Reverse Merger transaction and satisfying the one-year trading requirement. Further, NYSE proposed to require that the Reverse Merger company maintain on both an absolute and an average basis for a sustained period a minimum stock price of $4 both immediately preceding the filing of the initial listing application and the company's listing on the Exchange. Finally, the Exchange proposed an exception from the requirements of the rule if the Reverse Merger company is listing in connection with an initial firm commitment underwritten public offering where the proceeds to the company are sufficient on a stand-alone basis to meet the aggregate market value of publicly-held shares requirement set forth in Section 102.01B of the Exchange's Listed Company Manual ("Manual").[12]

III. Comment Summary

As stated previously, the Commission received only one comment letter on the proposal.[13] However, a related proposal by Nasdaq received five comment letters,[14] one of which specifically discusses the NYSE proposal.[15] The Commission is treating all six comment letters as being applicable to the NYSE filing since the NYSE and Nasdaq filing address the

---

12 The Commission notes that Section 102.01B of the Manual would require a company to demonstrate an aggregate market value of publicly-held shares of $40 million for companies that list either at the time of their initial public offerings or as a result of spin-offs or under the affiliated company standard or, for companies that list at the time of their initial firm commitment underwritten public offering and $100 million for other companies.

13 See Hermes Letter.

14 See Feldman Letter; WestPark Letter; Locke Lord Letter; New York Global Group Letter; and Donohoe Letter.

15 See Locke Lord Letter.

same substantive issues.[16] Two of the commenters objected broadly to the proposed additional listing requirements for Reverse Merger companies,[17] while four commenters suggested discrete changes to the proposal.[18]

One commenter who objected broadly to Nasdaq's related proposal expressed the view that it could have a "chilling effect of discouraging exciting growth companies from pursuing all available techniques to obtain the benefits of a public listed stock and greater access to capital."[19] The commenter further noted, in response to Nasdaq's justifications for the proposed rule change, that virtually all of the suggestions of wrongdoing involve Chinese companies that completed reverse mergers, but that a number of other Chinese companies that completed full traditional initial public offerings face the very same allegations, so that focusing on the manner in which these companies went public may not be appropriate. Rather than imposing a seasoning requirement, the commenter suggests a review of regulatory histories and financial arrangements with promoters, and refrain from listing companies where the issues are great. In any event, the commenter recommends an exception from the seasoning requirement for a company coming to the Exchange with a firm commitment underwritten public offering. In addition, the commenter expressed concern that the requirement to maintain a $4 trading price for 30 days prior to the listing application is unfair, and unrealistic to expect companies to achieve in the over-the-counter markets, and suggested it be eliminated.[20]

---

16 In instituting disapproval proceedings for the Nasdaq proposal, the Commission stated that the NYSE and NYSE Amex had filed similar proposals designed to address the same concerns as the Nasdaq proposal.

17 See Feldman Letter and New York Global Group Letter.

18 See Hermes Letter; WestPark Letter; Donohoe Letter; and Locke Lord Letter.

19 See Feldman Letter.

20 Id.

The other commenter that objected broadly to the proposal believed that the proposal would harm capital formation and hinder small companies' access to the capital markets.[21] The commenter expressed the view that no objective research or hard data has been published that supports the notion that Reverse Merger companies bear additional scrutiny, and that the Commission should not approve the proposal until an independent and comprehensive study concludes that (i) exchange listed reverse merger companies tend to fail more often than IPO companies, thus necessitating the additional scrutiny, (ii) the proposed six to twelve month "seasoning" for reverse merger companies will indeed deter corporate frauds, and (iii) the exchanges do not already have sufficient rules in place to discourage corporate frauds in both reverse merger and IPO companies.[22] Based on its research, the commenter believes that more Chinese companies have been delisted that have gone public through an IPO than through a Reverse Merger, and that they were delisted more than three years after they became public, which is well beyond the seasoning period.[23]

The commenter that specifically commented on the NYSE proposed rule change was supportive of the changes proposed but also stated that more stringent listing requirements are necessary to reduce the risk of fraud and other regulatory concerns that can occur when companies seek to list on an exchange quickly and inexpensively through a Reverse Merger with a shell company.[24] This commenter believed that "further tests" should be introduced that go beyond the proposed seasoning period, but did not offer any specific suggestions.

---

21 See New York Global Group Letter.

22 Id.

23 Id. As noted above, the comment letter refers specifically to Nasdaq, but applies equally to the NYSE proposal.

24 See Hermes Letter.

A fourth commenter expressed support for the proposed rule change's objective to protect investors from potential accounting fraud, manipulative trading, abusive practices or other inappropriate behavior on the part of companies, promoters and others.[25] The commenter, however, recommended that, in order to avoid unnecessary burdens on smaller capitalization issuers, the proposed rule change be modified to exclude Form 10 share exchange transactions from the reverse merger definition, or provide an exception for a reverse merger company listing in connection with a firm commitment underwritten public offering.[26] This commenter also recommended that an exchange should consider requiring companies listing on the Exchange to engage a recognized independent diligence firm to conduct a forensic audit and issue a forensic diligence report prior to approval of the listing application.[27]

Another commenter, while it did not believe the Exchange had presented a sufficient rationale or data to support the need for a Reverse Merger seasoning period, agreed that a reasonable seasoning period for Reverse Merger companies could be beneficial, and was of the view that the six-month seasoning period proposed by Nasdaq was preferable to the one-year seasoning period proposed by NYSE and NYSE Amex.[28] The commenter also believed that Nasdaq's proposed requirement that a Reverse Merger company maintain the requisite stock price for at least 30 of the 60 trading days immediately preceding the filing of the listing application was lacking because, among other things, it would not apply to the period during which the listing application was under review.[29] In addition, this commenter expressed support

---

25 See WestPark Letter.

26 Id.

27 Id. As noted above, this comment letter was specifically addressed to Nasdaq, but applies equally to the NYSE proposal.

28 See Donohoe Letter.

29 Id.

for an underwritten public offering exception, regardless of size, from the proposed rule's additional listing requirement.[30]

A sixth commenter also expressed the view that there should be an exception where the securities issued in the Reverse Merger were registered with the Commission, so that the additional listing standards would be directed toward those transactions that have not been subjected to full Commission review.[31] This commenter also suggested that, if a Reverse Merger company is controlled by a non-U.S. person, the control person should be required to execute a consent to service of process in the U.S.[32]

IV. NYSE Amendment No. 2 and Response to Comments

In Amendment No. 2, NYSE proposed several changes to more effectively align its proposal with that of Nasdaq. NYSE amended its proposal to require that a Reverse Merger company "maintain a closing stock price of $4 or higher for a sustained period of time, but in no event for less than 30 of the most recent 60 trading days prior to the filing of the initial listing application" and prior to listing. In addition, NYSE amended the requirement that a Reverse Merger company provide all required reports to clarify that such reports must include "all required" audited financial statements.

Amendment No. 2 also proposes a new exception to the Reverse Merger rules and clarifies that all other listing requirements are applicable to all Reverse Merger companies, even those Reverse Merger companies that can take advantage of either of the two exceptions being proposed under the new rules. As noted above, as proposed, the rule provides that a Reverse Merger company would not be subject to the requirements of the rule if, in connection with the

---

30 Id.

31 See Locke Lord Letter.

32 Id.

listing, it completes a firm commitment underwritten public offering where the proceeds to the company will be sufficient on a stand-alone basis to meet the aggregated market value of publicly-held shares requirement for Initial Firm Commitment Underwritten Public Offerings as set forth in Section 102.01B and the offering is occurring subsequent to or concurrently with the Reverse Merger.[33] Amendment No. 2 additionally proposes that the Reverse Merger company would not be subject to the requirement that it maintain a closing stock price of $4 or higher for at least 30 of the most recent 60 days prior to each of the filing of the initial listing application and the date of the Reverse Merger company's listing, if it has satisfied the one-year trading requirement and has filed at least four annual reports with the Commission which each contain all required audited financial statements for a full fiscal year commencing after filing the required information.[34] The amended rule language states that a Reverse Merger company must comply with all applicable listing requirements. Applicable listing standards include, but are not limited to, the corporate governance requirements set forth in Section 303A of the Manual and the applicable distribution, stock price and market value requirements of Sections 102.01A, 102.01B and 303A of the Manual. In either case, the language makes clear that companies that fall under the exceptions must also comply with all other listing requirements.

Finally, NYSE made several technical changes in Amendment No. 2, including those to conform its language more closely to that of the Nasdaq proposal.

---

33 See note 12, supra.

34 Amendment No. 2 also proposes that, to be eligible for this exception, such companies be required to (i) comply with the stock price requirement of Section 102.01B of the Manual at the time of the filing of the initial listing application and the date of the Reverse Merger company's listing and (ii) not be delinquent in its filing obligations with the Commission.

On November 7, 2011, NYSE responded to the comments received on the proposal.[35] One commenter expressed concern that the NYSE proposal might not provide investors with sufficient protections in relation to listed Reverse Merger companies and noted and welcomed the NYSE's ability to exercise its discretion to apply additional or more stringent criteria to a Reverse Merger company. In response, NYSE noted that the same discretion is included in the NYSE Amex proposal. The NYSE further noted that it does not believe that it is necessary at this time to adopt any additional general requirements for all companies that would be considered for listing under the proposed rules. The Exchange also stated that the proposed approach, in its belief, strikes an appropriate balance by providing discretionary authority to the Exchange to apply additional or more stringent criteria,[36] while also providing transparency as to the factors that would prompt the imposition of such criteria. NYSE believes that it is appropriate to apply those new requirements for a period of time, while closely monitoring the performance of Reverse Merger companies that list under the new rules. If at any time it becomes apparent that there are significant continuing investor protection or regulatory concerns associated with the listing of Reverse Merger companies, NYSE will consider the desirability of adopting additional more stringent requirements.

NYSE noted that the Commission received two negative comment letters in relation to the NYSE Amex filing.[37] Both commenters supported the proposed rule's exception for Reverse Merger companies listing in conjunction with an underwritten public offering, but argued that the

---

35 See Email from John Carey, Chief Counsel, NYSE Regulation Inc., to Sharon Lawson, Senior Special Counsel, Commission and David Michehl, Special Counsel, Commission dated November 7, 2011.

36 See supra, note 11.

37 The Commission notes that the two comment letters submitted on the NYSE Amex filing are substantially similar to two of the letters filed on the Nasdaq proposal. See Feldman Letter and Westpark Letter.

transaction size requirement should either be eliminated from the proposal or set at a far lower level. The Exchange believes that the substantial offering size requirement provides a significant regulatory benefit. One of the commenters argued that the requirement that a Reverse Merger Company must trade in another market for at least a year prior to listing is unnecessary. As noted in the filing, significant regulatory concerns have arisen with respect to a number of reverse merger companies in recent times. NYSE believes that a "seasoning" period prior to listing should provide greater assurance that the company's operations and financial reporting are reliable, and will also provide time for its independent auditor to detect any potential irregularities, as well as for the company to identify and implement enhancements to address any internal control weaknesses. The seasoning period will also provide time for regulatory and market scrutiny of the company, and for any concerns that would preclude listing eligibility to be identified. NYSE believes that the elimination of the one year trading requirement would significantly weaken the value of the seasoning period in that less scrutiny would generally be present. The other commenter argued that the rule should not apply to a Reverse Merger company which resulted from a merger between an operating company and a new shell company with no prior business operations. Based on the Exchange's experience with the listing of Reverse Merger companies, the Exchange believes that it is appropriate to apply the proposed rules to all Reverse Merger companies, regardless of whether the shell company into which the operating company merged had ever had any previous business operations.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing and whether Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2011-38 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSE-2011-38. This file number should be included on the subject line if e-mail is used.

To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of NYSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSE-2011-38, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Discussion and Commission Findings

The Commission has carefully reviewed the proposed rule change, as modified by Amendment No. 2, and finds that it is consistent with the requirements of the Act and the rule and regulations thereunder applicable to a national securities exchange,[38] and, in particular, Section 6(b)(5) of the Act,[39] which, among other things, requires that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The development and enforcement of meaningful listing standards for an exchange is of substantial importance to financial markets and the investing public. Among other things, listing standards provide the means for an exchange to screen issuers that seek to become listed, and to provide listed status only to those that are bona fide companies with sufficient public float, investor base, and trading interest likely to generate depth and liquidity sufficient to promote fair and orderly markets. Meaningful listing standards also are important given investor expectations regarding the nature of securities that have achieved an exchange listing, and the role of an exchange in overseeing its market and assuring compliance with its listing standards.

NYSE proposed to make more rigorous its listing standards for Reverse Merger companies, given the significant regulatory concerns, including accounting fraud allegations, that

---

38 In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

39 15 U.S.C. 78f(b)(5).

have recently arisen with respect to these companies. As noted above, Nasdaq and NYSE Amex filed similar proposals for the same reasons.[40] Among other things, the proposals seek to improve the reliability of the reported financial results of Reverse Merger companies by requiring a pre-listing "seasoning period" during which the post-merger public company would have produced financial and other information in connection with its required Commission filings. The proposals also seek to address concerns that some might attempt to meet the minimum price test required for exchange listing through a quick manipulative scheme in the securities of a Reverse Merger company, by requiring that minimum price to be sustained for a meaningful period of time.

The Commission believes the proposed one-year seasoning requirement for Reverse Merger companies that seek to list on the Exchange is reasonably designed to address concerns that the potential for accounting fraud and other regulatory issues is more pronounced for this type of issuer. As discussed above, these additional listing requirements will assure that a Reverse Merger company has produced and filed with the Commission at least one full year of all required audited financial statements following the Reverse Merger transaction before it is eligible to list on NYSE. The Reverse Merger company also must have filed all required Commission reports since the consummation of the Reverse Merger, which should help assure that material information about the issuer have been filed with the Commission and that the issuer has a demonstrated track record of meeting its Commission filing and disclosure obligations. In addition, the requirement that the Reverse Merger company has traded for at least one year in the over-the-counter market or on another exchange could make it more likely that

---

40 See Securities Exchange Act Release No. 65633 (August 4, 2011), 76 FR 49513 (August 10, 2011) and Securities Exchange Act Release No. 65033 (August 4, 2011), 76 FR 49522.

analysts have followed the company for a sufficient period of time to provide an additional check on the validity of the financial and other information made available to the public.

Although certain commenters expressed concern that the proposal might inhibit capital formation and access by small companies to the markets, the Commission notes that the enhanced listing standards apply only to the relatively small group of Reverse Merger companies – where there have been numerous instances of fraud and other violations of the federal securities laws – and merely requires those entities to wait until their first annual audited financial statements are produced before they become eligible to apply for listing on the Exchange. While fraud and other illegal activity may occur with other types of issuers, as noted by certain commenters, the Commission does not believe this should preclude NYSE from taking reasonable steps to address these concerns with Reverse Merger companies.

The Commission also believes the proposed requirement for a Reverse Merger company to maintain the specified minimum share price for a sustained period, and for at least 30 of the most recent 60 trading days, prior to the date of the initial listing application and the date of listing, is reasonably designed to address concerns that the potential for manipulation of the security to meet the minimum price requirements is more pronounced for this type of issuer. By requiring that minimum price to be maintained for a meaningful period of time, the proposal should make it more difficult for a manipulative scheme to be successfully used to meet the Exchange's minimum share price requirements.

In addition, the Commission believes that the proposed exceptions to the enhanced listing requirements for Reverse Merger companies that (1) complete a substantial firm commitment

underwritten public offering in connection with its listing,[41] or (2) have filed at least four annual reports containing all required audited financial statements with the Commission following the filing of all required information about the Reverse Merger transaction, and satisfying the one-year trading requirement, reasonably accommodate issuers that may present a lower risk of fraud or other illegal activity. The Commission believes it is reasonable for the Exchange to conclude that, although formed through a Reverse Merger, an issuer that (1) undergoes the due diligence and vetting required in connection with a sizeable underwritten public offering, or (2) has prepared and filed with the Commission four years of all required audited financial statements following the Reverse Merger, presents less risk and warrants the same treatment as issuers that were not formed through a Reverse Merger. Nevertheless, the Commission expects the Exchange to monitor any issuers that qualify for these exceptions and, if fraud or other abuses are detected, to propose appropriate changes to its listing standards.

The Commission notes that certain commenters suggested the Exchange impose specific additional requirements on Reverse Merger companies that seek an exchange listing, such as the completion of an independent forensic diligence report on the issuer, the execution of a consent to service of process in the U.S. by foreign controlling persons, and additional more stringent standards in addition to the proposed seasoning period. Although there may be merit in these or other potential ways to enhance listing standards for Reverse Merger companies, the Commission believes that the additional listing standards proposed by the Exchange should help prevent fraud and manipulation, protect investors and the public interest, and are otherwise consistent with the Act.

---

41 The Commission notes that several commenters supported an exception for issuers with underwritten public offerings. See WestPark Letter; Donohoe Letter; and Locke Lord Letter.

The Commission also notes that several of the changes proposed by the Exchange in Amendment No. 2 were clarifying in nature and designed to make its proposal consistent with the proposals submitted by Nasdaq and NYSE Amex.

For the reasons discussed above, the Commission believes that NYSE's proposal will further the purposes of Section 6(b)(5) of the Act by, among other things, helping prevent fraud and manipulation associated with Reverse Merger companies, and protecting investors and the public interest.

The Commission also finds good cause, pursuant to Section 19(b)(2) of the Act,[42] for approving the proposed rule change, as modified by Amendment No. 2, prior to the 30th day after the date of publication of notice in the Federal Register. As noted above, the changes made in Amendment No. 2 harmonize the proposed rule change with similar proposals by Nasdaq and NYSE Amex that have been subject to public comment, in addition to providing clarifying language consistent with the intent of the original rule proposal. In addition, the Commission believes it is in the public interest for NYSE to begin applying its enhanced listing standards as soon as practicable, in light of the serious concerns that have arisen with respect to the listing of Reverse Merger companies.

---

42 15 U.S.C. 78s(b)(2).

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NYSE-2011-38), as amended, be, and hereby is, approved, on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[43]

Kevin M. O'Neill
Deputy Secretary

---

[43] 17 CFR 200.30-3(a)(12).

45 FR 73906

November 7, 1980

Rules and Regulations

Reporter
45 FR 73906

Federal Register* > *1980* > *November* > *November 7, 1980* > *Rules and Regulations* > *FEDERAL REGISTER

Title: Filings by Self-Regulatory Organizations of Proposed Rule Changes and Other Materials with the Commission

Action: Final rules and form; revocation of rule and form.

Agency

FEDERAL REGISTER

Identifier: [Release No. 34-17258, File No. S7-590]

Administrative Code Citation

17 CFR Parts 240 and 249

Synopsis

SUMMARY: The Commission is amending the requirements applicable to the filing by self-regulatory organizations of proposed rule changes and certain other materials. The amendments, which are intended to facilitate the review of proposed rule changes, (i) specify in greater detail the information required in a filing; (ii) expand the categories of proposed rule changes that may become effective summarily to include certain rules effecting changes in existing services of registered clearing agencies; and (iii) clarify which actions of self-regulatory organizations are proposed rule changes. In addition, the Commission is revoking the requirement that self-regulatory organizations file stated policies, practices, and interpretations not deemed to be rules. The Commission is also revoking requirements that each national securities exchange or registered securities association file separately information about its rules in effect on June 4, 1975, and certain forms, reports, or questionnaires. Finally, the Commission is adopting a rule requiring registered clearing agencies to file material they make generally available. The Commission is withdrawing, in a separate release, proposals relating to these matters.

Text

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission today announced the following action with respect to proposals in its May 1979 release [1] (the "Proposal Release") to facilitate review of proposed

---

[1] Securities Exchange Act Release No. 15838 (May 18, 1979), *44 FR 30924* (May 29, 1979). The Commission received comments in response to the Proposal Release from the American Stock Exchange, Inc. ("Amex"), Chicago Board Options

rule changes of self-regulatory organizations under Section 19(b) [2] of the Securities Exchange Act of 1934 (the "Act"): [3]

(1) Adoption of amendments to Rule 19b-4 under the Act, [4]

(A) Clarifying which actions of a self-regulatory organization constitute proposed rule changes,

(B) Providing summary effectiveness for certain rules changing existing services of registered clearing agencies,

(C) Eliminating the requirement that a self-regulatory organization file on Form 19b-4B [5] notice of stated policies, practices, and interpretations not deemed to be rules, and

(D) Eliminating the requirement that each national securities exchange and registered securities association file information about its rules in effect on June 4, 1975.

(2) Adoption of amendments to Form 19b-4A [6] and redesignation of Form 19b-4A as Form 19b-4.

(3) Revocation of Form 19b-4B, on which notice is filed of stated policies, practices, and interpretations not deemed to be rules.

(4) Revocation of Rule 17a-18, [7] which requires national securities exchanges and registered securities associations to file new or substantially modified forms, reports, or questionnaires.

(5) Adoption of Rule 17a-22 [8] requiring registered clearing agencies to file materials they issue or make generally available.

(6) Withdrawal of proposed amendments to Rule 19b-4 and Form 19b-4A that would have provided summary effectiveness for certain proposed rule changes of self-regulatory organizations circulated, for pre-filing review, to the Commission and to persons who would be subject to the rules.

(7) Withdrawal of proposed Rule 3b-7, which would have defined the term "rule" of a self-regulatory organization for purposes of Sections 3(a)(27) and 3(a)(28) of the Act. [9]

Exchange, Inc. ("CBOE"), Depository Trust Company ("DTC"), Municipal Securities Rulemaking Board ("MSRB"), National Association of Securities Dealers, Inc. ("NASD"), National Securities Clearing Corporation ("NSCC"), New York Stock Exchange, Inc. ("NYSE"), and Options Clearing Corporation ("OCC"). Securities and Exchange Commission File No. S7-590 ("File No. S7-590").

[2] *15 U.S.C. 78s*(b). Section 19(b) requires a self-regulatory organization to file with the Commission each of its proposed rule changes, accompanied by a concise general statement of the basis and purpose of the proposed rule change. A proposed rule change cannot take effect unless the Commission approves it, or it is otherwise permitted to become effective under Section 19(b). To approve a proposed rule change, the Commission must find that the rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the self-regulatory organization proposing the rule change.

[3] *15 U.S.C. 78aet seq.*

[4] 17 CFR 240.19b-4. Rule 19b-4 was adopted in August 1975. Securities Exchange Act Release No. 11604 (Aug. 19, 1975), *40 FR 40509* (Sept. 3, 1975).

[5] 17 CFR 249.819b.

[6] 17 CFR 249.819a.

[7] 17 CFR 240.17a-18.

[8] 17 CFR 240.17a-22.

[9] *15 U.S.C. 78c*(a)(27), 78c(a)(28).

The Commission's actions announced today [10] are intended to facilitate the review of proposed rule changes of self-regulatory organizations [11] and are designed to complement the Commission's ongoing program to improve the review process. [12] The self-regulatory organizations have also undertaken efforts to improve the review process and have substantially assisted the Commission in its efforts in this area. Continued cooperation and communication between the Commission and the self-regulatory organizations is essential to the efficient administration of Section 19(b).

The Commission's actions are discussed in detail in the remainder of this release, [13] which consists of the following sections:

I. Amendments to Form 19b-4.

II. Expansion of categories of proposed rule changes that may become effective on filing.

III. Self-regulatory organization actions constituting proposed rule changes.

IV. Revocation of certain filing requirements; adoption of rule 17a-22 concerning registered clearing agencies.

V. Statutory basis.

VI. Text of rules and form.

I. Amendments to Form 19b-4

A major problem the Commission has encountered in administering Section 19(b) is that many proposed rule change filings have not provided an adequate basis for Commission review. As a result, the Commission's staff has had to devote considerable time and resources to obtaining from self-regulatory organizations necessary information not provided in the filings, thereby delaying the rule review process. To avoid such delays, the Commission proposed amendments to Form 19b-4A designed to elicit the information necessary for it to review proposed rule changes promptly and efficiently. The Commission is adopting the proposed amendments with the modifications described below and is redesignating Form 19b-4A as Form 19b-4.

A. Instruction B. Need for Careful Preparation of the Completed Form, Including Exhibits

The Commission proposed a new Instruction B to Form 19b-4 emphasizing that the information required by the form is necessary for the Commission to determine whether, as required by Section 19(b) of the Act, a proposed rule change is consistent with the Act and the rules and regulations thereunder. Instruction B also makes clear that any filing not in compliance with the requirements of the form may be returned to the self-regulatory organization at any time before issuance of the notice of filing.

---

[10] In accordance with Section 17A(d)(3)(A)(i) of the Act, *15 U.S.C. 78q-1*(d)(3)(A)(i), at least fifteen days before this announcement, the Commission consulted and requested the views of the Board of Governors of the Federal Reserve System.

[11] Rule 19b-4 applies only to proposed rule changes of self-regulatory organizations. The Commission has proposed a separate rule under the Act, proposed Rule 11Aa3-2, which would establish procedures relating to plans governing the planning, developing, operating or regulating of a national market system, or one or more facilities thereof. See Securities Exchange Act Release No. 16410 (Dec. 7, 1979), *44 FR 72607* (Dec. 14, 1979).

[12] Each year since 1975 the Commission has received approximately three hundred filings of proposed rule changes and stated policies, practices, and interpretations not deemed to be rules.

[13] The withdrawal of proposed Rule 3b-7 and certain proposed amendments to Rule 19b-4 and Form 19b-4A is the subject of a brief companion release also issued today, Securities Exchange Act Release No. 17259 (October 30, 1980) (the "Companion Release").

Commentators expressed concern that Instruction B would permit the Commission or its staff to return filings on the basis of substantive objections. [14] Instruction B, however, does not contemplate that filings will be returned for reasons other than failure to comply with the requirements of the form.

Another commentator stated that Instruction B could exacerbate pre-filing delays unless the Commission established a limit on the time for determining whether a filing is deficient. [15] The Commission intends to publish notices of filing promptly. Since prompt publication of the notices will effectively reduce pre-filing delays, the Commission believes that establishing further limits on the time for pre-filing review is unnecessary.

The Commission believes that the information provided on Form 19b-4 must be adequate to support a Commission finding that a proposed rule change is consistent with the Act and applicable rules and regulations. [16] Returning deficient filings permits the Commission and its staff to focus on filings that provide an adequate basis for review. Accordingly, the Commission is adopting Instruction B, as proposed, with only editorial changes.

B. Instruction D. Amendments

Instruction D prescribes requirements for amending rule change filings. The Commission proposed certain amendments to the instruction, including requirements to indicate changes, if any, made from the preceding filing and from existing rules of the self-regulatory organization.

One commentator stated that when amending a filing the self-regulatory organization should not be required to submit the entire text of a lengthy rule in order to alter, for example, only one page of the text. [17] The Commission agrees that the filing requirement should afford some flexibility in that regard and has revised the instruction to provide that if the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may file only those portions of the text in which amendments are made if the filing is clearly understandable on its face.

Instruction D has also been revised in several other respects. First, it has been revised to make clear that the self-regulatory organization must file, in accordance with Instruction F, copies of any correspondence or other communications reduced to writing (including comment letters) to and from the self-regulatory organization that it prepares or receives on a proposed rule change after the rule change is filed with the Commission but before the Commission takes final action on it. Second, Instruction D has been revised to provide that if information in such a communication makes the rule change filing inaccurate, the filing must be amended to correct the inaccuracy. Third, it has been revised to describe more clearly the manner in which changes made by the amendment are to be marked. Finally, the instruction has been revised to provide that the self-regulatory organization is required to explain the purpose of the amendment and, if the amendment changes the purpose of the proposed rule change, it is also required to provide a revised statement of the purpose of the proposed rule change. [18]

C. Instruction E. Completion of Action by the Self-Regulatory Organization on the Proposed Rule Change

Instruction E provides that if the self-regulatory organization files a proposed rule change before it has completed all action necessary for internal approval of the change, it must consent to an extension of time until at least thirty-five days after the self-regulatory organization files an amendment stating that it has completed action on the rule

---

[14] DTC, NASD, and NYSE Responses, File No. S7-590.

[15] Amex Response, File No. S7-590.

[16] *See* text accompanying n. 24, *infra*.

[17] NASD Response, File No. S7-590.

[18] As indicated elsewhere in this release, the Commission has decided not to adopt the proposed category for summary effectiveness of proposed rule changes subjected to pre-filing review (see text accompanying n. 46 *infra*). Therefore, the Commission is withdrawing related proposed amendments to Instructions D and E and Item 7. See the Companion Release.

change. One commentator stated that the requirement is unnecessarily rigid. [19] The commentator suggested that the instruction should provide for extensions of up to thirty-five days, to be negotiated as circumstances warrant.

In most instances, after the self-regulatory organization files an amendment stating that it has completed action on the proposed rule change, the Commission requires thirty-five days to complete its review. Where the Commission completes its review before expiration of the thirty-five day period, it can accelerate effectiveness of the rule change. [20] Accordingly, the Commission is adopting Instruction E without the suggested amendment.

D. Item 1. Text of the Proposed Rule Change

Paragraph (a) of Item 1 requires the self-regulatory organization to set forth the text of the proposed rule change. The Commission proposed to amend paragraph (a) to require the self-regulatory organization to submit any existing form, report, or questionnaire that is directly related to a proposed rule change. A number of self-regulatory organization rules are implemented through prescribed forms, reports, or questionnaires not set forth in the text of the rules published by the self-regulatory organization. In considering such rules, the Commission reviews the related forms, reports, or questionnaires. Accordingly, to expedite the review process, the Commission is adopting the amendment to Item 1(a) as proposed.

Paragraph (b) of Item 1 of Form 19b-4A as originally adopted requires the self-regulatory organization to set forth the text of any rules the application of which is affected, directly or indirectly, by the proposed rule change. In response to comments that that requirement was overly burdensome, the Commission proposed to amend paragraph (b) to require that the designation or title, rather than the text, of such rules be provided.

One commentator suggested that the Commission revise paragraph (b) to delete the requirement that the self-regulatory organization list those rules that the proposed rule change affects indirectly. [21] The commentator stated that the requirement is unwieldy and burdensome because indirect effects cannot be predicted fully and accurately.

The Commission does not intend to require the self-regulatory organization to predict every effect a proposed rule change could have on the organization's existing rules. Rather, the Commission intends to require the self-regulatory organization merely to identify those rules on which the organization reasonably expects the proposed rule change to have direct or significant indirect effects. Accordingly, the Commission has revised the amendment to Item 1(b) to make that intent clear.

E. Item 2. Procedures of the Self-Regulatory Organization

Item 2 requires the self-regulatory organization to describe action on the proposed rule change taken by its members or board of directors or other governing body. The Commission proposed to amend Item 2 to require the self-regulatory organization to provide the name and telephone number of the staff member prepared to respond to questions and comments on the proposed rule change. The Commission has revised the amendment, in light of a suggestion made by one commentator, [22] to provide for instances where different persons at the self-regulatory organization are best prepared to discuss different aspects of the proposal.

F. Item 3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

---

[19] NYSE Response, File No. S7-590.

[20] Section 19(b)(2) of the Act provides that the Commission shall not approve any proposed rule change before the thirtieth day after the date of publication of notice of the filing thereof, unless the Commission finds good cause for doing so. If the self-regulatory organization requests accelerated effectiveness pursuant to Section 19(b)(2), it should so indicate in Item 7(d) of Form 19b-4 and provide a statement explaining why there is good cause for the Commission to accelerate effectiveness.

[21] NYSE Response, File No. S7-590.

[22] *Id.*

Item 3 of Form 19b-4A as originally adopted requires a statement of the purpose of a proposed rule change, and Item 4 requires a statement of its basis under the Act. The Commission proposed to combine the statements of purpose and basis. The Commission also proposed amendments to specify in detail the information required in the statement, making clear that the statement should be sufficiently detailed and specific to support a Commission finding under Section 19(b) that the proposed rule change is consistent with the Act and rules and regulations thereunder. Several commentators objected to proposed Item 3, contending that the required statement either is unnecessary or exceeds the Section 19(b)(2) requirement for a "concise" statement. [23]

The statement of purpose and basis must be sufficient to support a finding by the Commission that a proposed rule change is consistent with the Act and rules and regulations thereunder. The Congress anticipated that, in most instances, the Commission's statement of reasons for approving a proposed rule change would "simply be an endorsement of the justification filed by the self-regulatory agency." [24] The Commission is adopting the proposed amendments to the statement of purpose and basis, limiting the requirement to discuss problems persons are likely to have in complying with the proposed rule change. In light of objections raised by commentators, [25] the Commission has modified that requirement to require discussion only of significant compliance problems.

G. Item 4. Self-Regulatory Organization's Statement on Burden on Competition

Item 4 requires the self-regulatory organization to provide a discussion of any burden on competition the proposed rule change would impose. The Commission proposed to amend Item 4 to make it clear that the discussion must be clearly articulated and thorough and to specify in detail the information to be included.

One commentator stated that the proposed amendment would require self-regulatory organizations to speculate on competition issues. [26] A second commentator suggested that the requirement to discuss competition issues raised by commentators should be limited to significant issues. [27]

The Commission believes that the statement concerning any burden on competition must be sufficiently detailed and specific to support a Commission finding that the proposed rule change does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act and is adopting Item 4 essentially as proposed. It has, however, revised the requirement to respond to comments received concerning any impact on competition to comments received concerning any significant impact on competition. [28]

H. Items 5 and 9. Comments on the Proposed Rule Change

Item 5 requires the self-regulatory organization to summarize the comments it receives on a proposed rule change. The Commission proposed to amend Item 5 to require the self-regulatory organization to respond in detail to significant issues raised by commentators that are not discussed in response to Items 3 or 4.

One commentator stated that the requirement in Item 5 to respond to comments is unnecessary in light of the Item 4 requirement to provide a discussion of comments on any burden on competition. [29] A second commentator stated that the requirement is unnecessary because self-regulatory organizations will not risk rejection or disapproval of a proposed rule change by failing to respond to any comment concerning the statutory basis for the proposed rule

---

[23] DTC, NASD, and NYSE Responses, File No. S7-590.

[24] Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 30 (1975).

[25] DTC and NASD Responses, File No. S7-590.

[26] DTC Response, File No. S7-590.

[27] NYSE Response, File No. S7-590.

[28] See text accompanying n. 29 *infra*.

[29] NYSE Response, File No. S7-590.

change. [30] This commentator also stated that the new requirement would, in effect, require the self-regulatory organization to respond to every comment received because the significance of a comment would be determined not by the self-regulatory organization but by the Commission's staff in its review of the filing. [31] A third commentator stated that the comments to which the self-regulatory organization must respond should be limited to written comments, at least as far as clearing agencies are concerned. n32

The requirement in Item 5 to respond to comments does not duplicate the Item 4 requirement to discuss comments on competition. Item 5 provides that if a comment is addressed in the statement of basis and purpose (Item 3) or discussion of competition issues (Item 4), the self-regulatory organization should cross-reference the response.

The Commission does not believe that the requirement to respond to comments raising significant issues would impose an undue burden on self-regulatory organizations. The amendment is intended to require only that the self-regulatory organization respond to written comments. The volume of such comment letters usually is not great. Frequently, none or at most a very few are received. Moreover, it has not been the Commission's experience that the comment letters typically raise inappropriate or trivial issues. Accordingly, the Commission is adopting the amendment to Item 5, modified to make clear that the requirement applies only to written comments.

A related provision, Item 9, requires the self-regulatory organization to file copies of any comment letters it receives. The Commission proposed to amend Item 9 to require the self-regulatory organization to provide, in addition to the required copies of comment letters, an alphabetical list of such letters and a transcript of comments on the proposed rule change made at any public meeting or, if a transcript is not available, a summary of such comments.

One commentator suggested that the Commission make it clear that the term "public meeting" does not include, except to the extent specifically designated as "public," meetings such as board meetings, committee meetings, and informal meetings between staff and members of the self-regulatory organization. [33] The Commission does not intend, and does not believe the term "public meeting" is generally understood, to cover such meetings. The Commission believes transcripts or summaries of comments made at public meetings would facilitate Commission review. [34]

The Commission is adopting Item 9 as proposed with one revision. It has revised Item 9 to reflect the requirement in Instruction D that the self-regulatory organization file copies of any correspondence or other communications reduced to writing (including comment letters) to and from the self-regulatory organization concerning the rule change that it receives or prepares after the proposed rule change is filed with the Commission but before the Commission takes final action on it.

I. Item 7. Basis for Summary Effectiveness or Accelerated Effectiveness of the Proposed Rule Change

Item 7 requires the self-regulatory organization to indicate under which provision of Section 19(b)(3), if any, it is designating the proposed rule change for summary effectiveness. The Commission is amending that item to reflect the new category for summary effectiveness of certain clearing agency rules. [35] It is also adding a new paragraph (d) to Item 7 providing that if the self-regulatory organization requests accelerated effectiveness pursuant to Section 19(b)(2), it must provide a statement explaining why there is good cause for the Commission to accelerate effectiveness. n36

---

[30] Amex Response, File No. S7-590.

[31] *Id.* 32 DTC Response, File No. S7-590.

[33] Amex Response, File No. S7-590.

[34] The Commission is amending paragraph (h) of Rule 19b-4, to require that a self-regulatory organizations retain in a file, available for public inspection and copying, any correspondence and other communications reduced to writing (including comment letters) to and from such self-regulatory organization concerning any proposed rule change filing, whether the correspondence or communication is prepared or received before or after the filing of the proposed rule change.

[35] See text accompanying n. 49 *infra.* 36 See n. 20 *supra.*

J. Item 8. Proposed Rule Change Based on Other Rules

The Commission proposed a new Item 8 to require the self-regulatory organization to state whether a proposed rule change is based on a rule of another self-regulatory organization or of the Commission and, if so, to identify the rule and explain any differences between that rule and the proposed rule change.

One commentator asserted that it is inappropriate to require the self-regulatory organization to interpret the rules of another self-regulatory organization, with respect to which it does not have jurisdiction, expertise, or experience. [37] The Commission is adopting Item 8, revised to make clear that any discussion of rules of other self-regulatory organizations or of the Commission is to be based on the self-regulatory organization's understanding of those rules.

K. Exhibit 1. Notice of Filing

The Commission is adopting the proposed amendments to Exhibit 1 of Form 19b-4, the Notice of Filing for publication in the Federal Register. n38 The Commission is also adopting two other amendments to Exhibit 1. First, it is amending Item I to require that the response to the item include only the terms of substance of the proposed rule change or the text of the proposed rule change, if it is relatively brief. Second, it is amending Item II to require a brief summary of the most significant aspects, rather than the full text, of the responses to Items 3, 4, and 5 in the completed Form 19b-4. These two changes are designed to reduce the length of notices published in the Federal Register. 38 For the reasons expressed in the Proposal Release, the Commission plans to continue publishing notices in the Federal Register. See Proposal Release, *44 FR 30932.*

II. Expansion of Categories of Proposed Rule Changes That may Become Effective on Filing

Section 19(b)(3)(A)(iii) of the Act [39] authorizes the Commission to expand the categories of proposed rule changes that self-regulatory organizations may designate for summary effectiveness. [40] The Commission proposed to exercise that authority by amending Rule 19b-4 to permit the self-regulatory organization to designate a proposed rule change for summary effectiveness if the self-regulatory organization provides a thirty-day pre-filing comment period on the rule and before the rule change becomes operative affords the Commission a sixty-day period to consider abrogation (and refiling under Section 19(b)). The proposal was intended to permit proposed rule changes to be put into effect more rapidly than frequently is the case when full Commission review and approval are required.

Commentators questioned both the usefulness of the proposed category [41] and the Commission's authority to adopt it. [42] The major objection to the proposed amendment was to the length of time required between circulation and

---

[37] NYSE Response, File No. S7-590.

[39] Section 19(b)(3)(A) provides that a proposed rule change may take effect upon filing if designated by the self-regulatory organization as (i) constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization, (ii) establishing or changing a due, fee, or other charge imposed by the self-regulatory organization, or (iii) concerned solely with the administration of the self-regulatory organization or other matters which the Commission, by rule, consistent with the public interest and the purposes of Section 19(b), may specify as without the provisions of Section 19(b)(2).

[40] The Commission announced in the Proposal Release that, as a matter of general policy, if a self-regulatory organization, other than the MSRB, files under Section 19(b)(3)(A)(ii) a proposed rule change that establishes or changes a due, fee, or other charge applicable to a non-member or a non-participant, the Commission intends, unless unusual circumstances are present, to abrogate the rule change and require that it be filed for review under Section 19(b)(2). Proposal Release, *44 FR 30928.* Several commentators stated that they believe that general policy is too broad. The Commission, however, continues to believe that, in the absence of unusal circumstances, dues, fees, and other charges applicable to non-members or non-participants should receive full review under Section 19(b)(2). The general policy announced is sufficiently flexible to permit summary effectiveness on a case-by-case basis.

[41] Amex, CBOE, DTC, NSCC, NYSE, and OCC Responses, File No. S7-590.

operation of the rule. [43] Commentators stated that the time savings offered by the proposed category would not be sufficient to cause them to forego Commission approval under Section 19(b)(2). They suggested that the proposed new category be revised either to permit the Commission to use its discretion to set a postfiling operative date up to 60 days after filing [44] or to dispense with the post-filing delay in operation. [45]

The proposed category for summary effectiveness was intended to provide, consistently with the purposes of Section 19(b), a meaningful opportunity for public comment on, and Commission review of, proposed rule changes filed under the category. The Commission believes that the suggested revisions do not make sufficient provision for comment or review before such rule changes become operative. Accordingly, because commentators indicated that they would not use the new category as proposed, the Commission is withdrawing the proposal. [46]

The Commission also is not adopting the proposal suggested by certain commentators [47] that proposed rule changes of limited duration be permitted to become effective summarily. The proposal does not make adequate provision for pre-effective comment or review, nor does it provide sufficient assurance that a defective rule could be abrogated promptly. A substantive rule change involving, for example, facilities implementation or clearing practices that became operative under the proposed category might not be able to be withdrawn without undue disruption. The Commission also does not agree with commentators that the proposal would reduce the Commission's work. In fact, if adopted, the proposal might require a disproportionate amount of staff time for evaluation of such filings to avoid disruption resulting from abrogation. [48]

The Commission, however, is expanding the categories of clearing agency rules that may become effective summarily, as suggested in the Proposal Release and supported by clearing agency commentators. [49] Clearing agencies often include in their rules the precise mechanical or operational details of their procedures. [50] Frequently, minor changes in these details do not fail within any existing category of proposed rule changes that may be designated for summary effectiveness, and therefore they require Commission review and approval.

Proposed rules dealing solely with mechanical or operational details of existing clearing agency services are similar to "solely administrative" rules, which currently qualify for summary effectiveness under Section 19(b)(3)(A)(iii) of the Act. Allowing such changes to become effective on filing should increase staff time available to review other filings. The Commission believes that it is consistent with the public interest and the purposes of Section 19(b) to amend paragraph (d) of Rule 19b-4 (redesignated as paragraph (e)) by adding a new subparagraph (4) to provide that:

(e) A proposed rule change may take effect upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act if properly designated by the self-regulatory organization as * * *

* * * * *

---

[42] CBOE, NYSE, and OCC Responses, File No. S7-590.

[43] CBOE Response, File No. S7-590.

[44] NYSE Response, File No. S7-590.

[45] Amex Response, File No. S7-590.

[46] See Companion Release.

[47] CBOE, NSCC, and OCC Responses, File No. S7-590.

[48] The Commission has previously accelerated the effectiveness of, or taken similar steps for, temporary or test programs filed as proposed rule changes under Section 19(b)(2). The Commission will continue to do so for appropriate proposed rule changes.

[49] NSCC and OCC Responses, File No. S7-590.

[50] DTC, NSCC, and OCC Responses, File No. S7-590.

(4) effecting a change in an existing service of a registered clearing agency that (i) does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible and (ii) does not significantly affect the respective rights or obligations of the clearing agency or persons using the service.

The Commission believes that permitting such proposed rule changes to become summarily effective could expedite the review process significantly. [51] For example, proposed rule changes that make minor modifications or improvements in services or implement changes of a "housekeeping" nature would be eligible for summary effectiveness under the category. [52]

III. Self-Regulatory Organization Actions Constituting Proposed Rule Changes

The Commission's proposals to facilitate filing and review of proposed rule changes included a new rule, proposed Rule 3b-7, defining the term "rule." That definition was intended to clarify which stated policies, practices, and interpretations and other self-regulatory actions must be filed as proposed rule changes. Commentators, however, stated that they did not believe the proposed definition would provide clarification.

The Commission has decided to withdraw proposed Rule 3b-7 and to amend Rule 19b-4 to specify more precisely which self-regulatory actions constitute proposed rule changes. The amendments to Rule 19b-4 are discussed in detail below. As background for that discussion, this section first discusses (A) the standards under the Act and under Rule 19b-4 as originally adopted for determining which actions are proposed rule changes and (B) proposed Rule 3b-7.

A. Standards Under the Act and Rule 19b-4 as Originally Adopted

Section 19(b) defines the term "proposed rule change" to mean any proposed rule or any proposed change in, addition to, or deletion from the rules of the self-regulatory organization. Read together, Sections 3(a)(27) and 3(a)(28) of the Act define "rules of a self-regulatory organization" to mean (i) the rules of the MSRB and the constitution, articles of incorporation, bylaws, and rules, or instruments corresponding thereto, of any other self-regulatory organization, and (ii) such stated policies, practices, and interpretations of the self-regulatory organization, other than the MSRB, as the Commission deems to be rules.

Paragraph (b) of Rule 19b-4 as originally adopted defines "stated policies, practices, and interpretations" to include certain self-regulatory actions and paragraph (a) of the rule deems certain of these to be rules. The definition of "stated policies, practices, and interpretations" in paragraph (b) focuses primarily on whether the self-regulatory action is either a material aspect of the operation of the facilities of a self-regulatory organization or a statement that is made generally available to specified persons and has certain effects on those persons. [53] Paragraph (a) deems

---

[51] The Commission, at this time, is not expanding this category to include rule changes of other self-regulatory organizations. Clearing agencies, unlike other self-regulatory organizations, function primarily as providers of services to their participants. As other self-regulatory organizations develop more varied and complex services, it may become appropriate to expand the category to include certain rules of those organizations.

[52] The Commission, of course, retains the authority, under Section 19(b)(3)(C), to abrogate summarily within sixty days of the date of filing any proposed rule change that has become effective under Section 19(b)(3)(A).

[53] Paragraph (b) of Rule 19b-4 as originally adopted provided that the term "stated policies, practices, and interpretation" includes:

Any material aspect of the operation of the facilities of the self-regulatory organization or any statement made generally available to the membership of, or all participants in, or persons having or seeking access (including, in the case of national securities exchanges or registered securities associations, through a member) to facilities of, a self-regulatory organization, or to a group or category of such persons, establishing or changing any standards or guidelines with respect to (1) the rights or obligations of such persons or, in the case of national securities exchanges or registered securities associations, persons associated with such persons or (2) the application or interpretation of an existing rule.

a stated policy, practice, or interpretation to be a rule only if it meets one of several primarily procedural tests, such as being required, under the rules of the self-regulatory organization, to be approved by the organization's governing body. [54] The standards established by paragraphs (a) and (b) were entended to ensure that all significant regulatory actions by self-regulatory organizations would be subject to Commission review.

The definition of "stated policies, practices, and interpretations" in paragraph (b) of Rule 19b-4 is sufficiently broad to encompass most significant self-regulatory initiatives. The definition, however, does not make clear that certain significant regulatory matters that may be considered to concern "privileges," rather than "rights or obligations," are within the definition. In addition, the definition does not cover significant interpretations if they are not made generally available, even if the interpretation is approved or ratified by the governing body of the self-regulatory organization.

The Commission believes that paragraph (a), which deems certain stated policies, practices, and interpretations to be rules, focuses too extensively on procedural aspects of how the statement was adopted rather than on the substance of the statement. For example, paragraph (a) deems a stated policy, practice, or interpretation to be a rule if it is required to be approved by the governing body of the self-regulatory organization; however, not all matters that are required to be so approved are necessarily significant enough to warrant Commission review. At the same time, certain other matters that are not required to be approved by the governing body have significant regulatory effects and should be subject to Commission review.

B. Proposed Rule 3b-7

Proposed Rule 3b-7 was intended to resolve problems encountered with Rule 19b-4 by defining the term "rule" functionally, instead of procedurally, to include statements and stated policies, practices, and interpretations having specified significant regulatory effects. [55] The definition of "rule" in proposed Rule 3b-7 was drawn, in large part, from the definition of "rule" in the Administrative Procedure Act ("APA"). [56] The definition expressly excluded certain stated policies, practices, and interpretations of the self-regulatory organization that are reasonably and fairly implied by the organization's existing rules.

(a) that is of general or particular applicability and future effect,

(b) that is designed to implement, interpret, describe, or prescribe a requirement, procedure, definition, standard, guideline, policy, or any part of a corporate or financial structure or organization, and

(c) that directly or indirectly affects the rights or obligations of any person or the conduct of business by any person;

Provided, however, that the term "rule" shall not include any stated policy, practice, or interpretation with respect to an existing rule that is reasonably and fairly implied by that rule and that is not required under the rules of the self-regulatory organization to be approved by the governing body of the self-regulatory organization.

Commentators raised a number of objections to the proposed definition of "rule." Several commentators stated that they believe the meaning of the term "rule" is already sufficiently clear. They questioned both the Commission's

---

(1) Action thereon by the members or by the board of directors, or similar governing body, of such self-regulatory organization is required under its constitution, articles of incorporation, by-laws, rules, or instruments corresponding thereto, (2) a self-regulatory organization elects or is required, pursuant to its constitution, articles of incorporation, by-laws, rules, or instruments corresponding thereto, to treat it as a rule change hereunder, (3) it represents a change in, addition to, or deletion from a stated policy, practice or interpretation which the self-regulatory organization previously treated as a proposed rule change or (4) it requires a determination, or affects a prior determination, pursuant to Rules 8c-1(g) or 15c2-1(g).

[54] Paragraph (a) of Rule 19b-4 as originally adopted provided that a stated policy, practice, or interpretation of a self-regulatory organization shall be deemed to be a rule of the self-regulatory organization if:

[55] Proposed Rule 3b-7 defined "rule" to include: The whole or part of any statement or of any stated policy, practice, or interpretation (including any form, report, or questionnaire)

[56] 5 U.S.C. 551(4).

authority to define "rule" [57] and the usefulness of doing so. [58] One commentator stated that the proposed definition of "rule" is difficult to read and understand. [59] Several commentators questioned whether the APA definition of "rule" is an appropriate basis for a definition of "rule" for self-regulatory organizations. [60] In addition, one commentator stated that the proposed definition appears to preclude the self-regulatory organization from designating actions that are not within the proposed definition as proposed rule changes. [61]

The major objection to proposed Rule 3b-7, however, was to the breadth of the definition of "rule." [62] Commentators were concerned that the definition is too open-ended and would, inappropriately, cover internal administrative matters [63] and many day-to-day business decisions of self-regulatory organizations. [64] Clearing agencies expressed concern that the definition would cover minor changes in clearance and settlement systems. [65] A few commentators suggested that the definition would cover such statements or documents as contracts for goods and services, individual employment arrangements, real estate leases, and annual reports. [66]

Several commentators focused separately on the exclusion from the definition of "rule" of any stated policy, practice, or interpretation that is "reasonably and fairly implied" by an existing rule of the self-regulatory organization and is not required under the rules of the organization to be approved by its governing body (the "exclusion"). Commentators stated that the "reasonably and fairly implied" standard would not provide sufficient guidance to self-regulatory organizations as to when an action would not be required to be filed as a proposed rule change, [67] and that the standard would allow self-regulatory determinations to be "second-guessed" by the Commission. [68] In addition, the MSRB expressed concern that, because the exclusion would not be available if the action was required to be approved by the self-regulatory organization's governing body, the exclusion would not be available for MSRB interpretations. [69] The MSRB explained that it has adopted internal procedures to ensure that the Board itself is directly involved in the interpretive process.

C. Amendments to Rule 19b-4

The Commission continues to believe it is important to make clear to self-regulatory organizations that they must file all significant regulatory actions for Commission review. [70] The Commission also continues to believe that additional guidance can be provided, beyond that contained in Rule 19b-4 as originally adopted, as to which self-regulatory actions are proposed rule changes. In light of the comments received on proposed Rule 3b-7, however, the Commission does not believe that it is useful to attempt to provide additional guidance through a definition of "rule"

---

[57] Amex and CBOE Responses, File No. S7-590.

[58] Amex Response, File No. S7-590.

[59] CBOE Response, File No. S7-590.

[60] Amex, CBOE, and NSCC Responses, File No. S7-590.

[61] OCC Response, File No. S7-590. See n. 74 *infra*.

[62] Amex, CBOE, DTC, NSCC, NYSE, and OCC Responses, File No. S7-590.

[63] Amex, CBOE, and NYSE Responses, File No. S7-590.

[64] Amex, NSCC, NYSE, and OCC Responses, File No. S7-590.

[65] DTC and NSCC Responses, File No. S7-590.

[66] CBOE, DTC, NSCC, NYSE, and OCC Responses, File No. S7-590.

[67] NSCC, NYSE, and OCC Responses, File No. S7-590.

[68] OCC Response, File No. S7-590.

[69] MSRB Response, File No. S7-590.

[70] The Commission expects that, in most instances where a self-regulatory organization acts in such a manner as to have a significant regulatory impact on persons, the self-regulatory organization will designate the action as a "rule." Sections 6, 15A, 15B, and 17A of the Act provide that self-regulatory organizations must have "rules" designed to achieve specified objectives.

based on the APA. Accordingly, the Commission is withdrawing proposed Rule 3b-7 [71] and is amending Rule 19b-4 to specify more precisely which self-regulatory actions are proposed rule changes.

The amendments (i) make minor modifications in the definition of "stated policies, practices, and interpretations" in paragraph (b); (ii) revise paragraph (a) (redesignated as paragraph (c)) to deem stated policies, practices, and interpretations to be proposed rule changes primarily on the basis of their substantive effect; and (iii) add a new paragraph (d) deeming to be a proposed rule change any interpretation of an existing rule of the self-regulatory organization if it is approved or ratified by the governing body of the self-regulatory organization and is not reasonably and fairly implied by the existing rule. [72]

Paragraphs (a) through (d) of Rule 19b-4 will read as follows:

(a) Filings with respect to proposed rule changes by a self-regulatory organization shall be made on Form 19b-4.

(b) The term "stated policy, practice, or interpretation" means (1) any material aspect of the operation of the facilities of the self-regulatory organization or (2) any statement made generally available to the membership of, to all participants in, or to persons having or seeking access (including, in the case of national securities exchanges or registered securities associations, through a member) to facilities of, the self-regulatory organization ("specified persons"), or to a group or category of specified persons, that establishes or changes any standard, limit, or guideline with respect to (i) the rights, obligations, or privileges of specified persons or, in the case of national securities exchanges or registered securities associations, persons associated with specified persons, or (ii) the meaning, administration, or enforcement of an existing rule.

(c) A stated policy, practice, or interpretation of the self-regulatory organization shall be deemed to be a proposed rule change unless (1) it is reasonably and fairly implied by an existing rule of the self-regulatory organization or (2) it is concerned solely with the administration of the self-regulatory organization and is not a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization.

(d) Regardless of whether it is made generally available, an interpretation of an existing rule of the self-regulatory organization shall be deemed to be a proposed rule change if (1) it is approved or ratified by the governing body of the self-regulatory organization and (2) it is not reasonably and fairly implied by that rule.

Paragraphs (b), (c), and (d) will operate as discussed below.

1. Paragraph (b): Definition of Stated Policy, Practice, or Interpretation

Revised paragraph (b) continues to define "stated policy, practice, or interpretation" as, essentially, (1) any material aspect of the operation of the facilities of the self-regulatory organization or (2) any statement that the self-regulatory organization makes generally available to specified persons and that has certain effects. [73] The revised definition differs from the definition as originally adopted in several minor respects.

First, the revised definition substitutes "stated policy, practice, or interpretation means" for "stated policies, practices, and interpretations includes" to clarify that a self-regulatory action that is not within the definition is not a

---

[71] See Companion Release.

[72] Self-regulatory organizations may seek interpretive advice from the Commission's staff in those instances where the self-regulatory organization is uncertain whether a particular action is a proposed rule change or should have been previously treated as one.

[73] Material, even if it is not included in the definition of "stated policy, practice, or interpretation," that the self-regulatory organization (other than a registered clearing agency) makes generally available is required to be filed with the Commission under Rules 6a-3, 15Aj-1, and 17a-21 under the Act, 17 CFR 240.6a-3, 240.15Aj-1, and 240.17a-21. Rule 17a-22, the adoption of which is announced in this release, will impose a similar requirement on registered clearing agencies.

stated policy, practice, or interpretation. [74] Second, for simplification, it adds the term "specified persons" as a definition of the persons included in the definition of "stated policy, practice, or interpretation" in Rule 19b-4.

Third, the revised definition adds the word "limit" to the list of specified effects to make clear that a statement prohibiting conduct is within the definition. Fourth, it adds in paragraph (b)(2)(i) the word "privileges" to make clear that statements establishing or changing any standard, limit, or guideline with respect to the privileges of specified persons are within the definition. Finally, it substitutes, in paragraph (b)(2)(ii), "meaning, administration, or enforcement of an existing rule" for "application or interpretation of an existing rule." That substitution is intended to conform the language of the provision to that in Section 19(b)(3)(A)(i) of the Act and is not intended to change the meaning of paragraph (b)(2). [75]

2. Paragraph (c): Stated Policy, Practice, or Interpretation Deemed to be a Proposed Rule Change

Revised paragraph (c) is intended to limit the stated policies, practices, and interpretations subject to Commission review to those most likely to affect significantly the activities of specified persons. It does so by excepting two categories of stated policies, practices, and interpretations from those deemed to be proposed rule changes. The first exception is for stated policies, practices, and interpretations "reasonably and fairly implied" by the self-regulatory organization's existing rules. The second exception is for certain stated policies, practices, and interpretations that are "concerned solely with the administration" of the self-regulatory organization. The two exceptions are intended to operate independently of each other; if the action meets the requirements of either exception, it will not be considered a proposed rule change under paragraph (c). The two exceptions are discussed further below.

(i) "Reasonably and Fairly Implied" Exception

The "reasonably and fairly implied" exception is intended to make clear that self-regulatory organizations may issue stated policies, practices, and interpretations with respect to their existing rules without necessarily being subject to rule filing requirements. For example, interpretations of existing rules arising out of individual enforcement or disciplinary proceedings would not have to be filed as proposed rule changes if the interpretations are reasonably and fairly implied by the existing rules.

The "reasonably and fairly implied" standard is the same standard used in proposed Rule 3b-7 to except certain stated policies, practices, and interpretations from the definition of "rule." The Commission believes, in spite of commentators' objections that the standard is vague, that it provides as much guidance to self-regulatory organizations as is now possible. The limits of the "reasonably and fairly implied" exception will have to be determined on a case-by-case basis. It is clear, however, the a stated policy, practice, or interpretation that prescribes extensive and specific limitations on particular types of transactions or conduct that are not apparent from the face of the existing rule is not "reasonably and fairly implied" by the rule. [76] Moreover, the fact that a self-regulatory organization, for purposes of its internal operations, characterizes a stated policy, practice, or

---

[74] The self-regulatory organization could, of course, elect to designate as a "rule" a statement that is not within the definition of "stated policy, practice, or interpretation."

[75] A form, report, or questionnaire of a self-regulatory organization that constitutes a stated policy, practice, or interpretation under paragraph (b) would have to be filed as a proposed rule change if, under paragraph (c), it is a stated policy, practice, or interpretation deemed to be a proposed rule change.

[76] As the Commission explained in connection with its discussion of the "reasonably and fairly implied" standard in the exclusion of proposed Rule 3b-7, the standard would not be met by an interpretation such as that filed by the CBOE and other exchanges concerning "front-running." *See, e.g.,* File No. SR-CBOE-78-28. The standard also would not be met by a stated policy, practice, or interpretation that implements a system if if affects the manner in which members or others do business or in which the system functions, in a way that is not reasonably foreseeable from the rule to which the stated policy, practice, or interpretation applies.

interpretation as reasonably and fairly implied does not mean the statement is reasonably and fairly implied for purposes of Rule 19b-4. [77]

(ii) "Concerned Solely with the Administration" Exception

The "concerned solely with the administration" exception in paragraph (c) is intended to prevent the self-regulatory organization from having to file as a proposed rule change most stated policies, practices, or interpretations that deal solely with "housekeeping" matters. [78] The exception should eliminate concern, stemming from the definition of "rule" in proposed Rule 3b-7, that self-regulatory organizations would have to file as proposed rule changes stated policies, practices, or interpretations relating to matters such as floor decorum. [79]

The exception would not be available for stated policies, practices, and interpretations with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization. The Commission believes that, once the self-regulatory organization has chosen to handle a housekeeping matter by rule, the Commission and the public should be given notice of any stated policy, practice, or interpretation that effectively modifies the terms of that rule. [80] Any such stated policy, practice, or interpretation should be set forth in the self-regulatory organization's rule book.

3. Paragraph (d): Governing Body Interpretations Deemed to be Proposed Rule Changes

The Commission believes that any interpretation of an existing rule that is of sufficient importance to be approved or ratified by the governing body of the self-regulatory organization, whether or not it is made generally available, is a proposed rule change subject to Commission review unless it is reasonably and fairly implied by the existing rule.

Accordingly, the Commission is amending Rule 19b-4 to provide, in paragraph (d), that regardless of whether it is made generally available, an interpretation of an existing rule of the self-regulatory organization is a proposed rule change if it is approved or ratified by the governing body of the self-regulatory organization and it is not reasonably and fairly implied by the existing rule. [81] Paragraph (d) makes clear that, whenever the governing body of the self-regulatory organization, including that of the MSRB, [82] approves or ratifies an interpretation that is not reasonably and fairly implied by an existing rule, its action is a proposed rule change.

---

[77] For example, the governing body of the NASD adopts or amends specific implementing policies under general rules adopted by its membership, such as its rule requiring observance of just and equitable principles of trade, and, for purposes of its by-laws, characterizes the implementing policies as reasonably and fairly implied by the general rules. See the NASD's interpretations and policy statements relating to "free-riding," advertising, and underwriting arrangements. Such interpretations or policy statements are required to be filed as proposed rule changes. NASD Manual (CCH) para. 2151. See also Article VII of the NASD's By-Laws, NASD Manual (CCH) para. 1501 *et seq.*

[78] If the self-regulatory organization adopts a "rule" that is concerned solely with the administration of the organization, that rule is required to be filed as a proposed rule change, but it may qualify for summary effectiveness under Section 19(b)(3)(A) of the Act.

[79] An administrative stated policy, practice, or interpretation having implications beyond housekeeping matters would not, of course, qualify for this exception. For example, a stated policy, practice, or interpretation establishing or changing floor procedures, procedures for resolving or determining the rights or obligations of members, or composition of the self-regulatory organization's governing body would generally not be "concerned solely with the administration" of the self-regulatory organization.

[80] For example, if the self-regulatory organization has a rule establishing a dress code, any stated policy, practice, or interpretation with respect to the dress code would be a proposed rule change, unless it is reasonably and fairly implied by the rule, in which case it would qualify for the first exception.

[81] If the governing board of the self-regulatory organization establishes a committee to approve or ratify interpretations, the self-regulatory organization should treat interpretations approved or ratified by that committee as having been acted upon by the governing body.

[82] Paragraph (d) makes clear that if the MSRB issues an interpretation of an existing rule that is not reasonably and fairly implied by that rule, it is a proposed rule change.

IV. Revocation of Certain Filing Requirements; Adoption of Rule 17a-22 Concerning Registered Clearing Agencies

The Commission proposed to revoke several filing requirements that it believes are unduly burdensome. First, the Commission proposed to revoke the provision in paragraph (c) of Rule 19b-4 as originally adopted, and related Form 19b-4B, requiring self-regulatory organizations to file on Form 19b-4B notice of stated policies, practices, and interpretations not deemed to be rules. The filing requirement partially duplicates filing requirements in Rules 6a-3, 15Aj-1, and 17a-21 under the Act, [83] which require national securities exchanges, registered securities associations, and the MSRB, respectively, to submit to the Commission any material they make generally available.

Second, the Commission proposed to revoke Rule 17a-18, which requires a national securities exchange or registered securities association to file with the Commission any form, report, or questionnaire it requires or proposes to require its members to complete. The Commission believes this requirement is unnecessary because self-regulatory organizations are required to file such documents under Section 19(b).

Finally, the Commission proposed to revoke paragraph (g) of Rule 19b-4. Paragraph (g) required self-regulatory organizations to respond to Items 3, 4, 5, and 6 of Form 19b-4A with respect to their rules in effect on June 4, 1975, and to file those responses with the Commission by April 1, 1976. Paragraph (g) was intended to afford national securities exchanges and associations an opportunity to provide relevant information on their existing rules before any Commission action under Section 31(b) of the Securities Acts Amendments of 1975. Commentators expressed the view that the information supplied would be of little assistance to the Commission and that supplying the information would impose a considerable burden on self-regulatory organizations. To avoid imposing that burden, the Commission decided in early 1976 not to require compliance with paragraph (g) of Rule 19b-4. [84]

The Commission did not receive any comments on its proposals to revoke the Form 19b-4B filing requirement, Rule 17a-18, and paragraph (g) of Rule 19b-4, and, as proposed, is revoking those provisions.

In conjunction with its proposal to revoke Form 19b-4B, the Commission proposed Rule 17a-22, which would establish for registered clearing agencies a filing requirement parallel to the filing requirements imposed under Rules 6a-3, 15Aj-1, and 17a-21. Registered clearing agencies, unlike national securities exchanges, registered securities associations, and the MSRB, previously have not been required to file with the Commission materials (other than stated policies, practices, and interpretations deemed not to be rules) they make generally available. Receipt of such material is important to the Commission's oversight responsibilities under the Act. The Commission did not receive any comments on proposed Rule 17a-22 and is adopting the rule as proposed, with minor modifications.

V. Statutory Basis

On the basis of the foregoing analysis and discussion, the Commission finds that the rule and the amendments to the rule and the form adopted are consistent with the public interest, the protection of investors, and the purposes of the Act. The Commission also finds that the amendment to paragraph (e) of Rule 19b-4, expanding the categories of proposed rule changes that may become effective pursuant to Section 19(b)(3)(A) of the Act, is consistent with the public interest and the purposes of Section 19(b) of the Act. The Commission, pursuant to Section 23(a)(2) of the Act, finds that the rule and the amendments to the rule and the form adopted herein do not impose any burdens on competition.

Rule 17a-22 is promulgated under the Act, and particularly Sections 2, 3, 17, 17A, and 23, *15 U.S.C. 78b.*, 78c, 78q, 78q-1, and 78w. The amendments to Rule 19b-4 and Form 19b-4A (redesignated as Form 19b-4) are promulgated under the Act, and particularly Sections 2, 3, 6, 11A, 15A, 15B, 17, 17A, 19, and 23, *15 U.S.C. 78b*, 78c, 78f, 78k-1, 78o -3, 78o -4, 78q, 78q-1, 78s, and 78w.

---

[83] 17 CFR 240.6a-3, 240.15Aj-1, and 240.17a-21. Rule 17a-22, the adoption of which is announced in this release, will impose a similar requirement on registered clearing agencies.

[84] Securities Exchange Act Release Nos. 12157 (Mar. 2, 1976), ***41 FR 10662*** (Mar. 12, 1976), and 13100 (Dec. 22, 1976), *42 FR 782* (Jan. 4, 1977).

45 FR 73906

VI. Text of Rules and Form

Regulations

The Commission is amending Title 17, Chapter II, of the Code of Federal Regulations as follows:

PART 240 -- GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

§ 240.17a-18 [Removed]

1. By revoking § 240.17a-18.

2. By adding § 240.17a-22 to read as follows:

§ 240.17a-22 Supplemental material of registered clearing agencies.

Within ten days after issuing, or making generally available, to its participants or to other entities with whom it has a significant relationship, such as pledgees, transfer agents, or self-regulatory organizations, any material (including, for example, manuals, notices, circulars, bulletins, lists, or periodicals), a registered clearing agency shall file three copies of such material with the Commission. A registered clearing agency for which the Commission is not the appropriate regulatory agency shall at the same time file one copy of such material with its appropriate regulatory agency.

(Secs. 2, 3, 17, and 23, *Pub. L. No. 78-291, 48 Stat. 881*, 882, 897, and 901, as amended by secs. 2, 3, 14, and 18, *Pub. L. No. 94-29, 89 Stat. 97*, 137, and 155 *(15 U.S.C. 78b,* 78c, 78q, and 78w); sec. 17A, as added by sec. 15, *Pub. L. No. 94-29, 89 Stat. 141 (15 U.S.C. 78q-1))*

3. By revising § 240.19b-4 to read as follows:

§ 240.19b-4 Filings with respect to proposed rule changes by self-regulatory organizations.

(a) Filings with respect to proposed rule changes by a self-regulatory organization shall be made on Form 19b-4.

(b) The term "stated policy, practice, or interpretation" means (1) any material aspect of the operation of the facilities of the self-regulatory organization or (2) any statement made generally available to the membership of, to all participants in, or to persons having or seeking access (including, in the case of national securities exchanges or registered securities associations, through a member) to facilities of, the self-regulatory organization ("specified persons"), or to a group or category of specified persons, that establishes or changes any standard, limit, or guideline with respect to (i) the rights, obligations, or privileges of specified persons or, in the case of national securities exchanges or registered securities associations, persons associated with specified persons, or (ii) the meaning, administration, or enforcement of an existing rule.

(c) A stated policy, practice, or interpretation of the self-regulatory organization shall be deemed to be a proposed rule change unless (1) it is reasonably and fairly implied by an existing rule of the self-regulatory organization or (2) it is concerned solely with the administration of the self-regulatory organization and is not a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization.

(d) Regardless of whether it is made generally available, an interpretation of an existing rule of the self-regulatory organization shall be deemed to be a proposed rule change if (1) it is approved or ratified by the governing body of the self-regulatory organization and (2) it is not reasonably and fairly implied by that rule.

(e) A proposed rule change may take effect upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act if properly designated by the self-regulatory organization as (1) constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule, (2) establishing or changing a due, fee, or other charge, (3) concerned solely with the administration of the self-regulatory organization, or (4) effecting a change in an existing

service of a registered clearing agency that (i) does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible and (ii) does not significantly affect the respective rights or obligations of the clearing agency or persons using the service.

(f) After instituting a proceeding to determine whether a proposed rule change should be disapproved, the Commission will afford the self-regulatory organization and interested persons an opportunity to submit additional written data, views, and arguments and may afford, in the discretion of the Commission, an opportunity to make oral presentations.

(g) Notice of orders issued pursuant to Section 19(b) of the Act will be given by prompt publication thereof, together with a statement of written reasons therefor.

(h) Self-regulatory organizations shall retain at their principal place of business a file, available to interested persons for public inspection and copying, of all filings made pursuant to this section and all correspondence and other communications reduced to writing (including comment letters) to and from such self-regulatory organization concerning any such filing, whether such correspondence and communications are received or prepared before or after the filing of the proposed rule change.

(Secs. 2, 3, 6, 17, 19, and 23, *Pub. L. No. 78-291, 48 Stat. 881*, 882, 885, 897, 898, and 901, as amended by secs. 2, 3, 4, 14, 16, and 18, *Pub. L. No. 94-29, 89 Stat. 97*, 104, 137, 146, and 155 *(15 U.S.C. 78b,* 78c, 78f, 78q, 78s, and 78w); sec. 15A, as added by sec. 1, *Pub. L. No. 75-719, 52 Stat 1070,* as amended by sec. 12, *Pub. L. No. 94-29, 89 Stat. 127* (15 U.S.C. 78*o* -3); secs. 11A, 15B, and 17A, as added by secs. 7, 13, and 15, *Pub. L. No. 94-29, 89 Stat. 111*, 131, and 141 *(15 U.S.C. 78k-1,* 78*o* -4, and 78q-1))

PART 249 -- FORMS, SECURITIES EXCHANGE ACT OF 1934

§ 249.819a [Redesignated as § 249.819 and Amended]

1. By redesignating § 249.819a (Form 19b-4A, for filings with respect to proposed rule changes by all self-regulatory organizations) as § 249.819, by amending the heading of this section to refer to "Form 19b-4," and by amending the text of this form as provided by this release.

§ 249.819b [Removed]

2. By revoking § 249.819b.

Copies of the form have been filed with the Office of the Federal Register and will be forwarded to the self-regulatory organizations. Copies may be requested from the Commission.

By the Commission.

George A. Fitzsimmons,

Secretary.

October 30, 1980.

[FR Doc. 80-34737 Filed 11-6-80; 8:45 am]

BILLING CODE 8010-01-M

Dates

EFFECTIVE DATE: January 1, 1981.

Contacts

FOR FURTHER INFORMATION CONTACT:

45 FR 73906

Susan Davis, Esq., (202) 272-2828; or Jeffrey Jordan, Esq., (202) 272-2847, Division of Market Regulation, Securities and Exchange Commission, Washington, D.C. 20549.

FEDERAL REGISTER
