

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53705; File No. SR-ISE-2006-04)

April 21, 2006

Self-Regulatory Organizations; International Securities Exchange, Inc.; Order Approving Proposed Rule Change and Amendments No. 1 and 2 and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3 Relating to the Proposal to Reorganize from its Current Structure into a Holding Company Structure

I. Introduction

On January 12, 2006, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² the International Securities Exchange, Inc. (“ISE, Inc.”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change to reorganize from its current structure into a holding company structure (“Reorganization”). ISE, Inc. filed Amendment No. 1 on March 3, 2006, and withdrew Amendment No. 1 on March 3, 2006. On March 3, 2006, ISE, Inc. filed Amendment No. 2. The proposed rule change, as amended, was published for comment in the Federal Register on March 17, 2006.³ The Commission received no comment letters regarding the proposal. On April 7, 2006, ISE, Inc. filed Amendment No. 3 to the proposed rule change.⁴ This order approves the proposed rule change, as amended, grants accelerated approval to Amendment No. 3 to the proposed rule change, and solicits comments from interested persons on Amendment No. 3.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 53450 (March 8, 2006), 71 FR 13875.

⁴ In Amendment No. 3, ISE, Inc. proposed a technical change to the filing. The complete text of Amendment No. 3 is available on the Commission’s Web site (<http://www.sec.gov/rules/sro.shtml>), at the Commission’s Public Reference Room, at the principal office of ISE, Inc., and on ISE, Inc.’s Web site (<http://www.iseoptions.com>).

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁵ In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b) of the Act,⁶ which, among other things, requires a national securities exchange to be so organized and have the capacity to be able to carry out the purposes of the Act and to enforce compliance by its members and persons associated with its members with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange, and assure the 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. Section 6(b) of the Act⁷ also requires that the rules of the exchange be designed 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, in general, to protect investors and the public interest.

A. Accelerated Approval of Amendment No. 3

The Commission also finds good cause for approving Amendment No. 3 to the proposed rule change prior to the thirtieth day after publishing notice of Amendment No. 3 in the Federal Register pursuant to Section 19(b)(2) of the Act.⁸

⁵ In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁶ 15 U.S.C. 78f(b).

⁷ Id.

⁸ 15 U.S.C. 78s(b)(2). Pursuant to Section 19(b)(2) of the Act, the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of the notice thereof, unless the Commission finds good cause for so doing.

In Amendment No. 3, ISE, Inc. proposes to amend ISE Rule 303, Supplementary Material .02, to replace a reference to the “Certificate of Incorporation” of ISE, Inc. with a reference to the “LLC Agreement” of International Securities Exchange, LLC (“ISE, LLC”) to reflect that, upon consummation of the Reorganization, ISE, Inc. would merge with, and thereafter operate as, a limited liability company.

The Commission believes that Amendment No. 3 is non-substantive in nature, raises no novel issues, and is consistent with the Act. Therefore, the Commission finds that good cause exists to accelerate approval of the proposed rule change in Amendment No. 3, pursuant to Section 19(b)(2) of the Act.⁹

B. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether Amendment No. 3 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-ISE-2006-04 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-ISE-2006-04. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

⁹ 15 U.S.C. 78s(b)(2).

comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<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 inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of ISE, Inc. 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 Amendment No. 3 of File Number SR-ISE-2006-04 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

II. Description and Discussion

ISE, Inc., a Delaware corporation and publicly-traded company,¹⁰ proposes to reorganize into a holding company structure. ISE, Inc. has formed International Securities Exchange Holdings, Inc., a Delaware corporation ("ISE Holdings"), and its wholly owned subsidiary, ISE, LLC, a Delaware limited liability company, in contemplation of the Reorganization. After satisfaction of certain conditions, including approval of the Reorganization by the Commission, ISE, Inc. will merge into ISE, LLC, with ISE, LLC as the surviving entity of the merger ("Merger").

¹⁰ See Securities Exchange Act Release No. 51029 (January 12, 2005), 70 FR 3233 (January 21, 2005) (SR-ISE-2004-29) (discussing ISE, Inc.'s current capital stock and governance structure).

As a result of the Merger, ISE Holdings will effectively become the sole equity owner of ISE, LLC, and the shares of ISE Holdings common stock (“ISE Holdings Common Stock”) will in turn be publicly held. The holders of shares of ISE, Inc. Class A Common Stock (“Class A Common Stock”) will become holders of ISE Holdings Common Stock, and holders of ISE, Inc. Class B Common Stock, Series B-1 (“Series B-1 Common Stock”), ISE, Inc. Class B Common Stock, Series B-2 (“Series B-2 Common Stock”), and ISE, Inc. Class B Common Stock, Series B-3 (“Series B-3 Common Stock”)¹¹ will become holders of PMM Rights, CMM Rights, and EAM Rights, respectively.¹² Upon consummation of the Merger, the percentage of the outstanding shares of ISE Holdings Common Stock held after the Merger by each holder of Class A Common Stock will be identical to the percentage of Class A Common Stock that such holder held prior to the Merger. The percentage of Exchange Rights held after the Merger by each holder of Class B Common Stock also will be identical to the percentage of Class B Common Stock that such holder held prior to the Merger.

As is currently the case with respect to ISE, Inc. and its shares of Class B Common Stock,¹³ ISE, LLC will require ownership of an Exchange Right as a predicate to obtaining the trading rights and privileges associated with such Exchange Right.¹⁴ Where still relevant and practical, ISE, Inc. has preserved certain rights of the holders of Class B Common Stock following the Reorganization. As a result, holders of PMM and CMM Rights will be entitled to vote on any

¹¹ The Series B-1 Common Stock, Series B-2 Common Stock, and Series B-3 Common Stock are herein collectively referred to as the “Class B Common Stock.”

¹² See proposed Limited Liability Company Agreement of ISE, LLC (“LLC Agreement”), Section 6.2, for the definition of “PMM Rights,” “CMM Rights,” and “EAM Rights.” PMM Rights, CMM Rights, and EAM Rights are herein collectively referred to as the “Exchange Rights.”

¹³ Amended and Restated Certificate of Incorporation of ISE, Inc. (“ISE, Inc. Amended Certificate”), Article Fourth, Subdivision II(b)(ii).

¹⁴ LLC Agreement, Section 6.2.

change in, amendment, or modification of the same Core Rights to which the holders of Series B-1 Common Stock and Series B-2 Common Stock are entitled with respect to ISE, Inc.¹⁵ In addition, holders of Exchange Rights will continue to be entitled to vote with respect to any amendments to the LLC Agreement or the proposed Constitution of ISE, LLC (“LLC Constitution”) that would alter or change the powers, preferences, or special rights of one or more series of Exchange Rights so as to affect them adversely.¹⁶ Further, as discussed below, holders of Exchange Rights will continue to be entitled to elect six Exchange Directors of the board of directors of ISE, LLC (“LLC Board”).¹⁷

The proposed rule change includes: (a) the elimination of the ISE, Inc. Amended Certificate and the Amended and Restated Constitution of ISE, Inc. (“ISE, Inc. Amended Constitution”); (b) the Certificate of Incorporation of ISE Holdings (“Holdings Certificate”) and the bylaws of ISE Holdings (“Holdings Bylaws”); (c) the LLC Agreement and the LLC Constitution; and (d) certain amendments to the Rules of ISE, Inc. (“ISE Rules”) to reflect the Reorganization.¹⁸

¹⁵ See LLC Agreement, Section 2.2, for the definition of “Core Rights.” Core Rights means any increase in the number of authorized PMM Rights or CMM Rights.

¹⁶ LLC Agreement, Section 8.1, and LLC Constitution, Section 10.1. The sole LLC member (ISE Holdings) will have a similar right to approve amendments to the LLC Constitution or LLC Agreement if such amendments would alter or change the powers, preferences, or special rights of the sole LLC member so as to affect it adversely. Id.

¹⁷ Because ISE, LLC will have limited liability members instead of stockholders, ISE Holdings (as the sole LLC member) and the holders of Exchange Rights will not have voting, dividend, or liquidation rights typically associated with common stock under state law.

¹⁸ ISE, Inc. is proposing to amend the ISE Rules to, among other things, change references to “Class B common stock,” “Class B stockholders,” “shares,” and similar or derivative words to “Exchange Rights,” “Exchange Rights holders,” and “Rights” and the like.

A. ISE Holdings

1. ISE Holdings as Sole Member

ISE, LLC will be a wholly owned subsidiary of ISE Holdings. ISE Holdings will have sole voting control over ISE, LLC, except for certain matters relating to Exchange Rights.¹⁹

Section 19(b) of the Act²⁰ and Rule 19b-4 thereunder²¹ require a self-regulatory organization (“SRO”) to file proposed rule changes with the Commission. Although ISE Holdings is not an SRO, certain provisions of the Holdings Certificate and Holdings Bylaws are rules of an exchange²² if they are stated policies, practice, or interpretations, as defined in Rule 19b-4 of the Act,²³ of the exchange, and must be filed with the Commission pursuant to Section 19(b) of the Act²⁴ and Rule 19b-4 thereunder.²⁵ Accordingly, ISE, Inc. has filed the Holdings Certificate and Holdings Bylaws with the Commission.²⁶

¹⁹ ISE Holdings will not have any voting rights with respect to the Core Rights, the election of PMM Directors, CMM Directors, or EAM Directors, or any other matters relating to the Exchange Rights, such as the eligibility and approval of persons to own, transfer or lease Exchange Rights, rulemaking, supervision of entities holding Exchange Rights, and the like. See LLC Agreement, Section 2.2. See also LLC Constitution, Section 3.2(b), for the definitions of “PMM Director,” “CMM Director,” and “EAM Director.” The PMM Directors, CMM Directors, and EAM Directors are herein collectively referred to as the “Exchange Directors.”

²⁰ 15 U.S.C. 78s(b).

²¹ 17 CFR 240.19b-4.

²² See Section 3(a)(27) of the Act, 15 U.S.C. 78c(a)(27).

²³ 17 CFR 240.19b-4.

²⁴ 15 U.S.C. 78s(b).

²⁵ 17 CFR 240.19b-4.

²⁶ If ISE Holdings decides to amend the Holdings Certificate or the Holdings Bylaws, the Board of Directors of ISE Holdings (“Holdings Board”) must submit such amendment to the LLC Board, and if the LLC Board determines that such amendment is required to be filed with, or filed with and approved by, the Commission before the same may be effective pursuant to Section 19 of the Act and the rules thereunder, such amendment shall not be effective until filed with, or filed with and approved by, the Commission, as

2. Ownership and Voting Limitations; Changes in Control of ISE, LLC

The Holdings Certificate and Holdings Bylaws will include substantially the same ownership and voting limitations that are contained in the ISE, Inc. Amended Certificate and ISE, Inc. Amended Constitution.²⁷ Specifically, the Holdings Certificate provides that no Person,²⁸ either alone or together with its Related Persons,²⁹ may own, directly or indirectly, shares of the capital stock of ISE Holdings constituting more than 40 percent of the outstanding shares of any class or series of capital stock of ISE Holdings.³⁰ Further, the Holdings Certificate provides that no

the case may be. See Holdings Certificate, Article Sixteenth, and Holdings Bylaws, Section 10.1.

²⁷ ISE, Inc. represents that currently, no Person, either alone or together with its Related Persons, owns more than 40 percent of the outstanding shares of any class or series of capital stock of ISE, Inc., and no member, either alone or together with its Related Persons, owns more than 20 percent of the outstanding shares of any class or series of capital stock of ISE, Inc. ISE, Inc. therefore represents that there is no reason to believe that the Reorganization will result in any large concentrations of ownership or voting power by ISE, Inc.'s current stockholders or members.

²⁸ See Holdings Certificate, Article Fourth, Subdivision III, for the definition of "Person."

²⁹ See ISE, Inc. Amended Certificate, Article Fourth, Subdivision III, for the current definition of "Related Person" and Holdings Certificate, Article Fourth, Subdivision III, for the proposed modification to the definition of "Related Persons" in connection with the Reorganization. Currently, "Related Person" means (1) with respect to any Person, all "affiliates" and "associates" of such Person (as such terms are defined in Rule 12b-2 under the Act); (2) with respect to any Person constituting an exchange member (as defined in the ISE, Inc. Amended Constitution), any broker or dealer with which such Exchange Member is associated; and (3) any two or more Persons that have any agreement, arrangement, or understanding (whether or not in writing) to act together for the purpose of acquiring, voting, holding, or disposing of shares of the capital stock of ISE, Inc. ISE, Inc. proposes to modify the definition of "Related Persons" in connection with the Reorganization to also include, with respect to any Person, any executive officer (as defined under Rule 3b-7 under the Act), director, general partner, manager, or managing member, as applicable, and, with respect to any Person that is an executive officer (as defined under Rule 3b-7 under the Act), director, general partner, manager, or managing member of a company, corporation, or similar entity, such company, corporation, or entity, as applicable.

³⁰ Holdings Certificate, Article Fourth, Subdivision III(a).

Member,³¹ either alone or together with its Related Persons, may own, directly or indirectly, shares of the capital stock of ISE Holdings constituting more than 20 percent of the outstanding shares of any class or series of capital stock of ISE Holdings.³² The Holdings Certificate also provides that no Person, either alone or together with its Related Persons, may, directly or indirectly, vote or cause the voting of shares of the capital stock of ISE Holdings representing more than 20 percent of the voting power of any class or series of the then issued and outstanding capital stock of ISE Holdings.³³ If a Person, either alone or with its Related Persons, beneficially owns shares of stock of ISE Holdings in violation of the relevant ownership limitation, ISE Holdings will apply substantially the same corrective procedures that were previously approved by the Commission.³⁴ Also, as is currently the case with respect to ISE, Inc., if any stockholder purports to vote or cause the voting of shares of the capital stock of ISE Holdings that would violate the relevant voting limitation, then the ISE, Holdings will not honor such vote to the extent that such provision would be violated.³⁵

ISE, LLC also will continue to have a 20 percent limit with respect to Exchange Rights.³⁶ Specifically, no holder or lessee of Exchange Rights, together with any affiliate, may own (or exercise any of the non-trading rights associated with) more than 20 percent of the PMM Rights, the CMM Rights, or the EAM Rights.³⁷

³¹ The term “Member,” as proposed to be defined in ISE Rule 100, means an organization that has been approved to exercise trading rights associated with Exchange Rights.

³² Holdings Certificate, Article Fourth, Subdivision III(a).

³³ Holdings Certificate, Article Fourth, Subdivision III(b).

³⁴ ISE, Inc. Amended Certificate, Article Fourth, Subdivision III(c).

³⁵ Holdings Certificate, Article Fourth, Subdivision III(d).

³⁶ LLC Agreement, Section 6.5(a).

³⁷ Id.

Members that trade on an exchange traditionally have ownership interests in such exchange. As the Commission has noted in the past, however, a member's interest in an exchange could become so large as to cast doubt on whether the exchange can fairly and objectively exercise its self-regulatory responsibilities with respect to that member.³⁸ A member that is a controlling shareholder of an exchange might be tempted to exercise that controlling influence by directing the exchange to refrain from, or the exchange may hesitate to, diligently monitor and surveil the member's conduct or diligently enforce its rules and the federal securities laws with respect to conduct by the member that violates such provisions.

In addition, as proposed, ISE, LLC will be a wholly owned subsidiary of ISE Holdings. The LLC Agreement identifies this ownership structure.³⁹ Any changes to the LLC Agreement, including any changes to the provision that identifies ISE Holdings as the sole LLC member, must be filed with and approved by the Commission pursuant to Section 19 of the Act.⁴⁰ Further, any assignment of its interest in ISE, LLC by ISE Holdings will be subject to prior Commission approval pursuant to Section 19 of the Act.⁴¹

The Commission finds that the ownership and voting limitations in the Holding Certificate and the change in control provisions and limit on Exchange Rights in the LLC Agreement are consistent with the Act. These requirements should minimize the potential that a person could

³⁸ See Securities Exchange Act Release Nos. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131); 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005) (SR-CHX-2004-26); 49718 (May 17, 2004), 69 FR 29611 (May 24, 2004) (SR-PCX-2004-08); 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (SR-Phlx-2003-73); and 49067 (January 13, 2004), 69 FR 2761 (January 20, 2004) (SR-BSE-2003-19).

³⁹ The LLC Agreement only permits ISE, LLC to have one LLC member at any given time, and identifies ISE Holdings as the sole LLC member. See preamble to the LLC Agreement and Sections 2.1 and 3.1.

⁴⁰ 15 U.S.C. 78s.

⁴¹ LLC Agreement, Section 7.1.

improperly interfere with or restrict the ability of the Commission or ISE, LLC to effectively carry out their regulatory oversight responsibilities under the Act.

B. Exchange Operations and Independence of Self-Regulatory Function of ISE, LLC

Upon consummation of the Merger, ISE, LLC will be the successor to the registration of ISE, Inc. as a national securities exchange. ISE, LLC thus will operate as the registered national securities exchange under Section 6 of the Act⁴² and be responsible for enforcing its member compliance with the federal securities laws and ISE Rules.⁴³ Further, all decisions with respect to the listing and delisting of options and related products will continue to be made in accordance with ISE Rules. ISE, Inc. also represents that provisions of the LLC Agreement and LLC Constitution dealing with exchange operations are substantively the same as the current ISE, Inc. Amended Certificate and ISE, Inc. Amended Constitution, respectively.

As an SRO, ISE, LLC will have ultimate responsibility for the administration and enforcement of the rules governing its options business operations. ISE, Inc. represents that the regulatory relationship that it currently maintains with the National Association of Securities Dealers (“NASD”) will not be affected by the Reorganization and that ISE, LLC, as the successor-in-interest to ISE, Inc., will continue to have the same relationship with the NASD.⁴⁴ ISE, LLC’s disciplinary process will be the same as the process for ISE, Inc. and will be carried out by the

⁴² 15 U.S.C. 78f.

⁴³ Under the Act, the holders or lessees of Exchange Rights are “members” of ISE, LLC. See Section 3(a)(3) of the Act, 15 U.S.C. 78c(a)(3). However, the holders of Exchange Rights are not “members” for purposes of the Delaware Limited Liability Company Act or the LLC Agreement. LLC Agreement, Section 6.1.

⁴⁴ See Securities Exchange Act Release No. 4781 (May 14, 2003), 68 FR 27869 (May 21, 2003) (approving a plan pursuant to Rule 17d-2 of the Act between NASD and ISE, Inc.).

Business Conduct Committee which is composed of members.⁴⁵ Likewise, ISE, Inc. represents that ISE, LLC will participate in various national market system plans, including the Options Price Reporting Authority and the Options Intermarket Linkage Plan, in which ISE, Inc. is currently a participant.

Certain provisions in the LLC Agreement, LLC Constitution, and ISE Rules are designed to facilitate the ability of ISE, LLC to fulfill its regulatory obligations under the Act and to help ensure the independence of its regulatory function from its market operations and other commercial interests. Specifically, the LLC Constitution provides that all meetings of the LLC Board pertaining to the self-regulatory function of ISE, LLC or to the structure of the market that ISE, LLC regulates will be closed to all persons other than the LLC Board and officers, staff, counsel, or other advisors of ISE, LLC whose participation is necessary or appropriate to the proper discharge of ISE, LLC's regulatory functions and any representative of the Commission. No members of the Holdings Board who are not also LLC Board members, and no officers, staff, counsel, or advisors of ISE Holdings who are not also officers, staff, counsel, or advisors of ISE, LLC, will be allowed to participate in such meetings.⁴⁶

In addition, the LLC Agreement provides that, in discharging his or her responsibilities as a member of the LLC Board, each director shall take into consideration the effect that his or her actions would have on the ability of ISE, LLC to carry out its responsibilities under the Act.⁴⁷ Further, in discharging his or her responsibilities as a member of the LLC Board or as an officer or

⁴⁵ Currently, the Chief Executive Officer ("CEO") of ISE, Inc. authorizes the institution of disciplinary actions, and ISE, Inc., with the assistance of the NASD staff, if appropriate, conducts disciplinary proceedings before the Business Conduct Committee. Decisions of the Business Conduct Committee may be appealed to the Committee for Review of ISE, Inc., which is composed of directors of ISE, Inc.

⁴⁶ LLC Constitution, Section 3.2(d).

⁴⁷ LLC Agreement, Section 5.1(b).

employee of ISE, LLC, each director, officer, or employee shall comply with the federal securities laws and rules and regulations thereunder and cooperate with the Commission.⁴⁸ The LLC Agreement also provides that all confidential information pertaining to the self-regulatory function of ISE, LLC contained in books and records of ISE, LLC shall not be made available to any persons other than to those officers, directors, employees, and agents of ISE, LLC that have a reasonable need to know the contents thereof, be retained in confidence by such parties, and not be used for any commercial purposes.⁴⁹

The Commission further notes that ISE has taken steps to safeguard the use of regulatory monies. In particular, ISE, LLC will interpret ISE Rules to require that any revenue it receives from regulatory fees or penalties will be segregated and applied to fund the legal, regulatory, and surveillance operations of ISE, LLC and will not be used to pay distributions to the sole LLC member (ISE Holdings) or holders of Exchange Rights, except in the event of liquidation of ISE, LLC, in which case the sole LLC member will be entitled to the distribution of ISE, LLC's remaining assets.⁵⁰

Finally, proposed ISE Rule 312 provides that, without prior Commission approval, ISE, LLC or any entity with which it is affiliated shall not, directly or indirectly through one or more intermediaries, acquire or maintain an ownership interest in a Member or non-member owner. In addition, pursuant to ISE Rule 312, a Member or non-member owner shall not be or become an

⁴⁸

Id.

⁴⁹

LLC Agreement, Section 4.1(b). The Commission believes that any non-regulatory use of such information would be for a commercial purpose.

⁵⁰

See Securities Exchange Act Release No. 45803 (April 23, 2002), 67 FR 21306 (April 30, 2002).

affiliate of ISE, LLC or an affiliate of any affiliate of ISE, LLC.⁵¹ Moreover, the LLC Constitution prohibits officers or employees of ISE, LLC from being holders of Exchange Rights or being affiliated with a Member.⁵² The Commission believes that these provisions mitigate its concerns about the potential for unfair competition and conflicts of interest between an exchange's self-regulatory obligations and its commercial interest. The Commission also believes that ISE Rule 312 minimizes the potential for unfair competitive advantage that the affiliated member could have by virtue of informational or operational advantages, or the ability to receive preferential treatment.⁵³

The Commission finds that the proposed organization of ISE, LLC is consistent with the Act, particularly with Section 6(b)(1),⁵⁴ which requires that an exchange be so organized and have the capacity to carry out the purposes of the Act.

C. Relationship of ISE Holdings to ISE, LLC; Jurisdiction over ISE Holdings

Following the Reorganization, ISE Rules, LLC Agreement, and LLC Constitution will reflect ISE, LLC's status as a wholly owned subsidiary of ISE Holdings, under management of the ISE, LLC Board and its designated officers and with self-regulatory obligations pursuant to ISE, LLC's registration as a national securities exchange.

⁵¹ ISE Rule 312 also provides that it does not prohibit a Member or non-member owner from acquiring or holding any equity interest in ISE Holdings that is permitted by the Holdings Certificate. Further, ISE Rule 312 does not prohibit any Member from being or becoming an affiliate of ISE, LLC or an affiliate of any affiliate of ISE, LLC solely by reason of any officer, director, or partner of such Member being or becoming an Exchange Director pursuant to the LLC Constitution.

⁵² LLC Constitution, Section 4.5.

⁵³ See Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (order approving the business combination of New York Stock Exchange, Inc. and Archipelago Holdings, Inc.).

⁵⁴ 15 U.S.C. 78f(b)(1).

As the sole owner of ISE, LLC, ISE Holdings' activities must be consistent with, and not interfere with, ISE, LLC's obligations under the Act. Certain provisions in the Holdings Certificate and Holdings Bylaws are designed to enable ISE, LLC to operate in a manner that complies with federal securities laws, including the objectives of Sections 6(b) and 19(g) of the Act,⁵⁵ and facilitate the ability of ISE, LLC and the Commission to fulfill their regulatory and oversight obligations under the Act.

For example, the Holdings Certificate provides that ISE, Holdings, each director of the Holdings Board, and each officer or employee of ISE Holdings shall comply with the federal securities laws and rules and regulations thereunder and shall cooperate with ISE, LLC and the Commission.⁵⁶ In addition, in discharging his or her responsibilities as a member of the Holdings Board, each director of the Holdings Board shall take into consideration the effect that ISE Holdings' actions would have on the ability of ISE, LLC to carry out its responsibilities under the Act.⁵⁷ ISE Holdings and its officers, directors, and employees also shall give due regard to the preservation of the independence of the self-regulatory function of ISE, LLC and to ISE, LLC's obligations under the Act and the rules thereunder and shall not take any actions which he or she knows or reasonably should have known would interfere with the effectuation of any decisions by the LLC Board relating to ISE, LLC's regulatory functions or which would adversely affect the ability of ISE, LLC to carry out ISE, LLC's responsibilities under the Act.⁵⁸

⁵⁵ 15 U.S.C. 78f(b) and 78s(g).

⁵⁶ Holdings Certificate, Article Twelfth and Article Fifteenth. ISE Holdings also shall take reasonable steps necessary to cause its agents to cooperate with ISE, LLC and the Commission with respect to such agents' activities related to ISE, LLC. Holdings Certificate, Article Fifteenth.

⁵⁷ Holdings Certificate, Article Twelfth.

⁵⁸ Holdings Bylaws, Section 1.5. ISE Holdings also will take reasonable steps necessary to cause its officers, directors, and employees, prior to accepting a position as such, to

Further, all confidential information pertaining to the self-regulatory function of ISE, LLC contained in books and records of ISE, LLC that shall come into the possession of ISE Holdings shall not be made available to any Persons other than to officers, directors, employees, and agents of ISE Holdings that have a reasonable need to know, be retained in confidence by such parties, and not be used for any commercial purposes.⁵⁹

In addition, ISE Holdings' books and records will be subject at all times to inspection and copying by the Commission and are deemed to be the books and records of ISE, LLC for purposes of and subject to oversight pursuant to the Act, in each case to the extent they relate to the exchange business of ISE, LLC.⁶⁰ ISE Holdings and its officers, directors, employees, and agents will also submit to the jurisdiction of the U.S. federal courts, the Commission, and ISE, LLC with respect to activities relating to ISE, LLC.⁶¹

The Holdings Certificate and Holdings Bylaws also provide that any amendment to the Holdings Certificate or Holdings Bylaws must be submitted by the Holdings Board to the LLC Board. If the LLC Board determines that such amendment is required, under Section 19 of the Act⁶² and the rules promulgated thereunder, to be filed with, or filed with and approved by, the Commission, then such amendment will not become effective until filed with, or filed and approved

consent in writing to the applicability to them of Article Twelfth, Article Thirteenth, and Article Fourteenth of Holdings Certificate and Sections 1.4 and 1.5 of Holdings Bylaws, as applicable, with respect to their activities related to ISE, LLC. Holdings Bylaws, Section 1.6.

⁵⁹ Holdings Certificate, Article Thirteenth. The Commission believes that any non-regulatory use of such information would be for a commercial purpose.

⁶⁰ Holdings Certificate, Article Fourteenth.

⁶¹ Holdings Bylaws, Section 1.4. ISE Holdings and its officers, directors, employees, and agents will also maintain an agent for service of process in the U.S. Id.

⁶² 15 U.S.C. 78s.

by, the Commission.⁶³ The Commission finds that these provisions are consistent with the Act, and that they will support ISE, LLC's ability to fulfill its self-regulatory obligations and administer and comply with the requirements of the Act.

Under Section 20(a) of the Act,⁶⁴ any person with a controlling interest in ISE, LLC would be jointly and severally liable with, and to the same extent that, ISE, LLC is liable under any provision of the Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Act⁶⁵ creates aiding and abetting liability for any person who knowingly provides substantial assistance to another person in violation of any provision of the Act or rule thereunder. Further, Section 21C of the Act⁶⁶ authorizes the Commission to enter a cease-and-desist order against any person who has been a "cause of" a violation of any provision of the Act through an act or omission that the person knew or should have known would contribute to the violation. These provisions are applicable to ISE Holdings' dealings with ISE, LLC.

D. Governance of ISE, LLC

The corporate governance provisions of the LLC Agreement and LLC Constitution are substantively the same as the current the ISE, Inc. Amended Certificate and ISE, Inc. Amended Constitution, respectively.

Although ISE Holdings will have sole voting control over ISE, LLC (except for certain matters relating to Exchange Rights),⁶⁷ the management and administration of ISE, LLC will be

⁶³ Holdings Certificate, Article Sixteenth, and Holdings Bylaws, Section 10.1.

⁶⁴ 15 U.S.C. 78t(a).

⁶⁵ 15 U.S.C. 78t(e).

⁶⁶ 15 U.S.C. 78u-3.

⁶⁷ See supra note 19.

carried out by the LLC Board and by the executive officers of ISE, LLC.⁶⁸ Among other officers, ISE, LLC will have a President and CEO and a Chief Regulatory Officer that will manage the business and affairs of ISE, LLC, subject to the oversight of the ISE, LLC Board.⁶⁹

As is the case currently with respect to the board of directors of ISE, Inc. (“ISE, Inc. Board”), the LLC Board will be composed of 15 members,⁷⁰ eight of whom will be Non-Industry Directors,⁷¹ six of whom will be Exchange Directors, and the CEO of ISE, LLC.⁷² Each year, the Nominating Committee⁷³ will nominate the Exchange Directors and the Corporate Governance Committee will nominate the Non-Industry Directors.⁷⁴ At the first annual meeting of the sole LLC

⁶⁸ See LLC Constitution, Section 5.1(a). See also LLC Agreement, Section 5.1.

⁶⁹ In some cases this management will be subject to the approval of ISE Holdings as the sole LLC member. ISE, Inc. represents that, under Delaware law, certain events such as the sale of all or substantially all of the assets, merger, or liquidation of ISE, LLC may require the approval of ISE Holdings.

The initial officers of ISE, LLC will be the individuals currently serving as the officers of ISE, Inc. Further, ISE, LLC will have a Finance & Audit Committee, a Corporate Governance Committee, and a Compensation Committee, all of which will be governed by charters. LLC Constitution, Sections 5.4, 5.5, and 5.6.

⁷⁰ ISE, Inc. proposes that the number of members of the LLC Board may only be changed by the LLC Board with the approval of the affirmative vote of the holders of two-thirds of the then outstanding Exchange Rights. LLC Constitution, Section 3.2.

⁷¹ See LLC Constitution, Section 3.2(b), for the definition of “Non-Industry Director” and Section 13.1(w), for the definition of “non-industry representative.” These definitions are the same as the current definitions. See ISE, Inc. Amended Constitution, Sections 3.2(b) and 14.1(q), respectively. Further, as is currently the case, at least 2 Non-Industry Directors will be required to be public representatives. See LLC Constitution, Section 3.2(b)(iv).

⁷² LLC Agreement, Section 5.2, and LLC Constitution, Section 3.2(b). ISE, Inc. represents that the initial members of the LLC Board were the individuals serving as directors of ISE, Inc. on the date of formation of ISE, LLC.

⁷³ The proposed Nominating Committee will be composed of one representative of PMM Rights, one representative of CMM Rights, and one representative of EAM Rights. See LLC Constitution, Section 5.3(a). This composition is essentially the same as the current Nominating Committee of ISE, Inc. See ISE, Inc. Amended Constitution, Section 5.3(a).

⁷⁴ The proposed Corporate Governance Committee will be composed of three, and no more than eight, Non-Industry Directors. See LLC Constitution, Section 5.4. This is the same

member (ISE Holdings) and holders of Exchange Rights, and at each subsequent annual meeting, ISE Holdings will elect the eight Non-Industry Directors (rather than the holders of the Class A Common Stock, as is currently the case), and holders of Exchange Rights will elect the six Exchange Directors, to serve until the next annual meeting or until their successors are elected and qualified.⁷⁵ The Chairman of the LLC Board will be a Non-Industry Director who is elected by the LLC Board.

As is currently the case, each director of ISE, LLC will hold office for a two-year term, except the CEO of ISE, LLC will hold office for a one-year term or such earlier time as such person no longer serves as the CEO. The directors, other than the CEO, will be divided into two classes.⁷⁶ If there is a vacancy on the LLC Board, the vacancy will be filled by the LLC Board, and the person chosen to fill the vacancy will serve until the expiration of the term of office of the class to which such person was elected. No Exchange Director may serve more than three consecutive terms, and, after a two-year hiatus, may again be eligible to serve as an Exchange Director.⁷⁷

Holders of Exchange Rights also may continue to nominate Exchange Directors by petition. ISE, Inc. represents that the petition process following the Reorganization will be substantially similar to the petition process currently in place for ISE, Inc. However, for purposes of determining whether a person has been nominated for election by petition by the requisite

as the current Corporate Governance Committee. See ISE, Inc. Amended Constitution, Section 5.4.

⁷⁵ LLC Constitution, Section 3.2(c).

⁷⁶ At each annual meeting, the successors of the class of directors whose term expires at that meeting will be elected to hold office for a term expiring at the annual meeting held in the second year following the year of their election and until their successors are elected and qualified.

⁷⁷ LLC Constitution, Section 3.2(e). ISE, Inc. did not impose term limits on Non-Industry Directors, and ISE, LLC does not propose to do so, though the ISE, LLC Corporate Governance Committee may determine whether and how to provide for such term limits at a later time.

percentage set forth in the LLC Constitution, no Member, alone or together with its affiliates, may account for more than 50 percent of the signatures of the holders of outstanding Exchange Rights of the series entitled to elect such person.⁷⁸

The proposed governance structure of ISE, LLC following the Reorganization will be substantially the same as the governance structure currently in place for ISE, Inc. The Commission therefore finds that proposed governance structure, including the composition of the LLC Board and the selection of directors, continue to satisfy the requirements of the Act, including Sections 6(b)(1) and 6(b)(3) of the Act.⁷⁹

III. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and rules and regulations thereunder applicable to the national securities exchange.

⁷⁸ LLC Constitution, Section 3.10. Petitions submitted for nominees for Exchange Directors of ISE, LLC also will not be required to contain all the information that is required to be disclosed pursuant to Regulation 14A under the Act, because ISE, LLC will not be subject to the proxy requirements under the Act.

⁷⁹ 15 U.S.C. 78f(b)(1) and 78f(b)(3). The Commission notes that it is in the process of reviewing a range of governance issues relating to SROs, including possible steps to strengthen the framework for, and ways to improve the transparency of, the governance procedures of all SROs and has proposed rules in furtherance of this goal. Depending upon the results of the proposed rules, ISE, LLC may be required to make changes to further strengthen its governance structure. The Commission also believes that the LLC Board should continue to monitor and evaluate ISE, LLC's governance structure and processes on an ongoing basis, and propose further changes as appropriate. See Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126 (December 8, 2004).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act⁸⁰ that the proposed rule change (SR-ISE-2006-04), as amended, is approved, and Amendment No. 3 is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸¹

Nancy M. Morris
Secretary

⁸⁰ 15 U.S.C. 78s(b)(2).

⁸¹ 17 CFR 200.30-3(a)(12).